ANALYTICAL PERSPECTIVES

BUDGET OF THE UNITED STATES GOVERNMENT

Fiscal Year 2006

THE BUDGET DOCUMENTS

Budget of the United States Government, Fiscal Year 2006 contains the Budget Message of the President, information on the President's budget and management priorities, and budget overviews organized by agency.

Analytical Perspectives, Budget of the United States Government, Fiscal Year 2006 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.

The *Analytical Perspectives* volume also contains a CD–ROM with several large tables previously published in the budget documents, along with summaries of new performance assessments and updates on earlier assessments for approximately 600 Federal programs.

Historical Tables, Budget of the United States Government, Fiscal Year 2006 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 2006. To the extent feasible, the data have been adjusted to provide consistency with the 2006 Budget and to provide comparability over time.

Appendix, Budget of the United States Government, Fiscal Year 2006 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 separate *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.budget.gov/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.

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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 data that place the budget in context. The volume presents crosscutting analyses of Government programs and activities from several 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 ten analyses, including many subjects 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 remained a separate volume since then, with the exception of the budgets for 1991–1994, when all of the budget material was included in one large volume. Beginning with the *1995 Budget,* the volume has been named *Analytical Perspectives*.

The volume this year continues to reflect 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 is discussed in many other chapters, especially those in the section, "Crosscutting Programs." One-page summaries of each program are on the *Analytical Perspectives* CD ROM (inside back cover).

The volume includes a new chapter this year on the California Bay-Delta restoration program (Chapter 11).

Again this year, several large tables are included as part of the *Budget* on the enclosed *Analytical Perspectives* CD ROM, along with evaluations and analyses of programs and management at Federal departments and agencies. A list of the items on the CD ROM is in the Table of Contents of this volume.

Overview of the Chapters

Introduction

1. Introduction. This chapter discusses each chapter briefly and highlights the emphasis on performance in a crosscutting context.

Performance and Management Assessments

2. Budget and Performance Integration. 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. Additional details of each of the assessments can be found on the OMB web page under "Budget Documents" at *http://www.budget.gov/budget/*.

Crosscutting Programs

3. Homeland Security 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 *2006 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. The chapter includes material on the PART assessments related to direct Federal investment spending. There is also a section on capital stocks.

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, "Table 7–10. Direct Loan Transactions of the Federal Government" and "Table 7–11. Guaranteed Loan Transactions of the Federal Government", are on the enclosed *Analytical Perspectives* CD ROM.

8. Aid to State and Local Governments. This discussion presents crosscutting information on Federal grants to State and local governments, including highlights of Administration proposals. The chapter also 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. Three detailed tables, "Table 9–1. Effectiveness of Agency's IT Management and E-Gov Processes," "Table 9–2. Management Guidance," and "Table 9–3. Status of Presidential E-Government Initiatives," are on the enclosed *Analytical Perspectives* CD ROM.

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

11. California-Federal Bay-Delta Program Budget Crosscut (CALFED). This chapter presents information on Federal funding for the California Bay-Delta restoration program, in partial fulfillment of the reporting requirements for this program. A detailed table, "CALFED-Related Federal Funding" is on the enclosed *Analytical Perspectives* CD ROM.

Economic Assumptions and Analyses

12. 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. This chapter also covers topics related to the effects on the budget of changes in economic conditions and assumptions.

13. Stewardship. This chapter assesses the Government's financial condition and sustainability in an integrated framework that includes Federal assets and liabilities; 75-year projections of the Federal budget under alternative assumptions for discretionary spending, health cost, productivity, and demographics; 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.

14. 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 NIPA 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

15. 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

16. 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

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

18. 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.

19. Tax Expenditures. This discussion describes and presents estimates of tax expenditures, which are defined as revenue losses from special exemptions, credits, or other preferences in the tax code. An appendix discusses possible alternatives to the current tax expenditure baselines. This section is prepared by the Department of the Treasury.

Dimensions of the Budget

20. Comparison of Actual to Estimated Totals. This chapter compares the actual receipts, outlays, and deficit for 2004 with the estimates for that year published two years ago in the 2004 Budget. It also includes a historical comparison of the differences between receipts, outlays, and the deficit as originally proposed with final outcomes.

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

22. 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, "Table 22–4. Income, Outgo, and Balances of Major Trust Funds" and "Table 22–5. Income, Outgo, and Balances of Selected Federal Funds" are on the enclosed *Analytical Perspectives* CD ROM.

23. 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).

24. 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

25. Current Services Estimates. This chapter presents estimates, based on rules similar to those contained in the Budget Enforcement Act (BEA), 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 describes differences with the BEA requirements. Two detailed tables, “Table 25–12. Current Services Budget Authority by Function, Category, and Program” and “Table 25–13. Current Services Outlays by Function, Category, and Program” are on the enclosed *Analytical Perspectives* CD ROM.

Budget System and Concepts

26. The Budget System and Concepts. This is a basic reference to the budget process, concepts, laws, and terminology, and includes a glossary of budget terms.

Other

The following material appears only on the enclosed *Analytical Perspectives* CD ROM:

- *Detailed Functional Tables.* Table 27–1. “Budget Authority and Outlays by Function, Category, and Program”.
- *Federal Programs by Agency and Account.* Table 28–1. “Federal Programs by Agency and Account”.
- PART Summaries. This section provides one-page summaries of the program assessments and a summary list of all of the assessments with funding, scores, and ratings.

PERFORMANCE AND MANAGEMENT ASSESSMENTS

2. BUDGET AND PERFORMANCE INTEGRATION

The President's Management Agenda (PMA) aims to improve the management and performance of the Federal government. The **Budget and Performance Integration (BPI)** initiative of the PMA specifically directs departments to improve program results and to ensure that performance is routinely considered in funding and management decisions.

> *It's not enough to advocate reform. You have to be able to get it done. And that's what we have done. When it comes to reforming schools to provide excellent education for all our children, we got the job done. Results matter. When it comes to health care reforms to give families more access and more choices, results matter. When it comes to improving our economy and creating jobs, results matter. When it comes to having a strong farm economy, results matter. When it comes to better securing our homeland, fighting the forces of terror, and spreading the peace, results matter.*
>
> President George W. Bush
> Mankato, Minnesota
> August 4, 2004

I. THE OBJECTIVES OF THE BUDGET AND PERFORMANCE INTEGRATION INITIATIVE

The Federal government spends over $2 trillion a year on its programs. In a results-oriented government, the burden of proof rests with these Federal programs and their advocates to show that programs are achieving results for the American people in the most effective and efficient manner. Furthermore, it is the government's responsibility to make difficult decisions about whether to increase or decrease the funding of a program, or terminate a program's funding entirely if it is not producing the desired results. The Budget and Performance Integration Initiative is making this link between a program's performance and decisions about its funding more routine.

American taxpayers expect managers of Federal programs to constantly assess whether their programs are achieving the desired results at acceptable costs. If the answer is "no" or "we don't know," the taxpayer expects those in charge to take immediate corrective action.

This results-focus is evident in the meaningful progress that agencies make in the BPI Initiative, which has three specific objectives all supporting the goal of using performance information in budgeting and improving program performance and efficiency:

- **Increasing accountability, effectiveness, and efficiency**—implementing plans designed to improve the management and performance of programs.
- **Investing in high pay-off or high priority activities**—focusing most on programs that can achieve demonstrably greater results for the same or less cost.
- **Improving program design**—developing, enacting, and implementing legislative or other proposals to fix flaws identified through the Program Assessment Rating Tool (PART) that impede performance.

What is the PART and How is it Used?

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

To reflect that Federal programs deliver goods and services using different mechanisms, the PART is customized by program category. The seven PART categories are: Direct Federal, Competitive Grant, Block/Formula Grant, Research and Development, Capital Assets and Acquisition, Credit, and Regulatory. The PART types apply to both discretionary and mandatory programs.

Each PART includes 25 basic questions and some additional questions tailored to the program type all divided up into four sections. The first section of questions gauges whether a program's design and purpose are clear and defensible. The second section involves strategic planning, and weighs whether the agency establishes valid annual and long-term goals for its programs. The third section rates the management of an agency's program, including financial oversight and program improvement efforts. The fourth section 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 numerical score for each section from 0 to 100 (100 being the best score). Because reporting a single weighted numerical rating could suggest false precision, or draw attention away from the very areas most in need of improvement, numerical scores are translated into qualitative ratings. The bands and associated ratings are as follows:

Rating	Range
Effective	85–100
Moderately Effective	70–84
Adequate	50–69
Ineffective	0–49

Regardless of overall score, programs that do not have acceptable performance measures or have not yet collected performance data generally receive a rating of "Results Not Demonstrated."

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. In some cases, 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 if it is not a priority or has completed its mission. However, most of the time, an "Effective" is an indication that the program is using its funding well and that major changes may not be needed.

II. RESULTS AGENCIES AND PROGRAMS ARE ACHIEVING

BPI Initiative Success

More and more agencies are achieving greater results with the help of the habits and discipline established through the Budget and Performance Integration (BPI) Initiative. These agencies recognize that BPI is much broader than the PART and that the PART is simply a tool used to achieve the much larger goals of the initiative.

In 2004, eight agencies achieved green status on the BPI Scorecard, a quarterly rating that assesses whether agencies have achieved clear standards of success for the initiative. The agencies at green are: Department of Energy, Department of Labor, Department of Transportation, Department of State, National Aeronautics and Space Administration, National Science Foundation, Small Business Administration, and Social Security Administration.

Scorecard—Standards for Success

For each initiative, the PMA established clear, Government-wide goals or Standards for Success (http://results.gov/agenda/standards.pdf). Agencies then develop and implement detailed, aggressive action plans to achieve these goals. Most importantly, agencies are held publicly accountable for adopting these disciplines. The Standards for Success for the BPI Initiative are below:

- Senior agency managers meet at least quarterly to examine reports that integrate financial and performance information that covers all major responsibilities of the department. Agency **demonstrates improvement in program performance and efficiency in achieving results;**
- **Strategic plans** contain a limited number of **outcome-oriented goals and objectives.** Annual budget and performance documents incorporate all measures identified by the PART and focus on the information used in the senior management report described in the first criterion;
- Has **performance appraisal plans** and awards programs for all SES and managers, and more than 60% of agency positions that effectively: link to agency mission, goals and outcomes; hold employees accountable for results appropriate to their level of responsibility; differentiate between various levels of performance; and provide consequences based on performance. The agency is also working to include all agency employees under such systems
- **Reports the full cost of achieving performance goals** accurately in budget and performance documents and can **accurately estimate the marginal cost** (+/ - 10%) of changing performance goals;
- Has at least one **efficiency measure** for all PARTed programs; and
- **Uses PART evaluations to direct program improvements,** and PART ratings and performance information are used consistently to justify funding requests, management actions, and legislative proposals. Fewer than 10% of agency programs receive a Results Not Demonstrated rating for more than two years in a row.

Each quarter, agencies are rated on their status in achieving the overall goals for each initiative and progress in implementing their respective action plans. To that end, a simple grading system of red, yellow, and green was developed. Green status is for success in achieving results in each of the criteria above; yellow is for an intermediate level of performance; and red is for unsatisfactory results.

The Government-wide scorecard reporting on individual agency progress is published quarterly at http://results.gov/agenda/scorecard.html.

Best Practices

Executive branch agencies are using and sharing with each other innovative management practices to achieve the goals of the BPI initiative and thereby improving organizational and program performance. One of the best practices shared across the Executive Branch came from the Department of State (DOS). Management at DOS has integrated the PART into their automated performance planning system. This capability allows DOS to 1) monitor the quality and content of PART submissions, 2) track the status of PART recommendations to improve program performance, and 3) most importantly, allows the Department of State to make this information available to managers so that they can use performance information to influence budget decisions.

The Department of Transportation (DOT) shared with other agencies its successes with implementing marginal cost methodologies, which assists in articulating the cost/benefit of putting additional resources into a program. This year, DOT improved its performance budgeting by estimating the marginal cost of performance for selected programs. DOT's disciplined approach allows it to see how inputs affect outputs and how outputs roll up to produce outcomes. As an example, DOT is able to estimate the reduction in rail-related accidents and incidents it expects to achieve at various funding levels. DOT now submits a budget that shows expected performance at both a baseline level and a specified marginal level. As a result, annual performance targets will be adjusted accordingly to reflect the specified levels of funding.

The bottom line is that without solid performance baselines, you cannot accurately predict performance changes resulting from varying resource levels.

Programs Assessed Using the PART

This marks the third year that the PART was used to assess program performance, make recommendations to improve program performance, and help link performance to budget decisions. To date, the Administration has assessed 607 programs, which represent approximately 60 percent of the Federal budget. Over the next two years, the Administration will use the PART to assess the performance and management of all remaining Federal programs with limited exceptions. Alternative methods and timelines for assessment are being considered for programs with limited impact and large activities where it is difficult to determine an appropriate unit of analysis.

With the help of the PART, we have improved program performance and transparency. There has been a substantial increase in the total number of programs rated either "Effective," "Moderately Effective," or "Adequate". This increase came from both re-assessments and newly PARTed programs. The Table 2–1 below shows the percentage of programs by ratings category.

Of the 607 programs assessed, 71 percent have defined and are tracking clear outcome goals to measure their results and 59 percent have efficiency measures in place to manage costs.

Unfortunately, in 2004 33 percent of PARTed programs are rated "Results Not Demonstrated" or "Ineffective." Particularly in a period of tight budgets, these programs must improve their performance or their resources may be moved to higher performing programs.

Programs Reassessed

Programs are reassessed when significant changes have been made to improve the program and those improvements can be demonstrated. For example, programs might be reassessed when new performance measures are agreed upon, PART recommendations have been implemented, new performance data have been compiled, or a program evaluation has been completed.

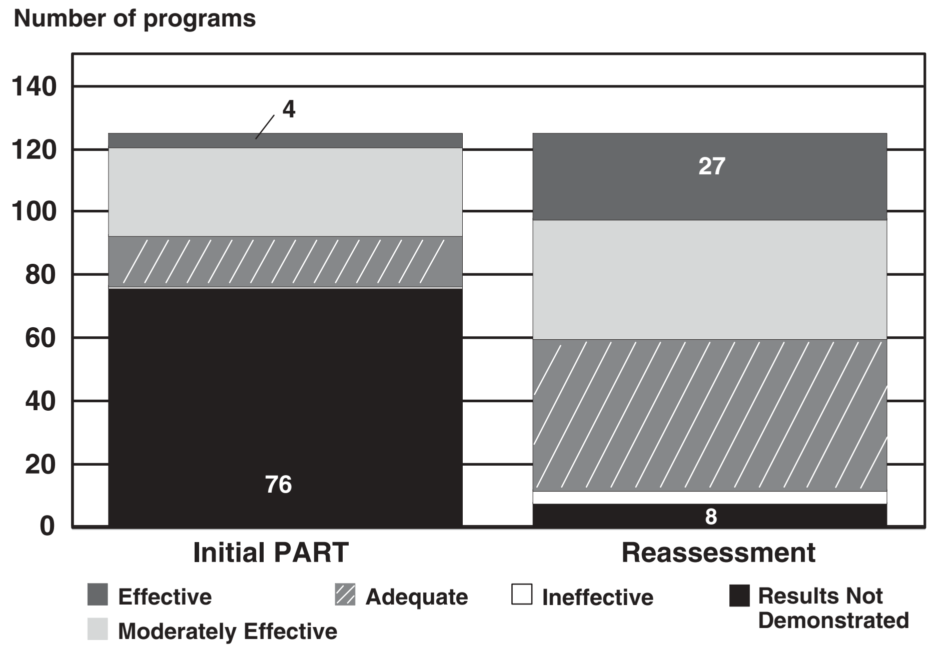
In the last two years more than 127 programs were reassessed. Chart 2–1 which follows demonstrates that PART recommendations are being implemented and we are seeing results. The chart illustrates a significant increase in "Effective" programs and a decrease in programs rated "Results Not Demonstrated."

Table 2–1. PROGRAM RATINGS ARE IMPROVING

(Cumulative program results by ratings category 2002–2004)

Ratings/year	Year 2002	2003	2004
Number of Programs [1]	234	407	607
Effective	6%	11%	15%
Moderately Effective	24%	26%	26%
Adequate	15%	20%	26%
Ineffective	5%	5%	4%
Results Not Demonstrated	50%	38%	29%

Chart 2-1. Comparison of Ratings from Initial PART to Most Recent Reassess



Following up on PART Recommendations. While the Administration believes that an increasing number of programs will earn "Effective" ratings, we also stress that PART recommendations are more important than PART ratings because the focus of the PART is on continuous improvement of program performance. The PART serves its purpose if its findings and recommendations play a substantial role in guiding decisions on spending, management and program improvements.

A number of Federal programs across the government have improved their management or performance by implementing recommendations made through the PART process:

- **Health Centers:** 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. From 2001 to 2005, this program increased the number of low-income individuals served by over 30 percent. In 2006, the program has a goal to serve approximately 16.4 million people, up from 10.3 million in 2001.
- **Broadcasting Board of Governors:** As a result of the PART, this program established goals for weekly audience size, program quality, signal strength and cost-per-listener for all language programs. The Near East Asia and South Asia programs are on track to attain their long-term weekly audience size goal in Arabic speaking countries of 21 million listeners and viewers by 2008—a nearly 700% increase from 3.1 million weekly listeners and viewers in 2002.
- **FAA's Facilities and equipment Program:** The PART helped management determine the reasons projects in this program consistently experienced large costs and schedule overruns. In response to a PART recommendation, the FAA began focusing on increasing the use of performance based contracts as a means of controlling costs. Managers are now held accountable for achieving cost, schedule, and performance targets through the FAA's Performance management system, which is evaluated semiannually.
- **National Weather Service (NWS):** During a PART reassessment it was determined that NWS increased its tornado warning lead time from 10 minutes to 13 minutes; improved its flash flood warning accuracy from 86 percent to 89 percent; and accurately predicted the tracks of hurricanes within 94 nautical miles. It has set goals to improve these and other key indicators of its ability to protect lives and property from national disasters.
- **The Migratory Bird Management Program:** This year the program developed new performance goals during the PART process. Specifically, one of the new goals examines the percent of migratory birds that are at healthy and sustainable levels. If the program is successful, and external factors that also affect migratory bird populations do not dramatically change, by 2008, 62 percent

of all migratory bird populations will be healthy and sustainable.

- **Corps Hydropower Program:** A reassessment of the Hydropower Program credited the Corps with developing an overall asset management plan for plant and program mangers. This management plan is used by managers in making risk-based hydropower investment decisions, as well as setting regional and national hydropower investment priorities. The management plan was developed in response to deficiencies cited in the initial PART.
- **Nonpoint Source Grants (NPS):** The Environmental Protection Agency's program provides grants to states to identify and address NPS pollution problems, a leading cause of water quality impairment. NPS pollution comes from both urban and rural sources, including roads, farms, and mines. A previous program assessment recommended that the NPS program improve its performance metrics and take steps to reduce any activities duplicated by similar Department of Agriculture (USDA) programs. As a result, in agricultural areas, the program refocused its efforts on watershed planning to avoid redundancy with USDA's efforts. The program also developed good long-term, annual, and efficiency measures.
- **The Capital Security Construction Program:** A past program assessment identified a standard embassy design which would promote the construction of new embassy compounds more quickly, efficiently and in a cost effective manner. This year's reassessment found that the Department of State implemented this design recommendation across overseas capital construction programs and for security and non-security projects.
- **Citizenship and Immigration Services (CIS):** In response to an assessment completed two years ago, Citizenship and Immigration Services has begun to implement significant IT and process improvements. Since May 2003, more than 182,000 immigration applications have been filed on-line, reducing processing time and errors. One CIS field office is piloting a green card replacement project. This field office is accepting e-filed applications and has demonstrated results by reducing the average renewal processing time from eight months to approximately two business weeks. This improvement is accompanied by a significant rise in e-filed applications from an average of 650 per month prior to the pilot to about 1,650 per month.
- **Occupational Safety and Health Administration:** In response to the PART recommendations, this program now identifies the monetary costs and net benefits for all new economically significant regulations. In addition, the 2006 Budget requests $1 million for an initiative to allow OSHA to develop more timely data to assess performance.

Efficiency Measures

One of the greatest challenges for agencies has been developing meaningful measures of program efficiency. Ideally, programs should be able to articulate production costs for each unit of what it is they are achieving. Agencies should be able to use efficiency measures to capture skillfulness in executing programs and achieving results while avoiding wasted resources, time, and effort. Although much work remains, this year we experienced many notable examples of success:

- **Department of Commerce.** In 2005 the Patent and Trademark Office (PTO) continues to align resources with its goal of promoting scientific progress by securing inventors' rights to their respective discoveries. PTO has clearly defined quantitative performance measures that are linked to its annual funding request. For example, for 2005, PTO set the following annual targets for the patent program: quality (as measured by an error rate of 3.75%), processing time (as measured by patent pendency of 31 months), and unit cost of $4,052 per production unit for a funding level of $1.337 billion. Moreover, PTO's budget is not only framed around its strategic plan, but its specific initiatives are linked to PTO's three strategic goals: improving the quality, processing times, and flexibility of its organization.
- **Department of Justice.** The Drug Enforcement Administration (DEA) has demonstrated proficiency at quantifying the impact of funding increases (or decreases) on its performance measures relative to targets established from the PART process. DEA is capable of translating a budget increase for additional drug enforcement agents into a specific number of drug trafficking organizations that will be either disrupted or dismantled in the fiscal year.
- **Social Security Administration (SSA).** SSA's ability to link financial resources and performance has assisted executive and legislative branch decision makers during the appropriations process. SSA was able to determine the number of claims that could be processed at different funding level proposals. This efficiency measure provided the requisite information to arrive at the best possible funding decision.
- **Department of State.** The State Department has developed efficiency measures for each of its programs and is using them to drive down cost while increasing performance. For instance, the Refugee Admissions program has decreased the per-person cost of admitting refugees to the United States from nearly $4,500 in 2002 to $3,500 in 2004, while exceeding the goal of admitting 50,000 refugees.
- **Department of Energy.** The Weatherization Assistance program increases the energy efficiency of dwellings occupied by low-income Americans, thereby reducing their energy costs, while safeguarding their health and safety. The program

added a long-term efficiency measure to maintain a benefit-cost ratio greater than one, which compares estimated lifetime energy cost savings of all homes weatherized in a given year to total program costs for that year.

Cross-cutting Review of Federal Programs

The Administration continues to look for new ways to improve the performance of programs with similar purpose or design by using the PART to analyze performance across agencies (i.e., cross-cutting analysis). Cross-cutting analysis can improve coordination and communication by getting managers from multiple agencies to agree to a common set of goals and placing the focus on quantifiable results. This type of analysis breaks down barriers across the Federal government and at the state and local levels so that all are working toward the same goal. This past year the Administration began a cross-cutting analysis of community and economic development programs and rural water programs.

Community and Economic Development cross-cut analysis. To help foster community and economic development, the Federal Government provides financial assistance to communities through 35 grant, loan, and tax incentive programs spread across seven agencies. In 2005 nearly $16 billion will be spent on efforts to revitalize distressed communities and increase economic opportunity in areas that, despite increases in national economic growth and productivity, continue to suffer from high unemployment, low incomes and economic disruption.

During 2004, OMB reviewed the effectiveness and structure of Federal community and economic development programs. An inter-agency group, the Interagency Collaborative on Community and Economic Development, also assisted this review by highlighting the strengths, weaknesses and challenges of community and economic development efforts. OMB reviewed the PART assessments of several programs to identify challenges shared by these programs. First, several of these programs had unclear long-term objectives, which resulted in many instances in a focus on short-term outputs (e.g., number of people assisted and number of housing units constructed), not on long-term community impacts. Second, the programs did not coordinate effectively, and in many cases overlapped in mission and function. For example, assistance for infrastructure investment is provided by at least four Federal agencies. Third, and most importantly, the programs were unable to demonstrate that they were achieving long-term outcomes. In fact, there was little research to demonstrate that Federal investment had improved communities over the long-term. Ultimately, these programs should be able to measure conditions and track changes in key indicators such as job creation, homeownership, commercial development and increases in private sector investment.

To ensure the efficient use of taxpayer resources and improve the focus on results, the Budget proposes a $3.7 billion program within the Department Commerce to support communities' economic development and revitalization efforts. This initiative will consolidate programs such as Community Development Block Grants and the Economic Development Assistance Programs into a more targeted, unified program that sets accountability standards in exchange for flexible use of the funds. Further discussion on this initiative can be found in the Department of Commerce budget chapter.

Rural Water cross-cut analysis. At least 12 different Federal programs participate in building facilities that provide drinking water or wastewater services to rural areas of the country. These programs have some overlapping missions and use similar service delivery mechanisms. Water development is part of the core mission of the Bureau of Reclamation in the Department of Interior, the Rural Utilities Service in USDA, and the Environmental Protection Agency's Clean Water and Drinking Water State Revolving Funds. Other agencies, such as the Indian Health Service in the Department of Health and Human Services and the Economic Development Administration in the Department of Commerce, support activities related to rural water development, but use them as means to achieve broader program goals such as promoting economic development. Analysis of these programs also revealed that the Federal government's role in developing water resources is unclear, which hampers the long-term strategic planning of these agencies and creates uncertainty as to what actions Federal agencies should undertake and how to prioritize funding for Federal water projects. Consolidating some of these programs may result in more efficient program management and better delivery of on-the-ground services for rural communities. The Administration will develop recommendations regarding consolidation and reform of Federal rural water programs that it will forward to a proposed Results Commission, if authorized by Congress. (See next section).

III. NEXT STEPS FOR THE BPI INITIATIVE

Results Commission

Dysfunctional program overlap is why many of the 30 percent of programs are rated either ineffective or unable to demonstrate results. Cross-cutting analysis can help in many of these areas, but overlapping jurisdictions in Congress provide daunting hurdles to legislative remedies for the poor performance of duplicative programs. To overcome this challenge, the President will propose that Congress enact legislation that gives him the authority to recommend the creation of "Results Commissions" to consider and revise Administration proposals to improve the performance of programs or agencies by restructuring or consolidating them. Proposals approved by a commission would then be approved by the President and considered by Congress under expedited procedures.

The President's proposal to the Congress will also include a process by which programs undergo the regular scrutiny brought about by having to defend their existence before a Sunset Commission. Programs would be reviewed by the Sunset Commission according to a schedule enacted by Congress. The Commission would consider and revise Administration proposals to retain, restructure, or terminate programs. Programs would automatically terminate according to the schedule unless Congress took some action to reauthorize them.

Both components of this proposal—the Results Commissions and the Sunset Commission—will require enactment by Congress and the President. In the absence of these reforms, the Administration will continue to pursue all opportunities to improve program performance to include using the PART for cross-cutting analysis.

Other Cross-Cuts of Federal Programs

In 2005, the Administration will conduct additional cross-cuts in three different areas: block grant programs, small business innovation research programs and credit programs.

Block Grants. One of the most common tools used by the Federal government is the block grant, particularly in the social services area where states and localities are the service providers. Block grants are embraced for their flexibility to meet local needs and criticized because accountability for results can be difficult when funds are allocated based on formulas and population counts rather than achievements or needs. In addition, block grants pose performance measurement challenges precisely because they can be used for a wide range of activities. The obstacles to measuring and achieving results through block grants are reflected in PART scores: they receive the second lowest average score of the seven PART types, 8 percent of block grant programs assessed to date are rated ineffective, and 45 percent are rated Results Not Demonstrated.

Nonetheless, the PART shows that some Federal block grant programs are achieving results superior to others, effectively combining the flexibility that localities need with the results that taxpayers deserve. In the coming year, the Administration will apply the lessons learned from the effective block grants to several of those performing inadequately. This project will identify the methods used to manage highly rated block grant programs and adapt and implement those practices in large, low-scoring programs. Each of the programs targeted for improvement will develop an action plan and implementation timeline that will be tracked quarterly. The targeted programs will be re-analyzed through the PART in one to two years to assess whether implementing the block grant best practices results in improved performance.

Small Business Innovation Research (SBIR). The SBIR program established in 1982, sets aside 2.5 percent of government research and development (R&D) contract and grant funding to allow small businesses to explore innovative ideas. The goal of the program is to assist small businesses in undertaking and obtaining the benefits of research and development, while assisting the funding agencies to realize their mission. Approximately $2 billion was spent last year in SBIR programs.

All Federal agencies with R&D budgets above $100 million per year must publish a list of technical topics that they would like to support, after which small businesses are encouraged to submit research funding proposals addressing opportunities in those areas. First, agencies investigate the feasibility of the project and, if deemed promising, funding is provided for research and development. Awards generally are limited to about $1 million per project. Agencies monitor the progress of the selected projects and report key data annually to the Small Business Administration.

This year the Administration will review the SBIR programs of several agencies in a cross-agency review. Key questions to be asked include how well the program is managed; how well it is coordinated among the participating agencies; how well the program has done in commercializing products in the marketplace; and how well it has contributed to the success of the missions of the participating agencies.

Credit Programs. The Federal Government is one of the world's largest lenders. At the end of 2003, the Government held a financial asset portfolio of nearly $1.5 trillion, including direct loans, loan guarantees, defaulted loans, and non-credit debt owed to agencies. Many agencies lack the data, processes, or overall understanding of the credit lifecycle (origination, loan servicing/lender monitoring, liquidation, and debt collection) needed to effectively assist intended borrowers while also proactively reducing errors, risk, and cost to the Government. Some credit program PART scores reflect these fundamental inefficiencies.

A cross-cutting analysis will identify best practices that can be implemented across the major credit agencies, with the goal of strengthening Government credit management practices at all stages of the credit lifecycle. This will in turn lead to improved credit program PART scores as well as substantial budgetary savings: upfront subsidy costs and administrative expenses could be reduced by hundreds of millions of dollars, and delinquent debt could be reduced by up to $10 billion.

Additional discussion of the credit program cross-cut can be found in chapter seven of this Analytical Perspectives volume ("Credit and Insurance").

Follow-up on Recommendations

Rigorous follow-up on recommendations from the PART will accelerate improvements in the performance of Federal programs. The Administration is developing a web-based PART recommendation tracking system that will monitor what actions are required and their state of completion. This will ensure that the hard work done through the PART produces performance and management improvements.

APPENDIX 1: DESCRIPTION OF HOW THE PART WORKS

Sections of the PART. The accompanying table provides a brief description of the four sections along with examples of programs that scored high or low in this year. For more detailed information regarding PART guidance and PART worksheets, visit the OMB website at *www.omb.gov/part*.

Table 2–2. SECTIONS OF THE PART

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	Migrant and Seasonal Farm workers—program design needs significant improvement	Nonproliferation and International Security Program—clear purpose and strong design, which is not duplicated in the Federal government
Strategic Planning Weight = 10 percent	To assess whether the agency has established valid long-term and annual measures and targets for the program	Juvenile Accountability Block Grants—lacks strategic planning, ambitious goal setting	Healthcare Facilities Construction—Long-term and annual measures that assess critical health-focused outcomes
Program Management Weight = 20 percent	To rate agency management of the program, including financial oversight and program improvement efforts	Alaska Native Villages Program—poor program management resulted in significant contracting, accounting, and performance problems	Capital Security Construction 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	Natural Gas Technologies Program—has shown little evidence of improved outcomes and results	DOD Energy Conservation Improvement Program—achieves results, reduction in cost, and net savings for investment

PART Questionnaire. The table below illustrates key questions from each section of the PART.

Table 2–3. 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 effort? • Is the program designed free of major flaws that would limit program effectiveness or efficiency? • 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 meaningful 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*

Table 2–3. THE PART QUESTIONNAIRE—Continued

Key Questions for Every Program	Description
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/ACCOUNTABILITY • Has the program demonstrated adequate progress in achieving its long-term performance goals? • 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. The PART worksheet, under the "Measures Page," calls for data on a few years of performance targets and results to be reported. Answers in this section are rated as *Yes, Large Extent, Small Extent,* and *No.*

PART Categories. The PART segments mandatory and discretionary Federal programs into seven categories. The accompanying table describes the program categories:

Table 2–4. 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 Program • Mars Exploration

APPENDIX 2: SUMMARY RESULTS OF PROGRAMS EVALUATED USING THE PART

Since its inception, the PART has been improved annually based on feedback received from agencies and the public. Although there were no changes to the PART questions for this past year, the guidance has been refined each year to improve consistency in application of the PART across programs. Feedback from Federal agencies, General Accounting Office, Center for Excellence in Government, National Academy of Public Administrators, the public, and internal quality control reviews all helped improve the guidance.

The table that follows lists summary PART results and funding information for each of the assessed programs. 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, 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, and full PART worksheets can be found on OMB's web page *(www.budget.gov/budget/fy2006/part.html)*

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2004 Actual	Estimate 2005	Estimate 2006
Department of Agriculture:					
Agricultural Credit Insurance Fund—Guaranteed Loans.	Moderately Effective	Credit	2,402	2,763	2,866
Agricultural Credit Insurance Fund Direct Loans.	Moderately Effective	Credit	844	955	937
Animal Welfare	Adequate	Regulatory Based	17	17	18
APHIS Plant and Animal Health Monitoring Programs.	Effective	Regulatory Based	173	232	283
Bioenergy	Adequate	Direct Federal	150	100	60
CCC Marketing Loan Payments	Moderately Effective	Direct Federal	843	6,423	5,096
CCC Export Credit Guarantee Programs (GSM–102, GSM–103, SCGP, FGP).	Moderately Effective	Credit	4,275	4,556	4,556
Commodity Grading and Certification Programs.	Adequate	Direct Federal	171	185	189
Commodity Supplemental Food Program (CSFP).	Results Not Demonstrated	Block/Formula Grant	109	110	107
Community Facilities Program	Results Not Demonstrated	Credit	726	527	527
Conservation Technical Assistance	Results Not Demonstrated	Direct Federal	729	706	622
Counter Cyclical Payments	Adequate	Direct Federal	812	3,942	5,950
Crop Insurance	Results Not Demonstrated	Direct Federal	3,437	3,091	3,730
Dairy MILC Program	Results Not Demonstrated	Direct Federal	221	500	50
Dairy Price Support Program	Results Not Demonstrated	Direct Federal	399	280	130
Direct Crop Payments	Adequate	Direct Federal	5,289	5,303	5,303
Emergency Watershed Protection Program	Results Not Demonstrated	Direct Federal	150	250	0
Environmental Quality Incentives Program (EQIP).	Moderately Effective	Direct Federal	903	1,017	1,000
Farmland Protection Program	Results Not Demonstrated	Competitive Grant	91	112	84
Food Aid Programs	Moderately Effective	Competitive Grant	515	524	539
Food Safety and Inspection Service	Adequate	Regulatory Based	778	820	853
Food Safety Research	Results Not Demonstrated	Research and Development	98	103	108
Food Stamp Program	Moderately Effective	Block/Formula Grant	27,205	32,397	35,922
Forest Service: Forest Legacy Program	Moderately Effective	Competitive Grant	64	57	80
Forest Service: Invasive Species Program	Results Not Demonstrated	Direct Federal	263	167	173
Forestry Research Grants	Results Not Demonstrated	Block/Formula Grant	22	22	11
In House Research: Economic Opportunities for Producers.	Moderately Effective	Research and Development	381	385	321
Intermediary Relending Program (IRP)	Adequate	Credit	40	34	34
Land Acquisition	Results Not Demonstrated	Direct Federal	102	156	41
Multifamily Housing Direct Loans and Rental Assistance.	Results Not Demonstrated	Mixed	631	620	884
Mutual Self Help Housing—Technical Assistance Grants.	Moderately Effective	Competitive Grant	34	34	34
National Agricultural Statistics Service	Moderately Effective	Direct Federal	128	128	145
National Forest Improvement and Maintenance.	Adequate	Capital Assets and Service Acquisition	635	704	391
National Resources Inventory	Results Not Demonstrated	Direct Federal	35	37	37
National School Lunch	Results Not Demonstrated	Block/Formula Grant	6,649	6,967	7,254
Perishable Agricultural Commodities Act	Moderately Effective	Direct Federal	10	9	10
Pest and Disease Exclusion	Effective	Regulatory Based	126	125	144
Pesticide Data/Microbiological Data Programs.	Adequate	Direct Federal	21	21	22
Plant Materials Program	Results Not Demonstrated	Research and Development	12	15	11
RBS Business and Industry Guaranteed Loan Program.	Adequate	Credit	26	30	44
Research/Extension Grants: Economic Opportunities for Producers.	Moderately Effective	Research and Development	382	396	424
Resource Conservation and Development	Results Not Demonstrated	Direct Federal	53	51	27
Rural Business Enterprise Grant Program	Results Not Demonstrated	Competitive Grant	43	40	40
Rural Business-Cooperative Service Value-Added Producer Grants.	Results Not Demonstrated	Competitive Grant	14	16	16
Rural Distance Learning and Telemedicine Loan and Grant Program.	Results Not Demonstrated	Mixed	325	74	25
Rural Electric Utility Loans and Guarantees	Adequate	Credit	3,989	3,317	2,520
Rural Telecommunications Loan Programs	Adequate	Credit	514	518	670

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2004 Actual	Estimate 2005	Estimate 2006
Rural Water and Wastewater Grants and Loans.	Results Not Demonstrated	Mixed	601	548	450
School Breakfast Program	Moderately Effective	Block/Formula Grant	1,792	1,910	2,030
Single Family Housing Direct Loans	Moderately Effective	Credit	1,351	1,100	1,100
Single Family Housing Loan Guarantees	Moderately Effective	Credit	2,610	2,500	3,100
Snow Survey Water Supply Forecasting	Moderately Effective	Direct Federal	10	11	10
Soil Survey Program	Moderately Effective	Direct Federal	87	89	88
USDA Wildland Fire Management	Results Not Demonstrated	Direct Federal	1,876	2,014	1,493
Watershed Protection and Flood Prevention	Adequate	Direct Federal	126	111	20
Wildlife Habitat Incentives Program	Results Not Demonstrated	Direct Federal	38	47	60
Department of Commerce:					
Advanced Technology Program	Adequate	Competitive Grant	169	136	0
Bureau of Economic Analysis	Effective	Direct Federal	67	73	81
Coastal Zone Management Act Programs	Results Not Demonstrated	Block/Formula Grant	136	128	96
Commerce Small Business Innovation Research (SBIR) Program.	Results Not Demonstrated	Competitive Grant	9	7	5
Current Demographic Statistics	Effective	Direct Federal	58	59	62
Decennial Census	Moderately Effective	Direct Federal	253	388	464
Economic Census	Effective	Direct Federal	73	68	71
Economic Development Administration	Moderately Effective	Competitive Grant	308	284	27
Export Administration	Adequate	Regulatory Based	26	26	31
Intercensal Demographic Estimates	Moderately Effective	Direct Federal	9	9	10
Manufacturing Extension Partnership	Moderately Effective	Competitive Grant	39	108	47
Minority Business Development Agency	Results Not Demonstrated	Competitive Grant	29	30	31
National Marine Fisheries Service	Adequate	Regulatory Based	644	686	627
National Weather Service	Effective	Direct Federal	825	783	839
NIST Laboratories	Effective	Research and Development	300	375	412
NOAA Climate Program	Moderately Effective	Research and Development	242	275	250
NOAA Navigation Services	Moderately Effective	Direct Federal	89	83	92
NOAA Protected Areas	Adequate	Regulatory Based	62	71	46
Pacific Coastal Salmon Recovery Fund	Results Not Demonstrated	Block/Formula Grant	89	89	90
Survey Sample Redesign	Effective	Direct Federal	13	11	10
U.S. Patent and Trademark Office—Patents	Adequate	Direct Federal	1,098	1,380	1,517
U.S. Patent and Trademark Office—Trademarks.	Moderately Effective	Direct Federal	131	174	186
US and Foreign Commercial Service (USFCS).	Adequate	Direct Federal	225	216	232
Department of Defense—Military:					
Air Combat Program	Moderately Effective	Capital Assets and Service Acquisition	13,904	14,537	14,559
Air Force Aircraft Operations	Effective	Direct Federal	10,481	8,299	9,341
Air Force Depot Maintenance	Effective	Direct Federal	3,402	3,576	3,533
Airlift Program	Moderately Effective	Capital Assets and Service Acquisition	5,143	6,356	5,960
Army Land Forces Operations	Effective	Direct Federal	9,236	9,710	9,488
Basic Research	Effective	Research and Development	1,358	1,513	1,319
Chemical Demilitarization	Ineffective	Capital Assets and Service Acquisition	1,620	1,454	1,406
Comanche Helicopter Program	Results Not Demonstrated	Capital Assets and Service Acquisition	1,068	0	0
Communications Infrastructure	Results Not Demonstrated	Capital Assets and Service Acquisition	3,625	4,244	4,021
Defense Health	Adequate	Direct Federal	17,769	18,177	19,792
Depot Maintenance—Naval Aviation	Effective	Direct Federal	1,078	980	962
Depot Maintenance—Ship	Effective	Direct Federal	4,107	3,889	3,967
DoD Applied Research Program	Moderately Effective	Research and Development	4,350	4,850	4,139
DoD Small Business Innovation Research/ Technology Transfer.	Results Not Demonstrated	Research and Development	1,100	1,133	1,500
Energy Conservation Improvement	Effective	Capital Assets & Service Acquisition	50	50	60
Facilities Sustainment, Restoration, Modernization, and Demolition.	Adequate	Direct Federal	11,189	11,291	12,795
Housing	Moderately Effective	Direct Federal	17,001	15,554	16,371

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions) 2004 Actual	Estimate 2005	Estimate 2006
Military Force Management	Effective	Direct Federal	115,549	105,273	108,942
Missile Defense	Moderately Effective	Capital Assets and Service Acquisition	8,618	10,044	8,567
Navy Ship Operations	Effective	Direct Federal	4,372	4,224	4,406
Navy/Marine Corps Air Operations	Effective	Direct Federal	4,632	5,687	5,649
Recruiting	Moderately Effective	Direct Federal	1,935	2,048	2,217
Shipbuilding	Adequate	Capital Assets and Service Acquisition	11,989	11,384	9,354
Department of Education:					
21st Century Community Learning Centers	Adequate	Block/Formula Grant	999	991	991
Adult Education State Grants	Results Not Demonstrated	Block/Formula Grant	574	570	200
American Indian Vocational Rehabilitation Services.	Adequate	Competitive Grant	31	32	33
Assistive Technology (AT) Alternative Financing Program.	Results Not Demonstrated	Competitive Grant	0	4	15
B.J. Stupak Olympic scholarships	Results Not Demonstrated	Competitive Grant	1	1	0
Byrd Honors Scholarships	Results Not Demonstrated	Block/Formula Grant	41	41	0
Child Care Access Means Parents in School	Results Not Demonstrated	Competitive Grant	16	16	16
College Assistance Migrant Program (CAMP).	Results Not Demonstrated	Competitive Grant	16	16	16
Comprehensive Regional Assistance Centers	Results Not Demonstrated	Competitive Grant	28	0	0
Comprehensive School Reform	Adequate	Block/Formula Grant	234	205	0
Even Start	Ineffective	Block/Formula Grant	247	225	0
Federal Family Education Loans	Adequate	Credit	9,602	10,111	7,241
Federal Pell Grants	Adequate	Block/Formula Grant	12,007	12,365	17,953
Federal Perkins Loans	Ineffective	Credit	165	66	0
Federal Work-Study	Results Not Demonstrated	Block/Formula Grant	999	990	990
GEAR UP	Adequate	Competitive Grant	298	306	0
Graduate Assistance in Areas of National Need.	Results Not Demonstrated	Competitive Grant	31	30	30
High School Equivalency Program (HEP)	Results Not Demonstrated	Competitive Grant	19	19	19
IDEA Grants for Infants and Families	Results Not Demonstrated	Block/Formula Grant	444	441	441
IDEA Grants to States	Results Not Demonstrated	Block/Formula Grant	10,068	10,590	11,098
IDEA Part D—Parent Information Centers	Results Not Demonstrated	Competitive Grant	26	26	26
IDEA Part D—Personnel Preparation	Results Not Demonstrated	Competitive Grant	91	91	91
IDEA Part D—Research and Innovation	Results Not Demonstrated	Research and Development	78	83	73
IDEA Part D—Technical Assistance and Dissemination (TA&D).	Results Not Demonstrated	Competitive Grant	53	52	49
IDEA Preschool Grants	Results Not Demonstrated	Block/Formula Grant	388	385	385
Impact Aid Payments for Federal Property	Results Not Demonstrated	Block/Formula Grant	62	62	62
Improving Teacher Quality State Grants	Results Not Demonstrated	Block/Formula Grant	2,930	2,917	2,917
Independent Living (IL) Programs	Results Not Demonstrated	Competitive Grant	127	131	131
International Education Domestic	Results Not Demonstrated	Competitive Grant	89	92	92
Javits Fellowships	Adequate	Competitive Grant	10	10	10
Leveraging Educational Assistance Partnership.	Results Not Demonstrated	Block/Formula Grant	66	66	0
Magnet Schools	Adequate	Competitive Grant	109	108	108
National Assessment	Effective	Research and Development	90	89	111
National Center for Education Statistics	Effective	Research and Development	92	91	91
National Writing Project	Results Not Demonstrated	Competitive Grant	18	20	0
Nat'l Institute on Disability and Rehab. Research (NIDRR).	Results Not Demonstrated	Research and Development	107	108	108
Occupational and Employment Information	Results Not Demonstrated	Competitive Grant	9	9	0
Parental Information and Resource Centers	Results Not Demonstrated	Competitive Grant	42	42	0
Projects with Industry	Adequate	Competitive Grant	22	22	0
Ready to Learn Television	Results Not Demonstrated	Competitive Grant	23	23	23
Safe and Drug Free Schools State Grants	Ineffective	Block/Formula Grant	441	437	0
State Assessment Grants	Adequate	Block/Formula Grant	390	412	412
Student Aid Administration	Adequate	Capital Assets and Service Acquisition	912	914	939
Supplemental Educational Opportunity Grants.	Results Not Demonstrated	Block/Formula Grant	770	779	779
Teacher Quality Enhancement	Results Not Demonstrated	Competitive Grant	89	68	0
Teaching American History	Results Not Demonstrated	Competitive Grant	119	119	119

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2004 Actual	Estimate	
				2005	2006
Tech-Prep Education State Grants	Results Not Demonstrated	Block/Formula Grant	107	106	0
Training and Advisory Services	Results Not Demonstrated	Competitive Grant	7	7	7
Tribally Controlled Postsecondary Vocational and Technical Institutions.	Results Not Demonstrated	Competitive Grant	7	7	7
TRIO Student Support Services	Results Not Demonstrated	Competitive Grant	263	275	275
TRIO Talent Search	Results Not Demonstrated	Competitive Grant	144	145	0
TRIO Upward Bound	Ineffective	Competitive Grant	312	313	0
Troops-to-Teachers	Adequate	Competitive Grant	15	15	15
Vocational Education State Grants	Ineffective	Block/Formula Grant	1,195	1,194	0
Vocational Rehabilitation State Grants	Adequate	Block/Formula Grant	2,548	2,636	2,720
William D. Ford Direct Student Loans	Adequate	Credit	–169	–89	–616
Department of Energy:					
Advanced Fuel Cycle Initiative	Moderately Effective	Research and Development	66	67	70
Advanced Scientific Computing Research	Moderately Effective	Research and Development	202	232	207
Advanced Simulation and Computing (ASCI)	Effective	Research and Development	718	741	666
Basic Energy Sciences	Effective	Research and Development	1,011	1,105	1,146
Biological and Environmental Research	Effective	Research and Development	641	582	456
Bonneville Power Administration	Moderately Effective	Capital Assets and Service Acquisition	1,403	–10	–10
Building Technologies	Adequate	Research and Development	58	65	58
Clean Coal Research Initiative	Adequate	Research and Development	378	273	286
Directed Stockpile Work (DSW)	Moderately Effective	Capital Assets and Service Acquisition	1,349	1,406	1,421
Distributed Energy Resources	Moderately Effective	Research and Development	61	60	57
Elimination of Weapons-Grade Plutonium Production Program.	Results Not Demonstrated	Capital Assets and Service Acquisition	65	50	132
Energy Information Administration (EIA)	Results Not Demonstrated	Direct Federal	81	84	86
Environmental Management	Adequate	Capital Assets and Service Acquisition	7,052	7,284	6,505
Facilities and Infrastructure	Moderately Effective	Capital Assets and Service Acquisition	239	316	284
Fuel Cells (Stationary)	Adequate	Research and Development	69	74	65
Fusion Energy Sciences	Moderately Effective	Research and Development	263	274	291
Generation IV Nuclear Energy Systems Initiative.	Moderately Effective	Research and Development	27	40	45
Geothermal Technology	Moderately Effective	Research and Development	26	25	23
High Energy Physics	Moderately Effective	Research and Development	734	736	714
High Temperature Superducting (HTS) R&D	Moderately Effective	Research and Development	34	55	45
Hydrogen Technology	Moderately Effective	Research and Development	82	94	99
Inertial Confinement Fusion Ignition and High Yield Campaign/NIF Construction Project.	Moderately Effective	Research and Development	513	492	460
International Nuclear Materials Protection and Cooperation.	Effective	Direct Federal	258	238	343
National Nuclear Infrastructure	Results Not Demonstrated	Capital Assets and Service Acquisition	76	113	98
Natural Gas Technologies	Ineffective	Research and Development	43	45	10
Nonproliferation and International Security	Effective	Direct Federal	114	124	80
Nuclear Energy Research Initiative	Results Not Demonstrated	Research and Development	6	0	0
Nuclear Physics	Effective	Research and Development	390	405	371
Nuclear Power 2010	Adequate	Research and Development	19	50	56
Oil Technology	Ineffective	Research and Development	35	34	10
Readiness in Technical Base and Facilities (RTBF), Operations.	Moderately Effective	Capital Assets and Service Acquisition	1,314	1,310	1,388
Safeguards and Security	Moderately Effective	Direct Federal	626	707	708
Secure Transportation Asset (STA)	Moderately Effective	Direct Federal	186	201	212
Solar Energy	Moderately Effective	Research and Development	83	85	84
Southeastern Power Administration	Moderately Effective	Direct Federal	5	5	0
Southwestern Power Administration	Moderately Effective	Direct Federal	29	29	3
State Energy Programs	Results Not Demonstrated	Block/Formula Grant	44	44	41
Strategic Petroleum Reserve (SPR)	Effective	Direct Federal	176	170	166
Vehicle Technologies	Moderately Effective	Research and Development	177	165	166
Weatherization Assistance	Moderately Effective	Block/Formula Grant	227	228	230

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2004 Actual	Estimate	
				2005	2006
Western Area Power Administration	Moderately Effective	Capital Assets and Service Acquisition	177	172	54
Wind Energy	Moderately Effective	Research and Development	41	41	44
Yucca Mountain Project	Adequate	Capital Assets and Service Acquisition	577	572	651
Department of Health and Human Services:					
317 Immunization Program	Adequate	Competitive Grant	469	520	429
Administration on Aging	Moderately Effective	Block/Formula Grant	1,243	1,253	1,272
Adolescent Family Life Program (AFL)	Results Not Demonstrated	Competitive Grant	31	31	31
Agency for Toxic Substances and Disease Registry.	Adequate	Competitive Grant	73	76	76
Assets for Independence	Adequate	Competitive Grant	25	25	25
CDC State and Local Preparedness Grants	Results Not Demonstrated	Block/Formula Grant	918	927	797
CDC: Buildings and Facilities	Adequate	Capital Assets and Service Acquisition	260	270	30
CDC: Epidemic Services	Results Not Demonstrated	Direct Federal	92	92	92
CDC: Infectious Diseases	Adequate	Competitive Grant	222	226	225
CDC: Occupational Safety and Health	Adequate	Research and Development	277	286	286
CDC: STD and TB	Adequate	Competitive Grant	296	298	299
Child Care and Development Fund	Moderately Effective	Block/Formula Grant	4,804	4,801	4,801
Child Welfare—Community-Based Child Abuse Prevention (CBCAP).	Results Not Demonstrated	Block/Formula Grant	33	43	43
Child Welfare- CAPTA State Grant	Results Not Demonstrated	Block/Formula Grant	22	27	27
Children's Hospitals Graduate Medical Education Payment Program.	Adequate	Block/Formula Grant	303	298	200
Childrens Mental Health Services	Moderately Effective	Competitive Grant	102	105	105
Chronic Disease—Breast and Cervical Cancer.	Adequate	Competitive Grant	197	204	204
Chronic Disease—Diabetes	Adequate	Competitive Grant	60	63	63
Community Mental Health Services Block Grant.	Adequate	Block/Formula Grant	435	433	433
Community Services Block Grant	Results Not Demonstrated	Block/Formula Grant	642	637	0
Data Collection and Dissemination	Moderately Effective	Research and Development	65	65	63
Developmental Disabilities Grant Programs	Adequate	Block/Formula Grant	150	154	154
Domestic HIV/AIDS Prevention	Results Not Demonstrated	Competitive Grant	668	662	658
Emergency Medical Services for Children	Results Not Demonstrated	Competitive Grant	20	20	0
Family Violence Prevention and Services Program.	Results Not Demonstrated	Block/Formula Grant	129	129	129
Food and Drug Administration	Moderately Effective	Regulatory Based	1,695	1,801	1,881
Foster Care	Adequate	Block/Formula Grant	4,974	4,855	4,855
Head Start	Results Not Demonstrated	Competitive Grant	6,774	6,843	6,888
Health Alert Network	Adequate	Competitive Grant	0	0	0
Health Care Facilities Construction	Effective	Capital Assets and Service Acquisition	94	89	3
Health Care Fraud and Abuse Control (HCFAC).	Results Not Demonstrated	Direct Federal	160	160	160
Health Centers	Effective	Competitive Grant	1,617	1,734	2,038
Health Professions	Ineffective	Competitive Grant	409	416	129
HIV/AIDS Research	Moderately Effective	Research and Development	2,850	2,920	2,933
Hospital Preparedness Grants	Results Not Demonstrated	Block/Formula Grant	515	491	483
IHS Federally-Administered Activities	Moderately Effective	Direct Federal	1,698	1,793	1,887
IHS Sanitation Facilities Construction Program.	Moderately Effective	Capital Assets and Service Acquisition	93	92	94
Independent Living Program	Results Not Demonstrated	Block/Formula Grant	140	140	140
Low Income Home Energy Assistance Program.	Results Not Demonstrated	Block/Formula Grant	1,889	2,182	2,000
Maternal and Child Health Block Grant (MCHBG).	Moderately Effective	Block/Formula Grant	730	724	724
Medicare	Moderately Effective	Direct Federal	296,825	328,239	396,347
Medicare Integrity Program (HCFAC)	Effective	Block/Formula Grant	720	720	795
National Bone Marrow Donor Registry	Moderately Effective	Competitive Grant	23	25	23
National Health Service Corps	Moderately Effective	Competitive Grant	170	132	127
NIH Extramural Research Programs	Effective	Research and Development	20,880	21,146	21,385

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2004 Actual	Estimate	
				2005	2006
Nursing Education Loan Repayment and Scholarship Program.	Adequate	Competitive Grant	27	31	31
Office of Child Support Enforcement	Effective	Block/Formula Grant	3,815	3,934	4,081
Office on Women's Health	Results Not Demonstrated	Competitive Grant	29	29	30
Organ Transplantation	Adequate	Competitive Grant	25	24	23
Patient Safety	Adequate	Research and Development	80	84	84
Pharmaceutical Outcomes	Moderately Effective	Research and Development	13	27	26
Poison Control Centers	Adequate	Block/Formula Grant	24	24	23
Projects for Assistance in Transition from Homelessness.	Moderately Effective	Block/Formula Grant	50	55	55
Refugee and Entrant Assistance	Adequate	Block/Formula Grant	201	214	214
Resource and Patient Management System	Effective	Capital Assets and Service Acquisition	34	36	37
Runaway and Homeless Youth	Results Not Demonstrated	Competitive Grant	89	89	89
Rural Health Activities	Adequate	Competitive Grant	147	147	33
Ryan White	Adequate	Block/Formula Grant	2,045	2,073	2,083
State Children's Health Insurance Program	Adequate	Block/Formula Grant	4,607	5,343	6,233
Substance Abuse Prevention and Treatment Block Grant.	Ineffective	Block/Formula Grant	1,779	1,775	1,775
Substance Abuse Prevention PRNS	Moderately Effective	Competitive Grant	198	199	185
Substance Abuse Treatment Programs of Regional and National Significance.	Adequate	Competitive Grant	419	422	448
Translating Research into Practice	Adequate	Research and Development	8	6	1
Traumatic Brain Injury	Results Not Demonstrated	Competitive Grant	9	9	0
Urban Indian Health Program	Adequate	Block/Formula Grant	32	32	33
Department of Homeland Security:					
Aids to Navigation	Results Not Demonstrated	Direct Federal	843	942	1,031
Assistance to Firefighters Grant Program	Results Not Demonstrated	Competitive Grant	746	715	500
Baggage Screening Technology	Results Not Demonstrated	Capital Assets and Service Acquisition	310	645	594
Biological Countermeasures	Effective	Research and Development	286	398	385
Border Patrol	Results Not Demonstrated	Direct Federal	1,441	1,547	1,606
Coast Guard Domestic Icebreaking Program	Effective	Direct Federal	48	52	72
Coast Guard Fisheries Enforcement	Moderately Effective	Direct Federal	615	715	779
Coast Guard Migrant Interdiction Program	Moderately Effective	Direct Federal	244	267	301
Coast Guard Polar Icebreaking Program	Results Not Demonstrated	Direct Federal	47	47	0
Container Security Initiative	Results Not Demonstrated	Direct Federal	61	126	139
Detention and Removal	Moderately Effective	Direct Federal	1,084	1,257	1,493
Drug Interdiction	Results Not Demonstrated	Direct Federal	904	985	1,114
Federal Air Marshal Service	Results Not Demonstrated	Direct Federal	623	663	689
Federal Law Enforcement Training Center	Results Not Demonstrated	Direct Federal	192	196	224
Federal Protective Service	Moderately Effective	Direct Federal	424	478	487
FEMA Response	Adequate	Direct Federal	617	1,307	326
Foreign Protectees and Foreign Missions	Effective	Direct Federal	80	106	110
Hazard Mitigation Grant	Results Not Demonstrated	Block/Formula Grant	155	161	161
Immigration Services	Adequate	Direct Federal	1,576	1,775	1,854
Inspection Technology	Results Not Demonstrated	Direct Federal	184	205	232
Marine Environmental Protection	Moderately Effective	Regulatory Based	230	295	288
Metropolitan Medical Response System	Results Not Demonstrated	Block/Formula Grant	50	30	0
National Flood Insurance	Moderately Effective	Direct Federal	2,153	1,524	1,632
Office of Investigations	Adequate	Direct Federal	941	1,181	1,399
Passenger Screening Technology	Results Not Demonstrated	Capital Assets and Service Acquisition	27	103	147
Protective Intelligence	Effective	Direct Federal	57	59	60
Recovery	Adequate	Direct Federal	3,031	6,466	1,374
Screener Training	Adequate	Direct Federal	106	89	91
Screener Workforce	Results Not Demonstrated	Direct Federal	2,334	2,522	2,669
Search and Rescue	Results Not Demonstrated	Direct Federal	691	768	794
Standards	Adequate	Research and Development	38	40	37
State Homeland Security Grants	Results Not Demonstrated	Block/Formula Grant	1,200	1,500	1,020
Threat and Vulnerability, Testing and Assessment (TVTA).	Results Not Demonstrated	Research and Development	93	66	50

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2004 Actual	Estimate	
				2005	2006
Department of Housing and Urban Development:					
Community Development Block Grant (Formula).	Ineffective	Block/Formula Grant	4,331	4,117	0
Fair Housing Assistance Program	Moderately Effective	Block/Formula Grant	28	26	23
Fair Housing Initiatives Program	Results Not Demonstrated	Competitive Grant	20	20	16
Family Self-Sufficiency Program (FSS)—within Housing Vouchers.	Adequate	Competitive Grant	48	46	55
FHA Single-Family Mortgage Insurance	Adequate	Credit	–2,660	–2,121	–1,867
HOME Investment Partnerships Program	Moderately Effective	Block/Formula Grant	2,006	1,900	1,941
Homeownership Voucher	Moderately Effective	Competitive Grant	4	3	5
HOPE VI	Ineffective	Competitive Grant	149	143	–143
Housing Counseling	Adequate	Competitive Grant	40	42	40
Housing for Persons with Disabilities	Results Not Demonstrated	Competitive Grant	249	238	120
Housing for the Elderly	Results Not Demonstrated	Competitive Grant	773	741	741
Housing Opportunities for Persons with AIDS.	Results Not Demonstrated	Block/Formula Grant	297	282	268
Housing Vouchers	Moderately Effective	Competitive Grant	14,415	14,717	15,784
Indian Community Development Block Grant Program.	Adequate	Competitive Grant	72	68	58
Lead Hazard Grants	Moderately Effective	Competitive Grant	164	167	110
National Community Development Initiative	Moderately Effective	Block/Formula Grant	35	34	0
Native American Housing Block Grants	Results Not Demonstrated	Block/Formula Grant	650	622	522
Partnership for Advancing Technology in Housing (PATH).	Results Not Demonstrated	Research and Development	7	7	0
Project-Based Rental Assistance	Ineffective	Capital Assets and Service Acquisition	4,769	4,950	4,682
Rural Housing and Economic Development	Ineffective	Competitive Grant	25	24	0
Department of the Interior:					
Abandoned Mine Land Reclamation	Results Not Demonstrated	Block/Formula Grant	172	168	170
DOI Wildland Fire Management	Results Not Demonstrated	Direct Federal	685	733	757
Energy and Minerals Management	Adequate	Direct Federal	109	108	117
Energy Resource Assessments	Moderately Effective	Research and Development	25	24	21
Federal Regulatory and Abandoned Mine Land Program.	Results Not Demonstrated	Regulatory Based	54	58	58
Geologic Hazard Assessments	Moderately Effective	Research and Development	75	76	82
Habitat Restoration Activities	Moderately Effective	Direct Federal	144	150	158
Indian 477—Job Placement and Training	Moderately Effective	Block/Formula Grant	8	9	9
Indian Forestry Program	Adequate	Direct Federal	49	53	53
Indian Law Enforcement	Results Not Demonstrated	Direct Federal	172	180	192
Indian Post Secondary Education—Tribal Colleges.	Adequate	Block/Formula Grant	94	97	88
Indian Roads—Operation and Maintenance	Results Not Demonstrated	Direct Federal	27	27	27
Indian School Construction	Results Not Demonstrated	Capital Assets and Service Acquisition	295	263	174
Indian School Operations	Adequate	Direct Federal	522	518	522
Land & Water Conservation Fund (LWCF) State Grants.	Results Not Demonstrated	Block/Formula Grant	91	90	0
LWCF Land Acquisition	Results Not Demonstrated	Direct Federal	98	103	114
Migratory Bird Program	Results Not Demonstrated	Direct Federal	119	129	141
Mineral Resource Assessments	Moderately Effective	Research and Development	55	54	26
Minerals Revenue Management	Results Not Demonstrated	Direct Federal	99	103	104
National Fish Hatchery System	Moderately Effective	Direct Federal	58	57	58
National Historic Preservation Programs	Moderately Effective	Block/Formula Grant	97	98	88
National Mapping	Effective	Research and Development	130	119	139
National Park Service Cultural Resource Stewardship.	Adequate	Direct Federal	92	95	96
National Park Service Facility Management	Adequate	Capital Assets and Service Acquisition	700	690	717
National Park Service Natural Resource Stewardship.	Moderately Effective	Direct Federal	198	206	210
National Wildlife Refuge Operations and Maintenance.	Results Not Demonstrated	Direct Federal	412	402	415

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions) 2004 Actual	Estimate 2005	Estimate 2006
Outer Continental Shelf Environmental Studies.	Moderately Effective	Research and Development	27	27	26
Partners for Fish and Wildlife	Adequate	Direct Federal	42	48	52
Project Planning and Construction	Results Not Demonstrated	Capital Assets and Service Acquisition	143	143	143
Realty and Ownership Management	Adequate	Direct Federal	107	107	97
Reclamation Hydropower	Effective	Capital Assets and Service Acquisition	59	69	71
Recreation and Concessions	Adequate	Capital Assets and Service Acquisition	10	10	10
Recreation Management	Adequate	Direct Federal	64	63	68
Regulation of Surface Coal Mining Activities	Results Not Demonstrated	Regulatory Based	70	71	71
Resource Evaluation and Leasing Program	Moderately Effective	Direct Federal	54	58	59
Rural Water Supply Projects	Results Not Demonstrated	Capital Assets and Service Acquisition	75	89	55
Science & Technology Program (S&T)	Effective	Research and Development	16	17	10
Southern Nevada Public Land Management Act.	Results Not Demonstrated	Direct Federal	240	401	521
Title XVI Water Reuse and Recycling	Moderately Effective	Competitive Grant	28	26	10
Tribal Courts	Results Not Demonstrated	Direct Federal	18	18	18
Tribal Land Consolidation	Moderately Effective	Capital Assets and Service Acquisition	22	35	35
Water Information Collection and Dissemination.	Moderately Effective	Research and Development	66	64	64
Water Resources Research	Moderately Effective	Research and Development	143	141	140
Department of Justice:					
ATF Arson & Explosives Program	Moderately Effective	Direct Federal	215	188	195
ATF Firearms Programs—Integrated Violence Reduction Strategy.	Moderately Effective	Direct Federal	596	673	712
Bureau of Prisons	Moderately Effective	Direct Federal	4,755	4,776	5,066
Community Oriented Policing Services	Results Not Demonstrated	Competitive Grant	742	499	22
Criminal Justice Services	Moderately Effective	Direct Federal	291	435	464
Cybercrime	Adequate	Direct Federal	183	234	251
Drug Courts	Results Not Demonstrated	Competitive Grant	38	39	70
Drug Enforcement Administration	Adequate	Direct Federal	2,070	2,208	2,269
Juvenile Accountability Block Grants	Ineffective	Block/Formula Grant	59	54	0
National Criminal History Improvement Program.	Moderately Effective	Block/Formula Grant	30	25	58
Organized Crime/Drug Enforcement	Adequate	Direct Federal	379	581	545
Residential Substance Abuse Treatment	Results Not Demonstrated	Block/Formula Grant	0	25	44
State Criminal Alien Assistance Program	Results Not Demonstrated	Block/Formula Grant	297	301	0
U.S. Attorneys	Adequate	Direct Federal	1,525	1,542	1,623
USMS Apprehension of Fugitives	Adequate	Direct Federal	181	186	191
USMS Protection of the Judicial Process	Adequate	Direct Federal	539	551	599
Weed and Seed	Adequate	Competitive Grant	58	61	60
White Collar Crime	Adequate	Direct Federal	429	508	529
Department of Labor:					
Black Lung Benefits Program	Moderately Effective	Direct Federal	1,451	1,446	1,401
Bureau of Labor Statistics	Effective	Direct Federal	524	534	543
Community Service Employment for Older Americans.	Ineffective	Direct Federal	439	437	437
Davis-Bacon Wage Determination Program	Results Not Demonstrated	Regulatory Based	10	10	10
Dislocated Worker Assistance	Adequate	Block/Formula Grant	1,236	1,203	1,094
Employee Benefits Security Administration (EBSA).	Moderately Effective	Regulatory Based	134	148	154
Employment Service	Adequate	Block/Formula Grant	787	780	696
Federal Employees' Compensation Act (FECA).	Moderately Effective	Direct Federal	2,571	2,634	2,702
H–1B Labor Condition Applications Program	Moderately Effective	Direct Federal	5	5	6
International Child Labor Program and Office of Foreign Relations.	Adequate	Competitive Grant	111	93	12
Job Corps	Moderately Effective	Direct Federal	1,566	1,576	1,547
Migrant and Seasonal Farmworkers	Ineffective	Competitive Grant	79	78	0

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2004 Actual	Estimate	
				2005	2006
Mine Safety and Health Administration	Adequate	Regulatory Based	269	279	280
Native American Programs—Workforce Investment Act.	Adequate	Competitive Grant	57	56	56
Occupational Safety and Health Administration.	Adequate	Regulatory Based	458	464	467
Office of Federal Contract Compliance Programs (OFCCP).	Adequate	Regulatory Based	79	80	82
Pension Benefit Guaranty Corporation	Moderately Effective	Direct Federal	294	312	297
Permanent Labor Certification Program	Adequate	Direct Federal	37	38	40
Trade Adjustment Assistance	Ineffective	Direct Federal	1,341	1,060	969
Unemployment Insurance Administration State Grants.	Moderately Effective	Block/Formula Grant	2,815	2,699	2,660
Youth Activities	Ineffective	Block/Formula Grant	1,005	1,012	960
Department of State:					
Andean Counterdrug Initiative (ACI)	Adequate	Direct Federal	727	725	735
Capital Security Construction Program	Effective	Capital Assets and Service Acquisition	753	775	810
Contribution to the United Nations Development Programme (UNDP).	Effective	Block/Formula Grant	101	108	95
Contributions For International Peacekeeping Activities.	Effective	Direct Federal	795	483	1,036
Educational and Cultural Exchange Programs in Near East Asia and South Asia.	Effective	Competitive Grant	80	89	125
Global Educational and Cultural Exchanges	Effective	Competitive Grant	321	356	430
Humanitarian Migrants to Israel	Effective	Block/Formula Grant	49	50	40
International Narcotics Control and Law Enforcement Programs in the Western Hemisphere (INCLE WHA).	Adequate	Direct Federal	47	45	51
International Fisheries Commissions	Adequate	Block/Formula Grant	19	21	25
Nonproliferation of WMD Expertise (NWMDE).	Moderately Effective	Direct Federal	36	38	44
Non-Security Based Capital Construction Program.	Effective	Capital Assets and Service Acquisition	64	0	0
Refugee Admissions to the U.S	Effective	Competitive Grant	142	138	223
UN High Commissioner for Refugees (UNHCR).	Effective	Block/Formula Grant	297	270	285
Visa and Consular Services	Effective	Direct Federal	649	755	791
Worldwide Security Upgrades	Effective	Direct Federal	640	650	690
Department of Transportation:					
FAA Air Traffic Services	Adequate	Direct Federal	6,581	7,475	7,247
FAA Grants-in-Aid for Airports (Airport Improvement Program).	Moderately Effective	Competitive Grant	3,784	3,987	3,021
Facilities and Equipment	Adequate	Capital Assets and Service Acquisition	2,863	2,525	2,448
Federal Highway Administration (FHWA): Research and Development/Intelligent Transportation Systems (ITS).	Moderately Effective	Research and Development	436	458	430
Federal Lands	Moderately Effective	Block/Formula Grant	664	750	973
Federal Motor Carrier Safety Administration Grant Program.	Moderately Effective	Block/Formula Grant	193	193	225
FHWA Highway Infrastructure	Moderately Effective	Block/Formula Grant	32,728	32,926	33,167
Formula Programs—Section 5307 and 5309	Effective	Block/Formula Grant	4,427	5,384	5,024
Hazardous Materials Transportation	Moderately Effective	Block/Formula Grant	14	14	14
Maritime Security Program	Effective	Capital Assets and Service Acquisition	102	101	156
National Highway Traffic Safety Administration Grant Program.	Moderately Effective	Block/Formula Grant	224	227	469
New Starts	Moderately Effective	Competitive Grant	1,438	1,531	1,531
Operations and Programs	Moderately Effective	Direct Federal	175	229	233
Operations and Research	Moderately Effective	Regulatory Based	112	278	285
Pipeline Safety	Moderately Effective	Regulatory Based	101	116	92
Railroad Safety Program (RSP)	Moderately Effective	Regulatory Based	143	157	148
Regulation & Certification	Moderately Effective	Regulatory Based	871	903	942

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2004 Actual	Estimate	
				2005	2006
Research and Development	Moderately Effective	Research and Development	37	44	51
Research, Engineering & Development	Effective	Research and Development	137	165	146
Department of the Treasury:					
Administering the Public Debt	Effective	Direct Federal	173	175	177
ATF Consumer Product Safety Activities	Adequate	Regulatory Based	20	37	41
Bank Enterprise Award	Results Not Demonstrated	Competitive Grant	15	10	0
CDFI Fund: Financial and Technical Assistance.	Adequate	Competitive Grant	38	32	0
Coin Production	Effective	Direct Federal	431	481	480
Debt Collection	Effective	Direct Federal	64	44	50
Earned Income Tax Credit (EITC) Compliance.	Ineffective	Direct Federal	197	165	169
Financial Management Service (FMS): FMS Collections.	Effective	Direct Federal	17	20	17
IRS Tax Collection	Results Not Demonstrated	Direct Federal	1,773	1,826	2,015
IRS Taxpayer Advocate Service	Moderately Effective	Direct Federal	166	170	174
IRS Taxpayer Service	Adequate	Direct Federal	2,361	2,329	2,254
New Currency Manufacturing	Effective	Direct Federal	340	345	410
New Markets Tax Credit	Adequate	Competitive Grant	5	6	4
OCC Bank Supervision	Effective	Regulatory Based	477	488	509
Office of Foreign Assets Control (OFAC)	Results Not Demonstrated	Direct Federal	22	22	24
OTS Thrift Supervision	Effective	Regulatory Based	178	182	187
Submission Processing (SP)	Results Not Demonstrated	Direct Federal	1,275	1,276	1,274
U.S. Mint: Numismatic Program	Effective	Direct Federal	452	709	696
Department of Veterans Affairs:					
Burial Benefits	Moderately Effective	Direct Federal	431	453	467
Disability Compensation	Results Not Demonstrated	Direct Federal	26,995	29,845	30,644
General Administration	Moderately Effective	Direct Federal	551	622	677
Housing	Results Not Demonstrated	Credit	9,385	11,440	10,678
Medical Care	Adequate	Direct Federal	28,207	29,925	30,705
Montgomery GI Bill (MGIB) (Education Benefits).	Results Not Demonstrated	Direct Federal	1,968	1,991	2,580
VA Research and Development	Results Not Demonstrated	Research and Development	866	784	786
Corps of Engineers-Civil Works:					
Coastal Ports and Harbors	Results Not Demonstrated	Capital Assets and Service Acquisition	914	911	907
Coastal Storm Damage Reduction	Results Not Demonstrated	Capital Assets and Service Acquisition	93	82	69
Corps Hydropower	Adequate	Capital Assets and Service Acquisition	245	285	240
Emergency Management	Moderately Effective	Direct Federal	3	148	70
Flood Damage Reduction	Results Not Demonstrated	Capital Assets and Service Acquisition	1,077	1,059	967
Inland Waterways Navigation	Results Not Demonstrated	Capital Assets and Service Acquisition	866	844	898
Non-regulatory Wetlands Activities	Results Not Demonstrated	Capital Assets and Service Acquisition	413	423	507
Recreation Management	Moderately Effective	Direct Federal	260	268	268
USACE Regulatory Program	Moderately Effective	Regulatory Based	140	144	160
Environmental Protection Agency:					
Acid Rain	Moderately Effective	Regulatory Based	19	19	19
Air Toxics	Adequate	Regulatory Based	96	99	100
Alaska Native Villages	Ineffective	Block/Formula Grant	43	45	15
Brownfields	Adequate	Competitive Grant	170	210	210
Civil Enforcement	Adequate	Direct Federal	446	446	467
Clean Water State Revolving Fund	Adequate	Block/Formula Grant	1,342	1,091	730
Climate Change Programs	Adequate	Direct Federal	110	109	113
Criminal Enforcement	Adequate	Direct Federal	43	46	51
Drinking Water State Revolving Fund	Adequate	Block/Formula Grant	845	850	850
Ecological Research	Results Not Demonstrated	Research and Development	115	94	84
Endocrine Disruptors	Adequate	Direct Federal	17	17	18
Environmental Education	Results Not Demonstrated	Competitive Grant	9	9	0

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions) 2004 Actual	Estimate 2005	Estimate 2006
Existing Chemicals	Adequate	Direct Federal	16	16	17
Leaking Underground Storage Tanks	Adequate	Block/Formula Grant	72	69	69
Mobile Source Standards and Certification	Moderately Effective	Regulatory Based	61	68	70
New Chemicals	Moderately Effective	Direct Federal	15	14	15
Nonpoint Source Grants	Adequate	Block/Formula Grant	237	209	209
Particulate Matter Research	Results Not Demonstrated	Research and Development	57	64	66
Pesticide Enforcement Grant Program	Ineffective	Block/Formula Grant	20	20	19
Pesticide Field Programs	Results Not Demonstrated	Block/Formula Grant	38	40	38
Pesticide Registration	Adequate	Direct Federal	43	45	44
Pesticide Reregistration	Adequate	Direct Federal	54	61	61
Pollution Prevention and New Technologies	Results Not Demonstrated	Research and Development	43	34	26
Public Water System Supervision Grant Program.	Adequate	Block/Formula Grant	102	105	101
RCRA Base Program, Permits and Grants	Adequate	Regulatory Based	152	156	158
RCRA Corrective Action	Adequate	Regulatory Based	40	41	41
Stratospheric Ozone Protection	Adequate	Regulatory Based	17	19	18
Superfund Remedial Action	Adequate	Direct Federal	622	748	622
Superfund Removal	Results Not Demonstrated	Direct Federal	232	229	246
Tribal General Assistance	Adequate	Block/Formula Grant	62	63	58
U. S.-Mexico Border Water Infrastructure	Adequate	Block/Formula Grant	50	50	50
Underground Injection Control (UIC) Grant Program.	Adequate	Block/Formula Grant	11	11	11
General Services Administration:					
Asset Management of Federally-Owned Real Property.	Effective	Capital Assets and Service Acquisition	2,384	2,393	2,725
GSA New Construction (BA51) Program DRAFT.	Results Not Demonstrated	Capital Assets and Service Acquisition	1,035	956	845
GSA's Regional IT Solutions Program	Results Not Demonstrated	Capital Assets and Service Acquisition	5,401	5,217	5,311
Leasing Space	Results Not Demonstrated	Capital Assets and Service Acquisition	3,722	4,164	4,198
Multiple Award Schedules	Results Not Demonstrated	Direct Federal	463	479	506
National IT Solutions Program	Results Not Demonstrated	Capital Assets and Service Acquisition	1,829	1,847	1,937
Office of Governmentwide Policy	Results Not Demonstrated	Regulatory Based	93	133	125
Personal Property Management Program (FBP).	Results Not Demonstrated	Direct Federal	32	29	31
Real Property Disposal (PR)	Results Not Demonstrated	Direct Federal	27	47	45
Supply Depots and Special Order	Adequate	Capital Assets and Service Acquisition	1,075	1,166	1,226
Vehicle Acquisition	Adequate	Capital Assets and Service Acquisition	1,292	1,321	1,376
Vehicle Leasing	Moderately Effective	Capital Assets and Service Acquisition	1,117	1,138	1,161
National Aeronautics and Space Administration:					
Aeronautics Technology	Moderately Effective	Research and Development	1,057	906	852
Biological Sciences Research	Results Not Demonstrated	Research and Development	365	482	385
Earth Science Applications	Results Not Demonstrated	Research and Development	103	76	76
Earth System Science	Moderately Effective	Research and Development	1,505	1,384	1,248
Education	Adequate	Competitive Grant	230	217	167
Mars Exploration	Effective	Research and Development	596	681	723
Mission and Science Measurement Technology.	Moderately Effective	Research and Development	459	0	0
Solar System Exploration	Effective	Research and Development	1,296	1,125	1,043
Space and Flight Support	Adequate	Capital Assets and Service Acquisition	466	485	376
Space Shuttle	Results Not Demonstrated	Capital Assets and Service Acquisition	4,061	4,669	4,531
Space Station	Moderately Effective	Capital Assets and Service Acquisition	1,364	1,676	1,857
Structure and Evolution of the Universe	Effective	Research and Development	451	378	353
Sun-Earth Connection	Effective	Research and Development	731	696	740

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2004 Actual	Estimate	
				2005	2006
National Science Foundation:					
Biocomplexity in the Environment	Effective	Research and Development	104	99	84
Collaborations	Effective	Research and Development	398	306	298
Facilities	Effective	Research and Development	566	615	692
Individuals	Effective	Research and Development	567	547	519
Information Technology Research	Effective	Research and Development	309	197	167
Institutions	Effective	Research and Development	181	177	159
Nanoscale Science and Engineering	Effective	Research and Development	256	297	257
Polar Tools, Facilities and Logistics	Effective	Research and Development	277	257	301
Office of Personnel Management:					
Federal Employees Group Life Insurance (FEGLI).	Adequate	Direct Federal	3,499	3,607	3,844
Federal Employees Health Benefits Program	Adequate	Direct Federal	29,220	32,126	34,625
Federal Employees Retirement Program	Adequate	Direct Federal	52,475	55,951	58,850
FEHBP Integrity	Effective	Direct Federal	12	13	13
Small Business Administration:					
Business Information Centers	Results Not Demonstrated	Direct Federal	0	0	0
Disaster Loan Program	Effective	Credit	169	112	138
SCORE	Moderately Effective	Block/Formula	5	5	5
Section 504 Certified Development Company Guaranteed Loan Program.	Adequate	Credit	0	0	0
Section 7 (a) Guaranteed Loan Program	Adequate	Credit	78	0	0
Small Business Development Centers	Moderately Effective	Block/Formula	88	88	88
Small Business Investment Company	Adequate	Credit	0	0	0
Social Security Administration:					
Disability Insurance	Moderately Effective	Direct Federal	78,162	83,951	90,041
Supplemental Security Income	Moderately Effective	Direct Federal	36,903	41,843	41,381
International Assistance Programs					
Department of State:					
Anti-Terrorism Assistance	Effective	Direct Federal	141	128	150
Assistance Coordination of SEED/FSA	Effective	Competitive Grant	1,026	949	864
Economic Support Fund (HRDF)	Adequate	Competitive Grant	34	37	27
Economic Support Fund (WHA)	Moderately Effective	Competitive Grant	149	146	174
Export Controls	Effective	Direct Federal	35	38	44
Humanitarian Demining	Effective	Direct Federal	50	59	72
Military Assistance to new NATO and NATO Aspirant Nations.	Moderately Effective	Direct Federal	149	173	141
Nonproliferation & Disarmament Fund	Effective	Direct Federal	29	32	38
PKO—OSCE Programs	Moderately Effective	Direct Federal	28	2	2
Security Assistance for the Western Hemisphere.	Moderately Effective	Direct Federal	133	140	149
Security Assistance to Sub-Saharan Africa	Moderately Effective	Direct Federal	57	86	147
Terrorist Interdiction Program (TIP)	Effective	Direct Federal	4	4	8
Department of the Treasury:					
African Development Fund	Results Not Demonstrated	Block/Formula Grant	112	105	136
Global Environment Facility	Results Not Demonstrated	Block/Formula Grant	138	107	108
International Development Association	Adequate	Block/Formula Grant	908	843	950
Treasury Technical Assistance	Adequate	Direct Federal	19	19	20
Tropical Forest Conservation Act [1]	Results Not Demonstrated	Credit	20	20	0
Overseas Private Investment Corporation:					
Overseas Private Investment Corporation—Finance.	Adequate	Credit	24	24	20
Overseas Private Investment Corporation—Insurance.	Adequate	Credit	1,800	2,000	2,000
U.S. Trade and Development Agency:					
U.S. Trade and Development Agency	Moderately Effective	Competitive Grant	67	58	52
United States Agency for International Development:					
Child Survival and Health (CSH—LAC)	Moderately Effective	Competitive Grant	150	130	132
Development Assistance (LAC)	Moderately Effective	Competitive Grant	265	255	224
Office of Transition Initiatives	Moderately Effective	Competitive Grant	55	49	325

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2004 Actual	Estimate 2005	Estimate 2006
Operating Expenses and Capital Investment Fund (OE/CIF).	Moderately Effective	Direct Federal	737	672	758
Public Law 480 Title II Food Aid	Adequate	Competitive Grant	1,185	1,173	885
USAID Climate Change	Adequate	Competitive Grant	180	180	150
USAID Development Assistance—Population	Moderately Effective	Competitive Grant	373	372	346
Other Independent Agencies					
American Battle Monuments Commission:					
World War II Memorial	Effective	Capital Assets and Service Acquisition	22	0	0
Appalachian Regional Commission:					
Appalachian Regional Commission	Adequate	Competitive Grant	66	65	65
Armed Forces Retirement Home:					
Asset Management of AFRH Real Property	Moderately Effective	Capital Assets and Service Acquisition	68	65	61
Broadcasting Board of Governors:					
Broadcasting to Africa	Moderately Effective	Direct Federal	13	14	13
Broadcasting to East Asia & Eurasia	Moderately Effective	Direct Federal	102	100	106
Broadcasting to Near East Asia and South Asia.	Moderately Effective	Direct Federal	136	145	170
Commodity Futures Trading Commission:					
Enforcement Program	Results Not Demonstrated	Direct Federal	35	38	40
Consumer Product Safety Commission:					
Consumer Product Safety Commission	Results Not Demonstrated	Regulatory Based	60	62	62
Corporation for National and Community Service:					
AmeriCorps	Results Not Demonstrated	Competitive Grant	312	288	277
Court Services and Offender Supervision Agency for the District:					
Community Supervision Program	Adequate	Direct Federal	118	110	131
Pretrial Services Agency	Moderately Effective	Direct Federal	38	39	42
Delta Regional Authority:					
Delta Regional Authority	Results Not Demonstrated	Competitive Grant	5	6	6
Denali Commission:					
Denali Commission	Adequate	Competitive Grant	59	70	6
Export-Import Bank of the United States:					
Export Import Bank—Long Term Guarantees.	Moderately Effective	Credit	585	764	490
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	52	55
National Archives and Records Administration:					
Electronic Records Services	Results Not Demonstrated	Capital Assets and Service Acquisition	54	50	49
Records Services Program	Adequate	Direct Federal	351	363	384
National Credit Union Administration:					
Community Development Revolving Loan Fund—Loan and Technical Assistance Grant components.	Results Not Demonstrated	Credit	4	6	6
Neighborhood Reinvestment Corporation:					
Neighborhood Reinvestment Corporation	Moderately Effective	Block/Formula Grant	114	114	118
Nuclear Regulatory Commission:					
Fuel Facilities Licensing & Inspection	Effective	Regulatory Based	22	39	36
Nuclear Materials Users Licensing & Inspection (NMULI).	Effective	Regulatory Based	44	63	65
Reactor Inspection and Performance Assessment.	Effective	Regulatory Based	107	180	193
Office of National Drug Control Policy:					
CTAC Counterdrug Research & Development.	Results Not Demonstrated	Research and Development	18	18	10
CTAC Technology Transfer Program	Results Not Demonstrated	Competitive Grant	24	24	20
Drug-Free Communities Support Program	Adequate	Competitive Grant	70	79	80

Table 2–5 PROGRAM ASSESSMENT AND FUNDING INFORMATION—Continued

(Current Data for All Programs Assessed by PART)

Agency/Program Title	Rating	Primary Program Type	Program Funding Level (dollars in millions)		
			2004 Actual	Estimate	
				2005	2006
High Intensity Drug Trafficking Areas (HIDTA).	Results Not Demonstrated	Competitive Grant	225	227	100
Youth Anti-Drug Media Campaign	Results Not Demonstrated	Capital Assets and Service Acquisition	144	119	120
Public Defender Service for the District of Columbia:					
Public Defender Service for the District of Columbia.	Results Not Demonstrated	Direct Federal	25	30	30
Securities and Exchange Commission:					
Enforcement	Results Not Demonstrated	Direct Federal	303	361	356
Full Disclosure Program (Corporate Review)	Results Not Demonstrated	Regulatory Based	96	128	129
Tennessee Valley Authority:					
TVA Power	Moderately Effective	Capital Assets and Service Acquisition	7,657	7,875	8,153
TVA Resource Stewardship (Non-Power)	Effective	Capital Assets and Service Acquisition	87	87	85

[1]Tropical Forest Conservation Act——Funding for 2006 will be provided within the amount appropriated for debt relief based on the program's ability to demonstrate results in 2005

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, identifying and pursuing terrorists abroad and implementing an array of measures to secure our citizens and resources at home. The Administration has worked with the Congress to reorganize the Federal Government, acquire countermeasures to biological weapons, enhance security at our borders, transportation systems, critical infrastructure and local communities, and strengthen America's preparedness and response capabilities. To build upon these accomplishments, the President signed landmark legislation to reorganize America's intelligence agencies and implement other recommendations of the 9/11 Commission, the Intelligence Reform and Terrorism Prevention Act of 2004. These are elements of our national homeland security strategy—to prevent terrorist attacks within the United States, reduce America's vulnerability to terrorism, and minimize the damage from attacks that may occur—involving every level of government, the private sector, and individual citizens. Since September 11th, homeland security has remained a major policy focus for all levels of government, and one of the President's highest priorities.

To underscore the importance of 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 legislative 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 the efforts of 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 total governmental spending on homeland security.

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.[2] As in the Budget, where appropriate, the data is also updated to reflect agency activities, Congressional action, and technical re-estimates. 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.

Total funding for homeland security has grown significantly since the attacks of September 11, 2001. For 2006, the President's Budget includes $49.9 billion for homeland security activities, a $3.9 billion (8.6 percent) increase over the 2005 level, excluding DHS' Project BioShield.[3] The 2006 level is more than $29 billion above, or approximately 240 percent, of the 2002 level of $20.7 billion. Excluding mandatory funding, the Department of Defense, and DHS' Project BioShield, the 2006 Budget proposes a gross discretionary increase of $2.9 billion (8.3 percent) over the 2005 level. The Budget also proposes to increase aviation security fees to allow the Government to recover most of the cost of Federal aviation screening operations. Including this

[1] All data in the Federal expenditures section are based on the President's policy for the 2006 Budget. Additional policy and baseline data is presented in the "Additional Tables" section. Due to rounding differences, data in this section may not add to totals in other Budget volumes.

[2] For the estimates in this section, the significant changes of this type are: 1) a change to estimates in the U.S. Coast Guard to reflect distribution of defense-related funding consistent with appropriations, 2) a change to estimates to capture additional resources for plant and animal monitoring and surveillance programs in the Animal and Plant Health Inspection Service, and 3) a change to estimates to remove resources for the Health Resources and Services Administration's poison control activities. Historical data has been adjusted to reflect these changes. Major changes to the classification of homeland security activities will be reviewed pursuant to section 889 of the Homeland Security Act of 2002.

[3] The Department of Homeland Security Appropriations Act, 2004, provided $5.6 billion for Project BioShield, to remain available through 2013. Pursuant to that Act, specific amounts became available in 2004 ($0.9 billion) and 2005 ($2.5 billion) that are intended to cover programmatic activities through 2008. The remainder will become available in 2009. Including this uneven funding stream can distort year-over-year comparisons.

fee proposal, the net non-defense discretionary increase from 2005 to 2006 is 3.1 percent.

A total of 33 agencies comprise Federal 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 2006:

Table 3–1. HOMELAND SECURITY FUNDING BY AGENCY

(Budget authority, in millions of dollars)

Budget Authority	2004 Enacted	2004 Supplemental	2005 Enacted *	2006 Request
Department of Agriculture	411.1	....	599.9	703.7
Department of Commerce	124.6	....	166.7	183.2
Department of Defense	7,024.0	....	8,570.1	9,513.5
Department of Education	8.0	....	23.8	22.7
Department of Energy	1,364.0	....	1,562.0	1,665.8
Department of Health and Human Services	4,062.2	....	4,230.3	4,406.7
Department of Homeland Security	22,832.7	90.7	24,870.7	27,332.5
Department of Housing and Urban Development	1.7	....	2.0	1.9
Department of the Interior	82.9	....	65.0	57.1
Department of Justice	2,164.9	15.5	2,677.8	3,103.6
Department of Labor	52.4	....	56.1	47.9
Department of State	696.4	....	824.1	938.1
Department of Transportation	283.5	....	181.7	191.5
Department of the Treasury	90.4	....	101.1	110.5
Department of Veterans Affairs	271.3	....	280.4	298.9
Corps of Engineers	101.5	....	89.0	72.0
Environmental Protection Agency	131.0	....	106.8	184.3
Executive Office of the President	35.0	....	29.5	22.4
General Services Administration	78.9	....	65.2	79.8
National Aeronautics and Space Administration	207.0	....	218.0	205.0
National Science Foundation	340.0	....	342.2	344.2
Office of Personnel Management	3.0	....	3.0	3.8
Social Security Administration	143.4	....	159.4	177.5
District of Columbia	19.0	....	15.0	15.0
Federal Communications Commission	1.0	....	1.6	3.5
Intelligence Community Management Account	1.0	....	72.4	55.8
National Archives and Records Administration	16.0	....	17.1	20.2
Nuclear Regulatory Commission	66.8	....	59.2	61.0
Postal Service	....	....	503.0	....
Securities and Exchange Commission	5.0	....	5.0	5.0
Smithsonian Institution	78.3	....	75.0	86.6
United States Holocaust Memorial Museum	8.0	....	8.0	8.7
Corporation for National and Community Service	22.8	....	17.0	20.4
Total, Homeland Security Budget Authority	**40,727.7**	**106.2**	**45,998.2**	**49,942.9**
Less Department of Defense	–7,024.0	....	–8,570.1	–9,513.5
Non-Defense Homeland Security Budget Authority excluding BioShield	**33,703.7**	**106.2**	**37,428.1**	**40,429.5**
Less Fee-Funded Homeland Security Programs	–3,289.1	....	–3,941.0	–5,889.5
Less Mandatory Homeland Security Programs	–1,940.2	....	–2,225.1	–2,302.0
Net Non-Defense Discretionary, Homeland Security Budget Authority excluding BioShield	**28,474.4**	**106.2**	**31,262.0**	**32,237.9**
Plus BioShield	885.0	....	2,508.0	....
Net Non-Defense Discretionary, Homeland Security Budget Authority including BioShield	**29,359.4**	**106.2**	**33,770.0**	**32,237.9**
Obligations Limitations				
Department of Transportation Obligations Limitation	139.8	....	57.7	54.6

* Excludes $16M in supplemental appropriations provided to the Coast Guard in 2005.

The growth in Federal homeland security funding is indicative of the efforts that have been initiated to secure our Nation. However, it should be recognized that fully developing the strategic capacity to protect America is a complex effort. There is a wide range of potential threats and risks from terrorism. To optimize 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, each with a unique role in protecting our Nation.

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. For this analysis, agencies categorize their funding data based on the critical mission areas defined in the *National Strategy*: 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."

The *National Strategy* is a dynamic document; it includes actions that agencies use and must build upon 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 continue to develop a better understanding of risks and threats—such as the biological agents most likely to be used by a terrorist group or the highest-risk critical infrastructure targets—in order to develop benchmarks.

This chapter highlights some significant results from OMB's Performance Assessment Rating Tool (PART), as well as some major performance metrics and milestones. These are not an exhaustive list of homeland security PART results, measures, or milestones; nor are they exempt from the performance measurement challenges highlighted above. However, they do illustrate the Government's efforts in building a more robust architecture to measure homeland security performance.

The following table summarizes funding levels by the *National Strategy's* mission areas; more detailed analysis is provided in subsequent mission-specific analysis sections.

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

(Budget authority, in millions of dollars)

Agency	2004 Enacted	2004 Supplemental	2005 Enacted	2006 Request
Intelligence and Warning	242.2	....	349.8	431.9
Border and Transportation Security	15,840.8	90.7	17,550.2	19,285.8
Domestic Counterterrorism	3,379.3	12.3	3,944.5	4,468.7
Protecting Critical Infrastructure and Key Assets	12,279.1	2.5	14,939.4	15,632.2
Defending Against Catastrophic Threats	2,974.2	0.7	3,399.2	3,898.3
Emergency Preparedness and Response	6,002.6	....	5,765.2	6,121.6
Other	9.6	....	49.8	104.5
Total, Homeland Security Budget Authority	**40,727.7**	**106.2**	**45,998.2**	**49,942.9**
Plus BioShield	885.0	....	2,508.0	....
Total, Homeland Security Budget Authority, including BioShield	**41,612.7**	**106.2**	**48,506.2**	**49,942.9**

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 the resulting intelligence may inform homeland security activities—nor does it fully capture classified intelligence activities. In 2006, the bulk of the funding for intelligence and warning is in DHS (61 percent in 2006), primarily in the Information Analysis and Infrastructure Protection (IAIP) Directorate and the Secret Service, DOJ (21 percent in 2006), primarily in the Federal Bureau of Investigation (FBI), and the Intelligence Community Management Account (13 percent in 2006). 2006 funding for intelligence and warning activities would increase by 23 percent over the 2005 level.

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

- Unifying and enhancing intelligence and analytical capabilities to ensure officials have the information they need to prevent attacks; and
- Implementing the Homeland Security Advisory System and other information sharing and warning mechanisms to allow Federal, State, local, and private authorities to take action to prevent attacks and protect potential targets.

The recently-passed Intelligence Reform and Terrorism Prevention Act of 2004, supported by executive orders on information sharing, management of the in-

Table 3–3. INTELLIGENCE AND WARNING FUNDING

(Budget authority, in millions of dollars)

Agency	2004 Enacted	2004 Supplemental	2005 Enacted	2006 Request
Department of Agriculture	0.8	....	6.3	22.3
Department of Homeland Security	236.0	....	226.4	262.4
Department of Justice	2.0	....	44.2	90.9
Department of the Treasury	2.5	....	0.6	0.6
Intelligence Community Management Account	1.0	....	72.4	55.8
Total, Intelligence and Warning	**242.2**	....	**349.8**	**431.9**

telligence community, and the National Counterterrorism Center, will improve the Nation's intelligence and warning capabilities. The new Director of National Intelligence (DNI) is empowered to set collection and analysis priorities, which will help ensure that homeland security requirements are addressed. The DNI is also empowered to ensure that information sharing takes place across the intelligence community. These changes implement the recommendations of the 9/11 Commission, and should allow the intelligence community to "connect the dots" more effectively, develop a better integrated system for identifying and analyzing terrorist threats, and issue warnings more rapidly.

In addition, the newly created National Counterterrorism Center (NCTC) is specifically chartered to centralize U.S. Government terrorism threat analysis and ensure that all agencies receive relevant analysis and information. The NCTC will serve as the primary organization in the U.S. Government for analyzing and integrating all intelligence pertaining to terrorism and counterterrorism (excepting purely domestic terrorism); operate as the central and shared knowledge bank on known and suspected terrorists and international terror groups; and ensure that agencies, as appropriate, have access to and receive the all-source intelligence support needed to execute their counterterrorism plans or perform independent, alternative analysis. NCTC is tasked to coordinate counterterrorism operations on a global basis and develop strategic, operational plans for the Global War on Terrorism. The NCTC will use this capability to allocate requirements to the agencies with the assets and capabilities to address them. NCTC will not direct operations, leaving mission execution to the appropriate agencies. This structure will ensure that the chain of command remains intact and prevent bureaucratic micromanagement of counterterrorism missions. Taken together, the creation of the NCTC and recent legislation and executive orders will ensure that counterterrorism assets are better allocated and coordinated to produce improved indications and warning intelligence to benefit homeland security.

These structural changes complement ongoing efforts to improve information sharing. The Information Systems Council (ISC) established by Executive Order 13356, "Strengthening of Terrorism Information to Protect Americans," was directed to establish an interoperable terrorism "environment" to automate information sharing among the homeland security, law enforcement, and intelligence communities. The ISC recently reported to the President a plan to improve sharing of terrorism information through the establishment of an interoperable terrorism information sharing "environment." The proposed plan includes a vision for the future of the environment, including additional functions and capabilities, and a four-phase plan for moving forward, including near-term solutions to address gaps. The environment will enable the interchange of information between appropriate Federal, State, and local authorities and the private sector while protecting the privacy rights and civil liberties of Americans.

As discussed above, the DNI and the NCTC will continue to utilize the unique assets and capabilities of other Government agencies—some of which are reorganizing to improve these capabilities and better interface with the new intelligence structure. After 9/11, the FBI created an Office of Intelligence to establish intelligence requirements and coordinate information collection and sharing. The 2005 Department of Justice Appropriations Act and the Intelligence Reform and Terrorism Prevention Act directed the FBI to re-designate the Office of Intelligence as the Directorate of Intelligence. The new Directorate supervises all national intelligence programs of the FBI, oversees field intelligence operations, and is developing an FBI intelligence career service. The 2006 Budget provides $117 million in new funding for FBI to enhance its intelligence programs. Performance measures that will be used by the FBI program include the percentage of intelligence products meeting all standards and the percentage of investigations that are intelligence-based.

The Department of Homeland Security's Information Analysis and Infrastructure Protection Directorate (IAIP) will also contribute to the new intelligence structure. By maintaining and expanding its partnership the NCTC, IAIP will continue to coordinate its activities with other members within the newly reorganized intelligence community. IAIP was established as part of DHS to fill a 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. IAIP's Office of Information Analysis, which is the Department's intelligence division, centralizes analysis and information about threats to homeland security. IAIP is also the focal point for disseminating information to states and local entities. For example, IAIP is connected to homeland security directors of States and territories through the Homeland Security Information Network (HSIN). All fifty States and major urban areas are now connected to HSIN. In 2006, HSIN will be rolled out to major counties as well. In addition, IAIP's analysis informs the Secretary as he administers the Homeland Security Advisory System.

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 ($18.2 billion, or 94 percent, in 2006) 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. The President's 2006 request would increase funding for border and transportation security activities by 10 percent over the 2005 level.

Securing our borders and transportation systems is a complex task. Security enhancements in one area may make another avenue more attractive to terrorists. Therefore, our border and transportation security strategy aims to make the U.S. borders "smarter"—targeting resources toward the highest risks and sharing information so that frontline personnel can stay ahead of potential adversaries—while facilitating the flow of legitimate visitors and commerce. 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. Rather than having separate systems for managing goods, people, and agricultural products, one agency is now accountable for ensuring that there is one cohesive border management system.

In 2005 and 2006, the Administration will focus on implementing Homeland Security Presidential Directive (HSPD) 11, Comprehensive Terrorist-Related Screening Procedures. Although resources related to screening are spread throughout mission areas, the majority are captured in border and transportation security because of the sizable Federal efforts to screen people, cargo, and conveyances as they cross U.S. borders or travel through U.S. transportation systems. A cohesive screening system is a key element of a smart border strategy.

Internally, DHS will modify its own organizational structure to consolidate screening programs previously spread throughout the Department's components. The new Screening Coordination and Operations Office (SCO) will manage the two DHS centerpiece screening programs: US-VISIT, which screens international travelers arriving at our ports of entry; and the Secure Flight program, which conducts automated screening of all domestic aviation passengers. At least nine other existing programs will also be consolidated, including the Free and Secure Trade (FAST) and the Transportation Worker Identification (TWIC) card programs. DHS is also leading the HSPD-11 interagency effort to implement a coordinated approach to terrorist-related screening in immigration, law enforcement, intelligence, counterintelligence, border and transportation systems, and critical infrastructure. This effort covers diverse areas, from information sharing to screener training. SCO will play a central coordinating role. The 2006 Budget includes more than $800 million in discretionary, fee-funded, and mandatory resources to support SCO.

Key to the Federal government's screening of international visitors is the US-VISIT program, which will be incorporated into SCO. US-VISIT is designed to expedite the clearance of legitimate travelers while identifying and denying clearance to those who may intend to do harm. In 2004 and 2005 the first phases of US-VISIT were successfully deployed. The 2006 Budget includes a $50 million increase for accelerated deployment of US-VISIT at land border ports of entry and for enhancing border personnel's access to immigration, criminal, and terrorist information. Through 2006, over $1.4 billion will be appropriated to support this initiative.

In the area of aviation security, the Administration continues to strengthen multiple layers of security implemented in the wake of the September 11th attacks. The Federal Government will continue to improve the

Table 3–4. BORDER AND TRANSPORTATION SECURITY FUNDING

(Budget authority, in millions of dollars)

Agency	2004 Enacted	2004 Supplemental	2005 Enacted	2006 Request
Department of Agriculture	147.9	....	163.1	164.2
Department of Homeland Security	14,941.7	90.7	16,560.6	18,207.3
Department of Justice	20.1	....	34.5	20.8
Department of State	663.9	....	778.2	878.4
Department of Transportation	67.2	....	13.9	15.1
Total, Border and Transportation Security	**15,840.8**	**90.7**	**17,550.2**	**19,285.8**

airport screening system to ensure that it provides effective security with less bother to travelers. TSA will refine its training programs and screening procedures to ensure a balance among security needs, screening efficiency, and traveler privacy. While maintaining the more than 10,000 screening devices at 448 airports, TSA will also begin to upgrade equipment and address technology gaps, such as screening for explosives on higher risk passengers and property. TSA will receive an increase of more than $400 million over 2005 for aviation security. Improved domestic and international passenger prescreening systems and processes will be fully implemented in 2006 to ensure that higher risk passengers receive scrutiny before boarding aircraft. The Budget also proposes to set aviation security fees at a level that allows the Government to recover most of the cost of Federal aviation screening operations.

Outside of passenger and baggage screening, DHS has recently proposed a comprehensive set of air cargo security requirements. The rulemaking process should be completed this year. The Budget will support a strong air cargo prescreening and regulatory enforcement program in CBP and TSA, and air cargo technology research and development program in the DHS Science and Technology (S&T) Directorate. In addition, the S&T Directorate will continue its R&D program on the viability of countermeasures that could be placed on commercial aircraft to defend against the threat of shoulder-fired missiles. The Budget provides $110 million to test these systems to determine operational, safety, and reliability issues.

The security of our seaports is 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 ports, vessels, and facilities to conduct security assessments. In 2006, the Coast Guard will continue implementation of MTSA to ensure compliance with port and vessel security standards and regulations.

The 2006 Budget provides more than $2 billion for port security across DHS, including $1.9 billion in discretionary funding for Coast Guard port security activities such as Maritime Safety and Security Teams and harbor patrols for ports with liquefied natural gas terminals. In addition, the Coast Guard budget funds operations to strengthen intelligence collection and surveillance capabilities in the maritime environment, both of which contribute to the broader Coast Guard effort to enhance Maritime Domain Awareness.

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 2006 would increase by more than $150 million over the 2005 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 screens cargo containers at foreign ports before the containers are placed on ships bound for the United States. The 2006 Budget requests $138 million for CSI.

A major focus across mission areas for 2006 is the effort to upgrade our radiological and nuclear detection capability. The 2006 Budget provides $178 million to CBP (along with an increase for radiological and nuclear detection research, discussed below) to defend against radiological and nuclear threats by deploying current non-intrusive inspection technologies and piloting next-generation radiation detection technologies. The 2006 PART on the Inspection Technology program found that while the program is lacking in specific targets to measure long-term success, it has a very clear program purpose and sound management.

To ensure detention and removal of illegal aliens present in the U.S., the 2006 Budget also supports a $176 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. A 2005 PART found this program moderately effective because DHS Immigration and Customs Enforcement (ICE) has reorganized its operations and engaged in significant strategic and performance planning efforts to identify ambitious goals to improve program performance.

The State Department is the second largest agency contributor to border and transportation security. The Bureau of Consular Affairs Border Security program consists of visa, passport and American Citizen Services programs. The State Department Border Security program underwent a PART analysis in 2004, 2005 and 2006 budgets, and was found to be effective. The analysis determined that State, working in coordination with the other border and transportation security agencies, has effectively targeted programs and funding, established achievable annual and long term goals as well as developed thoughtful policies that not only secure processes related to screening of all travelers to the US but also facilitate legitimate travel. The 2006 Budget includes funding in State for technology related to increased interviews, screening, and information sharing between Federal agencies on visa applicants; the development and production of new machine-readable biometric U.S. passports; and for increased interoperability of border security and counterterrorism systems between State, DHS, and FBI.

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 largest contributors to the domestic counterterrorism mission are law enforcement organizations: the Department of Justice (largely for the FBI) and DHS (largely for ICE), accounting for 53 and 45 percent of funding for 2006, respectively. The President's 2006 request would increase funding for domestic counterterrorism activities by 13 percent over the 2005 level.

Table 3–5. DOMESTIC COUNTERRORISM FUNDING

(Budget authority, in millions of dollars)

Agency	2004 Enacted	2004 Supplemental	2005 Enacted	2006 Request
Department of Homeland Security	1,703.7	....	1,867.0	2,008.8
Department of Justice	1,608.4	12.3	1,999.0	2,372.7
Department of Transportation	21.0	....	20.0	22.0
Department of the Treasury	45.2	....	54.9	61.0
Social Security Administration	1.0	....	3.7	4.2
Total, Domestic Counterterrorism	**3,379.3**	**12.3**	**3,944.5**	**4,468.7**

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 domestic counterterrorism 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.

Over the past three years, FBI has transformed its organization and established priorities to ensure that protecting the U.S. from terrorist attack is its primary focus. To support this transformation, resources have been shifted from lower priority programs, counterterrorism 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 2002 to over $1.7 billion in 2006, with the 2006 Budget providing an increase of approximately $300 million over the 2005 level. The increase will support a range of activities, such as counterterrorism investigations and countering cyber crime. To specifically promote information sharing efforts, it includes an additional $17 million for FBI to upgrade its Integrated Automated Fingerprint Identification System. This will enhance system capacity, speed, and capabilities, and will promote information sharing between the FBI, DHS, and other agencies.

By merging existing immigration and customs enforcement functions into ICE, the Department of Homeland Security created one of America's largest law enforcement agencies. The Nation is better prepared to apprehend potential terrorists because DHS has combined the information and resources to identify and investigate illegal activities—such as smuggling, identity theft, and money laundering, and trafficking in dangerous materials. The 2006 PART found that the investigative arm of ICE, the Office of Investigations, has made significant progress in the integration of former customs and immigration investigators, and has started to reap the benefits of additional investigative authorities. However, the program must institute stronger financial and management controls to ensure appropriate expenditure and budgeting of resources and to hold managers and agency partners accountable for performance results. The 2006 Budget provides an increase of $34 million to expand these enforcement activities.

The interagency Terrorist Screening Center (TSC) is a hub for domestic counterterrorism activity. TSC was established in September 2003 pursuant to HSPD-6 in order to consolidate terror screening watch lists and to support Federal screeners worldwide. In its first year, TSC has created a single point for terrorist screening data; established a round-the-clock call center for officials encountering suspects; coordinated response for Federal, State, and local law enforcement; and instituted a formal process for tracking encounters. TSC staff, who include participants from DOD, DHS, DOJ, State, and other agencies, currently field nearly 100 calls per day from Federal, State, and local law enforcement representatives. The 2006 Budget provides $104 million for TSC, a $75 million increase over 2005, to enable TSC to meet its increasing responsibilities, particularly in support of the DHS Secure Flight program.

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 an estimated more than 85 percent are not Federally-owned. DOD reports the largest share of funding in this category for 2006 ($8.7 billion, or 56 percent), and includes programs focusing on physical security and improving the military's ability to prevent or mitigate the consequences of attacks against personnel and bases. DHS has overall responsibility for prioritizing and executing infrastructure protection activities at a national level and accounts for $2.8 billion (18 percent) of 2006 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 2006 request increases funding for activities to protect critical infrastructure and key assets by $0.7 billion (5 percent) over the 2005 level.

Securing America's critical infrastructure and key assets is a complex 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.

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

(Budget authority, in millions of dollars)

Agency	2004 Enacted	2004 Supplemental	2005 Enacted	2006 Request
Department of Agriculture	36.9	......	150.7	129.3
Department of Defense	6,543.8	......	7,916.9	8,700.8
Department of Energy	1,256.4	......	1,456.1	1,481.0
Department of Health and Human Services	162.8	......	168.3	170.3
Department of Homeland Security	2,128.3	......	2,585.9	2,820.0
Department of Justice	409.2	2.5	455.8	566.1
Department of Transportation	180.1	......	137.0	141.2
Department of Veterans Affairs	239.2	......	242.9	262.3
National Aeronautics and Space Administration	207.0	......	218.0	205.0
National Science Foundation	313.0	......	315.2	317.2
Social Security Administration	142.1	......	155.0	172.6
Postal Service	......	......	503.0	......
Other Agencies	660.4	......	634.6	666.3
Total, Protecting Critical Infrastructure and Key Assets	12,279.1	2.5	14,939.4	15,632.2

IAIP is the focal point for DHS infrastructure protection efforts, and is responsible for prioritizing and addressing requirements at a national level. IAIP maintains the National Asset Database, which catalogues critical infrastructure and key assets. IAIP leverages tactical intelligence with a risk-based strategy that identifies critical infrastructures in targeted areas, assesses the vulnerabilities of that infrastructure, and recommends protective measures. IAIP conducts site visits and assessments of more than 1,000 sites each year, and has used this information to develop site security guidelines for nuclear power plants and chemical facilities. Security guidelines are also being developed for all infrastructure sectors, covering spent nuclear fuel, petroleum refineries, natural gas facilities, and railroads, for example. In addition, IAIP trains State and local officials and infrastructure owners to improve security in the areas immediately surrounding critical sites. The 2006 Budget provides $530 million for IAIP activities in the protecting critical infrastructures and key assets mission area. In addition, the Administration proposes $600 million for Targeted Infrastructure Protection (TIP) grants. Awarded through the Office of State and Local Government Coordination and Preparedness, TIP grants and assistance will supplement state and local infrastructure protection efforts, especially detection and security investments.

Cyberspace security is a key element of infrastructure protection because the internet and other computer systems link infrastructure sectors. The consequences of a cyber attack could cascade across the economy, imperiling public safety and national security. To address this threat, 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. NCSD has also established the U.S. Computer Emergency Response Team (US-CERT). US-CERT supports watch and warning capability responsible for tracking incident and trend data, ranking associated severity, and generating real-time alerts. $73 million is requested for the NCSD in 2006.

HSPD-7, signed in December 2003, established a national policy to protect critical infrastructures and key resources from attack, ensure the delivery of essential goods and services, and maintain public safety and security. Under HSPD-7, DHS is responsible for coordinating Federal critical infrastructure protection efforts. To provide a consistent structure to integrate critical infrastructure protection, DHS has an interim National Infrastructure Protection Plan. Under the plan's framework, DHS will coordinate the infrastructure protection efforts of other Federal departments and agencies. A number of agencies rely on specialized expertise and long-standing relationships with industry in conducting infrastructure protection activities.

Recognizing that each infrastructure sector possesses it own unique characteristics, a sector-specific agency has been designated to oversee infrastructure protection efforts for each sector. Consequently, sector-specific agencies are pursuing infrastructure protection efforts in concert with DHS. For example, the Department of Energy is coordinating protection activities within the energy sector. The Department of Agriculture is protecting agricultural resources, a source of essential commodities, through research and testing programs. There are 13 critical infrastructure sectors and nine sector-specific agencies.

The Environmental Protection Agency (EPA), the water sector-specific agency under HSPD-7, guides the protection of water infrastructure through training and technical support for water utilities and grants for State water security coordinators. In 2006, EPA will address the HSPD-9 requirement to lead the development of surveillance and monitoring systems for water quality. EPA will introduce Water Sentinel, a program to develop and demonstrate cost-effective, real-time sampling and analysis capabilities at critical points in a water system for early detection of disease, pest, or poisonous agents. The Administration's request for $44 million in 2006 will fund Water Sentinel as a pilot program in five major cities.

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 ($2.0 billion, or 51 percent, of the 2006 total), largely for research in the National Institutes of Health, and in DHS, mostly for the Directorate of Science and Technology (S&T) ($1.2 billion, or 31 percent, of the 2006 total), to help develop and field technologies to counter CBRN threats. The President's 2006 request would increase funding for activities defending against catastrophic threats by 15 percent over the 2005 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, and improving decontamination techniques.

A key element in addressing these requirements is developing and maintaining adequate countermeasures for a CBRN attack. This not only means stockpiling 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, a CBRN attack may not be immediately apparent. Working to ensure earlier detection and characterization of an attack helps protect and save lives.

Table 3–7. DEFENDING AGAINST CATASTROPHIC THREATS FUNDING

(Budget authority, in millions of dollars)

Agency	2004 Enacted	2004 Supplemental	2005 Enacted	2006 Request
Department of Agriculture	168.2	......	222.7	317.2
Department of Commerce	60.0	......	73.4	84.7
Department of Defense	146.8	......	178.2	158.9
Department of Energy	......	......	7.5	62.8
Department of Health and Human Services	1,754.1	......	1,901.8	1,971.5
Department of Homeland Security	774.0	......	936.1	1,212.1
Department of Justice	27.9	0.7	33.5	43.0
National Science Foundation	27.0	......	27.0	27.0
Nuclear Regulatory Commission	16.2	......	19.0	21.2
Total, Defending Against Catastrophic Threats	**2,974.2**	**0.7**	**3,399.2**	**3,898.3**

The Federal Government is addressing these requirements. The DHS Biological Countermeasures Office budget request is $385 million in 2006, a $22 million increase over 2005. This program received an effective PART rating, demonstrating significant accomplishments for a new program. Within the Biological Countermeasures Office, new vaccine research funds will target specific vaccines that can be used to defend our food supply from the intentional or accidental introduction of foreign animal diseases into the country. These vaccines will help protect the Nation from the catastrophic economic consequences that a major disease outbreak would cause. Funds are also requested for a National Agrodefense Facility that will be able to analyze pathogens in large animals. The 2006 Budget also includes $59 million for the Department of Agriculture to complete a state-of-the-art animal disease research and diagnostic facility at Ames, Iowa.

The Budget continues to invest in efforts to decrease the time between an attack and implementation of Federal, State and local response protocols. The Science and Technology Directorate will expand and enhance the BioWatch environmental monitoring program, which samples and analyzes air in over 30 metropolitan areas to continually check for dangerous biological agents. The program is designed to provide early warning of a large-scale biological weapon attack, allowing the distribution of life-saving treatment and preventative measures before the development of serious and widespread illnesses.

The Administration maintains HHS' investment in developing medical countermeasures to CBRN threats, investing nearly $1.8 billion, an increase of $56 million over 2005 and $1.7 billion over the level prior to September 11th (this includes funding for programs focused on chemical and radiological and nuclear countermeasures referenced below). HHS will continue to improve human health surveillance with $79 million dedicated to the BioSense program (collecting information from hospitals, emergency departments, and laboratories to identify "real-time" trends), increasing laboratory capacity, and augmenting the number and quality of border health and quarantine stations. The Food and Drug Administration and the U.S. Department of Agriculture will also conduct surveillance to ensure the security of the food supply. Information collected from these programs will be disseminated to the National Biosurveillance Integration Center at DHS.

In addition, the Administration proposes to double the amount of spending on chemical agent R&D conducted by DHS, including $36 million in additional spending on non-traditional chemical agent threats, enhancing our ability to detect and counter these weapons. This funding level includes the creation of a state-of-the-art materials testing facility that will be housed with the Department of Defense chemical countermeasures programs. The National Institutes of Health will also devote $50 million to research chemical agent countermeasures.

To protect against a nuclear or radiological weapon entering the country, a new Domestic Nuclear Detection Office (DNDO) is being created in the Department of Homeland Security. The DNDO will be responsible for developing and deploying a comprehensive system to detect and report any attempt to import a nuclear explosive device or radiological material. This Office will have oversight of all research and development for detection, identification, and reporting of radiological and nuclear materials. It will also be responsible for establishing response protocols to ensure that the detection of a nuclear explosive device or radiological material leads to timely and effective action by military, law enforcement, emergency response, and other appropriate government assets.

The Administration is requesting $262 million in DHS R&D funds for advanced detection devices to minimize the likelihood that a radiological or nuclear device could enter the United States; this more than doubles the amount provided in 2005. This R&D program will be integrated with our overseas non-proliferation and border security efforts to keep these devices out of the hands of terrorists and outside the borders of this country. The DNDO will also work with CBP on its pilot program to deploy next-generation radiation detectors. Finally, the Office will work with State and local grant recipients to best deploy their radiation detection assets to work in concert with Federal detection efforts.

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 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. DHS maintains the largest share of funding in this category ($2.7 billion, or 45 percent, for 2006), mainly for preparedness grant assistance to State and local first responders. HHS, the second largest contributor ($2.2 billion, or 37 percent, in 2006), also assists States and localities to upgrade public health capacity. A total of 24 other agencies include emergency preparedness and response funding. A number maintain specialized response assets that may be called upon in select circumstances, and others report only funding for their agency's internal preparedness capability. Excluding BioShield, in the President's 2006 Budget, funding for emergency preparedness and response activities would increase by $0.4 billion (6 percent) over the 2005 level. The major requirements addressed in this mission area include:

- 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 meet national pre-

Table 3–8. EMERGENCY PREPAREDNESS AND RESPONSE FUNDING

(Budget authority, in millions of dollars)

Agency	2004 Enacted	2004 Supplemental	2005 Enacted	2006 Request
Department of Defense	333.3	......	469.0	651.4
Department of Energy	107.6	......	98.4	122.1
Department of Health and Human Services	2,145.3	......	2,160.2	2,264.9
Department of Homeland Security	3,049.0	......	2,655.8	2,725.8
Other Agencies	367.3	......	381.9	357.5
Total, Emergency Preparedness and Response	**6,002.6**	......	**5,765.2**	**6,121.6**
Plus BioShield	885.0	......	2,508.0	......
Total, Emergency Preparedness and Response including BioShield	**6,887.6**	......	**8,273.2**	**6,121.6**

paredness goals in a coordinated and complementary manner.

- Encouraging standardization and interoperability of first responder equipment, especially for communications.
- Building a national training, exercise, and evaluation system.
- Implementing the National Incident Management System.
- Preparing health care providers for a mass casualty event.
- Augmenting America's pharmaceutical and vaccine stockpiles.

Many of the key elements of the national emergency response system are already in place. During 2004, separate Federal response plans were integrated into a single all-discipline National Response Plan. To ensure that Federal, State, and local investments translate into improvements in preparedness, we must continue to identify capability gaps, establish national preparedness goals, and improve 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, 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 2005, the Federal Government has allocated $18.2 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 $4.8 billion in the 2006 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; better target funds based on risks, threats, vulnerability and need; and develop and implement national preparedness goals. In addition, DHS' new Office of Interoperability and Compatibility is developing a strategic plan to standardize public safety communications equipment and protocols.

In 2005, DHS will begin to implement the National Response Plan and develop national preparedness goals. DHS will leverage the existing network of State and local responder training facilities by focusing more effort on "training the trainer." DHS will organize 150 terrorism preparedness exercises during 2005, and provide grant funding to support approximately 400 exercises at the State and local level. The 2006 Budget continues to provide coordinated terrorism preparedness training and equipment for State and local responders across the various responder agencies. The 2006 request includes $3.6 billion for terrorism preparedness grants, training, and exercises to be administered by the Office of State and Local Government Coordination and Preparedness within DHS, and proposes a significant restructuring in the grant allocation process to better address threats and needs. The Budget also supports a range of Federal response capabilities, including providing $110 million for the Department of Energy's Nuclear Emergency Support Team and other emergency response, management, and operations assets. The capabilities of these teams range from providing radiological assistance in support of State and local agencies to responding to major incidents worldwide.

In 2005 and 2006 a new catastrophic incident response planning initiative will be undertaken. This planning effort will span across Federal agencies, as well as State and local governments. In addition to this planning initiative, the budget includes $80 million in the Departments of Homeland Security and Health and Human Services to strengthen the nation's capabilities to respond to a mass casualty event.

The Budget reflects ongoing investment 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.

The Budget includes $600 million for the Strategic National Stockpile to maintain and augment the 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. This now includes funding for storage and maintenance of products purchased through BioShield, and $50 million for the purchase of supplies under the medical surge capacity initiative. HHS has the lead role in preparing public health providers for catastrophic terrorism. For 2005, HHS will provide $483 million to continue improvements for hospital infrastructure and mutual aid through the Health Resources and Services Administration, and $797 million for States through the Centers for Disease Control and Prevention 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 more than $7 billion.

Non-Federal Expenditures [4]

State and local governments and private-sector firms also have devoted resources of their own to the task of defending against terrorist threats. Some of the additional spending has been of a one-time nature, such as investment in new security equipment and structures; some additional spending has been ongoing, such as hiring more personnel, and increasing overtime for existing security personnel. In many cases, own-source spending has supplemented the resources provided by the Federal government.

Many governments and businesses are placing a high priority on, and providing additional resources for, security. On the other hand, many entities have not increased their spending. A survey conducted by the National Association of Counties in the spring of 2004 found that as a result of the homeland security process of intergovernmental planning and funding, three out of four counties believed they were better prepared to respond to terrorist threats. Moreover, almost 40 percent of the surveyed counties had appropriated their own funds to assist with homeland security. Own-source resources supplemented funds provided by states and the Federal Government. However, the same survey revealed that 54 percent of counties had not used any of their own funds. [5]

There is also a diversity of responses in the businesses community. In a survey conducted by the Conference Board in 2003, just over half of the companies reported that they had permanently increased security spending post-September 11, 2001. About 15 percent of the companies surveyed had increased their security spending by 20 percent or more. Large increases in spending were especially evident in critical industries, such as transportation, energy, financial services, media and telecommunications, information technology, and healthcare. However, about one-third of the surveyed companies reported that they had not increased their security spending after September 11th. [6]

In light of the range of spending responses to the new security environment and the inherent difficulty of obtaining survey results that are representative of the entire universe of States, localities, and businesses, it is not surprising that estimates of non-Federal security spending also differ widely. Estimates by two private consulting firms for 2004 reveal that States and localities may have spent as little as $8 billion (according to International Horizons Unlimited) or as much as $15 billion (according to Deloitte Consulting). The business sector may have spent about $5 billion (International Horizons Unlimited) or as much as $46 billion (Deloitte Consulting).

The estimates by International Horizons Unlimited were published in September 2003. They are on a Federal fiscal year basis. The Deloitte Consulting estimates were published in June 2002. They are on a fiscal year basis appropriate to the reporting entity. For State and local governments, both sets of estimates attempted to remove spending funded by Federal grants to avoid double counting spending that was reported by the Federal Government.

Additional Tables

The tables in the Federal expenditures section above present data based on the President's policy for the 2006 Budget. The tables below present additional policy and baseline data, as directed by the Homeland Security Act of 2002.

[4] OMB does not collect detailed homeland security expenditure data from State, local, or private entities directly.

[5] Source: National Association of Counties, "Homeland Security Funding—2003 State Homeland Security Grants Programs I and II."

[6] Source: Conference Board, "Corporate Security Management" 2003

Estimates by Agency:

Table 3–9. DISCRETIONARY FEE-FUNDED HOMELAND SECURITY ACTIVITIES BY AGENCY

(Budget authority, in millions of dollars)

Agency	2004 Enacted	2004 Supplemental	2005 Enacted	2006 Request
Department of Energy	1.2	....	1.2	1.5
Department of Homeland Security	2,335.0	....	2,875.0	4,688.0
Department of Labor	14.9	....	17.6	14.2
Department of State	649.0	....	763.3	866.0
General Services Administration	72.8	....	58.6	72.9
Social Security Administration	143.4	....	159.4	177.5
Federal Communications Commission	1.0	....	1.6	3.5
Nuclear Regulatory Commission	66.8	....	59.2	61.0
Securities and Exchange Commission	5.0	....	5.0	5.0
Total, Discretionary Homeland Security Fee-Funded Activities	**3,289.1**	....	**3,941.0**	**5,889.5**

Table 3–10. MANDATORY HOMELAND SECURITY FUNDING BY AGENCY

(Budget authority, in millions of dollars)

Agency	2004 Enacted	2004 Supplemental	2005 Enacted	2006 Request
Department of Agriculture	119.0	....	135.0	137.0
Department of Commerce	9.5	....	8.4	8.6
Department of Education	....	....	2.7	....
Department of Energy	11.0	....	11.0	11.0
Department of Health and Human Services	13.9	....	14.2	15.9
Department of Homeland Security	1,783.7	....	2,051.2	2,125.5
Department of Labor	3.2	....	2.6	4.0
Total, Homeland Security Mandatory Programs	**1,940.2**	....	**2,225.1**	**2,302.0**

Table 3–11. BASELINE ESTIMATES—TOTAL HOMELAND SECURITY FUNDING BY AGENCY

(Budget authority, in millions of dollars)

Agency	2005 Enacted*	Baseline				
		2006	2007	2008	2009	2010
Department of Agriculture	601	617	632	651	668	686
Department of Commerce	167	172	177	185	188	194
Department of Defense	8,566	8,865	9,137	9,423	9,722	10,032
Department of Education	25	22	23	23	23	24
Department of Energy	1,562	1,595	1,618	1,655	1,690	1,728
Department of Health and Human Services	4,229	4,323	4,423	4,522	4,624	4,730
Department of Homeland Security*	24,887	25,714	26,169	26,903	27,663	28,456
Department of Housing and Urban Development	2	2	2	2	2	3
Department of the Interior	65	68	69	71	73	76
Department of Justice	2,679	2,778	2,879	2,976	3,079	3,190
Department of Labor	55	56	57	59	61	62
Department of State	824	840	859	876	894	914
Department of Transportation	182	190	197	206	214	223
Department of the Treasury	102	107	110	115	118	124
Department of Veterans Affairs	281	291	301	312	324	336
Corps of Engineers	89	91	93	95	97	99
Environmental Protection Agency	107	109	113	117	119	124
Executive Office of the President	30	31	31	32	32	33
General Services Administration	65	66	67	68	70	71
National Aeronautics and Space Administration	218	223	226	232	237	241
National Science Foundation	342	349	357	364	371	379
Office of Personnel Management	3	3	3	3	3	3
Social Security Administration	160	163	166	170	173	177
District of Columbia	15	15	16	16	16	17
Federal Communications Commission	2	....	....	....	....	....
Intelligence Community Management Account	72	73	75	77	78	80
National Archives and Records Administration	17	17	18	18	18	19
Nuclear Regulatory Commission	59	62	64	66	68	71
Postal Service	503	513	524	534	546	558
Securities and Exchange Commission	5	5	5	5	5	6
Smithsonian Institution	75	79	82	87	90	94
United States Holocaust Memorial Museum	8	8	8	8	9	9
Corporation for National and Community Service	17	17	17	19	19	19
Total, Homeland Security Budget Authority	**46,014**	**47,464**	**48,518**	**49,890**	**51,294**	**52,778**
Less Department of Defense	–8,566	–8,865	–9,137	–9,423	–9,722	–10,032
Non-Defense Discretionary Homeland Security Budget Authority, excluding BioShield	**37,448**	**38,599**	**39,381**	**40,467**	**41,572**	**42,746**
Less Fee-Funded Homeland Security Programs	–3,942	–4,052	–4,140	–4,228	–4,318	–4,412
Less Mandatory Homeland Security Programs	–2,225	–2,303	–2,057	–2,079	–2,099	–2,122
Net Non-Defense Discretionary Homeland Security Budget Authority excluding BioShield	**31,281**	**32,244**	**33,184**	**34,160**	**35,155**	**36,212**
Plus BioShield	2,508	....	....	....	2,175	....
Net Non-Defense Discretionary Homeland Security Budget Authority including BioShield	**33,789**	**32,244**	**33,184**	**34,160**	**37,330**	**36,212**
Obligations Limitations						
Department of Transportation Obligations Limitation	19	19	19	20	21	22

* FY 2005 Enacted estimates include supplemental funding, but baseline estimates assume that these are one-time events.

Estimates by Budget Function:

Table 3–12. HOMELAND SECURITY FUNDING BY BUDGET FUNCTION

(budget authority, in millions of dollars)

Agency	2004 Enacted	2004 Supplemental	2005 Enacted *	2006 Request
National Defense	8,960	80	12,171	12,830
International Affairs	697	......	821	938
General Science Space and Technology	583	......	617	608
Energy	109	......	102	112
Natural Resources and the Environment	342	......	289	345
Agriculture	398	......	582	664
Commerce and Housing Credit	103	......	649	162
Transportation	8,350	11	8,620	10,463
Community and Regional Development	2,789	......	2,743	3,069
Education, Training, Employment and Social Services	151	......	164	168
Health	4,152	......	4,276	4,473
Medicare	11	......	8	9
Income Security	6	......	5	6
Social Security	143	......	160	177
Veterans Benefits and Services	272	......	281	300
Administration of Justice	12,937	16	13,769	14,843
General Government	727	......	742	775
Total, Homeland Security Budget Authority	**40,730**	**107**	**45,999**	**49,942**
Less National Defense, DoD	–7,025	......	–8,566	–9,513
Total, Homeland Security Budget Authority excluding BioShield	**33,705**	**107**	**37,433**	**40,429**
Less Fee-Funded Homeland Security Programs	–3,289	......	–3,942	–5,888
Less Mandatory Homeland Security Programs	–1,941	......	–2,225	–2,303
Net Discretionary, Homeland Security Budget Authority excluding BioShield	**28,475**	**107**	**31,266**	**32,238**
Plus BioShield	885	......	2,508	......
Net Discretionary, Homeland Security Budget Authority including BioShield	**29,360**	**107**	**33,774**	**32,238**

* Excludes $16 million in supplemental appropriations provided to the Coast Guard in 2005.

Table 3–13. BASELINE ESTIMATES—HOMELAND SECURITY FUNDING BY BUDGET FUNCTION

(Budget authority, in millions of dollars)

Budget Authority	2005 Enacted*	Baseline				
		2006	2007	2008	2009	2010
National Defense	12,171	12,555	12,914	13,291	13,681	14,087
International Affairs	821	837	856	873	891	911
General Science Space and Technology	617	630	643	656	670	683
Energy	102	106	97	100	102	107
Natural Resources and the Environment	289	296	305	313	319	331
Agriculture	582	598	612	630	646	664
Commerce and Housing Credit	649	662	676	694	709	726
Transportation	8,636	8,907	9,204	9,480	9,766	10,063
Community and Regional Development	2,743	2,800	2,858	2,918	2,981	3,044
Education, Training, Employment and Social Services	163	164	169	178	183	189
Health	4,276	4,371	4,471	4,572	4,676	4,782
Medicare	8	8	9	9	9	10
Income Security	5	6	6	6	6	7
Social Security	160	163	166	170	173	177
Veterans Benefits and Services	281	291	301	312	324	336
Administration of Justice	13,769	14,307	14,454	14,897	15,353	15,840
General Government	742	763	777	791	805	821
Total, Homeland Security Budget Authority	**46,014**	**47,464**	**48,518**	**49,890**	**51,294**	**52,778**
Less National Defense, DoD	–8,566	–8,865	–9,137	–9,423	–9,722	–10,032
Net Discretionary, Homeland Security Budget Authority, excluding BioShield	**37,448**	**38,599**	**39,381**	**40,467**	**41,572**	**42,746**
Less Fee-Funded Homeland Security Programs	–3,942	–4,052	–4,140	–4,228	–4,318	–4,412
Less Mandatory Homeland Security Programs	–2,225	–2,303	–2,057	–2,079	–2,099	–2,122
Net Discretionary, Homeland Security Budget Authority	**31,281**	**32,244**	**33,184**	**34,160**	**35,155**	**36,212**
Plus BioShield	2,508	....	....	....	2,175	....
Net Discretionary, Homeland Security Budget Authority, including BioShield	**33,789**	**32,244**	**33,184**	**34,160**	**37,330**	**36,212**

* FY 2005 Enacted estimates include supplemental funding, but baseline estimates assume that these are one-time events.

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. The Federal statistical community remains on alert for opportunities to strengthen these measures of our Nation's performance. For example, during 2004, Federal statistical agencies launched the first new economic indicator survey in 40 years—the Quarterly Services Survey (Census Bureau); expanded regional economic data from 318 to 934 American communities (BEA); successfully adopted new collection and processing technologies that will greatly accelerate the release of data from the National Health Interview Survey (NCHS); and completed the first data collection on the cyberinfrastructure of academic and biomedical facilities (NSF's SRS).

For Federal statistical programs to effectively benefit such 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 statistical 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 2006 budget proposals.

Performance Standards

Statistical programs 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 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.

Product quality and program performance standards are designed to serve as indicators when answering specific questions in the Administration's PART process. Chart 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. During the past year, four agencies (BTS, EIA, NCES, and SRS) have improved the status of their indicators. 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.

Chart 4-1. ICSP Statistical Quality and Program Performance Dimensions, 2006

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

✓ Indicator Available P Indicator in development

Description of Dimensions

Product Quality

Relevance: Qualitative or quantitative descriptions of the degree to which products and services are useful to users and responsive to users' 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.

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 effect 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

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 and services are useful and responsive to users' needs. Relevance of data products and analytic reports may be monitored 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 their products, and encourage data users and other stakeholders to contribute to the agency's data collection and dissemination programs. 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 may be defined as the degree of closeness to the target value and measured as 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 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 timing of information releases. Timeliness may be measured as time from the close of the reference period to the release of information, or customer satisfaction with timeliness. 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 or 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 web sites, 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 effect of, or satisfaction with, statistical programs. For Government 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 and the general public. 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 frequently difficult to trace the effects of information products on the public good. Such products often are necessary intermediate inputs in the creation of high visibility information 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 universally 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 can claim credit for contributing to the GDP and/or the CPI and to the many uses of these information products. In addition, the statistics produced by statistical agencies are used to track the performance of programs managed by their parent or other organizations related to topics 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 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, the relationship between program outputs and their beneficial uses and outcomes is often complex and difficult to track. Consequently, agencies use both qualitative and quantitative indicators to make this linkage as explicit as feasible.

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 statistical information's effects on measuring agency policy or change of policy, supporting research focused on policy issues, informing 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.

Of the 14 principal Federal statistical agencies that are members of the ICSP, six agencies have programs that have been assessed using the PART process. Most of these agencies' programs have received PART summary ratings of Effective or Moderately Effective, as shown in Chart 4–2. While recognizing the strength of the Energy Information Administration's purpose and management, EIA's PART evaluation found that it lacks specific annual performance measures, baselines, and targets and should consider enhancing independent expert evaluation of its major program areas. EIA is correcting both of these shortcomings, which should bring its PART rating into line with those of its sister agencies. As additional ICSP agencies have an opportunity to undergo the PART process, the agencies plan to continue to use the results of the collaborative performance standards development effort to help maintain and extend their generally favorable assessments.

Chart 4–2. Most Recent PART Summary Ratings for Statistical Programs

	Summary Rating
Bureau of Economic Analysis	Effective
Bureau of Labor Statistics	Effective
Census Bureau	
Current Demographic Statistics	Effective
Decennial Census	Moderately Effective
Economic Census	Effective
Intercensal Demographic Estimates	Moderately Effective
Survey Sample Redesign	Effective
Energy Information Administration	Results Not Demonstrated
National Agricultural Statistics Service	Moderately Effective
National Center for Education Statistics	
Statistics	Effective
Assessment	Effective

Highlights of 2006 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 units that have statistical activities as their principal mission. (Please see Table 4–1.) The remaining funding supports work in 60-plus agencies or units 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 2006,* when it is published later this year. The following highlights elaborate on the Administration's

Table 4–1. 2004–2006 BUDGET AUTHORITY FOR PRINCIPAL STATISTICAL AGENCIES

(in millions of dollars)

	2004 Actual	Estimate	
		2005 [1]	2006
Bureau of Economic Analysis [2]	68	73	81
Bureau of Justice Statistics [3]	32	34	63
Bureau of Labor Statistics	518	529	543
Bureau of Transportation Statistics	30	30	33
Census Bureau [4]	629	765	897
Salaries and Expenses [4]	213	216	240
Periodic Censuses and Programs	416	549	657
Economic Research Service	71	74	81
Energy Information Administration	81	84	86
National Agricultural Statistics Service [5]	128	128	145
National Center for Education Statistics	187	185	208
Statistics	92	91	91
Assessment	95	94	117
National Center for Health Statistics [6]	90	109	109
Science Resources Statistics Division, NSF	31	32	32
Statistics of Income Division, IRS	36	39	39

[1] Reflects any recissions.

[2] 2005 estimate includes $2 million for a National Academy of Public Administration study of off-shoring.

[3] The 2006 estimate includes funds for the Felony Arrestee Drug Use Reporting program (previously funded as the Arrestee Drug Abuse Monitoring program within the National Institute of Justice) as well as funds for management and administrative costs that were displayed separately in 2004 and 2005.

[4] 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 Chidren's Health Insurance Program funds.

[5] Includes funds for the periodic Census of Agriculture of $25, $22, and $29 million in 2004, 2005, and 2006, respectively. The 2006 Budget includes an increase of $6.5 million due to cyclical activities including finalizing content, developing mail lists, and streamlining and upgrading processing systems in preparation for the 2007 Census of Agriculture.

[6] All funds from the Public Health Service Evaluation Fund. Funds for 2004 are shown comparably with 2005 and 2006. Administrative costs for NCHS that previously were displayed as part of the NCHS budget line are now reflected in two consolidated CDC-wide budget lines for management and administrative costs.

proposals to strengthen the programs of the principal Federal statistical agencies.

Bureau of Economic Analysis: Funding is requested to: (1) make selected improvements to the timeliness and comprehensiveness of the Nation's international statistics on multinational corporations and trade in services; (2) complete work to accelerate the release of gross state product, metropolitan personal income, and county-level personal income; (3) enhance the accuracy of BEA statistics by acquiring and incorporating real-time data into core BEA accounts; (4) improve data on international financial transactions by working with the Department of the Treasury and the Federal Reserve Board to incorporate newly developed estimates of derivatives and other financial instruments; and (5) produce up-to-date, annual estimates of business investment spending by industry in order to more accurately discern where high-tech and other investments are being made in the manufacturing and service sectors.

Bureau of Justice Statistics: Funding is requested to 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; (6) data on correctional populations and facilities from Federal, State, and local governments; and (7) the Felony Arrestee Drug Use Reporting program (previously funded as the Arrestee Drug Abuse Monitoring program within the National Institute of Justice).

Bureau of Labor Statistics: Funding is requested to support 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 (IPP), and producing new data outputs, such as indexes based on the North American Industry Classification System for the IPP; (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; and (3) releasing the 2004–2014 Employment Projections and publishing the 2006–2007 edition of the *Occupational Outlook Handbook*.

Bureau of Transportation Statistics: Funding is requested to: (1) enhance the Freight Data Program, a continuous source of data from shippers, carriers, and receivers, to replace the current Commodity Flow Survey; (2) move the Air Transportation 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 reengineered 2010 Census. For the Census Bureau's economic and demographic programs, funding is requested to: (1) plan for the 2007 Economic Census, (2) plan and implement the organizational phase of the 2007 Census of Governments and plan for the employment and finance phases, (3) improve measurement of services by expanding key source data for critical quarterly and annual estimates of our Nation's Gross Domestic Product, (4) support improved coverage and electronic reporting of trade statistics, (5) support the development of a database infrastructure to integrate State administrative data and Census Bureau data products in order to fill critical data gaps at the State and local levels, (6) continue efforts begun in 2003 to eliminate data gaps by measuring migration across U.S. borders, and (7) purchase furniture and relocate operations and employees to the new headquarters facility to avoid disruption of mission-critical operations necessary for the successful completion of Census Bureau surveys. For 2010 Census planning, funding is requested to continue to: (1) conduct planning, testing, and development activities to support a reengineered 2010 Census; (2) complete map feature accuracy within 7.6 meters of true GPS location for 700 of the Nation's counties; and (3) continue to conduct 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 support ongoing programs and to continue the development of an integrated and comprehensive data and analysis framework of the food system beyond the farmgate to provide a basis for understanding, monitoring, tracking, and identifying changes in the food supply and consumption patterns.

Energy Information Administration: Funding is requested to continue ongoing operations, with a focus on: (1) improving petroleum and natural gas data security, reliability, and quality; (2) conducting the commercial, manufacturing, and residential energy consumption surveys; (3) implementing the enhanced Voluntary Reporting of Greenhouse Gases program to support the President's Climate Change Initiative; and (4) developing a program performance prototype to assess EIA's data collection and operations costs at a more disaggregated level.

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; (2) continue development and implementation of a locality-based agricultural county estimates/small area estimation program; and (3) continue preparations for the 2007 Census of Agriculture.

National Center for Education Statistics: Funding is requested to: (1) support the ongoing data collection and analysis of the Early Childhood Longitudinal Study Birth and Kindergarten Cohorts, which provide data to inform child development practices and early education; (2) continue the Integrated Education Postsecondary Data System, which collects information on enrollment, completions, and finances from postsecondary institutions; (3) sustain the ongoing data collection efforts for the Beginning Postsecondary Students Longitudinal Study; (4) maintain U.S. participation in international assessments that compare educational achievement in the United States with that in other countries; and (5) continue the National Assessment of Educational Progress (NAEP) program, including funding to support the expansion of State NAEP to grade 12.

National Center for Health Statistics: Funding is requested to: (1) increase timeliness by upgrading electronic systems for data collection and processing; (2) expand the content of surveys, particularly those addressing the health care delivery system; (3) redesign the sample for the National Health Interview Survey, NCHS' largest population survey; and (4) work collaboratively with States and other agencies on upgrading the technology for collecting data from State birth and death certificates.

Science Resources Statistics Division, NSF: Funding is requested to: (1) continue to implement the results of prior methodological, analytical, and planning activities directed toward improving the relevance, accuracy, timeliness, and accessibility of SRS products, including the suite of Research and Development surveys and the Survey of Graduate Students and Postdoctorates in Science and Engineering; and (2) lead a cross-agency effort to examine and revise current taxonomies used for classifying academic fields of study, including the development of crosswalks between existing taxonomies and any potential new taxonomy, as well as strengthen methods to enhance the identification and description of cross-disciplinary and multi-disciplinary fields.

Statistics of Income Division, IRS: Funding is requested to: (1) maintain and modernize core data collection systems, including several major statistical programs for the Department of the Treasury, 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.

5. RESEARCH AND DEVELOPMENT

I. INTRODUCTION

U.S. investments in science and technology in past decades have greatly enhanced the standard of living and quality of life we enjoy today and have generated significant economic growth in the United States. Advances have been possible only with the support of both public and private investment in research and development (R&D).

The U.S. Government boasts the highest level of R&D investment in the world: $132 billion. However, unlike 40 years ago, when Federal R&D expenditures were double those of the private sector, industry R&D spending now exceeds Federal Government R&D spending.

While the U.S. investment is, by a wide margin, the largest in the world, we also strive to make sure it is going to the highest priority and highest quality work. The President's 2006 Budget maintains a strong focus on winning the war against terrorism, while moderating the growth in overall spending, and this focus is reflected in the R&D the Administration proposes for 2006. In addition, recognizing that fundamental research fuels future innovation and technology development, the Administration has maintained high levels of support for priority R&D areas such as nanotechnology, information technology, hydrogen energy, and space exploration.

The Federal Government funds many types of R&D. First, the Government is the primary supporter of basic research, which is directed toward greater understanding of fundamental scientific 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 has an important role in supporting applied research, which is driven by more targeted scientific questions and specific needs, and development, which applies scientific knowledge and technology to specific needs. Together, these R&D activities are critical for ensuring that agencies effectively implement their missions.

In addition to direct R&D investments, the Federal Government also helps stimulate private investment and provide 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.

The Administration continues 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 fully pay off for years, agencies can establish meaningful program goals and measure annual progress and performance in appropriate ways.

Towards that end, the Administration continues to implement and improve investment criteria for R&D programs across the Government as part of the President's Management Agenda. 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.

This chapter discusses how the Administration will improve the performance of R&D programs through investment principles and other means that encourage and reinforce quality research. Highlights of the coordination of multi-agency R&D priority areas are also included. The chapter concludes with details of R&D funding across the Federal Government.

II. IMPROVING THE 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. Therefore, and consistent with the Government Performance and Results Act, every Federal R&D dollar must be invested as effectively as possible. The discussion below will focus on the use of R&D investment criteria and the effect on overall performance of research earmarks on the Federal R&D portfolio.

R&D Investment Criteria

The Administration is improving the effectiveness of the Federal Government's investments in R&D by applying transparent investment criteria in analyses that inform recommendations for program funding and management. R&D performance assessment must be done with care. Research often leads scientists and engineers down unpredictable pathways with unpredictable results. This outcome can require special consideration when measuring an R&D program's performance against its initial goals.

With this in mind, 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.

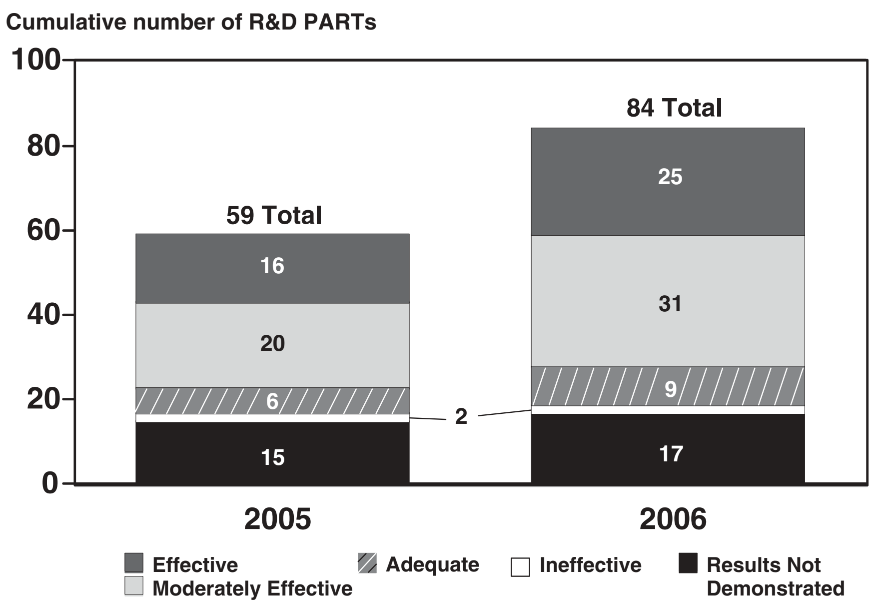
As directed by the President's Management Agenda, the R&D Investment Criteria accommodate the wide range of R&D activities, from basic research to development and demonstration programs, by addressing three fundamental aspects of R&D:

- *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 apply 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.

As discussed throughout the 2006 Budget, the Office of Management and Budget (OMB) and the agencies are working on other initiatives as part of the President's Management Agenda. For the Budget and Performance Integration initiative, the Administration developed the Program Assessment Rating Tool (PART) to consistently assess the effectiveness of programs. A section of the PART specifically addresses the assessment of R&D program management and performance and is aligned with the R&D Investment criteria. In the last three years, agencies have completed PART assessments of 84 R&D programs. The results of these PART assessments may be found on the web at http://www.whitehouse.gov/omb/part/.

Chart 5-1. Scores of R&D PART Assessments



Performance assessments help policy makers identify those programs that are the most effective and worthy of funding; however, the Administration does not allocate funding levels and initiate management reforms strictly by formula or based solely on PART results. For instance, funding may be reduced for "effective" programs that have achieved what they set out to do, and "ineffective" programs might receive more money if it is clear it would help them become more effective. The PART provides information that leads to more informed decisions. For example, as a result of the PART review process, the Department of Veterans Affairs designed new performance measures that will enable its senior management to better assess the agency's overall research direction and its contributions to the health of veterans and the general population. In another case, the PART informed a decision in the 2006 Budget to eliminate funds for the Department of Energy's oil and gas R&D programs, which were determined to often duplicate private-sector R&D efforts and generate benefits primarily for the private sector.

R&D agencies will continue to integrate the R&D Criteria more meaningfully into the budget formulation process in the coming year. Interagency R&D initiatives use the R&D Criteria in developing plans and reports, such as "A 21st Century Frontier for Discovery: The Physics of the Universe." 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.

President's Management Agenda Initiative

Research and Development Investment Criteria

FY 2005, 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 has momentum, as some agencies have made improvements this year, including the National Science Foundation and the Department of Energy. 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. All of the top 13 R&D agencies are using the R&D PART to assess their programs this year. Most of the major R&D agencies submitted 2006 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 using the R&D PART 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 strongly supports awarding research funds based on merit review through a competitive process. Such a system generally 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. Earmarks signal to potential investigators that there is an acceptable alternative to creating quality research proposals for merit-based consideration, including the use of political influence or appeals to parochial interests. Such an alternative is seldom the most effective use of taxpayer funds.

Unfortunately, the practice of earmarking to colleges, universities and other entities for specific research projects has expanded dramatically in recent years. The American Association for the Advancement of Science (AAAS) recently estimated that R&D earmarks total $2.1 billion in 2005, an increase of nine percent over the Association's 2004 estimate.

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 earmarks 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.

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 research agencies have procedures and programs to reward "out-of-the-box" thinking. 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 the National Science Foundation (NSF) set aside a share of funding for higher-risk projects in which they see high potential.

Often Congressional direction has little to do with an agency's mission. In addition to earmarked funding noted above, the Congress also directed DOD to fund research on a wide range of diseases, including breast cancer, ovarian cancer, prostate cancer, diabetes, leukemia, and muscular dystrophy. Funding at DOD for such research totals about $900 million in 2005 alone, an increase of about $200 million in just one year. 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 the Congress, academic organizations, colleges and universities to discourage the practice of research earmarks and to achieve our common objectives.

III. PRIORITIES FOR FEDERAL RESEARCH AND DEVELOPMENT

The 2006 Budget requests $132 billion for Federal R&D funding, which targets key research investments within agencies such as NSF, the National Aeronautics and Space Administration, the Department of Commerce's National Institute of Standards and Technology, and the National Institutes of Health (Table 5–2 provides details by agency).

The "Federal Science and Technology" (FS&T) budget (shown in Table 5–3) highlights the creation of new knowledge and technologies more consistently and accurately than the traditional R&D data collection. The FS&T budget emphasizes research, does not count funding for defense development, testing, and evaluation, and totals less than half of Federal R&D spending. The 2006 Budget requests $61 billion for FS&T.

Over the last year, the Office of Science and Technology Policy 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 hydrogen R&D, address newly recognized needs. The discussion below focuses on five multi-agency priority areas and concludes with how the Federal Government stimulates private R&D investment.

Multi-Agency R&D Priorities

The 2006 Budget targets important research investments that must be coordinated across multiple agencies. Three of these multi-agency initiatives—nanotechnology, information technology R&D, and climate change science—are coordinated by three separate dedicated 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: Since September 2001, the Administration increased its focus on R&D that aids in securing the homeland. Research programs across the Federal Government are being coordinated to develop systems to help prevent future terrorist attacks, minimize our Nation's vulnerability to terrorist acts, and respond and recover if an attack should occur.

The President issued 12 Homeland Security Presidential Directives (HSPD) that call for, among other things, increased interagency coordination of R&D to defend against biological threats to our people, economy, agriculture, food and water supplies. For example, one HSPD, *Defense of United States Agriculture and Food,* establishes a national policy to provide protection against an attack on the agriculture and food systems.

In 2004, multi-agency efforts made significant progress. For example, the Department of Homeland Security established both the National Biodefense Analysis and Countermeasures Center to study biological agents and the National Bioforensic Analysis Center to provide a world class forensics center. These centers join other DOD, U.S. Department of Agriculture, and National Institutes of Health facilities at Fort Detrick to create a National Interagency Biodefense Campus that will become a focal point for countermeasures research. Together, these agencies will establish research priorities to reduce the threat of biological terrorism.

Networking and Information Technology R&D: The budget provides $2 billion for the multi-agency Networking and Information Technology Research and Development (NITRD) program, which focuses and coordinates agency research efforts in advanced computing systems, networks, software, and information-management technologies. The agencies involved in this program work together enabling more rapid advancement than they could achieve working on their own. These advances have an impact on virtually every sector of the economy.

In 2004, agencies with responsibilities for high-end computing—ultra-powerful supercomputers, components and software—made significant progress in implementing the recommendations of the interagency High-End Computing Revitalization Task Force. For example, new supercomputing activities at both NASA and the Department of Energy (DOE) were begun and will be managed in accord with the Federal Plan for High-End Computing.

To enable a better understanding of the potential scientific impact of high-end capability computing, the NITRD National Coordination Office will commission a National Academy of Sciences study that identifies and categorizes important scientific questions and technological problems for which an extraordinary advancement in our understanding is difficult or impossible without leading-edge scientific simulation capabilities.

Nanotechnology R&D: The budget provides $1 billion for the multi-agency National Nanotechnology Initiative (NNI). The NNI focuses on R&D that creates 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 level, environmental monitoring and protection, energy production and storage, and creating electronic devices that have even greater capabilities than those available today.

Guided by the NNI, participating agencies 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. For example, the 2006 Budget provides funding for DOE to complete construction on four new major nanoscale science research centers located around the country. In addition, agencies continue to maintain a focus on the responsible development of nanotechnology, with attention to the human and environmental health impacts, as well as ethical, legal, and other societal issues.

Climate Change R&D: The 2006 Budget for the Climate Change Science Program (CCSP) continues to support the goals outlined in the CCSP Strategic Plan, which was released in July 2003. The Budget reflects the coordinated planning efforts of the 13 departments and agencies that participate in CCSP. Beginning in FY 2006, CCSP will formally track the expected actions, deliverables, and milestones for each of its programs in order to assess overall performance. Additional detail on individual agency activities will be provided in the Administration's FY 2006 edition of *Our Changing Planet***.**

The Climate Change Technology Program (CCTP) continues to prioritize the portfolio of Federally funded climate change technology R&D consistent with the President's National Climate Change Technology Initiative (NCCTI). In 2005, the CCTP will publish a draft Strategic Plan and solicit comments from the scientific community and the public. The CCTP will also identify within its portfolio a subset of NCCTI priority activities, defined as discrete R&D activities that address technological challenges, which, if solved, could advance technologies with the potential to dramatically reduce, avoid, or sequester greenhouse gas emissions.

Hydrogen R&D: In 2004, the Hydrogen R&D Interagency Task Force, established by the Office of Science and Technology Policy, initiated a plan to coordinate agency efforts in key research areas, such as novel materials for fuel cells and hydrogen storage, inexpensive and durable catalysts, and hydrogen production from alternative sources. In 2005, the task force will implement this plan and expand public outreach and collaboration with the private sector, state agencies, and other stakeholders. The U.S., through the Department of Energy, will continue to lead the International Partnership for the Hydrogen Economy, established in 2003 to coordinate hydrogen research among 15 nations representing two thirds of global energy consumption.

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 includes an 11-percent increase in targeted basic research investments in 2006, 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.

Stimulating Private Investment

Along with direct spending on R&D, the Federal Government has sought to stimulate private R&D investment through incentives in the Internal Revenue Code. Current law provides a 20-percent tax credit for private research and experimentation expenditures above a certain base amount. The credit, which expired in June 2004, was extended again for another 18 months, through 2005, in the Working Families Tax Relief Act of 2004. 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 2006 to 2010. 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 tax depreciation allowance. 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

(Revenue loss, dollar amounts in millions)

	2005	2006	2007	2008	2009	2010	2006–10
Current Law	5,080	2,100	910	390	180	50	3,630
Proposed Extension	....	2,097	4,601	5,944	6,889	7,669	27,200
Total	5,080	4,197	5,511	6,334	7,069	7,719	30,830

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)

	2004 Actual	2005 Estimate	2006 Proposed	Dollar Change: 2005 to 2006	Percent Change: 2005 to 2006
By Agency					
Defense	65,462	70,422	70,839	417	1%
Health and Human Services	28,047	28,752	28,807	55	....
NASA	10,574	10,990	11,527	537	5%
Energy	8,779	8,629	8,528	–101	–1%
National Science Foundation	4,160	4,082	4,194	112	3%
Agriculture	2,222	2,415	2,039	–376	–16%
Homeland Security	1,053	1,185	1,467	282	24%
Commerce	1,137	1,134	1,013	–121	–11%
Transportation	661	748	808	60	8%
Veterans Affairs	866	784	786	2	....
Interior	627	615	582	–33	–5%
Environmental Protection Agency	661	572	569	–3	–1%
Other	1,089	1,243	1,145	–98	–8%
Total	**125,338**	**131,571**	**132,304**	**733**	**1%**
Basic Research					
Defense	1,358	1,513	1,319	–194	–13%
Health and Human Services	14,780	15,124	15,246	122	1%
NASA	2,473	2,368	2,199	–169	–7%
Energy	2,847	2,887	2,762	–125	–4%
National Science Foundation	3,524	3,432	3,480	48	1%
Agriculture	829	851	788	–63	–7%
Homeland Security	68	85	112	27	32%
Commerce	43	58	71	13	22%
Transportation	20	38	41	3	8%
Veterans Affairs	347	315	315	....	....
Interior	37	36	30	–6	–17%
Environmental Protection Agency	113	66	70	4	6%
Other	149	155	175	20	13%
Subtotal	**26,588**	**26,928**	**26,608**	**–320**	**–1%**

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

(Budget authority, dollar amounts in millions)

	2004 Actual	2005 Estimate	2006 Proposed	Dollar Change: 2005 to 2006	Percent Change: 2005 to 2006
Applied Research					
Defense	4,351	4,851	4,139	–712	–15%
Health and Human Services	13,007	13,274	13,410	136	1%
NASA	3,006	2,497	3,233	736	29%
Energy	2,693	2,760	2,709	–51	–2%
National Science Foundation	266	279	276	–3	–1%
Agriculture	1,055	1,093	942	–151	–14%
Homeland Security	247	346	399	53	15%
Commerce	828	825	763	–62	–8%
Transportation	349	423	494	71	17%
Veterans Affairs	476	430	433	3	1%
Interior	538	530	495	–35	–7%
Environmental Protection Agency	423	365	386	21	6%
Other	599	562	553	–9	–2%
Subtotal	**27,838**	**28,235**	**28,232**	**–3**	....
Development					
Defense	59,701	63,903	65,331	1,428	2%
Health and Human Services	41	54	28	–26	–48%
NASA	3,189	3,727	3,511	–216	–6%
Energy	1,992	1,846	1,959	113	6%
National Science Foundation	....	....	....	....	....
Agriculture	159	157	146	–11	–7%
Homeland Security	481	599	746	147	25%
Commerce	152	149	90	–59	–40%
Transportation	279	269	254	–15	–6%
Veterans Affairs	43	39	38	–1	–3%
Interior	49	46	54	8	17%
Environmental Protection Agency	125	141	113	–28	–20%
Other	324	495	396	–99	–20%
Subtotal	**66,535**	**71,425**	**72,666**	**1,241**	**2%**
Facilities and Equipment					
Defense	52	155	50	–105	–68%
Health and Human Services	219	300	123	–177	–59%
NASA	1,906	2,398	2,584	186	8%
Energy	1,247	1,136	1,098	–38	–3%
National Science Foundation	370	371	438	67	18%
Agriculture	179	314	163	–151	–48%
Homeland Security	257	155	210	55	35%
Commerce	114	102	89	–13	–13%
Transportation	13	18	19	1	....
Veterans Affairs	....	....	....	....	N/A
Interior	3	3	3	....	....
Environmental Protection Agency	....	....	....	....	N/A
Other	17	31	21	–10	–32%
Subtotal	**4,377**	**4,983**	**4,798**	**–185**	**–4%**

Table 5–3. FEDERAL SCIENCE AND TECHNOLOGY BUDGET

(Budget authority, dollar amounts in millions)

	2004 Actual	2005 Estimate	2006 Proposed	Dollar Change: 2005 to 2006	Percent Change: 2005 to 2006
By Agency					
National Institutes of Health	**27,878**	**28,444**	**28,607**	**163**	**1%**
NASA	**9,231**	**9,116**	**9,493**	**377**	**4%**
Science	5,600	5,527	5,476	–51	–1%
Aeronautics	1,057	906	852	–54	–6%
Exploration Systems	2,574	2,683	3,165	482	18%
National Science Foundation	**5,578**	**5,473**	**5,605**	**132**	**2%**
Defense	**5,709**	**6,363**	**5,458**	**–905**	**–14%**
Basic Research	1,358	1,513	1,319	–194	–13%
Applied Research	4,351	4,850	4,139	–711	–15%
Energy [1]	**5,494**	**5,635**	**5,357**	**–278**	**–5%**
Science Programs	3,484	3,600	3,463	–137	–4%
Energy Supply: Renewables	357	380	354	–26	–7%
Energy Supply: Electricity Transmission & Distribution	81	101	84	–17	–17%
Energy Supply: Nuclear Energy	292	386	390	4	1%
Energy Conservation [2]	607	596	576	–20	–3%
Fossil Energy	673	572	491	–81	–14%
Agriculture	**2,047**	**2,127**	**1,922**	**–205**	**–10%**
CSREES Research and Education [3]	629	670	560	–110	–16%
Economic Research Service	71	74	81	7	9%
Agricultural Research Service [4]	1,081	1,102	996	–106	–10%
Forest Service: Forest and Rangeland Research	266	276	285	9	3%
Interior (USGS)	**938**	**935**	**934**	**–1**	......
Commerce	**965**	**992**	**858**	**–134**	**–14%**
NOAA: Oceanic & Atmospheric Research	393	404	361	–43	–11%
NIST: Intramural Research and Facilities	401	451	485	34	8%
NIST: Advanced Technology Program	171	137	......	–137	–100%
Environmental Protection Agency [5]	**826**	**780**	**792**	**12**	**2%**
Veterans Affairs [6]	**866**	**784**	**786**	**2**	......
Transportation	**683**	**694**	**673**	**–21**	**–3%**
Highway research [7]	564	566	543	–23	–4%
Federal Aviation Administration: Research, Engineering, and Development	119	131	130	–1	–1%
Education	**350**	**355**	**345**	**–10**	**–3%**
Special Education Research and Innovation	78	83	73	–10	–12%
National Institute on Disability and Rehabilitation Research	107	108	108	......	......
Research, Development, and Dissemination [8]	165	164	164	......	......
Total	**60,565**	**61,696**	**60,819**	**–877**	**–1%**

[1] Data do not reflect actual transfers to Science Programs from other Department of Energy R&D programs to support the Small Business Innovation Research and the Small Business Technology Transfer programs.

[2] Excludes weatherization and state grant programs.

[3] Includes receipts and interest for Native American Endowment: $11 million in 2004; $14 million in 2005; $15 million in 2006.

[4] Excludes buildings and facilities.

[5] Includes the medical care and prosthetic research appropriation and VA medical care support transfer to research.

[6] Science and Technology, plus Superfund transfer.

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

[8] 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)

	2004 Actual	2005 Estimate	2006 Proposed	Dollar Change: 2005 to 2006	Percent Change: 2005 to 2006
Networking and Information Technology R&D					
Defense [1]	241	277	294	17	6%
National Science Foundation	773	795	803	8	1%
Health and Human Services [2]	542	573	551	–22	–4%
Energy	343	383	355	–28	–7%
Commerce	47	58	61	3	5%
National Aeronautics and Space Administration	258	192	57	–135	–70%
Environmental Protection Agency	2	4	6	2	50%
Total	**2,206**	**2,282**	**2,127**	**–155**	**–7%**
National Nanotechnology Initiative					
National Science Foundation	256	338	344	6	2%
Defense	291	257	230	–27	–11%
Energy	202	210	207	–3	–1%
Health and Human Services [3]	108	145	147	2	1%
Commerce (NIST)	77	75	75	....	....
National Aeronautics and Space Administration	47	45	35	–10	–22%
Agriculture	2	3	8	5	167%
Environmental Protection Agency	5	5	5	....	....
Justice	2	2	2	....	....
Homeland Security	1	1	1	....	....
Total	**991**	**1,081**	**1,054**	**–27**	**–2%**
Climate Change Science Program					
National Aeronautics and Space Administration	1,321	1,264	1,162	–102	–8%
National Science Foundation	215	198	197	–1	–1%
Commerce (NOAA)	116	124	181	57	46%
Energy	133	129	132	3	2%
Agriculture	70	73	88	15	21%
National Institutes of Health	61	65	65	....	....
Interior (USGS)	28	24	24	....	....
Environmental Protection Agency	22	20	21	1	5%
Smithsonian	6	6	6	....	....
U.S. Agency for International Development	6	6	6	....	....
Transportation	1	3	3	....	N/A
State	1	1	1	....	....
Total	**1,975**	**1,913**	**1,886**	**–27**	**–1%**
Subtotal, CCRI (included in CCSP total)	**168**	**221**	**183**	**–38**	**–17%**

[1] In 2006, DOD will reassess which of its IT R&D programs are appropriate to count as part of the NITRD program, and any changes will be reported in subsequent NITRD publications.

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

[3] Includes funds from both the National Institutes of Health and National Institute of Occupational Safety and Health.

V. ALLOCATION OF RESEARCH FUNDING

Federal funds appropriated to Executive Branch agencies may be used in different ways, ranging from grants awarded to university researchers to supporting research at Federal laboratories. The Administration strongly supports the competitive, merit review process for funding research in most cases. However, there are appropriate roles for other modes of allocating research funding in some circumstances, such as funding research at specific facilities that have unique capabilities. In such cases, however, the proposed allocation should be reviewed by scientific or technological experts, as well as mangement and program experts.

In order to better understand and characterize the methods agencies use to allocate their research funding, agencies reported how research funds are allocated by the following five categories:

Research performed at congressional direction consists of intramural and extramural research programs where funded activities are awarded to a single performer or collection of performers with limited or no competitive selection or with competitive selection but outside of the agency's primary mission, based on direction from the Congress in law, in report language, or by other direction.

Inherently unique research is intramural and extramural research programs where funded activities are awarded to a single performer or team of performers without competitive selection. The award may be based on the provision of unique capabilities, concern for timeliness, or prior record of performance (e.g., facility operations support for a unique facility, such as an electron-positron linear collider; research grants for rapid-response studies to address an emergency).

Merit-reviewed research with limited competitive selection is intramural and extramural research programs where funded activities are competitively awarded from a pool of qualified applicants that are limited to organizations that were created to largely serve Federal missions and continue to receive most of their annual research revenue from Federal sources. The limited competition may be for reasons of stewardship, agency mission constraints, or retention of unique technical capabilities (e.g., funding set aside for researchers at laboratories or centers of DOD, NASA, EPA, NOAA, and NIH; Federally Funded Research and Development Centers; formula funds for USDA).

Merit-reviewed research with competitive selection and internal (program) evaluation is intramural and extramural research programs where funded activities are competitively awarded following review for scientific or technical merit. The review is conducted by the program manager or other qualified individuals from within the agency program, without additional independent evaluation (e.g., merit-reviewed research at DOD).

Merit-reviewed research with competitive selection and external (peer) evaluation is intramural and extramural research programs where funded activities are competitively awarded following review by a set of external scientific or technical reviewers (often called peers) for merit. The review is conducted by appropriately qualified scientists, engineers, or other technically-qualified individuals who are apart from the people or groups making the award decisions, and serves to inform the program manager or other qualified individual who makes the award (e.g., NSF's single-investigator research; NASA's research and analysis funds).

Table 5–5 lists how Federal R&D agencies report allocating research funding among these categories.

Table 5–5. ALLOCATION OF FEDERAL RESEARCH FUNDING, 2004 AND 2005

(Percent of Agency Research)

	Research Performed at Congressional Direction		Inherently Unique Research		Merit Reviewed Research with Limited Competitive Selection		Merit Reviewed Research with Competitive Selection and Internal Evaluation		Merit Reviewed Research with Competitive Selection and External Evaluation	
	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005
By Agency										
Health & Human Services	....	1%	1%	1%	12%	12%	....	....	86%	86%
Defense	17%	12%	9%	8%	6%	6%	65%	72%	3%	3%
Energy	5%	4%	23%	23%	51%	52%	4%	4%	18%	17%
NASA	4%	9%	1%	2%	10%	11%	35%	26%	51%	52%
National Science Foundation	....	....	....	....	6%	6%	21%	21%	73%	73%
Agriculture	17%	17%	55%	52%	14%	14%	....	....	13%	17%
Commerce	6%	6%	41%	44%	15%	14%	18%	18%	22%	18%
Veterans Affairs	....	....	....	....	....	....	....	....	100%	100%
Interior	7%	7%	30%	30%	33%	33%	27%	27%	2%	2%
Transportation	13%	15%	17%	23%	1%	1%	69%	61%	....	....
Homeland Security	....	24%	....	....	30%	23%	48%	36%	22%	16%
Environmental Protection Agency	8%	....	3%	7%	44%	50%	12%	15%	32%	28%
Research Funding (dollars in millions)	**2,312**	**2,427**	**3,965**	**4,101**	**8,174**	**8,414**	**7,587**	**7,888**	**32,398**	**32,549**
Percentage of Federal Research	**4%**	**4%**	**7%**	**7%**	**15%**	**15%**	**14%**	**14%**	**60%**	**59%**

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.

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, spending for physical investment and research and development related to education and training is 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 7, "Credit and Insurance", 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 $368.5 billion in 2004. They are estimated to increase to $396.5 billion in 2005 and are projected to decline slightly to $395.1 billion in 2006. Major Federal investment outlays will comprise an estimated 15 percent of total Federal outlays in 2006 and 3.1 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 $183.5 billion in 2006. 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 $88.9 billion 2006. Almost all of these outlays, or an estimated $81.3 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 $30.2 billion in 2006. These outlays include $16.2 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 Indian Health Service hospitals and clinics; facilities for space and science programs; Postal Service facilities; and construction for embassy security. Outlays for the acquisition of major equipment are estimated to be $13.7 billion in 2006. The largest amounts are for the air traffic control system.

Grants to State and local governments for physical investment are estimated to be $64.4 billion in 2006. More than two-thirds of these outlays, or $45.9 billion, are to assist States and localities with transportation infrastructure, primarily highways. Other major grants for physical investment fund sewage treatment plants, community and regional development, and public housing.

Conduct of research and development. Outlays for the conduct of research and development are estimated to be $124.9 billion in 2006. 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 $73.5 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 $51.4 billion in 2006. 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 $86.7 billion in 2006. 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 $52.3 billion in 2006, three-fifths of the total. They include education programs for the disadvantaged and individuals with disabilities, other education programs, training programs in the Department of Labor, and Head Start. Direct Federal education and training outlays are estimated to be $34.3 billion in 2006. 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

Table 6–1. COMPOSITION OF FEDERAL INVESTMENT OUTLAYS

(In billions of dollars)

	2004 Actual	Estimate	
		2005	2006
FEDERAL INVESTMENT			
Major public physical capital investment:			
Direct Federal:			
National defense	83.6	87.5	88.9
Nondefense	27.4	31.7	30.2
Subtotal, direct major public physical capital investment	111.0	119.1	119.1
Grants to State and local governments	59.4	61.9	64.4
Subtotal, major public physical capital investment	170.4	181.1	183.5
Conduct of research and development:			
National defense	65.3	71.4	73.5
Nondefense	48.0	51.1	51.4
Subtotal, conduct of research and development	113.4	122.4	124.9
Conduct of education and training:			
Grants to State and local governments	47.9	51.8	52.3
Direct Federal	36.8	41.1	34.3
Subtotal, conduct of education and training	84.7	92.9	86.7
Total, major Federal investment outlays	**368.5**	**396.5**	**395.1**
MEMORANDUM			
Major Federal investment outlays:			
National defense	149.0	158.8	162.4
Nondefense	219.5	237.6	232.7
Total, major Federal investment outlays	368.5	396.5	395.1
Miscellaneous physical investment:			
Commodity inventories	–1.4	0.2	–1.0
Other physical investment (direct)	2.8	3.3	3.0
Total, miscellaneous physical investment	1.4	3.5	2.0
Total, Federal investment outlays, including miscellaneous physical investment	369.8	399.9	397.1

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 $1.0 billion in 2006.

Outlays for other miscellaneous physical investment are estimated to be $3.0 billion in 2006. 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		
	2004 Actual	2005 Estimate	2006 Estimate	2004 Actual	2005 Estimate	2006 Estimate
GRANTS TO STATE AND LOCAL GOVERNMENTS						
Major public physical investments:						
Construction and rehabilitation:						
Transportation:						
Highways	34,231	34,078	33,573	30,188	32,014	34,360
Mass transportation	7,813	8,450	8,517	7,567	8,183	8,284
Air transportation	3,649	3,697	2,531	2,958	3,042	3,264
Subtotal, transportation	45,693	46,225	44,621	40,713	43,239	45,908
Other construction and rehabilitation:						
Pollution control and abatement	2,445	2,190	1,938	2,066	1,961	1,886
Community and regional development	6,207	6,063	4,276	6,761	6,783	6,766
Housing assistance	6,843	6,508	5,846	7,659	7,877	7,924
Other construction	393	434	204	613	444	329
Subtotal, other construction and rehabilitation	15,888	15,195	12,264	17,099	17,065	16,905
Subtotal, construction and rehabilitation	61,581	61,420	56,885	57,812	60,304	62,813
Other physical assets	1,772	1,585	1,279	1,599	1,619	1,542
Subtotal, major public physical capital	63,353	63,005	58,164	59,411	61,923	64,355
Conduct of research and development:						
Agriculture	267	270	148	269	275	218
Other	414	389	353	327	343	454
Subtotal, conduct of research and development	681	659	501	596	618	672
Conduct of education and training:						
Elementary, secondary, and vocational education	36,609	37,175	37,191	32,194	36,298	36,840
Higher education	510	506	33	499	615	515
Research and general education aids	728	801	738	714	822	822
Training and employment	3,476	3,509	4,232	4,064	3,378	3,655
Social services	9,936	10,120	9,541	9,746	10,002	9,795
Agriculture	444	451	437	424	426	410
Other	260	281	249	234	261	272
Subtotal, conduct of education and training	51,963	52,843	52,421	47,875	51,802	52,309
Subtotal, grants for investment	115,997	116,507	111,086	107,882	114,343	117,336
DIRECT FEDERAL PROGRAMS						
Major public physical investment:						
Construction and rehabilitation:						
National defense:						
Military construction and family housing	6,666	7,154	7,365	6,368	6,291	6,937
Atomic energy defense activities and other	811	527	639	754	564	632
Subtotal, national defense	7,477	7,681	8,004	7,122	6,855	7,569
Nondefense:						
International affairs	1,464	1,471	1,591	1,319	1,403	1,477
General science, space, and technology	1,706	2,034	2,214	1,485	1,860	2,332
Water resources projects	3,061	3,249	2,753	2,812	3,083	2,978
Other natural resources and environment	1,117	1,025	888	972	1,087	996
Energy	1,537	1,492	1,475	1,534	1,493	1,443
Postal Service	638	1,065	847	456	491	702
Transportation	51	194	101	55	152	190
Veterans hospitals and other health facilities	1,288	1,912	1,531	1,748	2,633	2,792
Federal Prison System	161	25	–289	282	128	199
GSA real property activities	1,747	1,616	1,670	1,329	1,518	1,729
Other construction	2,672	2,576	1,178	2,140	2,971	1,358

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

(in millions of dollars)

Description	Budget Authority 2004 Actual	Budget Authority 2005 Estimate	Budget Authority 2006 Estimate	Outlays 2004 Actual	Outlays 2005 Estimate	Outlays 2006 Estimate
Subtotal, nondefense	15,442	16,659	13,959	14,132	16,819	16,196
Subtotal, construction and rehabilitation	22,919	24,340	21,963	21,254	23,674	23,765
Acquisition of major equipment:						
National defense:						
Department of Defense	83,072	78,345	78,043	76,232	80,255	80,870
Atomic energy defense activities	385	381	473	296	387	470
Subtotal, national defense	83,457	78,726	78,516	76,528	80,642	81,340
Nondefense:						
General science and basic research	603	588	676	569	612	621
Space flight, research, and supporting activities	542	710	650	475	751	563
Postal Service	598	1,389	672	452	914	972
Air transportation	3,367	3,183	3,254	3,527	3,624	3,312
Water transportation (Coast Guard)	919	941	1,209	671	851	920
Other transportation (railroads)	1,218	1,207	360	1,282	1,259	360
Hospital and medical care for veterans	920	725	1,096	1,734	1,367	2,067
Law enforcement activities	1,851	1,794	1,880	1,348	1,962	1,740
Department of the Treasury (fiscal operations)	506	319	304	481	455	387
Department of Commerce (NOAA)	719	865	913	638	762	927
GSA general services funds	750	768	906	672	807	906
Other	721	804	788	854	911	882
Subtotal, nondefense	12,714	13,293	12,708	12,703	14,275	13,657
Subtotal, acquisition of major equipment	96,171	92,019	91,224	89,231	94,917	94,997
Purchase or sale of land and structures:						
National defense	–40	–38	–27	–40	–38	–27
Natural resources and environment	251	187	164	302	328	200
General government	170	161	168	222	224	205
Other	56	59	–13	37	36	–13
Subtotal, purchase or sale of land and structures	437	369	292	521	550	365
Subtotal, major public physical investment	119,527	116,728	113,479	111,006	119,141	119,127
Conduct of research and development:						
National defense:						
Defense military	65,410	70,267	70,789	61,510	67,016	69,549
Atomic energy and other	3,723	3,910	3,814	3,835	4,353	3,990
Subtotal, national defense	69,133	74,177	74,603	65,345	71,369	73,539
Nondefense:						
International affairs	264	255	255	254	258	258
General science, space, and technology:						
NASA	7,853	7,686	10,835	8,037	7,970	6,987
National Science Foundation	3,790	3,711	3,756	3,439	3,754	3,724
Department of Energy	2,736	2,787	2,682	2,701	2,706	2,655
Subtotal, general science, space, and technology	14,643	14,439	17,528	14,431	14,688	13,624
Energy	1,373	1,225	1,352	1,387	1,463	1,498
Transportation:						
Department of Transportation	479	564	620	431	558	672
NASA	1,056	906	852	551	871	838
Other	12	16	....	17	16	7
Subtotal, transportation	2,920	2,711	2,824	2,386	2,908	3,015
Health:						
National Institutes of Health	26,900	27,503	27,821	24,498	26,388	27,384
All other health	685	681	649	760	585	602

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

(in millions of dollars)

Description	Budget Authority			Outlays		
	2004 Actual	2005 Estimate	2006 Estimate	2004 Actual	2005 Estimate	2006 Estimate
Subtotal, health	27,585	28,184	28,470	25,258	26,973	27,986
Agriculture	1,468	1,601	1,346	1,425	1,460	1,330
Natural resources and environment	2,084	2,033	1,971	1,574	1,494	1,589
National Institute of Standards and Technology	397	416	342	493	406	472
Hospital and medical care for veterans	866	784	786	850	792	777
All other research and development	1,425	1,666	1,811	1,021	1,739	1,938
Subtotal, nondefense	51,388	51,834	55,078	47,438	50,460	50,731
Subtotal, conduct of research and development	120,521	126,011	129,681	112,783	121,829	124,270
Conduct of education and training:						
Elementary, secondary, and vocational education	1,530	1,593	1,273	1,691	1,904	1,627
Higher education	25,233	29,487	27,283	25,201	28,892	22,461
Research and general education aids	1,890	1,888	1,910	1,883	1,997	1,949
Training and employment	1,576	1,629	1,616	1,552	1,571	1,646
Health	1,557	1,567	1,178	1,858	1,504	1,404
Veterans education, training, and rehabilitation	2,556	2,772	3,245	2,707	3,084	3,240
General science and basic research	941	948	871	878	969	948
National defense	9	8	....	11	8	....
International affairs	355	384	458	441	377	418
Other	631	675	543	558	835	653
Subtotal, conduct of education and training	36,278	40,951	38,377	36,780	41,141	34,346
Subtotal, direct Federal investment	276,326	283,690	281,537	260,569	282,111	277,743
Total, Federal investment	392,323	400,197	392,623	368,451	396,454	395,079

PART II: PERFORMANCE OF FEDERAL INVESTMENT

Introduction. In recent years there has been increased emphasis on improving the performance of Government programs. This emphasis began with the Performance and Results Act of 1993, which requires agencies to prepare strategic plans and annual performance plans, and then report on their actual performance annually.

This Administration set out to ensure that agencies worked to improve their performance, not just report on it. Beginning in the 2004 Budget, the Administration began to assess every Federal program by a method known as the Program Assessment Rating Tool, or PART. The Administration set a target of assessing all Federal programs over five years. With this budget, the third year of using the PART, the Administration has assessed over 600 programs, about three-fifths of the Federal Budget.

The PART system assesses each program in 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 84 percent, adequate if the score is 50 to 69 percent, and inadequate if the score is 49 percent or lower. The program receives a rating “Results Not Demonstrated” if it does not have a good long-term and annual performance measure or does not have data to report on its measures. 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 and training. 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 summarizes 166 programs:

- Programs for capital assets are those identified in the PART system as “capital assets and service acquisition” (60 programs);
- Programs for research and development are essentially those identified in the PART system as “research and development” (84 programs); and

- Programs for education and training (22 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 programs in other agencies, such as the Montgomery GI Bill in the Department of Veterans Affairs, the Health Professions program in the Department of Health and Human Services, and the Job Corps program in the Department of Labor.

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 166 investment programs that have been rated by PART was 67 percent, which is a rating of "adequate". These programs had total spending of $184.6 billion in 2004. Of these programs:

- 37 were rated effective ($35.8 billion);
- 48 were rated moderately effective ($57.7 billion);
- 28 were rated adequate ($50.6 billion);
- 7 were rated ineffective ($7.4 billion); and
- 46 were rated "results not demonstrated" ($33.2 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	81%	92%	79%	86%
Planning	75%	80%	75%	78%
Management	81%	86%	66%	82%
Results/Accountability	48%	59%	37%	52%
Weighted Average [1]	64%	73%	55%	67%
Average Rating	Adequate	Moderately effective	Adequate	Adequate
	Number of Programs			
Ratings [2]				
Effective	10	25	2	37
Moderately effective	15	31	2	48
Adequate	11	9	8	28
Ineffective	2	2	3	7
Results not demonstrated	22	17	7	46
Total number of investment programs rated	60	84	22	166
	In millions of dollars (2004)			
Effective	$3,595	$31,782	$401	35,778
Moderately effective	41,781	14,179	1,736	57,696
Adequate	27,600	945	22,025	50,570
Ineffective	6,389	78	886	7,353
Results not demonstrated	25,492	3,407	4,337	33,236
All investment programs that were rated in PART	$104,857	$50,391	$29,385	$184,633

[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, 70–84 percent; adequate, 50–69 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 (DOD). Air Combat Program ($13.9 billion in 2004). 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 ($12.0 billion in 2004). 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.

Department of Defense. Missile Defense ($8.6 billion in 2004). Rating: *Moderately Effective*. This program consists of various systems and capabilities developed by the Missile Defense Agency (MDA) and military services. This program acquires and operates active defenses against short, medium, and long-range missiles in a global, multi-layered defensive system.

The assessment found that: a) the Department of Defense has aggressively worked to fund operations and support costs fully, and has been successful in coordinating service and MDA budget responsibilities; b) the Department continues to fund only two years deployment costs per each "block" of missile defense deployments, even if significant portions of those deployments require four to five years of funding to fully implement. This policy continues to put at risk the completion of approved missile defense deployments; and c) MDA did not meet its testing goals in 2004 for the Ground Based Mid-Course Defense system, the main element of its first operational deployment.

Tennessee Valley Authority. TVA Power ($7.7 billion in 2004). 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 also lacks a strategic plan, which makes it hard to assess TVA's plans to spend funds on additional power plants and transmission lines.

Department of Energy. Environmental Management ($7.1 billion in 2004). 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. Program managers will continue to work with Federal and State regulators to resolve outstanding issues with revised cleanup plans. The program has established annual cost and schedule performance measures.

General Services Administration. GSA's Regional IT Solutions Program ($5.4 billion in 2004). 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. Airlift Program ($5.1 billion in 2004). 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 2004). 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 can generally not 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 ($12.0 billion in 2004). 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 the Pell program total more than $350 million annually.

Department of Education. Federal Family Education Loan Program ($9.6 billion in 2004). Rating: *Adequate*. Under the Federal Family Education Loan (FFEL) Program, the Department encourages private lenders to make loans to undergraduate and graduate students by guaranteeing such loans in the case of default and providing lenders with financial subsidies that ensure a minimum rate of return on all loans made. Overall, the assessment concluded that both this program and the William D. Ford Direct Student Loan program fulfill their purpose of ensuring that low- and middle-income students can afford the costs of postsecondary education. The program also has meaningful performance measures and outcome data on these measures. However, the Department has been minimally successful in achieving its long-term and annual performance goals for its main student aid programs.

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 13, "Stewardship," in this volume. Additional detail about these methods appeared in a methodological note in 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. The total stock grew at a 2.2 percent average annual rate from 1960 to 2004, with periods of faster growth during the late 1960s and the 1980s. The stock amounted to $2,197 billion in 2004 and is estimated to increase to $2,315 billion by 2006. In 2004, the national defense capital stock accounted for $661 billion, or 30 percent of the total, and nondefense stocks for $1,536 billion, or 70 percent of the total.

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	2,023	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	2,138	646	1,492	380	166	213	1,112	690	193	135	94
2004	2,197	661	1,536	390	168	223	1,146	714	196	136	100
2005 estimate	2,259	677	1,582	403	169	234	1,179	738	199	137	105
2006 estimate	2,315	690	1,625	413	170	244	1,211	762	201	138	110

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 $1,536 billion in 2004. With the investments proposed in the budget, nondefense stocks are estimated to grow to $1,625 billion in 2006. 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 $661 billion in 2004 to $690 billion in 2006.

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 2004, 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 $1,099 billion in 2004 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 2004. 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 recent years has begun to increase the stock, and it is projected to increase to $531 billion in 2006.

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	423	43	380	461	294	167	884	336	547
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	454	54	401	598	424	174	1,052	478	575
2004	479	55	424	620	446	174	1,099	501	598
2005 estimate	506	56	449	643	468	175	1,149	524	624
2006 estimate	531	57	473	665	489	176	1,196	547	649

[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 $1,309 billion in 2004 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.[1] 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 5.3 percent from 1970 to 2004. The expansion of the education stock is projected to continue under this budget, with the stock rising to $1,428 billion in 2006.

[1] For estimates of the total education stock, see table 13–4 in Chapter 13, "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	1,120	819	302
2001	1,169	844	325
2002	1,210	873	336
2003	1,263	915	348
2004	1,309	953	355
2005 estimate	1,364	997	368
2006 estimate	1,428	1,049	379

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 2004, there were $219 billion in Federal direct loans outstanding and $1,231 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 GSE 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 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 were gauged by 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 discusses Federal credit programs and GSEs in four sectors: housing, education, business and community development, and exports. The discussions focus on program objectives, recent developments, performance, and future plans for each program.
- The final section reviews 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

In most cases, private lending and insurance companies efficiently meet societal demands by allocating resources to the most productive uses. Market imperfections, however, can cause inadequate provision of credit or insurance in some sectors. Federal credit and insurance programs improve economic efficiency if they effectively fill the gaps created by market imperfections. On the other hand, Federal credit and insurance programs that have little to do with correcting market imperfections may be ineffective, or can even be counter-productive; they may simply do what the private sector would have done in their absence, or interfere with what the private sector would have done better. Federal credit and insurance programs also help disadvantaged groups. This role alone, however, may not be enough to justify credit and insurance programs. For the purpose of helping disadvantaged groups, direct subsidies are generally more effective and less distortionary.

Market imperfections that can justify Federal intervention include insufficient information, limited ability to secure resources, imperfect competition, and externalities.

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.

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. Private entities also face some liquidity constraints. Small lenders operating in a local market, for example, 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. If the lack of competition forces some borrowers to pay excessively high interest on loans, Government credit programs aiming to increase the availability of credit and lower the borrowing cost in those markets may improve economic efficiency.

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.

Effects of Changing Financial Markets

Financial markets have become much more efficient, thanks to technological advances and financial services deregulation. By facilitating the gathering and processing of information and lowering transaction costs, technological advances have significantly contributed to improving the screening of credit and insurance applicants, enhancing liquidity, refining risk management, and spurring competition. 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.

These changes have reduced market imperfections, and hence 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. As a result, the private market is more willing and able to serve the populations traditionally targeted by Federal programs. The benefits of technological advances and deregulation, however, have been uneven across sectors and populations. To remain effective, therefore, Federal credit and insurance programs need to focus more narrowly on those sectors that have been less affected by financial evolution and those populations that still have difficulty in obtaining credit from private lenders. The Federal Government also needs to pay more attention to new challenges introduced by financial evolution and other economic developments. Even those changes that are beneficial overall often bring new risks and challenges.

The Federal role of alleviating the information problem is generally not as important as it once was. Nowadays, lenders and insurers have easy access to large databases, powerful computing devices, and sophisticated analytical models. This advancement in communication and information processing technology enables lenders to evaluate the risk of borrowers more objectively and accurately. As a result, creditworthy borrowers are less likely to be turned down, while high-risk borrowers are less likely to be approved for credit. The improvement, however, may be uneven across sectors. The prevalence of credit scoring (an automated process that converts relevant borrower characteristics into a numerical score indicating creditworthiness) is a good sign that the information problem is not serious. Credit scoring is widely applied to home mortgages and consumer loans, but for small business loans and agricultural loans, its application is largely limited to small loans. Credit scoring is still difficult to apply to some borrowers with unique characteristics that are difficult to standardize.

Financial evolution has also alleviated resource constraints faced by private entities. Advanced financial instruments have enabled lenders and insurers to manage risks more effectively and secure needed funds more easily. Thus, it is less likely that a large potential loss discourages an insurer from offering an actuarially fair contract or that the lack of liquid funds prevents a lender from lending to creditworthy borrowers. 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. The extent of risk sharing in this way, however, 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, thanks to financial deregulation and improved communication technology. Financial deregulation removed geographic and industry barriers to competition. As a result, major financial holding companies offer both banking and insurance products nationwide. Internet-based financial services have lowered the cost of financial transactions and reduced the importance of physical location. These developments have been particularly more beneficial to small and geographically isolated customers, as lower transaction costs make it easier to offer good prices to small customers. In addition, there are more financing alternatives for both commercial and individual borrowers that used to rely heavily on banks. Many 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. Venture capital has become a much more important financing source for small businesses. Finance companies have gained market shares both in business and consumer financing.

Problems related to externalities may persist because the price mechanisms that drive the private market ignore the value of externalities. Externalities, however, are a general market failure, rather than a financial market failure. Thus, credit and insurance programs are not necessarily the best means to address externalities, and their effectiveness should be compared with other forms of Government intervention, such as tax incentives and grants. In particular, if a credit program was initially intended to address multiple problems including externalities, and those other problems have been alleviated, then there may be a better way to address the remaining externalities.

Overall, the financial market has become more efficient and safer. Financial evolution and other economic developments, however, are often accompanied by new risks. In addition, security-related risks unexpectedly emerged in recent years, prompting Government intervention. Federal agencies need to be vigilant to identify and manage new risks to the Budget. For example, financial derivatives enable their users either to decrease or to increase risk exposure. If some beneficiaries of Federal programs use financial derivatives to take more risk, the costs of Federal programs, especially insurance programs, can rise sharply. The sheer size of some financial institutions has also created a new risk. While well-diversified institutions are generally safer, even a single failure of a large private institution or a GSE, such as Fannie Mae, Freddie Mac, and Federal Home Loan Banks could shake the entire financial market. A more visible risk today is the Pension Benefit Guaranty Corporation (PBGC) of the Department of Labor. PBGC is facing serious financial challenges due to unfavorable economic conditions in recent years and to flaws in program structure.

The September 11 attacks have increased security-related risks. The Federal Government had to intervene, due to the reluctance of private insurers to offer sufficient coverage. Managing insurance programs covering security-related risks is challenging because 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 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.

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. The overall rating (effective, moderately effective, adequate, ineffective, or results not demonstrated) is determined based on the numerical scores and some other factors.

There are 23 credit programs (defined as those involving repayment obligations) and 3 insurance programs among 607 programs that have been rated by the PART. For the group as a whole, credit and insurance programs have fairly similar PART scores to those for other programs (see Table “Summary of PART Scores”). When appropriately weighted, higher scores for credit and insurance programs in two categories are roughly offset by lower scores in the other two categories. The overall ratings for credit and insurance programs, however, are more clustered around the middle; the rating of “adequate” is much more common for credit and insurance programs (48 percent, compared with 25 percent for other programs), while the ratings of “effective” (4 percent, compared with 15 percent for other programs) and “results not demonstrated”

SUMMARY OF PART SCORES

	Purpose and Design	Strategic Planning	Program Management	Program Results
Credit and Insurance Programs				
Average	0.773	0681	0.853	0.541
Standard Deviation	0.207	0.222	0.215	0.165
Other Programs (all others excluding credit and insurance programs)				
Average	0.865	0.723	0.805	0.463
Standard Deviation	0185	0.246	0.185	0.269

(15 percent, compared with 30 percent for other programs) are rarer. The clustering around the middle suggests that most credit and insurance programs make useful contributions, but need to improve their effectiveness.

Across categories, credit and insurance programs show some similarities to other types of programs. For most programs that have been rated by the PART, 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 results.

The PART indicates that most credit and insurance programs have clear purposes. Many 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 flawed designs limiting their effectiveness and efficiency. Flawed designs are generally correctable. If some programs have become redundant or duplicative of the private sector's activities due to financial evolution, however, those programs need to be reviewed carefully. They may need to be refocused on activities that have been affected less by financial evolution, or to be discontinued.

In the program management category, while most credit and insurance programs are strong in basic financial and accounting practices, such as spending funds for intended purposes, some programs show weaknesses in more sophisticated financial management, such as cost control. Overall, credit and insurance programs are somewhat better in financial management than other programs. Given that these programs deal with highly complex financial problems, however, credit and insurance programs may still need to make significant improvements and show superior performance in financial management.

Program results, the most important category of performance, are a weak area for credit and insurance programs, as well as for some other programs assessed by the PART. A particularly troubling indication from detailed analyses is that many credit and insurance programs show deficiencies in 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. Most credit programs are also intended to address imperfections in financial markets. These common features are discussed in relation to 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. Understanding common features should help to interpret PART results and to devise adequate steps to improve performance.

Program purpose and design. Program purposes vary widely across credit programs. They include increasing homeownership, increasing the number of 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, changes in financial markets may have significantly affected the usefulness of some credit programs. Examining the effect of financial evolution may be a critical part of achieving effective reforms.

Credit programs share many critical elements of design. They try to correct imperfections in financial markets by making credit available to those borrowers who would not be able to obtain credit at reasonable cost without government assistance. To target the right borrowers, the program design needs to takes into account various factors, such as borrowers' incentives, accessibility, the state of financial markets, and general economic conditions. Credit programs also need to deal with many complexities, such as screening borrowers, servicing loans, and collecting defaulted loans. Given these complexities, most credit programs may benefit from the private sector's expertise. To be effective, however, partnership with the private sector should be designed such that the private partner's profit is closely tied to its contribution to increasing the program's effectiveness and efficiency. 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.

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 maximum efficiency, program managers need to 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 find themselves serving a narrower pool of riskier customers and need to adjust their policies and cost estimates accordingly. Quickly adopting new technologies is also important, because financial institutions are increasingly applying advanced technologies to risk management. Falling behind, Federal credit and insurance programs can be left with much riskier customers as private entities attract better-risk customers away from Federal programs.

Program management. Credit programs face some unique challenges. To assess how credit programs manage the challenges, the PART adds two extra items for credit programs; one item addresses managing risks and the other addresses estimating the program's cost and risk. Credit programs share similar risks as does the lending business. To manage those risks effectively, program managers need to monitor the credit quality of loans and practice tight financial management. For credit programs, accurately estimating the program cost is a critical element of effective management. The cashflow is uncertain for credit programs; some loans default, while some others are prepaid. Thus, the program cost must be estimated based on the expected default, prepayment, and recovery rates. An inaccurate estimation would result in inadequate budgeting and incorrect program evaluation.

Some other management issues are more important, though not unique, for credit programs than they are for other programs. Data collection, for example, is critical for effective risk management and accurate cost estimation. Effective risk management requires accurate and timely information on loan performance. The key ingredients of predicting loan performance are loan performance histories and detailed data on borrower and lender characteristics.

Program Results. The main difficulty in evaluating program performance is measuring the net outcome of the program (improvement in the intended outcome net of what would have occurred in the absence of the program). Suppose that an education program is intended to increase the number of college graduates. Although it is straightforward to measure the number of college graduates who were assisted by the program, it is difficult to tell how many of those would not have obtained a college degree without the program's assistance. Credit programs face an additional difficulty of estimating the program cost accurately. In evaluating programs, the outcome must be weighed against the cost. In the above example, the ultimate measure of effectiveness is not the net number of college graduates produced by the program but the net number per Federal dollar spent on the program. Thus, an inaccurate cost estimation would lead to incorrect program evaluation; an underestimation (overestimation) of the cost would make the program appear unduly effective (ineffective). Results for credit programs need to be interpreted in conjunction with the accuracy of cost estimation.

The net outcome of a credit program can change quickly because it depends on the state of financial markets, which are very dynamic. 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. Thus, the effect of financial evolution needs to be analyzed carefully. A sub-par performance by a credit program could be related to financial market developments; the program might have failed to adapt to rapid changes in financial markets, or its function might have become obsolete due to financial evolution. The program should be restructured in the former case, and discontinued in the latter case.

PART Cross-Cut for Credit Programs

As one of the world's largest lenders, with a portfolio of nearly $1.5 trillion in direct loans and loan guarantees, the Federal Government has a great interest in efficient risk management. This need is even stronger when considered in the context of the Government's target borrower population: those whose risk profiles prevent them from obtaining private credit on reasonable terms. Given the higher default probability and the substantial portfolio size, lax management can result in a large increase in the cost to the Government. Thus, the Government must adopt effective risk management techniques to keep defaults in check and increase recoveries when defaults do occur.

At the same time, the Government must ensure that it is effectively serving its intended borrowers. A number of credit program PART scores indicate that many agencies lack the data, processes, or overall understanding of the credit lifecycle (origination, loan servicing/lender monitoring, liquidation, and debt collection) to achieve these dual, and occasionally conflicting, goals.

Over the next year, OMB will conduct a PART cross-cut examining the major credit agencies' programs. This effort will be supported by a Credit Council comprised of OMB and agency representatives. The Council will identify agency and private sector best practices that can be implemented across the major credit agencies, leading to higher program and management efficiencies, budgetary savings, and improved PART scores.

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 two and a quarter years since the goal was announced, over 1.9 million minority families have become homeowners. HUD's Federal Housing Administration (FHA) accounted for over 400,000 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 traditional financial resources or credit history to qualify for a home mortgage in the conventional marketplace. In 2004, FHA insured $107 billion in mortgages for almost 900 thousand households. Over 70 percent of these were people buying their first homes, many of whom were minorities.

For 2006, 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 Incentives 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 program was evaluated under the PART. The assessment found that the program is meeting its statutory objective to serve underserved borrowers while maintaining an adequate capital reserve. In 2004, 73 percent of FHA-insured loans were to first-time homeowners, and 37 percent were to minority homebuyers. However, the program lacks quantifiable annual and long-term performance goals which measure FHA's ability to achieve its statutory mission. In addition, the program's credit model does not accurately predict losses to the insurance fund, nor can FHA demonstrate its ability to reduce fraud in the program.

In response to these findings, in 2006 FHA will establish performance goals for the percentage of FHA Single Family endorsements for first-time and minority homeowners, and performance goals for fraud detection and prevention. FHA will also continue development of a credit model that more accurately and reliably predicts claims costs.

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 2004, VA provided $35 billion in guarantees to assist 270,571 borrowers.

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. VA provided 109,493 zero down payment loans in 2004.

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 44 percent of its 2004 interventions, and its goal is to achieve at least a 47 percent success rate in 2006.

Rural Housing Service

The U.S. Department of Agriculture'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 (115 percent of median income or less) rural residents. The programs' emphasis is on reducing the number of rural residents living in substandard housing. In 2004, over $4.5 billion in assistance was provided by RHS for homeownership loans and loan guarantees; $3.23 billion of guarantees went to 34,800 households, of which 30 percent went to very low- and low-income families (with income 80 percent or less than median area income).

For the section 502 guaranteed loan program, the 2005 appropriation bill increased the guarantee fee on new loans to 2.0 percent. This was 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. The guarantee fee for refinance loans remains 0.5 percent. The guarantee fees are expected to remain at the same rate in 2006. Funding in 2006 stands at $3 billion for purchase loans, and $225 million for refinance loans.

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 section 502 direct loans offer extraordinary assistance to lower-income homeowners by reducing the interest rate down to as low as 1 percent for such borrowers. The section 502 direct 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 direct program cost is balanced between interest subsidy and defaults. For 2006, RHS expects to provide $1.0 billion in loans with a subsidy cost of 11.39 percent.

RHS also offers multifamily rental housing loans, and loans and grants for farm labor housing. Direct loans are provided to private, public, and non-profit borrowers to construct, rehabilitate, and repair multi-family rental housing for very low- and low-income residents, either through general occupancy properties or elderly and handicapped housing. To help achieve affordable rents, the interest rate is subsidized to a level between 1 and 2 percent. Many very low- and low-income residents' rents are further reduced to 30 percent of their adjusted income through rental assistance grants. During 2006, $641 million for Section 521 rental assistance will be directed primarily to continue existing commitments.

RHS recently received a contracted study that addressed the preservation issues surrounding the over 40-year old program. A long-term initiative has been shaped to address the revitalization of the 17,400-property portfolio. During 2006, $214 million will be directed to begin the revitalization initiative, primarily to transition existing residents in properties leaving the program. The $27 million loan program level for the direct rural rental housing will be used to address repair and rehabilitation needs of preservation worthy properties. Additionally, the farm labor housing combined grant and loan level will provide $56 million in 2006 for new construction as well as repair and rehabilitation. RHS also guarantees multifamily rental housing loans. RHS expects to be able to guarantee $200 million in loans for 2006, which is double the amount from 2005.

Housing GSEs

Fannie Mae and Freddie Mac were chartered by Congress to increase the liquidity of mortgages and to promote access to mortgage credit for groups that historically have been underserved by private markets. Fannie Mae and Freddie Mac do not participate directly in the origination of mortgages. They carry out their chartered mission primarily by purchasing residential mortgages or guaranteeing mortgage-backed securities (MBS) consisting of residential mortgages. The guaranteed MBS are held by investors, mortgage lenders, and increasingly by Fannie Mae and Freddie Mac themselves. Fannie Mae and Freddie Mac finance their acquisition of loans and MBS assets by issuing debt; both also charge fees to mortgage originators who exchange a pool of loans for MBS issued and guaranteed by one of the enterprises.

As Government-Sponsored Enterprises (GSEs), Fannie Mae and Freddie Mac have a unique status among private financial institutions. They are publicly held companies but were granted certain privileges to facilitate their chartered mission, including exemption from most state and local taxes and registration requirements with the Securities and Exchange Commission (SEC). Also, their debt and MBS may be held without limit by federally chartered depository institutions.

Regulatory oversight of Fannie Mae and Freddie Mac is shared among multiple agencies across the Government. The Office of Federal Housing Enterprise Oversight (OFHEO), an independent agency in the Department of Housing and Urban Development (HUD), is the primary safety and soundness regulator of Fannie Mae and Freddie Mac. HUD is responsible for the establishment and enforcement of affordable housing goals for the enterprises, ensuring their compliance with fair housing laws and their charters, and reviewing new activities and programs in consultation with OFHEO. The Treasury Department has discretionary authority to approve or disapprove the issuance of the GSEs' debt, and the SEC now regulates Fannie Mae under the Securities Exchange Act of 1934. Freddie Mac has not yet registered under the 1934 Act, but has publicly committed to do so when able.

The Federal Home Loan Bank System (FHLBS) was established by Congress to provide liquidity to home mortgage lenders who are members of the individual Banks. The System comprises 12 separate, regional Federal Home Loan Banks (FHLBs, or Banks), each of which is a member-owned cooperative. The Banks issue debt for which the Banks are jointly and severally liable, and use the proceeds principally to make advances (secured loans) to their members. Member institutions primarily secure advances with residential mortgages and other housing-related assets. Like Fannie Mae and Freddie Mac, the Banks have been granted special privileges as part of their Government charter, including exemption of their corporate earnings from Federal income tax and from State and local taxes. In addition, the Secretary of the Treasury has authority to purchase up to $4 billion of these entities' debt securities. In recent years, some FHLBs have begun to purchase mortgages from their members. At the end of 2003, the 12 FHLBs held about $115 billion of mortgages, equivalent to 7 percent of the combined total of $1.5 trillion held by Fannie Mae and Freddie Mac. In addition, as of 2003, the FHLBs held about $774 billion in debt, while Fannie Mae held $976 billion, and Freddie Mac held $757 billion.

The Federal Housing Finance Board (FHFB) regulates the mission and the safety and soundness of the FHLBs. As it does with respect to Fannie Mae and Freddie Mac, the Treasury Department has discretionary authority over the issuance of FHLB debt. The FHFB recently required that the FHLBs register with the SEC, and registration is expected for most if not all of the FHLBs later this year.

GSE Borrowing Advantage

Their unique status enables all three housing GSEs to borrow at rates lower than investors would ordinarily accept, theoretically to pay higher prices to originating lenders for mortgages, and in the case of the FHLBs to make low-cost advances to member institutions. Although the prospectus for each GSE security clearly states that it is not backed by the U.S. Government, the misperception exists among many investors that the Government backs the GSEs. In 2004 the Congressional Budget Office estimated the implicit Federal subsidy to the three housing GSEs was $23 billion during the previous year. A Federal Reserve study suggests that over one-half of the implicit subsidy to Fannie Mae and Freddie Mac accrues to the GSEs' shareholders.

Risk

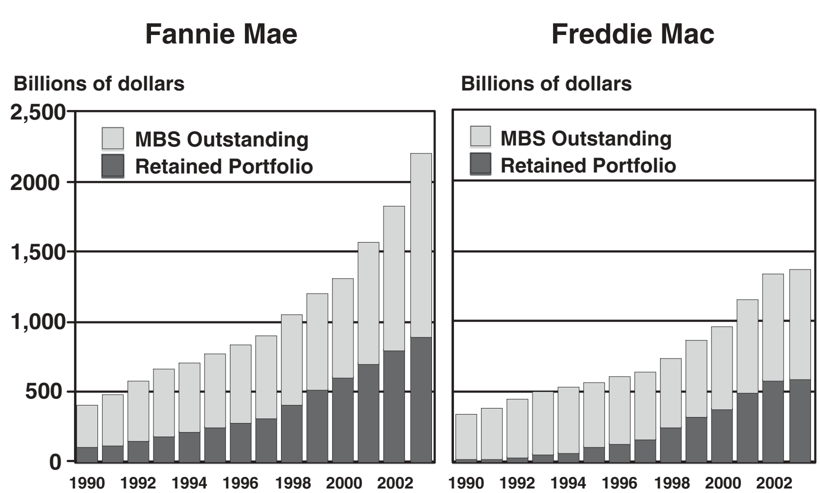
As with all financial institutions, risk is inherent in the way the housing GSEs conduct their business. By assuming and managing some of the risks arising from mortgage lending, the GSEs generate some benefits for consumers and significant profits for their owners. However, the mix of benefits and risks varies depending on how the GSEs conduct their businesses.

Credit Risk. By issuing and guaranteeing securities based on pools of mortgages they purchase from lenders, Fannie Mae and Freddie Mac assume some portion of credit risk, which enhances liquidity to the mortgage market and thereby reduces the cost of credit to borrowers. Fannie Mae and Freddie Mac control their credit risk by using underwriting standards to evaluate the mortgages they purchase for securitization. Their risk is further limited by statutory provisions that require private mortgage insurance or equivalent protection on high loan-to-value ratio mortgages. Credit losses for the enterprises, as a percentage of the face value of mortgages they purchased, averaged 5.4 basis points for a fifteen-year period ending in 2002 and have been declining. Viewed in isolation, Fannie Mae and Freddie Mac's assumption of credit risk arising from guarantees of MBS held by other investors benefits the market and homebuyers while incurring a risk that is easily managed and well-understood.

Interest Rate Risk. A more challenging form of risk arises from the effect that interest rate movements can have on portfolios of mortgages and mortgage-backed securities. Interest rate risk arises from the changing market values of the GSEs' interest-sensitive assets and liabilities. Interest rate movements can cause the interest margins between their mortgage and other assets and their liabilities to grow or shrink, potentially changing the mark-to-market value of their equity capital and estimated future earnings dramatically in a short period. Historically, the FHLBs assumed interest rate risk by issuing debt and using the proceeds to make loans, often of comparable maturities, to member institutions to support their mortgage lending and other investments; this risk is somewhat mitigated since they often require prepayment penalties on advances to member institutions. Much more recently, however, some of the Banks have created mortgage purchase programs that assume interest rate risk for pools of mortgages.

Fannie Mae, and more recently Freddie Mac, have built large portfolios of mortgages and repurchased MBS. However, by choosing to borrow substantially in order to build large retained portfolios of mortgages and mortgage-backed securities, they assume a different, more challenging set of risks and increase the complexity of their operations. Their ability to repurchase large volumes of their own MBS is driven by their ability to finance these mortgages with lower-cost debt than other investors, thanks to market misperceptions of a unique status for the enterprises that allow them to borrow at lower rates. Federal Reserve economists have found no evidence that these repurchases provide any additional benefit to borrowers. They clearly provide an opportunity for the GSEs to increase their earnings, however.

Chart 7-1. Total Mortgages, 1990-2003



At the end of 2003, Fannie Mae's retained portfolio as a percentage of its MBS outstanding (held by others) was 69.4 percent, or almost $900 billion; Freddie Mac's retained portfolio as a percentage of MBS outstanding was 78.1 percent, or over $600 billion. In periods of declining interest rates, mortgage refinancings increase, so higher-yielding mortgages prepay, exposing holders of these mortgages or securities based on them to the risk of having to reinvest these funds at lower rates. As Federal Reserve Chairman Greenspan has noted, Fannie Mae and Freddie Mac have chosen not to offset the interest rate risk arising from their portfolio operations by increasing capital but to attempt to manage that risk by issuing callable debt and by purchasing derivative financial instruments, such as interest rate swaps and options on swaps. For example, they might hedge fixed-rate mortgages, which drop in value when interest rates increase, using derivative instruments that increase in value under the same scenario. The techniques necessary to manage interest rate risk and its potential effect on earnings are complex, and their management becomes increasingly difficult with increases in the size and complexity of the portfolio to be managed. Chairman Greenspan has also noted that the sophistication of the operations required to hedge prepayment risk with little capital places an enormous burden on these institutions.

Like other financial institutions, the housing GSEs attempt to limit their interest rate exposure and the effect of interest rate movements on their earnings. Chairman Greenspan has suggested statutory limits on the dollar amount of the debt held by Fannie Mae and Freddie Mac relative to the dollar amounts of mortgages securitized and held by other investors, and limiting the ability of the FHLBs to hold mortgages and mortgage-backed securities directly, as additional ways to manage the interest rate risk of the GSEs.

Operations risk. Recent events reinforced concerns over the risks posed by the GSEs and their existing regulatory framework. These events have illustrated how the burden of managing interest rate risk mixed with management deficiencies can lead to operational failings. In 2003, Freddie Mac reported that it had understated its earnings by $5 billion over three years, and eventually acknowledged substantial issues with accounting, management practices, and internal controls. OFHEO subsequently assessed substantial financial penalties on the company, and its senior management was replaced. A year-long investigation into the accounting, internal controls, and management practices at Fannie Mae by OFHEO led to findings of inappropriate accounting procedures and practices, internal control deficiencies, and questionable management oversight. The SEC concurred in the finding of inappropriate accounting practices and directed that Fannie restate its earnings for 2001–2004. These findings led Fannie Mae to replace its Chairman and CEO, and its CFO. The Enterprise estimated it would be forced to recognize $9 billion in losses, reducing its capital below the regulatory minimum requirement. During the same period, two of the twelve FHLBs entered into written agreements with FHFB that required review of operational practices and controls, announcing that their accounting practices needed revision and, in one instance, that earnings required restatement.

These developments now reveal some of the ways that the assumption of large-scale interest rate risk complicates the operational challenges facing the GSEs. The techniques necessary to manage interest rate risk and its potential effect on earnings are complex, and their management becomes increasingly difficult with increases in the size and complexity of the portfolio to be managed. While other large financial institutions may face similar challenges, the management of interest rate risk and operations risk is a particular challenge for the GSEs, given their size, regulatory structure, and the lack of full market discipline.

The rules governing accounting for derivatives likewise are complex. Interpreting and applying the accounting rules have posed challenges to companies that use derivatives. Out of concern that firms were using inconsistent methods to account for the use of derivatives to hedge interest rate risk and the potential that their use could obscure a company's true position or misrepresent earnings, in 1998 the Financial Accounting Standards Board (FASB) promulgated the rule known as FAS 133; it became effective in 2000. In part, this rule requires companies, with narrow exceptions, to reflect on their balance sheets the amount that derivatives rise or fall in value, even if derivatives contracts are still open and gains or losses are not yet locked in.

In 2004, OFHEO found, and the SEC concurred, that Fannie did not adequately document its hedges and routinely violated FAS 133 in a number of ways. For example, Fannie Mae, in its treatment of hedges when it changed financial strategies and, with no new testing or proof of effectiveness, took derivatives that were initially paired with one liability, and paired them with another. The SEC also found that Fannie Mae failed to comply in material respects with FAS 133. At OFHEO's behest, Fannie Mae agreed to cease all hedge accounting that did not conform with FAS 133 by the first quarter of CY 2005, and to ensure going forward that all hedge accounting complies with this requirement. Fannie Mae has already stated that this correction will reduce its capital and its earnings by $9 billion from 2001 through mid-2004. This leaves Fannie Mae below the minimum regulatory capital requirement and subjects it to further regulatory actions. This follows upon the events of 2003, when Freddie Mac discovered substantial accounting and internal control issues, including issues with the application of FAS 133, leading to replacement of senior management and restatement of its financial statements over the 2000–2003 timeframe. The SEC and the Department of Justice have continued to investigate both Fannie Mae and Freddie Mac.

During the same period, the FHFB announced a written agreement with the FHLB of Chicago which resulted in a review of the Bank's accounting practices, changes to certain accounting methods under FAS 133, and subsequently, a delay in the Bank's issuance of its third quarter 2004 financial statements.

The failure of Fannie Mae and Freddie Mac and, to a lesser extent, the FHLBs to account for the use of derivatives and hedges consistent with Generally Accepted Accounting Principles (GAAP) prompted their regulators to investigate for the presence of control deficiencies and weaknesses in corporate governance, which they have identified. Fannie Mae and Freddie Mac were cited within a nine-month period for serious and systemic operational control deficiencies that contributed in part to the need for massive earnings restatements. The cited deficiencies included management cultures that stressed earnings stability at the expense of other considerations, ineffective processes for developing accounting policies, and absence of independent internal controls for review of certain transactions. These developments highlight the risks inherent in the GSEs' operations, risks that because of their size and relationships with other institutions could have far-reaching effects should one of them falter.

Systemic Risk. The risks undertaken by the GSEs, if not properly managed, may pose a threat to their solvency. Under some circumstances, they also may threaten the stability or solvency of other financial institutions and the economy. Current Federal law explicitly exempts the securities of the GSEs from the statutory limitation on commercial banks' investment in the "investment securities" of individual firms. In a February 2003 study conducted by OFHEO utilizing FDIC data, over 2,000 commercial banks held at least 51 percent of their capital in the form of debt issued by Fannie Mae; and almost 1,000 commercial banks held at least 51 percent of their capital in the form of debt issued by Freddie Mac.

Should a financial crisis affecting the GSEs and other financial actors develop, the market's misperception of Government backing of GSE securities could affect its course and resolution. A September 2004 Federal Reserve Bank of Atlanta study indicated concern that severe stress to one of the GSEs might contribute to weakness in other financial institutions that hold significant GSE obligations, especially if the path to resolution of the crisis and the potential for Government intervention are misunderstood.

The potential for systemic risk arising from the GSEs' size and their central role in mortgage markets combined with the difficulty of managing the risks inherent in a large mortgage portfolio raise fundamental questions about the value they add through their support for mortgage lending and reduced costs to borrowers relative to the risks their current operations pose. Some research by Federal Reserve economists suggests that GSE securitization activities have a relatively small effect on mortgage interest rates—just a few dollars a month on an average mortgage—and that their practice of holding mortgages in portfolio has almost no effect on mortgage costs. Instead of being leaders in increasing historically underserved groups' access to credit, the GSEs have actually trailed the market averages in a number of dimensions. The Administration has sought to narrow the gap by lessening the risks posed by the GSEs and increasing the benefits they offer to the public.

Enhancing Safety and Soundness

Events of the past year reinforced concerns over the risks posed by the GSEs and highlighted the need for meaningful GSE reform. A strengthened regulator would have the in-house expertise to monitor accounting methodology and to detect any problems, as well as the authority and expertise to monitor regulatory standards for the development and implementation of systems and controls. A strong regulator would also hold the authority to place a failing entity into receivership similar to that held by the other financial safety and soundness regulators.

The Administration intends that any proposed new regulatory framework for the GSEs follows the principles for regulation of financial institutions established by the international Basel Committee, principles accepted throughout the world as requirements for first-class regulation. As described in the President's FY 2005 Budget, these principles involve increasing market discipline, strengthening supervision, and ensuring appropriate capital requirements.

Market Discipline. Chief among the factors that guide a company in its decision-making is the discipline imposed by the market. Investors can discipline the GSEs to the extent that they have adequate information about their risks and financial condition. Current market discipline is hindered by a misperception that the Federal Government would back GSE securities in the event of a GSE default, and because GSE investors do not enjoy the same level of disclosure, or oversight of disclosures, as investors in other public companies. Ironically, at the times when investors would most benefit from detailed information about the enterprises' finances, they are left without adequate information for months or years.

The Administration in 2002 called upon the three housing GSEs to register voluntarily their equity securities under the 1934 Securities Exchange Act. In June 2004, the FHFB adopted a final rule that will require each FHLB to register a class of its stock by June 30, 2005, leading to improved disclosures. Fannie Mae voluntarily registered and began filing disclosures with the SEC in 2003. However, because of its recent accounting problems, Fannie Mae is no longer able to provide these disclosures. Freddie Mac does not anticipate being in compliance with SEC standards before the second quarter of 2006. Since the GSEs are not subject to the same market discipline as other public companies, market discipline by itself is not always sufficient to ensure safety and soundness.

Supervision. An effective financial regulator must possess authorities commensurate with its responsibilities and capabilities. The Administration determined that the safety and soundness regulators of the housing GSEs lack sufficient powers and stature to meet their responsibilities. The President's 2005 Budget reflected, therefore, that both OFHEO, regulator of Fannie Mae and Freddie Mac, and the FHFB, regulator of the FHLBS, should be replaced with a new, consolidated regulatory regime, empowered with expanded enforcement authority, receivership authority, and access to its funding independent of the annual appropriations process.

A new regulator, like other Federal regulators of financial institutions, 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. It would have authority to review their ongoing business activities and reject new ones if they would be inconsistent with their charter or prudential operations or incompatible with the public interest. HUD would continue to be consulted on new activities in order to ensure that the GSEs are in compliance with their charters and that the GSEs carry out their public mission.

Currently, the means by which the failure of a GSE could be resolved differs between Fannie Mae and Freddie Mac, on the one hand, and the FHLBs, on the other. In the case of a failed FHLB, the FHFB has power to liquidate such institution, subject to certain limitations relating to the whole number of Banks in the system. OFHEO, on the other hand, lacks the power to place an entity into bankruptcy or receivership.

The Federal banking regulators have broad powers to place a failed institution into receivership, and to conduct the orderly wind-down of a failed bank in such a way that systemic disruption is minimized. Giving such uniform powers to a Federal regulator of GSEs could likewise help prevent dislocation in financial markets in the event of the insolvency of such an institution. Further, such powers would address any misperception that the GSEs are backed by the Government. By providing clarity to the markets that the GSEs (and their creditors) are subject to the same business risks as are other corporate entities, an even greater level of market discipline might be brought to bear on the GSEs' operations. In general, this type of market discipline has proven very effective in ensuring that businesses operate in a prudential, and safe and sound manner.

Capital requirements. Because neither investors nor regulators can predict all 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 unknown 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 unambiguous authority to adjust both risk-based and minimum capital requirements.

Affordable Housing Mission

One of the public purposes of the GSEs is to promote access to mortgage credit for low- and moderate income families. By law, HUD establishes annual affordable housing goals for Fannie Mae and Freddie Mac. In 2004, HUD established the affordable housing goals for Fannie Mae and Freddie Mac for 2005 through 2008. The low and moderate income goal will increase from 50 percent (of the minimum share of housing units financed by a GSE's mortgage purchases in a particular year) in 2004 to 56 percent by 2008; the underserved areas goal will increase from 36 percent in 2004 to 39 percent by 2008; and the special affordable housing goal will increase from 20 percent in 2004 to 27 percent by 2008.

The table below shows how Fannie Mae and Freddie Mac have trailed the marketplace in lending to first-time minority homebuyers in the 2001–2003 timeframe. It is likely that, as a result of these new, higher goals, they will need to improve their efforts to reach out to low-income and minority first-time homebuyers.

PERCENTAGE OF FANNIE MAE AND FREDDIE MAC LOANS TO FIRST-TIME MINORITY HOMEBUYERS COMPARED TO THE FULL MARKETPLACE, 2001–2003 AVERAGES [1]

	Fannie Mac	Freddie Mac	Both GSEs	Full Market [2]
All Race/Ethnicity Groups	25.7%	26.1%	25.9%	39.1%
African American and Hispanic	4.7%	3.5%	4.2%	9.0%
All Minorities	7.5%	6.1%	6.9%	12.3%

Source: Department of Housing and Urban Development.

[1] The first-time homebuyer definition for the market analysis is homebuyers who have never owned a home. The definition for the GSEs is purchasers who have not owned a home within the past three years. The percentages show first-time homebuyer mortgages by race/ethnicity category as a share of all home purchase mortgages purchased by the GSE or originated in the market.

[2] "Market" means conventional, conforming home purchase loans.

With their growth as a share of the mortgage marketplace, Fannie Mae and Freddie Mac have faced increased market competition in the acquisition of mortgages and MBS; the increase in affordable housing goals and subgoals may mean that Fannie Mae and Freddie Mac must be more innovative or aggressive in purchasing loans that meet the goals classifications. They can do this in part by using a larger portion of the subsidy they enjoy as a result of their Government ties to support purchases of goals-qualifying loans.

Part of the Administration's proposal for a strengthened regulatory framework would provide HUD with the authority to penalize Fannie Mae and Freedie Mac if they fail to reach the affordable housing goals. Current law does not permit the Secretary of HUD to impose timely and appropriate penalties for a GSE's failure to reach a goal.

The FHLBs address their affordable housing obligations in a different fashion. For instance, by statute, each FHLB is assessed ten percent of its net income for support of affordable housing. This assessment enables each FHLB member to provide subsidized and other low-cost funding to create affordable rental and homeownership opportunities, and support for commercial and economic development activities that benefit low- and moderate-income neighborhoods.

With their large subsidy, and with their substantial market share, the GSEs should lead the market in creating homeownership opportunities for less advantaged Americans. However, 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. One purpose of a stronger regulatory approach is to ensure that all three housing GSEs fulfill their charter obligations.

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), created in 1972 as a GSE to develop the secondary market for guaranteed student loans, has now been privatized.

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 2006, over 9 million borrowers will receive over 15.1 million loans totaling over $95 billion. Of this amount, more than $62 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, 35 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 2006, FFEL lenders will make over 11.5 million loans totaling over $72 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 2006, the Direct Loan program will generate almost 3.6 million loans with a total value of nearly $23 billion, including over $7 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 Administration is strongly committed to the lender-based FFEL program and expects it to continue as the primary source of loans to students in the years ahead. In addition, the Administration will continue to maintain a DL program to ensure that no eligible student is denied access to student loans in the event a student or school cannot find a suitable lender.

However, problems in the structures of the current student loan programs prevent them from meeting current policy and program objectives. Specifically, the Federal Government assumes almost all of the risk for the loans, while federal subsidies to intermediaries lenders and guaranty agencies are set high enough to allow the less efficient ones to generate a profit. These problems lead to unnecessary costs for taxpayers and prevent the program from achieving the efficiencies the market is designed to provide.

The 2006 Budget proposes a package of reforms to both the FFEL and DL loan programs to achieve significant cost savings and improve effectiveness. These reforms will link subsidy payments for lenders and guaranty agencies more closely to their costs and will modify interest rates for borrowers who are no longer in school and have just consolidated their loans. The Budget achieves $34 billion in savings over ten years by cutting unnecessary subsidies and payments to lenders, state guaranty agencies, and loan consolidators, and by placing a larger share of the loan risks on lenders. These savings will be used to increase the Pell Grant maximum award, pay off the current $4 billion Pell shortfall, and improve benefits to students in school by increasing loan limits for first year students and extending the current favorable interest rate framework.

Sallie Mae

The Student Loan Marketing Association (Sallie Mae) was created as a shareholder-owned government sponsored enterprise (GSE) by the Education Amendments of 1972 to expand funds available for student loans by providing liquidity to lenders engaged in the Federal Family Education Loan Program (FFELP), formerly the guaranteed student loan program (GSLP). Sallie Mae was reorganized in 1997 pursuant to the authority granted by the Student Loan Marketing Association Reorganization Act of 1996. Under the Reorganization Act, the GSE became a wholly owned subsidiary of SLM Corporation and was required to be wound down and liquidated by January 30, 2008. On June 30, 2004, the SLM Corporation first purchased FFELP student loans through non-GSE affiliates and, as a result, the GSE was required by statute to terminate purchases of FFELP student loans. Accordingly, the GSE is no longer a source of liquidity for SLM Corporation for the purchase of student loans, and the GSE-related financing activities have primarily been limited to refinancing the remainder of its assets through non-GSE sources. As of September 2004, the Company had substantially completed the wind-down of the GSE and, on November 1, 2004, SLM Corporation sent notices to the Secretary of Education and the Secretary of the Treasury that it intended to wind-down and dissolve the GSE on December 31, 2004 or as soon as practicable thereafter, three years in advance of the statutory deadline. The dissolution was completed on December 29, 2004.

All GSE debt that remains outstanding upon completion of these wind-down activities will be defeased through the creation of a fully collateralized trust. The collateral, consisting of cash and financial instruments backed by the full faith and credit of the U.S. government, will generate cash flows that provide for the interest and principal obligations of the defeased debt.

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) 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 2006 Budget requests $307 million, including administrative funds, for SBA to leverage more than $25 billion in financing for small businesses and disaster victims. The 7(a) General Business Loan program will support $16.5 billion in guaranteed loans while the 504 Certified Development Company program will support $5.5 billion in guaranteed loans. SBA will supplement the capital of Small Business Investment Companies (SBICs) with $3 billion in long-term loans for venture capital investments in small businesses.

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 2004, while the number of small businesses served has grown from 43,748 to 81,133 during the same time period.

2) Improving program and risk management

Improving management by measuring and mitigating risks in SBA's $57 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 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 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 estimate more accurately the cost of subsidizing small businesses. During 2003 and 2004, SBA followed through on its commitment to improve its accuracy in estimating the cost of its major credit programs by developing loan-level credit and reestimate models for the Section 504, Disaster, 7(a), and Secondary Market Guarantee programs. The 2006 Budget reflects net upward reestimates of the lifetime expected taxpayer costs for outstanding loans—of $408 million for the 7(a) program, $123 million for the Section 504 program, $267 million for Disaster Loans, and $922 million for SBIC Participating Securities. A net downward reestimate of $60 million is also reflected for the SBIC Debentures program. The 2006 upward trend in reestimates generally reflects technical corrections to credit subsidy models (e.g., the 7(a) subsidy model failed to account for purchased interest on defaulted loans), higher interest rates and the agency's shift from the traditional approach (based on historical account activity) to the balances approach for performing reestimates. In adopting the balances approach, SBA uncovered that its historical records did not reconcile to the credit programs' asset and liability balances currently recorded with Treasury. SBA is working to improve its financial record keeping to mitigate future accounting discrepancies.

Total budgetary cost increases over the past 3 years totaled $4.0 billion ($3.1 billion in reestimates and $0.9 billion for interest on the reestimates) for existing SBA-guaranteed loans and $1.7 billion ($1.1 billion for reestimates and the remainder for interest on reestimates) for existing direct loans. While most of these budgetary cost increases related to the weak performance of the SBIC Participating Securities program and Disaster Loan asset sales, the agency's two largest business programs also generated significant budgetary cost increases for taxpayers. Over the three-year period, the net budgetary cost increase was $636 million for outstanding 7(a) guarantees ($330 million in reestimates) and $180 million ($87 million in reestimates) for outstanding Section 504 guarantees.

The 2006 Budget supports $3 billion in guaranteed venture capital investments for small businesses through the SBIC Debentures program, which provides credit financing to small business investment companies. However, the 2006 budget does not support new guaranteed investments for the Participating Securities program. Over ten years of operations, the Participating Securities program has realized and projected losses of approximately $2.2 billion out of $6.2 billion in disbursements. These losses reflect a structurally flawed program in which the Federal Government contributes up to two-thirds of investment capital but only receives up to ten percent of profits. Further, as the Program Assessment Rating Tool (PART) analysis revealed, SBICs do not have incentives to repay capital expeditiously, extending the Government's risk exposure. Rather than make new investments through this program, SBA will continue to improve efforts to monitor and mitigate risk in approximately $9 billion in commitments in the program's portfolio. The program had already ceased making new guaranteed investments on October 1, 2004 because sufficient borrower fees to cover the program's costs were not enacted.

3) Operating more efficiently

To operate more efficiently, SBA is piloting an automated loan origination system for the Disaster Loan program. 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 2004, SBA implemented new procedures for Section 504 loan processing. Results have been positive with the average loan processing time reduced from four weeks to only a few days. In 2005, SBA will streamline its 7(a) loan origination functions. Similarly, SBA is also centralizing its 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 2006 President's Budget is $1.5 billion. These funds are available to communities of 10,000 or fewer 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 percent of the project cost (it can be up to 75 percent). 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 2006. USDA also provides grants, direct loans, and loan guarantees to assist rural businesses, including cooperatives, to increase employment and diversify the rural economy. In 2006, USDA proposes to provide $899 million in loan guarantees to rural businesses (these loans serve communities of 50,000 or less).

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 2006, USDA expects to retain or create over 74,784 jobs through its business programs, which will be achieved primarily through the Business and Industry guarantee and the IRP loan programs.

Electric and Telecommunications Loans

USDA's Rural Utilities Service (RUS) programs provide loans for rural electrification, telecommunications, distance learning, telemedicine, and broadband, and also provide grants for distance learning and telemedicine. See the Budget Appendix for more information on these programs.

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 is reviewing 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, USDA will require recertification of rural status for each electric and telecommunications borrower on the first loan request received in or after FY 2006 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.

The Budget includes $2.5 billion in direct electric loans, $670 million in direct telecommunications loans, $359 million in broadband loans and $25 million in DLT grants. The budget proposes blocking the mandatory broadband funding and providing discretionary funding. 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. RUS electric borrowers are expected to upgrade 225 rural electric systems, which will benefit over 3.4 million customers. The telecommunications 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. DLT grants are expected to support the provision of distance learning facilities to 150 schools, libraries, and rural education centers and also to provide telemedicine equipment to 150 rural health care providers, benefiting millions of residents in rural America.

The Administration proposes to establish the process and terms to implement a dissolution of the Rural Telephone Bank (RTB). Dissolution will allow the RTB to close as the demand for loans has been fulfilled through other sources. In addition, the stock holders will obtain a cash payout for their stock while removing this cumbersome program from the Government. This proposal avoids the privatization of a bank that will either fail or need continued Government support to remain in operation.

Loans to Farmers

The Farm Service Agency (FSA) assists low-income family farmers in starting and maintaining viable farming operations. Emphasis is placed on 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 to 3.6 percent in 2004, compared to 4.7 percent in 2003. 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 0.69 percent in 2004, as compared to 0.71 percent in 2003. 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.

In 2004, FSA provided loans and loan guarantees to approximately 26,000 family farmers totaling $3.1 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. The demand for FSA direct and guaranteed loans continues to be high due to crop/livestock price decreases and some regional production problems. In 2006, USDA's FSA proposes to make $3.8 billion in direct and guaranteed loans through discretionary programs.

A PART evaluation conducted in 2004 showed that the FSA's direct loan program functions well in general. To improve program effectiveness further, FSA is 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 results of this review will assist FSA in improving the delivery of its services and the economic viability of farmers and ranchers.

The Farm Credit System and Farmer Mac

The Farm Credit System (FCS or System) and the Federal Agricultural Mortgage Corporation (FarmerMac) 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, related businesses, and rural homeowners, while Farmer Mac provides a secondary market for agricultural real estate and rural housing mortgages.

The Farm Credit System

During 2004, the financial condition of the System's banks and associations continued a 15-year trend of improving financial health and performance. As of September 30, 2004, capital increased 11.1 percent for the year and stood at $18.0 billion. These capital numbers exclude $2.1 billion of restricted capital held by the Farm Credit System Insurance Corporation (FCSIC). Loan volume has increased since 1989 to $94.9 billion in September 2004. The rate of asset growth for the preceding three-year period (2001-2003) has been averaging 7.4 percent. However, the rate of capital accumulation has been greater, resulting in total capital (including restricted capital) equaling 16.2 percent of total assets at year-end 2003, compared to 15.3 percent at year-end 2000. Nonperforming loans decreased significantly to 0.88 percent of total loans in September 2004, compared to 1.38 percent in September 2003. Competitive pressures, higher balances of lower yielding investments, and a low interest rate environment have narrowed the FCS's year-to-date net interest margin to 2.52 percent for September 2004 from 2.62 percent in 2003. The current interest rate environment and strong competition in the lending markets are likely to continue placing pressure on the net interest margin. Consolidation continues to affect the structure of the FCS. In January 1995, there were nine banks and 232 associations; by September 2004, there were five banks and 97 associations.

The FCSIC ensures the timely payment of principal and interest on FCS obligations. FCSIC manages the Insurance Fund which supplements the System's capital and supports the joint and several liability of the System banks. On September 30, 2004 the Insurance Fund's net assets totaled $1.9 billion, of which $40 million was allocated to the Allocated Insurance Reserve Accounts (AIRAs) held for the System banks and the Financial Assistance Corporation's stockholders. Not including the AIRAs, the Insurance Fund was at 2.01 percent of adjusted insured debt obligations of the System banks, slightly above the statutory minimum of 2 percent.

Improvement in the FCS's financial condition is also reflected in the examinations by the Farm Credit Administration (FCA), its 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, no institutions were rated 5, and 26 institutions were under enforcement action. In September 2004, all 102 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 $3.6 billion, or 3.9 percent, while over the past five years they have grown $25.2 billion, or 36.2 percent. The volume of lending secured by farmland increased 51.5 percent, while farm-operating loans have increased 34.7 percent since 1999. Agricultural producers represented the largest borrower group, with $76.9 billion including loans to rural homeowners and leases, or 81.1 percent of the dollar amount of loans outstanding. International loans (export financing) represent 3.0 percent of the System's loan portfolio. Loans to young, beginning, and small farmers and ranchers represented 12.9, 18.7, and 31.8 percent, respectively, of the total dollar volume outstanding in 2003, which is slightly higher than in 2002. 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 a variety of risks, including concentration risk, possible changes to government programs, the volatility of agricultural exports and commodity prices, animal and plant diseases, and concerns about future off-farm employment prospects, given the trends in job outsourcing and global competition.

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 core capital and regulatory risk-based capital requirements. Farmer Mac's total program activity (loans purchased and guaranteed, and AgVantage bonds purchased) as of September 30, 2004, totaled $5.5 billion. That volume represents 1.8 percent reduction from program activity at September 30, 2003. Of total program activity, $2.2 billion were on-balance sheet loans and agricultural mortgage-backed securities and $3.3 billion were off-balance sheet obligations. Total assets were $3.8 billion at the close of the calendar third quarter, with non-program investments accounting for $1.4 billion of those assets. Farmer Mac's net income to common stockholders for the first three quarters of 2004 was $18.4 million, a decrease of $1.74 million, or 8.7 percent from the same period in 2003.

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 without the lending. 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 (BIS) 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 2006, 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 provide generally higher lending levels using lower appropriations in 2006.

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.

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 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 $3.6 trillion of deposits at 7,660 commercial banks and 1,365 savings institutions. NCUA insures about 9,113 credit unions with $495 billion in insured shares.

Current Industry and Insurance Fund Conditions

The bank industry continues to earn record profits. In the quarter ending September 30, 2004, banks reported record-high earnings for the sixth time in the last seven quarters. In fiscal year 2004, industry net income totaled $122 billion, an increase of 7 percent over fiscal year 2003. The quality of loans continues to improve as net charge-offs fell to a four-year low. Despite the improving trends, some risks remain. Rising interest rates, for example, might cause stresses in certain real-estate markets and strains on banks in some regions.

Only four BIF members and one SAIF member with a combined $175 million dollars in assets failed during fiscal year 2004. In comparison, in the last five years, assets associated with BIF failures have averaged $857 million per year, while failures associated with SAIF averaged $455 million. At the height of the banking crisis in 1989, failed assets rose to over $150 billion in one year. The FDIC currently classifies 95 institutions with $25 billion in assets as "problem institutions," compared to 116 institutions with $30 billion in assets a year ago.

In fiscal year 2004, the reserve ratio (ratio of insurance reserves to insured deposits) of BIF stayed above the 1.25-percent statutory target. As of September 30, 2004, BIF had estimated reserves of $34 billion, or 1.32 percent of insured deposits. Factors that helped BIF stay above the statutory target in fiscal year 2004 include fewer bank failures, slow growth of insured deposits, and increases in unrealized gains on securities available for sale. The SAIF reserve ratio also remained above the designated reserve ratio throughout the year.

As of September 30, 2004, SAIF had reserves of $12.5 billion, or 1.33 percent of insured deposits. Through June 30, 2005, 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 2004.

During 2004, 22 Federally insured credit unions with $120 million in assets failed (including assisted mergers). In comparison, in 2003, 8 Federally insured credit unions with $25 million in assets failed. The National Credit Union Share Insurance Fund (NCUSIF) ended fiscal year 2004 with assets of $6.3 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 2004 because the ratio stayed above 1.25 percent. As the Fund's equity ratio did not exceed 1.30 percent, NCUA did not provide a dividend to credit unions in fiscal year 2004.

The Federal banking regulators (the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Reserve) are planning a rulemaking that would implement the new Basel Capital Accord (Basel II). The original Basel Capital Accord is an international agreement establishing a uniform capital standard across nations. It adopted a risk-based capital requirement that applies differing risk weights to a few broad categories of assets. Basel II proposes several ways to improve the risk-based capital requirement, including refining risk categories and applying sophisticated models calculating the risk of various assets. U.S. regulators are considering implementing the model-based capital requirement for the largest banks (about 20) that have complex financial structures and expertise to apply sophisticated models. The new capital requirement would be a major change because those banks hold the overwhelming majority of U.S. banking assets.

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 Congress a proposal that would accomplish this objective. Specifically, the proposal would merge the BIF and the SAIF. A single merged fund would be stronger and better diversified than either fund alone and would prevent the possibility that institutions posing similar risks would again 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 1.25 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 reduce potential pro-cyclical effects by stabilizing industry costs over time and avoiding sharp premium increases when the economy may 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 increase their insured deposits rapidly 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 reduce losses in the event the plan terminates.

PBGC's single-employer program suffered record annual losses from underfunded plan terminations in 2001 through 2004. As a result of these record losses, the program's deficit at FY 2004 year-end stood at \$23.3 billion, compared to \$11.2 billion a year earlier and a \$9.7 billion surplus at FY 2000 year-end. Large underfunded terminations include: in FY 2002, LTV, a steel company, with a claim of nearly \$2 billion, which was PBGC's largest to date; in FY 2003, Bethlehem Steel, with a claim of about \$3.6 billion, National Steel, and US Airways' Pilots Plan; and in FY 2004, Kaiser Aluminum's Salaried Plan, Pillowtex, and Weirton Steel. More important in FY 2004 than claims for completed terminations was the increase in claims for "probable" terminations to \$16.9 billion from \$5.2 billion in FY 2003.

Additional risk and exposure may remain for the future because of economic uncertainties and significant underfunding in single-employer pension plans, which exceed an estimated \$450 billion at fiscal year-end, compared to \$350 billion at the end of FY 2003 and \$50 billion at the end of December 2000. PBGC's exposure to "reasonably possible" terminations, the amount of unfunded vested benefits in pension plans sponsored by companies at greater risk of default, stood at \$96 billion at the end of December 2003, up from \$82 billion a year earlier.

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. The deficit fell to \$236 million in 2004. However, estimated underfunding in multiemployer plans approximated \$150 billion at year-end, up from over \$100 billion at the end of FY 2003.

With assets of \$39 billion, the agency can meet its obligations for a number of years into the future, but, with \$62 billion of liabilities in the single-employer program, it is clear that the financial integrity of the federal pension insurance program is at risk.

Looking to the long term, to avoid benefit reductions, strengthen PBGC, and help stabilize the defined-benefit pension system, the 2006 Budget proposes legislative reforms to:

- Require employers to fully fund their plans by making up their funding shortfall over a reasonable period of time and give companies added flexibility to contribute more in good economic times.
- Require that funding be based on a more accurate measure of liabilities and establish appropriate funding targets based on a plan's risk of termination.
- Update the variable-rate premium to reflect the new funding targets and provide for the PBGC Board to reexamine it periodically to cover the cost of expected claims and to improve PBGC's financial position; and adjust the flat-rate premium to reflect the growth in worker wages.
- Require employers to forego benefit increases if the sponsor is financially weak or has a significantly underfunded pension plan.
- Require plans to provide timely information on the true financial health of pension plans to workers and make such information publicly available to other stakeholders.

The Administration's comprehensive reforms will strengthen funding for workers' defined-benefit pensions; provide more accurate information about pension liabilities and plan underfunding; and ensure PBGC's continued ability to safeguard pension benefits for 44 million Americans.

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 4.9 million policies from more than 19,000 communities with \$828 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 85,000 policies in 2004, bringing the policy total to 4.5 million. 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 that are located in flood plains and have 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. The Flood Insurance Reform Act of 2004 defines the criteria that qualify these repetitively-damaged properties for special mitigation. The legislation also extended the NFIP's authority through September 30, 2008. 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 is in the process of evaluating 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, 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 on reinsurance provided by the Federal Government and also by the commercial reinsurance market to manage their individual risk portfolio. The Federal Government 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. The Agricultural Risk Protection Act of 2000 (ARPA) increased premium subsidy levels to encourage farmers to purchase higher and more effective levels of coverage.

RMA renegotiated the Standard Reinsurance Agreement (SRA) in 2004. The SRA contains the operational and financial risk sharing terms between the Federal Government and the private companies. The ARPA allowed these terms to be renegotiated once between the 2001 and 2005 reinsurance years. RMA utilized this opportunity to strengthen the document to address such issues as company oversight and quality control. As a result of these negotiations, company administrative expense reimbursements were reduced by approximately 3 percent, and a 5 percent net book quota share was introduced to better balance profit potential between the companies and the Federal Government. The new SRA is expected to generate annual program cost savings of approximately $36 million.

In addition to these changes, the 2006 Budget includes a legislative proposal that would require any farmer that receives a Federal commodity payment for his/her crop to buy crop insurance at a minimum coverage level of 50/100. This proposal is intended to ensure farmers have adequate protection in the event of a natural disaster without resorting to ad hoc disaster assistance. Additionally, the Administration's proposal will lower the imputed premium on Catastrophic Crop Insurance (CAT) by 25 percent and charge an administrative fee on CAT equal to the greater of $100 or 25 percent of the (restated) imputed CAT premium, subject to a maximum fee of $5,000. The proposal will also reduce premium subsidies by 5 percentage points on policies with a coverage level of 70 percent or below (75 percent for Group Risk Protection (GRP)) and by 2 percentage point on policies with a coverage level of 75 percent or above (80 percent for GRP). Plus the proposal reduces the A&O reimbursement on all buy-up coverage by 2 percentage points and increases the net book quota share to 22 percent, but provides a ceding commision to the companies of 2 percent. These changes are expected to be in effect in 2007 and will save $140 million a year.

There are various types of insurance programs. The most basic type of coverage is CAT, which compensates the farmer for losses in excess of 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 an 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 CAT coverage level. 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 82 percent of eligible acres participated in one or more crop insurance programs in 2004.

For producers purchasing the additional levels of insurance, there are a wide range of yield- and revenue-based insurance products available through the Federal 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. Revenue products have gained wide acceptance among producers and have played an integral role in providing more effective risk management options for the nation's agricultural producers. In crop year 2004, these revenue products accounted for over 52 percent of all policies earning premium, 59 percent of net insured acres, and 55 percent of total program liability.

USDA also continues to expand coverage. In 2004, a sugar beet stage removal pilot program was introduced. In addition, approval was given to a pilot program of crop insurance for Silage Sorghum in two states and to make Adjusted Gross Revenue-Lite available in five additional states, both effective for the 2005 crop year. USDA also expanded the availability of the Livestock Risk Protection plan of insurance to additional states and for additional types of livestock. Further, RMA has issued 4 contracts for development of new risk management tools for pasture, rangeland and forage. ARPA directed FCIC to establish the development of a pasture, rangeland and forage program as one of its highest research and development priorities. RMA continues to pursue a number of avenues to increase program participation among underserved states and commodities.

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 smooth functioning of our economy that the Federal Government insure against some security-related risks until the private sector learns enough to be comfortable about estimating those risks.

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 established 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 is scheduled to 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 was required to determine whether to extend this requirement into the third and final year of the program. On June 18, 2004, the Secretary of the Treasury announced his decision to extend the "make available" requirement through the third and final year. 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 terrorist attack on private businesses and others covered by this program, insurance companies will cover 100 percent of the insured losses up to each insurance company's deductible as specified in the Act. Insured losses above that amount would then be shared between the insurance company and the Treasury, with Treasury covering 90 percent of the losses above the insurance 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. At that point, the Act explains that Congress will determine the procedures and source of any further payments. The Act also provides authority for the Treasury to recoup Federal payments via surcharges on policyholders. Certain recoupment is mandatory, based on insurance marketplace aggregate annual retention amounts specified in the enabling statute. In other circumstances, the Act authorizes optional recoupment.

Treasury has created a separate Terrorism Risk Insurance Program office to implement the Act, which has included setting up an infrastructure to handle potential claims under the Act. In order to be ready to make payments under the Act, Treasury has: 1) finalized all of the regulations necessary for the submission and payment of potential claims under the Act; 2) contracted with a claims management contractor and an auditor to assist with the processing and verification of potential claims; and 3) established a web-based claims facility. The Act also requires Treasury to conduct a study on the effectiveness of the program and to report the results to the Congress by June 30, 2005. Treasury has been conducting a comprehensive survey of insurers, reinsurers, and policyholders as part of that study.

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. 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. Under Presidential Determination No. 01–29, the President delegated the authority to extend the duration of aviation insurance to the Secretary of Transportation. Starting in 2001, insurance coverage was initially provided in 60-day increments, but Presidential Determination Nos. 2004–9 and 2005–15 subsequently extended the allowable period of insurance up to one year.

The Homeland Security Act of 2002 included airline war risk insurance legislation. This law mandated an extended term for third-party war risk coverage and expanded the scope of coverage to include war risk hull, passenger and 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. The 2003 Department of Defense supplemental appropriation (P.L. 108–11), the Century of Aviation Reauthorization Act (P.L. 108–176, Vision 100), and the Consolidated Appropriations Act of 2005 (P.L. 108–447) ultimately extended the mandatory provision of insurance through August 31, 2005. Consequently, in December 2004, the President issued Presidential Determination 2005–15, authorizing the continued provision of insurance now in force through August 31, 2005, and the DOT issued policies to conform to that date. The basic authority of the insurance program extends through March 30, 2008

Currently 75 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 2004, the fund collected approximately $180 million in premiums for insurance provided by DOT. In 2005, it is anticipated that $109 million in premiums will be collected by DOT for the provision of insurance. At the end of 2004, the balance of the Aviation Insurance Revolving Fund available for future claim payments was $401 million. The Federal Government would pay any claims by the airlines that exceed the balance in the aviation insurance revolving fund.

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 7-2. Face Value of Federal Credit Outstanding

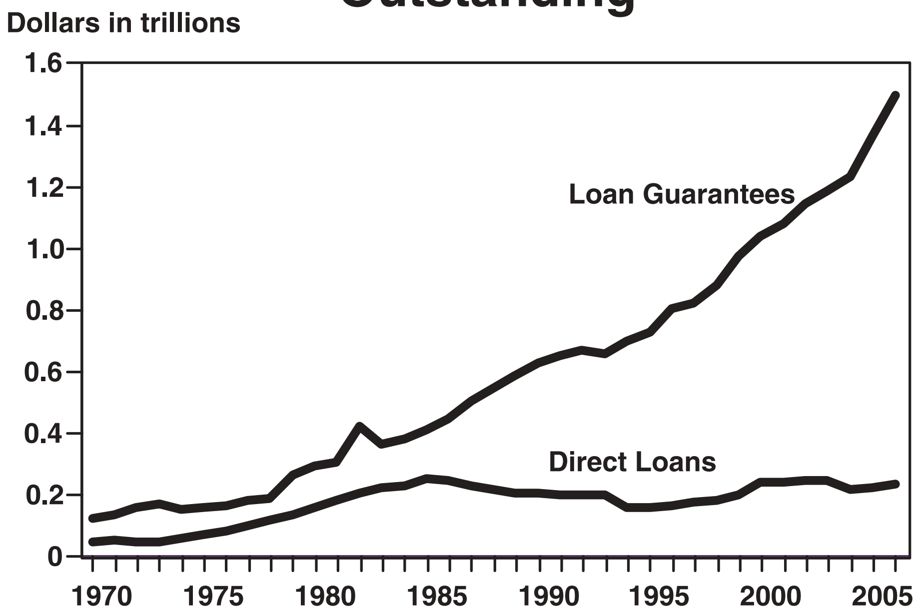


Table 7–1. ESTIMATED FUTURE COST OF OUTSTANDING FEDERAL CREDIT PROGRAMS

(in billions of dollars)

Program	Outstanding 2003	Estimated Future Costs of 2003 Outstanding [1]	Outstanding 2004	Estimated Future Costs of 2004 Outstanding [1]
Direct Loans: [2]				
Federal Student Loan Programs	102	10	107	8
Farm Service Agency (excl. CCC), Rural Development, Rural Housing	44	11	43	10
Rural Utilities Service and Rural Telephone Bank	32	3	32	3
Housing and Urban Development	13	3	13	3
Agency for International Development	9	4	8	3
Public Law 480	11	7	9	5
Export-Import Bank	11	4	11	5
Commodity Credit Corporation	7	3	7	3
Federal Communications Commission	5	1	4	4
Disaster Assistance	3	1	3	1
Other Direct Loan Programs	12	....	13	2
Total Direct Loans	249	47	250	47
Guaranteed Loans: [2]				
FHA Mutual Mortgage Insurance Fund	407	2	384	1
VA Mortgage	323	5	351	4
Federal Family Education Loan Program	213	15	245	23
FHA General/Special Risk Insurance Fund	89	4	91	4
Government National Mortgage Association (GNMA) [3]	....	*	....	*
Small Business	53	2	57	2
Export-Import Bank	34	3	36	2
International Assistance	19	2	21	2
Farm Service Agency and Rural Housing	24	1	24	1
Commodity Credit Corporation	4	*	4	*
Air Transportation Stabilization Program	2	1	2	1
Other Guaranteed Loan Programs	16	1	17	3
Total Guaranteed Loans	1,184	36	1,232	43
Total Federal Credit	**1,907**	**83**	**1,935**	**90**

*$500 million or less.

[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.

[3] GNMA outstandings are excluded from the totals because they are secondary guarantees on loans guaranteed by FHA, VA and RHS.

Table 7–2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992–2004 [1]

(Budget authority and outlays, in millions of dollars)

Program	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
DIRECT LOANS:												
Agriculture:												
Agriculture credit insurance fund	–72	28	2	–31	23		331	–656	921	10	–701	–147
Farm storage facility loans									–1	–7	–8	7
Apple loans									–2	1		*
Emergency boll weevil loan										1	*	
Agricultural conservation	–1											
Distance learning and telemedicine									1	–1	–1	
Rural electrification and telecommunications loans	*	61	–37	84		–39		–17	–42	101	265	
Rural telephone bank [1]	1			10		–9		–1		–3	–7	
Rural housing insurance fund [2]	2	152	46	–73		71		19	–29	–435	–64	
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	–84	–1
P.L. 480			–37	–1				–23	65	–348	33	–43
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												*
Education:												
Federal direct student loan program: [3]												
Volume reestimate						22		–6		43		–14
Other technical reestimate			3	–83	172	–383	–2,158	560		3,678	1,999	683
College housing and academic facilities loans								–1				
Homeland Security:												
Disaster assistance							47	36	–7	–6	*	5
Interior:												
Bureau of Reclamation loans							3	3	–9	–14		–15
Bureau of Indian Affairs direct loans						1	5	–1	–1	2	*	*
Assistance to American Samoa											*	*
State:												
Repatriation Loans												–2
Transportation:												
High priority corridor loans					–3							
Alameda corridor loan							–58				–12	
Transportation infrastructure finance and innovation										–4		3
Railroad rehabilitation and improvement program											–5	–9
Treasury:												
Community development financial institutions fund							1			*	–1	*
Veterans Affairs:												
Veterans housing benefit program fund	–39	30	76	–72	465	–111	–52	–107	–697	17	–178	986
Native American veteran housing										–3	*	*
Vocational Rehabilitation Loans										*	*	*
Environmental Protection Agency:												
Abatement, control and compliance								3	–1	*	–3	*
International Assistance Programs:												
Foreign military financing				13	4	1	152	–166	119	–397	–64	–41
U.S. Agency for International Development:												
Micro and small enterprise development									*		*	
Overseas Private Investment Corporation:												
OPIC direct loans										–4	–21	3
Debt reduction							36	–4		*	–47	–104
Small Business Administration:												
Business loans								1	–2	1	25	
Disaster loans					–193	246	–398	–282	–14	266	589	195
Other Independent Agencies:												
Export-Import Bank direct loans	–28	–16	37				–177	157	117	–640	–305	111
Federal Communications Commission spectrum auction					4,592	980	–1,501	–804	92	346	380	732
LOAN GUARANTEES												
Agriculture:												
Agriculture credit insurance fund	5	14	12	–51	96		–31	205	40	–36	–33	–22

Table 7–2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992–2004 [1]—Continued

(Budget authority and outlays, in millions of dollars)

Program	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Agriculture resource conservation demonstration project	....	....	....	....	....	....	....	2	....	1	–1	*
Commodity Credit Corporation export guarantees	3	103	–426	343	....	....	....	–1,410	....	–13	–230	–205
Rural development insurance fund	49	....	....	–3	....	....	....	....	....	....	....	....
Rural housing insurance fund	2	10	7	–10	....	109	....	152	–56	32	50	....
Rural community advancement program [2]	....	....	....	–10	....	41	....	63	17	91	15	....
Commerce:												
Fisheries finance	....	....	....	....	–2	....	....	–3	–1	3	*	1
Emergency steel guaranteed loans	....	....	....	....	....	....	....	....	....	50	*	3
Emergency oil and gas guaranteed loans	....	....	....	....	....	....	....	*	*	*	*	*
Defense:												
Military housing improvement fund	....	....	....	....	....	....	....	....	....	....	–3	–1
Defense export loan guarantee	....	....	....	....	....	....	....	....	....	....	....	–5
Education:												
Federal family education loan program: [3]												
Volume reestimate	....	....	535	99	....	–13	–60	–42	....	277	....	–420
Other technical reestimate	97	421	60	....	....	–140	667	–3,484	....	–2,483	–3,278	1,321
Health and Human Services:												
Heath center loan guarantees	....	....	....	....	....	....	3	....	*	*	....	1
Health education assistance loans	....	....	....	....	....	....	....	....	....	–5	–37	–33
Housing and Urban Development:												
Indian housing loan guarantee	....	....	....	....	....	....	....	–6	*	–1	*	–4
Title VI Indian guarantees	....	....	....	....	....	....	....	....	....	–1	1	4
Community development loan guarantees	....	....	....	....	....	....	....	....	....	....	19	–10
FHA-mutual mortgage insurance	....	....	....	–340	....	3,789	....	2,413	–1,308	1,100	5,947	1,980
FHA-general and special risk	–175	....	–110	–25	743	79	....	–217	–403	77	352	507
Interior:												
Bureau of Indian Affairs guaranteed loans	....	....	....	31	....	....	....	–14	–1	–2	–2	*
Transportation:												
Maritime guaranteed loans (title XI)	....	....	....	....	....	–71	30	–15	187	27	–16	4
Minority business resource center	....	....	....	....	....	....	....	....	1	....	*	*
Treasury:												
Air transportation stabilization program	....	....	....	....	....	....	....	....	....	113	–199	292
Veterans Affairs:												
Veterans housing benefit fund program	–447	167	334	–706	38	492	229	–770	–163	–184	–1,515	–462
International Assistance Programs:												
U.S. Agency for International Development:												
Development credit authority	....	....	....	....	....	....	....	....	–1	....	1	–3
Micro and small enterprise development	....	....	....	....	....	....	....	....	....	....	2	–2
Urban and environmental credit	–2	–1	–7	....	–14	....	....	....	–4	–15	48	–2
Loan Guarantees to Israel	....	....	....	....	....	....	....	....	....	....	–76	–111
Overseas Private Investment Corporation:												
OPIC guaranteed loans	....	....	....	....	....	....	....	....	5	77	60	–213
Small Business Administration:												
Business loans	....	....	257	–16	–279	–545	–235	–528	–226	304	1,750	1,034
Other Independent Agencies:												
Export-Import Bank guarantees	–11	–59	13	....	....	....	–191	–1,520	–417	–2,042	–1,133	–655
Total	**–616**	**995**	**727**	**–832**	**5,642**	**4,518**	**–3,641**	**–6,427**	**–1,832**	**–142**	**3,469**	**5,349**

* $500,000 or less.

[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.

Table 7–3. DIRECT LOAN SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2004-2006

(in millions of dollars)

Agency and Program	2004 Actual			2005 Enacted			2006 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	13.32	117	881	7.40	70	955	7.14	67	937
Farm storage facility loans	1.22	1	63	–2.44	–2	83	–1.34	–1	67
Rural community advancement program	1.88	27	1,395	7.50	107	1,425	6.09	79	1,300
Rural electrification and telecommunications loans	–1.60	–70	4,345	–1.28	–44	3,440	–0.18	–6	3,189
Rural telephone bank	–4.32	–7	170	–1.83	–3	175	....	....	....
Distance learning, telemedicine, and broadband program	2.09	13	633	2.07	13	596	2.68	8	328
Farm labor	42.73	15	36	47.06	18	38	44.59	19	42
Rural housing insurance fund	12.25	185	1,509	14.68	193	1,314	12.55	136	1,085
Rural development loan fund	43.27	17	40	46.38	16	34	43.02	15	34
Rural economic development loans	18.76	3	15	18.79	5	25	19.97	5	25
Public law 480 title I	58.08	23	39	55.98	27	48	55.40	24	43
Commerce:									
Fisheries finance	–6.31	–4	64	–6.01	–11	185	–5.02	–2	24
Defense—Military:									
Defense family housing improvement fund	33.73	56	166	33.95	71	209	25.34	145	572
Education:									
College housing and academic facilities loans	....	....	55	....	....	70	....	....	50
Loans for short-term training	....	....	....	....	....	....	–1.56	–1	85
Federal direct student loan program	–0.61	–135	21,979	–0.53	–131	24,480	–3.51	–861	24,530
Homeland Security:									
Disaster assistance direct loans	....	....	....	–2.60	–1	25	–0.19	....	25
Housing and Urban Development:									
FHA-mutual mortgage insurance	....	....	....	....	....	50	....	....	50
FHA-general and special risk	....	....	50	....	....	50	....	....	50
State:									
Repatriation loans	70.75	1	1	69.73	1	1	64.99	1	1
Loan for renovation of UN Headquarters	....	....	....	0.47	6	1,200	....	....	....
Transportation:									
Federal-aid highways	....	....	....	5.94	142	2,400	6.18	149	2,400
Railroad rehabilitation and improvement program	....	....	263	....	....	250	....	....	....
Treasury:									
Community development financial institutions fund	34.37	2	5	36.52	2	5	....	....	....
Veterans Affairs:									
Vocational rehabilitation and employment administration	1.33	....	3	1.14	....	4	1.59	....	4
Housing	0.83	1	127	–2.71	–25	941	–2.61	–44	1,696
International Assistance Programs:									
Debt restructuring	....	28	....	....	338	....	....	....	....
Overseas Private Investment Corporation	3.03	6	198	10.67	19	178	10.27	19	185
Small Business Administration:									
Disaster loans	11.72	79	668	12.86	514	3,982	14.64	83	810
Business loans	9.55	2	23	10.25	1	10	....	....	....
Export-Import Bank of the United States:									
Export-Import Bank loans	11.40	22	193	34.00	17	50	34.00	17	50
Total	**N/A**	**382**	**32,921**	**N/A**	**1,343**	**42,223**	**N/A**	**–148**	**37,582**

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, 2004–2006

(in millions of dollars)

Agency and Program	2004 Actual			2005 Enacted			2006 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	3.10	75	2,402	2.91	80	2,763	2.66	76	2,866
Commodity Credit Corporation export loans	10.58	457	4,318	6.83	309	4,528	8.93	393	4,396
Rural community advancement program	3.75	46	1,217	3.36	29	885	3.74	44	1,184
Rural electrification and telecommunications loans	....	....	....	0.01	....	1,100	....	....	....
Distance learning, telemedicine, and broadband program	....	....	....	....	....	....	3.82	1	30
Rural housing insurance fund	1.68	54	3,333	1.09	37	3,381	1.33	52	3,881
Rural business investment	....	....	....	8.05	....	60	....	....	....
Renewable energy	....	....	....	1.87	11	615	1.75	5	286
Defense—Military:									
Arms initiative	3.00	....	4	4.10	1	28	20.00	1	5
Education:									
Loans for short-term training	....	....	....	....	....	....	5.71	11	198
Federal family education loans	11.40	9,602	84,219	11.96	10,111	84,548	8.22	6,556	79,754
Health and Human Services:									
Health education assistance loans	16.48	25	46	....	....	....	....	....	....
Health resources and services	12.58	2	13	5.35	1	17	5.40	1	17
Housing and Urban Development:									
Indian housing loan guarantee fund	2.73	5	197	2.58	5	145	2.42	3	99
Native Hawaiian Housing Loan Guarantee Fund	2.73	1	40	2.58	1	37	2.42	1	35
Native American housing block grant	10.56	2	17	10.32	2	18	12.26	5	38
Community development loan guarantees	2.30	6	287	2.30	6	275	....	....	....
FHA-mutual mortgage insurance	–2.47	–2,660	107,699	–1.82	–2,121	185,000	–1.70 [2]	–1,867	185,000
FHA-general and special risk	–1.00	–276	29,000	–0.51	–180	35,000	–0.98	–341	35,000
Interior:									
Indian guaranteed loans	6.13	5	84	6.76	5	85	4.75	6	119
Transportation:									
Minority business resource center program	2.53	....	8	2.08	....	18	1.85	1	18
Federal-aid highways	....	....	....	4.68	9	200	3.67	7	200
Maritime guaranteed loan (title XI)	7.65	13	174	27.54	39	140	....	....	....
Treasury:									
Air transportation stabilization program	–8.93	–3	30	....	....	....	....	....	....
Veterans Affairs:									
Housing	0.54	200	35,613	–0.28	–125	44,206	–0.22	–105	47,208
International Assistance Programs:									
Loan guarantees to Israel	....	....	1,750	....	....	3,000	....	....	2,360
Microenterprise and small enterprise development	....	1	....	....	....	....	....	....	....
Development credit authority	3.11	10	351	4.31	21	487	3.90	21	539
Overseas Private Investment Corporation	0.27	–96	1,647	–3.42	–45	1,300	–4.38	–62	1,400
Small Business Administration:									
General business loans	0.38	91	23,972	....	....	34,253	....	....	37,000
Export-Import Bank of the United States:									
Export-Import Bank loans	1.88	172	13,128	2.80	288	13,761	2.91	291	13,761
Presidio Trust:									
Presidio Trust	....	....	....	0.08	....	20	0.08	....	50
Total	**N/A**	**7,732**	**309,549**	**N/A**	**8,484**	**415,870**	**N/A**	**5,100**	**415,444**
ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENT LIMITATIONS									
GNMA:									
Guarantees of mortgage-backed securities	–0.27	–405	146,066	–0.23	–368	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] Rate includes effects of legislative proposals. For more details, see the Federal Credit Supplement.

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

(In billions of dollars)

	Actual								Estimate	
	1997	1998	1999	2000	2002	2002	2003	2004	2005	2006
Direct Loans:										
Obligations	33.6	28.8	38.4	37.1	39.1	43.7	45.4	42.0	56.0	47.6
Disbursements	32.2	28.7	37.7	35.5	37.1	39.6	39.7	38.7	47.9	44.2
New subsidy budget authority[1]	*	–0.8	1.6	–0.4	0.3	*	0.7	0.4	1.3	–0.1
Reestimated subsidy budget authority[2]	....	7.3	1.0	–4.4	–1.8	0.5	2.9	2.6	4	....
Total subsidy budget authority	2.4	6.5	2.6	–4.8	–1.5	0.5	3.5	3.0	5.1	–0.1
Loan Guarantees:										
Commitments	282.3	348.4	415.9	298.1	418.0	482.6	561.8	450.2	494.4	489.1
Lender disbursements	254.7	337.9	388.2	286.3	366.7	446.2	247.2	429.0	468.0	459.0
New subsidy budget authority[1]	*	3.3	*	3.6	2.3	2.9	3.8	7.3	8.1	4.7
Reestimated subsidy budget authority[2]	....	–0.7	4.3	0.3	–7.1	–2.4	–3.5	2.0	2.9	....
Total subsidy budget authority	3.6	2.6	4.3	3.9	–4.8	0.5	0.3	9.3	11.0	4.7

* $500 million or less.

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

[2] Includes interest on reestimate.

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]		
	2004 actual	2005 estimate	2006 estimate	2004 actual	2005 estimate	2006 estimate
DIRECT LOAN WRITEOFFS						
Agriculture:						
Agricultural credit insurance fund	147	129	126	1.69	1.59	1.65
Commodity Credit Corporation fund	18	....	....	0.16	....	....
Rural community advancement program	13	11	14	0.16	0.12	0.14
Rural telephone bank	....	3	3	....	0.30	0.31
Rural development insurance fund	2	1	1	0.08	0.04	0.05
Rural housing insurance fund	121	126	121	0.44	0.47	0.46
P.L.480	934	....	....	9.11	....	....
Debt reduction (P.L.480)	154	11	....	22.48	1.85	....
Commerce:						
Economic development revolving fund	2	1	1	8.33	7.14	10.00
Education:						
Student financial assistance	6	7	7	1.84	2.16	2.16
Perkins loan assets	....	....	51	....	....	....
Federal direct student loan program	256	350	396	0.24	0.31	0.39
Homeland Security:						
Disaster assistance direct loan program	13	127	....	9.09	81.93	....
Housing and Urban Development:						
Revolving fund (liquidating programs)	....	1	1	....	16.66	25.00
Guarantees of mortgage-backed securities	99	30	28	79.83	50.84	45.16
Interior:						
Indian direct loan	11	2	2	22.44	6.25	7.69
Labor:						
Pension Benefit Guaranty Corporation	10	31	90	100	100	100
Transportation:						
Railroad rehabilitation and improvement	2	4	6	0.54	0.65	1.03
Treasury:						
Community development financial institutions fund	....	1	....	....	1.58	....
Veterans Affairs:						
Veterans housing benefit program	13	8	8	0.72	0.39	0.28
International Assistance Programs:						
Military debt reduction	....	11	....	....	4.34	....
Debt reduction (AID)	8	7	....	3.37	0.93	....
Overseas Private Investment Corporation	....	8	8	....	1.40	1.34
Small Business Administration:						
Disaster loans	53	44	61	1.53	0.73	0.89
Business loans	6	9	6	1.80	3.22	2.69
Other Independent Agencies:						
Export-Import Bank	27	67	71	0.24	0.65	0.76
Debt reduction (ExIm Bank)	5	121	....	0.45	11.04	....
Spectrum auction program	50	....	3,422	0.97	....	88.76
Tennessee Valley Authority	....	1	....	....	1.40	....
Total, direct loan writeoffs	1,950	1,111	4,423	0.65	0.28	1.49
GUARANTEED LOAN TERMINATIONS FOR DEFAULT						
Agriculture:						
Agricultural credit insurance fund	94	83	83	0.74	0.63	0.63
Commodity Credit Corporation export loans	130	160	160	1.97	1.83	1.82
Rural community advancement program	119	147	174	2.16	2.94	3.57
Rural electrification and telecommunications loans	....	6	6	....	0.38	0.39
Rural housing insurance fund	122	134	146	0.72	0.80	0.86
Commerce:						
Emergency steel guaranteed loan program	....	12	8	....	7.69	6.89

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]		
	2004 actual	2005 estimate	2006 estimate	2004 actual	2005 estimate	2006 estimate
Defense—Military:						
Family housing improvement fund	....	4	4	....	1.65	1.70
Education:						
Federal family education loan	3,679	4,992	5,837	1.28	1.55	1.67
Health and Human Services:						
Health education assistance loans	58	41	40	2.32	1.69	1.69
Housing and Urban Development:						
Indian housing loan guarantee	....	1	4	....	0.67	2.48
Title VI Indian Federal guarantees program	....	1	2	....	1.06	1.85
FHA—Mutual mortgage insurance	7,390	6,056	5,484	1.43	1.21	1.01
FHA—General and special risk	1,790	2,052	1,731	1.57	1.84	1.50
Guarantees of mortgage-backed securities	260	70	600	0.04	0.01	0.09
Interior:						
Indian guaranteed loan	1	1	1	0.26	0.24	0.23
Transportation:						
Maritime guaranteed loan (Title XI)	....	50	35	....	1.41	1.06
Treasury:						
Air transportation stabilization program	....	923	8	....	54.19	1.19
Veterans Affairs:						
Veterans housing benefit program	1,374	2,763	2,816	0.38	0.69	0.64
International Assistance Programs:						
Foreign military financing	....	3	10	....	0.09	0.38
Micro and small enterprise development	3	1	1	6.00	1.31	2.00
Urban and environmental credit program	34	22	26	1.78	1.19	1.52
Development credit authority	....	2	3	....	0.87	0.90
Overseas Private Investment Corporation	78	57	58	1.77	1.43	1.39
Small Business Administration:						
General business loans	1,378	1,308	1,272	2.04	1.66	1.43
Pollution control equipment	....	1	....	....	16.66	....
Other Independent Agencies:						
Export-Import Bank	360	440	494	0.81	0.93	0.99
Total, guaranteed loan terminations for default	16,870	19,330	19,003	0.80	0.89	0.82
Total, direct loan writeoffs and guaranteed loan terminations	18,820	20,441	23,426	0.79	0.83	0.89
ADDENDUM: WRITEOFFS OF DEFAULTED GUARANTEED LOANS THAT RESULT IN LOANS RECEIVABLE						
Agriculture:						
Agricultural credit insurance fund	....	1	1	....	5.88	5.88
Education:						
Federal family education loan	286	259	233	1.38	1.19	1.02
Health and Human Services:						
Health education assistance loans	24	24	24	2.54	2.56	2.59
Housing and Urban Development:						
FHA—Mutual mortgage insurance	1	....	....	0.10	....	....
FHA—General and special risk	310	383	6	7.01	7.56	0.10
Interior:						
Indian guaranteed loan	10	1	1	40.00	7.14	9.09
Treasury:						
Air transportation stabilization program	....	....	617	....	....	66.27
Veterans Affairs:						
Veterans housing benefit program	83	120	148	5.87	6.14	6.26

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]		
	2004 actual	2005 estimate	2006 estimate	2004 actual	2005 estimate	2006 estimate
International Assistance Programs:						
Overseas Private Investment Corporation	....	29	3	....	12.18	1.18
Small Business Administration:						
General business loans	249	262	280	7.51	6.30	5.90
Total, writeoffs of loans receivable	963	1,079	1,313	2.42	2.46	2.75

[1] For direct loans and loan guarantees, outstanding loans equal start-of-year outstanding balance plus new disbursements. For loans receivable, outstanding loans equal start-of-year outstanding balance plus terminations for default resulting in loans receivable.

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

(in millions of dollars)

Agency and Program	2004 Enacted	2005 Enacted	2006 Proposed
DIRECT LOAN OBLIGATIONS			
Agriculture:			
P.L. 480 direct credit	39	48	43
Commerce:			
Fisheries finance	64	185	24
Education:			
Historically black college and university capital financing	229	229	162
Loans for short-term training	....	....	85
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
State:			
Repatriation loans	1	1	1
Loan for renovation of UN Headquarters	....	1,200	....
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	....
Veterans Affairs:			
Native American and transitional housing	....	50	30
Vocational rehabilitation	3	4	4
International Assistance Programs:			
Military debt reduction	31	....	....
Small Business Administration:			
Business loans	23	10	....
Total, limitations on direct loan obligations	2,926	4,263	2,874
LOAN GUARANTEE COMMITMENTS			
Agriculture:			
Agricultural credit insurance fund	2,402	2,763	2,866
Rural business investment program guarantee	....	60	....
Defense—Military:			
Arms initiative	4	28	5
Education:			
Loans for short-term training	....	....	198
Health and Human Services:			
Health education assistance loans	150	....	....
Housing and Urban Development:			
Indian housing loan guarantee fund	197	145	99
Title VI Indian Federal guarantees	17	18	38
Native Hawaiian Housing Loan Guarantee Fund	40	37	35
Community development loan guarantees	275	275	....
FHA-general and special risk	29,000	35,000	35,000
FHA-mutual mortgage insurance	185,000	185,000	185,000
Interior:			
Indian loans	84	85	119
Transportation:			
Minority business resource center	18	18	18
Transportation infrastructure finance and innovation program loan guarantee	200	200	200
Maritime guaranteed loan (title XI)	174	140	....
International Assistance Programs:			
Loan guarantees to Israel	3,000	3,000	....
Development credit authority	....	....	700

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

(in millions of dollars)

Agency and Program	2004 Enacted	2005 Enacted	2006 Proposed
Small Business Administration:			
General business loans	23,972	34,253	37,000
Total, limitations on loan guarantee commitments	244,533	261,022	261,278
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 [1]

(In billions of dollars)

	Outstanding	
	2003	2004
Government Sponsored Enterprises		
Fannie Mae [2]	N/A	N/A
Freddie Mac [3]	1,393	N/A
Federal Home Loan Banks [4]	N/A	N/A
Sallie Mae [5]	....	....
Farm Credit System	86	87
Total	**N/A**	**N/A**

N/A = Not available.

[1] Net of purchases of federally guaranteed loans.

[2] Financial data for Fannie Mae is not presented here because Fannie Mae announced in December 2004 that it would have to restate financial results for fiscal years 2001–2004.

[3] 2003 figure derived from Freddie Mac 2003 Annual Report. While financial data for 2003 is presented here, Freddie Mac announced on November 1, 2004 that it would report full-year audited results for 2004 by March 31, 2005.

[4] Financial data for the Federal Home Loan Banks are not presented here because the Federal Home Loan Banks announced through their Office of Finance in December 2004 that the consolidated financial statements of the Federal Home Loan Banks for 2002 and 2003, and the first two quarters of 2004 will need to be restated.

[5] 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)

(In millions of dollars)

Enterprise	2004
LENDING	
Student Loan Marketing Association	
Net change	–27,787
Outstandings	136
Federal National Mortgage Association: [1]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Federal Home Loan Mortgage Corporation: [2]	
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	(193)
Outstandings	23,270
Farm credit banks:	
Net change	2,409
Outstandings	60,762
Federal Agricultural Mortgage Corporation:	
Net change	(451)
Outstandings	5,549
Federal Home Loan Banks: [3]	
Net change	N/A
Outstandings	N/A
Less guaranteed loans purchased by:	
Student Loan Marketing Association:	
Net change	(27,787)
Outstandings	136
Federal National Mortgage Association: [1]	
Net change	N/A
Outstandings	N/A
Other:	
Net change [4]	N/A
Outstandings [4]	N/A
BORROWING	
Student Loan Marketing Association:	
Net Change	(24,763)
Outstandings	2,058
Federal National Mortgage Association: [1]	
Portfolio programs:	
Net Change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net Change	N/A
Outstandings	N/A
Federal Home Loan Mortgage Corporation: [2]	
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	175

Table 7–9 LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs)—Continued

(In millions of dollars)

Enterprise	2004
Outstandings	26,626
Farm credit banks:	
Net Change	3,763
Outstandings	71,812
Federal Agricultural Mortgage Corporation:	
Net Change	(414)
Outstandings	3,424
Federal Home Loan Banks:[3]	
Net Change	N/A
Outstandings	N/A
DEDUCTIONS	
Less borrowing from other GSEs:[4]	
Net Change	N/A
Outstandings	N/A
Less purchase of Federal debt securities:[4]	
Net Change	N/A
Outstandings	N/A
Less borrowing to purchase loans guaranteed by:	
Student Loan Marketing Association:	
Net Change	(27,787)
Outstandings	136
Federal National Mortgage Association: [1]	
Net Change	N/A
Outstandings	N/A
Other: [4]	
Net Change	N/A
Outstandings	N/A

N/A = Not available.

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 Fannie Mae is not presented here because Fannie Mae announced in December 2004 that it would have to restate financial results for fiscal years 2001–2004.

[2] Financial data for Freddie Mac is not presented here because Freddie Mac announced on November 1, 2004 that it would report full-year audited results for 2004 by March 31, 2005.

[3] Financial data for the Federal Home Loan Banks are not presented here because the Federal Home Loan Banks announced through their Office of Finance in December 2004 that the consolidated financial statements of the Federal Home Loan Banks for 2002 and 2003, and the first two quarters of 2004 will need to be restated.

[4] Totals and subtotals have not been calculated because a substantial portion of the total is subject to the above-described restatements.

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 $406.3 billion in 2004 and are estimated to be $425.8 billion in 2005 and $435.7 billion in 2006.

Grant outlays to State and local governments for individuals, such as Medicaid payments, are estimated to be 65 percent of total grants in 2006; 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 $98.5 billion in 2006. Chapter 19, "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 19–5 in that chapter, and also at the ends of Tables 19–1 and 19–2.

This chapter also 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)

Agency	2004 Actual	Estimate	
		2005	2006
Department of Agriculture	23.7	25.5	25.7
Department of Commerce	0.6	0.7	0.6
Department of Education	35.6	39.7	40.1
Department of Energy	0.3	0.2	0.3
Department of Health and Human Services	236.6	251.0	256.6
Department of Homeland Security	5.9	8.4	9.1
Department of Housing and Urban Development	32.7	33.5	34.8
Department of the Interior	3.4	4.2	4.1
Department of Justice	4.7	3.1	3.8
Department of Labor	8.4	7.7	7.1
Department of Transportation	41.3	43.9	46.8
Department of the Treasury	5.4	0.5	0.4
Department of Veterans Affairs	0.5	0.5	0.3
Environmental Protection Agency	4.0	3.7	3.8
Other agencies	3.3	3.3	2.2
Total	406.3	425.8	435.7

Table 8–1 shows the distribution of grants by agency. Grant outlays by the Department of Health and Human Services are estimated to be $256.6 billion in 2006, almost 60 percent of total grant outlays.

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.

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 programs. To date, the Administration has rated the effectiveness of about three 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.

[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.

In support of the Administration's initiative to identify and eliminate improper 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 the extent of improper payments, identify the causes and remedy them. The passage of the Improper Payments Information Act (IPIA) of 2002 codified the goals of the President's initiative to enhance the accuracy and integrity of Federal payments. The IPIA, and subsequent OMB implementing guidance, establish a framework for agencies to (i) review every Federal program, activity, and dollar to assess risk of significant improper payments; (ii) develop a statistically-valid estimate to measure the extent of improper payments in risk susceptible Federal programs; (iii) initiate process and internal control improvements to enhance the accuracy and integrity of payments; and (iv) report and assess progress on an annual basis. In 2004, all agencies began to develop and implement plans to comply with these expanded reporting requirements. As these efforts continue in 2005 and beyond, the Federal government is strengthening its position to make significant strides in identifying and eliminating improper payments.

In addition, under the auspices of the Federal Financial Assistance Management Improvement Act of 1999 (PL 106–107) and the Administration's Line of Business Grant Management Initiative, Federal grant making agencies have continued to work individually and collectively to improve and streamline the efficiency of grant programs and to achieve the vision of a Government-wide solution that supports end-to-end grants management activities. The goals are to promote grantee access, customer service, and agency financial and technical stewardship. Particularly, in 2004, the Federal Government has realized its objectives to:

- Establish a simple, unified "storefront" for all customers to find and apply for grants (called FIND and APPLY). FIND posted more than 1,500 funding opportunities in 2004 and received more than 200,000 hits per day;
- Establish a single location in the Code of Federal Regulations (Title 2 CFR) to place all the Government-wide and agency guidance regarding grant management;
- Create a grants governance committee that will ensure the continued streamlining effort.

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

This budget requests $5.6 billion in budget authority for 2006 for grants to State and local governments in the Department of Homeland Security (DHS).

An effective response to a major terrorist incident or natural disaster depends on adequate preparation. The Federal response to the hurricanes of 2004 demonstrated the value of proactive and aggressive response measures. This Budget continues to build on these capabilities and supports critical preparedness, response, and recovery efforts at all levels of government.

In 2004, the Federal Government developed the National Response Plan (NRP), a comprehensive approach to domestic management of emergencies. DHS also led the development of a National Incident Management System (NIMS). Released in July, 2004, NIMS establishes a standard framework for Federal, State, tribal, and local governments to respond to incidents and emergencies. The Budget requests $15 million to support the implementation of NIMS through the support of the NIMS Integration Center at the Department of Homeland Security.

Education

Grant outlays for elementary, secondary, and vocational education are estimated to be $36.9 billion in 2006.

Leaving no child behind. At the center of the President's commitment to education is his promise to "leave no child behind." When President Bush launched his No Child Left Behind initiative, he said, "The Federal role in education is not to serve the system. It is to serve the children." No Child Left Behind (NCLB) is making a difference for every child, in every public school. It is no longer acceptable for any child to slip through the cracks or fail to receive the challenging education he or she deserves. Schools are held accountable for ensuring that all children, including those who are disadvantaged or have a disability, become proficient in reading and math. Parents receive detailed information about the performance of their schools. Students who attend low-performing schools have the option to attend a better public school or, if their schools do not improve, to receive tutoring funded by the school district. The largest program that assists elementary and secondary education is Title I Grants to Local Educational Agencies. This Budget requests funding of $13.3 billion for this program in 2006.

Strengthening performance and accountability: reforming special education. On December 3, 2004, the President signed into law the Individuals with Disabilities Education Improvement Act of 2004 (IDEA). The reauthorized IDEA makes several adjustments to align special education to NCLB's accountability systems. Together, these landmark laws provide the framework for high hopes and expectations that all students, including the 6.9 million children with disabilities, can succeed in school. This law is fully consistent with the Administration's principles for IDEA reauthorization, and with the 2002 recommendations of the President's Commission on Excellence in Special Education.

Over the next year, the Administration will provide guidance and technical assistance to States, schools, and parents so that they can be partners with the Department of Education in implementing the myriad regulatory and paperwork changes required by the law, many of which will take effect in July 2005. The President's 2006 Budget complements the law and provides program levels of $12.2 billion for all IDEA programs, including $83 million for special education research, studies, and evaluations funded under the Institute for Education Sciences, and $11.1 billion for IDEA Grants to States. These increases, along with the law's local flexibility provisions, will improve the State and local special education systems, and produce real benefits for students served by IDEA.

Training and Employment

Training workers for the jobs of the 21st century. In April 2004 the President proposed significant reforms to the Department of Labor's (DOL) job training programs to double the number of workers trained and give workers more choice about their training and career paths. This Budget builds on that proposal by:

- *Giving Governors more flexibility.* The President's proposal would merge the four major Department of Labor (DOL) Federal job training and employment grant programs into a single grant program. The 2006 Budget requests $3.9 billion in budget authority for this program. In addition, Governors would be able to supplement this consolidated grant with their State's resources from a "menu" of several other Federal job training and employment programs.
- *Eliminating unnecessary overhead.* In exchange for more flexibility, the proposal would place strict limits on overhead costs. This would free resources to allow more workers to be trained.
- *Giving workers more choice.* The President's proposal would give workers greater control over their training through the use of personal innovation training accounts.
- *Demanding greater accountability.* The proposal would establish increasingly rigorous performance standards each year, leading to a goal in the tenth year that States place in employment 100 percent of the workers trained with grant resources. To ensure that individuals are placed in high-quality jobs, States would also be required to show improvements in earnings and job retention. States' performance would be ranked and published each year.

These reforms, along with the President's $250 million Community College job training initiative, will train 400,000 workers annually—twice as many as are trained under the current system.

Social Services

Head Start. The Budget provides $6.9 billion in budget authority for Head Start in 2006, including $45 million to support State implementation of a 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.

Independent living education and training vouchers. This Budget requests $60 million for the foster care independent living program to help older foster care youth transition to adulthood and self-sufficiency after leaving foster care. This program provides vouchers of up to $5,000 for education or vocational training to help youth leaving foster care to develop skills and lead independent and productive lives.

Child welfare program option. This Budget seeks legislation to introduce an option for all States to choose an alternative system for foster care that will better meet the needs of the child welfare population. Flexible financing will allow States to design programs with a stronger emphasis on prevention and family support and increased flexibility in services provided and populations served.

Income Support

Food and nutrition assistance. As part of its diverse array of programs, the United States Department of Agriculture (USDA) delivers programs that help those in need.

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. This Budget provides $5.5 billion in budget authority in 2006 for WIC services, full funding for all those estimated to be eligible and seeking services.

On July 30, 2004, President Bush signed the Child Nutrition and WIC Reauthorization Act of 2004. This law makes many important improvements to the National School Lunch Program that affect the 29 million children participating in the program on an average school day. The Administration is implementing these changes, which will increase access to nutrition for vulnerable children, help States and schools fight childhood obesity and improve the integrity of the school meals programs. Grant outlays for child nutrition programs are estimated to be $12.3 billion in 2006.

Housing assistance. Grant outlays for housing assistance are estimated to be $29.2 billion in 2006.

Ending Chronic Homelessness. The Administration remains committed to the goal of ending chronic homelessness. Chronically homeless individuals who have disabling conditions and live on the streets and in shelters for long periods comprise less than 10 percent of the homeless population, yet they consume over half of emergency homeless services. Housing this population will free Federal, State, and local emergency resources for families and individuals who need shorter-term assistance.

In 2004, the Federal Collaborative Initiative to End Chronic Homelessness, through the Department of Housing and Urban Development (HUD), the Department of Health and Human Services (HHS), and the Department of Veteran Affairs (VA), funded 11 grantees across the country. Building on the success of this initiative, in 2006, the Samaritan Housing Initiative provides up to $200 million through HUD in new housing subsidies paired with case management and supportive services in outlays is the specifically targeted to this population.

Across the country, 46 States and 170 localities, along with the private sector, have joined the Federal effort to move chronically homeless individuals from the streets to permanent supportive housing, and to prevent additional individuals from becoming chronically homeless.

The Budget provides more resources than ever for permanent supportive housing for homeless individuals who have been on the streets or in shelters for long periods. The 2006 budget includes $1.4 billion for Homeless Assistance Grants, $200 million more than in 2005. Altogether, the Administration requests $4 billion in 2006 for Federal housing and social programs for the homeless, an 8.5 percent increase.

Housing vouchers. The Housing Choice Voucher program provides two million low-income families with subsidies to help them afford a decent place to live. Participants contribute 30 percent of their income towards rent; 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 is concerned that voucher costs have increased at a rate of more than double the average increase in the private rental market for the past several years. This rate of increase, combined with an extremely complex set of laws and rules that govern the program, has limited its effectiveness.

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 2005 Consolidated Appropriations Act, the Administration proposes expanding the "dollar-based" approach. PHAs would continue to receive a set dollar amount as in 2005, but they would have the freedom to adjust the program to the unique and changing needs of their community, including the ability to set their own subsidy levels based on local market conditions. These changes would provide a more efficient and effective program to help low-income families more easily obtain decent, safe, and affordable housing.

Other income security. The Administration continues to pursue its plan to reauthorize the Temporary Assistance for Needy Families (TANF) program, which provides grants to States for programs that assist needy families with children. TANF grants also promote work and the formation of married-parent families in order to reduce dependence on government benefits. The Administration's plan maintains funding, strengthens work requirements, supports healthy marriages and family formation, and increases State flexibility. Outlays for TANF are estimated to be $18.2 billion in 2006.

Health

Medicaid and State Children's Health Insurance Program (SCHIP). Funding for Medicaid, a health care program for low-income individuals, is projected to be $338 billion ($193 billion in outlays is the Federal share) in 2006. Within that amount, Medicaid covers over 46 million children and adults. Long term care services for the disabled and elderly account for over 30 percent of Medicaid expenditures.

SCHIP makes available approximately $40 billion over ten years for States to provide health care coverage to targeted low-income, uninsured children. Since the beginning of the Administration, enrollment in SCHIP has grown by over one million children to a total of approximately 5.8 million in 2003.

The following proposals are intended to enhance coverage under both Medicaid and SCHIP:

Cover the Kids. Despite the availability of health care coverage through Medicaid and SCHIP, millions of children eligible for these programs have not enrolled. The 2006 Budget proposes Cover the Kids, a national outreach campaign that will provide $1 billion in grants over two years. By combining the resources of the Federal government, States, schools, and community organizations, Cover the Kids aims to enroll as many Medicaid- and SCHIP-eligible children as possible.

New Freedom Initiative. The Budget includes almost $3 billion in demonstrations and proposals that promote home- and community-based care options for people with disabilities. These policies are part of the President's New Freedom Initiative, which is a nationwide effort to integrate people with disabilities more fully into society.

Transitional Medical Assistance (TMA). TMA provides Medicaid coverage for former welfare recipients after they enter the workforce. This Budget proposes to extend TMA for one year with certain statutory modifications, including State options to eliminate TMA reporting requirements and provide 12 months of continuous eligibility regardless of changes in families' financial status. In addition, this Budget proposes a waiver of the TMA requirement for States that currently provide health benefits for families at 185 percent of the Federal poverty level, which is the statutorily mandated income eligibility level. These changes will allow for consistent enrollment of TMA beneficiaries while easing the administrative burden on States.

Medicare premium assistance. The Administration proposes to continue Medicare Part B premium assistance for Medicare beneficiaries between 120 and 135 percent of the Federal poverty level for one year. In 2005, these premiums will be $78.20 per month. States receive 100 percent Federal funding for these benefits.

Vaccines for children (VFC). VFC provides all recommended childhood vaccines, free of charge, to four categories of eligible children: Medicaid beneficiaries, American Indians/Alaskan Natives, the uninsured, and the underinsured (those without coverage for a particular vaccine). The Administration proposes to improve vaccine access by allowing underinsured children to receive VFC-funded vaccines at State and local health clinics, rather than only at federally qualified health centers and rural health centers.

Health Insurance Portability and Accountability Act (HIPAA). Since enacted in 1996, HIPAA has increased the continuity, portability, and accessibility of health insurance. To ensure that Medicaid and SCHIP beneficiaries receive the benefits of HIPAA coverage, the Administration proposes two legislative changes. Under this proposal, eligibility for a Medicaid/SCHIP Employer-Sponsored Insurance (ESI) Program would be a qualifying event, which would allow families to enroll in ESI immediately through special enrollment. This proposal also would require SCHIP programs to issue certificates of creditable coverage, which promote portable health coverage by verifying the period of time an individual was covered by a specific health insurance policy.

State Purchasing Pools. To help low-income individuals purchase coverage with the health insurance tax credit, the Administration proposes providing $4.0 billion in grants to States to establish purchasing pools. By combining the purchasing power of individuals and families, these pools would offer tax-credit recipients an additional affordable health insurance option and would make it easier and faster to shop for coverage.

Health Centers. Health Centers deliver high-quality, affordable primary and preventive health care to nearly 14 million patients, regardless of ability to pay at 3,740 sites across the United States annually. In 2006, Health Centers will serve an estimated 16 percent of the Nation's population at or below 200 percent of Federal Poverty Line.

The Budget will complete the President's commitment to create 1,200 new or expanded health center sites to serve an additional 6.1 million people by 2006. Almost 2.4 million additional individuals will receive health care in 2006 through 570 new or expanded sites in rural areas and underserved urban neighborhoods. The President has established a new goal to create a health center in every poor county that lacks a health center and can support one. The Budget includes $26 million to fund 40 new health center sites in high-poverty counties. Faith-based and community programs will be encouraged to compete for these grants.

Natural Resources and Environment

The Clean Water State Revolving Fund (CWSRF) provides grants to States to capitalize their municipal wastewater State revolving funds. States provide matching funds and then make loans to communities at below-market rates for wastewater infrastructure projects such as sewer rehabilitation and treatment plant expansion. Loan repayments and interest are recycled back into the program.

This Budget funds the CWSRF at $730 million. Due to significant additional funds provided by Congress in 2004 and 2005, at this funding level, the total capitalization provided between fiscal years 2004–2011 will remain the same as committed to in the 2004 Budget. This will ensure communities have access to capital to finance their wastewater infrastructure needs. Additionally, the program will meet its long-term revolving level target of $3.4 billion. The revolving level is the amount of loans available annually over the long term after Federal capitalization ends and an indicator of the CWSRF's financial stability.

The Environmental Protection Agency (EPA) has made the protection of drinking water a priority since enactment of the initial Safe Drinking Water Act (SDWA) in 1974, and continues to work to improve its drinking water programs. Statistics show that drinking water quality is improving, and the Centers for Disease Control and Prevention recently estimated that 31 drinking water-related waterborne disease outbreaks occurred in 2001–2002, down from 39 outbreaks in 1999–2000. The 1996 SDWA amendments created the Drinking Water State Revolving Fund (DWSRF) which, like the CWSRF, provides grants to States to help capitalize revolving loan funds. Communities use these funds to finance drinking water systems and infrastructure improvements, including compliance with regulatory drinking water requirements. This Budget provides $850 million to fund the DWSRF in 2006.

Administration of Justice

This Budget includes $2.8 billion in budget authority for State and local assistance programs, including Project Safe Neighborhoods, the DNA Initiative, USA Freedom Corps, State and Local Anti-Terrorism Training, and the Regional Information Sharing System (RISS). These and other programs funded within Department of Justice (DOJ) enhance the capability of State and local governments to reduce crime in our communities, as well as our vulnerability to terrorism.

Today crime, including violent crime, is at a 30-year low. The Project Safe Neighborhoods (PSN) initiative, announced by the President and the Attorney General in 2001, is a comprehensive strategy that brings together Federal, State, and local agencies to continue the record reduction in the violent crime in our communities. Working with the DOJ, each community tailors the program to target problems associated with the criminal misuse of firearms and to build on local capacities. Since 2001, the Administration has dedicated $1.3 billion in Federal resources to PSN, including grants to State and local task forces through the Office of Justice Programs, increased Federal prosecutors within U.S. Attorneys Offices, and additional agent and training resources within the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF). For 2006, this Budget requests $363 million for PSN, an increase of $138 million and 61 percent over the 2005 enacted level. The program increase will:

- Provide $74 million in grant assistance for State and local prosecution of criminal misuse of firearms.
- Increase funding for States to update criminal history records, which are needed to deter illegal fire-

arms purchases, by $34 million, which is more than double the 2005 enacted level.

- Augment Project ChildSafe, which distributes gun locks to prevent misuse of guns by children and youth, by $29 million over the 2005 enacted level.

Transportation

Grants support State and local programs for highways, mass transit, and airports. Grant outlays to State and local governments for transportation are estimated to be $46.8 billion in 2006.

- To ease gridlock, this Budget proposes a funding level of $283.9 billion over six years. This marks a 35-percent increase over the Transportation Equity Act for the 21st Century (TEA–21) six-year spending totals. This figure reflects the emerging consensus in Congress that was developed in a conference committee in 2004, and the Administration looks forward to working with the Congress to complete action on legislation to improve the surface transportation system.
- This Budget requests $231 million for the National Highway Traffic Safety Administration (NHTSA) safety operations and research programs and $465 million for grants to States for targeted highway safety programs for 2006, which is $23 million more than enacted for 2005. Funding increases are also directed toward improving the Fatalities Analysis Reporting System, Department of Transportation's (DOT) database used to measure and analyze trends in vehicle fatalities.

Community and Regional Development

Enhancing economic development and trade. The President's 2006 Budget proposes a new economic development program within the Department of Commerce, the Strengthening America's Communities Grant Program. The President's proposal replaces the current duplicative set of Federal community and economic development programs with a more consolidated approach that focuses resources on the creation of jobs and opportunities, encourages private sector investment, and includes rigorous accountability measures and incentives. The Strengthening America's Communities Grant Program is a targeted, results-oriented approach that will encourage innovation and economic opportunity. By streamlining the delivery of Federal economic development programs, taxpayers will see administrative savings. The President's Budget includes $3.7 billion in budget authority for 2006 for the Strengthening America's Communities Grant Program to provide economically distressed communities with a source of funding for planning, infrastructure development, and business financing to achieve long-term economic stability and growth.

Our changing economy presents challenges for certain communities where traditional industries, such as manufacturing, do not employ as many workers as they did a generation ago. The President has proposed a new Opportunity Zone Initiative that will help these local economies adapt and diversify by targeting Federal resources and encouraging new and existing businesses to invest in these areas. The Commerce Department will have the lead role in managing this initiative. These efforts, combined with the President's tax relief packages and initiatives to increase homeownership and reduce regulatory burdens, will help more communities participate in our growing national prosperity.

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 third year of using the PART, the Administration has evaluated about three-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 84 percent, adequate if the score is 50 to 69 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, 159 of the programs that have been assessed are primarily grants to State and local governments. Of these 159, 72 programs, or 45 percent of all grant programs assessed, received a rating of "Results Not Demonstrated". This is higher than for all programs, in which 29 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 measures, and therefore lack of focused planning to achieve common goals.

Table 8–2 also shows that the average weighted score for the 159 grant programs that have been rated by PART was 51 percent, which is a rating of "adequate". These programs had total spending of $154.2 billion in 2004. Of these 159 programs:

- 3 were rated effective ($9.9 billion);
- 25 were rated moderately effective ($67.4 billion);
- 46 were rated adequate ($24.5 billion); and
- 13 were rated ineffective ($9.8 billion).
- 72 were rated "results not demonstrated" ($42.5 billion);

If the 72 programs rated "Results Not Demonstrated" are excluded, the average score for the remaining 87 programs was 61 percent, higher than the rating for all 159 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 (159 programs)	Average Scores: Programs excluding grants rated "results not demonstrated" (87 programs)
Purpose	83%	84%
Planning	59%	75%
Management	71%	77%
Results/Accountability	29%	43%
Weighted average [1]	51%	61%
Average rating	Adequate	Adequate
Rating [2]	**Number of grants programs**	**2004 Program Level (in millions)**
Effective	3	$9.9
Moderately effective	25	67.4
Adequate	46	24.5
Ineffective	13	9.8
Results not demonstrated	72	42.5
Total number of grant programs rated	159	$154.2

[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, 70–84 percent; adequate, 50–69 percent; and ineffective, 49 percent or less.

The ratings of the largest five of these 159 grant programs are summarized here. More complete summaries of these and other programs are in the enclosed *Analytical Perspectives* CD ROM.

- *Department of Transportation: Highway Infrastructure ($32.7 billion in 2004). 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 ($14.4 billion in 2004). 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 ($10.1 billion in 2004). 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 $6.3 billion in 2001 to $10.6 billion in 2004, there is no evidence that this funding has further improved educational outcomes for children with disabilities.
- *Department of Health and Human Services: Head Start ($6.8 billion in 2004). 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 ($6.6 billion for 2004). 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. USDA is taking steps to improve the program's performance measures.

Block Grants. One of the most common tools used by the Federal Government is the block grant, particularly in the social services area where States and localities are the service providers. Block grants are embraced for their flexibility to meet local needs and criticized because accountability for results can be difficult when funds are allocated based on formulas and population counts rather than achievements or needs. In addition, block grants pose performance measurement challenges precisely because they can be used for a wide range of activities. The obstacles to measuring and achieving results through block grants are reflected in PART scores: they receive the second lowest average score of the seven PART types, 8 percent of block grant programs assessed to date were rated ineffective, and 45 percent were rated "results not demonstrated."

Nonetheless, the PART shows that some Federal block grant programs are achieving results better than others, effectively combining the flexibility that localities need with the results that taxpayers deserve. In the coming year, the Administration will apply the lessons learned from the effective block grants to several of those performing inadequately. This project will identify the methods used to manage highly rated block grant programs and adapt and implement those practices in large, low-scoring programs. Each of the programs targeted for improvement will develop an action plan and implementation timeline that will be tracked quarterly. The targeted programs will be re-analyzed through the PART in one to two years to assess whether implementing the block grant "best practices" results in improved performance.

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	2004	2005	2006
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	6.0	6.1	6.1
Agriculture	0.2	0.5	0.6	0.4	0.6	2.4	1.3	0.8	0.7	1.0	1.0	0.7
Transportation	3.0	4.1	4.6	5.9	13.0	17.0	19.2	25.8	32.2	41.5	43.9	46.8
Community and regional development	0.1	0.6	1.8	2.8	6.5	5.2	5.0	7.2	8.7	12.6	14.9	15.6
Education, training, employment, and social services	0.5	1.1	6.4	12.1	21.9	17.1	21.8	30.9	36.7	54.2	58.0	57.6
Health	0.2	0.6	3.8	8.8	15.8	24.5	43.9	93.6	124.8	189.9	203.3	208.9
Income security	2.6	3.5	5.8	9.4	18.5	27.9	36.8	58.4	68.7	86.0	89.3	91.3
Administration of Justice	....	....	0.0	0.7	0.5	0.1	0.6	1.2	5.3	5.1	3.6	4.5
General government	0.2	0.2	0.5	7.1	8.6	6.8	2.3	2.3	2.1	9.0	4.5	3.4
Other	0.0	0.1	0.1	0.2	0.7	0.8	0.8	0.8	0.9	1.1	1.2	1.0
Total	7.0	10.9	24.1	49.8	91.4	105.9	135.3	225.0	284.7	406.3	425.8	435.7
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	164.6	172.9	176.7
Mandatory	N/A	8.0	13.9	28.8	38.1	50.4	72.0	131.0	168.0	241.7	252.9	259.0
Total	7.0	10.9	24.1	49.8	91.4	105.9	135.3	225.0	284.7	406.3	425.8	435.7
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	262.2	278.3	284.9
Physical capital [1]	3.3	5.0	7.1	10.9	22.6	24.9	27.2	39.6	48.7	59.4	61.9	64.4
Other grants	1.2	2.2	8.3	22.2	36.2	30.9	30.9	41.0	53.4	84.7	85.6	86.4
Total	7.0	10.9	24.1	49.8	91.4	105.9	135.3	225.0	284.7	406.3	425.8	435.7
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%	64.5%	65.4%	65.4%
Physical capital [1]	47.3%	45.7%	29.3%	21.9%	24.7%	23.5%	20.1%	17.6%	17.1%	14.6%	14.5%	14.8%
Other grants	17.4%	20.2%	34.5%	44.5%	39.6%	29.2%	22.8%	18.2%	18.8%	20.9%	20.1%	19.8%
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	242.8	250.6	251.0
Physical capital [1]	17.0	24.2	27.2	26.0	38.9	34.2	32.6	43.3	48.7	54.7	54.9	55.4
Other grants	10.0	15.6	44.6	83.8	89.9	53.9	42.9	47.0	53.4	74.3	72.3	70.9
Total	39.0	56.7	105.3	157.7	192.6	163.1	172.1	247.9	284.7	371.7	377.9	377.3
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%	17.7%	17.2%	17.0%
Domestic programs [2]	18.0%	18.3%	23.2%	21.7%	22.2%	18.2%	17.1%	21.6%	22.0%	23.9%	22.8%	22.5%
State and local expenditures	14.8%	15.5%	20.1%	24.0%	27.4%	22.0%	18.9%	22.8%	22.1%	25.0%	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%	3.5%	3.5%	3.4%
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%	21.9%	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%	78.1%	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.
* 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 $371.5 billion, or more than 90 percent of total grant outlays in 2004.

The increase in total outlays for grants overall since 1990 has been driven by increases in grants for health, which have increased more than four-fold from $43.9 billion in 1990 to $189.8 billion in 2004. 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 $241.7 billion in 2004. The three largest mandatory grant programs are Medicaid, with outlays of $192.7 billion in 2006, Temporary Assistance for Needy Families, $18.2 billion, and child nutrition programs, $12.5 billion.

The funding level for discretionary grant programs is determined annually through appropriations acts. Outlays for discretionary grant programs were $164.6 billion in 2004. 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 26, "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 65 percent of the total in 2004.

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 2004, grants for physical capital were $59.4 billion, 15 percent of total grants.

The other grants are primarily for education, training, employment, and social services. These grants were 20 percent of total grants in 2004.

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 $371.7 billion in 2004, an average increase of 5.7 percent per year. During this same period, grants for payments to individuals increased an average of 6.8 percent per year; grants for physical capital an average of 3.8 percent per year, and other grants an average of 4.0 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 2004. Grants as a percentage of domestic programs were 24 percent in 2004. As a percentage of total State and local expenditures, grants have increased from 19 percent in 1990 to 25 percent in 2004.

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 22 percent of State and local gross investment in 2004.

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

[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.

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 14, "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		
	2004 Actual	2005 Estimate	2006 Estimate	2004 Actual	2005 Estimate	2006 Estimate
ENERGY						
Discretionary:						
Department of Energy:						
Energy Programs:						
Energy conservation	271	273	271	270	239	263
Mandatory:						
Tennessee Valley Authority:						
Tennessee Valley Authority fund	338	369	381	338	369	381
Total, energy	**609**	**642**	**652**	**608**	**608**	**644**
NATURAL RESOURCES AND ENVIRONMENT						
Discretionary:						
Department of Agriculture:						
Natural Resources Conservation Service:						
Watershed rehabilitation program	9	9	5	....	9	7
Resource conservation and development	....	....	....	1	1	1
Watershed and flood prevention operations	70	96	....	42	106	96
Forest Service:						
State and private forestry	342	342	209	277	322	333
Management of national forest lands for subsistence uses	6	6	5	6	6	5
Department of Commerce:						
National Oceanic and Atmospheric Administration:						
Operations, research, and facilities	106	108	90	62	57	43
Pacific coastal salmon recovery	85	88	90	83	83	89
Procurement, acquisition and construction	105	90	8	52	80	8
Department of the Interior:						
Office of Surface Mining Reclamation and Enforcement:						
Regulation and technology	57	58	59	55	57	58
Abandoned mine reclamation fund	173	168	168	177	192	166
Bureau of Reclamation:						
Bureau of Reclamation loan subsidy	....	21	....	3	21	....
United States Fish and Wildlife Service:						
State and tribal wildlife grants	69	69	74	38	61	68
Federal aid in wildlife restoration	....	....	....	13	13	....
Cooperative endangered species conservation fund	82	80	80	69	89	90
Landowner incentive program	30	22	40	4	32	34
National Park Service:						
Urban park and recreation fund	....	....	....	10	26	13
National recreation and preservation	60	61	37	64	60	45
Land acquisition and State assistance	94	92	2	95	114	107
Historic preservation fund	74	72	66	70	72	71
Environmental Protection Agency:						
State and tribal assistance grants	3,877	3,575	2,961	3,905	3,592	3,723
Hazardous substance superfund	103	64	60	51	40	52
Leaking underground storage tank trust fund	66	59	60	62	59	60
Total, discretionary	**5,408**	**5,080**	**4,014**	**5,139**	**5,092**	**5,069**
Mandatory:						
Department of the Interior:						
Bureau of Land Management:						
Miscellaneous permanent payment accounts	279	428	369	278	421	372
Minerals Management Service:						
National forests fund, Payment to States	4	8	8	4	8	8
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	223	250	250	222	214	235
Cooperative endangered species conservation fund	35	36	37	35	36	37
Sport fish restoration	345	339	361	318	342	346
Departmental Management:						
Everglades watershed protection	....	....	....	6	....	....
Everglades restoration account	....	....	....	1	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		
	2004 Actual	2005 Estimate	2006 Estimate	2004 Actual	2005 Estimate	2006 Estimate
Department of the Treasury:						
Financial Management Service:						
Payment to terrestrial wildlife habitat restoration trust fund	5	5	5	5	5	5
Total, mandatory	**892**	**1,068**	**1,032**	**870**	**1,029**	**1,006**
Total, natural resources and environment	**6,300**	**6,148**	**5,046**	**6,009**	**6,121**	**6,075**
AGRICULTURE						
Discretionary:						
Department of Agriculture:						
Cooperative State Research, Education, and Extension Service:						
Extension activities	444	451	437	421	423	410
Outreach for socially disadvantaged farmers	6	6	6	4	6	6
Research and education activities	241	242	139	242	241	183
Integrated activities	23	24	8	22	23	27
Agricultural Marketing Service:						
Payments to States and possessions	3	10	1	1	7	8
Farm Service Agency:						
State mediation grants	4	4	4	4	4	4
Total, discretionary	**721**	**737**	**595**	**694**	**704**	**638**
Mandatory:						
Department of Agriculture:						
Office of the Secretary:						
Fund for rural America				7	7	
Farm Service Agency:						
Commodity Credit Corporation fund	294	250	84	294	250	84
Total, mandatory	**294**	**250**	**84**	**301**	**257**	**84**
Total, agriculture	**1,015**	**987**	**679**	**995**	**961**	**722**
COMMERCE AND HOUSING CREDIT						
Mandatory:						
Department of Commerce:						
National Oceanic and Atmospheric Administration:						
Promote and develop fishery products and research pertaining to American fisheries	18	13	1	23	21	8
TRANSPORTATION						
Discretionary:						
Department of Homeland Security:						
Border and Transportation Security:						
Surface transportation security	173			173		
Department of Transportation:						
Federal Aviation Administration:						
Grants-in-aid for airports	2				1	1
Grants-in-aid for airports (Airport and airway trust fund)				2,958	3,041	3,263
Federal Highway Administration:						
State infrastructure banks				5	3	1
Appalachian development highway system	124	79		91	180	163
Appalachian development highway system (Highway trust fund)				45	7	7
Federal-aid highways				29,791	31,457	34,070
Miscellaneous appropriations	3	–2		134	260	195
Miscellaneous highway trust funds	50	34		256	276	237
Federal Motor Carrier Safety Administration:						
National motor carrier safety program	172	172				
Motor carrier safety		73			66	
Motor Carrier Safety Grants			232			65
National Highway Traffic Safety Administration:						
Highway traffic safety grants	213	211	448	194	227	322
Federal Railroad Administration:						
Alaska railroad rehabilitation	25	25		20	37	15
Federal Transit Administration:						
Job access and reverse commute grants	104			81	113	82

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		
	2004 Actual	2005 Estimate	2006 Estimate	2004 Actual	2005 Estimate	2006 Estimate
Interstate transfer grants-transit	....	....	....	....	3	....
Washington Metropolitan Area Transit Authority	....	....	....	12	4	3
Formula grants	4,740	....	....	4,724	3,380	2,328
Capital investment grants	3,189	....	....	2,789	3,686	2,513
Transit planning and research	17	....	....	10	94	71
Major capital investments grants	....	1,452	1,562	....	174	578
Discretionary grants (Highway trust fund, mass transit account)	....	....	....	161	96	103
Formula Grants and Research	....	7,056	7,077	....	733	2,701
Pipeline and Hazardous Materials Safety Administration:						
Pipeline safety	19	19	19	15	19	19
Total, discretionary	**8,831**	**9,119**	**9,338**	**41,459**	**43,857**	**46,737**
Mandatory:						
Department of Transportation:						
Federal Aviation Administration:						
Grants-in-aid for airports (Airport and airway trust fund)	3,647	3,697	2,531	....	....	....
Federal Highway Administration:						
Federal-aid highways	34,239	34,150	33,763	....	....	....
Pipeline and Hazardous Materials Safety Administration:						
Emergency preparedness grants	12	13	13	12	13	14
Total, mandatory	**37,898**	**37,860**	**36,307**	**12**	**13**	**14**
Total, transportation	**46,729**	**46,979**	**45,645**	**41,471**	**43,870**	**46,751**
COMMUNITY AND REGIONAL DEVELOPMENT						
Discretionary:						
Department of Agriculture:						
Rural Development:						
Rural community advancement program	716	664	452	797	792	741
Rural Utilities Service:						
Distance learning, telemedicine, and broadband program	48	44	25	41	39	51
Rural Housing Service:						
Rural community grants	....	....	–40	....	....	–33
Department of Commerce:						
Economic Development Administration:						
Economic development assistance programs	278	254	....	337	361	325
Economic Development Challenge:						
Strengthening America's communities grant program	....	....	3,710	....	....	74
Department of Homeland Security:						
Departmental Management:						
State and local programs	2,950	2,870	2,665	1,535	2,584	3,116
Firefighter assistance grants	746	715	500	508	551	702
Emergency Preparedness and Response:						
Operating Expenses	....	....	....	387	169	118
Mitigation grants	....	....	....	23	91	59
Disaster Relief	3,411	7,261	1,819	3,037	4,534	4,523
Department of Housing and Urban Development:						
Community Planning and Development:						
Community development fund	4,933	4,853	....	5,388	5,373	5,351
Urban development action grants	–30	....	....	1	....	....
Community development loan guarantees subsidy	7	7	....	7	8	7
Brownfields redevelopment	25	24	....	10	13	14
Empowerment zones/enterprise communities	15	10	....	48	50	50
Office of Lead Hazard Control and Healthy Homes:						
Lead hazard reduction	174	167	119	113	134	139
Department of the Interior:						
Bureau of Indian Affairs:						
Operation of Indian programs	146	148	148	245	126	152
Indian guaranteed loan subsidy	8	9	6	5	7	7
Appalachian Regional Commission	59	59	59	68	70	81
Delta Regional Authority	5	4	4	12	13	11
Denali Commission	58	66	3	16	24	32

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		
	2004 Actual	2005 Estimate	2006 Estimate	2004 Actual	2005 Estimate	2006 Estimate
Total, discretionary	**13,549**	**17,155**	**9,470**	**12,578**	**14,939**	**15,520**
Mandatory:						
Department of Agriculture:						
Rural Housing Service:						
Rural community grants	....	30	10	....	....	33
Department of Housing and Urban Development:						
Community Planning and Development:						
Community development loan guarantees subsidy	26	2	....	26	2	....
Total, mandatory	**26**	**32**	**10**	**26**	**2**	**33**
Total, community and regional development	**13,575**	**17,187**	**9,480**	**12,604**	**14,941**	**15,553**
EDUCATION, TRAINING, EMPLOYMENT, AND SOCIAL SERVICES						
Discretionary:						
Department of Commerce:						
National Telecommunications and Information Administration:						
Public telecommunications facilities, planning and construction	19	20	....	36	36	26
Information infrastructure grants	7	....	....	20	26	14
Department of Education:						
Office of Elementary and Secondary Education:						
Reading excellence	....	....	....	155	64	....
Impact aid	1,222	1,236	1,233	1,228	1,321	1,249
Chicago litigation settlement	....	....	....	1	1	....
Education reform	....	....	....	51	103	....
Education for the disadvantaged	13,800	14,797	16,384	12,417	14,524	14,768
School improvement programs	6,041	5,473	5,190	6,542	6,636	5,750
Office of Indian Education:						
Indian education	116	115	116	111	123	115
Office of Innovation and Improvement:						
Innovation and improvement	621	550	1,120	4	450	576
Office of Safe and Drug-Free Schools:						
Safe schools and citizenship education	815	820	270	13	462	746
Office of English Language Acquisition:						
English language acquisition	610	617	635	536	759	573
Office of Special Education and Rehabilitative Services:						
Special education	11,194	11,456	11,122	9,465	9,884	11,095
Rehabilitation services and disability research	129	135	83	159	203	101
American Printing House for the Blind	17	17	17	18	21	17
Office of Vocational and Adult Education:						
Vocational and adult education	2,060	1,974	992	1,909	1,963	1,886
Office of Postsecondary Education:						
Higher education	427	414	....	417	520	430
Federal Student Aid:						
Student financial assistance	66	66	....	65	69	52
Institute of Education Sciences:						
Institute of education sciences	....	25	57	43	38	28
Department of Health and Human Services:						
Administration for Children and Families:						
Promoting safe and stable families	400	399	407	420	393	401
Children and families services programs	8,420	8,653	8,031	8,326	8,519	8,285
Administration on Aging:						
Aging services programs	1,354	1,370	1,351	1,320	1,345	1,360
Department of the Interior:						
Bureau of Indian Affairs:						
Operation of Indian programs	119	129	116	110	91	85
Department of Labor:						
Employment and Training Administration:						
Training and employment services	3,476	3,509	4,232	3,883	3,372	3,655
Community service employment for older Americans	97	97	97	98	98	97
State unemployment insurance and employment service operations	142	141	68	163	143	78
Unemployment trust fund	1,059	1,061	256	1,110	1,065	298
Corporation for National and Community Service:						
Domestic volunteer service programs, operating expenses	150	150	120	82	82	96
National and community service programs, operating expenses	280	276	301	207	255	220

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		
	2004 Actual	2005 Estimate	2006 Estimate	2004 Actual	2005 Estimate	2006 Estimate
Corporation for Public Broadcasting:						
Corporation for Public Broadcasting	437	466	390	437	466	390
District of Columbia:						
District of Columbia General and Special Payments:						
Federal payment for resident tuition support	17	26	33	17	26	33
Federal payment for school improvement	40	40	42	40	40	42
National Endowment for the Arts:						
National Endowment for the Arts: grants and administration	40	41	41	37	39	41
Institute of Museum and Library Services:						
Office of Museum and Library Services: grants and administration	250	269	250	196	279	363
Total, discretionary	**53,425**	**54,342**	**52,954**	**49,636**	**53,416**	**52,870**
Mandatory:						
Department of Education:						
Office of Special Education and Rehabilitative Services:						
Rehabilitation services and disability research	2,584	2,636	2,720	2,453	2,583	2,684
Department of Health and Human Services:						
Administration for Children and Families:						
Social services block grant	1,700	1,700	1,700	1,752	1,764	1,762
Department of Labor:						
Employment and Training Administration:						
Welfare to work jobs	....	....	....	181	6	....
Federal unemployment benefits and allowances	259	259	259	179	245	257
Foreign labor certification processing	....	....	3	....	....	3
Total, mandatory	**4,543**	**4,595**	**4,682**	**4,565**	**4,598**	**4,706**
Total, education, training, employment, and social services	**57,968**	**58,937**	**57,636**	**54,201**	**58,014**	**57,576**
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
Health Resources and Services Administration:						
Health resources and services	3,300	3,222	3,132	2,807	2,741	2,599
Centers for Disease Control and Prevention:						
Disease control, research, and training	2,461	2,798	2,535	2,291	2,789	2,928
Substance Abuse and Mental Health Services Administration:						
Substance abuse and mental health services	2,318	2,353	2,315	2,241	2,297	2,332
Departmental Management:						
General departmental management	1,621	1,760	1,589	1,497	1,232	1,177
Department of Labor:						
Occupational Safety and Health Administration:						
Salaries and expenses	102	101	92	102	101	92
Mine Safety and Health Administration:						
Salaries and expenses	8	8	8	8	8	8
Total, discretionary	**9,853**	**10,287**	**9,717**	**8,989**	**9,213**	**9,182**
Mandatory:						
Department of Health and Human Services:						
Health Resources and Services Administration:						
Health resources and services	25	....	....	8	....	....
Centers for Medicare and Medicaid Services:						
Grants to States for medicaid	182,753	182,420	215,627	176,231	188,497	192,718
State children's health insurance fund	3,175	4,082	4,082	4,607	5,343	6,233
State grants and demonstrations	142	393	1,294	48	200	799
Total, mandatory	**186,095**	**186,895**	**221,003**	**180,894**	**194,040**	**199,750**

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		
	2004 Actual	2005 Estimate	2006 Estimate	2004 Actual	2005 Estimate	2006 Estimate
Total, health	**195,948**	**197,182**	**230,720**	**189,883**	**203,253**	**208,932**
INCOME SECURITY						
Discretionary:						
Department of Agriculture:						
Food and Nutrition Service:						
Food donations programs	....	....	....	3	....	....
Commodity assistance program	164	193	193	170	186	194
Special supplemental nutrition program for women, infants, and children (WIC)	4,712	5,235	5,510	4,860	5,087	5,465
Department of Health and Human Services:						
Administration for Children and Families:						
Low income home energy assistance	1,889	2,182	2,000	1,891	2,115	2,026
Refugee and entrant assistance	281	301	369	425	399	419
Payments to States for the child care and development block grant	2,080	2,076	2,076	2,131	2,092	2,076
Department of Homeland Security:						
Emergency Preparedness and Response:						
Emergency food and shelter	152	153	153	152	153	153
Department of Housing and Urban Development:						
Public and Indian Housing Programs:						
Public housing operating fund	3,579	2,438	3,407	3,434	3,600	3,403
Drug elimination grants for low-income housing	....	–5	....	46	17	....
Revitalization of severely distressed public housing (HOPE VI)	149	143	–143	596	590	567
Native Hawaiian Housing Block Grant	....	....	9	....	....	1
Tenant based rental assistance	....	10,600	15,845	....	10,600	15,845
Project-based rental assistance	....	346	388	....	208	464
Public housing capital fund	2,696	2,579	2,327	3,414	3,502	3,507
Native American housing block grant	650	601	583	675	717	727
Housing certificate fund	13,136	2,609	....	14,667	4,230	87
Community Planning and Development:						
Homeless assistance grants	1,260	1,241	1,440	1,232	1,300	1,431
Home investment partnership program	2,006	1,900	1,941	1,597	1,650	1,700
Housing opportunities for persons with AIDS	295	282	268	254	261	262
Rural housing and economic development	25	24	....	23	25	25
Housing Programs:						
Homeownership and opportunity for people everywhere grants (HOPE grants)	....	....	....	2	2	2
Housing for persons with disabilities	249	238	120	2	255	258
Housing for the elderly	773	741	741	1,096	875	875
Department of Labor:						
Employment and Training Administration:						
Unemployment trust fund	2,619	2,674	2,633	2,650	2,666	2,639
Social Security Administration:						
Supplemental security income program	3	3	3	3	3	3
Total, discretionary	**36,718**	**36,554**	**39,863**	**39,323**	**40,533**	**42,129**
Mandatory:						
Department of Agriculture:						
Agricultural Marketing Service:						
Funds for strengthening markets, income, and supply (section 32)	1,123	722	1,122	846	1,129	822
Food and Nutrition Service:						
Food stamp program	4,277	4,438	4,519	4,204	4,410	4,506
Child nutrition programs	11,250	11,632	12,283	11,035	11,990	12,303
Department of Health and Human Services:						
Administration for Children and Families:						
Payments to States for child support enforcement and family support programs	4,413	4,074	3,272	3,815	3,934	4,031
Contingency fund	1,958	2,000	....	....	30	45
Payments to States for foster care and adoption assistance	6,814	6,806	6,580	6,340	6,474	6,561
Child care entitlement to States	2,732	2,717	2,717	2,695	2,718	2,718
Temporary assistance for needy families	17,209	17,649	17,148	17,725	18,099	18,164
Total, mandatory	**49,776**	**50,038**	**47,641**	**46,660**	**48,784**	**49,150**
Total, income security	**86,494**	**86,592**	**87,504**	**85,983**	**89,317**	**91,279**

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		
	2004 Actual	2005 Estimate	2006 Estimate	2004 Actual	2005 Estimate	2006 Estimate
SOCIAL SECURITY						
Discretionary:						
Social Security Administration:						
Federal disability insurance trust fund	4	4	4	4	4	4
Mandatory:						
Social Security Administration:						
Federal disability insurance trust fund	3	30	52	3	17	41
Total, social security	**7**	**34**	**56**	**7**	**21**	**45**
VETERANS BENEFITS AND SERVICES						
Discretionary:						
Department of Veterans Affairs:						
Medical Programs:						
Medical services	439	488	264	439	488	264
Medical facilities	101	114	12	15	17	2
Total, veterans benefits and services	**540**	**602**	**276**	**454**	**505**	**266**
ADMINISTRATION OF JUSTICE						
Discretionary:						
Department of Health and Human Services:						
Administration for Children and Families:						
Violent crime reduction programs	....	....	....	1	2	....
Department of Homeland Security:						
Departmental Management:						
State and local programs	497	400	400	46	212	355
Department of Housing and Urban Development:						
Fair Housing and Equal Opportunity:						
Fair housing activities	48	46	39	47	44	42
Department of Justice:						
Legal Activities and U.S. Marshals:						
Assets forfeiture fund	....	21	21	....	21	21
Office of Justice Programs:						
Justice assistance	135	150	970	291	108	1,434
State and local law enforcement assistance	1,282	1,151	....	2,329	1,049	455
Juvenile justice programs	297	331	....	283	221	136
Community oriented policing services	742	499	22	947	575	489
Violence Against Women Office	366	372	352	39	263	353
Equal Employment Opportunity Commission:						
Salaries and expenses	33	31	31	33	31	33
Federal Drug Control Programs:						
High-intensity drug trafficking areas program	195	226	....	191	222	136
State Justice Institute:						
State Justice Institute: salaries and expenses	2	3	....	2	....	....
Total, discretionary	**3,597**	**3,230**	**1,835**	**4,209**	**2,748**	**3,454**
Mandatory:						
Department of Justice:						
Legal Activities and U.S. Marshals:						
Assets forfeiture fund	275	289	293	267	277	287
Office of Justice Programs:						
Crime victims fund	621	540	614	533	541	643
Department of the Treasury:						
Departmental Offices:						
Treasury forfeiture fund	75	75	75	75	75	75
Total, mandatory	**971**	**904**	**982**	**875**	**893**	**1,005**
Total, administration of justice	**4,568**	**4,134**	**2,817**	**5,084**	**3,641**	**4,459**

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 2004 Actual	Budget Authority 2005 Estimate	Budget Authority 2006 Estimate	Outlays 2004 Actual	Outlays 2005 Estimate	Outlays 2006 Estimate
GENERAL GOVERNMENT						
Discretionary:						
Department of Health and Human Services:						
Administration for Children and Families:						
Disabled voter services	....	....	....	3	8	4
Department of the Interior:						
United States Fish and Wildlife Service:						
National wildlife refuge fund	14	14	14	14	14	14
Departmental Management:						
Payments in lieu of taxes	225	227	200	225	227	200
Insular Affairs:						
Assistance to territories	48	48	46	49	54	58
Trust Territory of the Pacific Islands	....	....	....	4	3	2
District of Columbia:						
District of Columbia Courts:						
Federal payment to the District of Columbia courts	167	189	222	136	186	217
Defender services in District of Columbia courts	33	38	45	39	37	45
Federal payment for family court act	....	....	....	12	....	....
District of Columbia General and Special Payments:						
Federal support for economic development and management reforms in the District	108	69	13	108	69	13
Election Assistance Commission:						
Election reform programs	1,491	....	....	1,283	1,038	....
Total, discretionary	**2,086**	**585**	**540**	**1,873**	**1,636**	**553**
Mandatory:						
Department of Agriculture:						
Forest Service:						
Forest Service permanent appropriations	410	413	410	397	413	410
Department of Energy:						
Energy Programs:						
Payments to States under Federal Power Act	3	3	3	3	3	3
Department of Homeland Security:						
Border and Transportation Security:						
Refunds, transfers, and expenses of operation, Puerto Rico	85	89	98	79	89	98
Department of the Interior:						
Bureau of Land Management:						
Miscellaneous permanent payment accounts	5	5	....	5	5	....
Minerals Management Service:						
Mineral leasing and associated payments	1,164	1,817	1,788	1,164	1,817	1,788
United States Fish and Wildlife Service:						
National wildlife refuge fund	7	6	7	7	7	7
Insular Affairs:						
Assistance to territories	28	28	28	22	22	29
Payments to the United States territories, fiscal assistance	114	115	115	113	115	115
Department of the Treasury:						
Financial Management Service:						
Temporary State fiscal assistance fund	5,000	....	....	5,000	....	....
Alcohol and Tobacco Tax and Trade Bureau:						
Internal revenue collections for Puerto Rico	336	404	359	336	404	359
Corps of Engineers-Civil Works:						
Permanent appropriations	9	9	9	9	9	9
Total, mandatory	**7,161**	**2,889**	**2,817**	**7,135**	**2,884**	**2,818**
Total, general government	**9,247**	**3,474**	**3,357**	**9,008**	**4,520**	**3,371**
Total, Grants	**423,018**	**422,911**	**443,869**	**406,330**	**425,793**	**435,681**
Discretionary	135,003	137,968	128,877	164,628	172,886	176,685
Mandatory	288,015	284,943	314,992	241,702	252,907	258,996

Table 8–5. Summary of Programs by Agency, Bureau, and Program

(obligations in millions of dollars)

Agency, Bureau, and Program	FY 2004 (actual)	Estimated FY 2005 obligations from:			FY 2006 (estimated)
		Previous authority	New authority	Total	
Department of Agriculture, Food and Nutrition Service					
National School Lunch Program (10.555)	6,633	126	6,841	6,967	7,314
Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)	5,038	5	5,237	5,241	5,576
Child and Adult Care Food Program (10.558)	2,056	....	2,066	2,066	2,174
State Administrative Matching Grants for Food Stamp Program (10.561)	2,310	....	2,402	2,402	2,481
Department of Education, Office of Elementary and Secondary Education					
Title I Grants to Local Educational Agencies (84.010)	12,342	....	12,740	12,740	13,342
Improving Teacher Quality State Grants (84.336)	2,930	....	2,917	2,917	2,917
Department of Education, Office of Special Education and Rehabilitative Services					
Special Education—Grants to States (84.027)	10,068	....	10,590	10,590	11,098
Rehabilitation Services—Vocational Rehabilitation Grants to States (84.126)	2,584	....	2,636	2,636	2,720
Department of Health and Human Services, Centers for Medicare and Medicaid Services					
State Children's Health Insurance Program (93.767)	3,175	....	4,082	4,082	4,082
Grants to States for Medicaid (93.778)	184,382	....	188,535	188,535	215,571
Department of Health and Human Services, Administration for Children and Families					
Temporary Assistance for Needy Families (TANF)—Family Assistance Grants (93.558)	17,183	....	17,100	17,100	17,100
Child Support Enforcement—Federal Share of State and Local Administrative Costs and Incentives (93.563)	3,994	....	4,056	4,056	4,174
Child Care and Development Block Grant (93.575)	2,087	....	2,083	2,083	2,083
Child Care and Development Fund—Mandatory (93.596a)	1,235	....	1,235	1,235	1,235
Child Care and Development Fund—Matching (93.596b)	1,496	....	1,482	1,482	1,482
Head Start (93.600)	6,774	....	6,843	6,843	6,888
Foster Care—Title IV–E (93.658)	4,714	....	4,627	4,627	4,645
Department of Homeland Security, Departmental Management					
State Homeland Security Grant Program (97.067)	2,207	....	1,664	1,664	1,240
Department of Housing and Urban Development, Public and Indian Housing Programs					
Public Housing Operating Fund (14.850)	3,581	3	2,438	2,441	3,407
Section 8 Moderate Rehabilitation (14.856)	135	2	225	227	205
Housing Choice Vouchers (14.871)	14,511	245	14,507	14,752	15,845
Public Housing Capital Fund (14.872)	3,111	287	2,579	2,866	2,327
Department of Housing and Urban Development, Community Planning and Development					
HOME Investment Partnerships Program (14.239)	2,006	....	1,900	1,900	1,941
Department of Transportation, Federal Aviation Administration					
Airport Improvement Program (20.106a)	3,498	....	3,472	3,472	3,000
Airport Improvement Program—Emergency Response Fund (20.106b)	1	*	....	*	....
Airport Improvement Program—Emergency Assistance to Airports (20.106c)	....	....	25	25	....
Department of Transportation, Federal Highway Administration					
Highway Planning and Construction (20.205)	30,280	29,557	10,886	40,444	35,065
Department of Transportation, Federal Transit Administration					
Federal Transit Formula Grants and Research (Section 5307) (20.507)	3,836	....	6,012	6,012	6,863
Total	332,169	30,225	319,181	349,406	374,776

* $500,000 or less

Table 8–6. Summary of Programs by State

(obligations in millions of dollars)

State or Territory	All programs FY 2004 (actual)	Programs distributed					FY 2006 Percentage of distributed total
		FY 2004 (actual)	Estimated FY 2005 obligations from:			FY 2006 (estimated)	
			Previous authority	New authority	Total		
Alabama	4,868	4,868	531	4,436	4,966	5,020	1.43
Alaska	1,560	1,560	148	1,405	1,552	1,554	0.44
Arizona	6,053	6,053	431	6,178	6,609	7,102	2.03
Arkansas	3,497	3,497	366	3,408	3,774	4,070	1.16
California	40,688	40,688	2,580	38,513	41,093	41,053	11.73
Colorado	3,236	3,236	283	2,973	3,255	3,379	0.97
Connecticut	3,877	3,877	320	3,593	3,913	4,054	1.16
Delaware	869	869	120	760	880	911	0.26
District of Columbia	1,679	1,679	142	1,475	1,617	1,664	0.48
Florida	14,656	14,656	1,157	14,203	15,360	15,955	4.56
Georgia	9,322	9,322	1,078	8,006	9,085	9,475	2.71
Hawaii	1,386	1,386	229	1,160	1,389	1,391	0.40
Idaho	1,369	1,369	193	1,233	1,425	1,497	0.43
Illinois	12,166	12,166	952	10,712	11,664	12,239	3.50
Indiana	5,633	5,633	503	5,614	6,117	6,476	1.85
Iowa	2,761	2,761	294	2,565	2,859	2,972	0.85
Kansas	2,458	2,458	317	2,243	2,560	2,650	0.76
Kentucky	5,180	5,180	401	4,735	5,136	5,363	1.53
Louisiana	6,119	6,119	583	5,479	6,062	6,383	1.82
Maine	2,093	2,093	121	1,944	2,065	2,095	0.60
Maryland	5,024	5,024	440	4,631	5,070	5,286	1.51
Massachusetts	8,222	8,222	1,078	7,769	8,846	9,014	2.58
Michigan	9,731	9,731	787	9,104	9,891	10,167	2.90
Minnesota	5,005	5,005	414	4,710	5,125	5,364	1.53
Mississippi	4,261	4,261	334	4,142	4,476	4,649	1.33
Missouri	6,550	6,550	517	6,437	6,954	7,437	2.12
Montana	1,171	1,171	196	970	1,166	1,211	0.35
Nebraska	1,790	1,790	188	1,638	1,826	1,920	0.55
Nevada	1,521	1,521	196	1,427	1,624	1,651	0.47
New Hampshire	1,228	1,228	135	1,101	1,237	1,252	0.36
New Jersey	8,524	8,524	774	7,903	8,677	8,887	2.54
New Mexico	3,053	3,053	245	2,798	3,043	3,122	0.89
New York	36,463	36,463	1,526	37,341	38,868	40,154	11.47
North Carolina	9,111	9,111	633	8,866	9,500	10,213	2.92
North Dakota	874	874	160	719	879	875	0.25
Ohio	12,792	12,792	1,129	12,210	13,339	14,129	4.04
Oklahoma	3,777	3,777	412	3,476	3,887	3,950	1.13
Oregon	3,455	3,455	274	3,372	3,646	3,705	1.06
Pennsylvania	14,617	14,617	1,538	14,439	15,977	16,465	4.70
Rhode Island	1,686	1,686	143	1,545	1,688	1,750	0.50
South Carolina	4,766	4,766	392	4,302	4,694	4,786	1.37
South Dakota	962	962	201	805	1,005	1,024	0.29
Tennessee	7,763	7,763	744	7,023	7,767	7,966	2.28
Texas	20,980	20,980	1,726	20,271	21,997	22,972	6.56
Utah	1,975	1,975	231	1,848	2,080	2,169	0.62
Vermont	1,002	1,002	142	841	983	992	0.28
Virginia	5,073	5,073	713	4,695	5,408	5,590	1.60
Washington	5,848	5,848	460	5,518	5,979	5,903	1.69
West Virginia	2,682	2,682	371	2,353	2,724	2,750	0.79
Wisconsin	5,103	5,103	507	4,550	5,057	5,059	1.45
Wyoming	693	693	148	544	692	696	0.20
American Samoa	55	55	1	49	51	46	0.01
Guam	121	121	1	131	132	131	0.04
Northern Mariana Islands	57	57	*	55	55	48	0.01
Puerto Rico	2,313	2,313	27	2,376	2,403	2,500	0.71
Freely Associated States	....	....	....	7	7	7	*
Virgin Islands	130	130	23	116	139	133	0.04
Indian Tribes	683	683	*	701	701	720	0.21
Total, distributed by State	**328,532**	**328,532**	**27,555**	**311,417**	**338,972**	**349,994**	**100.00**
MEMORANDUM:							
Undistributed	3,637	3,637	2,669	7,764	10,433	24,782	N/A
Total, including undistributed	332,169	332,169	30,225	319,181	349,406	374,776	N/A

* $500,000 or less or 0.005 percent or less.

Table 8–7. National School Lunch Program (10.555)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	127,226	2,419	131,476	133,895	140,567	1.92
Alaska	18,293	348	18,904	19,252	20,211	0.28
Arizona	143,895	2,735	148,702	151,437	158,984	2.17
Arkansas	74,373	1,414	76,857	78,271	82,172	1.12
California	892,272	16,960	922,078	939,038	985,842	13.48
Colorado	66,229	1,259	68,441	69,700	73,174	1.00
Connecticut	54,357	1,033	56,173	57,206	60,057	0.82
Delaware	14,134	269	14,606	14,875	15,616	0.21
District of Columbia	14,397	274	14,878	15,152	15,907	0.22
Florida	376,648	7,160	389,230	396,390	416,144	5.69
Georgia	261,885	4,978	270,633	275,611	289,347	3.96
Hawaii	28,001	532	28,936	29,468	30,937	0.42
Idaho	30,546	581	31,566	32,147	33,749	0.46
Illinois	255,714	4,861	264,256	269,117	282,529	3.86
Indiana	118,015	2,243	121,957	124,200	130,390	1.78
Iowa	55,782	1,060	57,645	58,705	61,631	0.84
Kansas	56,285	1,070	58,165	59,235	62,187	0.85
Kentucky	111,633	2,122	115,362	117,484	123,339	1.69
Louisiana	156,763	2,980	162,000	164,980	173,202	2.37
Maine	19,940	379	20,606	20,985	22,031	0.30
Maryland	83,998	1,597	86,804	88,401	92,806	1.27
Massachusetts	91,712	1,743	94,776	96,519	101,329	1.39
Michigan	167,524	3,185	173,120	176,305	185,091	2.53
Minnesota	83,472	1,587	86,260	87,847	92,225	1.26
Mississippi	113,322	2,154	117,108	119,262	125,205	1.71
Missouri	121,694	2,313	125,759	128,072	134,455	1.84
Montana	15,946	303	16,479	16,782	17,618	0.24
Nebraska	35,914	683	37,114	37,797	39,680	0.54
Nevada	38,065	724	39,337	40,061	42,057	0.57
New Hampshire	13,544	257	13,996	14,253	14,964	0.20
New Jersey	131,050	2,491	135,428	137,919	144,792	1.98
New Mexico	57,136	1,086	59,045	60,131	63,127	0.86
New York	429,700	8,168	444,054	452,222	474,760	6.49
North Carolina	205,617	3,909	212,486	216,395	227,179	3.11
North Dakota	11,252	214	11,628	11,842	12,432	0.17
Ohio	193,723	3,683	200,194	203,877	214,037	2.93
Oklahoma	93,504	1,777	96,628	98,405	103,309	1.41
Oregon	63,794	1,213	65,925	67,138	70,484	0.96
Pennsylvania	198,589	3,775	205,223	208,998	219,414	3.00
Rhode Island	19,438	370	20,087	20,457	21,476	0.29
South Carolina	118,039	2,244	121,982	124,226	130,417	1.78
South Dakota	17,558	334	18,145	18,479	19,399	0.27
Tennessee	139,614	2,654	144,278	146,932	154,254	2.11
Texas	741,731	14,100	766,509	780,609	819,511	11.20
Utah	52,134	991	53,876	54,867	57,601	0.79
Vermont	8,849	168	9,145	9,313	9,777	0.13
Virginia	124,205	2,361	128,354	130,715	137,229	1.88
Washington	108,928	2,071	112,567	114,638	120,351	1.65
West Virginia	42,497	808	43,917	44,725	46,953	0.64
Wisconsin	87,785	1,669	90,717	92,386	96,990	1.33
Wyoming	8,566	163	8,852	9,015	9,464	0.13
American Samoa	....	....	....	....	....	....
Guam	4,340	83	4,485	4,568	4,795	0.07
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	111,077	2,112	114,788	116,900	122,725	1.68
Freely Associated States	....	....	....	....	....	....
Virgin Islands	4,138	79	4,276	4,355	4,572	0.06
Indian Tribes	....	....	....	....	....	....
Undistributed	12,665	....	....	....	....	....
DOD/AF/USMC/Navy	5,328	101	5,506	5,607	5,887	0.08
Total	**6,632,836**	**125,847**	**6,841,319**	**6,967,166**	**7,314,381**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–8. Special Supplemental Nutrition Program for Women, Infants, and Children (WIC) (10.557)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from:			FY 2006 (estimated)	FY 2006 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	79,648	15	83,337	83,352	88,716	1.60
Alaska	21,718	4	22,724	22,728	24,191	0.44
Arizona	100,030	19	104,662	104,681	111,419	2.01
Arkansas	56,639	11	59,262	59,273	63,088	1.14
California	860,358	167	900,203	900,370	958,308	17.29
Colorado	50,301	10	52,630	52,640	56,028	1.01
Connecticut	34,712	7	36,320	36,327	38,664	0.70
Delaware	10,469	2	10,954	10,956	11,661	0.21
District of Columbia	13,133	3	13,741	13,744	14,628	0.26
Florida	235,383	45	246,284	246,329	262,182	4.73
Georgia	154,950	30	162,126	162,156	172,592	3.11
Hawaii	29,352	6	30,711	30,717	32,694	0.59
Idaho	20,183	4	21,118	21,122	22,481	0.41
Illinois	180,400	35	188,754	188,789	200,939	3.62
Indiana	75,117	14	78,596	78,610	83,669	1.51
Iowa	39,093	8	40,903	40,911	43,544	0.79
Kansas	39,548	8	41,379	41,387	44,051	0.79
Kentucky	72,697	14	76,064	76,078	80,974	1.46
Louisiana	92,667	18	96,958	96,976	103,217	1.86
Maine	12,265	2	12,833	12,835	13,661	0.25
Maryland	63,049	12	65,969	65,981	70,227	1.27
Massachusetts	66,842	13	69,937	69,950	74,452	1.34
Michigan	127,139	25	133,027	133,052	141,614	2.55
Minnesota	66,884	13	69,981	69,994	74,499	1.34
Mississippi	63,064	12	65,985	65,997	70,244	1.27
Missouri	78,025	15	81,638	81,653	86,908	1.57
Montana	14,068	3	14,719	14,722	15,670	0.28
Nebraska	23,396	5	24,479	24,484	26,060	0.47
Nevada	27,439	5	28,710	28,715	30,563	0.55
New Hampshire	10,123	2	10,592	10,594	11,276	0.20
New Jersey	91,066	18	95,283	95,301	101,434	1.83
New Mexico	37,619	7	39,361	39,368	41,902	0.76
New York	332,847	64	348,261	348,325	370,743	6.69
North Carolina	136,662	26	142,991	143,017	152,221	2.75
North Dakota	9,078	2	9,498	9,500	10,112	0.18
Ohio	153,669	30	160,785	160,815	171,165	3.09
Oklahoma	50,407	10	52,741	52,751	56,146	1.01
Oregon	64,026	12	66,991	67,003	71,316	1.29
Pennsylvania	136,033	26	142,333	142,359	151,521	2.73
Rhode Island	14,345	3	15,009	15,012	15,978	0.29
South Carolina	63,067	12	65,988	66,000	70,247	1.27
South Dakota	12,796	2	13,389	13,391	14,253	0.26
Tennessee	100,127	19	104,764	104,783	111,527	2.01
Texas	480,574	93	502,830	502,923	535,289	9.66
Utah	35,125	7	36,752	36,759	39,124	0.71
Vermont	11,401	2	11,929	11,931	12,699	0.23
Virginia	77,826	15	81,430	81,445	86,687	1.56
Washington	106,230	20	111,150	111,170	118,325	2.13
West Virginia	32,094	6	33,580	33,586	35,748	0.64
Wisconsin	64,460	12	67,445	67,457	71,799	1.30
Wyoming	6,627	1	6,934	6,935	7,382	0.13
American Samoa	6,145	1	6,430	6,431	6,845	0.12
Guam	6,343	1	6,637	6,638	7,065	0.13
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	176,815	34	185,003	185,037	196,946	3.55
Freely Associated States	....	....	....	....	....	....
Virgin Islands	5,565	1	5,823	5,824	6,199	0.11
Indian Tribes	47,426	9	49,622	49,631	52,826	0.95
Undistributed	32,585	....	29,165	29,165	32,000	....
Farmers' Market Nutrition Program [1]	27,952	3,684	....	3,684	....	....
Total	**5,037,602**	**4,644**	**5,236,720**	**5,241,364**	**5,575,719**	[2] **100.00**

[1] The Farmers' Market Nutrition Program is funded at $20 million in the Commodity Assistance Program account in FY 2005 and FY 2006.
[2] Excludes undistributed obligations.

Table 8–9. Child and Adult Care Food Program (10.558)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from:			FY 2006 (estimated)	FY 2006 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	32,785	....	34,702	34,702	36,517	1.68
Alaska	6,876	....	7,278	7,278	7,659	0.35
Arizona	42,104	....	44,566	44,566	46,897	2.16
Arkansas	23,428	....	24,798	24,798	26,095	1.20
California	232,699	....	246,301	246,301	259,186	11.92
Colorado	19,602	....	20,748	20,748	21,833	1.00
Connecticut	9,870	....	10,447	10,447	10,994	0.51
Delaware	8,525	....	9,023	9,023	9,495	0.44
District of Columbia	3,121	....	3,303	3,303	3,476	0.16
Florida	99,946	....	105,789	105,789	111,324	5.12
Georgia	70,993	....	75,143	75,143	79,075	3.64
Hawaii	4,648	....	4,920	4,920	5,177	0.24
Idaho	4,395	....	4,652	4,652	4,895	0.23
Illinois	91,681	....	97,041	97,041	102,118	4.70
Indiana	28,532	....	30,200	30,200	31,780	1.46
Iowa	18,384	....	19,459	19,459	20,477	0.94
Kansas	28,900	....	30,590	30,590	32,190	1.48
Kentucky	23,675	....	25,059	25,059	26,370	1.21
Louisiana	51,246	....	54,242	54,242	57,080	2.63
Maine	9,457	....	10,010	10,010	10,534	0.48
Maryland	31,999	....	33,870	33,870	35,642	1.64
Massachusetts	42,156	....	44,621	44,621	46,955	2.16
Michigan	48,595	....	51,436	51,436	54,127	2.49
Minnesota	55,948	....	59,219	59,219	62,317	2.87
Mississippi	25,598	....	27,095	27,095	28,512	1.31
Missouri	35,296	....	37,359	37,359	39,314	1.81
Montana	8,645	....	9,150	9,150	9,629	0.44
Nebraska	22,108	....	23,400	23,400	24,625	1.13
Nevada	4,015	....	4,250	4,250	4,472	0.21
New Hampshire	2,634	....	2,788	2,788	2,934	0.13
New Jersey	43,021	....	45,536	45,536	47,918	2.20
New Mexico	34,094	....	36,087	36,087	37,975	1.75
New York	136,673	....	144,663	144,663	152,232	7.00
North Carolina	73,019	....	77,288	77,288	81,331	3.74
North Dakota	8,940	....	9,463	9,463	9,958	0.46
Ohio	57,444	....	60,802	60,802	63,983	2.94
Oklahoma	46,242	....	48,945	48,945	51,506	2.37
Oregon	21,721	....	22,991	22,991	24,194	1.11
Pennsylvania	49,741	....	52,649	52,649	55,403	2.55
Rhode Island	6,409	....	6,784	6,784	7,139	0.33
South Carolina	22,405	....	23,715	23,715	24,956	1.15
South Dakota	6,086	....	6,442	6,442	6,779	0.31
Tennessee	38,604	....	40,861	40,861	42,999	1.98
Texas	159,436	....	168,757	168,757	177,586	8.17
Utah	19,948	....	21,114	21,114	22,219	1.02
Vermont	3,861	....	4,087	4,087	4,301	0.20
Virginia	26,978	....	28,555	28,555	30,049	1.38
Washington	36,864	....	39,019	39,019	41,061	1.89
West Virginia	14,565	....	15,417	15,417	16,223	0.75
Wisconsin	33,660	....	35,628	35,628	37,492	1.72
Wyoming	4,553	....	4,819	4,819	5,071	0.23
American Samoa	....	....	....	....	....	....
Guam	39	....	41	41	43	*
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	19,353	....	20,484	20,484	21,556	0.99
Freely Associated States	....	....	....	....	....	....
Virgin Islands	557	....	590	590	620	0.03
Indian Tribes	....	....	....	....	....	....
Undistributed	103,622	....	....	....	....	....
Total	**2,055,696**	....	**2,066,196**	**2,066,196**	**2,174,293**	[1] **100.00**

* $500 or less or 0.005 percent or less.
[1] Excludes undistributed obligations.

Table 8–10. State Administrative Matching Grants for Food Stamp Program (10.561)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	30,754	....	31,522	31,522	32,559	1.31
Alaska	7,665	....	7,857	7,857	8,115	0.33
Arizona	30,742	....	31,510	31,510	32,546	1.31
Arkansas	24,964	....	25,588	25,588	26,429	1.07
California	377,619	....	387,048	387,048	399,784	16.11
Colorado	24,359	....	24,967	24,967	25,788	1.04
Connecticut	17,994	....	18,444	18,444	19,050	0.77
Delaware	6,825	....	6,995	6,995	7,225	0.29
District of Columbia	10,233	....	10,489	10,489	10,834	0.44
Florida	77,776	....	79,719	79,719	82,341	3.32
Georgia	60,718	....	62,234	62,234	64,281	2.59
Hawaii	10,439	....	10,700	10,700	11,052	0.45
Idaho	8,563	....	8,777	8,777	9,065	0.37
Illinois	85,166	....	87,293	87,293	90,164	3.63
Indiana	38,927	....	39,899	39,899	41,211	1.66
Iowa	15,806	....	16,200	16,200	16,733	0.67
Kansas	15,132	....	15,510	15,510	16,020	0.65
Kentucky	27,996	....	28,695	28,695	29,639	1.19
Louisiana	42,871	....	43,942	43,942	45,387	1.83
Maine	9,547	....	9,786	9,786	10,108	0.41
Maryland	34,491	....	35,352	35,352	36,515	1.47
Massachusetts	32,542	....	33,355	33,355	34,452	1.39
Michigan	84,531	....	86,643	86,643	89,492	3.61
Minnesota	35,640	....	36,530	36,530	37,731	1.52
Mississippi	24,821	....	25,441	25,441	26,278	1.06
Missouri	33,575	....	34,414	34,414	35,545	1.43
Montana	6,295	....	6,453	6,453	6,665	0.27
Nebraska	14,720	....	15,087	15,087	15,584	0.63
Nevada	11,645	....	11,936	11,936	12,328	0.50
New Hampshire	5,151	....	5,280	5,280	5,453	0.22
New Jersey	81,582	....	83,620	83,620	86,370	3.48
New Mexico	19,258	....	19,739	19,739	20,388	0.82
New York	252,142	....	258,438	258,438	266,938	10.76
North Carolina	60,391	....	61,900	61,900	63,936	2.58
North Dakota	5,482	....	5,619	5,619	5,803	0.23
Ohio	105,536	....	108,172	108,172	111,730	4.50
Oklahoma	32,897	....	33,718	33,718	34,827	1.40
Oregon	37,347	....	38,280	38,280	39,539	1.59
Pennsylvania	125,890	....	129,034	129,034	133,278	5.37
Rhode Island	6,565	....	6,729	6,729	6,950	0.28
South Carolina	18,521	....	18,984	18,984	19,608	0.79
South Dakota	5,891	....	6,038	6,038	6,236	0.25
Tennessee	33,610	....	34,449	34,449	35,582	1.43
Texas	158,542	....	162,502	162,502	167,846	6.77
Utah	18,426	....	18,886	18,886	19,507	0.79
Vermont	5,973	....	6,122	6,122	6,324	0.25
Virginia	68,690	....	70,406	70,406	72,722	2.93
Washington	44,051	....	45,151	45,151	46,636	1.88
West Virginia	14,381	....	14,740	14,740	15,225	0.61
Wisconsin	30,899	....	31,671	31,671	32,712	1.32
Wyoming	3,634	....	3,725	3,725	3,847	0.16
American Samoa	....	....	....	....	....	....
Guam	2,439	....	2,500	2,500	2,582	0.10
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	....	....	....	....	....	....
Freely Associated States	....	....	....	....	....	....
Virgin Islands	3,816	....	3,911	3,911	4,040	0.16
Indian Tribes	....	....	....	....	....	....
Undistributed	−33,103	....	....	....	....	....
Total	**2,310,367**	....	**2,402,000**	**2,402,000**	**2,481,000**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–11. Title I Grants to Local Educational Agencies (84.010)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from:			FY 2006 (estimated)	FY 2006 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	187,083	...	194,434	194,434	202,510	1.52
Alaska	32,502	...	33,703	33,703	35,472	0.27
Arizona	229,883	...	248,135	248,135	259,425	1.95
Arkansas	118,717	...	124,322	124,322	128,638	0.96
California	1,765,538	...	1,782,922	1,782,922	1,865,502	13.99
Colorado	114,691	...	123,665	123,665	128,769	0.97
Connecticut	109,085	...	107,594	107,594	109,335	0.82
Delaware	32,225	...	33,817	33,817	35,703	0.27
District of Columbia	49,372	...	49,954	49,954	53,073	0.40
Florida	574,724	...	609,443	609,443	644,906	4.84
Georgia	381,941	...	401,779	401,779	418,947	3.14
Hawaii	43,294	...	47,518	47,518	50,217	0.38
Idaho	41,593	...	42,115	42,115	43,849	0.33
Illinois	523,252	...	538,448	538,448	565,117	4.24
Indiana	167,431	...	172,071	172,071	177,667	1.33
Iowa	64,685	...	63,983	63,983	65,227	0.49
Kansas	81,995	...	80,341	80,341	81,844	0.61
Kentucky	171,224	...	185,539	185,539	193,094	1.45
Louisiana	267,601	...	277,777	277,777	291,204	2.18
Maine	45,160	...	48,790	48,790	50,848	0.38
Maryland	163,739	...	171,796	171,796	181,074	1.36
Massachusetts	234,039	...	230,405	230,405	236,124	1.77
Michigan	416,587	...	434,040	434,040	449,565	3.37
Minnesota	105,428	...	108,893	108,893	111,522	0.84
Mississippi	160,730	...	167,439	167,439	173,358	1.30
Missouri	185,417	...	196,279	196,279	203,930	1.53
Montana	40,527	...	41,625	41,625	43,248	0.32
Nebraska	48,242	...	50,867	50,867	52,765	0.40
Nevada	64,007	...	67,770	67,770	71,686	0.54
New Hampshire	29,264	...	32,310	32,310	34,014	0.26
New Jersey	266,434	...	271,609	271,609	278,531	2.09
New Mexico	114,717	...	109,295	109,295	112,482	0.84
New York	1,241,954	...	1,232,206	1,232,206	1,292,886	9.70
North Carolina	271,257	...	287,345	287,345	300,766	2.26
North Dakota	30,257	...	32,136	32,136	33,884	0.25
Ohio	400,078	...	385,984	385,984	398,431	2.99
Oklahoma	141,060	...	140,047	140,047	144,199	1.08
Oregon	131,498	...	124,284	124,284	127,248	0.95
Pennsylvania	432,704	...	476,974	476,974	497,707	3.73
Rhode Island	45,773	...	47,986	47,986	50,190	0.38
South Carolina	165,457	...	178,282	178,282	186,045	1.40
South Dakota	34,602	...	36,167	36,167	38,255	0.29
Tennessee	199,727	...	203,229	203,229	212,517	1.59
Texas	1,110,706	...	1,173,904	1,173,904	1,232,413	9.24
Utah	50,780	...	55,430	55,430	57,646	0.43
Vermont	27,919	...	29,144	29,144	30,718	0.23
Virginia	195,589	...	216,198	216,198	226,007	1.69
Washington	170,680	...	176,327	176,327	182,792	1.37
West Virginia	94,828	...	103,025	103,025	106,969	0.80
Wisconsin	160,676	...	162,951	162,951	168,643	1.26
Wyoming	29,788	...	30,640	30,640	32,313	0.24
American Samoa	7,716	...	8,462	8,462	8,879	0.07
Guam	6,750	...	7,546	7,546	7,918	0.06
Northern Mariana Islands	3,463	...	3,660	3,660	3,840	0.03
Puerto Rico	449,160	...	467,838	467,838	536,146	4.02
Freely Associated States	...	...	...	...	...	...
Virgin Islands	10,368	...	11,371	11,371	11,931	0.09
Indian Tribes	90,093	...	91,322	91,322	95,819	0.72
Undistributed	8,300	...	8,436	8,436	8,500	...
Total	**12,342,309**	...	[1] **12,739,571**	[1] **12,739,571**	**13,342,309**	[2] **100.00**

[1] Amounts reflect program level, not budget authority.
[2] Excludes undistributed obligations.

Table 8–12. Improving Teacher Quality State Grants (84.336)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from:			FY 2006 (estimated)	FY 2006 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	46,771	....	46,549	46,549	46,549	1.60
Alaska	13,962	....	13,895	13,895	13,895	0.48
Arizona	48,198	....	47,919	47,919	47,919	1.65
Arkansas	28,585	....	28,446	28,446	28,446	0.98
California	341,332	....	339,525	339,525	339,525	11.70
Colorado	32,642	....	32,483	32,483	32,483	1.12
Connecticut	26,868	....	26,757	26,757	26,757	0.92
Delaware	13,962	....	13,895	13,895	13,895	0.48
District of Columbia	13,962	....	13,895	13,895	13,895	0.48
Florida	134,559	....	133,871	133,871	133,871	4.61
Georgia	77,740	....	77,338	77,338	77,338	2.66
Hawaii	13,962	....	13,895	13,895	13,895	0.48
Idaho	13,962	....	13,895	13,895	13,895	0.48
Illinois	118,017	....	117,504	117,504	117,504	4.05
Indiana	48,431	....	48,215	48,215	48,215	1.66
Iowa	22,015	....	21,924	21,924	21,924	0.76
Kansas	22,582	....	22,487	22,487	22,487	0.77
Kentucky	44,492	....	44,307	44,307	44,307	1.53
Louisiana	65,679	....	65,403	65,403	65,403	2.25
Maine	13,962	....	13,895	13,895	13,895	0.48
Maryland	41,811	....	41,631	41,631	41,631	1.43
Massachusetts	51,936	....	51,726	51,726	51,726	1.78
Michigan	109,363	....	108,973	108,973	108,973	3.76
Minnesota	37,902	....	37,755	37,755	37,755	1.30
Mississippi	42,509	....	42,331	42,331	42,331	1.46
Missouri	49,749	....	49,527	49,527	49,527	1.71
Montana	13,962	....	13,895	13,895	13,895	0.48
Nebraska	14,239	....	14,172	14,172	14,172	0.49
Nevada	15,136	....	15,050	15,050	15,050	0.52
New Hampshire	13,962	....	13,895	13,895	13,895	0.48
New Jersey	65,483	....	65,202	65,202	65,202	2.25
New Mexico	23,943	....	23,823	23,823	23,823	0.82
New York	233,276	....	232,363	232,363	232,363	8.01
North Carolina	65,057	....	64,712	64,712	64,712	2.23
North Dakota	13,962	....	13,895	13,895	13,895	0.48
Ohio	105,387	....	104,961	104,961	104,961	3.62
Oklahoma	34,205	....	34,037	34,037	34,037	1.17
Oregon	28,550	....	28,412	28,412	28,412	0.98
Pennsylvania	113,486	....	113,062	113,062	113,062	3.90
Rhode Island	13,962	....	13,895	13,895	13,895	0.48
South Carolina	36,901	....	36,716	36,716	36,716	1.27
South Dakota	13,962	....	13,895	13,895	13,895	0.48
Tennessee	50,062	....	49,814	49,814	49,814	1.72
Texas	242,257	....	241,052	241,052	241,052	8.31
Utah	18,739	....	18,650	18,650	18,650	0.64
Vermont	13,962	....	13,895	13,895	13,895	0.48
Virginia	52,577	....	52,325	52,325	52,325	1.80
Washington	47,659	....	47,438	47,438	47,438	1.63
West Virginia	23,827	....	23,743	23,743	23,743	0.82
Wisconsin	46,014	....	45,834	45,834	45,834	1.58
Wyoming	13,962	....	13,895	13,895	13,895	0.48
American Samoa	3,474	....	3,456	3,456	3,456	0.12
Guam	5,127	....	5,105	5,105	5,105	0.18
Northern Mariana Islands	1,636	....	1,628	1,628	1,628	0.06
Puerto Rico	96,838	....	96,331	96,331	96,331	3.32
Freely Associated States	....	....	....	....	....	....
Virgin Islands	4,341	....	4,322	4,322	4,322	0.15
Indian Tribes	14,577	....	14,510	14,510	14,510	0.50
Undistributed	14,651	....	14,583	14,583	14,583	....
Total	**2,930,126**	....	[1] **2,916,605**	[1] **2,916,605**	**2,916,605**	[2] **100.00**

[1] Amounts reflect program level, not budget authority.
[2] Excludes undistributed obligations.

Table 8–13. Special Education—Grants to States (84.027)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from:			FY 2006 (estimated)	FY 2006 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	160,386		167,865	167,865	175,112	1.58
Alaska	30,463		32,499	32,499	34,545	0.31
Arizona	152,382		162,563	162,563	172,800	1.56
Arkansas	98,750		103,546	103,546	108,906	0.98
California	1,072,637		1,132,573	1,132,573	1,192,554	10.76
Colorado	129,058		137,681	137,681	146,351	1.32
Connecticut	117,261		122,729	122,729	128,028	1.15
Delaware	27,920		29,785	29,785	31,661	0.29
District of Columbia	14,038		14,976	14,976	15,919	0.14
Florida	551,219		581,254	581,254	610,553	5.51
Georgia	267,886		285,784	285,784	303,780	2.74
Hawaii	35,212		36,854	36,854	38,709	0.35
Idaho	47,389		50,109	50,109	52,765	0.48
Illinois	446,658		467,485	467,485	487,668	4.40
Indiana	225,537		236,054	236,054	246,245	2.22
Iowa	107,669		112,690	112,690	117,555	1.06
Kansas	94,250		98,645	98,645	102,904	0.93
Kentucky	137,697		145,703	145,703	152,961	1.38
Louisiana	163,815		174,760	174,760	185,250	1.67
Maine	48,258		50,509	50,509	52,689	0.48
Maryland	176,590		184,824	184,824	193,392	1.74
Massachusetts	250,351		262,025	262,025	273,338	2.47
Michigan	353,313		369,788	369,788	385,753	3.48
Minnesota	167,415		175,222	175,222	182,787	1.65
Mississippi	104,964		109,859	109,859	114,602	1.03
Missouri	200,334		209,676	209,676	218,728	1.97
Montana	32,189		33,928	33,928	35,621	0.32
Nebraska	65,854		68,924	68,924	71,900	0.65
Nevada	57,306		61,135	61,135	64,985	0.59
New Hampshire	41,854		43,805	43,805	45,697	0.41
New Jersey	318,780		333,645	333,645	348,049	3.14
New Mexico	80,379		84,127	84,127	87,760	0.79
New York	669,506		700,725	700,725	730,978	6.59
North Carolina	271,197		288,837	288,837	303,763	2.74
North Dakota	22,670		24,185	24,185	25,708	0.23
Ohio	386,053		404,055	404,055	421,499	3.80
Oklahoma	130,456		136,539	136,539	142,434	1.28
Oregon	113,748		119,052	119,052	124,192	1.12
Pennsylvania	376,739		394,307	394,307	411,330	3.71
Rhode Island	38,567		40,365	40,365	42,108	0.38
South Carolina	154,478		161,682	161,682	168,662	1.52
South Dakota	27,006		28,811	28,811	30,625	0.28
Tennessee	205,686		215,277	215,277	224,571	2.03
Texas	834,470		889,556	889,556	936,850	8.45
Utah	93,688		98,468	98,468	103,653	0.93
Vermont	21,859		23,319	23,319	24,787	0.22
Virginia	246,109		259,999	259,999	273,145	2.46
Washington	195,226		204,329	204,329	213,151	1.92
West Virginia	66,978		70,101	70,101	73,128	0.66
Wisconsin	183,608		192,169	192,169	200,466	1.81
Wyoming	22,932		24,464	24,464	26,004	0.23
American Samoa	5,935		6,125	6,125	6,250	0.06
Guam	13,160		13,580	13,580	13,857	0.12
Northern Mariana Islands	4,510		4,654	4,654	4,749	0.04
Puerto Rico	93,148		99,371	99,371	105,629	0.95
Freely Associated States			6,579	6,579	6,579	0.06
Virgin Islands	8,364		8,631	8,631	8,807	0.08
Indian Tribes	81,617		83,546	83,546	85,253	0.77
Undistributed	22,579		10,000	10,000	10,000	
Total	**10,068,106**		[1] **10,589,746**	[1] **10,589,746**	**11,097,746**	[2] **100.00**

[1] Amounts reflect program levels, not budget authority.
[2] Excludes undistributed obligations.

Table 8–14. Rehabilitation Services—Vocational Rehabilitation Grants to States (84.126)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	54,054	....	53,746	53,746	54,409	2.00
Alaska	8,602	....	8,679	8,679	8,957	0.33
Arizona	48,460	....	50,162	50,162	52,642	1.94
Arkansas	33,685	....	33,647	33,647	34,285	1.26
California	247,893	....	248,655	248,655	259,966	9.56
Colorado	26,165	....	31,944	31,944	32,548	1.20
Connecticut	18,762	....	18,765	18,765	19,238	0.71
Delaware	8,614	....	8,679	8,679	8,957	0.33
District of Columbia	12,091	....	11,795	11,795	11,898	0.44
Florida	125,909	....	139,316	139,316	145,570	5.35
Georgia	76,060	....	77,939	77,939	81,909	3.01
Hawaii	10,212	....	10,447	10,447	10,749	0.40
Idaho	13,831	....	14,120	14,120	14,602	0.54
Illinois	94,794	....	94,851	94,851	100,013	3.68
Indiana	60,435	....	61,488	61,488	63,749	2.34
Iowa	27,272	....	29,757	29,757	30,428	1.12
Kansas	24,992	....	25,388	25,388	25,966	0.95
Kentucky	48,352	....	48,157	48,157	49,003	1.80
Louisiana	44,123	....	54,249	54,249	54,442	2.00
Maine	14,644	....	14,485	14,485	14,385	0.53
Maryland	38,306	....	37,913	37,913	37,563	1.38
Massachusetts	45,203	....	43,238	43,238	43,959	1.62
Michigan	88,505	....	88,861	88,861	91,954	3.38
Minnesota	40,635	....	40,247	40,247	41,739	1.53
Mississippi	39,128	....	39,012	39,012	39,560	1.45
Missouri	56,706	....	56,696	56,696	58,690	2.16
Montana	10,227	....	10,436	10,436	10,456	0.38
Nebraska	16,460	....	16,464	16,464	16,870	0.62
Nevada	12,920	....	15,581	15,581	16,595	0.61
New Hampshire	10,120	....	9,800	9,800	10,173	0.37
New Jersey	51,532	....	52,365	52,365	52,405	1.93
New Mexico	21,478	....	21,645	21,645	21,362	0.79
New York	135,187	....	135,117	135,117	141,341	5.20
North Carolina	81,859	....	82,554	82,554	86,186	3.17
North Dakota	8,511	....	8,679	8,679	8,957	0.33
Ohio	111,423	....	110,929	110,929	114,494	4.21
Oklahoma	38,443	....	39,104	39,104	39,002	1.43
Oregon	31,182	....	31,884	31,884	33,265	1.22
Pennsylvania	115,424	....	114,523	114,523	117,718	4.33
Rhode Island	9,730	....	9,895	9,895	9,972	0.37
South Carolina	45,035	....	46,250	46,250	47,450	1.74
South Dakota	8,651	....	8,679	8,679	8,957	0.33
Tennessee	60,634	....	60,699	60,699	62,257	2.29
Texas	190,424	....	193,029	193,029	201,770	7.42
Utah	23,887	....	24,527	24,527	25,154	0.92
Vermont	8,614	....	8,679	8,679	8,957	0.33
Virginia	59,270	....	58,599	58,599	59,719	2.20
Washington	45,222	....	44,933	44,933	46,564	1.71
West Virginia	24,381	....	24,070	24,070	24,014	0.88
Wisconsin	51,504	....	51,867	51,867	52,854	1.94
Wyoming	7,399	....	8,679	8,679	8,957	0.33
American Samoa	739	....	868	868	891	0.03
Guam	1,700	....	2,611	2,611	2,704	0.10
Northern Mariana Islands	960	....	1,000	1,000	1,055	0.04
Puerto Rico	61,124	....	66,280	66,280	67,984	2.50
Freely Associated States	....	....	....	....	....	....
Virgin Islands	1,889	....	1,861	1,861	1,903	0.07
Indian Tribes	30,800	....	32,000	32,000	33,024	1.21
Undistributed	....	....	....	....	....	....
Total	**2,584,162**	....	[1] **2,635,845**	[1] **2,635,845**	**2,720,192**	[2] **100.00**

[1] Amounts reflect program level, not budget authority.
[2] Excludes undistributed obligations.

Table 8–15. State Children's Health Insurance Program (93.767)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from:			FY 2006 (estimated)	FY 2006 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	51,973	....	68,041	68,041	68,041	1.67
Alaska	7,430	....	9,020	9,020	9,020	0.22
Arizona	87,709	....	106,473	106,473	106,473	2.61
Arkansas	34,154	....	48,662	48,662	48,662	1.19
California	548,808	....	667,444	667,444	667,444	16.35
Colorado	37,915	....	57,951	57,951	57,951	1.42
Connecticut	24,361	....	36,561	36,561	36,561	0.90
Delaware	8,686	....	9,046	9,046	9,046	0.22
District of Columbia	7,202	....	9,635	9,635	9,635	0.24
Florida	171,991	....	249,247	249,247	249,247	6.11
Georgia	96,977	....	130,915	130,915	130,915	3.21
Hawaii	9,648	....	12,404	12,404	12,404	0.30
Idaho	16,795	....	20,748	20,748	20,748	0.51
Illinois	132,153	....	164,936	164,936	164,936	4.04
Indiana	53,710	....	73,422	73,422	73,422	1.80
Iowa	21,368	....	28,266	28,266	28,266	0.69
Kansas	24,444	....	28,479	28,479	28,479	0.70
Kentucky	37,984	....	54,061	54,061	54,061	1.32
Louisiana	61,291	....	77,478	77,478	77,478	1.90
Maine	9,689	....	12,462	12,462	12,462	0.31
Maryland	33,648	....	48,349	48,349	48,349	1.18
Massachusetts	46,201	....	59,401	59,401	59,401	1.46
Michigan	95,696	....	111,346	111,346	111,346	2.73
Minnesota	30,626	....	38,615	38,615	38,615	0.95
Mississippi	37,673	....	48,165	48,165	48,165	1.18
Missouri	43,425	....	53,958	53,958	53,958	1.32
Montana	11,326	....	12,284	12,284	12,284	0.30
Nebraska	15,414	....	17,096	17,096	17,096	0.42
Nevada	30,436	....	40,387	40,387	40,387	0.99
New Hampshire	8,904	....	9,273	9,273	9,273	0.23
New Jersey	69,346	....	84,735	84,735	84,735	2.08
New Mexico	32,789	....	42,157	42,157	42,157	1.03
New York	227,517	....	270,142	270,142	270,142	6.62
North Carolina	81,748	....	110,255	110,255	110,255	2.70
North Dakota	5,437	....	6,385	6,385	6,385	0.16
Ohio	114,614	....	125,842	125,842	125,842	3.08
Oklahoma	44,622	....	57,371	57,371	57,371	1.41
Oregon	40,709	....	47,255	47,255	47,255	1.16
Pennsylvania	100,846	....	130,964	130,964	130,964	3.21
Rhode Island	7,319	....	9,355	9,355	9,355	0.23
South Carolina	43,402	....	54,306	54,306	54,306	1.33
South Dakota	6,152	....	7,887	7,887	7,887	0.19
Tennessee	58,354	....	78,905	78,905	78,905	1.93
Texas	311,504	....	449,972	449,972	449,972	11.02
Utah	24,694	....	31,699	31,699	31,699	0.78
Vermont	3,813	....	4,903	4,903	4,903	0.12
Virginia	53,438	....	76,255	76,255	76,255	1.87
Washington	50,326	....	64,705	64,705	64,705	1.58
West Virginia	18,551	....	24,423	24,423	24,423	0.60
Wisconsin	43,825	....	51,870	51,870	51,870	1.27
Wyoming	5,481	....	6,364	6,364	6,364	0.16
American Samoa	397	....	510	510	510	0.01
Guam	1,158	....	1,488	1,488	1,488	0.04
Northern Mariana Islands	364	....	468	468	468	0.01
Puerto Rico	30,297	....	38,953	38,953	38,953	0.95
Freely Associated States	....	....	....	....	....	....
Virgin Islands	860	....	1,106	1,106	1,106	0.03
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Total	**3,175,200**	....	**4,082,400**	**4,082,400**	**4,082,400**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–16. Grants to States for Medicaid (93.778)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	2,709,016	....	2,697,722	2,697,722	2,755,670	1.28
Alaska	653,930	....	645,185	645,185	707,126	0.33
Arizona	3,716,585	....	4,179,879	4,179,879	4,639,981	2.15
Arkansas	2,165,347	....	2,344,999	2,344,999	2,651,630	1.23
California	20,226,317	....	19,507,114	19,507,114	18,957,149	8.79
Colorado	1,542,064	....	1,482,810	1,482,810	1,564,516	0.73
Connecticut	2,109,574	....	2,081,199	2,081,199	2,178,051	1.01
Delaware	442,843	....	456,106	456,106	481,587	0.22
District of Columbia	919,116	....	903,761	903,761	924,455	0.43
Florida	8,196,029	....	8,404,176	8,404,176	8,936,165	4.15
Georgia	5,129,463	....	4,590,816	4,590,816	4,958,941	2.30
Hawaii	633,438	....	614,819	614,819	622,968	0.29
Idaho	735,561	....	760,884	760,884	846,211	0.39
Illinois	6,115,306	....	5,355,001	5,355,001	5,787,508	2.68
Indiana	3,221,866	....	3,570,656	3,570,656	3,862,291	1.79
Iowa	1,542,219	....	1,616,856	1,616,856	1,718,623	0.80
Kansas	1,250,974	....	1,342,034	1,342,034	1,427,217	0.66
Kentucky	3,122,433	....	3,020,952	3,020,952	3,230,402	1.50
Louisiana	3,731,377	....	3,542,163	3,542,163	3,842,520	1.78
Maine	1,457,560	....	1,433,866	1,433,866	1,459,864	0.68
Maryland	2,678,469	....	2,607,623	2,607,623	2,765,030	1.28
Massachusetts	4,738,636	....	5,280,988	5,280,988	5,355,052	2.48
Michigan	5,193,069	....	5,159,780	5,159,780	5,381,974	2.50
Minnesota	2,906,166	....	2,982,264	2,982,264	3,193,272	1.48
Mississippi	2,716,890	....	2,833,807	2,833,807	3,004,820	1.39
Missouri	4,020,441	....	4,345,386	4,345,386	4,778,898	2.22
Montana	533,728	....	557,623	557,623	594,002	0.28
Nebraska	967,629	....	995,974	995,974	1,076,176	0.50
Nevada	650,528	....	694,375	694,375	739,606	0.34
New Hampshire	660,723	....	692,589	692,589	710,446	0.33
New Jersey	4,561,848	....	4,481,915	4,481,915	4,576,345	2.12
New Mexico	1,932,576	....	1,859,639	1,859,639	1,936,059	0.90
New York	23,457,121	....	25,642,056	25,642,056	26,504,617	12.30
North Carolina	5,576,409	....	5,859,591	5,859,591	6,474,673	3.00
North Dakota	370,889	....	375,695	375,695	374,386	0.17
Ohio	7,511,293	....	7,805,898	7,805,898	8,569,309	3.98
Oklahoma	2,055,734	....	2,077,405	2,077,405	2,130,003	0.99
Oregon	1,844,212	....	1,991,033	1,991,033	2,014,350	0.93
Pennsylvania	8,456,730	....	9,433,359	9,433,359	9,897,025	4.59
Rhode Island	1,043,194	....	1,043,417	1,043,417	1,099,032	0.51
South Carolina	3,002,491	....	2,910,750	2,910,750	2,963,772	1.37
South Dakota	432,369	....	461,206	461,206	490,948	0.23
Tennessee	5,229,794	....	4,998,339	4,998,339	5,229,594	2.43
Texas	10,812,996	....	11,367,334	11,367,334	12,059,751	5.59
Utah	1,000,545	....	1,061,913	1,061,913	1,144,821	0.53
Vermont	557,405	....	546,219	546,219	556,556	0.26
Virginia	2,335,066	....	2,457,090	2,457,090	2,607,021	1.21
Washington	3,036,685	....	3,127,085	3,127,085	3,007,009	1.39
West Virginia	1,640,815	....	1,580,553	1,580,553	1,650,846	0.77
Wisconsin	2,828,633	....	2,694,359	2,694,359	2,686,870	1.25
Wyoming	265,033	....	258,001	258,001	262,416	0.12
American Samoa	3,947	....	3,950	3,950	3,950	*
Guam	6,745	....	6,961	6,961	6,690	*
Northern Mariana Islands	2,382	....	2,380	2,380	2,380	*
Puerto Rico	219,397	....	219,600	219,600	219,600	0.10
Freely Associated States	....	....	....	....	....	....
Virgin Islands	7,076	....	6,920	6,920	6,920	*
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Survey & Certification	168,752	....	247,420	247,420	251,900	0.12
Fraud Control Units	131,500	....	149,400	149,400	161,600	0.07
Vaccines For Children	1,052,030	....	1,634,850	1,634,850	1,502,333	0.70
Medicare Part B Transfer	168,240	....	190,000	190,000	....	....
Medicare Part D	....	....	72,800	72,800	99,100	0.05
Incurred Not Reported	....	....	....	....	22,910,109	10.63
Adjustments	−17,153	....	−733,538	−733,538	−4,981,327	−2.31
Total	**184,382,051**	....	**188,535,007**	**188,535,007**	**215,570,809**	[1] **100.00**

* $500 or less or 0.005 percent or less.
[1] Excludes undistributed obligations.

Table 8–17. Temporary Assistance for Needy Families (TANF)—Family Assistance Grants (93.558)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from:			FY 2006 (estimated)	FY 2006 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	106,437	....	104,408	104,408	104,408	0.61
Alaska	63,445	....	60,265	60,265	60,265	0.35
Arizona	230,168	....	226,131	226,131	226,131	1.32
Arkansas	65,758	....	62,951	62,951	62,951	0.37
California	3,694,716	....	3,687,671	3,687,671	3,687,671	21.57
Colorado	149,626	....	149,626	149,626	149,626	0.88
Connecticut	266,788	....	266,788	266,788	266,788	1.56
Delaware	32,683	....	32,291	32,291	32,291	0.19
District of Columbia	118,161	....	92,610	92,610	92,610	0.54
Florida	632,955	....	622,746	622,746	622,746	3.64
Georgia	368,025	....	368,025	368,025	368,025	2.15
Hawaii	97,984	....	98,905	98,905	98,905	0.58
Idaho	35,508	....	33,911	33,911	33,911	0.20
Illinois	585,057	....	585,057	585,057	585,057	3.42
Indiana	215,691	....	206,799	206,799	206,799	1.21
Iowa	136,014	....	131,525	131,525	131,525	0.77
Kansas	101,124	....	101,931	101,931	101,931	0.60
Kentucky	184,372	....	181,288	181,288	181,288	1.06
Louisiana	179,902	....	180,999	180,999	180,999	1.06
Maine	80,685	....	78,121	78,121	78,121	0.46
Maryland	254,098	....	229,098	229,098	229,098	1.34
Massachusetts	466,632	....	459,371	459,371	459,371	2.69
Michigan	785,845	....	775,353	775,353	775,353	4.53
Minnesota	280,561	....	267,161	267,161	267,161	1.56
Mississippi	98,382	....	95,803	95,803	95,803	0.56
Missouri	227,904	....	217,052	217,052	217,052	1.27
Montana	45,984	....	43,707	43,707	43,707	0.26
Nebraska	60,644	....	57,769	57,769	57,769	0.34
Nevada	47,282	....	47,710	47,710	47,710	0.28
New Hampshire	64,183	....	38,521	38,521	38,521	0.23
New Jersey	416,075	....	404,035	404,035	404,035	2.36
New Mexico	116,184	....	117,131	117,131	117,131	0.68
New York	2,467,931	....	2,442,931	2,442,931	2,442,931	14.29
North Carolina	338,350	....	338,350	338,350	338,350	1.98
North Dakota	27,720	....	26,400	26,400	26,400	0.15
Ohio	756,083	....	727,968	727,968	727,968	4.26
Oklahoma	150,624	....	147,594	147,594	147,594	0.86
Oregon	169,035	....	166,799	166,799	166,799	0.98
Pennsylvania	724,142	....	719,499	719,499	719,499	4.21
Rhode Island	94,256	....	95,022	95,022	95,022	0.56
South Carolina	103,759	....	99,968	99,968	99,968	0.58
South Dakota	22,027	....	21,280	21,280	21,280	0.12
Tennessee	222,665	....	213,089	213,089	213,089	1.25
Texas	538,965	....	538,965	538,965	538,965	3.15
Utah	87,831	....	84,314	84,314	84,314	0.49
Vermont	49,192	....	47,353	47,353	47,353	0.28
Virginia	166,199	....	158,285	158,285	158,285	0.93
Washington	389,495	....	388,732	388,732	388,732	2.27
West Virginia	114,000	....	110,176	110,176	110,176	0.64
Wisconsin	325,994	....	315,133	315,133	315,133	1.84
Wyoming	19,378	....	18,501	18,501	18,501	0.11
American Samoa	....	....	....	....	....	....
Guam	2,334	....	3,993	3,993	3,993	0.02
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	70,970	....	71,035	71,035	71,035	0.42
Freely Associated States	....	....	....	....	....	....
Virgin Islands	2,875	....	2,847	2,847	2,847	0.02
Indian Tribes	122,999	....	122,999	122,999	122,999	0.72
Undistributed	....	....	....	....	....	....
Tribal New Program	7,558	....	7,633	7,633	7,633	0.04
Employment Achieve Bonus	....	....	100,000	100,000	100,000	0.58
Family Formation Match	....	....	100,000	100,000	100,000	0.58
Territories Matching Fund	....	....	6,000	6,000	6,000	0.04
Total	[1] **17,183,255**	....	[1] **17,099,625**	**17,099,625**	[1] **17,099,625**	[2] **100.00**

[1] State levels include State Family Assistance Grants and Supplemental Population Grants. FY 2004 also includes High Performance bonuses and Illegitimacy bonuses.

[2] Excludes undistributed obligations.

Table 8–18. Child Support Enforcement—Federal Share of State and Local Administrative Costs and Incentives (93.563)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	45,470	....	46,079	46,079	47,322	1.13
Alaska	14,734	....	14,931	14,931	15,334	0.37
Arizona	44,404	....	44,998	44,998	46,212	1.11
Arkansas	28,485	....	28,867	28,867	29,645	0.71
California	740,807	....	750,721	750,721	770,976	18.47
Colorado	57,658	....	58,430	58,430	60,006	1.44
Connecticut	44,231	....	44,823	44,823	46,033	1.10
Delaware	17,080	....	17,309	17,309	17,776	0.43
District of Columbia	17,135	....	17,365	17,365	17,833	0.43
Florida	187,723	....	190,236	190,236	195,368	4.68
Georgia	87,095	....	88,260	88,260	90,642	2.17
Hawaii	7,831	....	7,935	7,935	8,149	0.20
Idaho	27,642	....	28,012	28,012	28,767	0.69
Illinois	128,926	....	130,651	130,651	134,176	3.21
Indiana	39,855	....	40,388	40,388	41,478	0.99
Iowa	32,013	....	32,442	32,442	33,317	0.80
Kansas	43,879	....	44,466	44,466	45,666	1.09
Kentucky	40,139	....	40,676	40,676	41,773	1.00
Louisiana	40,603	....	41,147	41,147	42,257	1.01
Maine	11,546	....	11,701	11,701	12,016	0.29
Maryland	74,947	....	75,950	75,950	77,999	1.87
Massachusetts	102,103	....	103,469	103,469	106,261	2.55
Michigan	209,889	....	212,697	212,697	218,436	5.23
Minnesota	94,483	....	95,747	95,747	98,330	2.36
Mississippi	34,950	....	35,417	35,417	36,373	0.87
Missouri	45,941	....	46,556	46,556	47,812	1.15
Montana	11,131	....	11,280	11,280	11,585	0.28
Nebraska	30,582	....	30,991	30,991	31,827	0.76
Nevada	27,292	....	27,657	27,657	28,403	0.68
New Hampshire	32,828	....	33,268	33,268	34,165	0.82
New Jersey	123,226	....	124,875	124,875	128,244	3.07
New Mexico	68,676	....	69,595	69,595	71,473	1.71
New York	211,802	....	214,636	214,636	220,426	5.28
North Carolina	78,273	....	79,321	79,321	81,461	1.95
North Dakota	37,503	....	38,005	38,005	39,031	0.94
Ohio	202,004	....	204,707	204,707	210,230	5.04
Oklahoma	31,837	....	32,263	32,263	33,133	0.79
Oregon	69,363	....	70,291	70,291	72,187	1.73
Pennsylvania	152,904	....	154,950	154,950	159,131	3.81
Rhode Island	6,593	....	6,681	6,681	6,861	0.16
South Carolina	32,663	....	33,100	33,100	33,993	0.81
South Dakota	44,469	....	45,064	45,064	46,280	1.11
Tennessee	56,793	....	57,553	57,553	59,106	1.42
Texas	184,466	....	186,934	186,934	191,978	4.60
Utah	34,184	....	34,642	34,642	35,577	0.85
Vermont	36,064	....	36,547	36,547	37,533	0.90
Virginia	52,295	....	52,995	52,995	54,425	1.30
Washington	78,431	....	79,481	79,481	81,625	1.96
West Virginia	20,874	....	21,153	21,153	21,724	0.52
Wisconsin	82,056	....	83,154	83,154	85,398	2.05
Wyoming	7,465	....	7,564	7,564	7,769	0.19
American Samoa	....	....	....	....	....	....
Guam	6,732	....	6,823	6,823	7,007	0.17
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	28,979	....	29,367	29,367	30,160	0.72
Freely Associated States	....	....	....	....	....	....
Virgin Islands	12,133	....	12,295	12,295	12,627	0.30
Indian Tribes	13,000	....	22,000	22,000	30,500	0.73
Undistributed	....	....	....	....	....	....
Total	**3,994,187**	....	**4,056,465**	**4,056,465**	**4,173,816**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–19. Child Care and Development Block Grant (93.575)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	41,348	....	41,574	41,574	41,574	2.00
Alaska	4,238	....	4,059	4,059	4,059	0.19
Arizona	47,827	....	49,265	49,265	49,264	2.37
Arkansas	24,828	....	25,161	25,161	25,160	1.21
California	236,074	....	229,313	229,313	229,313	11.01
Colorado	23,901	....	23,440	23,440	23,440	1.13
Connecticut	14,833	....	14,528	14,528	14,528	0.70
Delaware	4,406	....	4,605	4,605	4,605	0.22
District of Columbia	3,420	....	3,279	3,279	3,279	0.16
Florida	113,432	....	113,701	113,701	113,700	5.46
Georgia	74,026	....	74,993	74,993	74,992	3.60
Hawaii	8,540	....	8,440	8,440	8,440	0.41
Idaho	11,282	....	11,593	11,593	11,593	0.56
Illinois	78,796	....	78,276	78,276	78,276	3.76
Indiana	40,675	....	41,626	41,626	41,625	2.00
Iowa	18,452	....	18,473	18,473	18,472	0.89
Kansas	18,816	....	19,030	19,030	19,029	0.91
Kentucky	34,866	....	36,066	36,066	36,065	1.73
Louisiana	48,318	....	48,102	48,102	48,102	2.31
Maine	7,274	....	6,964	6,964	6,964	0.33
Maryland	28,257	....	27,004	27,004	27,004	1.30
Massachusetts	26,969	....	26,245	26,245	26,244	1.26
Michigan	59,304	....	59,474	59,474	59,473	2.86
Minnesota	25,791	....	25,914	25,914	25,914	1.24
Mississippi	33,350	....	33,165	33,165	33,165	1.59
Missouri	39,718	....	39,484	39,484	39,484	1.90
Montana	5,850	....	5,878	5,878	5,878	0.28
Nebraska	11,786	....	12,008	12,008	12,008	0.58
Nevada	12,666	....	13,304	13,304	13,304	0.64
New Hampshire	4,953	....	4,892	4,892	4,892	0.23
New Jersey	38,635	....	37,391	37,391	37,390	1.80
New Mexico	18,662	....	18,814	18,814	18,814	0.90
New York	112,927	....	109,665	109,665	109,664	5.26
North Carolina	64,051	....	65,039	65,039	65,039	3.12
North Dakota	4,128	....	4,027	4,027	4,027	0.19
Ohio	69,473	....	68,800	68,800	68,799	3.30
Oklahoma	30,891	....	31,773	31,773	31,772	1.53
Oregon	22,511	....	22,331	22,331	22,331	1.07
Pennsylvania	63,998	....	62,848	62,848	62,847	3.02
Rhode Island	5,558	....	5,964	5,964	5,964	0.29
South Carolina	36,762	....	37,591	37,591	37,591	1.80
South Dakota	5,935	....	5,875	5,875	5,875	0.28
Tennessee	45,807	....	45,486	45,486	45,485	2.18
Texas	206,707	....	210,972	210,972	210,972	10.13
Utah	21,301	....	22,446	22,446	22,446	1.08
Vermont	3,160	....	2,994	2,994	2,994	0.14
Virginia	40,722	....	40,274	40,274	40,273	1.93
Washington	34,113	....	33,571	33,571	33,570	1.61
West Virginia	13,656	....	14,289	14,289	14,289	0.69
Wisconsin	30,504	....	30,374	30,374	30,374	1.46
Wyoming	3,074	....	2,886	2,886	2,885	0.14
American Samoa	2,752	....	2,515	2,515	2,515	0.12
Guam	3,937	....	4,191	4,191	4,191	0.20
Northern Mariana Islands	1,723	....	1,594	1,594	1,594	0.08
Puerto Rico	42,538	....	41,463	41,463	41,463	1.99
Freely Associated States	....	....	....	....	....	....
Virgin Islands	2,025	....	2,115	2,115	2,115	0.10
Indian Tribes	41,746	....	41,658	41,658	41,658	2.00
Undistributed	....	....	....	....	....	....
Technical Assistance	5,218	....	5,207	5,207	5,207	0.25
Research Set-Aside	9,806	....	9,920	9,920	9,920	0.48
Child Care Aware	994	....	992	992	1,000	0.05
Total	**2,087,310**	....	**2,082,921**	**2,082,921**	**2,082,910**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–20. Child Care and Development Fund—Mandatory (93.596a)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from:			FY 2006 (estimated)	FY 2006 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**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–21. Child Care and Development Fund—Matching (93.596b)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	22,396	....	22,358	22,358	22,358	1.51
Alaska	3,813	....	3,807	3,807	3,807	0.26
Arizona	30,922	....	30,537	30,537	30,537	2.06
Arkansas	13,850	....	13,665	13,665	13,665	0.92
California	197,098	....	194,510	194,510	194,510	13.13
Colorado	23,738	....	23,435	23,435	23,435	1.58
Connecticut	17,916	....	17,711	17,711	17,711	1.20
Delaware	3,898	....	3,845	3,845	3,845	0.26
District of Columbia	2,442	....	2,409	2,409	2,409	0.16
Florida	79,292	....	78,288	78,288	78,288	5.28
Georgia	47,295	....	46,689	46,689	46,689	3.15
Hawaii	6,139	....	6,058	6,058	6,058	0.41
Idaho	7,537	....	7,438	7,438	7,438	0.50
Illinois	67,507	....	66,611	66,611	66,611	4.50
Indiana	32,829	....	32,397	32,397	32,397	2.19
Iowa	14,062	....	13,866	13,866	13,866	0.94
Kansas	13,986	....	13,962	13,962	13,962	0.94
Kentucky	19,084	....	18,815	18,815	18,815	1.27
Louisiana	23,785	....	23,785	23,785	23,785	1.61
Maine	5,409	....	5,340	5,340	5,340	0.36
Maryland	28,306	....	27,931	27,931	27,931	1.89
Massachusetts	29,996	....	29,583	29,583	29,583	2.00
Michigan	51,750	....	51,750	51,750	51,750	3.49
Minnesota	25,128	....	24,784	24,784	24,784	1.67
Mississippi	15,621	....	15,411	15,411	15,411	1.04
Missouri	28,316	....	27,930	27,930	27,930	1.89
Montana	4,222	....	4,163	4,163	4,163	0.28
Nebraska	8,904	....	8,784	8,784	8,784	0.59
Nevada	12,096	....	11,949	11,949	11,949	0.81
New Hampshire	6,139	....	6,055	6,055	6,055	0.41
New Jersey	44,038	....	43,455	43,455	43,455	2.93
New Mexico	10,116	....	9,979	9,979	9,979	0.67
New York	95,027	....	93,739	93,739	93,739	6.33
North Carolina	43,143	....	42,592	42,592	42,592	2.87
North Dakota	2,884	....	2,843	2,843	2,843	0.19
Ohio	58,831	....	58,044	58,044	58,044	3.92
Oklahoma	17,611	....	17,581	17,581	17,581	1.19
Oregon	17,416	....	17,186	17,186	17,186	1.16
Pennsylvania	57,451	....	56,664	56,664	56,664	3.82
Rhode Island	4,870	....	4,802	4,802	4,802	0.32
South Carolina	20,022	....	19,747	19,747	19,747	1.33
South Dakota	3,893	....	3,839	3,839	3,839	0.26
Tennessee	28,934	....	28,550	28,550	28,550	1.93
Texas	126,722	....	125,093	125,093	125,093	8.44
Utah	12,569	....	14,787	14,787	14,787	1.00
Vermont	2,708	....	2,669	2,669	2,669	0.18
Virginia	36,138	....	36,138	36,138	36,138	2.44
Washington	30,420	....	30,360	30,360	30,360	2.05
West Virginia	7,801	....	7,695	7,695	7,695	0.52
Wisconsin	26,729	....	26,364	26,364	26,364	1.78
Wyoming	2,350	....	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] **1,496,409**	....	**1,481,603**	**1,481,603**	**1,481,603**	[2] **100.00**

[1] Includes reappropriated funds from prior years.
[2] Excludes undistributed obligations.

Table 8–22. Head Start (93.600)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	105,500	......	106,555	106,555	106,555	1.55
Alaska	12,353	......	12,476	12,476	12,476	0.18
Arizona	102,023	......	103,043	103,043	103,043	1.50
Arkansas	63,808	......	64,447	64,447	64,447	0.94
California	823,696	......	831,931	831,931	831,931	12.08
Colorado	67,676	......	68,353	68,353	68,353	0.99
Connecticut	51,401	......	51,915	51,915	51,915	0.75
Delaware	12,771	......	12,899	12,899	12,899	0.19
District of Columbia	24,865	......	25,114	25,114	25,114	0.36
Florida	260,307	......	262,910	262,910	262,910	3.82
Georgia	166,837	......	168,505	168,505	168,505	2.45
Hawaii	22,665	......	22,892	22,892	22,892	0.33
Idaho	22,411	......	22,635	22,635	22,635	0.33
Illinois	267,111	......	269,783	269,783	269,783	3.92
Indiana	95,093	......	96,044	96,044	96,044	1.39
Iowa	51,050	......	51,560	51,560	51,560	0.75
Kansas	50,433	......	50,937	50,937	50,937	0.74
Kentucky	106,799	......	107,867	107,867	107,867	1.57
Louisiana	144,497	......	145,942	145,942	145,942	2.12
Maine	27,344	......	27,617	27,617	27,617	0.40
Maryland	77,277	......	78,050	78,050	78,050	1.13
Massachusetts	107,299	......	108,372	108,372	108,372	1.57
Michigan	232,215	......	234,537	234,537	234,537	3.40
Minnesota	71,119	......	71,831	71,831	71,831	1.04
Mississippi	160,121	......	161,722	161,722	161,722	2.35
Missouri	117,837	......	119,015	119,015	119,015	1.73
Montana	20,747	......	20,954	20,954	20,954	0.30
Nebraska	35,709	......	36,066	36,066	36,066	0.52
Nevada	23,698	......	23,953	23,953	23,953	0.35
New Hampshire	13,257	......	13,390	13,390	13,390	0.19
New Jersey	127,761	......	129,039	129,039	129,039	1.87
New Mexico	51,790	......	52,308	52,308	52,308	0.76
New York	430,086	......	434,387	434,387	434,387	6.31
North Carolina	139,360	......	140,753	140,753	140,753	2.04
North Dakota	17,009	......	17,179	17,179	17,179	0.25
Ohio	244,102	......	246,543	246,543	246,543	3.58
Oklahoma	80,249	......	81,052	81,052	81,052	1.18
Oregon	58,893	......	59,481	59,481	59,481	0.86
Pennsylvania	226,002	......	228,262	228,262	228,262	3.31
Rhode Island	21,802	......	22,020	22,020	22,020	0.32
South Carolina	81,718	......	82,565	82,565	82,565	1.20
South Dakota	18,644	......	18,830	18,830	18,830	0.27
Tennessee	118,217	......	119,399	119,399	119,399	1.73
Texas	474,092	......	478,833	478,833	478,833	6.95
Utah	37,399	......	37,773	37,773	37,773	0.55
Vermont	13,429	......	13,563	13,563	13,563	0.20
Virginia	98,142	......	99,124	99,124	99,124	1.44
Washington	100,193	......	101,195	101,195	101,195	1.47
West Virginia	50,152	......	50,654	50,654	50,654	0.74
Wisconsin	89,784	......	90,682	90,682	90,682	1.32
Wyoming	12,252	......	12,375	12,375	12,375	0.18
American Samoa	......	......	......	......	......	......
Guam	......	......	......	......	......	......
Northern Mariana Islands	......	......	......	......	......	......
Puerto Rico	246,792	......	249,260	249,260	249,260	3.62
Freely Associated States	......	......	......	......	......	......
Virgin Islands	7,919	......	7,998	7,998	7,998	0.12
Indian Tribes	186,704	......	188,571	188,571	188,571	2.74
Undistributed	......	......	......	......	......	......
Other Pacific	7,262	......	7,334	7,334	7,334	0.11
Migrant Program	264,621	......	267,267	267,267	267,267	3.88
Secretary's Reserve	......	......	1,528	1,528	1,550	0.02
Unallocated Expansion	......	......	......	......	68,431	0.99
State Demonstration	......	......	......	......	45,000	0.65
Technical Assistance	172,371	......	174,078	174,078	105,647	1.53
Research, Development & Education	20,000	......	20,000	20,000	20,000	0.29
Program Support	39,246	......	39,746	39,746	39,746	0.58
Total	**6,773,910**	......	**6,843,114**	**6,843,114**	**6,888,136**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–23. Foster Care—Title IV–E (93.658)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	19,221	....	18,834	18,834	18,748	0.40
Alaska	13,485	....	13,214	13,214	13,154	0.28
Arizona	58,857	....	57,674	57,674	57,411	1.24
Arkansas	38,467	....	37,693	37,693	37,521	0.81
California	1,302,629	....	1,276,435	1,276,435	1,270,617	27.35
Colorado	60,970	....	59,744	59,744	59,471	1.28
Connecticut	76,171	....	74,639	74,639	74,299	1.60
Delaware	6,430	....	6,301	6,301	6,272	0.14
District of Columbia	16,153	....	15,828	15,828	15,756	0.34
Florida	131,023	....	128,388	128,388	127,803	2.75
Georgia	55,318	....	54,205	54,205	53,958	1.16
Hawaii	19,529	....	19,136	19,136	19,049	0.41
Idaho	7,848	....	7,690	7,690	7,655	0.16
Illinois	281,928	....	276,259	276,259	274,999	5.92
Indiana	38,113	....	37,346	37,346	37,176	0.80
Iowa	24,274	....	23,786	23,786	23,678	0.51
Kansas	35,104	....	34,398	34,398	34,241	0.74
Kentucky	48,933	....	47,949	47,949	47,731	1.03
Louisiana	68,624	....	67,244	67,244	66,937	1.44
Maine	7,515	....	7,364	7,364	7,330	0.16
Maryland	111,762	....	109,514	109,514	109,015	2.35
Massachusetts	71,389	....	69,953	69,953	69,634	1.50
Michigan	121,710	....	119,263	119,263	118,719	2.56
Minnesota	64,412	....	63,117	63,117	62,829	1.35
Mississippi	3,178	....	3,114	3,114	3,100	0.07
Missouri	59,218	....	58,027	58,027	57,762	1.24
Montana	8,728	....	8,552	8,552	8,513	0.18
Nebraska	19,003	....	18,621	18,621	18,536	0.40
Nevada	16,580	....	16,247	16,247	16,173	0.35
New Hampshire	14,857	....	14,558	14,558	14,492	0.31
New Jersey	60,375	....	59,161	59,161	58,891	1.27
New Mexico	21,603	....	21,168	21,168	21,072	0.45
New York	492,406	....	482,504	482,504	480,304	10.34
North Carolina	65,132	....	63,822	63,822	63,531	1.37
North Dakota	10,983	....	10,763	10,763	10,713	0.23
Ohio	205,767	....	201,629	201,629	200,710	4.32
Oklahoma	17,335	....	16,986	16,986	16,909	0.36
Oregon	38,167	....	37,400	37,400	37,229	0.80
Pennsylvania	448,039	....	439,029	439,029	437,027	9.41
Rhode Island	13,236	....	12,970	12,970	12,910	0.28
South Carolina	17,095	....	16,751	16,751	16,675	0.36
South Dakota	5,662	....	5,548	5,548	5,523	0.12
Tennessee	35,099	....	34,393	34,393	34,237	0.74
Texas	153,905	....	150,810	150,810	150,123	3.23
Utah	21,684	....	21,248	21,248	21,151	0.46
Vermont	11,028	....	10,807	10,807	10,757	0.23
Virginia	84,761	....	83,056	83,056	82,678	1.78
Washington	73,521	....	72,042	72,042	71,714	1.54
West Virginia	27,335	....	26,785	26,785	26,663	0.57
Wisconsin	95,438	....	93,519	93,519	93,092	2.00
Wyoming	2,295	....	2,249	2,249	2,239	0.05
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	6,930	....	6,790	6,790	6,759	0.15
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Technical Assistance	5,065	....	12,477	12,477	15,514	0.33
New Program Option	....	....	....	....	36,000	0.78
Total	[1] **4,714,290**	....	**4,627,000**	[2] **4,627,000**	**4,645,000**	[3] **100.00**

[1] Reflects grant adjustments made after the end of the fiscal year.
[2] Assumes a lapse of $268.5 million.
[3] Excludes undistributed obligations.

Table 8–24. State Homeland Security Grant Program (97.067)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	36,853	....	28,153	28,153	....	....
Alaska	19,465	....	14,879	14,879	....	....
Arizona	41,243	....	31,708	31,708	....	....
Arkansas	28,815	....	21,561	21,561	....	....
California	175,457	....	134,343	134,343	....	....
Colorado	36,944	....	28,081	28,081	....	....
Connecticut	32,211	....	24,080	24,080	....	....
Delaware	20,206	....	14,984	14,984	....	....
District of Columbia	19,136	....	14,144	14,144	....	....
Florida	92,182	....	70,399	70,399	....	....
Georgia	55,288	....	41,585	41,585	....	....
Hawaii	22,186	....	16,675	16,675	....	....
Idaho	22,621	....	16,805	16,805	....	....
Illinois	73,571	....	54,593	54,593	....	....
Indiana	44,422	....	33,331	33,331	....	....
Iowa	29,841	....	22,291	22,291	....	....
Kansas	28,842	....	21,784	21,784	....	....
Kentucky	35,073	....	26,419	26,419	....	....
Louisiana	36,836	....	28,138	28,138	....	....
Maine	22,409	....	16,609	16,609	....	....
Maryland	41,251	....	30,812	30,812	....	....
Massachusetts	45,639	....	34,361	34,361	....	....
Michigan	62,032	....	46,490	46,490	....	....
Minnesota	39,267	....	29,548	29,548	....	....
Mississippi	29,547	....	22,081	22,081	....	....
Missouri	42,221	....	31,698	31,698	....	....
Montana	20,668	....	15,318	15,318	....	....
Nebraska	24,376	....	18,507	18,507	....	....
Nevada	26,387	....	19,930	19,930	....	....
New Hampshire	22,321	....	16,776	16,776	....	....
New Jersey	55,424	....	41,458	41,458	....	....
New Mexico	24,946	....	18,499	18,499	....	....
New York	103,243	....	77,268	77,268	....	....
North Carolina	54,203	....	41,130	41,130	....	....
North Dakota	19,421	....	14,376	14,376	....	....
Ohio	68,235	....	51,691	51,691	....	....
Oklahoma	32,362	....	24,403	24,403	....	....
Oregon	32,487	....	24,329	24,329	....	....
Pennsylvania	72,371	....	53,870	53,870	....	....
Rhode Island	21,392	....	16,074	16,074	....	....
South Carolina	35,138	....	26,284	26,284	....	....
South Dakota	19,996	....	14,809	14,809	....	....
Tennessee	42,786	....	32,605	32,605	....	....
Texas	115,110	....	88,727	88,727	....	....
Utah	27,033	....	20,308	20,308	....	....
Vermont	19,342	....	14,326	14,326	....	....
Virginia	49,556	....	38,185	38,185	....	....
Washington	44,015	....	33,336	33,336	....	....
West Virginia	24,705	....	18,289	18,289	....	....
Wisconsin	41,173	....	30,925	30,925	....	....
Wyoming	18,809	....	13,934	13,934	....	....
American Samoa	5,776	....	4,279	4,279	....	....
Guam	6,217	....	4,706	4,706	....	....
Northern Mariana Islands	5,830	....	4,333	4,333	....	....
Puerto Rico	34,014	....	25,169	25,169	....	....
Freely Associated States	....	....	100	100	....	....
Virgin Islands	6,009	....	4,612	4,612	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	1,240,000	....
Total	**2,206,903**	....	**1,664,108**	**1,664,108**	[1] **1,240,000**	....

[1] FY 2006 State allocations to be determined by the Secretary of Homeland Security.

Table 8–25. Public Housing Operating Fund (14.850)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	114,280	83	77,460	77,543	108,418	3.18
Alaska	8,165	6	5,534	5,540	7,768	0.23
Arizona	17,025	12	11,540	11,552	16,197	0.48
Arkansas	26,591	19	18,024	18,043	25,297	0.74
California	115,964	84	78,601	78,685	110,322	3.24
Colorado	17,843	13	12,094	12,107	16,975	0.50
Connecticut	52,403	38	35,519	35,557	49,853	1.46
Delaware	9,878	7	6,695	6,702	9,397	0.28
District of Columbia	50,351	37	34,128	34,165	47,901	1.41
Florida	94,139	69	63,808	63,877	89,559	2.63
Georgia	118,969	87	80,638	80,725	113,181	3.32
Hawaii	11,218	8	7,604	7,612	10,672	0.31
Idaho	1,109	1	752	753	1,055	0.03
Illinois	257,384	187	174,457	174,644	244,861	7.19
Indiana	42,621	31	28,889	28,920	40,547	1.19
Iowa	5,534	4	3,751	3,755	5,265	0.15
Kansas	15,997	12	10,843	10,855	15,219	0.45
Kentucky	50,955	37	34,538	34,575	48,476	1.42
Louisiana	65,589	48	44,457	44,505	62,398	1.83
Maine	9,023	7	6,116	6,123	8,584	0.25
Maryland	73,061	53	49,521	49,574	69,506	2.04
Massachusetts	103,529	75	70,173	70,248	98,492	2.89
Michigan	50,224	37	34,042	34,079	47,780	1.40
Minnesota	40,869	30	27,701	27,731	38,881	1.14
Mississippi	27,205	20	18,440	18,460	25,881	0.76
Missouri	37,311	27	25,290	25,317	35,496	1.04
Montana	4,235	3	2,871	2,874	4,029	0.12
Nebraska	11,289	8	7,652	7,660	10,740	0.32
Nevada	15,892	12	10,772	10,784	15,119	0.44
New Hampshire	6,522	5	4,421	4,426	6,205	0.18
New Jersey	162,979	119	110,468	110,587	155,050	4.55
New Mexico	8,992	7	6,095	6,102	8,555	0.25
New York	842,771	611	571,234	571,845	801,767	23.53
North Carolina	100,181	73	67,903	67,976	95,307	2.80
North Dakota	1,969	1	1,335	1,336	1,873	0.05
Ohio	166,035	121	112,540	112,661	157,957	4.64
Oklahoma	25,891	19	17,549	17,568	24,631	0.72
Oregon	16,502	12	11,185	11,197	15,699	0.46
Pennsylvania	254,569	185	172,549	172,734	242,485	7.12
Rhode Island	20,302	15	13,761	13,776	19,314	0.57
South Carolina	30,904	23	20,947	20,970	29,400	0.86
South Dakota	2,169	2	1,470	1,472	2,063	0.06
Tennessee	93,196	68	63,169	63,237	88,662	2.60
Texas	120,730	88	81,832	81,920	114,856	3.37
Utah	4,335	3	2,938	2,941	4,124	0.12
Vermont	2,556	2	1,732	1,734	2,432	0.07
Virginia	65,549	48	44,430	44,478	62,360	1.83
Washington	36,253	26	24,573	24,599	34,489	1.01
West Virginia	16,935	12	11,479	11,491	16,111	0.47
Wisconsin	18,808	14	12,748	12,762	17,893	0.53
Wyoming	1,219	1	826	827	1,160	0.03
American Samoa	....	....	....	....	....	....
Guam	3,600	3	2,440	2,443	3,425	0.10
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	100,493	73	68,115	68,188	95,604	2.81
Freely Associated States	....	....	....	....	....	....
Virgin Islands	18,930	14	12,831	12,845	18,009	0.53
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Other (DOJ Anti-Drug)	9,941	....	7,936	7,936	....	....
Other (Bonus Funds)	....	....	9,920	9,920	10,000	0.29
Total	**3,580,984**	**2,600**	[1] **2,438,336**	**2,440,936**	**3,407,300**	[2] **100.00**

[1] FY 2005 Appropriation provides funding on calendar year basis.
[2] Excludes undistributed obligations.

Table 8–26. Section 8 Moderate Rehabilitation (14.856)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	219	22	813	835	742	[1] 0.36
Alaska	....	4	....	4	....	....
Arizona	644	22	1,081	1,103	986	0.48
Arkansas	213	14	371	385	339	0.17
California	6,964	440	11,058	11,498	10,086	4.91
Colorado	7,481	34	9,296	9,330	8,478	4.13
Connecticut	4,619	43	5,376	5,419	4,903	2.39
Delaware	319	4	92	96	83	0.04
District of Columbia	....	15	8,419	8,434	7,678	3.74
Florida	19,384	101	27,880	27,981	25,428	12.38
Georgia	2,963	58	3,428	3,486	3,127	1.52
Hawaii	182	13	195	208	178	0.09
Idaho	....	5	....	5	....	....
Illinois	4,172	108	11,774	11,882	10,738	5.23
Indiana	614	29	795	824	725	0.35
Iowa	173	14	346	360	315	0.15
Kansas	....	8	160	168	146	0.07
Kentucky	81	23	834	857	761	0.37
Louisiana	1,802	27	2,489	2,516	2,270	1.11
Maine	1,887	11	2,385	2,396	2,175	1.06
Maryland	3,224	47	7,598	7,645	6,929	3.37
Massachusetts	6,115	116	12,648	12,764	11,536	5.62
Michigan	2,837	43	4,069	4,112	3,711	1.81
Minnesota	1,079	33	542	575	495	0.24
Mississippi	284	13	505	518	460	0.22
Missouri	386	31	860	891	784	0.38
Montana	1,237	5	1,795	1,800	1,637	0.80
Nebraska	795	9	1,273	1,282	1,161	0.57
Nevada	1,225	15	4,911	4,926	4,479	2.18
New Hampshire	583	10	689	699	629	0.31
New Jersey	10,640	86	14,693	14,779	13,400	6.52
New Mexico	34	11	56	67	51	0.02
New York	13,233	245	24,404	24,649	22,257	10.84
North Carolina	1,053	46	1,454	1,500	1,326	0.65
North Dakota	1,035	5	1,397	1,402	1,274	0.62
Ohio	9,286	76	7,918	7,994	7,222	3.52
Oklahoma	1,657	19	3,974	3,993	3,625	1.77
Oregon	882	30	3,064	3,094	2,795	1.36
Pennsylvania	2,352	72	6,237	6,309	5,688	2.77
Rhode Island	1,791	9	630	639	575	0.28
South Carolina	3,839	19	5,950	5,969	5,426	2.64
South Dakota	613	4	790	794	721	0.35
Tennessee	2,430	26	2,895	2,921	2,641	1.29
Texas	4,063	139	6,637	6,776	6,054	2.95
Utah	1,480	10	3,631	3,641	3,312	1.61
Vermont	245	5	511	516	466	0.23
Virginia	3,052	45	6,050	6,095	5,518	2.69
Washington	137	51	1,458	1,509	1,330	0.65
West Virginia	1,054	9	952	961	868	0.42
Wisconsin	744	21	806	827	735	0.36
Wyoming	965	2	1,162	1,164	1,060	0.52
American Samoa	....	....	....	....	....	....
Guam	....	5	....	5	....	....
Northern Mariana Islands	....	1	....	1	....	....
Puerto Rico	4,736	23	8,833	8,856	8,056	3.92
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	1	....	1	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Total	**[1] 134,803**	**2,277**	**225,184**	**227,461**	**205,379**	**[2] 100.00**

[1] This program was funded in the Housing Certificate Fund (86X0319) in FY 2004.
[2] Excludes undistributed obligations.

Table 8–27. Housing Choice Vouchers (14.871)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	137,937	2,312	134,961	137,272	147,407	[1] 0.93
Alaska	26,368	441	27,732	28,173	30,290	0.19
Arizona	139,589	2,346	145,606	147,952	159,033	1.00
Arkansas	89,116	1,495	91,614	93,109	100,063	0.63
California	2,825,645	47,396	2,773,778	2,821,174	3,029,570	19.12
Colorado	212,355	3,678	212,017	215,695	231,568	1.46
Connecticut	273,074	4,646	288,560	293,207	315,171	1.99
Delaware	27,980	474	30,673	31,147	33,502	0.21
District of Columbia	93,430	1,563	93,001	94,564	101,577	0.64
Florida	629,605	10,859	615,593	626,452	672,362	4.24
Georgia	371,106	6,259	349,527	355,786	381,760	2.41
Hawaii	84,193	1,412	92,607	94,019	101,147	0.64
Idaho	33,491	560	32,367	32,927	35,351	0.22
Illinois	692,123	11,651	691,617	703,268	755,397	4.77
Indiana	183,063	3,073	198,424	201,498	216,723	1.37
Iowa	88,843	1,489	87,562	89,051	95,636	0.60
Kansas	54,039	904	54,524	55,428	59,552	0.38
Kentucky	149,518	2,503	151,247	153,750	165,195	1.04
Louisiana	173,379	2,931	178,095	181,026	194,519	1.23
Maine	66,518	1,145	66,157	67,302	72,258	0.46
Maryland	297,793	5,037	336,013	341,050	366,999	2.32
Massachusetts	741,076	12,502	741,847	754,350	810,259	5.11
Michigan	273,429	4,623	277,637	282,259	303,240	1.91
Minnesota	210,280	3,537	208,298	211,834	227,507	1.44
Mississippi	83,644	1,404	86,089	87,493	94,027	0.59
Missouri	200,555	3,362	200,681	204,044	219,188	1.38
Montana	27,487	481	26,238	26,718	28,657	0.18
Nebraska	55,395	940	55,584	56,524	60,710	0.38
Nevada	93,479	1,585	90,919	92,504	99,304	0.63
New Hampshire	66,369	1,120	64,546	65,667	70,499	0.44
New Jersey	545,177	9,300	558,436	567,736	609,933	3.85
New Mexico	68,931	1,154	69,018	70,172	75,383	0.48
New York	1,560,457	26,332	1,496,743	1,523,075	1,634,770	10.32
North Carolina	295,345	4,959	304,186	309,145	332,237	2.10
North Dakota	29,493	511	28,173	28,684	30,771	0.19
Ohio	479,983	8,187	473,748	481,934	517,436	3.27
Oklahoma	121,596	2,062	121,296	123,358	132,482	0.84
Oregon	191,436	3,218	189,299	192,516	206,755	1.30
Pennsylvania	459,779	7,733	493,186	500,919	538,667	3.40
Rhode Island	57,001	984	62,601	63,585	68,374	0.43
South Carolina	121,082	2,090	116,709	118,799	127,472	0.80
South Dakota	25,420	436	25,605	26,041	27,967	0.18
Tennessee	164,425	2,792	159,896	162,688	174,642	1.10
Texas	891,576	14,986	894,047	909,033	976,494	6.16
Utah	64,369	1,102	62,069	63,171	67,793	0.43
Vermont	34,118	575	34,183	34,758	37,335	0.24
Virginia	287,985	4,870	289,925	294,795	316,661	2.00
Washington	325,366	5,446	322,124	327,571	351,830	2.22
West Virginia	58,285	993	59,486	60,479	64,971	0.41
Wisconsin	135,360	2,277	134,046	136,324	146,408	0.92
Wyoming	9,974	183	10,002	10,185	10,924	0.07
American Samoa	....	....	....	....	....	....
Guam	30,760	515	32,959	33,473	35,998	0.23
Northern Mariana Islands	2,775	46	2,187	2,233	2,388	0.02
Puerto Rico	142,444	2,463	156,291	158,754	170,704	1.08
Freely Associated States	....	....	....	....	....	....
Virgin Islands	7,338	123	7,626	7,749	8,330	0.05
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Total	**[1] 14,511,353**	**245,065**	**14,507,355**	**14,752,421**	**15,845,194**	**[2] 100.00**

[1] This program was funded in the Housing Certificate Fund (86X0319) in FY 2004.
[2] Excludes undistributed obligations.

Table 8–28. Public Housing Capital Fund (14.872)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from:			FY 2006 (estimated)	FY 2006 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	91,546	8,440	75,903	84,343	68,487	2.94
Alaska	3,556	328	2,948	3,276	2,660	0.11
Arizona	13,625	1,256	11,297	12,553	10,193	0.44
Arkansas	29,979	2,764	24,856	27,620	22,428	0.96
California	126,574	11,669	104,945	116,614	94,692	4.07
Colorado	18,805	1,734	15,592	17,325	14,068	0.60
Connecticut	43,342	3,996	35,936	39,932	32,425	1.39
Delaware	6,563	605	5,442	6,047	4,910	0.21
District of Columbia	31,977	2,948	26,513	29,461	23,922	1.03
Florida	82,667	7,621	68,541	76,162	61,844	2.66
Georgia	110,282	10,167	91,437	101,604	82,503	3.55
Hawaii	17,302	1,595	14,345	15,941	12,944	0.56
Idaho	1,756	162	1,456	1,618	1,314	0.06
Illinois	229,683	21,175	190,435	211,610	171,829	7.38
Indiana	37,863	3,491	31,393	34,884	28,326	1.22
Iowa	8,221	758	6,816	7,574	6,150	0.26
Kansas	17,571	1,620	14,569	16,188	13,145	0.56
Kentucky	63,561	5,860	52,700	58,560	47,551	2.04
Louisiana	68,969	6,358	57,184	63,542	51,597	2.22
Maine	7,641	704	6,335	7,040	5,716	0.25
Maryland	61,901	5,707	51,323	57,030	46,309	1.99
Massachusetts	86,196	7,947	71,467	79,414	64,484	2.77
Michigan	65,627	6,050	54,413	60,463	49,096	2.11
Minnesota	44,368	4,090	36,786	40,877	33,192	1.43
Mississippi	30,592	2,820	25,364	28,185	22,886	0.98
Missouri	49,251	4,541	40,835	45,376	36,845	1.58
Montana	4,133	381	3,427	3,808	3,092	0.13
Nebraska	13,370	1,233	11,085	12,318	10,002	0.43
Nevada	8,767	808	7,269	8,077	6,559	0.28
New Hampshire	7,459	688	6,184	6,872	5,580	0.24
New Jersey	118,300	10,906	98,085	108,991	88,502	3.80
New Mexico	10,898	1,005	9,036	10,040	8,153	0.35
New York	518,188	47,772	429,641	477,413	387,663	16.66
North Carolina	72,231	6,659	59,888	66,547	54,037	2.32
North Dakota	3,211	296	2,662	2,958	2,402	0.10
Ohio	135,466	12,489	112,318	124,807	101,344	4.35
Oklahoma	25,306	2,333	20,982	23,315	18,932	0.81
Oregon	16,222	1,496	13,450	14,946	12,136	0.52
Pennsylvania	225,454	20,785	186,929	207,714	168,665	7.25
Rhode Island	19,876	1,832	16,480	18,312	14,869	0.64
South Carolina	27,885	2,571	23,120	25,691	20,861	0.90
South Dakota	3,259	300	2,702	3,003	2,438	0.10
Tennessee	90,940	8,384	75,400	83,784	68,033	2.92
Texas	125,727	11,591	104,243	115,834	94,058	4.04
Utah	4,418	407	3,663	4,070	3,305	0.14
Vermont	2,939	271	2,437	2,708	2,199	0.09
Virginia	55,388	5,106	45,923	51,030	41,436	1.78
Washington	40,827	3,764	33,851	37,614	30,543	1.31
West Virginia	13,737	1,266	11,390	12,656	10,277	0.44
Wisconsin	26,633	2,455	22,082	24,537	19,924	0.86
Wyoming	1,723	159	1,429	1,587	1,289	0.06
American Samoa	....	....	....	....	....	....
Guam	1,408	130	1,167	1,297	1,053	0.05
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	179,455	16,544	148,790	165,334	134,253	5.77
Freely Associated States	....	....	....	....	....	....
Virgin Islands	8,123	749	6,735	7,484	6,077	0.26
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Total	**[1] 3,110,761**	**286,785**	**2,579,200**	**[1] 2,865,985**	**[1] 2,327,200**	**[2] 100.00**

[1] Includes Technical Assistance, Emergency/Disaster, and Resident Opportunities and Self-Sufficiency (ROSS) funding. FY 2004 also includes Neighborhood Networks funding.

[2] Excludes undistributed obligations.

Table 8–29. HOME Investment Partnerships Program (14.239)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from:			FY 2006 (estimated)	FY 2006 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	27,499	....	25,868	25,868	27,165	1.40
Alaska	4,307	....	4,184	4,184	4,394	0.23
Arizona	28,548	....	26,613	26,613	27,947	1.44
Arkansas	17,294	....	16,328	16,328	17,146	0.88
California	281,698	....	266,520	266,520	279,880	14.42
Colorado	24,462	....	22,855	22,855	24,001	1.24
Connecticut	22,290	....	21,295	21,295	22,362	1.15
Delaware	5,255	....	5,088	5,088	5,343	0.28
District of Columbia	9,675	....	9,220	9,220	9,682	0.50
Florida	88,165	....	82,937	82,937	87,094	4.49
Georgia	46,524	....	44,160	44,160	46,374	2.39
Hawaii	8,330	....	7,832	7,832	8,225	0.42
Idaho	7,514	....	7,057	7,057	7,411	0.38
Illinois	82,326	....	77,508	77,508	81,393	4.19
Indiana	33,036	....	31,171	31,171	32,733	1.69
Iowa	16,463	....	15,438	15,438	16,212	0.84
Kansas	14,912	....	13,886	13,886	14,582	0.75
Kentucky	27,039	....	25,487	25,487	26,765	1.38
Louisiana	33,792	....	31,906	31,906	33,505	1.73
Maine	9,077	....	8,609	8,609	9,041	0.47
Maryland	27,864	....	26,065	26,065	27,372	1.41
Massachusetts	51,243	....	48,900	48,900	51,351	2.65
Michigan	55,808	....	52,668	52,668	55,308	2.85
Minnesota	24,672	....	23,348	23,348	24,518	1.26
Mississippi	18,708	....	17,575	17,575	18,456	0.95
Missouri	33,652	....	31,684	31,684	33,272	1.71
Montana	6,710	....	6,330	6,330	6,647	0.34
Nebraska	10,026	....	9,339	9,339	9,807	0.51
Nevada	12,952	....	12,252	12,252	12,866	0.66
New Hampshire	7,054	....	6,655	6,655	6,989	0.36
New Jersey	53,059	....	50,417	50,417	52,944	2.73
New Mexico	11,857	....	11,231	11,231	11,794	0.61
New York	217,698	....	207,164	207,164	217,548	11.21
North Carolina	44,190	....	41,507	41,507	43,588	2.25
North Dakota	3,877	....	3,696	3,696	3,881	0.20
Ohio	72,978	....	68,637	68,637	72,077	3.71
Oklahoma	22,180	....	20,927	20,927	21,976	1.13
Oregon	23,850	....	22,326	22,326	23,445	1.21
Pennsylvania	82,212	....	77,375	77,375	81,253	4.19
Rhode Island	10,121	....	9,720	9,720	10,207	0.53
South Carolina	21,534	....	20,436	20,436	21,460	1.11
South Dakota	4,711	....	4,385	4,385	4,605	0.24
Tennessee	33,861	....	31,778	31,778	33,371	1.72
Texas	129,636	....	121,892	121,892	128,002	6.59
Utah	10,291	....	9,601	9,601	10,082	0.52
Vermont	4,592	....	4,343	4,343	4,561	0.23
Virginia	37,506	....	35,105	35,105	36,865	1.90
Washington	37,385	....	35,284	35,284	37,053	1.91
West Virginia	14,072	....	13,388	13,388	14,059	0.72
Wisconsin	30,937	....	29,261	29,261	30,728	1.58
Wyoming	3,650	....	3,586	3,586	3,766	0.19
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	35,002	....	33,722	33,722	35,412	1.82
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Technical Assistance and Housing Counseling [1]	63,503	....	65,121	65,121	14,482	0.75
Total	**2,005,597**	....	**1,899,680**	**1,899,680**	**1,941,000**	[2] **100.00**

[1] FY 2004 and FY 2005 include Housing Counseling. For FY 2006, a separate account is proposed for funding Housing Counseling.
[2] Excludes undistributed obligations.

Table 8–30. Airport Improvement Program (20.106a)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	55,895	....	55,420	55,420	47,497	1.63
Alaska	222,144	....	220,257	220,257	188,766	6.47
Arizona	87,936	....	87,189	87,189	74,723	2.56
Arkansas	38,600	....	38,272	38,272	32,800	1.12
California	243,908	....	241,837	241,837	207,261	7.10
Colorado	65,265	....	64,711	64,711	55,459	1.90
Connecticut	9,474	....	9,394	9,394	8,051	0.28
Delaware	5,486	....	5,440	5,440	4,662	0.16
District of Columbia	386	....	382	382	327	0.01
Florida	186,024	....	184,443	184,443	158,073	5.42
Georgia	92,010	....	91,228	91,228	78,185	2.68
Hawaii	54,909	....	54,442	54,442	46,658	1.60
Idaho	31,235	....	30,970	30,970	26,542	0.91
Illinois	109,830	....	108,897	108,897	93,328	3.20
Indiana	62,234	....	61,706	61,706	52,884	1.81
Iowa	35,703	....	35,400	35,400	30,339	1.04
Kansas	28,773	....	28,528	28,528	24,449	0.84
Kentucky	83,046	....	82,340	82,340	70,568	2.42
Louisiana	63,062	....	62,526	62,526	53,587	1.84
Maine	27,892	....	27,655	27,655	23,701	0.81
Maryland	29,741	....	29,488	29,488	25,272	0.87
Massachusetts	38,437	....	38,110	38,110	32,661	1.12
Michigan	104,388	....	103,501	103,501	88,703	3.04
Minnesota	66,728	....	66,161	66,161	56,702	1.94
Mississippi	43,395	....	43,027	43,027	36,875	1.26
Missouri	121,486	....	120,454	120,454	103,233	3.54
Montana	32,625	....	32,347	32,347	27,722	0.95
Nebraska	26,089	....	25,867	25,867	22,169	0.76
Nevada	61,531	....	61,008	61,008	52,286	1.79
New Hampshire	18,434	....	18,277	18,277	15,664	0.54
New Jersey	48,620	....	48,207	48,207	41,315	1.42
New Mexico	15,390	....	15,259	15,259	13,077	0.45
New York	138,813	....	137,634	137,634	117,956	4.04
North Carolina	91,487	....	90,709	90,709	77,740	2.66
North Dakota	22,782	....	22,588	22,588	19,359	0.66
Ohio	84,509	....	83,791	83,791	71,811	2.46
Oklahoma	39,666	....	39,329	39,329	33,706	1.16
Oregon	38,773	....	38,444	38,444	32,948	1.13
Pennsylvania	112,181	....	111,228	111,228	95,326	3.27
Rhode Island	12,209	....	12,105	12,105	10,374	0.36
South Carolina	41,546	....	41,193	41,193	35,304	1.21
South Dakota	20,149	....	19,978	19,978	17,122	0.59
Tennessee	66,470	....	65,905	65,905	56,482	1.94
Texas	222,320	....	220,431	220,431	188,915	6.48
Utah	28,843	....	28,598	28,598	24,509	0.84
Vermont	4,009	....	3,975	3,975	3,407	0.12
Virginia	74,389	....	73,757	73,757	63,212	2.17
Washington	84,743	....	84,023	84,023	72,010	2.47
West Virginia	34,275	....	33,984	33,984	29,125	1.00
Wisconsin	52,412	....	51,967	51,967	44,537	1.53
Wyoming	46,842	....	46,444	46,444	39,804	1.36
American Samoa	9,826	....	9,742	9,742	8,349	0.29
Guam	9,464	....	9,384	9,384	8,042	0.28
Northern Mariana Islands	29,845	....	29,591	29,591	25,360	0.87
Puerto Rico	31,681	....	31,412	31,412	26,921	0.92
Freely Associated States	....	....	....	....	....	....
Virgin Islands	4,996	....	4,953	4,953	4,245	0.15
Indian Tribes	....	....	....	....	....	....
Undistributed	65,305	....	68,252	68,252	82,397	....
Small Community Air Service Program	19,882	....	19,840	19,840	....	....
Airport Technology Research	....	....	....	....	17,500	0.60
Total	**3,498,093**	....	**3,472,000**	**3,472,000**	**3,000,000**	[1] **100.00**

[1] Excludes undistributed obligations.

Table 8–31. Airport Improvement Program—Emergency Response Fund (20.106b)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	575					
Alaska						
Arizona						
Arkansas						
California						
Colorado						
Connecticut						
Delaware						
District of Columbia						
Florida						
Georgia	32					
Hawaii						
Idaho						
Illinois	–491					
Indiana	589					
Iowa						
Kansas						
Kentucky						
Louisiana						
Maine						
Maryland	–20					
Massachusetts						
Michigan	–21					
Minnesota						
Mississippi						
Missouri						
Montana						
Nebraska						
Nevada						
New Hampshire						
New Jersey						
New Mexico						
New York	–4					
North Carolina						
North Dakota						
Ohio	–30					
Oklahoma						
Oregon						
Pennsylvania						
Rhode Island						
South Carolina						
South Dakota	–47					
Tennessee						
Texas						
Utah						
Vermont						
Virginia	–88					
Washington						
West Virginia						
Wisconsin	613	112		112		
Wyoming						
American Samoa						
Guam						
Northern Mariana Islands						
Puerto Rico						
Freely Associated States						
Virgin Islands						
Indian Tribes						
Undistributed						
Total	**1,108**	**112**		**112**		

Table 8–32. Airport Improvement Program—Emergency Assistance to Airports (20.106c)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	....	....	1,523	1,523	....	....
Alaska	....	....	....	....	....	....
Arizona	....	....	....	....	....	....
Arkansas	....	....	....	....	....	....
California	....	....	....	....	....	....
Colorado	....	....	....	....	....	....
Connecticut	....	....	....	....	....	....
Delaware	....	....	....	....	....	....
District of Columbia	....	....	....	....	....	....
Florida	....	....	23,143	23,143	....	....
Georgia	....	....	....	....	....	....
Hawaii	....	....	....	....	....	....
Idaho	....	....	....	....	....	....
Illinois	....	....	....	....	....	....
Indiana	....	....	....	....	....	....
Iowa	....	....	....	....	....	....
Kansas	....	....	....	....	....	....
Kentucky	....	....	35	35	....	....
Louisiana	....	....	....	....	....	....
Maine	....	....	....	....	....	....
Maryland	....	....	....	....	....	....
Massachusetts	....	....	....	....	....	....
Michigan	....	....	....	....	....	....
Minnesota	....	....	....	....	....	....
Mississippi	....	....	21	21	....	....
Missouri	....	....	....	....	....	....
Montana	....	....	....	....	....	....
Nebraska	....	....	....	....	....	....
Nevada	....	....	....	....	....	....
New Hampshire	....	....	....	....	....	....
New Jersey	....	....	....	....	....	....
New Mexico	....	....	....	....	....	....
New York	....	....	....	....	....	....
North Carolina	....	....	15	15	....	....
North Dakota	....	....	....	....	....	....
Ohio	....	....	....	....	....	....
Oklahoma	....	....	....	....	....	....
Oregon	....	....	....	....	....	....
Pennsylvania	....	....	88	88	....	....
Rhode Island	....	....	....	....	....	....
South Carolina	....	....	....	....	....	....
South Dakota	....	....	....	....	....	....
Tennessee	....	....	....	....	....	....
Texas	....	....	....	....	....	....
Utah	....	....	....	....	....	....
Vermont	....	....	....	....	....	....
Virginia	....	....	....	....	....	....
Washington	....	....	....	....	....	....
West Virginia	....	....	32	32	....	....
Wisconsin	....	....	....	....	....	....
Wyoming	....	....	....	....	....	....
American Samoa	....	....	....	....	....	....
Guam	....	....	....	....	....	....
Northern Mariana Islands	....	....	....	....	....	....
Puerto Rico	....	....	143	143	....	....
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	....	....	....	....
Indian Tribes	....	....	....	....	....	....
Undistributed	....	....	....	....	....	....
Total	....	....	**25,000**	**25,000**	....	....

Table 8–33. Highway Planning and Construction (20.205)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from:			FY 2006 (estimated)	FY 2006 Percentage of distributed total
		Previous authority	New authority	Total		
Alabama	556,546	517,626	134,261	651,887	621,042	1.91
Alaska	356,663	146,372	203,074	349,446	321,357	0.99
Arizona	489,792	424,144	136,371	560,515	568,558	1.75
Arkansas	358,318	360,245	66,710	426,955	408,933	1.26
California	2,513,459	2,503,375	564,577	3,067,952	3,077,532	9.45
Colorado	368,131	275,932	112,920	388,852	413,968	1.27
Connecticut	418,100	310,146	107,224	417,370	431,604	1.33
Delaware	133,508	119,127	5,680	124,807	132,989	0.41
District of Columbia	124,261	136,788	−10,808	125,980	128,969	0.40
Florida	1,299,973	1,130,987	447,598	1,578,585	1,542,259	4.74
Georgia	1,023,184	1,056,708	165,956	1,222,664	1,168,648	3.59
Hawaii	180,508	225,469	−53,364	172,105	167,281	0.51
Idaho	218,071	191,429	49,053	240,482	234,435	0.72
Illinois	990,907	914,181	217,882	1,132,063	1,119,075	3.44
Indiana	664,627	493,915	250,753	744,668	788,757	2.42
Iowa	364,329	290,517	77,454	367,971	380,309	1.17
Kansas	380,119	313,683	58,497	372,180	377,411	1.16
Kentucky	502,705	390,162	127,492	517,654	521,514	1.60
Louisiana	463,338	570,956	−49,360	521,596	506,005	1.55
Maine	159,423	118,558	32,718	151,276	161,011	0.49
Maryland	522,912	427,178	114,907	542,085	551,889	1.69
Massachusetts	563,833	1,055,195	−435,326	619,869	620,567	1.91
Michigan	878,988	773,219	216,805	990,024	997,105	3.06
Minnesota	416,954	404,914	41,477	446,391	454,773	1.40
Mississippi	344,857	327,771	81,709	409,480	402,045	1.23
Missouri	653,150	506,451	176,131	682,582	717,855	2.20
Montana	285,912	194,417	60,020	254,437	273,362	0.84
Nebraska	240,846	184,955	53,622	238,577	255,513	0.78
Nevada	203,078	193,273	62,790	256,063	236,829	0.73
New Hampshire	158,455	133,273	23,945	157,218	159,711	0.49
New Jersey	738,616	750,808	143,734	894,542	898,298	2.76
New Mexico	247,519	242,192	56,830	299,022	296,461	0.91
New York	1,515,961	1,442,924	239,125	1,682,049	1,650,655	5.07
North Carolina	807,531	617,820	194,794	812,614	852,405	2.62
North Dakota	200,745	159,339	39,125	198,464	203,081	0.62
Ohio	916,131	1,104,708	107,307	1,212,015	1,151,410	3.54
Oklahoma	476,262	405,313	126,160	531,473	530,903	1.63
Oregon	308,007	268,220	84,257	352,477	369,549	1.13
Pennsylvania	1,369,294	1,505,793	167,357	1,673,150	1,586,159	4.87
Rhode Island	175,417	139,977	32,941	172,918	180,208	0.55
South Carolina	501,467	385,397	96,813	482,210	506,068	1.55
South Dakota	216,544	199,508	25,273	224,781	220,687	0.68
Tennessee	578,167	729,639	69,270	798,909	737,121	2.26
Texas	2,377,527	1,684,704	746,630	2,431,334	2,531,233	7.77
Utah	235,734	228,782	28,524	257,306	260,753	0.80
Vermont	149,465	141,064	−519	140,545	144,749	0.44
Virginia	683,434	700,516	124,145	824,661	817,890	2.51
Washington	565,284	449,004	124,109	573,113	574,925	1.77
West Virginia	299,317	368,163	16,282	384,445	340,090	1.04
Wisconsin	559,950	500,374	111,051	611,425	606,377	1.86
Wyoming	191,174	147,653	47,590	195,243	208,627	0.64
American Samoa	8,003	1,346	2,754	4,100	3,906	0.01
Guam	8,463	....	13,172	13,172	14,349	0.04
Northern Mariana Islands	3,199	....	3,293	3,293	3,587	0.01
Puerto Rico	73,499	5,644	96,935	102,579	114,101	0.35
Freely Associated States	....	....	....	....	....	....
Virgin Islands	12,586	21,909	4,408	26,317	19,531	0.06
Indian Tribes	....	....	....	....	....	....
Undistributed	1,226,243	2,665,632	5,144,294	7,809,926	2,500,490	....
Total	**30,280,486**	**29,557,395**	**10,886,422**	**40,443,817**	**35,064,919**	**[1] 100.00**

[1] Excludes undistributed obligations.

Table 8–34. Federal Transit Formula Grants and Research (Section 5307) (20.507)

(obligations in thousands of dollars)

State or Territory	FY 2004 Actual	Estimated FY 2005 obligations from: Previous authority	New authority	Total	FY 2006 (estimated)	FY 2006 Percentage of distributed total
Alabama	10,091	....	35,518	35,518	41,589	0.61
Alaska	2,114	....	14,150	14,150	16,569	0.24
Arizona	100,856	....	70,755	70,755	82,849	1.21
Arkansas	8,580	....	21,829	21,829	25,560	0.37
California	752,267	....	1,147,648	1,147,648	1,287,902	18.77
Colorado	48,339	....	68,503	68,503	80,212	1.17
Connecticut	8,995	....	61,971	61,971	72,563	1.06
Delaware	2,674	....	10,407	10,407	12,186	0.18
District of Columbia	106,790	....	92,455	92,455	108,258	1.58
Florida	172,163	....	241,359	241,359	282,614	4.12
Georgia	88,252	....	166,556	166,556	184,263	2.68
Hawaii	20,950	....	40,055	40,055	46,901	0.68
Idaho	5,180	....	11,962	11,962	14,007	0.20
Illinois	217,557	....	345,311	345,311	398,552	5.81
Indiana	37,860	....	64,095	64,095	75,051	1.09
Iowa	13,582	....	27,771	27,771	32,518	0.47
Kansas	5,985	....	22,323	22,323	26,139	0.38
Kentucky	18,633	....	40,506	40,506	47,430	0.69
Louisiana	15,456	....	53,144	53,144	62,227	0.91
Maine	6,081	....	9,841	9,841	11,524	0.17
Maryland	22,483	....	99,862	99,862	116,931	1.70
Massachusetts	136,668	....	174,055	174,055	203,806	2.97
Michigan	60,222	....	112,260	112,260	131,449	1.92
Minnesota	45,786	....	69,627	69,627	81,528	1.19
Mississippi	2,146	....	19,774	19,774	23,154	0.34
Missouri	43,892	....	85,876	85,876	96,860	1.41
Montana	839	....	7,729	7,729	9,050	0.13
Nebraska	6,824	....	16,621	16,621	19,462	0.28
Nevada	43,628	....	35,572	35,572	41,652	0.61
New Hampshire	3,530	....	10,400	10,400	12,178	0.18
New Jersey	274,736	....	363,868	363,868	414,820	6.04
New Mexico	15,016	....	19,529	19,529	22,867	0.33
New York	524,584	....	870,415	870,415	1,001,204	14.59
North Carolina	23,597	....	76,986	76,986	90,145	1.31
North Dakota	2,352	....	6,808	6,808	7,971	0.12
Ohio	113,486	....	146,499	146,499	171,540	2.50
Oklahoma	11,470	....	32,340	32,340	37,868	0.55
Oregon	54,966	....	56,786	56,786	66,492	0.97
Pennsylvania	205,079	....	260,857	260,857	300,465	4.38
Rhode Island	9,368	....	13,177	13,177	15,429	0.22
South Carolina	10,532	....	32,113	32,113	37,602	0.55
South Dakota	1,953	....	6,828	6,828	7,995	0.12
Tennessee	29,760	....	55,558	55,558	65,054	0.95
Texas	206,194	....	339,664	339,664	354,807	5.17
Utah	32,533	....	40,009	40,009	46,848	0.68
Vermont	1,639	....	4,420	4,420	5,176	0.08
Virginia	76,625	....	117,391	117,391	132,477	1.93
Washington	124,314	....	139,405	139,405	163,234	2.38
West Virginia	4,363	....	14,411	14,411	16,875	0.25
Wisconsin	30,425	....	69,252	69,252	81,089	1.18
Wyoming	711	....	4,162	4,162	4,874	0.07
American Samoa	....	....	379	379	443	0.01
Guam	....	....	1,016	1,016	1,189	0.02
Northern Mariana Islands	....	....	586	586	686	0.01
Puerto Rico	58,595	....	99,839	99,839	110,318	1.61
Freely Associated States	....	....	....	....	....	....
Virgin Islands	....	....	767	767	898	0.01
Indian Tribes	....	....	....	....	....	....
Undistributed	12,564	....	....	....	....	....
Alaska Railroad	2,916	....	4,811	4,811	4,850	0.07
Over the Road Bus	....	....	6,894	6,894	6,950	0.10
National Research	....	....	49,352	49,352	47,792	0.70
Total	[1] **3,836,198**	....	**6,012,057**	[2] **6,012,057**	[2] **6,862,942**	[3] **100.00**

[1] Activity funded under Federal Transit Urbanized Area—Formula Grants (Section 5307). Includes Federal Highway transfers.

[2] Formula Grants and Research is a consolidated account structure proposed in the Administration's Surface Transportation Authorization proposal (SAFETEA). Amounts include Fixed Guideway Modernization (CFDA 20.500) new obligations of $1.2 billion for FY 2005 and $1.3 billion for FY 2006. Also includes Elderly and Persons with Disabilities (CFDA 20.513), Job Access and Reverse Commute (CFDA 20.516), and New Freedom Initiative.

[3] Excludes undistributed obligations.

9. INTEGRATING SERVICES WITH INFORMATION TECHNOLOGY

This year the President is proposing to spend about $65 billion for Information Technology (IT) and associated support services to deliver results for the American people, providing timely and accurate information to the citizens and government decision makers while ensuring security and privacy.

The three major efforts underway will continue this fiscal year to ensure the Federal government's investment in Information Technology returns benefits which far outweigh the costs. These efforts are:

- Managing for Results
- Expanding the Use of Electronic Government
- Integrating the Federal Enterprise Architecture

MANAGEMENT FOR RESULTS

Departments and agencies are focused on:

- Making it easier for citizens to obtain service and interact with the Federal government;
- Improving government efficiency and effectiveness;
- Improving government's responsiveness to citizens; and
- Making better purchasing decisions.

With these goals in mind, the Federal departments and agencies are fulfilling the goals of the Clinger-Cohen Act of 1996. This Act also requires the Director of the Office of Management and Budget (OMB) to submit an annual report to the Congress on the results we are achieving from Federal IT spending. This Budget chapter and Table 9–1, "Effectiveness of Agency's IT Management and E-Gov Processes," included on the CD-ROM, fulfill the statutory reporting requirement.

The Administration continues its oversight of agencies' IT planning and portfolio activities. Our goal is to be the best manager, innovator and user of information, services and information systems in the world. There are great opportunities to apply existing and emerging business best practices to government to achieve increases in productivity and delivery of services and information. Agencies are continuing to establish program performance metrics, identify benefits achieved by their IT investments and show results in the agency's overall program performance. Work continues in the operational analysis of cost, schedule and performance.

Performance of Government.—The measure of success rests in the results we achieve and the satisfaction of our customers. The ultimate success is determined by measuring distinct, quantitative, citizen-centered, performance results which are tied to the overall agencies' mission goals and outcomes. Each IT investment must have specific performance targets tied to a specific significant beneficial impact for our citizens. The IT projects represented by these investments must be monitored by the agencies and they must continually assess whether or not the projects are accomplishing their intended outcomes on-time while staying within their approved budgets.

Departments' or agencies' IT business cases for any planned and/or operational system critical to the mission of the agency must be evaluated. Each business case must have a clearly defined vision and outcomes, including security linked to the department's or agency's mission through their enterprise architecture. The business cases are scored on specific criteria, including whether:

- the expected benefits outweigh estimated costs;
- the likelihood the agency will succeed;
- cyber-security, planned or in place, as appropriate;
- the acquisition strategy helps manage project risks; and
- project management teams and plans are qualified and complete.

The Federal departments and agencies continue to improve in their efforts to guarantee the success and results for the taxpayer. The Administration continues to monitor the performance of its IT projects. With the release of the Fiscal Year 2005 President's Budget, there were 621 major projects representing about $22 billion on the "Management Watch List," i.e., those project justifications needing improvement in performance measurement, earned value management or system security. Agencies were directed to remediate the shortfalls identified prior to expending funds before the start of the fiscal year. The agencies have worked to remediate the weaknesses or have put measures in place to monitor the progress of the project. If a project is still on the "Management Watch List," agencies must describe their plans to manage or mitigate risk before undertaking or continuing that project. For example, the Department of Defense (DOD) successfully addressed deficiencies for 106 of its 107 business cases on the "Management Watch List," and developed a remediation plan and schedule for the remaining program. This year, less than a third (342 of 1,087 projects valued at $15 billion) are on the "Management Watch List." These projects still need to address performance, security or other related issues before obligating funding in Fiscal Year 2006.

The Report on Information Technology (IT) Spending for the Federal Government (Exhibit 53) located at *www.whitehouse.gov/OMB*, provides details of the Administration's proposed 2006 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, 2005.

Since the Administration's guidance was unchanged from Fiscal Year 2005 to Fiscal Year 2006, investments were studied for trends and duplications across government entities. At about $65 billion, the Fiscal Year 2006 Federal IT portfolio represents a 9 percent increase over Fiscal Year 2005 President's Budget (see July 2004, Update to the Report on Information Technology (IT) Spending for the Federal Government (Exhibit 53) located at *www.whitehouse.gov/OMB*.) The following represents the highlights:

	FY 2005	FY 2006	% Change
Major IT Investments	1,130	1,087	–4
Rated Unacceptable	54	16	–70
Well Planned and Managed	385	682	78
	(Value in millions)		
Major IT Investments	$32,341	$40,979	27
Rated Unacceptable	$1,109	$1,497	35
Well Planned and Managed	$8,478	$24,761	292

In addition to analyzing business cases for major acquisitions, the Administration identifies overlapping or duplicative IT investments. When there is duplication across Federal agencies, the Administration brings together the appropriate agencies and helps them to consider broad-based approaches to promote inter-agency data sharing and cooperation in building common solutions, rather than maintaining separate investments.

These inter-agency taskforces focus on the agency Lines of Business (LoB) rather than a specific technology or investment. In Fiscal Year 2004, there was significant progress made on five LoB efforts. These are:

- Case Management
- Federal Health Architecture
- Financial Management
- Human Resources Management
- Grants Management

The Case Management LoB is the business and technology foundation upon which new solutions for the Department of Justice and other agencies will be built. It will also provide a blueprint for sharing information and best practices across the Federal government. The goal of this LoB is to improve effectiveness and efficiency of law enforcement, investigation, and civil and criminal litigation case management business processes.

Federal Health Architecture (FHA) is focused on improving the efficiency, standardization, reliability, and availability of comprehensive health information solutions through a common framework. FHA is working within the Office of the National Coordinator for Health Information Technology in the Department of Health and Human Services to improve the safety and health of citizens by providing easier access to health-related information and services.

Cross-agency teams analyzed opportunities for integration and consolidation in the areas of Financial Management, Human Resources Management, and Grants Management. They have recommended the establishment of government-wide service providers in the areas of Financial Management and Human Resources Management. The Grants Management team is developing plans for the consolidation of Grants Management activities across the government. The analysis showed savings of more than $5 billion can be expected over a 10 year timeframe through the consolidation of Financial Management and Human Resources Management systems and the standardization and optimization of associated business processes and functions.

To realize these benefits, the Administration asked agencies with the skills and capabilities to function as government-wide service providers in the areas of Human Resources Management and/or Financial Management to submit business cases for doing so as part of the Fiscal Year 2006 budget process. The business cases were evaluated using a due diligence checklist developed in conjunction with third-party industry groups. This checklist assessed potential service providers' abilities in terms of past performance, current capabilities, and ability to operate a customer-focused organization. On the basis of the review, the following agencies were designated as eligible to enter into competitions to become cross-agency service providers:

Financial Management

- Department of the Interior (National Business Center)
- General Services Administration
- Department of Transportation
- Treasury/Bureau of Public Debt

Human Resources Management

- Department of the Interior (National Business Center)
- Department of Agriculture (National Finance Center)
- Department of Treasury
- Department of Health and Human Services
- Department of Defense

Rather than expend significant effort and resources modernizing existing systems, agencies will select, through a competitive process, beginning in Fiscal Year 2005, a government-wide service provider for Human Resources Management and/or Financial Management services. Upon migration to common, government-wide solutions, agencies will shut down existing systems—which will not only save money but also make available resources for agencies to better focus on achieving their missions.

This Administration continues to leverage government buying power while reducing redundant purchases through the SmartBUY program. SmartBUY is a Federal government-wide enterprise software licensing initiative managed by the General Services Administration (GSA) to streamline the acquisition process and provide the best priced, standards-compliant IT. The SmartBUY initiative includes commercial off-the-shelf software generally acquired using license agreements with terms and prices that vary based on volume, including the following types of software licenses: Office Automation; Network Management; Antivirus; Database; Business Modeling Tools; and Open Source Software Support. Since the Administration announced the SmartBUY program in June 2003, the program has completed agreements with four software vendors and plans to negotiate agreements with the remaining top software vendors to the Federal government. Based on these agreements already in place, the Federal government expects to reduce its annual software licenses expenses by $21.5 million annually. The Administration estimates when all agencies make joint use of these best priced software licenses, the Federal government could save in excess of $100 million per year.

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. Under this authority, the Director is required to evaluate information resources management practices of the executive agencies with respect to IT investments. Accordingly, OMB has taken several steps to assist the SmartBUY program in leveraging government buying power and reducing redundant purchases. The following actions were taken:

- Issued M–03–14 "Reducing Cost & Improving Quality in Federal Purchases of Commercial Software," (06/02/03) requesting agencies to assist and support the SmartBUY initiative by providing information on existing agreements, developing migration strategies, and taking steps to integrate agency common desktop and server software licenses with the initiative.
- Required, as part of the Fiscal Year 2005 budget process, in Fiscal Year 2004, agencies to review all commercial software acquisitions for possible inclusion into the SmartBUY program.
- Issued M–04–08 "Maximizing Use of SmartBUY and Avoiding Duplication of Agency Activities with the President's 24 E-Gov Initiatives," (02/25/04) to all senior procurement officers and Chief Information Officers (CIOs) directing agencies to postpone all further purchase requirements for a category of software once GSA has notified the agencies that it expects to award a SmartBUY contract within 30 days for that category of software.
- Established a formal waiver process for agencies with compelling procurement needs, ensuring compliance with SmartBUY and promoting negotiating leverage with software vendors.
- Issued M–04–16 "Software Acquisition," (07/01/04), reminding agencies of policies and procedures covering acquisition of software to support agency operations. This directive requires that all agency IT investment decisions be made consistent with the agency's enterprise architecture and the Federal Enterprise Architecture, must consider the total cost of ownership of IT investments, and coordinated, where applicable, with the SmartBUY program.

Other management guidance provided to Federal departments and agencies is included on Table 9–2, "Management Guidance," and is available at *www.whitehouse.gov/OMB/memoranda*.

Government IT Workforce.—Qualified Federal IT Project Managers with skilled interdisciplinary teams are the first line of defense against the cost overruns, schedule slippages, poor performance, and weakened security which threaten agencies' ability to deliver efficient and effective services to citizens. OMB issued M–04–19 "Information Technology (IT) Project Manager (PM) Qualification Guidance" (07/19/04) requiring agencies to submit, by July 30, 2004, a plan to implement the Chief Information Officer Council (CIOC) guidance on the qualifications of Federal IT project managers. The CIOC made great strides in the development of this guidance to further ensure the quality of our IT process. Agencies were asked to submit plans for meeting the CIOC guidance and to identify the required PM Level for each investment requested for their Fiscal Year 2006 IT budget requests. Agencies were also required to confirm whether the assigned project manager's qualifications for major IT investments had been validated against the CIOC guidance.

A review of the top tier of Agencies' IT requests indicates all agencies directly or indirectly addressed IT project management qualification standards in accordance with CIOC guidance. According to the submissions for the fourth quarter of Fiscal Year 2004 President's Management Agenda (PMA) scorecard reporting, over 75 percent of the project managers of major IT investments have been validated against CIOC guidance, and plans are in place across government to ensure remaining project managers are trained and validated by the end of the calendar year.

The Office of Personnel Management (OPM) and the CIO Council have conducted two annual government-wide IT workforce assessments in 2003 and 2004. The surveys revealed five critical jobs: IT Project Management, IT Security/Information Assurance, Customer Support, System Analysis, and Applications Software Management. Using these standardized assessments provides an efficient and effective government-wide view of competency and skill gaps assuring our critical systems are sufficiently staffed to provide for security, reliability and efficiency. Agencies have received the results of the Fall Fiscal Year 2004 survey and are participating in a specialized job activity target-setting exercise to provide a more defined skill gap analysis government-wide, and to apply to agency-specific workforce assessment and planning. A Spring assessment based on CIO's judgment revealed maintaining a cadre of qualified IT Project Managers, IT Security Specialists and IT Architects could best be managed through training programs.

The E-Government Act of 2002 requires the assessment and reporting of current training offerings and the oversight of development of curricula, training methods, and training priorities to meet projected personnel needs. In July 2004, OPM published its report on the "Establishment of a Government Information Technology Training Program." The training report establishes a common IT training framework and identifies a baseline of current government-wide IT training. The report reviewed and assessed the adequacy of existing government-wide IT training programs with the Clinger-Cohen Act core competencies as the basis for evaluation. This report also served as a baseline for OPM to track IT and Information Resources Management (IRM) training availability and adequacy across government in its ongoing responsibility to identify where gaps in IT and IRM training do not satisfy personnel needs.

OPM also recommended a government-wide IT training framework using the IT Workforce Development Roadmap as a foundation to link existing IT and IRM training programs. The framework supports the OPM requirement to assist agencies in establishing and operating IT training programs. Agency use of this framework will enable their workforce to obtain government-wide competencies and skills that improve the ability of the government to achieve agency missions and program goals. This framework fosters the development of highly skilled Federal IT workers who are better able to deliver essential services to the American people in the increasingly technical E-Government environment. However, skill gaps remain in the IT Workforce. The CIO Council will work in conjunction with OPM to develop guidelines for assisting departments and agencies in identifying the skill gaps in their workforce.

OMB asked agencies to report their use of training plans as well as their integration of IT plans in overall human capital planning. Most agencies have shown progress in identifying IT and the needs of the IT workforce as part of their overall human capital planning. Most indicate coordination and cooperation between their agencies' Chief Human Capital and Chief Information Officers and staffs to improve IT project management skills. Most agencies refer to their human capital planning efforts as a way to ensure the Federal government has sufficient highly qualified IT professionals to deliver services to citizens, businesses, and government entities, effectively and in direct alignment with the mission of the agency. A number of agencies discussed the importance of the government-wide survey data in relation to agency succession planning. Agencies also referred to OPM's report as the basis for selecting training in filling current workforce gaps, especially in the IT project management arena. The Administration's goal during Fiscal Year 2005 is to have no more than 50 percent of the agencies with IT skill gaps within their workforce.

On January 15, 2004, OPM published proposed regulations to implement an Information Technology Exchange Program. OPM has completed analysis of comments received from the public on the proposed IT Exchange Program Regulations. In accordance with Executive Order 12866 "Regulatory Planning and Review" (01/11/96), the final regulation is being provided to OMB for concurrence prior to publication in the Federal Register.

The IT Exchange Program can improve the skills of Federal IT managers by exposing them to cutting-edge management and technical trends in the private sector. The Program can improve the government's capability to apply advances in IT to enhance governmental functions and services, achieve more efficient performance, increase access to government information, and increase citizen participation in government.

Securing Government Systems.—Over the last four years the Federal government has improved the identification and resolution of long-standing, serious, and pervasive IT security problems. Agencies report both quarterly and annually on their efforts to address IT security weaknesses against key IT security performance measures.

For example, the Department of Labor and the Department of Transportation have excelled this year in protecting their information technology assets. Both agencies have increased the number of certified and accredited systems, with Labor moving from 58 percent to 96 percent accredited, and Transportation improving from 33 percent to 98 percent. Agency Inspectors General have approved the quality of these certification and accreditation processes as well as the effectiveness of agency remediation plans. By focusing on cyber-security, the Department of Labor and the Department of Transportation have taken great steps to protect the integrity of their agencies.

The overall security status and progress in percentage of systems*, from Fiscal Year 2002 to Fiscal Year 2004, is as follows:

	FY 2002	FY 2003	FY 2004
Effective Security and Privacy Controls (C&A)	47%	62%	77%
"Built in" with Security Costs	62%	77%	85%
Tested with Contingency Plans	35%	48%	57%
***Total Systems reported**	**7,957**	**7,998**	**8,623**

The number of agencies where the Inspector General has verified the process exists to remediate IT security weaknesses (POA&M):

FY 2002	N/A (was not required in until FY 2003)
FY 2003	12
FY 2004	18

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 these challenges, the Administration works with agencies, Inspectors General, the Congress and the Government Accountability Office (GAO) to assure appropriate cost-effective IT security programs, policies, and procedures are in place to protect government systems. OMB issued M–04–25 "FY 2004 Reporting Instructions for the Federal Information Security Management Act" (08/23/04) providing updated instructions for the agency reporting under the Federal Information Security Management Act of 2002 (FISMA). Agencies were directed to transmit their Fiscal Year 2004 reports on the effectiveness of their security programs to OMB by October 6, 2004.

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, 2005 and will be made available on OMB's website.

Additionally, the Administration intends to focus on the implementation of a security LoB to reduce costs and increase security effectiveness across government. Working with agencies, the Administration will analyze commonly used IT security processes and controls in an effort to identify the extent to which consolidation opportunities exist.

Protecting Privacy.—The Administration continues to work with departments and agencies to assure that privacy issues are addressed across boundaries providing a uniform and systematic process to protect citizen information. One method is through the Privacy Impact Assessment (PIA) process. The PIA is a description of business processes, data flows and technologies in the context of applicable privacy principles. Agencies have been conducting PIAs since the last budget cycle, submitting them to OMB as necessary and making them publicly available. The CIO Council has released a Security and Privacy Profile to be used in conjunction with the Federal Enterprise Architecture and the agency's specific enterprise architecture to ensure privacy and security are properly addressed within the planned IT investment. Because of the visibility of the PIA's and the work done, OMB did not request reporting on this activity this year.

The Administration plans for greater transparency on the part of the government agencies as it relates to information collection and will continue to use the PIA effort to provide this service.

Making Government Accessible to All.—Information technology is increasing access to Federal information and services. The Federal government continues to ensure electronic information technology is accessible to people with disabilities as required by Section 508 of the Rehabilitation Act of 1973. The creation of the Buy Accessible Wizard, a web-based application developed by GSA, helps agencies to determine relevance, applicability, and compliance to Section 508 when managing electronic and information technology products and services. The application helps Federal program managers to consistently and correctly apply the Federal Acquisition Regulation to their market research.

Agencies have also established inventories of the types of information available on their websites, as well as priorities and schedules for posting content. The inventories and schedules help ensure agency information products are adequately categorized and preserved so citizens can easily retrieve them when searching. These practices improve the quality and timeliness of the Federal government's information resources.

SUCCESSFUL USES OF ELECTRONIC GOVERNMENT

E-Government continues to seek to leverage information technologies to make government services available to the citizen while ensuring security of those systems, the privacy of the citizen information and the prudent use of taxpayer money. E-Government is about providing direct and measurable results supporting departments' and agencies' mission and goals. For departments and agencies, the benefits must far outweigh the cost of implementation. In the coming months, the Presidential E-Government initiatives graduate from development and implementation phases to mature service offerings supported by service fees. Increased agency adoption and customer utilization will become the primary measures of success. The expanded availability of government information and the utilization of an increased percentage of transactions between the Federal government and citizens will be measured, where appropriate.

Examples of how the tenets of E-Government are helping to deliver services to the citizen and make the government more effective include:

In Fiscal Year 2003, the Department of Labor (DOL) fully deployed the Safety and Health Information Management System (SHIMS) which manages employee injury reports and worker compensation claims and produces management reports and data to help guide intervention activities. Previously, claim forms were manually written and mailed which resulted in a two week response. With SHIMS, DOL electronically receives the claim within 24 hours and provides a response within two days. The cost savings are attributed to the implementation of the SHIMS in DOL. The system demonstrates a reduction in workers' compensation costs through quicker claims processing and the ability to identify persons able to return to work. As a result of this effort, DOL saved over $3.23 million from FY 2003 to FY 2004 in workers' compensation costs. Fourteen Federal agencies have agreed to implement SHIMS with six agencies working towards a January 2005 implementation target. DOL's successful project management performance in attaining Federal goals is a major factor in agencies seeking to partner for use of SHIMS.

The Department of Transportation's (DOT) Federal Motor Carrier Safety Administration implemented the Motor Carrier Management Information System providing businesses with an online, efficient method to apply for operating authority and register for a U.S.

DOT Number. The system improves the sharing of commercial motor carrier information among the levels of government. Federal, state, and local agencies all access the system for their safety, enforcement, licensing, and insurance needs. Prior to October 2003, Cargo Tank Manufacturers could not register online. Now over 4,000 Cargo Tank Manufacturers have registered online. This investment reduces costs and improves efficiencies in various ways by providing centrally-hosted information for all interstate carriers and targeting enforcement activities by utilizing motor carrier safety data.

The departments and agencies continue to focus on service improvements and best value for their customers. The government is managing itself as one entity. Through the continued work of the multi-agency E-Government initiatives, such as Recreation.gov and Disaster Management, multiple agencies work together to provide service to the citizen from a single location. Recreation.gov makes it easier for all citizens to make reservations at any of 3,000 Federal parks and other recreation sites without regard to which Federal agency manages the facility. Disaster Management, through DisasterHelp.gov has over 34,000 users registered with disaster management services being used in 69 actual emergencies as well as 344 disaster preparedness exercises.

The Administration continues the focus of the department and agency specific services movement to citizen-centered services. We have reduced overall E-Government funding annually since Fiscal Year 2004 as the initiatives have met their milestones and have become incorporated into the daily operations of Federal departments and agencies. This reduction has come as result of moving the initiatives to fee-for-service models where appropriate, thereby eliminating the need for agency contributions. Chapter 9, Table 9–3, “Status of the Presidential E-Government Initiatives,” included on the CD-ROM, provides an update for each project.

FEDERAL ENTERPRISE ARCHITECTURE

The Office of Management and Budget’s (OMB) E-Government and Information Technology Office with the support of the General Services Administration and the Federal Chief Information Officers (CIO) Council, established the Federal Enterprise Architecture (FEA) Program to build a comprehensive business-driven blueprint of the entire Federal government. The development of this framework has and will continue to enable the Federal government to identify opportunities to leverage technology to:

- Reduce redundancy;
- Facilitate horizontal (cross-federal) and vertical (federal, state and local) information sharing;
- Establish a direct relationship between IT and mission/program performance to support citizen-centered, customer-focused government; and
- Maximize IT investments to better achieve mission outcomes.

The FEA framework and its five supporting reference models (Performance, Business, Service, Technical and Data) are now used by departments and agencies in developing their budgets and setting strategic goals. With the recent release of the Data Reference Model, the FEA will be the “common language” for diverse agencies to use while communicating with each other and with state and local governments seeking to collaborate on common solutions for services.

Using these reference models, the FEA identified five major collaborative initiatives with potential to transform the Federal government, improve services and deliver substantial savings. Launched in February 2004, these initiatives, known as the Lines of Business (LoB), used EA principles to identify common solutions. These initiatives are projected to save $5 billion across government over the next 10 years.

Sharing Technology and Information Across Agencies Will Drive Results.—The Administration’s continued use of the Federal Enterprise Architecture data to drive lines of business analysis will continue to be a central focus in our efforts to direct information technology investments to support delivery of services to citizens and other entities. The Administration will continue to improve performance and achieve results by linking IT investments to another analytical tool used by the Administration, the Program Assessment Rating Tool (PART).

Looking Ahead.—In 2006 and beyond, the government will continue to identify IT opportunities for collaboration and consolidation. The Federal government continues to make significant progress in implementing E-Government to better serve the citizen, but much could still be done. Through the PMA, the Clinger-Cohen Act, the E-Government Act, budget guidance and other management tools, the Federal government has the ability to make it easier for the citizens and businesses to interact with their government. The FEA Framework will continue to guide the interfaces between systems and re-use of data and applications where appropriate. This service-oriented architecture approach will ensure future government IT investments will leverage existing capabilities to their maximum potential and will provide the most efficient and customer-centered services.

The Federal government is managing its IT more professionally as a resource for improving results. Seventy percent of the Federal government's IT systems are secure; 72 percent of the departments and agencies have mechanisms in place to validate performance relative to cost, schedule and performance goals for the IT investments; about half of those departments and agencies meet at least 90 percent of their cost and schedule goals. We have huge potential and opportunities for growth. This Administration will continue to work in all aspects of expanding E-Government to deliver results the American people deserve.

10. FEDERAL DRUG CONTROL FUNDING

Table 10–1. FEDERAL DRUG CONTROL FUNDING, FY 2004–2006 [1]

(Budget authority, in millions of dollars)

Department/Agency	FY 2004 Enacted	FY 2005 Estimate	FY 2006 Request
Department of Defense	953	907	896
Department of Education	594	593	233
Department of Health and Human Services	3,476	3,497	3,509
National Institutes on Drug Abuse	988	1,006	1,010
Substance Abuse and Mental Health Services Admin.	2,489	2,490	2,499
Department of Homeland Security	2,417	2,631	2,937
Immigration and Customs Enforcement	574	358	453
Customs and Border Patrol	1,070	1,429	1,511
U.S. Coast Guard	772	845	973
Department of Justice	2,541	2,671	2,922
Bureau of Prisons	48	49	50
Drug Enforcement Administration	1,703	1,785	1,893
Interagency Crime and Drug Enforcement	549	554	662
Office of Justice Programs	242	284	318
ONDCP	522	507	268
Operations	28	27	24
High Intensity Drug Trafficking Area Program [3]	225	227	....
Counterdrug Technology Assessment Center	42	42	30
Other Federal Drug Control Programs	228	212	213
Department of State	949	899	1,076
International Narcotics Control and Law Enforcement Affairs	212	174	341
Andean Counterdrug Initiative	738	725	735
Department of Treasury			
Interagency Crime and Drug Enforcement	....	....	56
Department of Veterans Affairs			
Veterans Health Administration	411	457	533
Other Presidential Priorities [4]	2	1	3
Total Federal Drug Budget	**11,867**	**12,163**	**12,431**

[1] Detail may not add due to rounding.
[2] Prior to FY 2006, funds for Interagency Crime and Drug Enforcement programs were appropriated into one account. Beginning in FY 2006, funds are requested within participating Federal agencies.
[3] Beginning with FY 2006, the High Intensity Drug Trafficking Area Program is transferred to Justice and incorporated into the Interagency Crime and Drug Enforcement account.
[4] Includes Small Business Administration Drug Free Workplace grants and National Highway Traffic Safety Administration Drug Impaired Driving Program.

11. CALIFORNIA-FEDERAL BAY–DELTA PROGRAM BUDGET CROSSCUT (CALFED)

The California-Federal Bay-Delta program (also known as CALFED) is a cooperative effort of the Federal government, the State of California, local governments, and water users, to proactively address the water management and aquatic ecosystem needs of California's Central Valley. This valley, one of the most productive agricultural regions of the world, is drained by the Sacramento River from the north, and the San Joaquin River from the south. The two rivers meet southwest of Sacramento, forming the Sacramento-San Joaquin Delta, and drain west into San Francisco Bay.

The extensive development of the area's water resources has significantly boosted agricultural production, but has also adversely affected the region's ecosystems. CALFED participants recognized the need to provide a safe, clean, reliable source of water for multiple uses, while at the same time restoring or maintaining the ecosystems of the area and protecting against floods. This recognition resulted in the 1994 Bay-Delta Accord, which laid the foundation for the CALFED program. CALFED's adaptive management approach to water resources development and management seeks to balance achievement among the program's four objectives: Water Supply Reliability, Levee System Integrity, Water Quality, and Ecosystem Restoration. The program integrates science and monitoring into program management to track progress toward achieving those goals. The parties signed a Record of Decision in 2000, spelling out the different program components and goals.

In 2004, the President signed the Calfed Bay-Delta Authorization Act (P.L. 108–361) into law. This Act, authorizing funding and activities for the CALFED program through 2010, provides new programmatic authority for participating agencies, authorizes $395 million to be appropriated for the Federal share of CALFED activities, and specifies criteria for program cost-shares and achieving balanced implementation of CALFED program components. Federal agencies contributing to CALFED goals include: the Department of the Interior's Bureau of Reclamation, Fish and Wildlife Service, and U.S. Geological Survey; the Department of Agriculture's Natural Resources Conservation Service; the U.S. Army Corps of Engineers; the Department of Commerce's National Oceanic and Atmospheric Administration; and the Environmental Protection Agency.

The Budget includes a crosscut of Federal funding by each of the CALFED agencies, in partial fulfillment of the reporting requirements of P.L. 108–361. Detailed tables are included on the CD–ROM included with the Analytical Perspectives; a separate CALFED Crosscut volume to be released shortly will address the remaining reporting requirements.

CALFED-RELATED FEDERAL FUNDING BUDGET CROSSCUT

Federal Fiscal Years 1998–2006

(Dollars in millions)

	1998 [1]	1999 [1]	2000 [1]	2001 [1]	2002 [1]	2003 [1]	2004 [1]	2005 [2]	2006 [3]
Bureau of Reclamation	$149.627	$107.063	$130.503	$79.030	$126.775	$83.403	$78.929	$74.571	$89.244
Corps of Engineers	$100.686	$103.341	$93.786	$54.192	$58.227	$70.624	$65.070	$34.023	$67.659
Natural Resources Conservation Service	....	$14.543	$12.845	$16.945	$39.078	$38.998	$48.745	$37.000	$37.000
National Oceanic and Atmospheric Administration	$0.300	$0.375	$0.450	$0.550	$0.575	$0.775	$0.775	$0.775	$0.775
Geological Survey	$3.158	$3.158	$4.319	$5.366	$5.089	$5.089	$4.960	$4.937	$4.937
Fish & Wildlife Service	$0.941	$1.143	$3.647	$18.230	$5.605	$11.189	$13.684	$2.018	$3.787
Environmental Protection Agency	$3.204	$3.049	$57.262	$53.375	$54.255	$20.693	$1.502	$0.707	....
Total	**$257.916**	**$232.672**	**$302.812**	**$227.688**	**$289.604**	**$230.771**	**$213.665**	**$154.031**	**$203.402**

[1] 1998–2004 totals reflect actual obligations.
[2] 2005 totals reflect estimates based on enacted levels.
[3] 2006 totals reflect amounts requested in the President's Budget.

ECONOMIC ASSUMPTIONS AND ANALYSES

12. ECONOMIC ASSUMPTIONS

Five years ago, at the beginning of the new millennium, optimism about the Nation's economic future abounded, but that period of optimism was followed by a succession of shocks whose cumulative severity was as great as any previous setback in the postwar period. Now, five years later, the effects of these shocks have been overcome and faith in the economy and the future are once again on the rise.

Negative Shocks

Six substantial shocks buffeted the economy starting in 2000.

The stock market bubble burst in March 2000; by October 2002, the market had lost half its value. Household equity wealth fell by $7 trillion, wiping out two-thirds of the equity gain from the last half of the 1990s.

Business investment slowed to a trickle beginning in mid-2000 as the stock market decline mirrored a dramatic revision in business expectations, and collapsed the following year as firms began to work off a huge overhang of what was now perceived to be excess capital. The over-investment was due in part to inflated expectations about the return on new technology and to a surge in Y2K-related computer hardware and software investment that ended abruptly in 2000. Not until 2003 did capital spending turn up. This nearly three-year slump was one of the longest and deepest in the postwar period.

The terrorist attacks of September 11th and the possibility of even more dangerous attacks depressed consumer and business confidence for a time, while substantially increasing the resources that governments, families, and businesses needed to devote to security measures. The War on Terror, especially as fought through the campaigns in Afghanistan and Iraq, also contributed to heightened uncertainties. The increased uncertainty hampered investment planning and contributed to the slump in investment spending.

Corporate accounting scandals were uncovered throughout 2002–2003. Although the scandals had been long in the making, their sudden revelation came as a further shock to confidence. The subsequent bankruptcy of some once-well-regarded corporations further shook investor confidence, and the revelation of conflicts of interest at several major accounting firms and Wall Street brokerage houses cast doubt on the reliability of the information and advice provided by them, again making investors leery of putting money at risk in the market. The scandals and the reaction to them had the effect of prolonging the slump in business investment.

Recession or slumping growth mired major U.S. trading partners for most of this period which restrained U.S. exports, especially of manufactured goods. Output in Japan and in the European Union grew only 1 percent per year on average during 2001–2003; outright declines occurred in several countries during this period.

Oil prices doubled in 2003–2004. The benchmark price of West Texas intermediate crude oil jumped from $28 per barrel in May, 2003, to $55 at its peak in late October, 2004. Prices moved down thereafter, closing the year at $42. On balance, however, the rise in oil prices slowed U.S. growth during 2004.

Timely Response

Policymakers responded quickly and appropriately to this series of adverse shocks. Expansionary policies, both fiscal and monetary, were adopted in a timely manner, and when combined with the inherent resilience of the American economy, succeeded in overcoming the forces of restraint and minimizing the actual downturn in 2001. From the peak in the fourth quarter of 2000 to its low point in the third quarter of 2001, real Gross Domestic Product (GDP) edged down a mere 0.2 percent. Partly because of quick policy action, both consumer spending and housing investment held up much better during the 2001 slump than in previous business downturns, which helped limit the decline in real output. During the subsequent recovery through mid-2003, however, growth was not as robust as usual, which is not surprising in light of the shocks that continued to buffet the economy and the relatively mild downturn that limited the likely size of the rebound.

Policymakers responded to the disappointing recovery by providing additional fiscal and monetary stimulus. This renewed stimulus worked, and as a result, the economy has achieved robust growth and an improved labor market since mid-2003 without a significant increase in inflation or interest rates. As 2005 begins, the near-term economic outlook is promising. A wide range of indicators suggests that the economy will continue to expand at faster than normal rates of growth. More than 100 thousand new jobs are being created monthly, adding to the purchasing power of workers; consumer spending remains strong; businesses' capital spending is growing at a rapid rate, and order books are lengthening; home sales have reached record levels, boosting home prices and household wealth; and manufacturing production and exports are again expanding. The stock market finally bottomed in 2002, and it has risen sharply since last August, adding to household wealth and reducing the cost of capital to business. By early 2005, the major stock market indices had reached their highest levels since mid-2001.

Looking beyond the next few years, the outlook is also encouraging. Over the long-run, the growth of output and the standard of living depend critically on productivity growth, and there is reason to be optimistic here. Productivity growth accelerated in the second half of the 1990s, and surprisingly in view of the shocks of recent years, it stepped up again after 2000 to reach a pace not seen in over fifty years. A slowdown from this torrid pace is expected by the Administration and most other forecasters, but even with a slowdown, productivity growth is expected to remain strong over the next decade, and with it the rise in the standard of living.

The Administration's near- and medium-term economic projections assume that the economy will not face exceptional disturbances in the coming years, unlike the last five. With that provision, the Administration anticipates strong, sustained growth, rising employment, and relatively low inflation and interest rates. The economic assumptions underlying the budget are close to those of the consensus of private-sector forecasts, and for real growth below those of the Congressional Budget Office. The prospects of a lengthy sustained expansion, exceptionally high productivity growth, and the Administration's policies mean that actual performance could exceed the official projections. In the interest of sound, prudent budgeting, however, the Administration has adopted a cautious economic forecast.

Policy Actions

Fiscal Policy: The Administration proposed, and Congress enacted, significant tax relief in each of the past four years designed to overcome the shocks that were restraining the economy and restore strong growth of output, income, and jobs. In addition to providing much needed near-term stimulus, the 2001 and 2003 Acts also were designed to raise long-term growth by reducing the disincentives and distortions in the tax system. These Acts reduced marginal tax rates on income, dividends, and capital gains. Lower tax rates encourage individuals and businesses to produce more, save more, and invest more. More saving and investment create capital, add to economic growth, and raise the standard of living. The combined tax relief from the four Acts totaled $68 billion in fiscal year 2001, $89 billion in 2002, $159 billion in 2003, and $272 billion in 2004, moderating to $189 billion in 2005.

Economic Growth and Tax Relief and Reconciliation Act: This act lowered marginal income tax rates; reduced the marriage tax penalty; and created a new, lower 10 percent tax bracket, among other changes. In July 2001, near the low point of the 2001 recession, taxpayers began receiving rebate checks reflecting their lower liability with the new 10 percent bracket; lower withholding schedules also went into effect at that time. With the benefit of hindsight, the fiscal stimulus from the tax relief was exceptionally well-timed: economic growth during the prior half-year had ground to a halt, yet it had resumed by year-end despite the terrorist attacks on September 11th.

Job Creation and Worker Assistance Act: In March 2002, the President signed this Act, which was designed to halt the ongoing slide in business capital spending and to aid unemployed workers. The Act permitted immediate depreciation of 30 percent of the value of qualified new capital assets put in place during the three years ending in September 11, 2004. Accelerated depreciation provided an incentive for firms to invest. For a limited time, more of a qualified investment could be written-off for tax purposes, thereby lowering the cost of capital and providing an incentive for firms to speed up their capital spending. The Act also extended unemployment insurance benefits to workers who had exhausted their normal benefits.

Jobs and Growth Tax Relief Reconciliation Act: In May 2003, the President signed both another extension of unemployment insurance benefits and the 2003 jobs and growth tax cut, which was designed to invigorate the lackluster recovery then underway. The Act lowered income tax rates, reduced the marriage penalty, raised the child tax credit, and raised the exemption amount for the individual Alternative Minimum Tax. Significantly, the Act reduced income tax rates on dividend income and capital gains, which reduced distortions in the tax code from the double taxation of corporate earnings. To stimulate business capital spending further, the Act raised the percentage of an asset's value that could be expensed immediately from 30 to 50 percent and lengthened the window of opportunity for businesses to take advantage of this benefit from September 11, 2004 to the end of the year. The Act also improved the outlook for small business investment and hiring by raising the maximum amount that a small business could expense from $25,000 per year to $100,000.

Working Families Tax Relief Act: In October 2004, the President signed this Act, which extended parts of the President's tax relief plan that were scheduled to expire at the end of 2004 and reinstated several expired or expiring business-related tax incentives. In doing so, the Act protected taxpayers from several scheduled tax increases. The Act also provided tax relief to certain military personnel with families, and simplified the tax code for many families by creating a uniform definition of a qualifying child for tax purposes.

The short-term benefits of the substantial tax relief of the past four years are evident in the strong expansion now underway. The longer-term benefits will be apparent in a more efficient allocation of the Nation's resources in coming years and a sustained increase in economic activity.

Monetary Policy: During the past four years, monetary policy has been focused on overcoming negative shocks and restoring strong, sustained growth. From the beginning of 2001 through mid-2003, the Federal Reserve lowered the target Federal funds rate 13 times, from 6½ percent to 1 percent. That low rate was maintained until June 2004 when the Federal Reserve began to increase the funds rate gradually. Over the course of 2004, it became increasingly evident that the economy was once again growing strongly and labor markets were improving, which reduced the need for monetary stimulus.

By December 2004, the Federal Reserve had raised the funds rate to 2¼ percent, a level that it believed was still accommodative. In its statement accompanying the December increase, the Federal Reserve indicated that it intended to move at a measured pace to reduce the accommodative stance of monetary policy further. As of early January, financial futures markets expected the funds rate to reach 3 percent by the end of 2005.

As a result of the accommodative monetary policy along with low expected inflation and sub-par growth, interest rates fell sharply from mid-2000 to mid-2003. The 91-day Treasury bill rate tracked the path of the funds rate, dropping by about 5 percentage points from its 2000 peak to a plateau of about 1 percent from mid-2003 to mid-2004, then rising to 2.2 percent by the end of 2004. As is usually the case, the swings in the longer-term interest rates were less than those of short-term rates. The yield on the 10-year Treasury note, for example, fell three percentage points from mid-2000 to 3.2 percent by mid-2003. This was its lowest level since the late 1950s. The yield fluctuated around a mild upward trend from mid-2003 to the end of 2004, finishing the year at 4.2 percent, a level that is still relatively low.

Private-sector financial instruments followed a similar pattern to U.S. Treasuries. The rate on 30-year fixed rate mortgages, for example, fell to 5.2 percent in June 2003, which was its lowest level since the early 1960s. The mortgage rate, like the long-term Treasury yield, then fluctuated around an upward trend and by the end of December 2004 had reached a level of 5.7 percent. Even so, the mortgage rate remained below its level in any month from the mid-1960s to early-2003.

Low interest rates have spurred interest-sensitive spending on such items as motor vehicles and housing. They have enabled homeowners to refinance their mortgages, saving on mortgage payments and enabling families to access some of their built-up home equity. Lower interest rates have enabled consumers, businesses, and governments to reduce their interest expenses. Finally, low rates have helped support the stock market.

In late 2002, the stock market responded to the cumulative effects of fiscal and monetary stimulus and the prospects of strong, sustained growth. Equity prices rose rapidly from the end of the third quarter of 2002 through the end of 2003. After remaining about unchanged during the first eight months of 2004, equity prices rose strongly once again. All told, from the beginning of October 2002 to the end of 2004, the S&P 500 and the Dow Jones Industrial Average gained about 45 percent; the hard-hit, technology-laden NASDAQ soared 85 percent. By the end of 2004, the S&P, NASDAQ and the Dow were at their highest levels since June 2001.

Recent Developments

Economic Growth: Beginning in the second quarter of 2003, the contractionary forces that had held back growth during the initial phase of the recovery gave way to stronger forces of expansion. During the year ending in the first quarter of 2004, inflation-adjusted Gross Domestic Product (GDP) increased 5.0 percent, the fastest advance of any four-quarter period in nearly two decades. Growth moderated to a 3.3 percent pace in the second quarter, but then picked up in the third quarter to a substantial 4.0 percent rate. Growth in the fourth quarter continued at a healthy pace. (Official estimates of fourth quarter growth were not available at the time the Budget was printed.) Although still relatively strong, growth in 2004 was hampered by the rise in oil prices.

Labor Market: In response to this stronger growth of output, the labor market also improved markedly. The Nation's payrolls began to increase in September 2003; by December 2004, there were 2.5 million more jobs than at the August low. (Based on preliminary indications from the Bureau of Labor Statistics, this figure is likely to be revised up, to at least 2.6 million, in the benchmark revision that will become available in early February after the Budget is printed.) The unemployment rate, which reached a peak of 6.3 percent in June 2003, fell to 5.4 percent by December 2004. Although still above its long-run sustainable rate, the level of the unemployment rate at the end of last year was lower than the average for the decades of the 1970s, 1980s, and 1990s.

Components of Aggregate Demand: During the six quarters from the second quarter of 2003 through the third quarter of 2004 (the latest quarter available when the Budget went to press), real GDP grew at a robust 4.6 percent annual average rate. That was a significant improvement from the sub-par 2.1 percent average pace during the first six quarters of the recovery. Faster growth of both consumer and business spending were largely responsible for the shift.

Consumer spending accounts for 70 percent of GDP, so its faster growth recently played a significant role in boosting overall growth. Consumer confidence took an upturn in early 2003, and as labor markets began to improve a few months later, consumers became increasingly willing and able to spend. During the six quarters ending in the third quarter of 2004, real consumer spending increased at a 3.9 percent annual rate, up from 3.3 percent during the prior six quarters. The saving rate, which had already declined to a historically low 1.0 percent by early 2003, fell even further to a mere 0.3 percent by November 2004. Underlying the gains in consumer spending have been increasing household wealth, led by higher home and stock prices, and rising after-tax incomes, supported by an improving labor market and tax relief.

Low mortgage interest rates and growing incomes also contributed to an exceptionally strong *housing* market. During the six quarters ending in the third quarter of 2004, real residential investment rose at a 10.5 percent average annual rate, a considerable step up from the 5.2 percent pace during the initial six quarters of the expansion. Housing starts during the six quarters through the third quarter of last year were at the highest level in 25 years; home sales were at the highest level since recordkeeping began in the 1960s. Housing starts, home sales, and real residential investment eased during the second half of 2004, in part because of the rise in mortgage rates from their 2003 lows and in part because housing activity had risen to unsustainable levels. While the level of housing investment is expected to remain strong, housing is not projected to lead the expansion in 2005–2010.

The turnaround in *business capital spending* was even more dramatic and it contributed significantly to the step-up in the pace of overall economic activity. During the latest six quarters of available data, real business fixed investment grew at an average annual rate of 11.3 percent. In contrast, investment fell at a 6.2 percent pace during the prior six quarters. Underlying the recovery of capital spending has been the acceleration of overall output, more favorable financial conditions including low interest rates, a rising stock market, and the temporary provision of accelerated depreciation that expired at the end of 2004. Business investment is expected to continue at a rapid rate as the expansion matures.

The *foreign sector* was a small drag on overall growth during the six quarters through the third quarter of 2004, trimming about one-third of a percentage point from GDP growth. That was an improvement over the first six quarters of the expansion when net exports reduced growth by about three-quarters of a percentage point on average. Throughout the expansion, growth of U.S. exports was restrained by slow growth overseas. The exchange value of the dollar peaked in February 2002, declining 12 percent on a trade-weighted basis against the currencies of our major trading partners by September 2004. During the last three months of 2004, the dollar declined another six percent, which should work to reduce the U.S. trade imbalance during 2005. Although this has been a substantial decline, it has merely retraced an earlier run-up so that by mid-January 2005 the dollar had returned to its level of 1997.

The *government sector* grew more slowly during the latest six quarters. Real Federal purchases continued to grow strongly, at a 6.1 percent annual rate, led by spending on the War on Terror, but real State and local purchases increased at a slow 0.3 percent pace, down from 2.4 percent during the first six quarters of the expansion. State and local governments restrained spending to cope with exceptionally large fiscal deficits created by the sharp fall-off in revenues from mid-2001 to early-2002. Although State and local government revenues are on the rise again, their combined revenues had only returned to their level in early 2001 by the third quarter of 2004.

Productivity Growth: In contrast to the initial six quarters of the expansion when output growth was entirely accounted for by strong productivity growth, during the subsequent six quarters both increased labor hours and productivity have contributed to increased output. Since the official business cycle peak in the first quarter of 2001, productivity has risen at a remarkable 4.2 percent average annual rate. By way of contrast, during 1996 through 2000, productivity growth averaged 2.5 percent per year, and during 1974 through 1995, productivity growth was a mere 1.4 percent on average. Usually productivity growth surges temporarily during the initial phase of a recovery and then slows markedly. In the current expansion, productivity growth during the six quarters ending in the third quarter of 2004 was even faster than during the prior six quarters.

The exceptional productivity performance during the last four years has helped keep inflation low and thereby enabled the Federal Reserve to focus monetary policy on overcoming shocks and restoring sustainable growth. Because of robust productivity growth, businesses have not had to rely on labor input to the extent they otherwise might have, which has hampered employment. Over the long term, however, the faster the growth of productivity, the faster will be the growth of our output and standard of living. In the long run, faster productivity growth will not permanently restrain employment growth.

Inflation: The Consumer Price Index (CPI) rose 3.3 percent during 2004, up from 1.9 percent during 2003. Much of the pick up was due to a surge in energy prices, which rose at a 17 percent annual rate, compared with just 7 percent during 2003. Excluding the volatile food and energy components, the core CPI rose 2.2 percent during 2004, compared with 1.1 percent during 2003.

Higher energy prices may have indirectly contributed to higher core inflation as they fed through to the costs of non-energy goods and services. Businesses also may have increased their markup of prices over unit labor costs, which had been subdued by weak demand earlier in the expansion. Reflecting the decline in crude oil prices in the closing months of 2004, gasoline prices moved down in November and December, suggesting that the energy-related upward push on the CPI was abating.

Summary: Entering 2005, the economy appears poised for continued strong expansion. Overall growth, led by consumer and business spending, is at a pace that suggests the steady creation of new jobs and a lower unemployment rate. Core inflation, although higher than in 2003, is still relatively low. Interest rates, too, are at historically low levels.

Economic Projections

The Administration's economic projections, based on information available as of early December, are summarized in Table 12–1. These assumptions are close to those of the Congressional Budget Office and the consensus of private-sector forecasters, as described in more detail below and shown in Table 12–2. In brief, the assumptions call for a continuation of the recent trends of strong, sustained growth, improving labor markets, low inflation, and, even allowing for a projected rise in the next few years, relatively low interest rates.

Real GDP, Potential GDP, and Unemployment Rate: Real GDP, which is estimated to have increased 4.4 percent in 2004 on a year-over-year basis, is projected to increase 3.6 percent this year. During the next few years, growth is likely to continue to exceed the long-run potential growth rate. As a result, the unemployment rate, at 5.4 percent in December, is projected to decline to 5.1 percent at the end of 2006 and then remain at that level. That rate is the center of the range that is thought to be consistent with stable inflation. The main sources of growth in demand in coming years are likely to be business capital spending, net exports, and to a lesser extent, consumer spending. The contributions to overall growth from residential investment and the government sector are expected to be small at best.

Potential growth is approximately equal to the sum of the trend rates of growth of the labor force and of productivity. Potential GDP growth is projected to be 3.2 percent through 2008, and then edge down to 3.1 percent during 2009–2010, primarily because of an assumed slowing in labor force growth. The labor force is projected to grow about 1.2 percent per year through 2008 on average, slowing to about 0.8 percent yearly on average during 2009–2010 as increasing numbers of baby boomers enter retirement.

Trend productivity growth is assumed, conservatively, to be 2.6 percent per year. That pace is noticeably below the average since the business cycle peak in the first quarter of 2001 (4.2 percent per year). It is, however, close to the pace during 1996–2000 (2.5 percent) and not far from the average since the official productivity series began in 1947 (2.3 percent).

Table 12–1. ECONOMIC ASSUMPTIONS [1]

(Calendar years; dollar amounts in billions)

	Actual 2003	Projections						
		2004	2005	2006	2007	2008	2009	2010
Gross Domestic Product (GDP):								
Levels, dollar amounts in billions:								
Current dollars	11,004	11,731	12,392	13,083	13,797	14,537	15,306	16,112
Real, chained (2000) dollars	10,381	10,842	11,233	11,626	12,011	12,395	12,782	13,179
Chained price index (2000=100), annual average	106.0	108.3	110.4	112.6	114.9	117.3	119.8	122.3
Percent change, fourth quarter over fourth quarter:								
Current dollars	6.2	6.3	5.5	5.6	5.4	5.4	5.3	5.3
Real, chained (2000) dollars	4.4	3.9	3.5	3.4	3.2	3.2	3.1	3.1
Chained price index (2000=100)	1.7	2.3	1.9	2.0	2.1	2.1	2.1	2.1
Percent change, year over year:								
Current dollars	4.9	6.6	5.6	5.6	5.5	5.4	5.3	5.3
Real, chained (2000) dollars	3.0	4.4	3.6	3.5	3.3	3.2	3.1	3.1
Chained price index (2000=100)	1.8	2.1	1.9	2.0	2.1	2.1	2.1	2.1
Incomes, billions of current dollars:								
Corporate profits before tax	874	998	1,307	1,276	1,265	1,266	1,270	1,292
Wages and salaries	5,104	5,345	5,649	5,988	6,340	6,719	7,104	7,502
Other taxable income [2]	2,311	2,451	2,549	2,675	2,798	2,917	3,047	3,181
Consumer Price Index: [3]								
Level (1982–84=100), annual average	184.0	188.9	193.4	197.8	202.5	207.4	212.4	217.5
Percent change, fourth quarter over fourth quarter	1.9	3.4	2.0	2.3	2.4	2.4	2.4	2.4
Percent change, year over year	2.3	2.7	2.4	2.3	2.4	2.4	2.4	2.4
Unemployment rate, civilian, percent:								
Fourth quarter level	5.9	5.4	5.3	5.1	5.1	5.1	5.1	5.1
Annual average	6.0	5.5	5.3	5.2	5.1	5.1	5.1	5.1
Federal pay raises, January, percent:								
Military [4]	4.7	4.15	3.5	3.1	NA	NA	NA	NA
Civilian [5]	4.1	4.1	3.5	2.3	NA	NA	NA	NA
Interest rates, percent:								
91-day Treasury bills [6]	1.0	1.4	2.7	3.5	3.8	4.0	4.1	4.2
10-year Treasury notes	4.0	4.3	4.6	5.2	5.4	5.5	5.6	5.7

NA = Not Available.
[1] Based on information available as of December 3, 2004.
[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; 2003 and 2004 figures are averages of various rank- and longevity- specific adjustments; percentages to be proposed for years after 2006 have not yet been determined.
[5] Overall average increase, including locality pay adjustments. Percentages to be proposed for years after 2006 have not yet been determined.
[6] Average rate, secondary market (bank discount basis).

Inflation: Inflation increased in 2004, in large part because of the surge in energy prices. With the recent easing of these prices, inflation is likely to be lower in 2005. On a year-over-year basis, the CPI is projected to increase 2.4 percent this year and remain close to that level in each year through 2010. This inflation rate is lower than the average during each decade of the 1970s, 1980s, and 1990s. The GDP chain-weighted price index is projected to increase around 2.0 percent in each year through 2010, slightly less than the CPI, which is the usual pattern.

The forecast of low inflation reflects the current very low core inflation rate, modest inflationary expectations, the additional downward pressure on wages and prices that will persist until excess labor and capital resources are fully re-employed, and the Federal Reserve's focus on removing policy accommodation at a measured pace so as to avoid an over-heated economy.

Interest Rates: As usually occurs during an expansion, interest rates are projected to rise. The 3-month Treasury bill rate, which was 2.2 percent at the end of December, is expected to increase to 4.2 percent by 2010. The yield on the 10-year Treasury note, 4.2 percent at the end of last year, is projected to increase to 5.7 percent by 2010. The larger increase at the shorter end of the maturity spectrum than at the longer end is also typical of past cyclical experience.

The forecast rates are historically low: the projected averages for 3-month and 10-year Treasuries during 2005–2010 are lower than the averages for these instruments during each decade of the 1970s, 1980s, and 1990s. The relatively low projected yields are due largely to the relatively low projected inflation rate. Adjusted for inflation, the projected real interest rates are close to their historical averages.

Income Shares: The share of labor compensation in GDP is projected to rise from its low level in 2004 while the share of corporate profits is projected to decline from the unusually high levels of 2004 and anticipated for 2005. In recent years, growth of labor compensation adjusted for inflation has not kept up with the growth of productivity. During the projection period, however, labor compensation is expected to catch up, which would raise the labor share in GDP back to its historical average.

Among the components of labor compensation, the wage share in GDP is expected to rise from its recent low level while the share of supplements to wages and salaries is expected to remain at around the high level reached in 2004. The supplement share in GDP has risen because of rapidly growing health insurance contributions paid by employers and by sharply higher employer contributions to defined-benefit pension plans.

Corporate profits before tax as shown in Table 12.1 jumps sharply as a share of GDP in 2005 because of the end of the accelerated depreciation permitted by the 2002 and 2003 tax acts. Accelerated depreciation lowered profits before tax compared with what they otherwise would have been in 2003 and 2004 by allowing firms to write off more of their investment sooner. After 2004, however, corporate profits before tax will increase both because new investment will not qualify for the temporary acceleration and because the remaining depreciation permitted on investment that used this provision will be less.

Among the other income components, the share of personal interest income in GDP is projected to decline reflecting the low nominal interest rates of recent years. The remaining shares of the tax base (dividends, rental income, and proprietors' income) are projected to remain relatively stable at around their 2004 levels.

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 12–2 compares the 2006 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 generally assumes that the President's Budget proposals will be enacted. The CBO baseline projection assumes that current law as of the time the estimates are made remains forever unchanged. Despite their differing policy assumptions, the three sets of economic projections, shown in Table 12–2, 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 3.6 percent growth on a year-over-year basis, about the same as the private sector consensus and slightly below CBO's forecast. For calendar year 2006, the Administration, at 3.5 percent, is mid-way between the consensus (at 3.4 percent), and CBO's 3.7 percent. Thereafter, the Administration's projection is very close to the consensus growth rate but generally below CBO's. Over the six-year span as a whole, the Administration and the private sector consensus both project a 3.3 percent average annual growth rate, CBO 3.5 percent.

All three forecasts anticipate continued low inflation in the range of 1.5 to 2.1 percent as measured by the GDP chain-weighted price index, and between 1.9 and 2.5 percent as measured by the CPI, with CBO lower than the Administration and the private sector consensus, which are close to each other. The three unem-

Table 12–2. COMPARISON OF ECONOMIC ASSUMPTIONS

(Calendar years)

	Projections						Average, 2005–10
	2005	2006	2007	2008	2009	2010	
GDP (billions of current dollars):							
2006 Budget	12,392	13,083	13,797	14,537	15,306	16,112	
CBO January	12,396	13,059	13,766	14,486	15,210	15,940	
Blue Chip Consensus January [2]	12,398	13,066	13,762	14,496	15,265	16,098	
Real GDP (chain-weighted): [1]							
2006 Budget	3.6	3.5	3.3	3.2	3.1	3.1	3.3
CBO January	3.8	3.7	3.7	3.4	3.1	2.9	3.5
Blue Chip Consensus January [2]	3.6	3.4	3.2	3.2	3.1	3.3	3.3
Chain-weighted GDP Price Index: [1]							
2006 Budget	1.9	2.0	2.1	2.1	2.1	2.1	2.0
CBO January	1.8	1.5	1.7	1.8	1.8	1.8	1.7
Blue Chip Consensus January [2]	2.0	2.0	2.1	2.1	2.1	2.1	2.1
Consumer Price Index (all-urban): [1]							
2006 Budget	2.4	2.3	2.4	2.4	2.4	2.4	2.4
CBO January	2.4	1.9	2.1	2.2	2.2	2.2	2.2
Blue Chip Consensus January [2]	2.5	2.3	2.4	2.4	2.4	2.4	2.4
Unemployment rate: [3]							
2006 Budget	5.3	5.2	5.1	5.1	5.1	5.1	5.2
CBO January	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Blue Chip Consensus January [2]	5.2	5.2	5.1	5.1	5.1	5.1	5.1
Interest rates: [3]							
91-day Treasury bills:							
2006 Budget	2.7	3.5	3.8	4.0	4.1	4.2	3.7
CBO January	2.8	4.0	4.6	4.6	4.6	4.6	4.2
Blue Chip Consensus January [2]	3.0	3.8	4.1	4.3	4.2	4.2	3.9
10-year Treasury notes:							
2006 Budget	4.6	5.2	5.4	5.5	5.6	5.6	5.3
CBO January	4.8	5.4	5.5	5.5	5.5	5.5	5.4
Blue Chip Consensus January [2]	4.7	5.3	5.6	5.6	5.6	5.6	5.4

Sources: Congressional Budget Office; Blue Chip Economic Indicators, Aspen Publishers, Inc.
[1] Year-over-year percent change.
[2] January 2005 Blue Chip Consensus forecast for 2005 and 2006; Blue Chip October 2004 long-run extension for 2007 - 2010.
[3] Annual averages, percent.

ployment rate projections are also similar with a projected rate just above 5 percent in the later years of the forecast. All three project slightly rising interest rates during the next few years, with CBO's increase slightly larger than those of the Administration and the private sector projection.

Changes in Economic Assumptions

The economic assumptions underlying this Budget are similar to those of the 2005 Budget, as shown in Table 12–3.

As in last year's Budget, real GDP growth is expected to be 3.6 percent in 2005 on a year-over-year basis and moderate gradually to 3.1 percent in the outyears. Consequently, the levels of real GDP projected this year are little changed from those of the 2005 Budget when allowance is made for the Commerce Department's historical revisions to the National Income and Product Accounts released in July 2004. The level of nominal GDP is now projected to be higher than in the 2005 Budget because of a faster-than-expected rise in the GDP price index last year and higher projected GDP inflation in the coming years.

The unemployment rate projection is virtually identical to last year's. As in the 2005 Budget, the rate is expected to decline to 5.1 percent by 2007 and remain at that relatively low level. Interest rates are expected to trend upward, as before. However, by 2009 the 3-month Treasury bill rate is projected to be 0.3 percentage point lower than in the 2005 Budget, and the yield on the 10-year Treasury note is expected to be 0.2 percentage point lower.

Structural and Cyclical Balances

When the economy is operating below potential, as is projected to be the case for the next few years, the unemployment rate exceeds the long-run sustainable average consistent with price stability. As a result, 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; the deficit is larger (or the surplus is smaller) than would be the case if the unemployment rate were at its sustainable long-run average. The portion of the deficit (or surplus) that can be traced to this factor can be called the cyclical component. The portion that would remain if the unem-

Table 12–3. COMPARISON OF ECONOMIC ASSUMPTIONS IN THE 2005 AND 2006 BUDGETS

(Calendar years; dollar amounts in billions)

	2004	2005	2006	2007	2008	2009	2010
Nominal GDP:							
2005 Budget assumptions [1]	11,622	12,197	12,807	13,460	14,163	14,902	15,671
2006 Budget assumptions	11,731	12,392	13,083	13,797	14,537	15,306	16,112
Real GDP (2000 dollars):							
2005 Budget assumptions [1]	10,837	11,226	11,608	11,994	12,377	12,763	13,159
2006 Budget assumptions	10,842	11,233	11,626	12,011	12,395	12,782	13,179
Real GDP (percent change): [2]							
2005 Budget assumptions	4.4	3.6	3.4	3.3	3.2	3.1	3.1
2006 Budget assumptions	4.4	3.6	3.5	3.3	3.2	3.1	3.1
GDP price index (percent change): [2]							
2005 Budget assumptions	1.2	1.3	1.5	1.7	2.0	2.0	2.0
2006 Budget assumptions	2.1	1.9	2.0	2.1	2.1	2.1	2.1
Consumer Price Index (percent change): [2]							
2005 Budget assumptions	1.4	1.5	1.8	2.1	2.4	2.5	2.5
2006 Budget assumptions	2.7	2.4	2.3	2.4	2.4	2.4	2.4
Civilian unemployment rate (percent): [3]							
2005 Budget assumptions	5.6	5.4	5.2	5.1	5.1	5.1	5.1
2006 Budget assumptions	5.5	5.3	5.2	5.1	5.1	5.1	5.1
91-day Treasury bill rate (percent): [3]							
2005 Budget assumptions	1.3	2.4	3.3	4.0	4.3	4.4	4.4
2006 Budget assumptions	1.4	2.7	3.5	3.8	4.0	4.1	4.2
10-year Treasury note rate (percent): [3]							
2005 Budget assumptions	4.6	5.0	5.4	5.6	5.8	5.8	5.8
2006 Budget assumptions	4.3	4.6	5.2	5.4	5.5	5.6	5.7

[1] Adjusted for July 2004 NIPA revisions.
[2] Year-over-year.
[3] Calendar year average.

Table 12–4. ADJUSTED STRUCTURAL BALANCE

(In billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Unadjusted surplus or deficit (–)	125.5	236.2	128.2	–157.8	–377.6	–412.1	–426.6	–390.1	–312.1	–250.8	–232.9	–207.3
Cyclical component	86.3	127.3	66.0	–62.8	–102.0	–60.2	–30.0	–13.4	–0.7	–0.2	....	....
Structural surplus or deficit (–)	39.2	108.8	62.1	–95.0	–275.6	–351.9	–396.6	–376.6	–311.4	–250.6	–232.9	–207.3
Deposit insurance outlays	5.3	3.1	1.6	1.0	1.4	2.0	0.3	1.0	2.3	2.3	2.2	1.8
Adjusted structural surplus or deficit (–)	44.5	111.9	63.7	–94.0	–274.1	–350.0	–396.3	–375.7	–309.1	–248.3	–230.7	–205.5

NOTE: The NAIRU is assumed to be 5.2% through calendar year 1998 and 5.1% thereafter.

ployment rate was at its long-run value is then called the structural deficit (or structural surplus).

Historically, the structural balance has often provided a clearer understanding of the stance of fiscal policy than has the unadjusted budget balance which includes a cyclical component. In the typical post-World War II business cycle, the structural balance has provided a clearer gauge of the surplus or deficit that would persist in the long run with the economy operating at the sustainable level of unemployment.

Conventional estimates of the structural balance are based on the historical relationship between changes in the unemployment rate and real GDP growth on the one hand, and receipts and outlays on the other. For various reasons, these estimated relationships do not take into account all of the cyclical changes in the economy. One example of a cyclical phenomenon not captured in these estimates was the sharply rising stock market during the second half of the 1990s. It boosted capital gains-related receipts and pulled down the deficit. The subsequent fall in the stock market reduced receipts and added to the deficit. Some of this rise and fall was cyclical in nature. Receipts would probably be higher today, if the cyclical component were removed from the stock market, although recently the stock market has recovered some of its earlier losses with a positive effect on receipts. It is not possible, however, to estimate the cyclical component of the stock market accurately, and for that reason, all of the stock market's contribution to receipts is counted in the structural balance.

Other factors unique to the current economic cycle provide other examples of less than complete cyclical adjustment. The extraordinary fall-off in labor force participation, from 67.1 percent of the U.S. population in 1997–2000, to 66.0 percent in 2004 appears to be at least partly cyclical in nature, and most forecasters are assuming some rebound in labor force participation as the expansion continues. Since the official unemployment rate does not include workers who have left the labor force, the conventional measures of potential GDP, incomes and Government receipts understate the extent to which potential work hours have been underutilized in the current expansion to date because of the decline in labor force participation.

A third example is the fall-off in the wage and salary share of GDP, from 49.2 percent in 2000 to 45.5 percent in the third quarter of 2004. Again this change is widely suspected to be at least partly cyclical. Since Federal taxes depend heavily on wage and salary income, the larger-than-predicted decline in the wage share of GDP suggests that the true cyclical component of the deficit is understated for this reason as well.

There are also lags in the collection of tax revenue that can delay the impact of cyclical effects beyond the year in which they occur. The result is that even after the unemployment rate has fallen, receipts may remain cyclically depressed for some time until these lagged effects have dissipated.

For all these reasons, the current estimates of the cyclical deficit are probably understated and perhaps by a large margin. The current unemployment gap is only 0.3 percentage points, and the Administration forecasts that the gap will be closed within two years, but in the broader sense discussed above, the cyclical gap in receipts is likely to be much larger than this and will not close as quickly.

From 1999 to 2001, the unemployment rate appears to have been lower than could be sustained in the long run. Therefore, as shown in Table 12–4, in those years the structural surplus was 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.

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 12–6.

For real growth and employment:

- As shown in the first block, if in 2005 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 2005 deficit is estimated to increase by $13.0 billion; receipts in 2005 would be lower by $10.2 billion, and outlays would be higher by $2.8 billion, primarily for unemployment-sensitive programs. In fiscal year 2006, the estimated receipts shortfall would grow further to $21.8 billion, and outlays would increase by $8.1 billion relative to the base, even though the growth rate in calendar year 2006 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 2005–2010, the cumulative increase in the budget deficit is estimated to be $195 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 2005–2010, the cumulative increase in the budget deficit is estimated to be $529 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 2005 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 and 2006, outlays would be above the base by $11.0 billion and $19.1 billion, respectively, due in part to lagged cost-of-living adjustments. Receipts would fall by $10.0 billion in 2005, due to the temporary effect of higher interest rates on finanical corporations' profits and taxes, but then would rise by $28.4 billion above the base in 2006 due to the sustained

effects of inflation on the tax base, resulting in a $9.3 billion improvement in the 2006 budget balance. In subsequent years, the amounts added to receipts would continue to be larger than the additions to outlays. During 2005–2010, cumulative budget deficits would be $38 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 $388 billion to outlays over 2005–2010 and $492 billion to receipts, for a net decrease in the 2005–2010 deficits of $104 billion.
- The outlay effects of a one percentage point increase in interest rates alone are 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 and the short-term effect of interest rate changes on financial corporations' profits (and taxes).
- 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 2005–2010. 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 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 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 12–5. SENSITIVITY OF THE BUDGET TO ECONOMIC ASSUMPTIONS

(In billions of dollars)

Budget effect	2005	2006	2007	2008	2009	2010	Total of Effects, 2005-2010
Real Growth and Employment							
Budgetary effects of 1 percent lower real GDP growth:							
(1) For calendar year 2005 only: [1]							
Receipts	–10.2	–21.8	–24.3	–25.6	–27.0	–28.4	–137.2
Outlays	2.8	8.1	8.8	10.6	12.5	14.7	57.4
Increase in deficit (–)	–13.0	–29.8	–33.0	–36.2	–39.5	–43.1	–194.6
(2) Sustained during 2005–2010, with no change in unemployment:							
Receipts	–10.4	–34.0	–62.9	–94.5	–129.0	–166.3	–497.1
Outlays	*	0.5	2.1	5.0	9.3	15.3	32.2
Increase in deficit (–)	–10.4	–34.5	–65.0	–99.5	–138.4	–181.6	–529.3
Inflation and Interest Rates							
Budgetary effects of 1 percentage point higher rate of:							
(3) Inflation and interest rates during calendar year 2005 only:							
Receipts	–10.0	28.4	37.1	24.7	26.0	27.4	133.6
Outlays	11.0	19.1	17.5	16.3	15.7	15.5	95.2
Decrease in deficit (+)	–21.0	9.3	19.6	8.3	10.3	11.9	38.4
(4) Inflation and interest rates, sustained during 2005–2010:							
Receipts	–10.0	22.7	67.2	100.7	136.0	175.1	491.7
Outlays	11.4	34.5	56.9	76.8	95.0	113.3	387.8
Decrease in deficit (+)	–21.4	–11.8	10.4	24.0	41.0	61.8	103.9
(5) Interest rates only, sustained during 2005–2010:							
Receipts	–20.5	–11.4	6.3	11.8	16.0	20.9	23.1
Outlays	8.8	24.3	37.0	46.0	53.3	60.1	229.5
Increase in deficit (–)	–29.3	–35.7	–30.7	–34.1	–37.3	–39.2	–206.4
(6) Inflation only, sustained during 2005–2010:							
Receipts	10.5	34.0	60.8	88.6	119.7	153.8	467.4
Outlays	2.7	10.5	20.5	32.0	43.7	56.2	165.5
Decrease in deficit (+)	7.8	23.6	40.3	56.6	76.0	97.6	301.9
Interest Cost of Higher Federal Borrowing							
(7) Outlay effect of $100 billion increase in borrowing in 2005	1.3	3.5	4.2	4.7	5.0	5.4	24.2

* $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.

13. 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 deficit provide only a partial picture of the consequences of the Government's financial and investment decisions. Indeed, changes in the annual budget deficit or surplus can be misleading. 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 judge the Government's fiscal condition properly.

For the Federal Government, there is no single number that corresponds to a business's bottom line. The Government is 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 13–1 is a schematic diagram showing the linkages.
- Part II presents the Government's physical and financial assets and its legal liabilities, which are all collected in Table 13–1. 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 13–2 and in a related set of charts. This part also provides present value estimates of the funding shortfall in Social Security and Medicare in Table 13–3. These data indicate the Government's future responsibilities and resources under current law and policy. In particular, they show the looming challenge that Federal entitlement programs present 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 13–4 presents summary data for total national wealth, while highlighting the Federal investments that have contributed to that wealth. Table 13–5 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. 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 or deficit. It includes balance-sheet information, but it goes beyond that to include long-run projections of the budget showing 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. 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 13–1. Although they are important, the obligations shown in Table 13–1 are only a subset of the Government's 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. These include, to mention only a few examples: Medicaid, veterans' pensions and health care, and food stamps. It also provides a wide range of other public services that must be financed through the tax system. The specific benefits and services may be modified or even ended at any time by the Congress and the President. Indeed, changes in laws governing these programs are a regular part of the legislative cycle. For these reasons, these programmatic commitments do not constitute "liabilities" in a legal or accounting sense, and they would not appear on a balance sheet. Until modified by law, 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 has many assets. These include financial assets, such as loans and mortgages which the Government has acquired though a variety of credit programs. They also include the physical plant and equipment used to produce Government services. The Government owns a substantial amount of land. Such assets would normally be shown on a balance sheet. The Government also has resources that go beyond the assets that would be expected to appear on a balance sheet. These additional resources include most importantly the Government's sovereign power to tax.

Because of its unique 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. Part III of this chapter presents a set of such projections under different assumptions about policy and future economic and demographic conditions. 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, 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 providing more complete information about Government programs and permit a closer alignment of the cost of programs with performance measures. These changes have been described in detail in previous Budgets. They are described in chapter 2 of this volume, and in the accompanying material that describes results obtained with the Program Assessment Rating Tool (PART). This chapter complements the detailed exploration of Government performance with an assessment of the overall impact of Federal policy as reflected in general measures of economic and social well-being, which are presented in Table 13–5.

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 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 balance sheet. The assets and liabilities on that balance sheet are all based on transactions and other events that have already occurred. A similar table can be found in Part II of this chapter but based on different data and methods of valuation. The *Report* also includes a statement of social insurance that reviews a substantial body of information on the condition and sustainability of the Government's social insurance programs. However, the Report does not extend that review to the condition or sustainability of the Government as a whole, which is a main focus of this chapter.

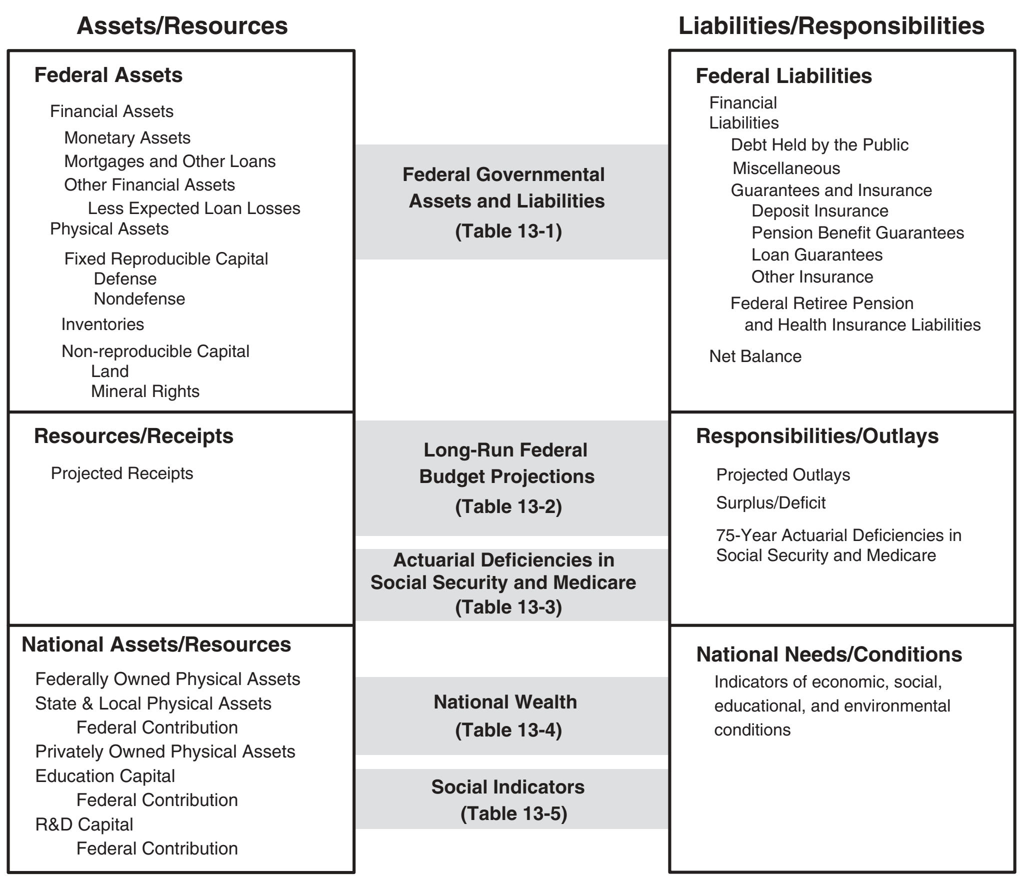
Connecting the Dots: The presentation that follows consists in large part of a series of tables and charts.

[1] Statement of Federal Financial Accounting Concepts, Number 1, *Objectives of Federal Financial Reporting*, September 2, 1993. Other objectives are budgetary integrity, operating performance, and systems and controls.

The schematic diagram, Chart 13–1, 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 categories—assets/resources and liabilities/responsibilities.

- The left-hand side of Chart 13–1 shows the full range of Federal resources, including assets the Government owns, tax receipts it can expect to collect given current and proposed law, and national wealth, including the trained skills of the national work force, that provide the base for Government revenues.
- The right-hand side reveals the full range of Federal obligations and responsibilities, beginning with the Government's acknowledged liabilities from past actions, such as the debt held by the public, and including future budget outlays needed to maintain present policies and trends. This column ends with a set of indicators highlighting areas where Government activity affects society or the economy.

Chart 13-1. A Presentation of the Federal Government's and the Nation's Financial Condition



QUESTIONS AND ANSWERS ABOUT THE GOVERNMENT'S STEWARDSHIP

1. According to Table 13–1, 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 different objectives from a business firm. The goal of every business is to earn a profit, and as a general rule the Federal Government properly leaves 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 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. Business investment motives 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 13–1 seems to imply that the Government is insolvent. Is it?

No. Just as the Federal Government's responsibilities are different from those of 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—Continued

3. Why are Social Security and Medicare not shown as Government liabilities in Table 13–1?

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 13–1. They appear in two ways: budget projections as a percent of GDP in Table 13–2, and the actuarial deficiency estimates in Table 13–3.

Other Federal programs make similar promises to those of Social Security and Medicare—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 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 doesn't the Federal Government follow normal business practice in its bookkeeping?

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, 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—Continued

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 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 shown in this chapter and the actuarial projections prepared for Social Security and Medicare 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 the Federal 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 would 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 pursues 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 will be other 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 13–1 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 2004 dollars and the balance is also shown as a ratio to GDP. Government liabilities have exceeded the value of assets (see chart 13–2) 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 in the mid-1980s.

Currently, the total real value of Federal assets is estimated to be 62 percent greater than it was in 1960. Meanwhile, Federal liabilities have increased by 234 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 such as the large increases in health benefits for Federal retirees and the sharp rise in veterans' disability compensation. The relatively slow growth in Federal asset values 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 $5.3 trillion or about $18,000 per capita. As a ratio to GDP, the excess of liabilities over assets reached a peak of 51 percent in 1993; it declined to 38 percent in 2000; it rose above 45 percent in 2003; and it fell below 45 percent in 2004. The average since 1960 has been 34 percent (see Table 13–1).

Chart 13-2. Net Federal Liabilities

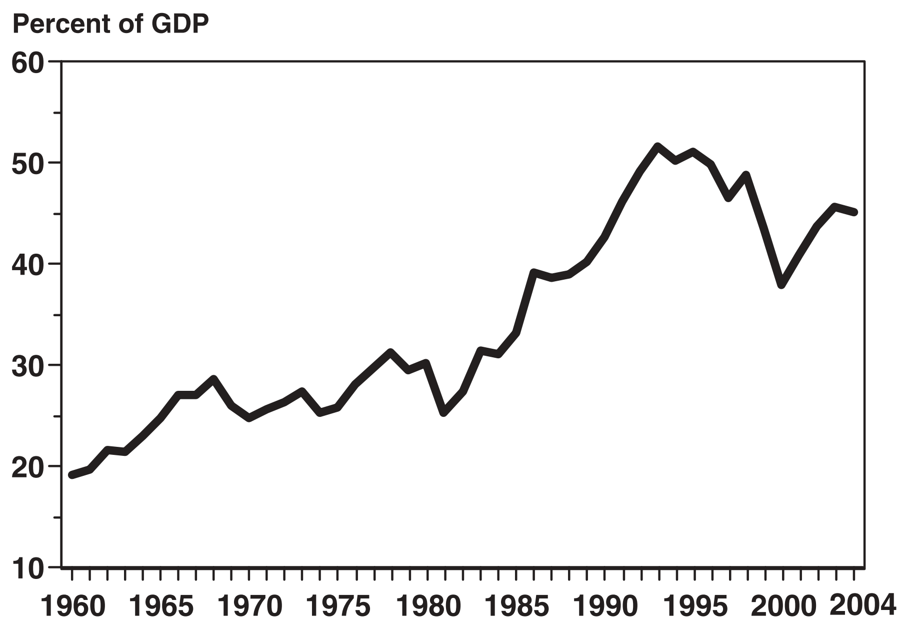


Table 13–1. GOVERNMENT ASSETS AND LIABILITIES*

(As of the end of the fiscal year, in billions of 2004 dollars)

	1960	1965	1970	1975	1980	1985	1990	1995	2000	2002	2003	2004
ASSETS												
Financial Assets:												
Cash and Checking Deposits	45	65	40	33	50	33	44	46	60	81	54	54
Other Monetary Assets	1	1	1	1	2	2	2	1	7	19	9	2
Mortgages	29	28	41	43	80	82	105	72	83	78	75	74
Other Loans	107	147	184	184	238	309	219	167	140	124	120	118
less Expected Loan Losses	–1	–3	–5	–10	–18	–18	–21	–26	–40	–47	–48	–47
Other Treasury Financial Assets	65	81	71	64	90	132	211	254	232	263	315	311
Subtotal	245	318	332	315	442	540	560	524	552	616	624	606
Nonfinancial Assets:												
Fixed Reproducible Capital	1,074	1,065	1,108	1,075	1,018	1,151	1,194	1,200	1,053	1,032	1,037	1,061
Defense	925	869	879	803	720	838	860	840	687	652	653	667
Nondefense	148	196	229	272	297	313	334	360	365	379	384	394
Inventories	281	243	226	202	250	286	254	195	201	200	247	249
Nonreproducible Capital	454	466	447	662	1,062	1,138	898	675	1,000	1,018	1,179	1,401
Land	99	137	172	273	348	362	372	282	426	487	517	601
Mineral Rights	356	330	275	390	713	776	526	393	574	532	663	801
Subtotal	1,809	1,775	1,781	1,939	2,330	2,575	2,346	2,071	2,254	2,250	2,463	2,711
Total Assets	2,054	2,093	2,114	2,254	2,772	3,115	2,906	2,594	2,806	2,866	3,087	3,318
LIABILITIES												
Debt held by the Public	1,225	1,259	1,120	1,139	1,416	2,341	3,190	4,240	3,692	3,685	4,002	4,296
Insurance and Guarantee Liabilities:												
Deposit Insurance	....	....	....	....	2	10	77	5	1	2	1	1
Pension Benefit Guarantee Corporation	....	....	....	46	34	47	46	22	44	84	73	88
Loan Guarantees	....	1	2	7	13	11	17	32	40	39	37	43
Other Insurance	33	30	23	21	29	18	21	19	17	17	16	16
Subtotal	33	31	26	74	78	85	161	78	102	142	127	148
Pension and Post-Employment Health Liabilities:												
Civilian and Military Pensions	857	1,077	1,288	1,459	1,937	1,921	1,878	1,821	1,856	1,905	1,989	2,022
Retiree Health Insurance Benefits	205	258	309	350	464	461	450	437	416	839	943	1,009
Veterans Disability Compensation	203	256	305	338	347	287	258	282	598	884	976	925
Subtotal	1,266	1,591	1,902	2,148	2,748	2,669	2,587	2,540	2,871	3,628	3,909	3,956
Other Liabilities:												
Trade Payables and Miscellaneous	29	36	46	57	88	115	158	131	107	108	110	106
Benefits Due and Payable	22	26	35	37	48	53	63	74	84	99	102	105
Subtotal	51	62	81	94	135	168	221	204	191	207	212	211
Total Liabilities	2,575	2,943	3,129	3,455	4,377	5,263	6,159	7,062	6,857	7,663	8,249	8,611
Net Assets (Assets Minus Liabilities)	–521	–850	–1,015	–1,201	–1,606	–2,148	–3,253	–4,468	–4,051	–4,796	–5,162	–5,293
Addenda:												
Net Assets Per Capita (in 2004 dollars)	–2,890	–4,382	–4,959	–5,569	–7,041	–8,997	–12,982	–16,733	–14,324	–16,620	–17,711	–17,988
Ratio to GDP (in percent)	–19.2	–24.9	–24.8	–25.9	–29.0	–32.5	–42.0	–51.1	–37.9	–43.7	–45.4	–44.8

* This table shows assets and liabilites for the Government as a whole excluding the Federal Reserve System. Data for 2004 are extrapolated in some cases.

Table 13–1 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 2004. Government-held mortgages (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 these bankrupt savings and loans. Meanwhile, Government holdings of other loans have been declining in real terms since the mid-1980s. 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 around $50 billion as of 2004. 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 2-1/4 percent. The Government also holds inventories of defense goods and other items that in 2004 amounted to about 25 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 13–1. 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 2002-2004. These fluctuations have caused the estimated value of Federal mineral deposits to fluctuate as well. In 2004 as estimated here, the combined real value of Federal land and mineral rights was higher than it has ever been, but only 3 percent greater than in 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 available inventory or realistic basis for valuing such unique assets.

Total Assets: The total value of Government assets measured in constant dollars has risen sharply in the past three years, and was higher in 2004 than ever before. The Government's asset holdings are vast. As of the end of FY 2004, Government assets were estimated to be worth about $3.3 trillion or 28 percent of GDP.

Liabilities

Table 13–1 includes all Federal liabilities that would normally be listed on a 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, which can be thought of as a form of deferred compensation. 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 liabilities reflect only binding short-term obligations, not the Government's full commitment under these programs.

Future benefit payments that are likely to be made through Social Security and other Federal income transfer programs are not Federal liabilities in a legal or accounting sense. They are Federal responsibilities, however, and it is important to gauge their size, but they are not binding in the same way as a legally enforceable claim would be. That is why a 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 $4.3 trillion at the end of 2004. 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.

Insurance and Guarantee Liabilities: The Federal Government has contingent liabilities arising from the loan guarantees it has made and from 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 13–1 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 2004.

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 $4.0 trillion at the end of FY 2004 up from $2.9 trillion in 2000.[2] There was a large expansion in Federal military retiree health benefits legislated in 2001.

The Balance of Net Liabilities

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 affected Federal creditworthiness. Long-term Government interest rates in 2003 reached their lowest

[2] The pension liability is the actuarial present value of benefits accrued-to-date based on past and projected salaries. The 2004 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 *2004 Financial Report of the United States Government* and *Reports* from earlier years.

levels in 45 years, and in 2004 they remained lower than at any time from 1965 through 2002. 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. The Government's ability to service its debt in the long run 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. That is the subject of the next section.

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 the uncertainty surrounding the necessary underlying assumptions, 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 important ones such as Social Security and Medicare, however, 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 3.3 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 support the retired population, the budgetary pressures will continue to grow. The problem posed by the demographic transition is a permanent one; indeed, it is a growing one.

Currently, the three major entitlement programs—Social Security, Medicare and Medicaid—account for 44 percent of non-interest Federal spending, up from 30 percent in 1980. By 2035, when the remaining baby boomers will be in their 70s and 80s, these three programs could easily account for nearly two-thirds of non-interest Federal spending. At the end of the projection period, the figure rises to around three-quarters 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, aside from interest, 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 are still in the work force. As the baby boomers begin to reach retirement age in large numbers, the deficit begins to rise. In about 10 years, the deficit as a share of GDP is projected to reach a low point and then begin an inexorable increase. By the end of this chapter's projection period, rising deficits would drive publicly held Federal debt to levels 2–½ 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 to eventually reach around 22 percent of GDP.

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 forecasting assumptions, the resources generated by the programs themselves will be insufficient to cover the long-run costs of Social Security and Medicare.

Table 13–2. LONG-RANGE MODEL RESULTS

(As a percent of GDP)

	1995	2005	2015	2025	2035	2045	2055	2065	2075
Receipts	18.5	16.8	18.5	19.1	19.6	20.2	20.9	21.5	22.0
Outlays:									
Discretionary	7.4	7.9	5.9	5.9	5.9	5.9	5.9	5.9	5.9
Mandatory:									
Social Security	4.5	4.2	4.4	5.4	6.0	6.0	6.1	6.2	6.4
Medicare	2.1	2.4	3.3	4.6	6.0	7.0	7.9	9.1	10.4
Medicaid	1.2	1.5	1.9	2.1	2.3	2.6	2.8	3.0	3.3
Other	2.2	2.8	2.0	1.7	1.5	1.3	1.2	1.1	1.0
Subtotal, mandatory	10.1	10.9	11.6	13.8	15.8	16.9	18.0	19.5	21.2
Net Interest	3.2	1.5	1.9	2.0	3.1	4.8	6.9	9.7	13.3
Total outlays	20.7	20.3	19.4	21.8	24.8	27.6	30.8	35.1	40.4
Surplus or Deficit (–)	–2.2	–3.5	–0.9	–2.7	–5.2	–7.4	–10.0	–13.6	–18.4
Federal Debt Held by the Public	49.2	38.6	35.6	38.1	58.7	90.4	130.0	181.3	249.0

Note: The figures shown in this table for 2015 and beyond are the product of a long-range forecasting model maintained by the Office of Management and Budget. This model is separate from the models and capabilities that produce the detailed programmatic estimates in the Budget. It was designed to produce long-range forecasts based on additional assumptions regarding the growth of the economy, the long-range evolution of specific programs, and the demographic and economic forces affecting those programs. The model, its assumptions, and sensitivity testing of those assumptions are presented in this chapter.

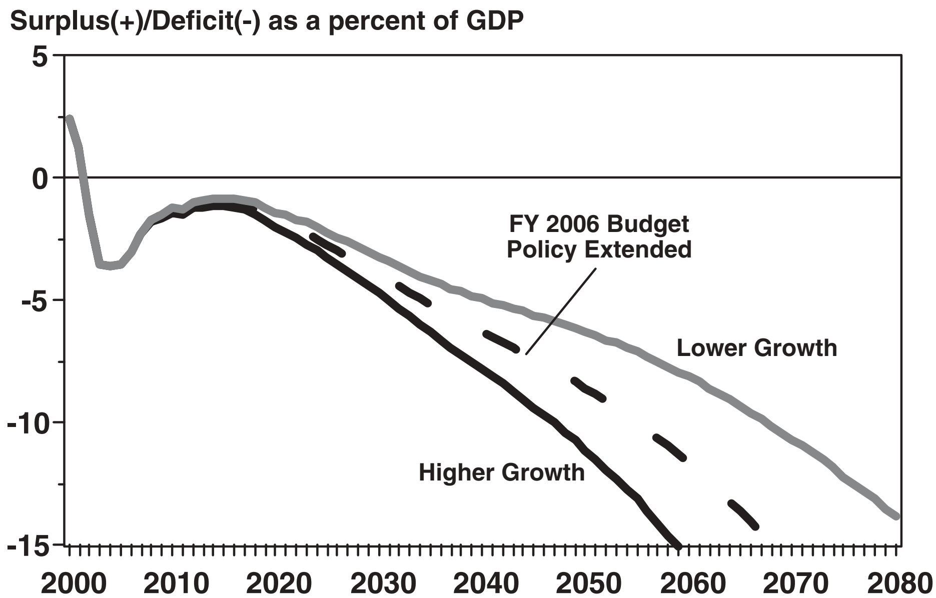
Alternative Economic and Technical Assumptions

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. All show that there are mounting deficits under most reasonable projections of the budget.

1. *Health Spending:* The projections for Medicare over the next 75 years are based on the actuarial projections in the 2004 Medicare Trustees' Report, that include the effects of the Medicare Prescription Drug and Modernization bill enacted in 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.

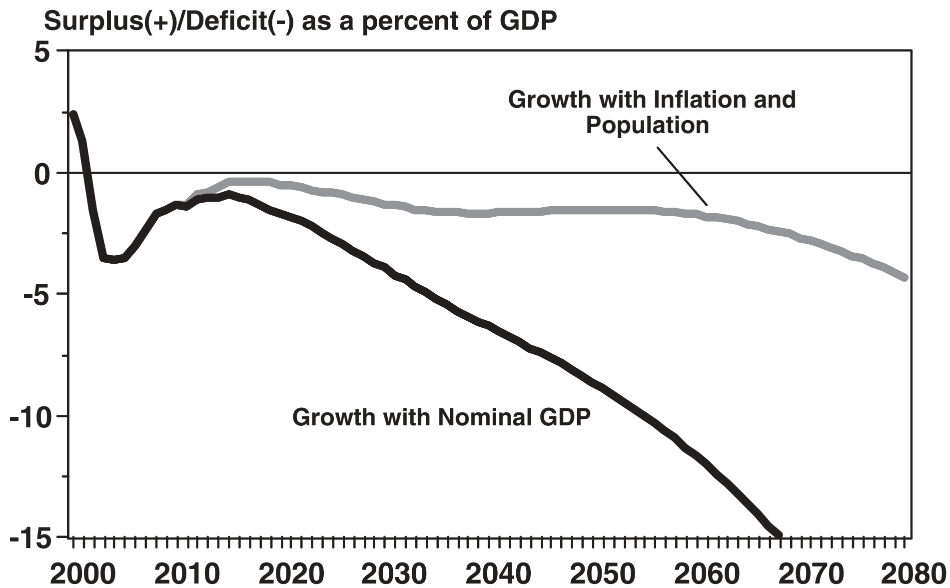
Eventually, the rising trend in health care costs for both Government and the private sector will have to end, but it is hard to know when and how that will happen. Improved health and increased longevity are highly valued, and society has shown that it is willing to spend a larger share of income on them than it did in the past. 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 or lowering the projected growth rate in per capita health care costs by ¼ percentage point.

Chart 13-3. Health Care Cost Alternatives

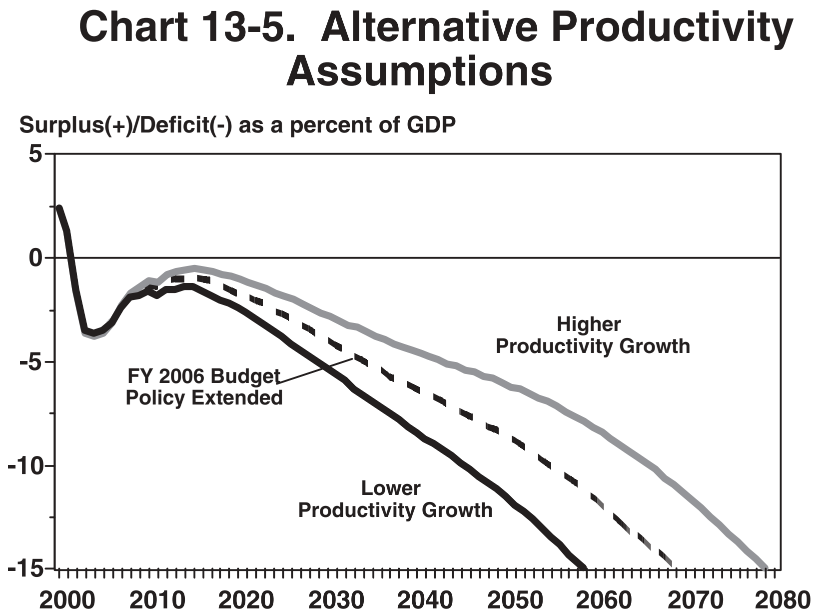


2. *Discretionary Spending:* The assumption used to project discretionary spending is essentially arbitrary, because discretionary spending is determined annually through the legislative process, and no formula can dictate future spending in the absence of legislation. Alternative assumptions have been 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 realistic. When the population and economy grow, as assumed in these projections, the demand for public services is very likely to expand as well. 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 to limit the percentage increase in discretionary spending to the increase in population plus inflation, in other words, to hold the real per capita inflation-adjusted level of discretionary spending 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 13-4. Alternative Discretionary Spending Assumptions

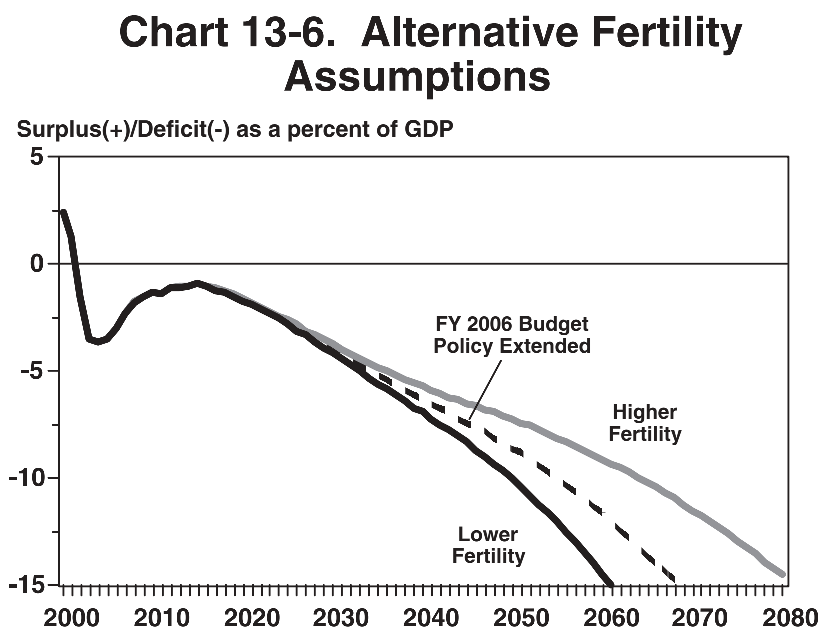


3. *Productivity:* The rate of future productivity growth has an important effect on the long-run budget outlook. It is also highly uncertain. Over the next few decades an increase in productivity growth would reduce projected budget deficits appreciably. Higher productivity growth adds directly to the 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, the rate of productivity growth increased unexpectedly and it has increased again since 2000. This 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. This is a cautious assumption. If the recent increase in trend productivity growth is sustained, it might continue growing faster than the historical average for some time to come. The alternatives highlight the effect of raising the projected productivity growth rate by ¼ percentage point and the effect of lowering it by the same amount.



4. *Population:* The key assumptions for projecting long-run demographic developments are 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 growth from low fertility and allows total population to expand throughout the projection period, although at a much slower rate than has prevailed historically.
- 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 2003 to 85.3 years by 2080, and the average male lifespan is projected to increase from 74.4 years in 2003 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 13-7. Alternative Mortality Assumptions

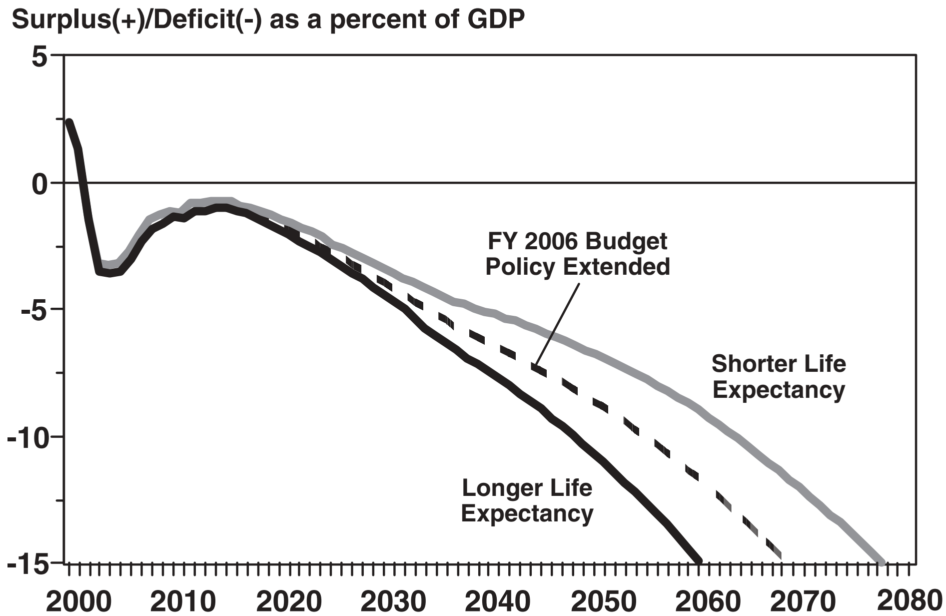
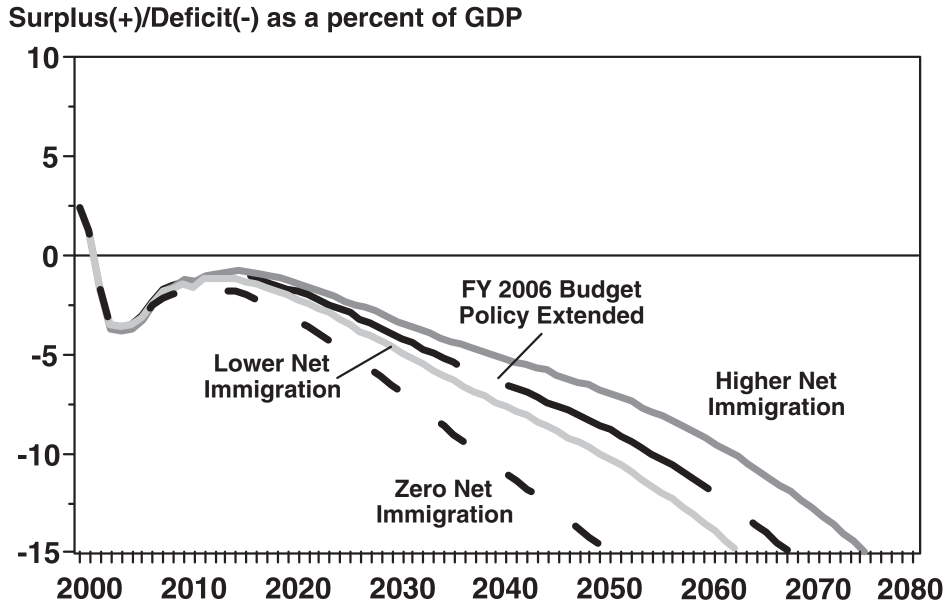


Chart 13-8. Alternative Immigration Assumptions



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. Both programs' actuaries have calculated that they face persistent long-run deficits. How best to measure the long-run imbalance in Social Security is a challenging analytical question. The imbalance is even more difficult to measure in Medicare, which includes both Hospital Insurance (HI), funded through the payroll tax, and Supplementary Medical Insurance (SMI), financed through premiums and general revenues. Under reasonable assumptions, however, each program embodies 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 both of these programs' financial problems.

Social Security: The Long-Range Challenge

Social Security provides retirement security and disability insurance for tens of millions of Americans. The Social Security system 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 within 20 years. Social Security's spending path is unsustainable under current law. The retirement of the baby-boom generation, born following World War II, will begin to increase greatly the number of Social Security beneficiaries within five 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 following the baby boomers passage through the system. The number of workers available to support each beneficiary is projected to decline from over 3 today to just around 2 in 2030, and remain there indefinitely. This decline in the workforce available to support retiree benefits means that the Government will not be able to meet current-law benefit obligations at current payroll tax rates.

The size of Social Security's future shortfall cannot be known with 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, the demands created by Social Security could compromise the rest of the budget and the Nation's economic health. The actuarial shortfall is estimated to be $11.9 trillion over an infinite horizon.

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 Supplemental Medical Insurance (SMI) or Part B, which pays for physicians' services and other related expenditures. Starting in 2006, Medicare will offer a voluntary prescription drug benefit, Medicare Part D, which is part of the SMI Trust Fund.

Like Social Security, HI is intended to be self-financing through dedicated taxes. According to the Medicare Trustees most recent report, the Trust Fund is projected to be depleted in 2019. Looking at the long run, the Medicare actuaries project a 75-year unfunded promise to Medicare's HI trust fund of around $8.5 trillion (net present value). However, this measure tells less than half the story because it does not include the deficiency in Medicare's Part B and Part D programs. The main source of dedicated revenues to the SMI Trust Fund 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 $28.1 trillion. SMI's financing gap is covered by an unlimited tap on general revenues. According to the Medicare Trustees 2004 report, "When the Part D program becomes fully implemented in 2006, general revenue transfers are expected to constitute the largest single source of income to the Medicare program as a whole—and would add significantly to the Federal Budget pressures."

This bifurcated trust fund structure finances Medicare as if the program offers two separate, unrelated benefits, instead of recognizing that Medicare provides integrated, comprehensive health insurance coverage. The Medicare Prescription Drug, Improvement and Modernization Act of 2003 took initial steps to address this problem and to monitor Medicare's use of general revenues. The Trustees are now required to include a new, comprehensive fiscal analysis, the Combined Medicare Trust Fund Analysis. This analysis examines the program as a whole, and signals whether Medicare's reliance on general revenue funding is projected to exceed 45 percent of total Medicare expenditures at any point in the following six years. Current projections indicate that Medicare's reliance on general revenues may exceed this threshold as early as 2012. The Administration supports efforts to integrate Medicare's financing structure and monitor the program's reliance on general revenue funding, such as a unified Medicare trust fund.

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 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 value of the Social Security imbalance over the next 75 years was estimated to be $5.2 trillion as of January 1, 2004. The comparable estimate for Medicare was $28.1 trillion. (The estimates in Table 13–3 were prepared by the Social Security and Medicare actuaries, and they are based on the intermediate economic and demographic assumptions used for the 2004 trustees' reports. These differ in some respects from the assumptions used for the long-run budget projections described in the preceding section, but Table 13–3 would still show large imbalances if the budget assumptions had been used for the calculations.)

Doing the calculations for a 75-year horizon understates the deficiencies, because the 75-year actuarial calculations omit the large deficits that continue to occur beyond the 75th year. The understatement is significant, even though values in the distant future are discounted by a large amount. For example, merely adding an additional year to the estimating period would widen the imbalance for Social Security from $5.2 trillion to $5.3 trillion. For the latest Social Security and Medicare trustees' reports, the programs' actuaries have also calculated the actuarial imbalances in perpetuity. See Table 13–3, which shows how much these distant benefits add to the programs' imbalances.

The imbalance for Social Security, when estimated on a perpetuity basis, was $11.9 trillion at the beginning of 2004. This was the amount that the Government would have had to raise in the private capital markets to resolve the program's imbalance. It was entirely accounted for by the benefits due to current workers and beneficiaries. Future participants do not add to the total, but their contributions do not significantly reduce it either. If nothing else were to change, the estimated imbalance would grow every year at approximately the rate of interest, just as an unpaid debt grows with interest each year it remains outstanding. For Social Security this would imply an increase of approximately $600 billion in 2004 and by growing amounts with every year that the imbalance remains unaddressed. The comparable imbalance in Medicare is even more staggering at $61.9 trillion. Unlike Social Security, future participants do add significantly to the Medicare imbalance, but the exact size of the imbalance is harder to estimate for Medicare because of greater uncertainty regarding the future growth of medical costs. If these costs continue to rise faster than GDP,

Table 13–3. ACTUARIAL PRESENT VALUES OF BENEFITS IN EXCESS OF FUTURE TAXES AND PREMIUMS
Over a 75–Year Projection Period as of January 1, in Trillions of Dollars

	2000	2001	2002	2003	2004
Social Security					
Future benefits less future taxes for those age 15 and over	9.6	10.5	11.2	11.7	12.6
Future benefits less taxes for those age 14 and under and those not yet born	–5.8	–6.3	–6.7	–6.8	–7.3
Net present value for past, present and future participants	3.8	4.2	4.6	4.9	5.2
Medicare					
Future benefits less future taxes and premiums for those age 15 and over	9.9	12.5	12.9	15.0	24.6
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	3.4
Net present value for past, present and future participants	9.2	12.8	13.3	15.8	28.1
Social Security and Medicare					
Future benefits less future taxes and premiums for those age 15 and over	....	23.0	24.1	26.7	37.2
Future benefits less taxes and premiums for those age 14 and under and not yet born	....	–6.0	–6.3	–6.0	–3.9
Net present value for past, present and future participants	....	17.0	17.8	20.7	33.3
Addendum:					
Actuarial deficiency as a percent of the discounted payroll tax base:					
Social Security	–1.89	–1.86	–1.87	–1.92	–1.89
Medicare HI	–1.21	–1.97	–2.02	–2.40	–3.12
In Perpetuity as of January 1					
					2004
Social Security	....	....	....	....	11.9
Medicare	....	....	....	....	61.9
Social Security and Medicare	....	....	....	....	73.8

then inevitably the Medicare program will place an unsustainable burden on the budget.

Social Security: The current deficiency in Social Security is essentially due to paying past and current participants more benefits than they have paid or will pay into the program in taxes (calculated in terms of present values). By contrast, future participants—those who are now under age 15 or not yet born—are projected to pay in present value about $7.3 trillion more over the next 75 years than they will collect in benefits over that period. Limiting the horizon at 75 years, however, prevents a full accounting of the expected benefits for these future participants, since many future participants will pay all of their lifetime taxes within the 75-year period, while continuing to receive benefits after the 75th year, while others will pay some taxes within the 75-year horizon without receiving any benefits until much later.

Extending the estimates to perpetuity avoids this distortion because everyone's taxes and benefits are fully included in the calculation and discounted to the present. Altogether, the far distant benefits, estimated in perpetuity, add about $6.7 trillion to the imbalance, which nearly offsets the expected net contribution of $7.3 trillion from future participants over the next 75 years. In other words, the taxes that future participants are expected to pay will be large enough to cover the benefits due them under current law, but not large enough to cover those benefits plus the benefits promised to current program participants in excess of the taxes paid by current program participants.

Medicare: Over the next 75 years, benefits due to current program participants exceed payroll taxes and premiums by $24.6 trillion in present value. This is twice as large as the Social Security gap for the same group. Future participants are also projected to collect more in benefits than they pay in taxes and premiums, but over the same time span the gap is much smaller for them, $3.4 trillion. Even so, this pattern is different from that for Social Security, where future participants are net contributors over a 75-year horizon. Extending the horizon to infinity shows that the benefits due future participants will eventually exceed projected payroll tax receipts and premiums by a much larger margin. The infinite horizon projections shown at the bottom of Table 13–3 reveal that total Medicare benefits exceed future taxes and premiums by $61.9 trillion in present value.

Passage of the Medicare Prescription Drug, Improvement and Modernization Act added substantially to Medicare's actuarial deficiency, as can be seen in the 75-year projections in Table 13–3 comparing 2003 with 2004. The legislation also increased private sector participation and added new fiscal safeguards which may help address Medicare's financial shortfall, but how large the impact of these changes will be is uncertain and their effects are not captured in the figures reported here.

General revenues have covered about 75 percent of SMI program costs for many years, with the rest being covered by premiums paid by the beneficiaries. In Table 13–3, 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. From the standpoint of the Government as a whole, only receipts from the public can finance expenditures.

A significant portion of Medicare's actuarial 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, waste, and the many of the costs associated with medical liability claims add needlessly to costs. But even though the projected increases in Medicare spending are likely to contribute to longer life-spans and safer treatments, the financial implications remain the 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, and that is reflected in the estimates shown in Tables 13–2 and 13–3.

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. The trust fund surpluses could have added to national saving if debt held by the public had actually been reduced because of the trust fund accumulations. But it is impossible to know for sure whether this happened or not.

At the time Social Security or Medicare redeems the debt instruments in the trust funds to pay benefits not covered by 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, and for that reason, the trust funds are not netted against future benefits in Table 13–3. The eventual claim on the Treasury is better revealed by the difference between future benefits and future taxes or premiums.

In any case, trust fund assets 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 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.

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 if the savings occurred outside the budget window. 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 long-run 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 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 the return on investment 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 also contribute to future tax receipts.

To show the importance of these kinds of issues, Table 13–4 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 types of capital, and these contributions are shown separately in the table. At the same time, the private wealth shown in Table 13–4 can be drawn on by Government to finance future public activities. The Nation's wealth sets the ultimate limit on the resources currently available to the Government. Data in this table are especially uncertain, because of the strong assumptions needed to prepare the estimates.

The table shows 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—$6.6 trillion. The Federal contribution is down from 8.8 percent in the mid-1980s and from 11.5 percent in 1960. Much of this reflects the relative decline in the stock of defense capital, which has fallen from around 13 percent of GDP in the mid-1980s to under 6 percent in 2004.

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, $49.3 trillion in 2004, consisting of $41.6 trillion in private physical capital and $7.8 trillion in public physical capital (including capital funded by State and local governments); by comparison, GDP was around $11.7 trillion in 2004. The Federal Government's contribution to this stock of capital includes its own physical assets of $2.7 trillion plus $1.3 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. Table 13–4 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. 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

Table 13–4. NATIONAL WEALTH

(As of the end of the fiscal year, in trillions of 2004 dollars)

	1960	1965	1970	1975	1980	1985	1990	1995	2000	2002	2003	2004
ASSETS												
Publicly Owned Physical Assets:												
Structures and Equipment	2.1	2.4	3.0	3.7	3.9	4.1	4.5	4.9	5.6	5.9	6.1	6.1
Federally Owned or Financed	1.2	1.3	1.4	1.6	1.7	1.9	2.0	2.1	2.1	2.2	2.2	2.3
Federally Owned	1.1	1.1	1.1	1.1	1.0	1.2	1.2	1.2	1.1	1.0	1.0	1.1
Grants to State and Local Governments	0.1	0.2	0.3	0.5	0.7	0.8	0.8	0.9	1.1	1.2	1.2	1.2
Funded by State and Local Governments	0.9	1.1	1.5	2.1	2.2	2.2	2.5	2.8	3.5	3.7	3.8	3.8
Other Federal Assets	0.7	0.7	0.7	0.9	1.3	1.4	1.2	0.9	1.2	1.2	1.4	1.7
Subtotal	2.8	3.1	3.6	4.5	5.2	5.5	5.6	5.8	6.8	7.2	7.5	7.8
Privately Owned Physical Assets:												
Reproducible Assets	7.3	8.3	10.2	13.0	16.1	17.5	20.0	22.1	26.7	28.6	29.5	30.5
Residential Structures	2.8	3.3	3.9	5.0	6.4	6.8	7.9	8.9	11.0	12.1	12.7	13.3
Nonresidential Plant & Equipment	2.9	3.3	4.1	5.4	6.5	7.4	8.3	9.0	10.9	11.6	11.7	12.0
Inventories	0.7	0.8	0.9	1.2	1.4	1.3	1.4	1.5	1.6	1.5	1.6	1.7
Consumer Durables	0.9	1.0	1.3	1.5	1.8	1.9	2.4	2.7	3.1	3.4	3.4	3.6
Land	2.1	2.5	2.9	3.8	5.8	6.6	6.8	5.2	7.8	8.9	9.5	11.0
Subtotal	9.4	10.9	13.1	16.8	21.9	24.1	26.8	27.3	34.5	37.6	38.9	41.6
Education Capital:												
Federally Financed	0.1	0.1	0.2	0.3	0.5	0.6	0.8	0.9	1.2	1.3	1.4	1.4
Financed from Other Sources	6.4	8.2	11.0	13.6	17.8	21.4	27.6	30.9	40.1	42.8	44.1	45.0
Subtotal	6.5	8.3	11.3	14.0	18.3	22.0	28.4	31.8	41.3	44.1	45.5	46.4
Research and Development Capital:												
Federally Financed R&D	0.2	0.4	0.5	0.6	0.6	0.7	0.8	1.0	1.0	1.1	1.1	1.2
R&D Financed from Other Sources	0.1	0.2	0.3	0.4	0.5	0.7	0.9	1.2	1.5	1.7	1.8	1.9
Subtotal	0.3	0.6	0.8	1.0	1.1	1.4	1.7	2.1	2.6	2.8	2.9	3.0
Total Assets	19.0	22.8	28.8	36.3	46.5	53.0	62.6	67.0	85.2	91.7	94.9	98.8
Net Claims of Foreigners on U.S. (+)	–0.1	–0.2	–0.2	–0.1	–0.4	0.1	0.8	1.6	3.0	3.5	4.1	4.5
Net Wealth	19.1	23.0	29.0	36.4	46.9	52.9	61.7	65.4	82.1	88.2	90.8	94.3
ADDENDA:												
Per Capita Wealth (thousands of 2004 $)	106.1	118.5	141.5	168.7	205.6	221.7	246.4	244.9	290.4	305.6	311.5	320.5
Ratio of Wealth to GDP (in percent)	703.4	672.4	708.7	785.5	845.8	799.8	797.9	747.9	769.1	803.4	798.7	798.2
Total Federally Funded Capital (trillions 2004 $)	2.2	2.5	2.9	3.4	4.1	4.7	4.8	4.9	5.6	5.8	6.2	6.6
Percent of National Wealth	11.5	10.7	9.9	9.3	8.7	8.8	7.8	7.5	6.8	6.6	6.8	7.0

$46.4 trillion in 2004, of which about 3 percent was financed by the Federal Government. It was almost 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.

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 total 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 earns 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 $3.0 trillion in 2004. Although this represents a large amount of research, it is a relatively small portion of total National wealth. Of this stock, 39 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 13–4 is intended to show National totals only. Total debt is important even though it does not appear in Table 13–4. The amount of debt owed by Americans to other Americans can exert both positive and negative effects on the economy. Americans' willingness and abil-

[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.

ity to borrow have helped fuel the current expansion by supporting consumption and housing purchases. On the other hand, growing debt would be a risk to future growth, if the ability to service the high level of debt were to become impaired.

The only debts that do appear in Table 13–4 are the debts Americans owe to foreigners for the investments that foreigners have made here. America's net 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 is at record levels, the size of the net foreign debt remains relatively small compared with the total stock of U.S. assets. It amounted to 4.5 percent of total assets in 2004.

Federal debt does not appear explicitly in Table 13–4 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 13–1, amount to 5.6 percent of net U.S. wealth as shown in Table 13–4. 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 2004 was almost $100 trillion, about eight times the size of GDP. Since 1960, 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 3.0 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. Net wealth has been growing at an average rate of 4.2 percent since 1995, about the same rate as from 1960 to 1973. 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 29 percent of privately owned physical assets. It grew 3.3 percent per year on average from 1960 to 2004. 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, growth of plant and equipment over the last eight years accelerated by only a few tenths of a percentage point compared with 1973–1995. Private plant and equipment grew 2.9 percent per year on average between 1973 and 1995 and just 3.2 percent per year from 1995 through 2004. 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 and land have all grown much more rapidly in real value since 1995 than from 1973 to 1995.

The accumulation of education capital has averaged 4.6 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, 1.9 percentage points faster than the average rate of growth in private physical capital during the same period. Since 1995, education capital has grown at a 4.3 percent annual rate. This reflects both the extra resources devoted to schooling in this period, and the fact that such resources have been increasing in economic value. Meanwhile, R&D stocks have grown at an average rate of 4.1 percent per year since 1995.

Other Federal Influences on Economic Growth

Federal investment decisions, as reflected in Table 13–4, obviously are important, but the Federal Government also affects 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 preserving national security, fostering healthy economic conditions including sound economic growth, promoting health and social welfare, and protecting the environment. Table 13–5 offers a rough cut of information that can be useful in assessing how well the Federal Government has been doing in promoting the domestic portion of these general objectives.

TABLE 13–5. ECONOMIC AND SOCIAL INDICATORS

Calendar Years	1960	1965	1970	1975	1980	1985	1990	1995	2000	2002	2003	2004
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	34,760	34,953	35,664	36,893
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	1.9	1.7	1.7
Median Income:												
All Households (2003 dollars)	N/A	N/A	35,832	35,559	37,447	38,510	40,865	40,845	44,853	43,381	43,318	N/A
Married Couple Families (2003 dollars)	30,903	35,966	43,130	44,789	48,917	50,695	54,431	56,395	63,110	62,657	62,405	N/A
Female Householder, Husband Absent (2003 dollars)	15,616	17,485	20,889	20,619	22,000	22,267	23,102	23,596	27,462	29,665	29,307	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	27.1	26.9	N/A
Poverty Rate (%) (a)	22.2	17.3	12.6	12.3	13.0	14.0	13.5	13.8	11.3	12.1	12.5	N/A
Economic Security:												
Civilian Unemployment (%)	5.5	4.5	4.9	8.5	7.1	7.2	5.5	5.6	4.0	5.8	6.0	5.5
CPI-U (% Change)	1.7	1.6	5.8	9.1	13.5	3.5	5.4	2.8	3.4	1.6	2.2	2.7
Payroll Employment Increase Previous 12 Months (millions)	–0.4	2.9	–0.4	0.4	0.3	2.5	0.3	2.2	1.9	–0.6	–0.1	2.2
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	34.6	34.8	34.9
Wealth Creation:												
Net National Saving Rate (% of GDP) (b)	10.6	12.4	8.3	6.7	7.4	6.2	4.4	4.1	5.9	1.7	1.2	1.6
Innovation:												
Patents Issued to U.S. Residents (thousands) (c)	42.3	54.1	50.6	51.5	41.7	45.1	56.1	68.2	103.6	104.6	105.9	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	N/A	N/A	N/A
Nonfarm Output per Hour (average 5 year percent change)	1.6	3.4	2.1	2.3	1.1	1.7	1.5	1.5	2.5	3.0	3.4	3.6
Environment:												
Air Quality:												
Nitrogen Oxide Emissions (thousand short tons)	18,163	21,297	26,883	26,377	27,079	25,757	25,529	24,956	22,598	21,102	N/A	N/A
Sulfur Dioxide Emissions (thousand short tons)	22,268	26,799	31,218	28,043	25,925	23,307	23,076	18,619	16,347	15,353	N/A	N/A
Lead Emissions (thousand short tons)	N/A	N/A	221	160	74	23	5	4	4	N/A	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	162	174	201	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	23.2	23.2	N/A
Safe Communities:												
Violent Crime Rate (per 100,000 population) (d)	160.0	199.0	364.0	482.0	597.0	558.1	729.6	684.5	506.5	494.4	475.0	N/A
Murder Rate (per 100,000 population) (d)	5.1	5.1	7.8	9.6	10.2	8.0	9.4	8.2	5.5	5.6	5.7	N/A
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	4.8	4.5	N/A	N/A
Health:												
Infant Mortality (per 1000 Live Births) (e)	26.0	24.7	20.0	16.1	12.6	10.6	9.2	7.6	6.9	7.0	6.8	6.6
Low Birthweight [<2,500 gms] Babies (%) (e)	7.7	8.3	7.9	7.4	6.8	6.8	7.0	7.3	7.6	7.8	7.9	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	77.3	N/A	N/A

TABLE 13–5. ECONOMIC AND SOCIAL INDICATORS—Continued

Calendar Years	1960	1965	1970	1975	1980	1985	1990	1995	2000	2002	2003	2004
Cigarette Smokers (% population 18 and older) (f)	N/A	41.9	39.2	36.3	33.0	29.9	25.3	24.6	23.2	22.4	21.6	20.1
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	84.1	84.6	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	26.7	27.2	N/A
Participation:												
Individual Charitable Giving per Capita (2000 dollars)	247	296	355	377	410	422	468	444	680	669	N/A	N/A
(by presidential election year)	(1960)	(1964)	(1968)	(1972)	(1976)	(1980)	(1984)	(1988)	(1992)	(1996)	(2000)	(2004)
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	55.3

(a) The poverty rate does not reflect noncash government transfers such as Medicaid or food stamps.
(b) 2004 through Q3 only.
(c) Preliminary data for 2003.
(d) Not all crimes are reported, and the fraction that go unreported may have varied over time.
(e) Data for 2003–2004 provisional, data for 2004 through June.
(f) Smoking data for 2004 through June.

The indicators shown in Table 13–5 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 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 beginning around 1995 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, violent crime has fallen by a third. The turnaround has been especially dramatic in the murder rate, which has been lower since 1998 than at any time since the early 1960s. The 2001 recession had an effect on some of these indicators: unemployment rose and real GDP growth declined for a time. But as the economy recovered much of the improvement shown in Table 13–5 was preserved. Indeed, productivity growth, the best indicator of future changes in the standard of living accelerated. Since 1999, it has increased faster than in any other five-year period since 1960.

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: For the years 2005-2015, 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 interval 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 2004 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 2.4 percent per year; the unemployment rate is constant at 5.1 percent; and the yield on 10-year Treasury notes is steady at 5.7 percent.
- Real GDP per hour grows at the same average rate as in the Administration's medium-term projections—2.3 percent per year.
- 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 slower rates of growth beyond that point. Annual population growth eventually reaches 0.2 percent.
- Real GDP growth declines over time with the expected slowdown in population growth and the increase in the portion of the population over age 65, which contributes less work effort. Historically, real GDP has grown at an average yearly rate of 3.4 percent. In these projections, average real GDP growth declines to around 2.5 percent per year.

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 2010, receipts and outlays follow the budget's policy projections. In the long run, 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 2004 Medicare trustees' report, adjusted for differences in inflation rate and the growth rate in GDP per capita. Federal pensions are derived from the most recent actuarial forecasts available at the time the budget is prepared, repriced using Administration inflation 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 principal 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, it was necessary to deflate the nominal investment series. This was done 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 1979–2003, 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 2004 is a projection. The health insurance liability was estimated by the program actuaries for 1997–2003, 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.

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 or financed 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 2004.

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 2004 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 13–5 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 the respective agencies' web sites.

14. 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 expenditures 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 framework 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 and grossing, 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 and grossing 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) reclassifying 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) adding a new receipts category called "income receipts on assets," which 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 prior to the 2003 comprehensive revision. The Bureau of Economic Analysis, however, has converted historical NIPA data to the new basis.

Netting and grossing 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" than does the budget. 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 as Government

[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 1994–2004, NIPA current expenditures averaged 4.0 percent higher than budget outlays, while NIPA current receipts averaged 2.4 percent higher than budget receipts.

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 day of a month falls on a weekend or holiday, monthly benefit checks normally mailed on the first day 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, lump sum payments to amortize the unfunded liability of the Uniformed Services Retiree Health Care Fund, 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 by and paid to the loan financing accounts; and both the NIPAs and the budget include administrative costs of program operations.

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.

Federal Sector Current Receipts

Table 14–1 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 a transfer of personal income within the household sector (as if the pension system were private), 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 14–1 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 among the addendum items in Table 14–1) 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.

Table 14–1. FEDERAL TRANSACTIONS IN THE NATIONAL INCOME AND PRODUCT ACCOUNTS, 1995–2006

(In billions of dollars)

Description	Actual										Estimate	
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
CURRENT RECEIPTS												
Current tax receipts	836.8	913.6	1,010.2	1,105.9	1,165.2	1,305.6	1,266.9	1,087.1	1,056.2	1,118.9	1,237.7	1,307.6
Personal current taxes	578.2	648.2	729.0	814.1	868.5	987.4	993.8	852.5	780.9	789.4	875.3	942.6
Taxes on production and imports	77.2	73.0	77.2	80.7	82.5	87.8	86.4	86.4	89.0	94.8	101.3	107.2
Taxes on corporate income	177.8	187.7	198.9	205.9	207.9	223.5	179.5	140.9	178.5	226.4	252.9	249.6
Taxes from the rest of the world	3.7	4.7	5.1	5.2	6.2	6.8	7.1	7.4	7.9	8.2	8.2	8.2
Contributions for government social insurance	515.3	535.3	565.4	604.4	642.2	687.8	713.8	728.3	750.9	781.3	833.0	883.4
Income receipts on assets	23.3	26.6	26.7	22.3	20.9	24.3	26.4	21.4	21.4	20.1	21.7	23.2
Current transfer receipts	20.2	19.1	23.8	21.0	21.8	24.9	26.5	25.4	25.3	32.1	35.5	37.8
Current surplus of government enterprises	0.3	–1.9	0.2	–*	0.3	–1.3	–6.5	–2.4	7.7	5.3	0.1	–3.9
Total current receipts	1,395.9	1,492.7	1,626.4	1,753.5	1,850.3	2,041.2	2,027.1	1,859.9	1,861.5	1,957.7	2,128.0	2,248.1
CURRENT EXPENDITURES												
Consumption expenditures	443.2	436.8	454.6	452.9	469.5	496.0	519.7	576.3	645.9	709.0	769.7	754.2
Defense	299.5	295.5	304.4	301.3	307.2	321.2	335.7	368.6	424.1	469.3	510.3	487.7
Nondefense	143.7	141.3	150.2	151.6	162.3	174.8	184.0	207.8	221.8	239.7	259.4	266.5
Current transfer payments	836.0	873.0	908.2	940.3	976.4	1,023.2	1,108.0	1,217.5	1,308.3	1,377.3	1,459.1	1,561.7
Government social benefits	635.3	670.2	700.0	716.4	733.0	762.7	823.6	901.6	955.3	1,005.8	1,065.9	1,162.6
Grants-in-aid to State and local governments	184.5	188.6	194.1	209.9	227.7	244.1	268.2	296.8	329.8	349.0	366.8	367.2
Other transfers to the rest of the world	16.2	14.1	14.2	14.0	15.7	16.4	16.3	19.0	23.2	22.5	26.4	31.9
Interest payments	285.1	295.8	299.4	299.7	285.9	283.3	267.9	234.8	215.3	219.7	241.5	276.9
Subsidies	34.8	33.3	31.3	33.6	36.1	49.6	53.7	37.5	45.6	41.1	52.9	56.6
Wage disbursements less accruals	....	....	....	....	....	....	....	....	....	....	....	....
Total current expenditures	1,599.1	1,638.9	1,693.5	1,726.5	1,767.9	1,852.0	1,949.3	2,066.2	2,215.1	2,347.1	2,523.2	2,649.3
Net Federal Government saving	–203.2	–146.1	–67.1	27.0	82.4	189.2	77.8	–206.3	–353.6	–389.5	–395.1	–401.3
ADDENDUM: TOTAL RECEIPTS AND EXPENDITURES												
Current receipts	1,395.9	1,492.7	1,626.4	1,753.5	1,850.3	2,041.2	2,027.1	1,859.9	1,861.5	1,957.7	2,128.0	2,248.1
Capital transfer receipts	14.6	17.1	19.7	23.9	27.6	28.8	28.2	26.4	21.7	24.7	23.6	26.0
Total receipts	1,410.5	1,509.8	1,646.1	1,777.4	1,877.9	2,070.0	2,055.3	1,886.3	1,883.2	1,982.4	2,151.6	2,274.0
Current expenditures	1,599.1	1,638.9	1,693.5	1,726.5	1,767.8	1,852.0	1,949.3	2,066.2	2,215.1	2,347.1	2,523.2	2,649.3
Net investment:												
Gross government investment:												
Defense	52.2	52.6	44.5	45.4	46.5	48.5	49.9	54.5	58.6	67.4	72.7	71.9
Nondefense	27.3	28.5	28.5	29.7	31.9	32.2	30.3	32.7	33.0	31.7	35.2	36.6
Less: Consumption of fixed capital:												
Defense	61.9	61.4	60.6	59.8	59.7	60.2	60.3	60.5	61.3	62.9	64.4	65.2
Nondefense	19.7	20.6	21.8	22.9	24.5	26.5	27.7	28.2	28.7	28.7	29.6	30.5
Capital transfer payments	27.2	27.7	28.9	28.2	31.3	35.1	39.8	44.0	45.2	61.9	63.0	66.6
Net purchases of nonproduced assets	–7.4	–0.1	–11.0	–5.3	–1.7	–0.3	–0.9	0.2	....	0.1	–0.1	–0.1
Total expenditures	1,616.7	1,665.5	1,702.2	1,741.8	1,791.7	1,880.8	1,980.3	2,108.8	2,261.9	2,417.0	2,600.0	2,729.0
Net lending or net borrowing (-)	–206.2	–155.7	–56.0	35.7	86.1	189.2	74.9	–222.6	–378.7	–434.3	–448.2	–454.7

* $50 million or less.

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 the NIPAs exclude as capital transfers, exceeded Medicare premiums, which the NIPAs 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 and grossing 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.

During the period 1975–1992, the budget deficit was a larger negative number than net Federal Government saving as measured in the NIPAs every year. The largest difference, $78.8 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 –$190.5 billion. In 1993–2002, the NIPA net Federal Government saving was a larger negative number than the budget deficit or lower positive number than the budget surplus each year. For 2003 and 2004, and in the estimate for 2005, though not that for 2006, the NIPA net Federal Government saving is a smaller negative number than the budget deficit.

Table 14–1 displays Federal transactions using NIPA concepts with actual data for 1995–2004 and estimates for 2005 and 2006 consistent with the Administration's budget proposals. Table 14–2 summarizes the reasons for differences between the data. Table 14–3 displays quarterly data beginning with the last quarter of 2003 based on NIPA concepts. Annual NIPA data for 1948–2006 are published in Section 14 of a separate budget volume, *Historical Tables, Budget of the U.S. Government, Fiscal Year 2006.*

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 14–2. RELATIONSHIP OF THE BUDGET TO THE FEDERAL SECTOR, NIPA's

Description	Actual									Estimate		
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
RECEIPTS												
Budget receipts	1,351.8	1,453.1	1,579.3	1,721.8	1,827.5	2,025.2	1,991.2	1,853.2	1,782.3	1,880.1	2,052.8	2,177.6
Contributions to government employee retirement plans	–4.6	–4.5	–4.4	–4.3	–4.5	–4.8	–4.7	–4.6	–4.6	–4.6	–4.6	–4.6
Capital transfers received	–14.6	–17.1	–19.7	–23.9	–27.6	–28.8	–28.2	–26.4	–21.7	–24.7	–23.6	–26.0
Other coverage differences	–2.6	–3.6	–3.8	–5.7	–6.6	–7.8	–7.7	–8.8	–9.1	–10.5	–11.4	–12.3
Netting and grossing	63.3	62.8	69.5	64.5	65.7	70.8	70.0	76.2	91.0	97.4	106.4	118.7
Timing differences	2.4	2.0	5.5	1.2	–4.2	–13.3	6.6	–29.8	23.7	20.0	8.4	–5.4
NIPA current receipts	1,395.9	1,492.7	1,626.4	1,753.5	1,850.3	2,041.2	2,027.1	1,859.9	1,861.5	1,957.7	2,128.0	2,248.1
EXPENDITURES												
Budget outlays	1,515.8	1,560.5	1,601.2	1,652.6	1,701.9	1,789.1	1,863.0	2,011.0	2,159.9	2,292.2	2,479.4	2,567.6
Government employee retirement plan transactions	28.7	26.8	31.6	31.3	32.1	31.7	31.5	33.7	32.5	34.0	42.4	47.0
Deposit insurance and other financial transactions	2.1	0.9	9.3	7.6	5.7	6.0	7.9	1.5	–1.6	–8.6	–20.5	–5.1
Capital transfer payments	–27.2	–27.7	–28.9	–28.2	–31.3	–35.1	–39.8	–44.0	–45.2	–45.7	–47.3	–50.3
Net purchases of nonproduced assets	17.3	7.4	–1.4	–1.4	–0.4	–1.1	1.2	1.0	12.3	–0.1	0.1	–0.1
Net investment	7.4	0.1	11.0	5.3	1.7	0.2	0.9	–0.2	*	–7.5	–13.8	–12.8
Other coverage differences	–11.5	–1.8	6.7	–4.4	–2.9	–3.9	0.6	–8.8	–22.7	–16.9	–21.0	–22.1
Netting and grossing differences	63.3	62.8	69.5	64.5	65.7	70.8	70.0	76.2	91.0	97.4	106.4	118.7
Timing differences	3.1	9.8	–5.6	–0.8	–4.7	–5.6	14.1	–4.3	–11.0	2.2	–2.6	6.4
NIPA current expenditures	1,599.1	1,638.9	1,693.5	1,726.5	1,767.8	1,852.0	1,949.3	2,066.2	2,215.1	2,347.1	2,523.2	2,649.3
ADDENDUM												
Budget surplus or deficit (–)	–164.0	–107.5	–21.9	69.2	125.5	236.2	128.2	–157.8	–377.6	–412.1	–426.6	–390.1
NIPA net Federal government saving	–203.2	–146.1	–67.1	27.0	82.4	189.2	77.8	–206.3	–353.6	–389.5	–395.1	–401.3

* $50 million or less.

Table 14–3. FEDERAL RECEIPTS AND EXPENDITURES IN THE NIPA's, QUARTERLY, 2004–2006

(In billions of dollars; seasonally adjusted at annual rates)

Description	Actual				Estimate							
	Oct.-Dec. 2003	Jan.-Mar. 2004	Apr.-June 2004	July-Sept. 2004	Oct.-Dec. 2004	Jan.-Mar. 2005	Apr.-June 2005	July-Sept. 2005	Oct.-Dec. 2005	Jan.-Mar. 2006	Apr.-June 2006	July-Sept. 2006
CURRENT RECEIPTS												
Current tax receipts	1,074.9	1,073.8	1,098.5	1,096.7		1,168.0	1,189.8	1,205.2	1,214.8	1,235.5	1,247.3	1,262.7
Personal current taxes	772.5	768.3	781.5	794.3		850.2	866.5	880.5	892.8	915.5	925.4	937.3
Taxes on production and imports	89.6	89.0	89.3	89.2		94.3	97.6	98.4	99.1	101.1	102.5	103.7
Taxes on corporate income	204.9	207.9	219.5	204.9		215.4	217.5	218.0	214.6	210.7	211.2	213.5
Taxes from the rest of the world	7.9	8.6	8.3	8.2		8.2	8.2	8.2	8.2	8.2	8.2	8.2
Contributions for government social insurance	769.5	787.9	797.6	806.2		837.1	847.5	857.9	867.8	893.4	904.1	914.7
Income receipts on assets	25.5	22.9	22.2	22.9		25.2	25.7	25.9	26.2	26.4	26.9	27.3
Current transfer receipts	25.6	26.1	26.2	26.6		28.6	29.2	29.7	30.1	30.8	31.6	32.4
Current surplus of government enterprises	5.0	4.6	4.5	4.3		–0.3	–1.9	–3.0	–4.2	–4.2	–4.9	–5.7
Total current receipts	1,900.6	1,915.3	1,949.1	1,956.7		2,058.7	2,090.3	2,115.8	2,134.5	2,182.0	2,204.9	2,231.4
CURRENT EXPENDITURES												
Consumption expenditures	671.3	691.1	700.3	713.0		741.9	752.4	761.4	748.5	741.8	729.9	719.9
Defense	450.2	465.2	473.6	487.1		506.1	510.9	513.9	502.7	496.0	484.0	474.0
Nondefense	221.1	225.9	226.7	225.9		235.8	241.5	247.5	245.8	245.8	245.9	245.9
Current transfer payments	1,350.6	1,365.9	1,367.9	1,368.8		1,451.0	1,455.5	1,465.5	1,473.5	1,567.3	1,568.3	1,583.4
Government social benefits	972.5	986.2	993.0	1,004.3		1,050.0	1,057.6	1,064.4	1,072.0	1,162.9	1,171.7	1,180.4
Grants-in-aid to State and local governments	357.2	346.0	351.9	342.1		364.7	372.0	373.6	370.1	362.8	365.1	369.6
Other transfers to the rest of the world	20.8	33.7	23.0	22.4		36.4	25.9	27.5	31.4	41.5	31.4	33.3
Interest payments	214.7	211.1	220.7	220.0		232.2	239.7	248.0	257.0	266.6	276.7	287.2
Subsidies	43.2	39.7	38.7	39.0		50.6	54.2	56.8	54.9	59.7	56.1	52.3
Wage disbursements less accruals	....	–1.5	1.5	*		....	....	....	....	....	....	....
Total current expenditures	2,279.8	2,306.3	2,329.1	2,340.8		2,475.7	2,501.7	2,531.7	2,533.9	2,635.3	2,630.9	2,642.8
Net Federal Government saving	–379.2	–391.0	–380.0	–384.1		–417.1	–411.5	–415.9	–399.3	–453.4	–426.0	–411.4
ADDENDUM: TOTAL RECEIPTS AND EXPENDITURES												
Current receipts	1,900.6	1,915.3	1,949.1	1,956.7		2,058.7	2,090.3	2,115.8	2,134.5	2,182.0	2,204.9	2,231.4
Capital transfer receipts	22.9	24.2	23.0	26.1		20.9	21.0	21.3	21.9	22.7	23.8	25.1
Total receipts	1,923.5	1,939.5	1,972.0	1,982.7		2,079.6	2,111.3	2,137.1	2,156.4	2,204.7	2,228.7	2,256.5
Current expenditures	2,279.8	2,306.3	2,329.1	2,340.8		2,475.7	2,501.7	2,531.7	2,533.9	2,635.3	2,630.9	2,642.8
Net investment:												
Gross government investment:												
Defense	63.4	69.0	67.6	69.8		73.6	72.4	73.6	74.3	71.0	71.9	70.5
Nondefense	32.8	33.2	36.5	34.6		37.1	37.8	38.4	38.4	38.7	38.9	39.2
Less: Consumption of fixed capital:												
Defense	61.8	62.5	63.5	63.9		64.3	64.5	64.7	64.9	65.1	65.3	65.5
Nondefense	28.9	29.1	29.3	29.4		29.5	29.8	30.0	30.2	30.5	30.7	31.0
Capital transfer payments	61.5	60.0	57.5	66.9		63.0	65.0	64.9	65.1	66.3	67.2	66.9
Net purchases of nonproduced assets	–0.7	....	–0.8	1.8		0.2	0.2	0.2	0.2	0.2	0.2	0.2
Total expenditures	2,346.1	2,376.9	2,397.2	2,420.4		2,555.8	2,582.8	2,614.0	2,616.7	2,715.9	2,713.1	2,723.0
Net lending or net borrowing (-)	–422.6	–437.4	–425.2	–437.7		–476.2	–471.6	–477.0	–460.3	–511.2	–484.4	–466.5

Department of Commerce advance estimates for the Oct.-Dec. quarter, released January 28, 2005, were not available in time for inclusion in this table.

* $50 million or less.

BUDGET REFORM PROPOSALS

15. BUDGET REFORM PROPOSALS

In April of last year, the Administration sent to the Congress budget enforcement legislation in the form of the proposed Spending Control Act of 2004. The Administration plans to re-propose that legislation with appropriate revisions. This chapter provides an overview of that updated legislation, and describes other budget reform proposals supported by the Administration. Certain administrative steps are planned to require agencies to propose offsets for regulatory actions that would increase mandatory spending.

In addition, the Administration requests that the Congress include the following budget enforcement proposals as part of its budget resolution:

- Discretionary caps that include separate defense, nondefense, highway and mass transit categories.
- Adjustments to the discretionary caps for program integrity activities.
- Limits on advance appropriations within the discretionary caps.
- A new scoring rule to ensure that funding shortfalls do not accumulate in the discretionary Pell Grant program in future years.
- A separate category for Project BioShield to ensure that funding is not reduced and used as an offset for other discretionary spending.
- A pay-as-you-go (PAYGO) requirement for all legislation that changes mandatory spending.
- A stricter standard for emergency designations and a requirement that the President and the Congress concur in those designations.
- Extension of expiring tax provisions in the 2001 and 2003 tax cut bills in the budget resolution baseline.
- Exclusion of discretionary funding for emergencies from the budget resolution baseline.
- A point of order against legislation that worsens the long-term unfunded obligation of major entitlement programs.

Discretionary Caps

The Administration proposes to set limits for 2005 through 2010 on net discretionary budget authority (BA) and outlays equal to the levels proposed in the 2006 Budget. Legislation that exceeds the discretionary caps would trigger a sequester of non-exempt discretionary programs. Table 15–1 displays the total levels of discretionary budget authority and outlays proposed for 2005 through 2010. This approach would put in place a budget framework for the next five years that ensures constrained, but reasonable growth in discretionary programs. For 2005 through 2007, separate defense (Function 050) and nondefense categories would be enforced. For 2008–2010, there would be a single cap for all discretionary spending. In addition, a separate category for transportation outlays, financed by dedicated revenues, would be established for 2005 through 2009. The proposal discontinues separate caps established for conservation programs in 2001 through an amendment to the Budget Enforcement Act (BEA).

Table 15–1. GENERAL PURPOSE DISCRETIONARY CAPS AND ADJUSTMENTS

(Amounts in billions of dollars)

	2005 [1]	2006	2007	2008	2009	2010
Proposed Discretionary Spending Categories:						
Discretionary Category:						
Defense Category (Function 050):						
Budget authority	420.2	438.8	462.6	NA	NA	NA
Outlays	463.5	444.3	446.1	NA	NA	NA
Nondefense Category:						
Budget authority	402.5	400.7	402.2	NA	NA	NA
Outlays	427.1	435.5	429.1	NA	NA	NA
Proposed Cap Adjustments:						
SSA Continuing Disability Reviews:						
Budget authority	NA	0.189	0.203	NA	NA	NA
Outlays	NA	0.166	0.201	NA	NA	NA
IRS Tax Enforcement:						
Budget authority	NA	0.446	0.514	NA	NA	NA
Outlays	NA	0.415	0.509	NA	NA	NA
Health Care Fraud and Abuse Control:						
Budget authority	NA	0.080	0.120	NA	NA	NA
Outlays	NA	0.080	0.120	NA	NA	NA

Table 15–1. GENERAL PURPOSE DISCRETIONARY CAPS AND ADJUSTMENTS—Continued

(Amounts in billions of dollars)

	2005 [1]	2006	2007	2008	2009	2010
Unemployment Insurance Improper Payments:						
Budget authority	NA	0.040	0.040	NA	NA	NA
Outlays	NA	0.034	0.040	NA	NA	NA
Subtotal, Nondefense Category, with Adjustments:						
Budget authority	402.5	401.5	403.1	NA	NA	NA
Outlays	427.1	436.1	430.0	NA	NA	NA
Discretionary Category:						
Budget authority	NA	NA	NA	886.6	907.9	919.8
Outlays	NA	NA	NA	889.3	905.6	971.4
Highway Category:						
Outlays	32.1	34.4	34.9	36.0	39.3	NA
Mass Transit Category: [2]						
Outlays	7.2	6.9	6.5	6.9	7.0	NA
Total, All Discretionary Categories:						
Budget authority	822.7	840.3	865.7	886.6	907.9	919.8
Outlays	929.9	921.7	917.4	932.2	951.9	971.4
Project BioShield Category:						
Budget authority	2.5	....	....	....	2.2	....
Memorandum: 2005 Hurricane Supplemental						
Budget authority	*11.9*	....	....	....	....	....

[1] The discretionary budget authority for Division B of the Military Construction Appropriations and Emergency Hurricane Supplemental Appropriations Act, 2005 (PL 108–324) and for emergencies in the Consolidated Appropriations Act, 2005 (PL 108–447) are displayed separately on a memorandum line.

[2] Includes prior-year outlays from general fund budget authority provided in years prior to 2005. Outlays from general fund budget authority for 2005 and beyond are included in the Discretionary Category.

Program Integrity Cap Adjustments.—An improper payment occurs when Federal funds go to the wrong recipient, the recipient receives an incorrect amount of funds, or the recipient uses the funds in an improper manner. Approximately 92 percent of improper payments are overpayments. The Administration has made the elimination of improper payments a major focus. Federal agencies have begun to review Federal programs to evaluate the risk of improper payments, have developed measures to assess the extent of improper payments, and have initiated processes and internal control improvements to enhance the accuracy and integrity of payments. For the first time, agencies have reported the results of these efforts, pursuant to the Improper Payments Information Act of 2002 (P.L. 107–300).

The results of the agency assessment have been aggregated into a government-wide report entitled *Improving the Accuracy and Integrity of Federal Payments*. (The full text of the report can be found at *http://www.whitehouse.gov/omb/financial/fia_improper.html*.) In 2004, the agencies reported a total of $45.1 billion in improper payments. This represents a 3.9 percent improper payment rate. Almost two-thirds of those improper payments are in four programs: Medicare, Unemployment Insurance, Supplemental Security Income, and Old-Age, Survivors, and Disability Insurance.

In the context of the Administration's efforts to eliminate improper payments, the Administration is proposing adjustments for spending above a base level of funding within the discretionary levels for several program integrity initiatives, specifically those efforts for continuing disability reviews (CDRs) in the Social Security Administration, Internal Revenue Service (IRS) tax enforcement, the Health Care Fraud and Abuse Control Program (HCFAC) in the Centers for Medicare and Medicaid Services and Unemployment Insurance improper payments in the Department of Labor. These cap adjustments provide an effective way to ensure that limited resources are applied to activities that reduce error and generate program savings.

In the past decade, there have been a variety of successful efforts to ensure dedicated resources for program integrity efforts. These efforts include cap adjustment funding for Social Security continuing disability reviews and integrity efforts associated with the Earned Income Tax Credit (EITC). These initiatives have led to increased savings for the Social Security program and an increase in enforcement efforts in EITC.

Additional spending on program integrity initiatives has proven to reduce erroneous payments in these programs. For example, the Social Security Administration reports that every $1 expended on CDRs has produced a $10 return to taxpayers. The Administration's proposed adjustments for program integrity activities will total $755 million in budget authority in 2006 and $877 million in budget authority in 2007.

Transportation Category.—The Administration's proposal for discretionary caps includes separate categories for spending on Federal Highway and Mass Transit programs. The Transportation levels will be financed by dedicated revenues over the six-year period from 2004 through 2009. This structure is consistent with the estimates provided in the 2006 Budget. Table 15–2 displays the Administration's Transportation proposal. The proposal discontinues the annual adjustment reflecting updated revenue estimates that was in the previous authorization, the Transportation Equity Act for the 21st Century (TEA–21).

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 and not in the year of enactment. 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. The effect of these advance appropriations is to limit the amount of discretionary BA available in subsequent years, thereby reducing future funding options available to both Congress and the President. 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.

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. By capping advance appropriations, increases in these and other programs can be budgeted and reflected in the year of their enactment. This year, the Administration proposes that total advance appropriations, excluding Project BioShield, continue to be capped in 2006 through 2010. Instead of capping total advance appropriations at the 2002 level, the Administration will propose a cap on advance appropriations of $22,602 million. This is the level of advance appropriations provided for 2007 in the President's 2006 Budget.

In addition, the Administration will also score the second—year effect of appropriations language that delays obligations of mandatory budget authority as advance appropriations that count against the discretionary caps. Appropriations acts often include provisions that delay obligations of mandatory BA from one year to the next. The first year is appropriately scored as a discretionary savings because it is included in an appropriations act and it reduces spending in that year. However, this is usually a temporary delay, and the funds become available for spending in the second year. Under this proposal, the second-year impact would be treated as an advance appropriation and scored against the discretionary caps. This will correct an inconsistency in the current practice where savings are scored in the first year, but the second year impact is reclassified in the subsequent budget as mandatory and not scored against the discretionary caps.

To enforce the level of advance appropriations, the discretionary cap proposal provides that total funding for advance appropriations (including obligation delays) provided in an appropriations act for 2006 through 2010 that is in excess of the Administration's limit on advance appropriations of $22,602 million will count against the discretionary cap in the year enacted, not against the year the funds first become available.

Federal Pell Grants.—The Pell Grant program provides grant aid to more than five million postsecondary students each year to help pay for their education. Pell

Table 15–2. TRANSPORTATION CATEGORY FOR HIGHWAYS AND MASS TRANSIT SPENDING

(Amounts in billions of dollars)

	2004 [1]	2005 [1]	2006	2007	2008	2009
Transportation Category:						
Highways:						
Obligation Limitations	34.6	35.2	35.9	37.3	39.8	45.9
Outlays	30.7	32.1	34.4	34.9	36.0	39.3
Mass Transit: [2]						
Obligation Limitations	5.8	6.7	6.8	6.5	7.0	7.6
Outlays	6.8	7.2	6.9	6.5	6.9	7.0
Memorandum:						
Discretionary budget authority for mass transit not under the Transportation Guarantee:						
Budget authority	*1.5*	*1.0*	*1.0*	*1.6*	*1.7*	*1.9*

[1] The Administration's SAFETEA proposal for Highway and Mass Transit programs applies to 2004 through 2009.

[2] Includes prior-year outlays from general fund budget authority provided in years prior to 2005. Outlays from general fund budget authority for 2005 and beyond are included in the Discretionary Category.

Grant funding is discretionary and is provided through the annual appropriations process. If a Pell-eligible student enrolls in school, however, he or she is automatically eligible for a need-based award up to the maximum award set in appropriations (currently $4,050). Pell Grant cost estimates are based on the February Budget's technical and economic assumptions; the Budget includes both the cost estimate for the budget year and revised cost estimates for prior years. In recent years, Pell Grant appropriations have been insufficient to cover program costs, creating an estimated $4.3 billion funding shortfall through the 2005–2006 award year.

In the FY 2006 Budget, the Administration is proposing a comprehensive package of reforms to the Federal student aid programs, including Pell Grants. In Pell, the Budget proposes to increase the $4,050 maximum award by $100 in FY 2006 and $500 over the next five years. The Budget also proposes to retire the estimated $4.3 billion funding shortfall in Pell through the 2005–2006 award year. The Budget requests mandatory budget authority for the additional funding from these Pell Grant proposals, which are offset by reforms to the Federal student loan programs that increase benefits to students while making these programs more cost effective. This mandatory funding for Pell Grants is contingent on adoption of the scoring rule discussed below, which will prevent future underfunding of Pell Grant program costs.

The Pell Grant program would remain discretionary. With the exception of the proposed funding to increase the maximum award by $500 over the next five years, the Administration would oppose efforts to convert Pell Grants into a mandatory program. Discretionary funding would still be required to support the cost of a $4,050 Pell Grant maximum award. Additional discretionary appropriations would also be needed to support any cost increases in the base Pell Grant program—due to increased enrollment, maximum award increases provided in appropriations, or other policy changes.

To ensure that funding shortfalls do not accumulate in the Pell Grant program in future years, the Administration is proposing to score appropriations at the amount needed to fully fund the award level set in appropriations acts, if the amount appropriated is insufficient to fully fund all awards. This amount would be increased to cover any funding shortfalls from previous years and reduced by any surpluses carried over from previous years. If the amount appropriated exceeded the estimated full cost, the amount appropriated would be scored against that year, and the surplus would carry over as a credit against the following year's cost estimate. The new scoring rule would only apply to Pell Grant costs beginning with the 2006–2007 award year. The existing shortfall would be funded as described above.

The Pell Grant scoring rule is a necessary component of the Administration's student aid reforms. It will ensure that Pell Grants costs are fully funded each year, which means that funding shortfalls will be paid for and will not accumulate in future years. The Administration believes that mandatory funding should not be used for Pell Grants unless this new budget scoring rule is in place.

Project BioShield Category.—The Administration proposes to create a separate BEA category for budget authority 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. The Administration's proposal to create a separate category will help ensure that 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 subject all legislation that changes mandatory spending to a pay-as-you-go requirement, so that such legislation, in total, does not increase the deficit. This proposal is modeled after the PAYGO requirement in the BEA, except that it does not apply to tax legislation. It also does not permit mandatory spending increases to be offset by tax increases. The Administration does not support increasing the tax burden on the American people and, therefore, proposes to remove tax legislation from the PAYGO calculation.

The five-year impact of any proposals affecting mandatory spending would continue to be scored. Table 15–3 displays the President's mandatory spending proposals. Legislation that exceeds the pay-as-you-go requirement in the current year and the budget year would trigger a sequester of direct spending programs. The 2006 Budget identifies as "PAYGO" only legislative proposals that change mandatory spending.

Table 15–3. PAYGO PROPOSALS

(Cost/Savings(–) in millions of dollars)

	2005	2006	2007	2008	2009	2010	2005–10
Outlay Effects of Tax Proposals [1]	....	–16	3,607	5,594	6,738	7,380	23,303
Pension Benefit Guaranty Corporation Reform [1]	....	–2,195	–3,702	–3,495	–3,226	–2,916	–15,534
Medicaid and State Children's Health Insurance Program	225	1,112	–1,549	–3,699	–4,214	–4,417	–12,542
User Fee Proposals	....	–824	–1,384	–1,482	–1,617	–1,593	–6,900
Student Loan Reforms and Pell Grant Increase	557	–1,172	–2,001	–1,752	–1,337	–986	–6,691
Byrd Amendment Repeal	....	–1,608	–1,615	–1,624	–855	–865	–6,567
Extension of Spectrum Auction Authority	....	....	....	1,083	–2,156	–3,239	–4,312
Commodity Credit Corporation and Crop Insurance	....	–587	–991	–982	–738	–674	–3,972
Allowing Power Marketing Administrations to Charge Market Rates	....	–40	–157	–446	–1,145	–1,406	–3,194
Southern Nevada Land Sales	....	–227	–418	–636	–641	–642	–2,564
Temporary Assistance for Needy Families Reauthorization	100	277	329	352	361	357	1,776
Arctic National Wildlife Refuge, lease bonuses	....	....	–1,201	–1	–101	–1	–1,304
Other Proposals	–62	–66	36	127	257	688	980
Total	820	–5,346	–9,046	–6,961	–8,674	–8,314	–37,521
Total, 2005 and 2006	....	–4,526	....	....	....	....	....

[1] Affects both receipts and outlays. Only the outlay effect is shown here.

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, the series of hurricanes that struck Florida this fall, 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."

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 used 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.

This definition codifies the criteria for an emergency that have been the standard for a number of years. It is designed to preclude funds from being declared an emergency for events that occur on an annual or recurring basis. For example, even though it is not possible to predict the specific occurrence of fires, tornados, hurricanes, and other domestic disasters, it is reasonable to assume that a combination of domestic disasters will occur in any given year that require funding equal to the five-year average for disaster relief. Funding at this five-year average, therefore, should not be considered an emergency under this definition. On the other hand, the five-year average for domestic disasters will not accommodate the level of funding necessary to address a large and relatively infrequent domestic disaster, like the series of hurricanes that struck Florida this past fall. Under this definition for emergencies, spending for extraordinary events could be classified as emergency funding. In the end, classification of certain spending as an emergency depends on common sense judgment, made on a case-by-case basis, about whether the totality of facts and circumstances indicate a true emergency.

In addition, the Administration proposes that the definition of an emergency requirement also encompass contingency operations that are national security related. Contingency operations that are national security related include both defense operations and foreign assistance. Military operations and foreign aid with costs that are incurred regularly should be a part of base funding and, as such, are not covered under this definition.

The Administration proposal also would 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:

- 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. This proposal is consistent with the BEA baseline rules for expiring mandatory spending and for excise taxes dedicated to a trust fund. Except for a few relatively small mandatory programs, the BEA assumes that mandatory spending and excise taxes dedicated to a trust fund will be reauthorized and extends them in the baseline. The 2001 Act and 2003 Act provisions were not intended to be temporary, and not extending them in the baseline raises inappropriate procedural road blocks to extending them at current rates.
- 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 estimates 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.
- 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. These programs should not be singled out for preferential treatment.

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 13 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.

Congress has already acted to require a more comprehensive review of the Medicare program's finances and to require the Medicare trustees to issue a warning when general revenue Medicare funding is projected to exceed 45 percent of Medicare's total expenditures. The Budget proposes to build on this reform by establishing a new enforcement measure to analyze the long-term impact of legislation on the unfunded obligations of major entitlement programs and to make it more difficult to enact legislation that would expand the unfunded obligations of these programs over the long-run. These measures would highlight proposed legislative changes that appear to cost little in the short run but result in large increases in the spending burdens passed on to future generations.

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.

Line-Item Veto

A perennial criticism of the Federal Government is that spending and tax legislation contain too many provisions benefiting a relative few which would likely not become law if considered as a stand-alone bill. The persistence of special interest items diverts resources from higher priority programs and erodes the confidence of citizens in Government. Appropriations bills, especially those considered at the end of the congressional session, often attract special interest spending items that could not be enacted on their own.

The President proposes that Congress correct this state of affairs by providing him and future Presidents with a line item veto that would withstand constitutional challenge. From the Nation's founding, Presidents have exercised the authority to not spend appropriated sums. However, Congress sought to curtail this authority in 1974 through the Impoundment Control Act, which restricted the President's authority to decline to spend appropriated sums. Although the Line Item Veto Act of 1996 attempted to give the President the authority to cancel spending authority and special interest tax breaks, 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 defer new spending whenever the President determines the spending is not an essential Government priority. All savings from the line-item veto would be used for deficit reduction, and they could not be applied to augment other spending.

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 it would give the budget resolution the force of law.

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 fully address problems in Federal programs. The preoccupation with these annual appropriations bills frequently precludes review and action on authorization legislation and on the growing portion of the Budget that is permanently funded under entitlement laws. According to the Congressional Budget Office, the Congress has appropriated about $170 billion for fiscal year 2005 for programs and activities whose authorizations of appropriations have expired.

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.

Government Shutdown Prevention.—For 23 out of the past 24 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 usually 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 of an impasse over 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 the expectation is that 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 raised by Congress and others with the Administration's previous proposals.

The 2005 Budget included a very limited proposal that would require the Patent and Trademark Office (PTO), 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. Congress enacted this provision for 2005, and the 2006 Budget proposes that this PTO provision be made permanent. Similarly, the Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108–18) requires the Postal Service to cover the full accruing cost of post-retirement annuities for its CSRS employees. In addition, the 2006 Budget proposes to use the pension savings provided to the Postal Service by P.L. 108–18 that would otherwise be held in escrow in 2006 and beyond, to put the Postal Service on a path that fully funds its substantial retiree health benefits liabilities.

Results Commission/Sunset Commission.—The Federal government's ability to serve the American people is often hampered by poorly designed programs or uncoordinated, overlapping programs trying to achieve the same objective. Overlapping jurisdictions in the Executive Branch and Congress provide daunting hurdles to legislative remedies to the poor performance of duplicative programs. Because the potential for savings and productivity are great, the Administration is proposing two mechanisms for realizing the opportunity to improve performance and control cost in a systematic and expedited fashion.

The Administration plans to propose legislation that gives the President the authority to propose Results Commissions. These commissions would consider and revise Administration proposals to improve the performance of programs or agencies by restructuring or consolidating them. Congress would approve individual Results Commissions to address single program or policy areas where duplication and the overlapping jurisdictions of Executive Branch agencies or Congressional committees hinder reform. Proposals approved by the commission would then be approved by the President and considered by Congress under expedited procedures.

The Administration also proposes a Sunset Commission to provide a process by which programs undergo the regular scrutiny brought about by having to defend their existence. Programs would be reviewed according to a schedule enacted by Congress. The Commission would consider proposals to retain, restructure, or terminate programs. Programs would automatically terminate according to the schedule unless Congress took some action to reauthorize them.

Administrative Actions

Budget Discipline for Agency Administrative Actions.—A significant amount of Federal policy is made via administrative action, which can increase Federal spending, often on the order of tens of billions of dollars in entitlement programs such as Medicare or Medicaid. Although known costs are incorporated into the Budget baselines of various programs, agencies frequently launch unplanned for and costly proposals. Often, these costs are not reflected in the baseline, or are not accompanied by other actions that would pay for the proposed change. This results in increased spending and deficits.

Support for restoring a PAYGO requirement for mandatory spending is integral to the Administration's commitment to reducing the deficit and enforcing fiscal discipline. Toward that end, the Office of Management and Budget plans to establish an internal review process that requires agencies, when proposing substantial administrative decisions that increase mandatory spending, to propose other offsetting administration decisions that reduce mandatory spending.

FEDERAL BORROWING AND DEBT

16. FEDERAL BORROWING AND DEBT

Debt is the largest legally binding obligation of the Federal Government. At the end of 2004, the Government owed $4,296 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 $168 billion of interest on this debt.

Table 16–1. 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	57.4	43.2	7.6	1.3
1960	236.8	1,127.8	45.7	33.8	8.5	1.5
1965	260.8	1,161.6	38.0	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	36.4	22.3	16.2	3.7
1986	1,740.6	2,443.0	39.4	22.6	16.1	3.6
1987	1,889.8	2,584.8	40.7	22.3	16.0	3.5
1988	2,051.6	2,720.6	41.0	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	16.2	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	23.5	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	3,243.1	33.0	17.6	11.6	2.1
2002	3,540.4	3,395.8	34.1	17.6	8.9	1.7
2003	3,913.4	3,687.1	36.1	18.0	7.5	1.5
2004	4,295.5	3,968.2	37.2	18.3	7.3	1.5
2005 estimate	4,721.2	4,274.5	38.6	N/A	7.4	1.5
2006 estimate	5,120.8	4,547.4	39.7	N/A	8.6	1.7
2007 estimate	5,454.0	4,745.5	40.1	N/A	9.7	1.9
2008 estimate	5,726.7	4,880.0	39.9	N/A	10.4	2.0
2009 estimate	5,981.8	4,992.7	39.6	N/A	10.8	2.1
2010 estimate	6,211.5	5,078.1	39.1	N/A	11.0	2.1

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).

The budget shifted from surplus to deficit in 2002, and the deficit then grew sharply in 2003 and edged up a little more in 2004. The shift from a surplus to a large deficit in these years was primarily because of several shocks to the economy—which included the bursting of the stock market bubble, the terrorist attack of September 11th, and the recession—together with the additional spending in response to terrorism and several measures of tax relief that were designed to stimulate the economy in the near-term and increase long-term growth. As a result, the deficit is estimated to rise slightly more in 2005 before declining. Debt held by the public as a percentage of GDP has risen since 2001 and is estimated to peak at 40.1 percent in 2007 before starting to decline gradually.

Trends in Debt Since World War II

Table 16–1 depicts trends in Federal debt held by the public from World War II to the present and estimates from the present through 2010. (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 spending surged, but at a slower pace than earlier decades, and 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 at the beginning of the 1980s, due in large part to a deep recession, and the ratio of Federal debt to GDP grew very 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 33.0 percent in 2001; and it fell more unevenly from 26.8 percent of total credit market debt in 1994 to 17.6 percent in 2001 and 2002. 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 downward trend in debt relative to GDP ceased as economic conditions changed and the terrorist attacks occurred. The decline in the stock market, the recession, and the initially slow recovery all 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 16–1 shows a rise in debt held by the public throughout the projection period. The increase in debt, however, is estimated to slow down. Debt continues to rise by small amounts as a percentage of GDP in 2004 and 2005 and then is essentially stable, declining a little in the later years of the decade.

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

[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 16–3 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.

Table 16–2. Federal Government Financing and Debt

(In billions of dollars)

	Actual 2004	Estimate 2005	2006	2007	2008	2009	2010
Financing:							
Unified budget deficit (–)	–412.1	–426.6	–390.1	–312.1	–250.8	–232.9	–207.3
Financing other than the change in debt held by the public:							
Net purchases (–) of non-Federal securities by the National Railroad Retirement Investment Trust	–2.5	–0.9	0.7	0.5	0.3	0.5	0.5
Changes in: [1]							
Treasury operating cash balance	–1.4	1.3	....	....	....	....	....
Compensating balances [2]	22.2	....	....	....	....	....	....
Checks outstanding, etc. [3]	6.5	....	....	....	....	....	....
Seigniorage on coins	0.7	0.6	0.7	0.7	0.7	0.7	0.7
Less: Net financing disbursements:							
Direct loan financing accounts	–4.9	–9.1	–12.8	–20.0	–20.7	–20.1	–20.7
Guaranteed loan financing accounts	9.4	8.9	1.8	–2.3	–2.1	–3.2	–2.9
Total, financing other than the change in debt held by the public	30.0	0.9	–9.5	–21.1	–21.8	–22.2	–22.5
Total, requirement to borrow from the public	–382.1	–425.7	–399.6	–333.2	–272.6	–255.1	–229.8
Change in debt held by the public	382.1	425.7	399.6	333.2	272.6	255.1	229.8
Changes in Debt Subject to Limitation:							
Change in debt held by the public	382.1	425.7	399.6	333.2	272.6	255.1	229.8
Change in debt held by Government accounts	212.6	251.0	276.6	309.2	325.9	339.8	364.0
Change in other factors	1.1	–13.4	0.2	0.5	0.7	2.8	2.4
Total, change in debt subject to statutory limitation	595.8	663.3	676.4	643.0	599.2	597.7	596.1
Debt Subject to Statutory Limitation, End of Year:							
Debt issued by Treasury	7,327.8	8,005.1	8,681.5	9,324.5	9,923.7	10,519.4	11,113.8
Less: Treasury debt not subject to limitation (–) [4]	–0.5	–14.5	–14.5	–14.5	–14.5	–12.4	–10.8
Agency debt subject to limitation	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Adjustment for discount and premium [5]	5.8	5.8	5.8	5.8	5.8	5.8	5.8
Total, debt subject to statutory limitation [6]	7,333.4	7,996.6	8,673.0	9,316.0	9,915.3	10,512.9	11,109.1
Debt Outstanding, End of Year:							
Gross Federal debt: [7]							
Debt issued by Treasury	7,327.8	8,005.1	8,681.5	9,324.5	9,923.7	10,519.4	11,113.8
Debt issued by other agencies	26.8	26.3	26.1	25.6	24.9	24.2	23.5
Total, gross Federal debt	7,354.7	8,031.4	8,707.6	9,350.1	9,948.6	10,543.5	11,137.3
Held by:							
Debt held by Government accounts	3,059.1	3,310.2	3,586.8	3,896.1	4,222.0	4,561.8	4,925.8
Debt held by the public [8]	4,295.5	4,721.2	5,120.8	5,454.0	5,726.7	5,981.8	6,211.5

[1] A decrease in the Treasury operating cash balance or compensating balances (which are assets) is a means of financing a deficit and therefore has a positive sign. An increase in checks outstanding (which is a liability) is also a means of financing a deficit and therefore also has a positive sign.

[2] Compensating balances were non-interest bearing Treasury bank deposits that Treasury mainly used 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 decided. The use of compensating balances was discontinued in 2004, and the amounts were drawn down to zero.

[3] Besides checks outstanding, includes accrued interest payable on Treasury debt, uninvested deposit fund balances, allocations of special drawing rights, and other liability accounts; and, as an offset, cash and monetary assets (other than the Treasury operating cash balance and compensating balances), other asset accounts, and profit on sale of gold.

[4] Consists primarily of Federal Financing Bank debt after 2004.

[5] Consists mainly 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.

[6] The statutory debt limit is $8,184 billion.

[7] 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).

[8] At the end of 2004, the Federal Reserve Banks held $700.3 billion of Federal securities and the rest of the public held $3,595.2 billion. Debt held by the Federal Reserve Banks is not estimated for future years.

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 future 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]

[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

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 general fund to the fund that holds the securities and are a mechanism for crediting interest to that fund on its recorded 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 13 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, "The Nation's Fiscal Outlook," 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 13 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 16–2 summarizes Federal borrowing and debt from 2004 through 2010. In 2004 the Government borrowed $382 billion, so the debt held by the public increased to $4,296 billion. The debt held by Government accounts increased $213 billion, and gross Federal debt increased by $595 billion to $7,355 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 16–2 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 12 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 ex-

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 14 of this volume, "National Income and Product Accounts."

[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.

cluded 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 2004 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 16–2, 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 2004 the deficit was $412 billion and the "financing other than the change in debt held by the public" was $30 billion. As a result, the Government borrowed $382 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 public." Over the last 20 years, the cumulative deficit was $2,812 billion and the increase in debt held by the public was $2,989 billion. The other factors added a total of $177 billion of borrowing, an average of $9 billion per year.

In individual years it is also often a good approximation to say that the deficit and borrowing (or the surplus and debt repayment) are about the same. The variation, however, can be wide, ranging over the last 20 years from additional borrowing (or lower repayment) of $63 billion in 2002 to reduced borrowing of $30 billion in 2004. In 2004, as shown in table 16–2, $22 billion of the $30 billion difference was attributable to a one-time change in compensating balances. In 2003, on the other hand, the difference was only $5 billion, whereas in 2002 several factors were large and in combination accounted for $63 billion of the $221 billion increase in debt held by the public. 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. During 2004, however, the initial cash balance was at about the level that had been planned. The operating cash balance then ended at essentially the same amount—only $1 billion more. It is estimated to again be essentially the same at the end of 2005. 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 used compensating balances for many years 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 held DCS instead of other acceptable investments, and the Treasury balances were secured by the DCS. The cost of the services provided to Treasury was 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 paid 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

[5] For further explanation of the off-budget Federal entities, see chapter 23, "Off-Budget Federal Entities and Non-Budgetary Activities."

Check Clearing for the 21st Century Act (P.L. 108-100). A permanent indefinite appropriation was then included in the Consolidated Appropriation Act of 2004 (P.L. 108-199). Treasury replaced the DCS by direct payments in March 2004. The total compensating balances at the end of 2003 under both systems were $22 billion, so table 16–2 shows that they were 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 were relatively small in 2004 and are estimated to remain relatively small in future years.[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. Under this Act, 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 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 several types of intra-governmental transactions. In particular, they receive payment from the credit program accounts for the costs of new direct loans and loan guarantees; they also receive payment for any upward reestimate of the costs of direct loans and loan guarantees outstanding. 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. In 2004, on the other hand, a large upward reestimate was made in the cost of outstanding Federal Housing Administration (FHA) housing mortgages. The credit program account in the budget made a large outlay to the guaranteed loan financing account, which in turn had an equal offsetting collection and therefore a large negative net financing disbursement. The result is shown as a positive amount in table 16–2, canceling out the effect of a higher budget deficit on the Government's borrowing requirement. Large upward reestimates of guarantees are also estimated for 2005, after which the pattern is expected to be more normal. The financing accounts are estimated to require additional financing of $11 billion in 2006 and from $17 billion to $18 billion in each of the following four years. A major part of this financing 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 94 percent of the total Federal debt held by Government accounts at the end of 2004. In 2004, for example, the total trust fund surplus was $193 billion, and Government accounts invested $213 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. 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 16–4.

Agency Debt

Several Federal agencies, shown in table 16–3, sell debt securities to the public and at times in the past

[6] The budget treatment of this fund is further discussed in chapter 26, "The Budget System and Concepts."

[7] The Federal Credit Reform Act of 1990 (sec. 505(b)) requires that the financing accounts be non-budgetary. As explained in chapter 23, "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 26 of this volume, "The Budget System and Concepts," and the other references cited in chapter 23.

have sold securities to other Government accounts. During 2004, agencies repaid $0.4 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 2005 and 2006.

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 2004, or 97 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 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

[8] For an explanation of the monetary credits issued by the Federal Communications Commission (FCC), see chapter 26 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.

[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 26, "The Budget System and Concepts."

Table 16–3. AGENCY DEBT

(In millions of dollars)

	Borrowing or repayment (–) of debt			Debt end of 2006 estimate
	2004 actual	2005 estimate	2006 estimate	
Borrowing from the public:				
Housing and Urban Development:				
Federal Housing Administration	–79	*	....	200
Small Business Administration:				
Participation certificates: Section 505 development company	....	–*	....	7
Architect of the Capitol	–3	–3	–4	156
Farm Credit System Financial Assistance Corporation	....	–325	....	....
Federal Communications Commission	–56	*	....	....
National Archives	–8	–8	–10	225
Tennessee Valley Authority:				
Bonds and Notes	–1,623	–88	–10	23,155
Lease/leaseback obligations	–60	–35	–33	1,110
Prepayment obligations	1,424	–105	–106	1,260
Total, borrowing from the public	–405	–563	–163	26,113

* $500 thousand or less.

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 16–3 separately from TVA bonds and notes to distinguish between the types of borrowing. The obligations for lease/leasebacks were $1.2 billion at the end of 2004 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 also entered into a contract with Memphis Light, Gas, and Water (MLGW), under which that distributor prepaid $1.5 billion in 2004 for a large portion of its power needs over the next 15 years in return for a discount on that power. MLGW, in turn, financed its prepayment by selling tax-exempt bonds.

The Office of Management and Budget 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 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 16–3 separately from bonds and notes and lease/leaseback obligations to distinguish among the types of borrowing. The prepayment obligations increased from zero to $47 million during 2003 and to $1,471 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 TVA provides electric power under the contracts.

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.

Investment by trust funds and other Government accounts has risen greatly for many years. It was $213 billion in 2004, as shown in table 16–4, and is estimated to rise to $277 billion in 2006. The holdings of Federal securities by Government accounts are estimated to grow to $3,587 billion by the end of 2006, or 41 percent of the gross Federal debt. The percentage is estimated to rise gradually in the following years, as the trust funds and several major revolving funds and special 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 $486 billion during 2004-06, which is 66 percent of the total estimated investment by Government accounts. The two Medicare trust funds—Hospital Insurance and Supplementary Medical Insurance—account for another 7 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 2004-06. The military retirement trust fund and the special fund for uniformed services retiree health care account for another 12 percent. Altogether, the investment by Social Security, Medicare, and these three Federal employee retirement funds is almost as much as the total investment by Government accounts during this period. At the end of 2006, 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.

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 16–4 at par value less unamortized discount. The only two Government accounts that held zero-coupon bonds during the period of this table are the Nuclear Waste Disposal fund in the Department of Energy and the Pension Benefit Guaranty Corporation (PBGC). The total unamortized discount on zero-coupon bonds was $15.1 billion at the end of 2004.

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 16–4 it is shown as a separate item at the end of the table and not distributed by account. The amount was $1.4 billion at the end of 2004.

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 16–2 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. Most of the Treasury debt not subject to the general statutory limit was issued by the Federal Financing Bank (FFB). The FFB, which is within the Treasury Department, is authorized to have outstanding up to $15 billion of publicly issued debt. It issued $14 billion of securities to the Civil Service Retirement and Disability fund on November 15, 2004, in exchange for an equal amount of regular Treasury securities, as explained below in the section on changes in the debt limit. The FFB securities have the same interest rates and maturities as the regular Treasury securities for which they were exchanged. The first maturity date is June 30, 2009, nearly five year after issuance; the final maturity date is June 30, 2019. The securities are expected to remain outstanding until they mature, and this assumption is reflected in tables 16–2 and 16–5. The other Treasury debt not subject to the general limit consists almost entirely of silver certificates and other currencies no longer being issued. It was $513 million at the end of 2004 and gradually declines over time.

The sole type of agency debt currently subject to the general limit is the debentures issued by the Federal Housing Administration, which were $200 million at the end of 2004.[10] 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 bonds and notes 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 7 to table 16–2 (and footnote 4 of table 16–5). The amount is relatively small: $5.8 billion at the end of 2004 compared to the total unamortized discount (less premium) of $51.2 billion on all Treasury securities.

[10] For purposes of the debt limit, the FHA debt was calculated to be $184 million.

Table 16–4. DEBT HELD BY GOVERNMENT ACCOUNTS [1]

(In millions of dollars)

Description	Investment or Disinvestment (–)			Holdings end of 2006 estimate
	2004 actual	2005 estimate	2006 estimate	
Investment in Treasury debt:				
Energy:				
Nuclear waste disposal fund [1]	1,894	957	....	17,043
Uranium enrichment decontamination fund	247	453	270	4,380
Health and Human Services:				
Federal hospital insurance trust fund	13,068	9,809	17,583	291,767
Federal supplementary medical insurance trust fund	–7,410	1,164	14,868	33,471
Vaccine Injury compensation fund	118	148	166	2,329
Housing and Urban Development:				
Federal Housing Administration mutual mortgage fund	–499	4,400	2,603	30,324
Other HUD	321	345	308	8,219
Interior:Abandoned Mine Reclamation fund	118	3	....	2,048
Labor:				
Unemployment trust fund	–2,949	827	....	46,066
Pension Benefit Guaranty Corporation [1]	264	514	299	13,293
State:Foreign Service retirement and disability trust fund	538	582	96	13,506
Transportation:				
Highway trust fund	–3,366	2,980	450	13,642
Airport and airway trust fund	–626	–35	–629	9,228
Homeland Security:				
Oil spill liability trust fund	–126	–132	–187	510
Aquatic resources trust fund	34	–144	....	1,306
Treasury:Exchange stabilization fund	–184	394	....	10,713
Veterans Affairs:				
National service life insurance trust fund	–298	–395	–476	10,078
Other trust funds	37	16	12	2,033
Federal funds	–24	–25	–33	415
Other Defense-Civil:				
Uniformed Services Retiree Health Care Fund	17,418	22,209	23,626	81,699
Military retirement trust fund	4,918	10,319	8,370	195,969
Harbor maintenance trust fund	295	–404	....	1,833
Environmental Protection Agency:				
Hazardous substance trust fund	–281	143	150	2,520
Leaking underground storage tank trust fund	195	203	....	2,436
International Assistance Programs:				
Overseas Private Investment Corporation	137	166	....	3,961
Office of Personnel Management:				
Civil Service retirement and disability trust fund	30,151	31,941	31,290	695,091
Employees life insurance fund	1,329	1,280	1,319	30,706
Employees health benefits fund	1,737	1,316	1,344	13,434
Social Security Administration:				
Federal old-age and survivors insurance trust fund [2]	139,172	151,016	164,948	1,768,563
Federal disability insurance trust fund [2]	12,007	9,982	8,979	201,760
Farm Credit System Insurance Corporation:				
Farm Credit System Insurance fund	205	–92	....	1,924
Federal Deposit Insurance Corporation:				
Bank Insurance fund	1,035	1,276	37	33,402
FSLIC Resolution fund	50	297	....	3,310
Savings Association Insurance fund	430	625	340	12,817
National Credit Union Administration:Share insurance fund	352	441	409	6,909
Postal Service fund [2]	–1,368	–1	....	1,282
Railroad Retirement Board trust funds [1]	–555	–212	490	2,042
Other Federal funds [3]	4,584	454	11	13,874
Other trust funds [3]	–384	–1,790	2	4,381
Unrealized discount, [3]	–28	*	....	–1,477
Total, investment in Treasury debt [1]	**212,559**	**251,032**	**276,645**	**3,586,806**

Table 16–4. DEBT HELD BY GOVERNMENT ACCOUNTS [1]—Continued

(In millions of dollars)

Description	Investment or Disinvestment (–) 2004 actual	2005 estimate	2006 estimate	Holdings end of 2006 estimate
Total, investment in Federal debt [1]	**212,559**	**251,032**	**276,645**	**3,586,806**
MEMORANDUM				
Investment by Federal funds (on-budget)	26,350	32,417	27,870	244,331
Investment by Federal funds (off-budget)	–1,368	–*	....	1,282
Investment by trust funds (on-budget)	36,426	57,617	74,848	1,372,348
Investment by trust funds (off-budget)	151,178	160,998	173,927	1,970,323
Unrealized discount [1]	–28	*	....	–1,477

* $500 thousand or less.

[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 and the Pension Benefit Guaranty Corporation (PBGC), 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 $14.4 billion higher than recorded in this table at the end of 2004; the debt held by PBGC would be $0.7 billion higher.

[2] Off-budget Federal entity.

[3] Retroactive adjustments were made as of the end of 2003. The debt held by the Telecommunications Development Fund is not recorded as Federal debt ($32 million); the debt held by the Railroad Retirement Board trust funds is increased by $2 million; and the absolute value of the unrealized discount is decreased by $193 million.

Changes in the debt limit.—The statutory debt limit has been changed many times. Since 1960, Congress has passed 71 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. During the 1990s, however, the debt limit was 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.[11]

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 process was repeated within less than one year. The debt reached the limit in February 2003, the Treasury Department again responded with various administrative actions, and on May 27, 2003, the President signed a bill that raised the limit to $7,384 billion.

This limit did not last much longer than the previous limit. By August 2004, the Secretary of Treasury wrote Congress that the debt subject to limit might reach the ceiling in September or October 2004. It did reach the limit on October 14 and stayed there until the limit was increased.

Treasury took a number of administrative steps to meet the Government's obligation to pay its bills and invest its trust funds while keeping debt under the statutory limit. On October 14, 2004, the Secretary of Treasury declared that he would not be able to fully invest the Government Securities Investment Fund (G-fund) as of that day. 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 forgone interest and investing the fund fully. Starting on October 14, 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. That amount was invested, and no more. The balances not invested varied throughout the period. In addition to this step, Treasury discontinued the acceptance of subscriptions to the state and local government series of securities.

As the need for financing grew, Treasury took further steps. On November 15, the Federal Financing Bank (FFB) issued $14 billion of FFB securities to the Civil Service Retirement and Disability fund in exchange for an equal amount of regular Treasury securities, which FFB then exchanged with Treasury at market value in return for the extinguishment of an equal market value of FFB debt owed to Treasury. The FFB securities are not subject to the debt limit, as explained above, whereas the regular Treasury securities are subject to the limit. The Secretary also declared a debt issuance suspension period from November 17 to December 2. This allowed him to redeem a limited amount of securities held by the Civil Service Retirement and Disability fund and stop investing its receipts. Treasury disinvested part of the Exchange Stabilization fund for one day. Treasury also delayed the announcement of auctions of marketable securities.

[11] The Acts and the statutory limits since 1940 are listed in *Historical Tables, Budget of the United States Government*, table 7.3.

All the steps taken during October and November had also been taken on previous occasions when the debt had reached the statutory limit, including 2002 or 2003. When the debt limit was reached in those years, Treasury also reduced its compensating balances held in banks to pay for services under financial agency agreements. However, compensating balances were discontinued in 2004, as explained in a previous section.

Table 16–5. FEDERAL FUNDS FINANCING AND CHANGE IN DEBT SUBJECT TO STATUTORY LIMIT

(In billions of dollars)

Description	Actual 2004	Estimate					
		2005	2006	2007	2008	2009	2010
Federal funds deficit (–)	–604.8	–653.0	–657.0	–583.5	–537.4	–530.7	–526.4
Means of financing other than borrowing:							
Change in: [1]							
Treasury operating cash balances	–1.4	1.3	....	....	....	....	....
Compensating balances [2]	22.2	....	....	....	....	....	....
Checks outstanding, etc [3]	9.1	6.9	18.9	0.5	0.3	0.5	0.5
Seignorage on coins	0.7	0.6	0.7	0.7	0.7	0.7	0.7
Less: Net financing disbursements:							
Direct loan financing accounts	–4.9	–9.1	–12.8	–20.0	–20.7	–20.1	–20.7
Guaranteed loan financing accounts	9.4	8.9	1.8	–2.3	–2.1	–3.2	–2.9
Total, means of financing other than borrowing	35.1	8.7	8.6	–21.1	–21.8	–22.2	–22.5
Decrease or increase (–) in Federal debt held by Federal funds	–25.0	–32.4	–27.9	–37.9	–39.3	–42.0	–44.9
Increase or decrease (–) in Federal debt not subject to limit	–0.3	13.4	–0.2	–0.5	–0.7	–2.8	–2.4
Total, requirement for Federal funds borrowing subject to debt limit	595.0	663.3	676.4	643.0	599.2	597.7	596.1
Change in discount and premium [4]	0.7	....	....	....	....	....	....
Change in unrealized discount [5]	–*	....	....	....	....	....	....
Increase in debt subject to limit	595.7	663.3	676.4	643.0	599.2	597.7	596.1
ADDENDUM							
Debt subject to statutory limit [6]	7,333.4	7,996.6	8,673.0	9,316.0	9,915.3	10,512.9	11,109.1

* $50 million or less

[1] A decrease in the Treasury operating cash balance or compensating balances (which are assets) is a means of financing the deficit and therefore has a positive sign. An increase in checks outstanding (which is a liability) is also a means of financing the deficit and therefore also has a positive sign.

[2] Compensating balances were non-interest bearing Treasury bank deposits that Treasury mainly used 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 decided. The use of compensating balances was discontinued in 2004 and the amounts were drawn down to zero.

[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. The unrealized discount is for Government account series securities.

[6] The statutory debt limit is $8,184 billion.

These Treasury actions were used for a little more than one month. Congress passed a bill raising the debt limit to $8,184 billion on November 18, and the President signed the bill on November 19. Treasury promptly invested the G-fund and Civil Service Retirement and Disability fund fully and restored the forgone interest as prescribed by law. The securities whose auctions were postponed were issued on time, except for one issue of 4-week bills that was delayed a few days, and subscriptions to the state and local government series were accepted again.

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, 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 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, although 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 16–2, 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 16–2. 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 2005 through 2010.

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.[12]

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 16–5 derives the change in debt subject to limit. In 2004 the Federal funds deficit was $605 billion, and other factors reduced the requirement to borrow subject to limit by $9 billion. The largest of these factors was ending the use of compensating balances, which allowed borrowing to be reduced by $22 billion. The net financing disbursements of the guaranteed loan financing accounts reduced the financing requirements by $9 billion, as explained in an earlier section. As an offset, special funds and revolving funds, which are part of the Federal funds group, invested $25 billion in Treasury securities. The largest single investment was $17 billion for the uniformed services retiree health care fund. As a net result of all these factors, debt subject to limit increased by $596 billion, while debt held by the public increased by $382 billion.

The debt subject to limit is estimated to increase to $7,997 billion by the end of 2005, which begins to approach the present statutory debt limit of $8,184 billion. This is caused by a rise in the Federal funds deficit, supplemented by the other factors shown in table 16–5. 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 $1,916 billion from the end of 2004 through 2010, debt subject to limit increases by $3,776 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 16–6, 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 2004 foreign holdings of Treasury debt were $1,886 billion, which was 44 percent of the total debt held by the public.[13] Foreign central banks owned 64 percent of the Federal debt held by foreign residents; private investors owned nearly all the rest. The percentage held by foreign central banks is up from 56 percent at the end of 2003, because they bought much greater quantities of Treasury securities than did private investors. All the Federal debt held by foreign residents is denominated in dollars.

Although the amount of Federal debt held by foreign residents has grown greatly over this period, the proportion that foreign residents own, after increasing abruptly in the very early 1970s, remained about 15-20 percent 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.[14] 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 the next few years the change in foreign debt holdings was much smaller. However, the Federal debt held by foreign residents increased by $255 billion in 2003 and by $430 billion in 2004.

[12] For further discussion of the trust funds and Federal funds groups, see chapter 22, "Trust Funds and Federal Funds."

[13] The debt calculated by the Bureau of Economic Analysis, Department of Commerce, is different, though similar in size, because of a different method of valuing the securities.

[14] Table 16–6 does not show the increase in foreign holdings in 1995 because of a benchmark revision. As explained in footnote 3 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.

The percentage of Federal debt held by foreign residents increased from 34 percent to 44 percent during these two years. In 2004, the increase in foreign holdings was more than the total Federal borrowing from the public.

Table 16–6. 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	1,200.8	33.9	220.8	N/A
2003	3,913.4	1,455.8	37.2	373.0	255.0
2004	4,295.5	1,885.9	43.9	382.1	430.2

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.

Foreign holdings of Federal debt are around 15 percent of the foreign-owned assets in the United States, 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 of this volume, "Credit and Insurance." Detailed data are presented in tables at the end of that chapter.

FEDERAL RECEIPTS AND COLLECTIONS

17. 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 2006 are estimated to be $2,177.6 billion, an increase of $124.7 billion or 6.1 percent relative to 2005. Receipts are projected to grow at an average annual rate of 6.7 percent between 2006 and 2010, rising to $2,820.9 billion. This growth in receipts is largely due to assumed increases in incomes resulting from both real economic growth and inflation.

As a share of GDP, receipts are projected to increase from 16.8 percent in 2005 to 16.9 percent in 2006. The receipts share of GDP is projected to increase annually thereafter, rising to 17.7 percent in 2010.

Table 17–1. RECEIPTS BY SOURCE—SUMMARY

(in billions of dollars)

	2004 Actual	Estimate					
		2005	2006	2007	2008	2009	2010
Individual income taxes	809.0	893.7	966.9	1,071.2	1,167.2	1,245.1	1,353.3
Corporation income taxes	189.4	226.5	220.3	229.8	243.4	252.4	257.6
Social insurance and retirement receipts	733.4	773.7	818.8	866.2	911.7	959.1	1,016.2
(On-budget)	(198.7)	(212.4)	(225.6)	(237.0)	(247.2)	(258.4)	(273.0)
(Off-budget)	(534.7)	(561.4)	(593.2)	(629.2)	(664.6)	(700.7)	(743.2)
Excise taxes	69.9	74.0	75.6	77.2	79.0	81.0	82.9
Estate and gift taxes	24.8	23.8	26.1	23.5	24.3	26.0	20.1
Customs duties	21.1	24.7	28.3	30.6	31.9	33.9	35.3
Miscellaneous receipts	32.6	36.4	41.6	45.6	49.5	52.6	55.4
Total receipts	**1,880.1**	**2,052.8**	**2,177.6**	**2,344.2**	**2,507.0**	**2,650.0**	**2,820.9**
(On-budget)	(1,345.3)	(1,491.5)	(1,584.4)	(1,715.0)	(1,842.4)	(1,949.3)	(2,077.7)
(Off-budget)	(534.7)	(561.4)	(593.2)	(629.2)	(664.6)	(700.7)	(743.2)
Total receipts as a percentage of GDP	16.3	16.8	16.9	17.2	17.5	17.5	17.7

Table 17–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2006	2007	2008	2009	2010
Social security (OASDI) taxable earnings base increases:					
$90,000 to $93,000 on Jan. 1, 2006	1.4	3.8	4.2	4.8	5.4
$93,000 to $97,200 on Jan. 1, 2007	....	2.0	5.4	6.1	6.9
$97,200 to $101,400 on Jan. 1, 2008	....	....	2.1	5.5	6.3
$101,400 to $106,200 on Jan. 1, 2009	....	....	....	2.4	6.5
$106,200 to $111,300 on Jan. 1, 2010	....	....	....	....	2.6

ENACTED LEGISLATION

Several laws were enacted in 2004 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

WORKING FAMILIES TAX RELIEF ACT OF 2004

The Working Families Tax Relief Act of 2004 (2004 tax relief act), which was signed by President Bush on October 4, 2004, was the fourth major tax measure enacted during this Administration. In addition to extending key parts of the President's tax relief plan for working families, which were scheduled to expire at the end of 2004, this Act provided tax relief to certain military personnel with families, created a uniform definition of a qualifying child for tax purposes, and reinstated a number of expired or expiring business-related tax incentives. The major provisions of this 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 and 2003 tax cuts) on various provisions of the tax code is shown in Chart 17–1.

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003 and 2004 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	Top of bracket 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 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 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 $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 17–1. Major Provisions of the Tax Code Under the 2001, 2003 and 2004 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 Includes 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 capital gains reduced to 5/15 percent					Tax on capital gains eliminated for taxpayers in 10/15 percent tax brackets	Tax rate on capital 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					

Tax Relief for Families

Extend accelerated expansion of the 10-percent individual income tax rate bracket.—The Economic Growth and Tax Relief Reconciliation Act (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). The 2001 tax cut provided for annual inflation adjustments to the width of the 10-percent tax rate bracket, effective for taxable years beginning after December 31, 2008. The Jobs and Growth Tax Relief Reconciliation Act (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 were scheduled to revert to the levels provided under the 2001 tax cut. The 2003 jobs and growth tax cut also provided for annual inflation adjustments to the width of the 10-percent tax rate bracket for taxable years beginning in 2004. The 2004 tax relief act extended the expansions of the 10-percent tax rate bracket provided under the 2003 jobs and growth tax cut through taxable year 2007 and provided for continued annual inflation adjustments to the width of 10-percent tax rate bracket for taxable years beginning after 2004. As provided under the 2001 tax cut, the 10-percent tax rate bracket will remain in effect for taxable years 2008 through 2010, and will be eliminated for taxable years beginning after December 31, 2010.

Extend accelerated 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 was scheduled to revert to the levels provided under the 2001 tax cut. The 2004 tax relief act extended the expanded standard deduction for married taxpayers filing a joint return provided under the 2003 jobs and growth tax cut to apply to taxable years 2005 through 2008. As provided under the 2001 tax cut, the standard deduction for married taxpayers filing a joint return will remain at 200 percent of the standard deduction for single taxpayers in 2009 and 2010, but will decline to 167 percent of the standard deduction for single taxpayers, effective for taxable years beginning after December 31, 2010.

Extend accelerated 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 was scheduled to revert to the levels provided under the 2001 tax cut. The 2004 tax relief act extended the expanded 15-percent tax rate bracket for married taxpayers filing a joint return provided under the 2003 jobs and growth tax cut through taxable year 2007. As 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 remain at twice the corresponding tax rate bracket for single taxpayers in 2008, 2009, and 2010, but will decline to 167 percent of the corresponding amount for single taxpayers, effective for taxable years beginning after December 31, 2010.

Extend accelerated 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 was scheduled to revert to the levels provided under the 2001 tax cut. The 2004 tax relief act extended the increased credit of $1,000 per child for five years, for taxable years 2005 through 2009. As provided under the 2001 tax cut, the credit will be $1,000 per child for taxable year 2010, but will decline to $500 for taxable years beginning after December 31, 2010.

Accelerate increase in refundability of child tax credit.—Prior to enactment of the 2001 tax cut, taxpayers with three or more qualifying children could be eligible for a refundable additional child tax credit if they had social security taxes, even if they had little or no individual income tax liability. However, taxpayers with one or two children were not eligible for the refundable additional child tax credit. The 2001 tax cut extended eligibility for the refundable credit to taxpayers with one or two children. Under the 2001 tax cut, the additional child tax credit was refundable to the extent of 10 percent of the taxpayer's earned income in excess of $10,000 for taxable years 2001 through 2004; the percentage was scheduled to increase to 15 percent for taxable years 2005 through 2010. The $10,000 income threshold was indexed for inflation beginning in 2002. The 2004 tax relief act accelerated to 2004 the increase in refundability to 15 percent that had been scheduled for 2005 under prior law.

Tax Relief for Military Families

Modify treatment of combat pay for purposes of computing the child tax credit and earned income tax crcdit (EITC).—Compensation received by an active member of the Armed Forces for service in a combat zone or while hospitalized as a result of wounds, disease, or injury incurred while serving in a combat zone is not included in gross income for tax purposes. The 2004 tax relief act provided that combat pay otherwise excluded from gross income is treated as earned income for purposes of calculating the refundable portion of the child credit, effective for taxable years beginning after December 31, 2003. The 2004 tax relief act also provided that a taxpayer could elect to treat combat pay otherwise excluded from gross income as earned income for purposes of the EITC, effective for taxable years ending after October 4, 2004 and before January 1, 2006.

Alternative Minimum Tax (AMT) Relief for Individuals

***Extend 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 excess. The AMT exemption amounts, as provided under the 2003 jobs and growth tax cut, were: (1) $58,000 for married taxpayers filing a joint return and surviving spouses for taxable years 2003 and 2004, declining in 2005 to $45,000; (2) $40,250 for single taxpayers for taxable years 2003 and 2004, declining in 2005 to $33,750; and (3) $29,000 for married taxpayers filing a separate return and estates and trusts, for taxable years 2003 and 2004, declining in 2005 to $22,500. 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. The 2004 tax relief act extended for one year, through taxable year 2005, the exemption amounts provided under the 2003 jobs and growth tax cut for taxable years 2003 and 2004. Effective for taxable years beginning after December 31, 2005, 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.

***Extend ability to offset the AMT with nonrefundable personal credits*.**—A temporary provision of prior law permitted nonrefundable personal tax credits to offset both the regular tax and the alternative minimum tax for taxable years beginning before January 1, 2004. The 2004 tax relief act extended minimum tax relief for nonrefundable personal credits for two years, to apply to taxable years 2004 and 2005. The extension did not apply to the child credit, the saver credit, or the adoption credit, which were provided AMT relief through December 31, 2010 under the 2001 tax cut.

Tax Simplification

***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 EITC. Under prior law, each provision defined an eligible "child" differently, thereby requiring taxpayers to wade through pages of bewildering rules and instructions, resulting in confusion and error. Under the 2004 tax relief act, effective for taxable years beginning after December 31, 2004, a qualifying child must meet the following three tests: (1) Relationship—The child must be the taxpayer's biological or adopted child, stepchild, sibling, step-sibling, foster child, or a descendant of one of these individuals. (2) Residence—The child must live with the taxpayer in the same principal home in the United States for more than half of the taxable year. (3) Age—The child must be under age 19 (under age 24 in the case of a full-time student), or totally and permanently disabled. However, prior-law requirements that a child be under age 13 for the dependent care credit and under age 17 for the child tax credit, were maintained. Neither the support nor gross income tests of prior law apply to qualifying children who meet these three tests. In addition, taxpayers are no longer required to meet a household maintenance test when claiming the child and dependent care tax credit. Taxpayers generally can continue to claim individuals who do not meet the relationship, residency, or age tests as dependents if they meet the dependency requirements under prior law, and no other taxpayer is eligible to claim the same individual as a qualifying child. A tie-breaking rule applies if a child would be a qualifying child with respect to more than one individual and if more than one individual claims a benefit with respect to that child.

Expiring Provisions

***Extend the research and experimentation (R&E) tax credit*.**—The 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit expired with respect to expenditures incurred after June 30, 2004. The 2004 tax relief act extended these credits for eighteen months, to apply to expenditures incurred before January 1, 2006.

***Extend the work opportunity tax credit*.**—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. Under prior law, the credit was available for qualified individuals who began work before January 1, 2004. The 2004 tax relief act extended the credit for two years, to apply to qualified individuals beginning work after December 31, 2003 and before January 1, 2006.

***Extend the welfare-to-work tax credit*.**—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. The 2004 tax relief act extended this credit for two years, to apply to qualified individuals who begin work after December 31, 2003 and before January 1, 2006. Under prior law the credit was available with respect to qualified individuals beginning work before January 1, 2004.

Extend tax incentives for employment and investment on Indian reservations.—The 2004 tax relief act extended for one year, through December 31, 2005, the employment tax credit for qualified workers employed on an Indian reservation and the accelerated depreciation rules for qualified property used in the active conduct of a trade or business within an Indian reservation. The employment tax credit is not available for employees involved in certain gaming activities or who work in a building that houses certain gaming activities. Similarly, property used to conduct or house certain gaming activities is not eligible for the accelerated depreciation recovery periods.

Extend authority to issue Qualified Zone Academy Bonds.—State and local governments are allowed 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. Under prior law, 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 could be carried forward for up to three years and unused authority arising in 2000 through 2003 could be carried forward for up to two years. The 2004 tax relief act authorized the issuance of an additional $400 million of qualified zone academy bonds in each of calendar years 2004 and 2005; unused authority can be carried forward for up to two years.

Extend authority to issue Liberty Zone Bonds.—The Job Creation and Worker Assistance Act (2002 economic stimulus act) 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, was extended through calendar year 2009 under the 2004 tax relief act. The 2004 tax relief act also extended for one year, through December 31, 2005, an expired provision that allowed certain bonds used to finance projects in New York City to be eligible for one additional advance refunding.

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. Under prior law, the DC Zone incentives were in effect for the period from January 1, 1998 through December 31, 2003. The 2004 tax relief act extended the DC Zone incentives for two years, 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). Under prior law, the credit did not apply to purchases after December 31, 2003. The credit was extended for two years under the 2004 tax relief act, making it available with respect to purchases after December 31, 2003 and before January 1, 2006.

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 contributions of computer technology and equipment to public libraries and to U.S. schools for educational purposes in grades K-12. The 2004 tax relief act extended the augmented deduction, which expired with respect to donations made after December 31, 2003, to apply to donations made before January 1, 2006.

Extend the above-the-line deduction for qualified out-of-pocket classroom expenses.—Teachers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses are allowed to deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceed two percent of adjusted gross income (AGI). Under prior law, certain teachers and other elementary and secondary school professionals were allowed 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 2004 tax relief act extended the above-the-line deduction for two years, to apply to qualified out-of-pocket expenditures incurred after December 31, 2003 and before January 1, 2006.

Extend Archer Medical Savings Accounts (MSAs).—Self-employed individuals and employees of small firms are allowed to establish Archer MSAs; the number of accounts is capped at 750,000. In addition to other requirements: (1) individuals who establish Archer MSAs must be covered by a high-deductible health plan (and no other plan) with a deductible of at least $1,750 but not greater than $2,650 for policies covering a single person and a deductible of at least $3,500 but not greater than $5,250 in all other cases (these amounts are indexed annually for inflation); (2) tax-preferred contributions are limited to 65 percent of the deductible for single policies and 75 percent of the deductible for other policies; and (3) either an individual or an employer, but not both, may make a tax-preferred contribution to an Archer MSA for a particular year. Under prior law, no new contributions could be made to an Archer MSA after December 31, 2003, except for the following: (1) those made by or on behalf of individuals who previously had Archer MSA contributions and (2) those made by individuals employed by a participating employer. The 2004 tax relief act extended the Archer MSA program for two years, thereby allowing new Archer MSAs through December 31, 2005.

Extend tax on failure to comply with mental health parity requirements applicable to group health plans.—Under prior law, group health plans that provided both medical and surgical benefits and mental health benefits, could not impose aggregate lifetime or annual dollar limits on mental health benefits that were not imposed on substantially all medical and surgical benefits. An excise tax of $100 per day for each individual affected (during the period of noncompliance) was imposed on an employer sponsoring a group plan that failed to meet these requirements. For a given taxable year, the tax was limited to the lesser of 10 percent of the employer's group health insurance expenses for the prior taxable year or $500,000. The mental health parity requirements expired with respect to benefits for services provided on or after December 31, 2004. The excise tax imposed on plans that failed to meet the requirements expired with respect to benefits for services provided after December 31, 2003. The 2004 tax relief act extended the mental health parity requirements to apply to benefits for services provided before January 1, 2006. The act also extended the excise tax, but only with respect to benefits for services provided after October 3, 2004 and before January 1, 2006. Therefore, the excise tax on failures to meet the mental health parity requirements did not apply to benefits for services provided after December 31, 2003 and before October 4, 2004.

Extend tax credit for the purchase of electric vehicles.—A 10-percent tax credit, up to a maximum of $4,000, is provided for the cost of a qualified electric vehicle. Under prior law, the full amount of the credit was available for purchases prior to January 1, 2004. The credit began to phase down in 2004 and was not available for purchases after December 31, 2006. The 2004 tax relief act extended the full amount of the credit for two years, making it available for purchases in 2004 and 2005. As provided under prior law, the credit is reduced by 75 percent for purchases in 2006 and is not available for purchases after December 31, 2006.

Extend deduction for qualified clean-fuel vehicles and qualified clean-fuel vehicle refueling property.—Under prior law, certain costs of acquiring clean-fuel vehicles (vehicles that use certain clean-burning fuels) and property used to store or dispense clean-burning fuels, could be expensed and deducted when the property was placed in service. For qualified clean-fuel vehicles, the maximum allowable deduction was $50,000 for a truck or van with a gross vehicle weight over 26,000 pounds, $5,000 for a van or truck with a gross weight between 10,000 and 26,000 pounds; and $2,000 in the case of any other motor vehicle. The full amount of the deduction could be claimed for vehicles placed in service before January 1, 2004, but began to phase down for vehicles placed in service after December 31, 2003, and was not available after December 31, 2006. The 2004 tax relief act extended the full amount of the deduction for two years, making it available for vehicles placed in service in 2004 and 2005. As provided under prior law, the deduction is reduced by 75 percent for vehicles placed in service in 2006 and is not available for vehicles placed in service after December 31, 2006.

Extend suspension of net income limitation on percentage depletion from marginal oil and gas wells.—Taxpayers are allowed to recover their investment in oil and gas wells through depletion deductions. For certain properties, deductions may be determined using the percentage depletion method; however, in any year, the amount deducted generally may not exceed 100 percent of the net income from the property. Under prior law, for taxable years beginning after December 31, 1997 and before January 1, 2004, domestic oil and gas production from "marginal" properties was exempt from the 100-percent-of-net-income limitation. The 2004 tax relief act extended the exemption to apply to taxable years beginning after December 31, 2003 and before January 1, 2006.

Extend tax credit for producing electricity from certain renewable 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, under prior law, had to be produced during the first 10 years of production at a facility placed in service before January 1, 2004. The 2004 tax relief act extended the credit for two years, to apply to electricity produced at facilities placed in service before January 1, 2006.

Extend expensing of brownfields remediation costs.—Taxpayers are allowed to elect to treat certain environmental remediation expenditures that would otherwise be chargeable to a capital account as deductible in the year paid or incurred. The 2004 tax relief act extended this provision, which expired with respect to expenditures paid or incurred after December 31, 2003, to apply to expenditures paid or incurred before January 1, 2006.

Extend provisions permitting disclosure of tax return information relating to terrorist activity.—Prior law permitted disclosure of tax return information relating to terrorism in two situations. The first was when an executive of a Federal law enforcement or intelligence agency had reason to believe that the return information was relevant to a terrorist incident, threat or activity and submitted a written request. The second was when the Internal Revenue Service (IRS) wished to apprise a Federal law enforcement agency of a terrorist incident, threat or activity. The 2004 tax relief act extended this disclosure authority, which expired on December 31, 2003, through December 31, 2005.

AMERICAN JOBS CREATION ACT OF 2004

The American Jobs Creation Act of 2004 (2004 jobs creation act) was signed by President Bush on October 22, 2004. This Act repealed the extraterritorial income exclusion of prior law, which had been declared a prohibited export subsidy by the World Trade Organization. This Act also provided a deduction against domestic manufacturing income, provided certain tax relief to U.S. businesses and industries, reformed and simplified the taxation of overseas operations of U.S. multinational firms, reformed the Federal tobacco subsidy program, provided a temporary itemized deduction for State and local general sales taxes, and included revenue-raising provisions. The major provisions of this Act that affect receipts are described below.

Extraterritorial Income

Repeal exclusion for extraterritorial income (ETI).—Under the ETI provisions of prior law, certain income attributable to foreign trading gross receipts was excluded from gross income for U.S. tax purposes. The 2004 jobs creation act repealed the ETI provisions, effective for transactions after December 31, 2004. Certain transitional tax rules apply to transactions occurring in 2005 and 2006, providing taxpayers with 80 percent and 60 percent, respectively, of the tax benefit that would have been otherwise allowable under the prior law ETI provisions. Moreover, the ETI provisions of prior law remain in effect for transactions in the ordinary course of a trade or business if such transactions are pursuant to a binding contract between the taxpayer and an unrelated person and the contract was in effect on September 17, 2003 and at all times thereafter.

Provide deduction for domestic manufacturing.—The 2004 jobs creation act provided a deduction equal to a portion of the taxpayer's qualified production activities income, phased in over six years. When fully effective for taxable years beginning after 2009, the deduction would be nine percent (three percent for taxable years 2005 and 2006 and six percent for taxable years 2007, 2008, and 2009) of the lesser of: (1) qualified production activities income for the taxable year; or (2) taxable income (determined without regard to the deduction) for the year. However, the deduction for a taxable year generally is limited to an amount equal to 50 percent of W–2 wages of the employer for the taxable year.

In general, qualified production activities income equals domestic production gross receipts in excess of: (1) the cost of goods sold that are allocable to such receipts; (2) other deductions, expenses, or losses directly allocable to such receipts; and (3) a proper share of other deductions, expenses, and losses that are not directly allocable to such receipts or another class of income. Domestic production gross receipts generally are gross receipts derived from: (1) any sale, lease, rental, license, exchange, or other disposition of (a) qualifying production property (generally any tangible personal property, computer software or sound recordings) manufactured, produced, grown, or extracted by the taxpayer in whole or in significant part within the United States; (b) any qualified film produced by the taxpayer (generally any motion picture film or videotape for which 50 percent or more of the total compensation relating to the production of such film is for specified services performed in the United States); and (c) electricity, natural gas, or potable water produced by the taxpayer in the United States; (2) construction activities performed in the United States; or (3) engineering or architectural services performed in the United States for construction projects in the United States. In general, domestic production gross receipts do not include any receipts derived from: (1) the sale of food or beverages prepared at a retail establishment; (2) the transmission or distribution of electricity, natural gas, or potable water; or (3) the leasing, licensing, or rental of property used by a related person.

Business Tax Incentives

Extend temporarily increased expensing for small businesses.—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 acquired by purchase for use in the active conduct of a trade or business. The amount that a taxpayer can 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 must be made on the taxpayer's original return for the taxable year to which the election relates, and can be revoked only with the consent of the IRS Commissioner. Effective for taxable years 2003 through 2005, the 2003 jobs and growth tax cut: (1) increased the maximum deduction to $100,000; (2) increased the annual investment limit to $400,000; (3) expanded the definition of qualifying property to include off-the-shelf computer software; and (4) allowed taxpayers to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner. The 2003 jobs and growth tax cut also provided for the indexation of the maximum deduction amount and investment limit, effective for taxable years beginning after 2003 and before 2006. The 2004 jobs creation act extended for two years, effective for taxable years 2006 and 2007, the changes provided in the 2003 jobs and growth tax cut.

Modify recovery period for depreciation of certain leasehold improvements.—A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system (MACRS). Under this system, depreciation is determined by applying specified recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property. Depreciation allowances for improvements made on leased property are determined under MACRS, even if the recovery period assigned to the property is longer than the term of the lease. Therefore, if the leasehold improvement constitutes an addition or improvement to nonresidential real property, the improvement is depreciated using the straight-line method over a 39-year recovery period, beginning at the midpoint of the month the addition or improvement was placed in service. The 2004 jobs creation act reduced the recovery period for qualified leasehold improvement property from 39 years to 15 years, effective for such property placed in service after October 22, 2004 and before January 1, 2006. For purposes of this provision, qualified leasehold improvement property is defined as any improvement to an interior portion of a building that is nonresidential real property: (1) made under or pursuant to a lease either by the lessee (or sublessee) or by the lessor of that portion of the building occupied exclusively by the lessee (or sublessee), and (2) placed in service more than three years after the date the building was first placed in service. Qualified leasehold improvement property does not include any improvement for which the expenditure is attributable to the enlargement of the building, any elevator or escalator, any structural component benefiting a common area, or the internal structural framework of the building.

Modify recovery period for depreciation of certain restaurant improvements.—Under MACRS, the cost of nonresidential real property is depreciated using the straight-line method over a 39-year recovery period. The 2004 jobs creation act reduced the recovery period for qualified restaurant property to 15 years, effective for such property placed in service after October 22, 2004 and before January 1, 2006. For purposes of this provision, qualified restaurant property is defined as any improvement to a building if (1) such improvement is placed in service more than three years after the date such building was first placed in service and (2) more than 50 percent of the building's square footage is devoted to the preparation of, and seating for on-premises consumption of, prepared meals.

Modify income forecast method of depreciation.—Under the income forecast method, a property's depreciation deduction for a taxable year is determined by multiplying the adjusted basis of the property (determined before adjustments for depreciation) by a fraction, the numerator of which is the income generated by the property during the year and the denominator of which is the total forecasted or estimated income expected to be generated prior to the close of the tenth taxable year after the year the property was placed in service. Any costs that are not recovered by the end of the tenth taxable year after the property was placed in service may be taken into account as depreciation in such year. The cost of certain motion picture films, sound recordings, copyrights, books, and patents are eligible to be recovered using the income forecast method. The 2004 jobs creation act stated that, solely for purposes of computing the allowable deduction for property under the income forecast method of depreciation, participations and residuals may be included in the adjusted basis of the property beginning in the year such property is placed in service, but only if such participations and residuals relate to income to be derived from the property before the close of the tenth taxable year following the year the property is placed in service. Participations and residuals are defined as costs the amount of which, by contract, varies with the amount of income earned in connection with such property. This act also stated that: (1) the amount of income from the property to be taken into account under the income forecast method is the gross income from such property (disregarding distribution costs), and (2) on a property-by-property basis, the taxpayer may deduct the costs of participations and residuals as they are paid, rather than accounting for them as a capitalized cost under the income forecast method. These changes were effective for property placed in service after October 22, 2004.

Reform and simplify taxation of S Corporations.—In general, S corporations do not pay Federal income tax. Instead, an S corporation passes through its items of income and loss to its shareholders. Each shareholder separately accounts for his or her share of these items on his or her individual income tax return. A small business corporation (except those designated ineligible under current law) may elect to be an S corporation with the consent of all its shareholders, and may terminate its election with the consent of shareholders holding more than 50 percent of the stock. Under prior law, a small business corporation was defined as a domestic corporation with only one class of stock and no more than 75 shareholders, all of whom were individuals (and certain trusts, estates, charities, and qualified retirement plans) and citizens or residents of the United States. For purposes of the 75 shareholder limitation, a husband and wife were treated as one shareholder. Ineligible small businesses included financial institutions using the reserve method of accounting for bad debts, insurance companies, corporations electing the benefits of the Puerto Rico and possessions tax credit, and Domestic International Sales Corporations (DISCs) or former DISCs. The 2004 jobs creation act contained a number of provisions, generally effective for taxable years beginning after December 31, 2004, that eased S corporation eligibility requirements and affected the tax treatment of some S corporation shareholders. Major changes: (1) increased the limitation on the number of shareholders from 75 to 100; (2) allowed all members of a family to be treated as one shareholder for purposes of the limitation on the number of shareholders; (3) allowed an individual retirement account (IRA) to be a shareholder of a bank S corporation, but only to the extent of stock held on October 22, 2004; (4) provided for the transfer of suspended losses when stock in an S corporation is transferred between spouses or as part of a divorce; and (5) required the filing of information returns by qualified subchapter S subsidiaries.

Repeal certain excise taxes on rail diesel fuel and inland waterway barge fuels.—Under prior law, diesel fuel used in trains and fuels used in barges operating on the designated inland waterways system were subject to a permanent 4.3-cents-per-gallon excise tax that was deposited in the General Fund of the Treasury. Under the 2004 jobs creation act, this tax declined to 3.3 cents per gallon on January 1, 2005, will decline to 2.3 cents per gallon on July 1, 2005, and will be repealed effective January 1, 2007.

Provide tax credit for railroad track maintenance.—The 2004 jobs creation act provided a 50-percent business tax credit for qualified expenditures incurred by eligible taxpayers for railroad track maintenance. The credit, which is effective for expenditures paid or incurred during taxable years beginning after December 31, 2004 and before January 1, 2008, is limited to the product of $3,500 times the number of miles of railroad track owned or leased by an eligible taxpayer as of the close of the taxable year. Qualified expenditures are amounts expended for maintaining railroad track (including roadbed, bridges, and related track structures) owned or leased as of January 1, 2005, by eligible taxpayers. Eligible taxpayers include: (1) certain types of railroads and (2) a person who transports property using the rail facilities of such railroads, or anyone who furnishes railroad-related property or services to such a person.

Suspend temporarily occupational taxes related to distilled spirits, wine and beer.—Special occupational taxes are imposed on producers and others engaged in the marketing of distilled spirits, wine, and beer. These taxes are payable annually, on July 1 of each year. Under the 2004 jobs creation act, these occupational taxes were suspended for the three-year period, July 1, 2005 through June 30, 2008.

Tax Relief for Agriculture and Small Manufacturers

Restructure incentives for alcohol-blended fuels.—Under prior law an income tax credit and an excise tax exemption were provided for ethanol and renewable source methanol used as a fuel. In general, the income tax credit for ethanol was 52 cents per gallon, but small ethanol producers (those producing less than 30 million gallons of ethanol per year) qualified 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 was allowed for renewable source methanol. As an alternative to the income tax credit, blenders of alcohol fuels could claim a gasoline tax exemption of 52 cents for each gallon of ethanol and 60 cents for each gallon of renewable source methanol blended into qualifying gasohol. The rates for the ethanol income tax credit and exemption were each reduced by 1 cent per gallon in 2005. The income tax credit was scheduled to expire on December 31, 2007 and the excise tax exemption was scheduled to expire on September 30, 2007. Neither the credit nor the exemption applied during any period in which motor fuel taxes dedicated to the Highway Trust Fund were limited to 4.3 cents per gallon.

Under prior law, 2.5 cents per gallon of the tax on alcohol-blended fuels was retained in the General Fund of the Treasury, 0.1 cent per gallon was deposited in the Leaking Underground Storage Tank (LUST) Trust Fund, and the balance of the reduced rate was deposited in the Highway Trust Fund.

The incentives for alcohol-blended fuels provided under prior law were restructured under the 2004 jobs creation act. The major changes provided in the act: (1) repealed the gasoline excise tax exemption for most alcohol-blended fuels, thereby levying the full amount of the gasoline excise tax on alcohol-blended fuels sold or used after December 31, 2004; (2) replaced the gasoline excise tax exemption for alcohol-blended fuels with two refundable excise tax credits (the alcohol fuel mixture credit and the biodiesel mixture credit), to be paid from the General Fund of the Treasury rather than from the Highway Trust Fund; (3) provided that the full amount of the excise tax on alcohol-blended fuels (except for the 0.1 cent per gallon deposited in the LUST Trust Fund) is deposited in the Highway Trust Fund, effective for fuels sold or used after September 30, 2004; (4) extended the prior law income tax credit for alcohol-blended fuels through December 31, 2010; and (5) provided a new income tax credit for biodiesel fuel and biodiesel fuel mixtures. The refundable alcohol fuel mixture excise tax credit, effective for fuels sold or used after December 31, 2004 and before January 1, 2011, is 51 cents for each gallon of ethanol (60 cents for each gallon of renewable source methanol) used by a taxpayer in producing an alcohol fuel mixture. The refundable biodiesel mixture excise tax credit, effective for fuels sold or used after December 31, 2004 and before January 1, 2007, is 50 cents for each gallon of biodiesel fuel ($1.00 for each gallon of agri-biodiesel fuel) used by a taxpayer in producing a qualified biodiesel fuel mixture. The income tax credit for biodiesel fuel and biodiesel fuel mixtures is effective for fuels sold or used after December 31, 2004 and before January 1, 2007, and is 50 cents for each gallon of biodiesel fuel ($1.00 for each gallon of agri-biodiesel fuel) that the taxpayer uses as fuel, sells at retail and places in the fuel supply tank of the customer's vehicle, or uses in producing a qualified biodiesel fuel mixture.

Provide tax incentives for agriculture.—The 2004 jobs creation act provided a number of tax incentives to taxpayers engaged in the agriculture business, which included: (1) special rules for the recognition of gain from the sale of livestock sold on account of drought, flood, or other weather-related conditions; (2) modifications allowing the small producer ethanol tax credit to be passed through to members of a cooperative; (3) extension of income averaging to taxpayers engaged in the trade or business of fishing; (4) AMT relief for farmers and fishermen using income averaging; and (5) expensing of up to $10,000 of qualified reforestation expenditures.

Provide tax incentives for small manufacturers.—The 2004 jobs creation act provided a number of tax incentives to small manufacturers, which included: (1) modification of the treatment of net income from publicly traded partnerships as qualifying income for regulated investment companies; (2) simplification of the excise tax imposed on bows and arrows (with further modifications provided in legislation modifying the taxation of arrows and bows signed by the President on December 23, 2004); (3) reduction of the excise tax imposed on fishing tackle boxes from ten percent to three percent; (4) repeal of the three-percent excise tax imposed on sonar devices suitable for finding fish; (5) extension of the placed in service date for bonus depreciation for certain aircraft; (6) expensing and credits allowed with respect to qualifying capital costs incurred by small business refiners in complying with the Highway Diesel Fuel Sulfur Control Requirements of the Environmental Protection Agency; and (7) modification of the qualified small issue bond capital expenditure limit.

Tax Reform and Simplification for U.S. Business

Modify foreign tax credit.—Subject to various limitations, U.S. taxpayers may credit foreign taxes paid or accrued against U.S. tax on foreign-source income. The 2004 jobs creation act made several changes to the foreign tax credit rules. The major changes included the following:

Modify foreign tax credit carryovers.—Under prior law, the amount of creditable taxes paid or accrued in any taxable year that exceeded the foreign tax credit limitation in that particular year was permitted to be carried back to the two immediately preceding taxable years and carried forward five taxable years and credited to the extent that the taxpayer otherwise had excess foreign tax credit limitation for those years. The 2004 jobs creation act extended the excess foreign tax credit carryforward period to ten years and limited the carryback period to one year. In general, the extended carryforward period is effective for excess foreign taxes that can be carried forward to any taxable year ending after October 22, 2004; the shortened carryback period is effective for excess foreign tax credits arising in taxable years beginning after October 22, 2004.

Modify interest expense allocation rules.—To determine taxable income for foreign tax credit limitation purposes, a taxpayer must allocate and apportion deductions between U.S.-source and foreign-source income. Interest expense of a U.S. affiliated group is allocated and apportioned between U.S.-source and foreign-source income based on the group's total U.S. and foreign assets. All members of a U.S.-affiliated group of corporations generally are treated as a single corporation and allocation of interest expense is made on the basis of the assets of such members, ignoring the debt and interest expense of foreign subsidiaries. The 2004 jobs creation act modified the interest allocation rules by providing a one-time election. Under the election, foreign-source income would be determined by allocating and apportioning interest expense in an amount equal to the excess (if any) of (1) the worldwide affiliated group's total interest expense multiplied by the ratio of foreign assets of the worldwide affiliated group to total assets, over (2) the interest expense of foreign members of the worldwide affiliated group. These changes in the interest expense allocation rules are effective for taxable years beginning after December 31, 2008.

Recharacterize overall domestic loss.—A taxpayer's losses from foreign sources in excess of income from foreign sources (an overall foreign loss, or OFL) may offsets U.S.-source taxable income, thereby reducing the effective tax rate on

U.S.-source income. To address this consequence, to the extent that an OFL offsets U.S.-source taxable income, foreign-source income in succeeding years must be recharacterized as U.S.-source income for foreign tax credit limitation purposes. This OFL recapture rule has the effect of reducing the foreign tax credit limitation in one or more years following an OFL year, thereby reducing the amount of U.S. tax that can be offset by the foreign tax credit in those years. Under prior law, there was no symmetrical treatment for overall domestic losses that offset foreign source income in a taxable year. The 2004 jobs creation act provided that to the extent U.S.-source losses offset foreign-source taxable income, U.S.-source income in succeeding years is recharacterized as foreign-source income for foreign tax credit limitation purposes in a manner similar to the OFL recapture rules. These changes with respect to overall domestic losses are effective for taxable years beginning after December 31, 2006.

Apply look-through approach to dividends paid by a 10/50 company.—Special rules apply in the case of dividends received from a foreign corporation in which the taxpayer owns at least 10 percent of the stock by vote and which is not a controlled foreign corporation (a “10/50 company”). Under prior law, dividends paid by a 10/50 company out of earnings and profits accumulated in taxable years after December 31, 2002 received “look-through” treatment based on the character of the underlying earnings. In contrast, dividends paid by a 10/50 company out of earnings and profits accumulated in taxable years before January 1, 2003 were subject to special basket rules. Effective for taxable years beginning after December 31, 2002, the 2004 jobs creation act generally applied the look-through approach to dividends paid by a 10/50 company, regardless of the year in which the earnings and profits out of which the dividends were paid were accumulated.

Consolidate foreign tax credit categories of income.—Under prior law, the foreign tax credit limitation rules were applied separately for nine statutory limitation categories or “baskets.” Effective for taxable years beginning after December 31, 2006, the 2004 jobs creation act generally reduced the number of foreign tax credit limitation categories from nine to two, with the foreign tax credit limitation rules applied separately to passive income and general income.

Provide AMT relief.—Taxpayers are permitted to reduce their AMT liability by an AMT foreign tax credit. Under prior law, the AMT foreign tax credit was limited to 90 percent of the pre-credit AMT. The 2004 jobs creation act repealed the 90-percent limitation on the use of the AMT foreign tax credit, effective for taxable years beginning after December 31, 2004.

Modify subpart F rules.—Subpart F rules require U.S. shareholders with a 10-percent or greater interest in a controlled foreign corporation (CFC) to currently include in income for U.S. tax purposes their pro-rata share of the subpart F income of the CFC, whether or not such income is currently distributed to the shareholders. The 2004 jobs creation act made changes to the subpart F rules, generally effective for taxable years beginning after December 31, 2004. Principal changes included the following: (1) The exceptions to the definition of U.S. property were expanded to include: (a) securities acquired and held by a CFC in the ordinary course of its trade or business as a dealer in securities and (b) obligations acquired by the CFC from a U.S. person who is not a domestic corporation and is not a U.S. shareholder of the CFC or a partnership, estate, or trust in which the CFC or any related person is a partner, beneficiary or trustee. (2) In general, the sale of a partnership interest by a CFC would be treated as a sale of a proportionate share of partnership assets attributable to such interest. (3) The requirements for gains or losses on commodities hedging transactions to be excluded from the definition of foreign personal holding company income were modified. (4) The temporary exceptions from foreign personal holding company income and foreign base company services income provided for active financing income were modified. (5) The subpart F rules relating to foreign base company shipping income were repealed, and a safe harbor was provided to treat certain rents derived from leasing an aircraft or vessel in foreign commerce as active income. (6) For purposes of the exception to the definition of U.S. property, “banking business” was defined. In addition, the anti-deferral rules applicable to foreign personal holding companies and to foreign investment companies were repealed; various other anti-deferral rules were consolidated and modified.

Provide incentive to reinvest foreign earnings in the United States.—Income from foreign operations conducted by foreign corporate subsidiaries generally is subject to U.S. tax when the income is distributed as a dividend to the domestic corporation. Until such repatriation, the U.S. tax on such income generally is deferred. Under the 2004 jobs creation act, certain dividends received by a U.S. corporation from controlled foreign corporations were provided an 85-percent dividends-received deduction. Various restrictions apply to determine whether dividends are eligible for the deduction, including a requirement that the funds be invested in the United States. At the taxpayer’s election, the deduction is available for dividends received either during the taxpayer’s first taxable year beginning on or after October 22, 2004, or during the taxpayer’s last taxable year beginning before such date. Dividends received after the election period will be taxed in the normal manner under present law.

State and Local General Sales Taxes

Provide optional temporary deduction for State and local general sales taxes.—An itemized deduction is permitted for certain State and local taxes, including individual income taxes, real property taxes, and personal property taxes. Under prior law, a deduction was not provided for State and local general sales taxes (a tax imposed at one rate with respect to the sale at retail of a broad range of classes of items). Under the 2004 jobs creation act, effective for taxable years beginning after December 31, 2003 and before January 1, 2006, a taxpayer would be allowed to elect to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction for State and local income taxes. The allowable deduction could be determined by tallying the amount of general State and local sales taxes paid on accumulated receipts, or from tables prescribed by the Secretary of the Treasury. A taxpayer tallying the amount of taxes paid would be able to include taxes imposed at one rate on the sale at retail of a broad range of classes of items, as well as taxes imposed at a lower rate on the sale at retail of food, clothing, medical supplies, and motor vehicles. Taxes imposed at a higher rate on the sale of motor vehicles would be deductible, but only up to the amount that would have been imposed at the general sales tax rate. The tables prescribed by the Secretary of the Treasury would be based on the average consumption of taxpayers on a State-by-State basis and would take into account filing status, number of dependents, adjusted gross income, and rates of State and local general sales taxes. Taxpayers who used the tables would be allowed to add to the table amounts general sales taxes paid with respect to purchases of motor vehicles, boats, and other items specified by the Secretary that would not be reflected in the tables.

Tobacco Reform

Reform the tobacco program.—Under prior law, the Federal tobacco program had two main components: a supply management component and a price support component. The supply management component limited and stabilized the quantity of tobacco marketed by farmers through marketing quotas. Because marketing quotas alone could not always guarantee tobacco prices, Federal support prices were established and guaranteed through the mechanism of nonrecourse loans available on each farmer's marketed crop. In 1982 legislation was enacted to ensure that the nonrecourse loan program was run at no-net-cost to the Federal government.

The 2004 jobs creation act repealed all aspects of the Federal tobacco program, effective for crop years beginning in 2005. Under the reformed program, quota holders and producers of quota tobacco (owners, operators, landlords, tenants, or sharecroppers who shared in the risk of production) would be entitled to receive payments in exchange for the termination of the quotas and price supports of prior law. A base quota level would be established for each tobacco quota holder and each producer. Eligible tobacco quota holders would receive $7 per pound on their basic quota allotment, paid in equal installments over 10 years. Eligible producers would receive $1 to $3 per pound, depending on the extent of their quota-related activity in the 2002-2004 marketing years, multiplied by their base quota level, paid in equal installments over 10 years.

Assessments would be imposed quarterly on each manufacturer and importer of tobacco products sold in the United States, effective for fiscal years 2005 through 2014. The assessments, which would be sufficient to fund the payments to quota holders and producers and other expenditures associated with the program, would be based on the class of tobacco product (cigarettes, snuff, chewing tobacco, pipe tobacco, roll-your-own tobacco and cigars) and market share.

Miscellaneous Provisions

Permit stock life insurance companies to make tax-free distributions from policyholder surplus accounts.—Policyholder surplus accounts of stock life insurance companies were established legislatively and represent earnings of such companies that were untaxed under prior law. Any direct or indirect distribution to shareholders from an existing policyholder surplus account of a stock life insurance company is subject to tax at the corporate rate in the taxable year of the distribution. Any distribution to shareholders is treated as made: (1) first out of the shareholder surplus account, to the extent thereof; (2) then out of the policyholder surplus account, to the extent thereof; and (3) finally, out of other accounts. A company may also elect to subtract from its policyholder surplus account any amount as of the close of a taxable year. For stock life insurance companies, the 2004 jobs creation act temporarily suspended the taxation of distributions to shareholders from an existing policyholder surplus account. The act also reversed the order in which distributions reduce the various accounts, so that distributions would be treated as: (1) first made out of the policyholder surplus account, to the extent thereof; (2) then out of the shareholder surplus account, to the extent thereof; and (3) lastly out of other income. These changes were effective for taxable years beginning after December 31, 2004 and before January 1, 2007.

Modify method of accounting for naval shipbuilding contracts.—Taxpayers generally must use the percentage-of-completion method to determine taxable income from long-term contracts. However, an exception exists for certain ship construction contracts, which may be accounted for using the 40/60 percentage-of-completion/capital cost method (PCCM). Under the 40/60 PCCM, 40 percent of the taxpayer's long-term contract income is subject to the percentage-of-completion method, the remaining 60 percent must be reported by consistently using the taxpayer's exempt contract method. Permissible exempt contract methods include the percentage of completion method, the exempt-contract percentage-of-completion method, and the completed contract method. The 2004 jobs creation act allowed qualified naval ship contracts to be accounted for using the 40/60 PCCM during the first five taxable years of the contract. The cumulative reduction in tax resulting from the provision over the five-year period must be recaptured and included in the taxpayer's tax liability in the sixth year. This change was effective for contracts for which construction commenced after October 22, 2004.

Defer gain on the disposition of electric transmission property.—Gain on the sale or other disposition of property is ordinarily recognized in the year of sale. The 2004 jobs creation act permitted the gain from certain sales of electric transmission property to be recognized ratably over eight years beginning with the year of sale, except to the extent proceeds of the sale are not used to purchase replacement utility property. To qualify for this treatment, the transmission property must be sold to an independent transmission company after October 22, 2004 and before January 1, 2007, and the proceeds from the sale must be used to purchase replacement utility property. To the extent the proceeds are not used to purchase replacement utility property, gain is recognized in the year of the sale.

Expand resources eligible for 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 under prior law, the electricity had to be sold to an unrelated third party and had to be produced during the first 10 years of production at a qualified facility placed in service before January 1, 2006 and after December 31, 1999 for a poultry waste facility, after December 31, 1992 for a closed-loop biomass facility and after December 31, 1993 for a wind energy facility. Under the 2004 jobs creation act, the credit was expanded to apply to electricity from closed-loop biomass produced at a facility originally placed in service before December 31, 1992 and modified to use closed-loop biomass to co-fire with coal, other biomass, or coal and other biomass before January 1, 2006. The credit for electricity produced by such facilities would be equal to the otherwise allowable credit multiplied by the ratio of the thermal content of the closed-loop biomass fuel burned in the facility to the thermal content of all fuels burned in the facility. The 2004 jobs creation act also expanded the credit to apply to the following new qualifying sources: (1) open-loop biomass (other than agricultural livestock waste nutrients) used at a facility placed in service before January 1, 2006; (2) municipal solid waste, agricultural livestock waste nutrients, geothermal energy, solar energy, small irrigation power, landfill gas, and trash combustion used at a qualifying facility placed in service after October 22, 2004 and before January 1, 2006; and (3) refined coal produced at a qualifying facility placed in service after October 22, 2004 and before January 1, 2009. For facilities using open-loop biomass, including agricultural livestock waste nutrients, geothermal energy, solar energy, small irrigation power, landfill gas, or trash combustion, the credit period was reduced from ten years to five years and (except for geothermal energy and solar energy) the credit rate was reduced by half. Facilities using refined coal could claim the credit at a rate of $4.375 per ton (indexed for inflation).

Revenue Provisions

Modify tax treatment of corporate inversions.—The 2004 jobs creation act addressed "inversion transactions," which occur when a U.S. corporation reincorporates in a foreign jurisdiction and replaces the U.S. parent corporation of a multinational corporate group with a foreign parent corporation. The 2004 jobs creation act included provisions that addressed two types of inversion transactions. These changes generally applied to taxable years ending after March 4, 2003, effective for companies (and certain partnerships) inverting after that date:

> ***Inversions with at least 80 percent identity of stock ownership***.—An inverting company generally would continue to be taxed as a U.S. company (that is, the inversion essentially would be disregarded) if: (1) it acquired substantially all the property of a U.S. corporation, (2) 80 percent or more of its stock was held by former shareholders of the U.S. corporation, and (3) its "expanded affiliated group" did not have substantial business activities in the country in which it was organized.
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> ***Inversions with at least 60 percent (but less than 80 percent) identity of stock ownership***.—Any inversion gain recognized by an inverting U.S. company generally would be taxed and the use of tax attributes such as net operating losses (NOLs) and foreign tax credits would be limited if: (1) it acquired substantially all the property of a U.S. corporation, (2) 60 percent or more of its stock was held by former shareholders of the U.S. corporation and (3) its "expanded affiliated group" did not have substantial business activities in the country in which it was organized.

Revise taxation of individuals who relinquish U.S. citizenship or terminate long-term residency.—An individual who gives up U.S. citizenship or terminates long-term U.S. residency to avoid tax is subject to an alternative tax regime for 10 years following loss of citizenship or termination of residency. The 2004 jobs creation act: (1) eliminated the subjective "principal purpose" standard and established objective standards for determining whether former citizens or long-term residents are subject to the alternative tax regime; (2) provided tax-based rules for determining when an individual is no longer a U.S. citizen or long-term resident; (3) imposed full U.S. taxation on individuals subject to the alternative tax regime who return to the U.S. for extended periods; (4) imposed the U.S. gift tax on gifts of stock of certain closely-held foreign corporations that hold U.S.-situated property; and (5) required individuals subject to the alternative tax regime to file an annual return. These changes applied to individuals who relinquished citizenship or terminated residency after June 3, 2004.

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 2004 jobs creation act contained several provisions designed to curtail the use of abusive tax avoidance transactions. The major changes included: (1) the imposition of new or increased penalties on taxpayers who fail to disclose listed or reportable transactions, report an interest in a foreign financial account, or accurately report a listed or reportable transaction; (2) the imposition of new or increased penalties on tax shelter promoters who make false or fraudulent claims to promote abusive tax avoidance transactions, fail to maintain investor lists, or fail to disclose listed or reportable transactions; (3) modification of actions to enjoin conduct related to tax shelters and reportable transactions; (4) expansion of the tax shelter exception for Federal practitioner privilege to apply to all tax shelters; (5) extension of the statute of limitations for unreported listed transactions; and (6) denial of a deduction for interest paid or accrued on any portion of an underpayment of tax attributable to an undisclosed listed transaction or an undisclosed reportable avoidance transaction.

Modify taxation of partnerships.—Although a partnership is a tax-reporting entity that must file an annual partnership return, a partnership does not pay Federal income tax. Instead, income or loss "flows through" to the partners who are each taxed on their distributive share of partnership taxable income. When filing their Federal income tax return, each partner must take into account their distributive share of certain items of partnership income, gain, loss, deduction, or credit. A partner generally is not taxed on distributions of cash or property received from the partnership, except to the extent that any money distributed exceeds the partner's adjusted basis in his partnership interest immediately before the distribution. Taxable gain can also result from distributions of property that were contributed to the partnership with a fair market value in excess of the adjusted basis (property with a built-in gain) and from property distributions characterized as sales and exchanges. The 2004 jobs creation act included several provisions that affect the calculation and allocation of partnership income and ownership interests. The major changes, which generally were applicable with respect to contributions of property, transfers of partnership interests and distributions of partnership property after October 22, 2004, included the following:

Disallow certain partnership loss transfers and modify basis adjustments.—Built-in losses with respect to contributed property would be taken into account only by the contributing partner and not by other partners. In determining the amount of items allocated to partners other than the contributing partner, the basis of the contributed property would be the fair market value at the time of contribution. If the contributing partner's partnership interest were transferred or liquidated, the partnership's adjusted basis in the property would be based on the fair market value at the time of contribution, and the built-in loss would be eliminated.

Modify basis adjustment in stock held by a partnership in a corporate partner.—In applying the basis allocation rules to a distribution in liquidation of a partner's interest, a partnership would be precluded from decreasing the basis of corporate stock of a partner or a related person. Any decrease in basis that would have otherwise been allocated to the stock would be allocated to other partnership assets. If the decrease in basis exceeded the basis of the other partnership assets, then the gain would be recognized by the partnership in the amount of the excess.

Limit the transfer and importation of built-in losses.—The basis of property with a net built-in loss imported into the U.S. in a tax-free incorporation or reorganization from persons not subject to U.S. tax would be its fair market value, thereby eliminating the built-in loss.

Reform the tax treatment for leasing arrangements with tax-indifferent parties.—Certain leasing arrangements (often referred to as sale-in/lease-out or SILO arrangements) 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 2004 jobs creation act limited a taxpayer's annual deductions or losses related to a lease with a tax-indifferent party by: (1) modifying the recovery period of certain property (qualified technological equipment, computer software and certain intangibles) leased to a tax-exempt entity to the longer of the property's assigned class life or 125 percent of the lease term; (2) altering the definition of lease term for all property leased to a tax-exempt entity to include the time period a lessee is under a service contract or similar obligation period; and (3) establishing rules to limit deductions associated with such leases to the net income generated from the lease unless the lease meets certain specified criteria. These rules generally were effective with respect to leases entered into after March 12, 2004, and did not apply to short-term leases of five or fewer years, with a modification for short-term leases of qualified technological equipment. Disallowed deductions could be carried forward and treated as deductions related to the lease in the next taxable year, subject to the same limitations, or taken when the taxpayer completely disposed of its interest in the leased property. Indian tribes and their instrumentalities were added to the definition of tax-exempt entities required to depreciate leased property on a straight line basis over a recovery period equal to the longer of the property's assigned class life or 125 percent of the lease term.

Improve tax administration.—A number of provisions included in the 2004 jobs creation act improved tax administration. The major provisions: (1) clarified the rules for payment of estimated tax with respect to tax attributable to a deemed asset sale; (2) clarified that the exclusion for gain on the sale or exchange of a principal residence does not apply in cases where the principal residence was acquired in a like-kind exchange in which any gain was not recognized within the prior five years; (3) allowed taxpayers to deposit cash with the Internal Revenue Service (IRS) that could subsequently be used to pay an underpayment of income, gift, estate, generation-skipping, or certain excise taxes; (4) authorized the IRS to enter into installment agreements that provide for the partial payment of taxes owed; (5) allowed the IRS to levy continuously up to 100 percent of Federal payments to vendors; (6) modified the rules regarding suspension of interest and penalties where the IRS fails to contact the taxpayer; (7) clarified the residence and income source rules relating to U.S. possessions; (8) expanded the prior law provision that disallowed a deduction for interest on certain corporate convertible or equity-linked debt; (9) prevented the mismatching of deductions for accrued interest and original issue discount with their inclusion in income in transactions with related foreign persons; and (10) permitted private collection agencies to engage in specific, limited activities to support IRS collection efforts.

Reduce fuel tax evasion.—A number of provisions included in the 2004 jobs creation act reduced fuel tax evasion. These provisions, which generally were effective after October 22, 2004, included: (1) codification of the exemption from certain excise taxes for mobile machinery vehicles; (2) modification of the definition of an off-highway vehicle; (3) modification of the point of taxation of aviation fuel from the sale by a producer or importer to removal from a refinery or terminal, or entry into the United States; (4) elimination of manual dying of fuel and the imposition of penalties for violation of fuel dying rules; (5) imposition of additional registration requirements on bulk transfers of tax-exempt fuel by pipeline, vessel or barge; (6) repeal of the installment method for payment of the heavy highway vehicle use tax and the elimination of reduced rates for certain heavy highway vehicles; and (7) expansion of taxable fuels to include transmix and diesel fuel blend stocks.

Modify deductions for charitable contributions.—The 2004 jobs creation act made several changes to prior law rules regarding allowable deductions for donations of contributed property. The major changes included the following:

Modify rules for donations of patents and other intellectual property.—In the initial year of a contribution of a patent or other intellectual property (other than certain copyrights or inventory), the allowable deduction would be limited to the lesser of the taxpayer's basis in the donated property or the fair market value of the property. In addition, in that year and in future years, additional amounts could be deducted based on a specified percentage of the amount of royalties or other revenue, if any, actually received by the donee charity from the donated property. These additional deductions would be allowed only to the extent that the aggregate of the amounts calculated exceeded the amount of the deduction claimed in the initial year of the contribution. No additional deductions would be permitted after the expiration of the legal life of the patent or intellectual property, or after the tenth anniversary of the date the contribution was made. This change was effective for contributions made after June 3, 2004.

Limit deductions for charitable contributions of vehicles.—Under prior law, taxpayers generally were permitted to deduct the fair market value of donated vehicles, regardless of whether the vehicle was actually used for a charitable purpose or resold with the charity receiving some revenue from the sale. Under the 2004 jobs creation act, the amount of deduction for charitable contributions of vehicles (generally including automobiles, boats, and airplanes for which the claimed value exceeded $500 and excluding inventory property) would depend upon the use of the vehicle by the donee organization. For vehicles sold by the donee organization without any significant intervening use or material improvement, the amount of the deduction could not exceed the gross proceeds from the sale. Deductions in excess of $500 would have to be substantiated by a contemporaneous written acknowledgement by the donee. Strict penalties would be levied on donee organizations knowingly furnishing false or fraudulent acknowledgements. These changes were effective for contributions made after December 31, 2004.

Require increased reporting for noncash charitable contributions.—Under prior law, any individual, closely-held corporation, personal service corporation, or S 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) was required to obtain a qualified appraisal for the property. The 2004 jobs creation act extended this requirement to all corporations. In addition, the act required that all taxpayers (whether an individual, a partnership, or a corporation) provide a copy of the appraisal to the IRS for deductions claimed in excess of $500,000. The change was effective for contributions made after June 3, 2004.

Modify treatment of nonqualified deferred compensation plans.—Under prior law, the determination of when amounts deferred under a nonqualified deferred compensation arrangement were includible in the gross income of the individual earning the compensation depended on the facts and circumstances of the arrangement. If the arrangement was unfunded, the compensation generally was includible in income when it was actually or constructively received. If the arrangement was funded, then income was includible for the year in which the individual's rights were transferable or not subject to a substantial risk of forfeiture. Under the 2004 jobs creation act, all amounts deferred under a nonqualified deferred compensation plan are currently includible in the gross income of the individual earning the compensation to the extent not subject to a substantial risk of forfeiture and not previously included in gross income, unless certain requirements are satisfied. Such requirements include permissible timing for deferral elections and distributions of deferred amounts. If the requirements are not satisfied, interest at the underpayment rate plus one percentage point will be imposed on the underpayments that would have occurred had the compensation been includible in income when first deferred, or if later, when not subject to a substantial risk of forfeiture. In addition, the amount required to be included in income will be subject to a 20-pecent additional tax. These changes apply with respect to amounts deferred in taxable years beginning after December 31, 2004.

Modify list of taxable vaccines.—A manufacturer's excise tax is imposed at the rate of 75 cents per dose on the following vaccines routinely recommended for administration to children: diphtheria, pertussis, tetanus, measles, mumps, rubella, polio, haemophilus influenza type B, hepatitis B, chicken pox, rotavirus gastroenteritis, and streptococcus pneumoniae. The tax applied to any vaccine that is a combination of vaccine components equals 75 cents times the number of components in the combined vaccine. Amounts equal to net revenue from the excise tax are deposited in the Vaccine Injury Compensation Trust Fund to finance compensation awards under the Federal Vaccine Injury Compensation Program for individuals who suffer certain injuries following administration of the taxable vaccines. The 2004 jobs creation act added any vaccine against hepatitis A and any trivalent vaccine against influenza to the list of taxable vaccines.

Extend IRS user fees.—The IRS has 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. The 2004 jobs creation act extended authority for these fees, which had expired effective with requests made after December 31, 2004, through September 30, 2014.

Establish specific class lives for utility grading costs.—A taxpayer is allowed a depreciation deduction for the exhaustion, wear and tear, and obsolescence of property that is used in a trade or business or held for the production of income. For most tangible property placed in service after 1986, the amount of the depreciation deduction is determined under MACRS using a statutorily prescribed depreciation method, recovery period, and placed in service convention. Under prior law, the cost of initially clearing and grading land improvements were depreciated over a seven-year recovery period under MACRS as assets for which no class life was provided. Under the 2004 jobs creation act, depreciable clearing and grading costs incurred to locate transmission and distribution lines and pipelines were assigned recovery periods of 20 years for electric utilities and 15 years for gas utilities. These changes were effective for property placed in service after October 22, 2004.

Modify treatment of start-up and organizational expenditures.—Under prior law, at the election of the taxpayer, start-up and organizational expenditures could be amortized over a period of not less than 60 months, beginning with the month in which the trade or business began. The 2004 jobs creation act allowed a taxpayer to elect to deduct up to $5,000 of start-up and $5,000 of organizational expenditures in the taxable year in which the trade or business began. However, each $5,000 amount was reduced (but not below zero) by the amount by which the cumulative cost of start-up and organizational expenditures exceeded $50,000, respectively. Start-up and organization expenditures that were not deductible in the year in which the trade or business began would be amortized over a 15-year recovery period. The change was effective for start-up and organizational expenditures incurred after October 22, 2004. Start-up and organizational expenditures incurred on or before October 22, 2004 would continue to be eligible to be amortized over a period not less than 60 months. However, all start-up and organizational expenditures related to a particular trade or business, whether incurred before or after October 22, 2004, would be considered in determining whether the cumulative cost of start-up or organizational expenditures exceeded $50,000.

***Limit deduction for certain entertainment expenses*.**—In general, deductions are not allowed with respect to an activity generally considered to be entertainment, amusement or recreation, unless the taxpayer establishes that the item was directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business, or a facility (such as an airplane) used in connection with such activity. However, under prior law, this general entertainment expense disallowance rule did not apply to entertainment expenses for goods, services, and facilities to the extent that the expenses were (1) reported by the taxpayer as compensation and wages to an employee, or (2) includible in the gross income of a recipient who was not an employee as compensation for services rendered or as a prize or award. For specified individuals (officers, directors, and 10-percent-or-greater owners of private and publicly-held companies), the 2004 jobs creation act disallowed the deduction, to the extent that such expenses exceeded the amount treated as compensation or includible in income for the individual, with respect to expenses for (1) nonbusiness activity generally considered to be entertainment, amusement or recreation, or (2) a facility used in connection with such activity. This change was effective for such expenses incurred after October 22, 2004.

***Limit expensing of sport utility vehicles*.**—Under prior law, taxpayers purchasing a sport utility vehicle for business use could expense and deduct up to \$100,000 of the cost in the year the vehicle was placed in service. The 2004 jobs creation act reduced the amount of expensing allowed with respect to the cost of a sports utility vehicle from \$100,000 to \$25,000. The change was effective for property placed in service after October 22, 2004.

PENSION FUNDING EQUITY ACT OF 2004

This Act, which was signed by the President on April 10, 2004, made changes to the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code that affect the operation of private pension plans. The major provisions of the Act: (1) established a two-year temporary replacement of the benchmark interest rate for determining funding liabilities of private sector pension plans; (2) established temporary alternative minimum funding standards that reduced funding requirements for commercial airlines, steel companies, and certain other employers; and (3) allowed certain multiemployer plans to temporarily delay the amortization of specified losses. This Act also contained a number of other provisions including: (1) modification of the definition of a property and casualty insurance company and the requirements for such companies to be eligible for tax-exempt status; (2) repeal of the prior law provision requiring reductions in deductions of mutual life insurance companies for policyholder dividends; and (3) extension, through December 31, 2013, of the prior law provision that allowed employers to transfer excess defined benefit plan assets to a special account for health benefits of retirees.

UNITED STATES-AUSTRALIA FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act implemented the U.S.-Australia Free Trade Agreement (FTA), as signed by the United States and Australia on May 18, 2004. The U.S.-Australia FTA advanced U.S. economic interests by providing increased access to Australia's markets for American services, manufactured goods, and agricultural products. The Agreement, which will create jobs and opportunities in both countries, solidified our relationship with an important partner in the global economy and set a strong example of the benefits of free trade and democracy.

UNITED STATES-MOROCCO FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act implemented the U.S.-Morocco FTA, as signed by the United States and Morocco on June 15, 2004. The U.S.-Morocco FTA advanced U.S. economic interests by providing increased access to Morocco's markets for American manufactured goods, agricultural products, services, and investment. The Agreement provided a significant opportunity to encourage economic reform and development in a moderate Muslim nation and was an important step in implementing the President's plan for a broader U.S.-Middle East Free Trade Area.

THE AGOA ACCELERATION ACT OF 2004

The African Growth and Opportunity Act (AGOA), enacted in May 2000, reduced barriers to trade, thereby increasing exports, creating jobs, and increasing opportunities for Africans and Americans alike. It gave American businesses greater confidence to invest in Africa, and encouraged African nations to reform their economies and governments to take advantage of the opportunities that AGOA provided. The AGOA Acceleration Act, which was signed by the President on July 13, 2004, built on that success by extending trade preferences for certain imports from designated sub-Saharan African countries through September 30, 2015. The deadline for expiration of these benefits had been September 30, 2008 under prior law. The AGOA Acceleration Act also extended the prior law deadline for use of third country fabric benefits from September 30, 2004 to September 30, 2007. Under this provision, any AGOA country with a per capita GNP less than \$1,500 enjoys duty-free access (subject to caps on the amount of imports as measured by square meter equivalents) to the U.S. market for apparel made from fabric originating anywhere in the world. This Act also expanded benefits by modifying rules of origin for certain apparel components, such as collars and cuffs, and expanded the scope of eligible goods to include ethnic fabrics made on machines, rather than just those made by hand.

THE MISCELLANEOUS TRADE AND TECHNICAL CORRECTIONS ACT OF 2004

This Act, which was signed by the President on December 3, 2004, provided for the temporary suspension of tariffs on about 330 new items, including a wide variety of chemicals, and a number of pigments and dyes that are for the most part not made in the U.S. and needed by U.S. manufacturers. This Act also extended suspensions of tariffs on a number of items, refunded tariffs on specified imports, and made technical corrections to several trade laws.

ADMINISTRATION PROPOSALS

REFORM THE FEDERAL TAX SYSTEM

On January 7, 2005, the President established an Advisory Panel on Federal Tax Reform to develop options to improve the tax system. The current tax system is complex, is perceived by many as unfair, and distorts household and business decisions. The excessive time taxpayers spend to understand and comply with the tax system is a burden and wastes resources. Taxpayers spend an estimated six billion hours to comply with the tax system at a cost of more than $100 billion annually. Individuals and businesses need a tax system that is simpler, and easier to understand and comply with. Faith in the fairness of our tax system is undermined when taxpayers believe others can exploit the complexities of the law to avoid paying tax. At the same time, Americans deserve a tax code that will allow them to make decisions based more on economic merit, free of the distortions generated by the tax system. The economic costs associated with these distortions can total hundreds of billions of dollars annually.

The Advisory Panel will broadly focus on revenue-neutral reforms that make the tax system simpler, encourage economic growth, and promote fairness, while recognizing the importance of homeownership and charitable giving in American society. Information on the Advisory Panel and its deliberations can be found at www.taxreformpanel.gov. The Advisory Panel will provide options for reforming the tax system to the Secretary of the Treasury no later than July 31, 2005. These options will help the Treasury Secretary and others within the Administration develop specific recommendations for the President.

Pending the outcome of fundamental tax reform, the President will continue to propose important policy initiatives including permanent extension of the increased expensing for small businesses and the reductions in taxes on capital gains and dividends provided in the 2003 jobs and growth tax cut. The President's policy initiatives 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, improve tax compliance, curtail abusive tax avoidance activities, and strengthen the employer-based pension system.

MAKE PERMANENT CERTAIN TAX CUTS ENACTED IN 2001 AND 2003

***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 business 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 through 2007. 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 2008. Also, with respect to a taxable year beginning after 2002 and before 2008, 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 2007.

***Extend permanently provisions expiring in 2010*.**—Most of the provisions of the 2001 tax cut 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 Individual Retirement Accounts (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 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, 2005 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).

Saving will be further simplified and encouraged by administrative changes already planned for the 2007 filing season that will allow taxpayers to have their tax refunds directly deposited into more than one account. Consequently, taxpayers will be able, for example, to direct that a portion of their tax refunds be deposited into an LSA or RSA.

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 generally 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, 2005.

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 2008. 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, 2006 and before January 1, 2014, to the first 900,000 IDA accounts opened before January 1, 2012.

Invest in Health Care

Provide a 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 adjusted gross income (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. In addition, individuals are allowed to accumulate funds in a health savings account (HSA) or medical savings account (MSA) on a tax-preferred basis to pay for medical expenses, provided they are covered by an HSA high-deductible health plan (and no other health plan). 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, 2005, 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.

If the health insurance qualifies as an HSA high-deductible health plan, an individual may opt to contribute 30 percent of the credit to a special HSA that could only be used to pay for medical expenses. Individuals could claim the tax credit for health insurance premiums paid as part of the normal tax-filing process. Alternatively, beginning July 1, 2007, 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 make purchasing health insurance easier and help reduce health insurance costs and increase coverage options for individuals, including older and higher-risk individuals.

Provide an above-the-line deduction for high-deductible insurance premiums.—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. Current law also allows individuals to accumulate funds in an HSA or MSA on a tax-preferred basis to pay for medical expenses, provided they are covered by a high-deductible health plan (and no other health plan). The Administration proposes to allow individuals who contribute to an HSA because they are covered under an HSA high-deductible health plan in the individual insurance market to deduct the amount of the premium in determining AGI (whether or not the person itemizes deductions). Individuals claiming other credits or deductions or covered by employer plans, public plans or otherwise not eligible to contribute to an HSA would not qualify. The provision would be effective to taxable years beginning after December 31, 2005.

Provide a refundable tax credit for contributions of small employers to employee HSAs.—Under current law, employers are provided a deduction for the cost of health coverage provided to employees and the value of that coverage is not subject to tax for the employees. Nevertheless, many American workers in small firms are currently without health coverage. In order to provide an incentive to small employers to sponsor group health coverage, especially high-deductible health coverage that encourages cost consciousness, the Administration proposes to provide a refundable tax credit for employer contributions to employee HSA accounts of up to $200 for single coverage and up to $500 for family coverage. The subsidy would be provided to for-profit employers that normally employ fewer than 100 employees. The employer would be required to maintain a high-deductible health plan (as defined for purposes of the HSA) accessible to all employees, but the employer would not be required to make contributions toward employees' premiums under the plan. The employer would not be entitled to a deduction for the amount reimbursed by the credit and the credit could not be carried back or carried forward. The amount of the employer contribution to the HSA for which a credit is claimed would be maintained in a special HSA that would be subject to the rules currently applicable to HSAs, except that withdrawals in excess of qualified medical expenses would subject the HSA owner to a tax equal to 100 percent of the amount of the withdrawal. Sole proprietors, partners and S-corporation shareholders would be eligible for the credit to the extent their business is a small employer or has no employees. However, self-employed individuals would not be entitled to any deductions for the amount reimbursed by the credit. The HSA tax credit would be effective for taxable years beginning after December 31, 2005.

Improve the Health Coverage Tax Credit.—The Health Coverage Tax Credit (HCTC) was created under the Trade 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 make the requirements for qualified State-based coverage under the HCTC more consistent with the rules applicable under the Health Insurance Portability and Accountability Act (HIPAA) and thus encourage more plans to participate in the HCTC program, the Administration proposes to allow State-based coverage to impose a pre-existing condition restriction for a period of up to 12 months, provided the plan reduces the restriction period by the length of the eligible individual's creditable coverage (as of the date the individual applied for the State-based coverage). This provision would be effective for eligible individuals applying for coverage after December 31, 2005. Also, in order to prevent an individual from losing the benefit of the HCTC just because his or her spouse becomes eligible for Medicare, the Administration proposes to permit spouses of HCTC-eligible individuals to claim the HCTC when the HCTC-eligible individual becomes entitled to Medicare coverage. The spouse, however, would have to be at least 55 years old and meet the other HCTC eligibility requirements. This provision would be effective for taxable years beginning after December 31, 2005. Finally, to improve the administration of the HCTC, the Administration proposes to: (1) modify the definition of "other specified coverage" for "eligible ATAA recipients," to be the same as the definition applied to "eligible TAA recipients;" (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 the 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.

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, 2004.

Provide Incentives for Charitable Giving

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, 2004.

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, 2004.

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 undistributed ordinary income for that year and all prior years; (2) capital gains to the extent of the trust's undistributed capital gain for that year and all prior years; (3) other income to the extent of the trust's undistributed other income for that year and all prior years; 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, 2004, 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, 2004.

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 current law, teachers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses are allowed to deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceeded two percent of AGI. Current law also allows 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). This additional deduction is effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2006. Unreimbursed expenditures for certain books, supplies, and equipment related to classroom instruction qualify for the above-the-line deduction. Expenses claimed as an above-the-line deduction may 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 in taxable years beginning after December 31, 2005, 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, 2005.

Provide Assistance to Distressed Areas

Establish Opportunity Zones.—The Administration proposes to establish authority to designate 40 opportunity zones (28 in urban areas and 12 in rural areas). The zone designation and corresponding incentives would be in effect from January 1, 2006 through December 31, 2015. To qualify to apply for zone status, a community must either have suffered from a significant decline in its economic base over the past decade as measured by the loss of manufacturing and retail establishments and manufacturing jobs, or be an existing empowerment zone, renewal community or enterprise community. The Secretary of Commerce would select opportunity zones through a competitive process based on the applicant's "community transition plan" and "statement of economic transition." The community transition plan would have to set concrete, measurable goals for reducing local regulatory and tax barriers to construction, residential development and business creation. The statement of economic transition would have to demonstrate that the local community's economic base is in transition, as indicated by a declining job base and labor force, and other measures, during the past decade. In evaluating applications, the Secretary of Commerce could consider other factors, including: (1) changes in unemployment rates, poverty rates, household income, homeownership and labor force participation; (2) the educational attainment and average

age of the population; and (3) for urban areas, the number of mass layoffs occurring in the area's vicinity over the previous decade. Empowerment zones and renewal communities designated as opportunity zones would not count against the limitation of 40 new opportunity zones. Such communities would be required to relinquish their current status and benefits once selected. Opportunity zone benefits for converted empowerment zones and renewal communities would expire on December 31, 2009. Tax benefits for enterprise communities expired at the end of 2004. Enterprise communities designated as opportunity zones would count against the limitation of 40 new zones and opportunity zone benefits would be in effect through 2015.

A number of tax incentives would be applicable to opportunity zones. First, a business would be allowed to exclude 25 percent of its taxable income if it qualified as an "opportunity zone business" and it satisfied a $5 million gross receipts test. The definition of an opportunity zone business would be based on the definition of a "qualified active low-income community business" for purposes of the new markets tax credit, treating opportunity zones as low-income communities. Second, an opportunity zone business would be allowed to expense the cost of section 179 property that is qualified zone property, up to an additional $100,000 above the amounts generally available under current law. Third, a commercial revitalization deduction would be available for opportunity zones in a manner similar to the deduction for renewal communities. A $12 million annual cap on these deductions would apply to each opportunity zone. Finally, individuals who live and work in an opportunity zone would constitute a new target group with respect to wages earned within the zone under the proposed combined work opportunity tax credit and welfare-to-work tax credit (see discussion later in this Chapter).

Provide Disaster Relief

Provide tax relief for Federal Emergency Management Agency (FEMA) hazard mitigation assistance programs.—The Federal Emergency Management Agency's mitigation assistance programs provide grants through State and local governments to businesses and individuals for cost-effective responses to natural hazards. FEMA may make grants in the aftermath of a major disaster, in anticipation of a natural hazard, or in areas of severe repetitive loss. Grants may fund demolition, retro-fitting, elevation, or other measures to reduce the cost of future property damage. Under current tax law, gross income includes governmental disaster payments unless they fall into certain exceptions that generally provide for relief with respect to damages or expenses incurred, but would not encompass payments to mitigate future damage. Tax relief is warranted to the extent that property owners may decline to participate in mitigation assistance programs because of the potential tax obligation. The Administration proposes to exclude FEMA mitigation grants from gross income. To prevent a double benefit, a business that receives a tax-free mitigation grant and uses the grant to purchase or repair property could not claim a deduction for those expenses. The exclusion would apply only to FEMA mitigation grants, and not to any compensation from a mitigation assistance program for the acquisition of property situated in a disaster or hazard area. However, if FEMA acquires property, and the owner replaces the property within a specified period, then instead of reflecting the compensation in gross income, the owner would have a carry-over cost basis in the replacement property. If a mitigation assistance program pays the cost of improving property, the cost would be excluded from gross income, but there would be no increase in the owner's cost basis in the property. Thus, if the property is later sold, any resulting gain potentially would be taxable. The proposal generally would be effective for mitigation assistance received after December 31, 2004, but the Department of Treasury would have administrative authority to provide retroactive relief.

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 2006, 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 was equal to the greater of $2.075 million or $1.80 per capita for 2004, and is indexed annually for inflation. 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, 2006, to treat certain environmental remediation expenditures that would otherwise be chargeable to a capital account as deductible in the year paid or incurred. The Administration proposes to extend this provision permanently making it available for expenditures paid or incurred after December 31, 2005, and 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, 2005 and before January 1, 2009.

Increase Energy Production and Promote Energy Conservation

Extend the tax credit for producing electricity from wind, biomass, and landfill gas and modify the tax credit for electricity produced from biomass.—Taxpayers are allowed a tax credit for electricity produced from wind, biomass, landfill gas, and certain other sources. Biomass includes closed-loop biomass (organic material from a plant grown exclusively for use at a qualifying facility to produce electricity) and open-loop biomass (biomass from agricultural livestock waste nutrients or cellulosic waste material derived from forest-related resources, agricultural sources, and other specified sources). Open-loop biomass does not include biomass that is co-fired with coal. Thus, electricity produced from biomass, other than closed-loop biomass, co-fired with coal does not qualify for the credit. The credit rate is 1.5 cents per kilowatt hour for electricity produced from wind and closed-loop biomass and 0.75 cent per kilowatt hour for electricity produced from open-loop biomass and landfill gas (both rates are adjusted for inflation since 1992). To qualify for the credit, the electricity must be produced at a facility placed in service before January 1, 2006. The Administration proposes to extend the credit for electricity produced from wind, biomass other than agricultural livestock waste nutrients, and landfill gas to electricity produced at facilities placed in service before January 1, 2008. In addition, a credit at 60 percent of the generally applicable rate for electricity produced from open-loop biomass would be allowed for electricity produced from open-loop biomass (other than agricultural livestock waste nutrients) co-fired in coal plants during the period from January 1, 2006 through December 31, 2008.

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, 2004 and before January 1, 2010 and to solar water heating equipment placed in service after December 31, 2004 and before January 1, 2008.

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, 2004.

Provide tax credit for purchase of certain hybrid and fuel cell vehicles.—Under current law, a 10-percent tax credit up to a maximum of $4,000 is provided for the cost of a qualified electric vehicle. The full amount of the credit is available for purchases prior to January 1, 2006. The credit is reduced by 75 percent for purchases in 2006 and is not available for purchases after December 31, 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, 2004 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, 2004 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 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, 2004 and before January 1, 2010.

Restructure Assistance to New York City

Provide tax incentives for transportation infrastructure.—The Administration proposes to restructure the tax benefits for New York recovery that were enacted in 2002. Some of the tax benefits that were provided to New York following the attacks of September 11, 2001, likely will not be usable in the form in which they were originally provided. As such, the Administration proposed in the Mid-Session Review of the 2005 Budget to sunset certain existing New York Liberty Zone tax benefits and in their place provide tax credits to New York State and New York City for expenditures incurred in building or improving transportation infrastructure in or connecting with the New York Liberty Zone. The tax credit would be available as of the date of enactment, subject to an annual limit of $200 million ($2 billion in total over 10 years), evenly divided between the State and the City. Any unused credit limit in a given year would be added to the $200 million allowable in the following year, including years beyond the 10-year period of the credit. Similarly, expenditures that could not be credited in a given year because of the credit limit would be carried forward and used against the next year's limitation. The credit would be allowed against any payments (e.g., income tax withholding) made by the City and State under any provision of the Internal Revenue Code, other than Social Security and Medicare payroll taxes and excise taxes. The Secretary of the Treasury may prescribe such rules as are necessary to ensure that the expenditures are made for the intended purpose.

Repeal certain New York City Liberty Zone incentives.—The Administration proposes to terminate the following tax incentives provided to qualified property within the New York Liberty Zone under the 2002 economic stimulus act: (1) the additional first-year depreciation deduction; (2) the five-year recovery period for leasehold improvement property; (3) increased expensing for small businesses; and (4) the extended replacement period for the nonrecognition of gain on involuntarily converted property. These terminations are proposed to be effective on the date of enactment. Property placed in service after the date of enactment would not be eligible for the first three incentives listed above unless a binding written contract was in effect on the date of enactment, in which case the property would need to be placed in service by the original termination dates provided in the 2002 economic stimulus act. Other related changes to the Internal Revenue Code would be made as appropriate.

SIMPLIFY THE TAX LAWS FOR FAMILIES

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 2005, the limitation on qualified adoption expenses for both the credit and the exclusion is $10,630. Taxpayers who adopt children with special needs may claim the full $10,630 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 $159,450 (in 2005), 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, 2005. 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.

Clarify eligibility of siblings and other family members for child-related tax benefits.—The 2004 tax relief bill created a uniform definition of a child, allowing, in many circumstances, a taxpayer to claim the same child for five different child-related tax benefits. Under the new rules, a qualifying child must meet relationship, residency, and age tests. While the new rules simplify the determination of eligibility for many child-related tax benefits, the elimination of certain complicated factual tests to determine if siblings and certain other family members were eligible to claim a qualifying child may have some unintended consequences. The new rules effectively deny the EITC to some young taxpayers who are the sole guardians of their younger siblings. Yet some taxpayers will be able to avoid income limitations on child-related tax benefits by allowing other family members, who have lower incomes, to claim the taxpayers' sons or daughters as qualifying children. To ensure that deserving taxpayers receive child-related tax benefits, the Administration proposes to clarify the eligibility of siblings and other family members for these benefits. First, a taxpayer would not be a qualifying child of another individual if the taxpayer is older than that individual. However, an individual could be a qualifying child of a younger sibling if the individual is permanently and totally disabled. Second, if a parent resides with his or her child for over half the year, the parent would be the only individual eligible to claim the child as a qualifying child. The parent could waive the child-related tax benefits to another member of the household who has higher adjusted gross income and is otherwise eligible for the tax benefits. The proposal is effective for taxable years beginning after December 31, 2004.

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.

Strengthen funding for single-employer pension plans.—Under current law, defined benefit pension plans are subject to minimum funding requirements imposed under both the Internal Revenue Code and the Employee Retirement Income Security Act of 1974 (ERISA). In the case of a qualified plan, the Internal Revenue Code excludes such contributions from gross income and allows a deduction for the contributions, subject to certain limits on the maximum deductible amount. The calculation of the minimum funding requirements and the limits on deductible contributions are determined under a series of complex rules and measures of assets and liability, many of which are manipulable and none of which entail the use of an accurate measure of the plan's assets and its true liabilities.

The Administration proposes rationalizing the multiple sets of funding rules applicable to single-employer defined benefit plans and replacing them with a single set of rules that provide for: (1) funding targets that are based on meaningful, accurate measures of liabilities that reflect the financial health of the employer; (2) the use of market value of assets; (3) a seven-year amortization period for funding shortfalls; (4) the opportunity for an employer to make additional deductible contributions in good years, even when the plan's assets are above the funding target; and (5) meaningful consequences for employers and plans whose funded status does not improve.

These funding rules changes and the addition of meaningful consequences for employers and plans whose funded status does not improve and improved disclosure to plan participants, investors and regulators are part of an overall package of reforms that will improve the health of defined benefit pensions and the PBGC guarantee system. As described in Chapter 7 of Analytical Perspectives and the Department of Labor Chapter of the Budget volume, this overall package includes reform of the premium structure for the PBGC, revision in the application of the PBGC guarantee rates and changes to the bankruptcy law.

Reflect market interest rates in lump sum payments.—Current law generally requires that a lump sum paid from a pension plan be calculated using the rate of interest on 30-year Treasury securities for the month preceding the distribution. Because there are no 30-year Treasury securities outstanding, the interest rate on the Treasury bond due February 15, 2031 is used for this purpose. The Administration proposes to require that these calculations reflect market interest rates and lump sum calculations would be calculated using interest rates that are drawn from a zero-coupon corporate bond yield curve. The yield curve would be issued monthly by the Secretary of Treasury and would be based on the interest rates (averaged over 90 business days) for high quality corporate bonds with varying maturities. In order to avoid disruptions, the proposal would be phased in for plan years beginning in 2007 and 2008 and would not be fully effective until the plan year beginning in 2009.

CLOSE LOOPHOLES AND IMPROVE TAX COMPLIANCE

Combat abusive foreign tax credit transactions.—Current law allows taxpayers a credit against U.S. taxes for foreign taxes incurred with respect to foreign income, subject to specified limits. The Administration proposes to provide the Department of Treasury with additional regulatory authority to ensure that the foreign tax credit rules cannot be used to achieve inappropriate results that are not consistent with the underlying economics of the transactions in which the foreign tax credits arise. The regulatory authority would allow the Department of Treasury 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. Regulations could provide for the disallowance of a credit for all or a portion of the foreign taxes or the reallocation of the foreign taxes among the participants to the transaction.

Modify the active trade or business test.—Current law allows corporations to avoid recognizing gain in certain spin-off and split-off transactions provided that, among other things, the active trade or business test is satisfied. The active trade or business test requires that immediately after the distribution, the distributing corporation and the corporation the stock of which is distributed (the controlled corporation) be engaged in a trade or business that has been actively conducted throughout the five-year period ending on the date of the distribution. There is no statutory requirement that a certain percentage of the distributing corporation's or controlled corporation's assets be used in that active trade or business in order for the active trade or business test to be satisfied. Because certain non-pro rata distributions resemble redemptions for cash, the Administration proposes to require that in the case of a non-pro rata distribution, in order for a corporation to satisfy the active trade or business test, as of the date of the distribution, at least 50 percent of its assets, by value, must be used or held for use in a trade or business that satisfies the active trade or business test.

Impose penalties on charities that fail to enforce conservation easements.—Although gifts of partial interests in property generally are not deductible as charitable contributions, current law allows a deduction for certain restrictions granted in perpetuity on the use that may be made of real property (such as an easement). A deduction is allowed only if the contribution is made to a qualified organization exclusively for conservation purposes. To qualify to receive such qualified conservation contributions, a charity must have a commitment to protect the conservation purposes of the donation and have the resources to enforce the restrictions. The Department of Treasury is concerned that in some cases charities are failing to monitor and enforce the conservation restrictions for which charitable contribution deductions were claimed. The proposal would impose significant penalties on any charity that removes or fails to enforce such a conservation restriction, or transfers the easement without ensuring that the conservation purposes will be protected in perpetuity. The amount of the penalty would be determined based on the value of the easement shown on the appraisal summary provided to the charity by the donor. The Secretary of the Treasury would be authorized to waive the penalty in certain circumstances. The Secretary of the Treasury also would be authorized to require such additional reporting as may be necessary or appropriate to ensure that the conservation purposes are protected in perpetuity.

Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields.—In general, an organization that is otherwise exempt from Federal income tax is taxed on income from any trade or business regularly carried on by the organization that is not substantially related to the organization's exempt purposes. In addition, income derived from property that is debt-financed generally is subject to unrelated business income tax. The 2004 jobs creation act created a special exclusion from unrelated business taxable income of gain or loss from the sale or exchange of certain qualifying brownfield properties. The exclusion applies regardless of whether the property is debt-financed. The new provision adds considerable complexity to the Internal Revenue Code and, because there is no limit on the amount of tax-free gain, could exempt from tax real estate development considerably beyond mere environmental remediation. The proposal would eliminate this special exclusion retroactive to January 1, 2005.

Apply an excise tax to amounts received under certain life insurance contracts.—Under current law, both death benefits and accrual of cash value under a life insurance contract are treated favorably for Federal income tax purposes. In many states, a charity has an insurable interest in the life of a consenting donor. The Department of Treasury has learned of arrangements in which private investors join with a charity to purchase life insurance on the lives of the charity's donors. The private investors have no relationship to the insured individuals, however, except by reason of the arrangement. These arrangements do more to facilitate investment by private investors in life insurance contracts than to further a charity's exempt purposes and may inappropriately afford benefits to private investors that would not otherwise be available without the charity's involvement. The Administration proposes to apply a nondeductible 25 percent excise tax to death benefits, dividends, withdrawals, loans or surrenders under a life insurance contract if: (1) a charity has ever had a direct or indirect ownership interest in the contract; and (2) a person other than a charity has ever had a direct or indirect interest in the same contract (including an interest in an entity holding an interest in that contract). The excise tax would not apply in enumerated situations that present a low risk of abuse. The proposal would be effective with respect to amounts received under life insurance contracts entered into after February 7, 2005.

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, 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. The Department of Treasury also is conducting a study of these rules and the potential for further modifications to ensure the prevention of inappropriate income-reduction opportunities.

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 account. In addition, current law creates opportunities for inappropriate use of these accounts. The proposal would simplify the tax consequences under these programs and promote use of these accounts to save for higher education. The most significant change made by this proposal is the elimination of substantially all post-contribution transfer taxes, thus permitting tax-free changes of the designated beneficiary of an account, without limitation as to the relationship or number of generations between the current and former beneficiaries. Any distribution used to pay the beneficiary's qualified higher education expenses would continue to be tax-free. However, to eliminate the potential transfer tax benefit of using an account for purposes not intended by the statute, the principal portion of any distribution that is not used for higher education expenses generally 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. Distributions from an account would be permitted to be made only to or for the benefit of the designated beneficiary. However, a contributor who sets up an account would be permitted to withdraw funds from the account during the contributor's life, subject to income tax on the income portion of the withdrawal. The income portion of a withdrawal by the account's contributor generally also would be subject to an additional tax to discourage individuals from using these accounts to save for retirement. The proposal would be effective for Section 529 accounts established after the date of enactment, and no additional contributions would be permitted to preexisting Section 529 savings accounts unless those accounts elect to be governed by the new rules.

TAX ADMINISTRATION, UNEMPLOYMENT INSURANCE, AND OTHER

Improve Tax Administration

Implement IRS administrative reforms.—The proposed modification to the IRS Restructuring and Reform Act of 1998 is comprised of five 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 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 Secretary of the Treasury 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 would encourage increased electronic filing of income tax returns by extending the April filing date for electronically filed income tax returns to April 30th, provided that any tax due is also paid electronically. The proposal also would provide the IRS additional authority to require electronic filing. This proposal would allow the IRS to process more returns and payments efficiently.

Allow IRS to access information in the National Directory of New Hires for tax administration purposes.—The National Directory of New Hires (NDNH), an electronic database maintained by the Department of Health and Human Services, contains timely, uniformly compiled employment data from State agencies across the country. Currently, the IRS may obtain data from the NDNH, but only for limited purposes. Access to NDNH data for tax administration purposes generally would make the IRS more productive by reducing the amount of resources it must dedicate to obtaining and processing data. The Administration proposes to amend the Social Security Act to allow the IRS access to NDNH data for general tax administration purposes, including data matching, verification of taxpayer claims during return processing, preparation of substitute returns for non-compliant taxpayers, and identification of levy sources. Data obtained by the IRS from the NDNH would be protected by existing taxpayer privacy law, including civil and criminal sanctions. The proposal would be effective on the date of enactment.

Extend IRS authority to fund undercover operations.—Current law places the IRS on equal footing with other Federal Law enforcement agencies by permitting the IRS to fund certain necessary and reasonable expenses of undercover operations. These undercover operations include international and domestic money laundering and narcotics operations. The Administration proposes to extend this funding authority, which will expire on December 31, 2005, through December 31, 2010.

Strengthen Financial Integrity of Unemployment Insurance

Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance.—The Administration has a five-part proposal to strengthen the financial integrity of the unemployment insurance (UI) system. The Administration's proposal will boost States' incentives to recover benefit overpayments by permitting them to use a portion of recovered funds on fraud and error reduction. The proposal would also require States to impose a monetary penalty on UI fraud, which would be used to reduce overpayments; permit more active participation by private collection agencies in the recovery of overpayments and delinquent employer taxes; require States to charge employers when their actions lead to overpayments; and collect delinquent UI overpayments through garnishment of Federal tax refunds. These efforts to strengthen the financial integrity of the UI system will keep State UI taxes down and improve the solvency of the State trust funds.

Other Proposals

Modify pesticide registration fee.—The Environmental Protection Agency has the authority and has promulgated a rule to collect fees for the registration of new pesticides. The collection of this fee has been blocked through appropriations acts since 1989. Most recently, provisions in the 2004 Consolidated Appropriations Act suspended this authority through 2010. The Administration proposes to eliminate the prohibition on the collection of the fee beginning in 2006 and to reclassify the fee as offsetting receipts.

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

Extend excise taxes deposited in the Highway Trust Fund.—Excise taxes imposed on nonaviation gasoline, diesel fuel, kerosene, special motor fuels, heavy highway vehicles, and tires for heavy highway vehicles are generally deposited in the Highway Trust Fund. Tax is imposed on nonaviation gasoline at a rate of 18.4 cents per gallon, on diesel fuel and kerosene at a rate of 24.4 cents per gallon, and on special motor fuels at varying rates. The tax rates are scheduled to fall, generally by 0.1 cent per gallon, on April 1, 2005 (reflecting the scheduled expiration of the LUST Trust Fund tax) and to 4.3 cents per gallon (or comparable rates in the case of special motor fuels) on October 1, 2005. A tax equal to 12 percent of the sales price is imposed on the first retail sale of heavy highway vehicles (generally, trucks with a gross weight greater than 33,000 pounds, trailers with a gross weight greater than 26,000 pounds, and highway tractors). In addition, a highway use tax of up to $550 per year is imposed on highway vehicles with a gross weight of at least 55,000 pounds. A tax is also imposed on tires with a rated load capacity exceeding 3,500 pounds, generally at a rate of 0.945 cent per pound of excess. The taxes on heavy highway vehicles and tires for heavy highway vehicles are scheduled to expire on September 30, 2005. The Administration proposes to extend the taxes on nonaviation gasoline, diesel fuel and kerosene, and special motor fuels at their current rates, except to the extent attributable to the LUST Trust Fund tax, through September 30, 2011. The Administration also proposes to extend the taxes on heavy highway vehicles and tires for heavy highway vehicles at their current rates through September 30, 2011.

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 2005 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.

PROMOTE TRADE

Implement free trade agreements with Bahrain, Panama, and the Dominican Republic.—Free trade agreements are expected to be completed with Bahrain, Panama, and the Dominican Republic in 2005, with ten-year implementation to begin in fiscal year 2006. These agreements will continue the Administration's effort to use free trade agreements to benefit U.S. consumers and producers as well as strengthen the economies of our partner countries.

EXTEND EXPIRING PROVISIONS

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 December 31, 2005.

***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, 2006.

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, 2006.

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 to individuals who begin work after December 31, 2005 and before January 1, 2007.

***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, 2005. The Administration proposes to extend the credit for one year, making the credit available with respect to purchases after December 31, 2005 and before January 1, 2007.

***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 2005. 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 2005 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 calendar years 2006; 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, 2005, to apply to donations made before January 1, 2007.

***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 will expire on December 31, 2005, through December 31, 2006.

***Extend excise taxes deposited in the Leaking Underground Storage Tank (LUST) Trust Fund*.**—An excise tax is imposed, generally at a rate of 0.1 cents per gallon, on gasoline and other liquid motor fuels used on highways, in aviation, on inland waterways, and in diesel-powered trains. The tax is deposited in the LUST Trust Fund. The tax is scheduled to expire on March 31, 2005. The Administration proposes to extend the tax at the current rate through March 31, 2007.

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 June 30, 2005. Abandoned mine 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. The Administration also proposes to modify the authorization language to allocate more of the receipts collected toward restoration of abandoned coal mine land.

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 $0.55 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 $0.50 per ton and $0.25 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.

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS

(in millions of dollars)

	2005	2006	2007	2008	2009	2010	2006–10	2006–15
Make Permanent Certain Tax Cuts Enacted in 2001 and 2003 (assumed in the baseline):								
Dividends tax rate structure	309	509	547	537	–16,725	–568	–15,700	–102,905
Capital gains tax rate structure	....	....	....	–5,268	–7,473	–5,076	–17,817	–59,016
Expensing for small business	....	....	....	–3,402	–5,417	–4,073	–12,892	–21,897
Marginal individual income tax rate reductions	....	....	....	....	....	....	....	–502,228
Child tax credit [1]	....	....	....	....	....	....	....	–96,777
Marriage penalty relief [2]	....	....	....	....	....	....	....	–36,029
Education incentives	....	....	....	....	....	3	3	–8,687
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes	4	–557	–910	–1,514	–1,847	–2,192	–7,020	–256,057
Modifications of pension plans	....	....	....	....	....	....	....	–2,323
Other incentives for families and children	....	....	....	....	....	5	5	–3,594
Total make permanent certain tax cuts enacted in 2001 and 2003	313	–48	–363	–9,647	–31,462	–11,901	–53,421	–1,089,513
Tax Incentives:								
Simplify and encourage saving:								
Expand tax-free savings opportunities	....	3,709	7,151	4,069	1,693	199	16,821	1,461
Consolidate employer-based savings accounts	....	–224	–335	–357	–382	–411	–1,709	–14,816
Establish Individual Development Accounts (IDAs)	....	....	–134	–286	–326	–300	–1,046	–1,763
Total simplify and encourage saving	....	3,485	6,682	3,426	985	–512	14,066	–15,118
Invest in health care:								
Provide a refundable tax credit for the purchase of health insurance [3]	....	–19	–1,435	–1,543	–1,370	–1,241	–5,608	–9,897
Provide an above-the-line deduction for high-deductible insurance premiums	....	–200	–2,029	–2,316	–2,636	–2,876	–10,057	–28,495
Provide a refundable tax credit for contributions of small employers to employee HSAs [4]	....	–61	–304	–834	–1,545	–2,025	–4,769	–17,760
Improve the Health Coverage Tax Credit [5]	....	....	–3	–4	–5	–5	–17	–49
Allow the orphan drug tax credit for certain pre-designation expenses	....	....	....	....	....	....	–1	–3
Total invest in health care	....	–280	–3,771	–4,697	–5,556	–6,147	–20,452	–56,204
Provide incentives for charitable giving:								
Permit tax-free withdrawals from IRAs for charitable contributions	–70	–335	–318	–318	–313	–304	–1,588	–3,095
Expand and increase the enhanced charitable deduction for contributions of food inventory	–42	–87	–96	–106	–116	–127	–532	–1,388
Reform excise tax based on investment income of private foundations	....	–148	–98	–105	–111	–119	–581	–1,321
Modify tax on unrelated business taxable income of charitable remainder trusts	–6	–5	–6	–6	–6	–7	–30	–69

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2005	2006	2007	2008	2009	2010	2006–10	2006–15
Modify basis adjustment to stock of S corporations contributing appreciated property	–4	–20	–21	–25	–28	–32	–126	–354
Repeal the $150 million limitation on qualified 501(c)(3) bonds	–3	–6	–10	–11	–10	–10	–47	–92
Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property	....	–2	–5	–9	–16	–24	–56	–278
Total provide incentives for charitable giving	–125	–603	–554	–580	–600	–623	–2,960	–6,597
Strengthen education:								
Extend, increase, and expand the above-the-line deduction for qualified out-of-pocket classroom expenses	....	–27	–267	–279	–282	–285	–1,140	–2,630
Encourage telecommuting:								
Exclude from income the value of employer-provided computers, software, and peripherals	....	–29	–50	–50	–55	–65	–249	–767
Provide assistance to distressed areas:								
Establish Opportunity Zones	....	–433	–806	–853	–899	–912	–3,903	–9,594
Provide disaster relief:								
Provide tax relief for FEMA hazard mitigation assistance programs	–20	–40	–40	–40	–40	–40	–200	–400
Increase housing opportunities:								
Provide tax credit for developers of affordable single-family housing	....	–7	–84	–342	–815	–1,425	–2,673	–17,370
Protect the environment:								
Extend permanently expensing of brownfields remediation costs	....	–138	–215	–203	–195	–184	–935	–1,743
Exclude 50 percent of gains from the sale of property for conservation purposes	....	–47	–92	–105	–60	....	–304	–304
Total protect the environment	....	–185	–307	–308	–255	–184	–1,239	–2,047
Increase energy production and promote energy conservation:								
Extend the tax credit for producing electricity from wind, biomass, and landfill gas and modify the tax credit for electricity from biomass	–48	–144	–321	–260	–160	–163	–1,048	–1,779
Provide tax credit for residential solar energy systems	–5	–11	–19	–24	–34	–16	–104	–104
Modify treatment of nuclear decommissioning funds	–47	–166	–162	–170	–177	–183	–858	–1,881
Provide tax credit for purchase of certain hybrid and fuel cell vehicles [6]	–13	–260	–447	–614	–680	–23	–2,024	–2,532
Provide tax credit for combined heat and power property	–17	–109	–84	–105	–114	–36	–448	–394
Total increase energy production and promote energy conservation	–130	–690	–1,033	–1,173	–1,165	–421	–4,482	–6,690
Restructure assistance to New York City:								
Provide tax incentives for transportation infrastructure	....	–200	–200	–200	–200	–200	–1,000	–2,000
Repeal certain New York City Liberty Zone incentives	....	200	200	200	200	200	1,000	2,000
Total restructure assistance to New York City	....	....	....	....	....	....	....	....
Total tax incentives	–275	1,191	–230	–4,896	–8,682	–10,614	–23,232	–117,417
Simplify the Tax Laws for Families:								
Simplify adoption tax benefits	....	–4	–40	–42	–43	–45	–174	–426
Clarify eligibility of siblings and other family members for child related tax benefits [7]	11	51	78	77	60	40	306	536
Total simplify the tax laws for families	11	47	38	35	17	–5	132	110
Strengthen the Employer-Based Pension System:								
Ensure fair treatment of older workers in cash balance conversions and protect defined benefit plans	....	57	62	78	92	104	393	1,096
Strengthen funding for single-employer pension plans	....	151	1,432	–869	–2,699	–1,762	–3,747	–12,735
Reflect market interest rates in lump sum payments	....	....	–3	–8	–15	–20	–46	–241
Total strengthen the employer-based pension system	....	208	1,491	–799	–2,622	–1,678	–3,400	–11,880
Close Loopholes and Improve Tax Compliance:								
Combat abusive foreign tax credit transactions	1	2	2	2	2	3	11	26
Modify the active trade or business test	2	6	8	8	8	8	38	87
Impose penalties on charities that fail to enforce conservation easements	3	8	8	8	9	9	42	96

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2005	2006	2007	2008	2009	2010	2006–10	2006–15
Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields	1	4	12	23	37	49	125	242
Apply an excise tax to amounts received under certain life insurance contracts	2	7	12	17	23	28	87	323
Limit related party interest deductions	74	128	134	141	148	155	706	1,607
Clarify and simplify qualified tuition programs	....	4	12	13	14	20	63	222
Total close loopholes and improve tax compliance	83	159	188	212	241	272	1,072	2,603
Tax Administration, Unemployment Insurance, and Other:								
Improve tax administration:								
Implement IRS administrative reforms and initiate cost saving measures [8]	....	....	....	....	....	....	....	....
Strengthen financial integrity of unemployment insurance:								
Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance [6]	....	....	6	–6	–129	–530	–659	–2,856
Other proposals:								
Modify pesticide registration fee	....	....	....	....	....	....	....	–152
Increase Indian gaming activity fees	....	....	4	4	5	5	18	43
Total tax administration, unemployment insurance, and other	....	....	10	–2	–124	–525	–641	–2,965
Reauthorize Funding for the Highway Trust Fund:								
Extend excise taxes deposited in the Highway Trust Fund [6]	....	10	11	11	11	11	54	65
Allow tax-exempt financing for private highway projects and rail-truck transfer facilities	–5	–22	–47	–75	–92	–97	–333	–601
Total reauthorize funding for the Highway Trust Fund	–5	–12	–36	–64	–81	–86	–279	–536
Promote Trade:								
Implement free trade agreements with Bahrain, Panama and the Dominican Republic [6]	....	–56	–84	–91	–97	–102	–430	–976
Extend Expiring Provisions:								
Research & Experimentation (R&E) tax credit	....	–2,097	–4,601	–5,944	–6,889	–7,669	–27,200	–76,225
Combined work opportunity/welfare-to-work tax credit	....	–131	–166	–65	–16	–5	–383	–383
First-time homebuyer credit for DC	....	–1	–18	....	....	....	–19	–19
Authority to issue Qualified Zone Academy Bonds	....	–3	–8	–13	–18	–20	–62	–162
Deduction for corporate donations of computer technology	....	–73	–49	....	....	....	–122	–122
Disclosure of tax return information related to terrorist activity [8]	....	....	....	....	....	....	....	....
LUST Trust Fund taxes [6]	74	152	77	....	....	....	229	229
Abandoned mine reclamation fees	....	304	312	318	322	323	1,579	3,230
Excise tax on coal [6]	....	....	....	....	....	....	....	479
Total extend expiring provisions	74	–1,849	–4,453	–5,704	–6,601	–7,371	–25,978	–72,973
Total budget proposals, including proposals assumed in the baseline	201	–360	–3,439	–20,956	–49,411	–32,010	–106,177	–1,293,547
Total budget proposals, excluding proposals assumed in the baseline	–112	–312	–3,076	–11,309	–17,949	–20,109	–52,756	–204,034

[1] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $37,319 million for 2006–2015.

[2] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $7,491 million for 2006–2015.

[3] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $78 million for 2006, $3,660 million for 2007, $5,514 million for 2008, $6,529 million for 2009, $7,035 million for 2010, $22,816 million for 2006–2010 and $64,078 million for 2006–2015.

[4] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $18 million for 2006, $87 million for 2007, $237 million for 2008, $392 million for 2009, $589 million for 2010, $1,323 million for 2006–2010 and $4,930 million for 2006–2015.

[5] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $3 million for 2006, $10 million for 2007, $11 million for 2008, $13 million for 2009, $14 million for 2010, $51 million for 2006–2010 and $130 million for 2006–2015.

[6] Net of income offsets.

[7] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is -$115 million for 2006, -$150 million for 2007, -$168 million for 2008, -$196 million for 2009, -$258 million for 2010, -$887 million for 2006–2010 and -$2,239 million for 2006–2015.

[8] No net budgetary impact.

Table 17–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2004 Actual	Estimate					
		2005	2006	2007	2008	2009	2010
Individual income taxes (federal funds):							
Existing law	808,959	893,698	964,283	1,069,364	1,177,249	1,280,242	1,370,919
Proposed Legislation	....	6	2,594	1,805	–10,076	–35,103	–17,644
Total individual income taxes	**808,959**	**893,704**	**966,877**	**1,071,169**	**1,167,173**	**1,245,139**	**1,353,275**
Corporation income taxes:							
Federal funds:							
Existing law	189,370	226,431	222,811	234,112	252,724	264,958	270,000
Proposed Legislation	....	95	–2,553	–4,295	–9,307	–12,595	–12,367
Total Federal funds corporation income taxes	189,370	226,526	220,258	229,817	243,417	252,363	257,633
Trust funds:							
Hazardous substance superfund	1	....	....	....	....	....	....
Total corporation income taxes	**189,371**	**226,526**	**220,258**	**229,817**	**243,417**	**252,363**	**257,633**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	457,120	479,891	507,087	537,849	568,092	598,946	635,310
Disability insurance (Off-budget)	77,625	81,472	86,104	91,333	96,469	101,708	107,883
Hospital insurance	150,589	161,360	172,135	182,412	193,079	204,007	216,710
Railroad retirement:							
Social Security equivalent account	1,729	1,726	1,760	1,778	1,819	1,853	1,891
Rail pension and supplemental annuity	2,297	2,187	2,209	2,252	2,192	2,203	2,364
Total employment and general retirement	689,360	726,636	769,295	815,624	861,651	908,717	964,158
On-budget	154,615	165,273	176,104	186,442	197,090	208,063	220,965
Off-budget	534,745	561,363	593,191	629,182	664,561	700,654	743,193
Unemployment insurance:							
Deposits by States [1]	32,605	35,371	37,513	38,870	39,620	40,399	42,420
Proposed Legislation	....	....	....	7	–7	–162	–662
Federal unemployment receipts [1]	6,718	7,009	7,357	7,181	6,011	5,798	6,124
Railroad unemployment receipts [1]	130	96	86	101	124	132	121
Total unemployment insurance	39,453	42,476	44,956	46,159	45,748	46,167	48,003
Other retirement:							
Federal employees' retirement—employee share	4,543	4,574	4,540	4,400	4,301	4,153	4,038
Non-Federal employees retirement [2]	51	45	43	39	36	33	30
Total other retirement	4,594	4,619	4,583	4,439	4,337	4,186	4,068
Total social insurance and retirement receipts	**733,407**	**773,731**	**818,834**	**866,222**	**911,736**	**959,070**	**1,016,229**
On-budget	198,662	212,368	225,643	237,040	247,175	258,416	273,036
Off-budget	534,745	561,363	593,191	629,182	664,561	700,654	743,193
Excise taxes:							
Federal funds:							
Alcohol taxes	8,105	7,909	8,056	8,190	8,330	8,579	8,716
Proposed Legislation	....	....	–56	–19	....	....	....
Tobacco taxes	7,926	7,899	7,732	7,590	7,459	7,325	7,202
Transportation fuels tax	1,381	–526	–1,325	–1,417	–1,460	–1,481	–1,500
Proposed Legislation	....	....	12	13	13	13	14
Telephone and teletype services	5,997	6,485	6,881	7,292	7,717	8,158	8,619
Other Federal fund excise taxes	1,157	1,373	1,329	1,370	1,423	1,478	1,533
Proposed Legislation	....	–1,089	–1,206	–1,214	–1,268	–1,301	–1,333
Total Federal fund excise taxes	24,566	22,051	21,423	21,805	22,214	22,771	23,251
Trust funds:							
Highway	34,711	37,792	39,119	39,908	40,630	41,315	41,989
Proposed Legislation	....	1,089	1,107	1,119	1,137	1,151	1,160

Table 17–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2004 Actual	Estimate 2005	2006	2007	2008	2009	2010
Airport and airway	9,174	10,517	11,319	11,996	12,651	13,346	14,077
Aquatic resources	416	424	426	439	451	466	479
Tobacco	....	1,098	1,089	964	964	964	964
Black lung disability insurance	566	584	601	618	636	650	660
Inland waterway	91	91	92	93	93	94	95
Vaccine injury compensation	142	170	188	192	194	196	199
Leaking underground storage tank	189	97	....	....	....	....	....
Proposed Legislation	....	100	202	103	....	....	....
Total trust funds excise taxes	45,289	51,962	54,143	55,432	56,756	58,182	59,623
Total excise taxes	**69,855**	**74,013**	**75,566**	**77,237**	**78,970**	**80,953**	**82,874**
Estate and gift taxes:							
Federal funds	24,831	23,754	26,810	24,628	25,973	27,625	21,509
Proposed Legislation	....	....	–689	–1,162	–1,649	–1,612	–1,371
Total estate and gift taxes	**24,831**	**23,754**	**26,121**	**23,466**	**24,324**	**26,013**	**20,138**
Customs duties:							
Federal funds	20,143	22,100	25,643	27,954	29,918	31,861	33,195
Proposed Legislation	....	1,608	1,540	1,512	734	736	739
Trust funds	940	966	1,073	1,170	1,246	1,295	1,345
Total customs duties	**21,083**	**24,674**	**28,256**	**30,636**	**31,898**	**33,892**	**35,279**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	96	100	110	106	106	106	106
Proposed Legislation	....	....	....	4	4	5	5
United Mine Workers of America combined benefit fund	127	96	119	128	125	122	119
Deposit of earnings, Federal Reserve System	19,652	24,102	28,528	32,197	36,076	39,441	42,239
Defense cooperation	13	7	7	8	8	8	8
Confiscated Assets	18	....	....	....	....	....	....
Fees for permits and regulatory and judicial services	8,675	9,625	10,049	10,360	10,316	10,004	10,058
Proposed Legislation	....	....	304	312	318	322	323
Fines, penalties, and forfeitures	3,902	4,252	4,276	4,265	3,551	3,592	3,633
Proposed Legislation	....	–1,608	–1,615	–1,624	–855	–865	–874
Gifts and contributions	153	195	188	187	188	190	192
Refunds and recoveries	–71	–326	–328	–336	–344	–352	–359
Total miscellaneous receipts	**32,565**	**36,443**	**41,638**	**45,607**	**49,493**	**52,573**	**55,450**
Total budget receipts	**1,880,071**	**2,052,845**	**2,177,550**	**2,344,154**	**2,507,011**	**2,650,003**	**2,820,878**
On-budget	1,345,326	1,491,482	1,584,359	1,714,972	1,842,450	1,949,349	2,077,685
Off-budget	534,745	561,363	593,191	629,182	664,561	700,654	743,193
MEMORANDUM							
Federal funds	1,100,875	1,228,758	1,307,760	1,423,134	1,539,578	1,633,820	1,746,109
Trust funds	495,410	545,688	637,748	665,392	694,810	727,810	765,078
Interfund transactions	–250,959	–282,964	–361,149	–373,554	–391,938	–412,281	–433,502
Total on-budget	**1,345,326**	**1,491,482**	**1,584,359**	**1,714,972**	**1,842,450**	**1,949,349**	**2,077,685**
Off-budget (trust funds)	**534,745**	**561,363**	**593,191**	**629,182**	**664,561**	**700,654**	**743,193**
Total	**1,880,071**	**2,052,845**	**2,177,550**	**2,344,154**	**2,507,011**	**2,650,003**	**2,820,878**

[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.

18. 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 18–1 summarizes these transactions. For 2006, total offsetting collections and receipts from the public are estimated to be $275.8 billion, and total user charges are estimated to be $207.3 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 21–1, "Outlays to the Public, Net and Gross," which appears in Chapter 21 of this volume.

Table 18–1. GROSS OUTLAYS, USER CHARGES, OTHER OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, AND NET OUTLAYS

(in billions)

	Actual 2004	Estimate	
		2005	2006
Gross outlays	2,541.8	2,732.5	2,843.4
Offsetting collections and receipts from the public:			
User charges [1]	169.2	183.4	203.9
Other	80.4	69.7	71.8
Subtotal, offsetting collections and receipts from the public	249.6	253.1	275.8
Net outlays	2,292.2	2,479.4	2,567.6

[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 18–2, "Total User Charge Collections."

Total user charges:			
Offsetting collections and receipts from the public	169.2	183.4	203.9
Receipts	2.7	3.2	3.4
Total, User charges	171.9	186.6	207.3

[1] Showing collections from business-type transactions as offsets on the spending side of the budget follows the concept recommended by the *Report of the President's Commission on Budget Concepts* in 1967. The concept is discussed in Chapter 26: "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 18–2 shows that user charges were $171.9 billion in 2004, and are estimated to increase to $186.6 billion in 2005 and to $207.3 billion in 2006, growing to an estimated $243.1 billion in 2010, including the user charges proposals that are shown in Table 18–3. This table shows that the Administration's user charge proposals, including extension of expiring charges, would increase user charges by an estimated $5.3 billion in 2006, growing to an estimated $11.2 billion in 2010.

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, 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. (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.

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

[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.

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 historic 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.

[3] Policies for setting user charges are promulgated in OMB Circular No. A-25: "User Charges" (July 8, 1993).

Classification of user charges in the budget. As shown in Table 18–1, 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 $3.4 billion in 2006 are classified on the receipts side and are included in the totals described in Chapter 17. "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 $203.9 billion in 2006, 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 conceptually would 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 $131.7 billion of user charges for 2006 are credited directly to expenditure accounts, and are generally available for expenditure when they are collected, without further action by the Congress. An estimated $72.2 billion of user charges for 2006 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 18–2 and 18–3 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 26, "The Budget System and Concepts."

II. Total User Charges

As shown in Table 18–2, total user charge collections (including those proposed in this Budget) are estimated to be $207.3 billion in 2006, increasing to $243.1 billion in 2010. 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 2006.

Table 18–2. TOTAL USER CHARGE COLLECTIONS

(in millions of dollars)

	Actual 2004	Estimates					
		2005	2006	2007	2008	2009	2010
Receipts							
Agricultural quarantine inspection fees	258	328	363	368	372	377	381
Abandoned mine reclamation fund	287	303	304	312	318	322	323
Department of State immigration, passport, and consular fees	556	846	886	889	892	895	898
Corps of Engineers harbor maintenance fees	870	896	1,002	1,098	1,173	1,221	1,269
Other	748	811	816	845	645	650	656
Subtotal, receipts	2,719	3,184	3,371	3,512	3,400	3,465	3,527
Offsetting Collections and Receipts from the Public							
Discretionary							
Department of Agriculture: Food safety inspection and other fees	289	227	231	226	226	225	222
Department of Commerce: Patent and trademark, fees for weather services, and other fees	1,628	1,757	1,898	1,996	2,105	2,241	2,393
Department of Defense: Commissary and other fees	9,316	9,287	9,783	9,828	9,853	9,853	9,853
Department of Energy: Federal Energy Regulation Commission, power marketing, and other fees	887	1,155	1,314	1,287	1,287	1,283	1,265
Department of Health and Human Services: Food and Drug Administration, Centers for Medicare and Medicaid Services, and other fees	1,324	899	981	958	960	955	940
Department of Homeland Security: Border and Transportation Security and other fees	1,997	2,449	4,325	4,528	4,751	4,984	5,230
Department of the Interior: Minerals Management Service and other fees	505	507	549	527	544	540	522
Department of Justice: Fees for bankruptcy oversight and other fees	284	302	313	306	306	305	300
Department of State: Passport and other fees	755	935	1,051	1,090	1,136	1,183	1,230
Department of the Treasury: Sale of commemorative coins and other fees	1,509	1,789	1,819	1,777	1,778	1,772	1,743
Department of Veterans Affairs: Medical care and other fees	1,815	2,033	2,248	2,344	2,446	2,553	2,663
Social Security Administration, State supplemental fees, supplemental security income	118	128	135	132	132	132	130
Federal Communications Commission: Regulatory fees	370	365	386	376	376	375	368
Federal Trade Commission: Regulatory fees	98	123	139	156	156	156	153
Nuclear Regulatory Commission: Regulatory fees	545	541	567	558	562	563	559
Securities and Exchange Commission: Regulatory fees	1,393	1,806	2,141	1,115	1,147	1,332	1,520
All other agencies, discretionary user charges	389	565	677	664	670	668	657
Subtotal, discretionary user charges	23,222	24,868	28,557	27,868	28,435	29,120	29,748
Mandatory							
Department of Agriculture: Crop insurance and other fees	1,539	1,959	1,971	2,008	2,066	2,131	2,181
Department of Defense: Commissary surcharge and other fees	877	908	589	518	404	354	338
Department of Energy: Proceeds from the sale of energy, nuclear waste disposal fees, and other fees	4,556	4,985	4,719	4,669	5,025	5,784	6,141
Department of Health and Human Services: Medicare Part B insurance premiums, and other fees	32,201	38,049	48,808	54,156	56,992	60,681	64,981
Department of Homeland Security: Customs, immigration, and other fees	5,176	6,052	6,496	6,677	6,864	7,048	7,234
Department of the Interior: Recreation and other fees	3,612	5,668	5,289	5,234	5,381	5,474	5,411
Department of Justice: Federal Prison Commissary fees and other fees	362	413	586	568	579	590	602
Department of Labor: Insurance premiums to guaranty private pensions and other fees	2,202	4,005	7,251	9,025	9,335	9,461	9,418
Department of the Treasury: Bank regulation, and other fees	752	812	988	1,003	1,024	1,047	1,068
Department of Veterans Affairs: Veterans life insurance and other fees	1,724	1,717	2,004	1,964	1,932	1,908	1,878
Office of Personnel Management: Federal employee health and life insurance fees	9,738	10,661	11,439	12,258	13,162	14,060	15,122
Federal Deposit Insurance Corporation: Deposit insurance premiums	763	666	908	1,071	1,470	2,059	3,059
National Credit Union Administration: Credit union share insurance and other fees	379	448	474	590	673	761	859
Postal Service: Fees for postal services	68,001	67,538	67,628	67,753	68,747	68,941	69,435
Tennessee Valley Authority: Proceeds from the sale of energy	7,576	7,797	8,075	8,108	8,091	8,149	8,338
Undistributed Offsetting Receipts: Sale of spectrum licenses, OCS receipts, and other charges	5,106	5,986	7,231	10,806	14,589	18,386	12,806
All other agencies, mandatory user charges	1,422	879	911	949	955	955	968
Subtotal, mandatory user charges	145,986	158,543	175,367	187,357	197,289	207,789	209,839
Subtotal, user charges that are offsetting collections and receipts from the public	169,208	183,411	203,924	215,225	225,724	236,909	239,587
TOTAL, User charges	171,927	186,595	207,295	218,737	229,124	240,374	243,114

III. User Charge Proposals

As shown in Table 18–3, the Administration is proposing new or increased user charges, including proposed extensions of expiring charges, that would increase collections by an estimated $5.3 billion in 2006, increasing to $11.2 billion in 2010.

A. Discretionary User Charge Proposals

1. Offsetting collections

Department of Commerce

Patent and Trademark Office (PTO). The Administration will propose legislation to permanently extend changes to PTO's patent and trademark fees that were enacted in the 2005 Consolidated Appropriations Act. These changes restructured patent fees and adjusted trademark fees for 2005 and 2006 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 Homeland Security

Transportation Security Administration: Aviation security fees. Aviation security fees are levied on both passengers and air carriers. The Budget proposes to increase aviation security passenger fees. In general, passenger security fees will rise by $3.00. On a typical one-way ticket, the passenger security fee will rise from $2.50 to $5.50. For passengers flying multiple legs on a one-way ticket, the fee will rise from $5.00 under current law to $8.00. This proposal, along with air carrier security fees, will result in fee levels that recover nearly all of the $4.5 billion cost of airport screening operations.

Table 18–3. USER FEE AND OTHER USER CHARGE PROPOSALS [1]

(estimated collections in millions of dollars)

	2006	2007	2008	2009	2010	2006–2010
DISCRETIONARY						
1. Offsetting collections						
Department of Commerce						
Patent and Trademark Office	....	168	145	115	81	509
Department of Homeland Security						
Transportation Security Administration:						
Aviation security fees	1,479	1,622	1,776	1,937	2,108	8,922
Department of Housing and Urban Development						
Office of Federal Housing Enterprise Oversight: Government-sponsored enterprise (GSE) regulation	–60	–59	–59	–58	–57	–293
2. Offsetting receipts						
Nuclear Regulatory Commission						
Extend Nuclear Regulatory Commission fees	365	351	350	346	337	1,749
Subtotal, discretionary user charge proposals	1,784	2,082	2,212	2,340	2,469	10,887
MANDATORY						
1. Offsetting collections						
Department of Housing and Urban Development						
Government-sponsored enterprise (GSE) regulation	6	6	6	6	6	30
Department of Labor						
Pension Benefit Guaranty Corporation	2,195	3,702	3,490	3,199	2,836	15,422
Department of the Treasury						
Office of Housing Finance Supervision: Government-sponsored enterprise (GSE) regulation	96	94	94	95	95	474
Federal Deposit Insurance Corporation						
Merge the bank insurance fund and the savings association insurance fund	....	....	....	–380	–856	–1,236
Federal Housing Finance Board						
Government-sponsored enterprise (GSE) regulation	–36	–37	–38	–39	–40	–190
2. Offsetting receipts						
User Fee Proposals						
Department of Agriculture						
Animal and Plant Health Inspection Service user fees*	11	11	11	12	12	57
Food Safety and Inspection Service user fees*	139	142	145	148	151	725
Grain Inspection, Packers and Stockyards Administration user fees*	25	26	26	27	27	131
Agricultural Marketing Service standardization user fees*	3	3	3	3	3	15
Department of Justice						
Bureau of Alcohol, Tobacco, Firearms and Explosives:						
Explosives regulation user fees*	120	120	120	120	120	600
Department of Transportation						
St. Lawrence Seaway Development Corporation user fees*	8	17	17	17	17	76

Table 18–3. USER FEE AND OTHER USER CHARGE PROPOSALS [1]—Continued

(estimated collections in millions of dollars)

	2006	2007	2008	2009	2010	2006–2010
Department of the Treasury						
Alcohol and Tobacco Tax and Trade Bureau regulatory activity user fees*	29	29	29	29	29	145
Department of Veterans Affairs						
Establish an annual enrollment fee for non-disabled, higher income veterans*	248	248	248	248	1,240	
Increased pharmaceutical copayments*	176	178	180	181	183	898
Medical services (illustrative discretionary spending authority—non-add)	*(424)*	*(426)*	*(428)*	*(429)*	*(431)*	*(2,138)*
Environment Protection Agency						
Pre-manufacture notice user fees*	4	8	8	8	8	36
Pesticide tolerance user fees* [2]	20	20	21	21	22	104
Pesticide registration user fees*	26	27	27	28	28	136
Federal Communications Commission						
Authorize spectrum license user fees	....	50	150	300	300	800
Analog spectrum lease fees	....	500	500	480	450	1,930
Subtotal, User fee proposals	**809**	**1,379**	**1,485**	**1,622**	**1,598**	**6,893**
Other Proposals						
Department of Agriculture						
Forest Service: Administration of rights-of-way	5	5	5	5	5	25
Forest Service: Facilities enhancement	42	42	42	65	65	256
Department of Energy						
Power Marketing Administrations: Charge market rates	40	157	446	1,145	1,406	3,194
Department of Homeland Security						
Immigration examination fees	31	31	31	31	31	155
Department of the Interior						
Arctic National Wildlife Refuge, sale of leases:						
Collections for payments to Alaska	....	1,200	1	101	1	1,303
Federal receipts	....	1,200	1	101	1	1,303
Department of Labor						
Foreign labor certification fees	40	40	40	40	40	200
Corps of Engineers—Civil Works						
Additional recreation fees	9	17	17	17	17	77
Federal Communications Commission						
Extending spectrum auction authority	....	....	–1,083	2,156	3,239	4,312
Subtotal, other proposals	167	2,692	–500	3,661	4,805	10,825
Subtotal, mandatory user charge proposals	3,237	7,836	4,537	8,164	8,444	32,218
GOVERNMENTAL RECEIPTS						
Department of the Interior						
Abandoned mine reclamation fees	304	312	318	322	323	1,579
Increase Indian Gaming Commission, activity fees	....	4	4	5	5	18
Subtotal, governmental receipts user charge proposals	304	316	322	327	328	1,597
Total, user charge proposals	5,325	10,234	7,071	10,831	11,241	44,702

[1] A negative sign indicates a decrease in collections.
[2] Includes outlay reductions in 2009 and 2010.
* The Administration will work with Congress to reclassify the enacted fees as discretionary beginning in 2007. Once reclassified, the Administration proposes to offset these fees against discretionary spending. Discretionary totals in those years will be reduced by these fees.

Department of Housing and Urban Development

Office of Federal Housing Enterprise Oversight: Government-sponsored enterprise (GSE) regulation. This proposal is discussed below in the Department of the Treasury entry for the Office of Housing Finance Supervision.

2. Offsetting receipts

Nuclear Regulatory Commission

Extend Nuclear Regulatory Commission (NRC) fees at their 2005 level for 2006 and later. The Budget is proposing to extend NRC fees. 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 a proposed $567 million in 2006 to $202 million, a loss of $365 million.

B. Mandatory User Charge Proposals

1. Offsetting collections

Department of Housing and Urban Development

Government-sponsored enterprise (GSE) regulation. This proposal is discussed below in the Department of the Treasury entry for the Office of Housing Finance Supervision.

Department of Labor

Pension Benefit Guaranty Corporation (PBGC). The PBGC receives much of its income for its single-employer plan through flat-rate and variable-rate premiums. The current flat-rate premiums are $19 per participant and have not been changed since 1991. The Administration's 2006 proposal would increase this amount to $30 per participant and future increases would be indexed to wage growth. Variable-rate premiums would also be reformed to reflect new funding targets. The PBGC's Board of Directors would periodically review the variable-rate premiums to cover the cost of expected claims and to improve the PBGC's financial position. In 2006 these changes would result in an additional $2,195 million in premium income for the PBGC.

Department of the Treasury

Office of Housing Finance Supervision: Government-sponsored enterprise (GSE) regulation. The Administration will again propose 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. The Budget places this new regulator in the Department of the Treasury. For additional information, see Chapter 7, "Credit and Insurance", in this volume, and the Department of the Treasury chapter in the Appendix volume.

Federal Deposit Insurance Corporation

Merge the bank insurance fund and the saving association insurance fund. The Federal Deposit Insurance Corporation (FDIC) insures deposits in banks and savings associations (thrifts) through the Bank Insurance Fund (BIF) and the Savings Association Insurance 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. Under baseline assumptions, BIF is expected to need to dramatically increase the insurance premiums it charges banks in 2009. Because the merged fund would be financially stronger, the combined fund is not expected to need to increase premiums until 2012.

Federal Housing Finance Board

Government-sponsored enterprise (GSE) regulation. This proposal is discussed above in the Department of the Treasury entry for the Office of Housing Finance Supervision.

2. Offsetting receipts

User Fee Proposals

For the proposals noted with an asterisk *(*)* in the text below and in Table 18–3, the Administration will work with Congress to reclassify the enacted fees as discretionary beginning in 2007. Once reclassified, the Administration proposes to offset these fees against discretionary spending. Discretionary totals in those years will be reduced by these fees.

Department of Agriculture

*Animal and Plant Health Inspection Service user fees.** The Administration proposes to establish user fees for animal welfare inspections, such as for animal research centers, humane societies, and kennels.

*Food Safety and Inspection Service user fees.** 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.

*Grain Inspection, Packers, and Stockyards Administration (GIPSA) user fees.** The Administration 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.

*Agriculture Marketing Service (AMS) standardization user fees.** The Administration proposes to recover the cost of developing, reviewing and modifying quality grade standards through user fees. This proposal would enable the AMS to charge fees to customers of the agency's inspection and grading programs for the cost associated with the development, review, and maintenance of official grade standards for which the agency has these established services.

Department of Justice

*Bureau of Alcohol, Tobacco, Firearms and Explosives: Explosives regulation user fees.** The Budget includes a proposal to authorize the Department of Justice to assess an explosives user fee on all explosives manufactured in or imported into the United States. For 2006, a user fee of $0.02/ pound would generate $120 million in additional collections. This new user fee, when combined with the Department's current explosives licensing fees, would provide full offset for the Bureau's regulation of the explosives industry. The fee would be set in regulation, and could be increased as deemed necessary by the Attorney General.

Department of Transportation

*St. Lawrence Seaway Development Corporation (SLSDC) user fees.** This SLSDC is a wholly owned government corporation and an operating administration of the Department of Transportation responsible for the operations and maintenance of the U.S. portion of the St. Lawrence Seaway between Montreal and Lake Erie. The President's Budget proposes permanent authority for the U.S. SLSDC to collect mandatory receipts from users of the seaway. The proposal also provides some funding in 2006 for SLSDC if revenues are not sufficient to cover operational costs in the first year of implementation. The President's proposal would make SLSDC consistent with the St. Lawrence Seaway Management Corporation, its Canadian counterpart, which currently supports its operations through fees.

Department of the Treasury

*Alcohol and Tobacco Tax and Trade Bureau regulatory activity user fees.** The Budget proposes to establish user fees to cover the costs of the Tax and Trade Bureau's regulatory functions under its "Protect the Public" line-of-business. The new user fees include filing fees for Certificate of Label Approvals, proposed formulas, and permit applications, among others.

Department of Veterans Affairs

*Establish an annual enrollment fee for PL 7 and PL 8 veterans (non-disabled, higher income).** The Administration proposes to establish an annual enrollment fee of $250 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.

*Increased pharmaceutical copayments for PL 7 and PL 8 veterans (non-disabled, higher income).** The Administration proposes to increase pharmaceutical copayments from $7 to $15 for Priority Level 7 and 8 veterans. The increased receipts will more closely align the Department of Veterans Affairs with the private sector and the Department of Defense while allowing 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

*Pre-manufacture notice user fees.** EPA presently collects fees from chemical manufacturers seeking to bring new chemicals into commerce. These fees are authorized by the Toxic Substances Control Act and are subject to an outdated statutory cap. The Administration proposes to eliminate the cap so that EPA can recover a greater portion of the cost of the program.

*Pesticide tolerance user fees.** The Federal Food, Drug, and Cosmetic Act (FFDCA) requires the Environmental Protection Agency (EPA) to collect fees for establishment and reassessment of pesticide tolerances. Tolerances are maximum limits set by EPA on the amount of pesticides that may remain in or on foods after they have been treated. Collection of these tolerance fees has been blocked in appropriations acts since 2001. Most recently, provisions in the 2004 Consolidated Appropriations Act suspended this authority through 2008. The Administration proposes to eliminate the prohibition on the collection of the tolerance fee beginning in 2006.

*Pesticide registration user fees.** EPA has the authority and an existing rule to collect fees from entities seeking to register their pesticides for use in the United States. However, these fees have been blocked through appropriations acts since 1989. Most recently, provisions in the 2004 Consolidated Appropriations Act suspended this authority through 2010. The Administration proposes to eliminate the prohibition on collecting this pesticide registration fee beginning in 2006.

Federal Communications Commission

Authorize spectrum license user fees. To continue to promote efficient spectrum use, the Administration proposes new authority for the FCC to set user fees on unauctioned spectrum licenses, based on public-interest and spectrum-management principles. Fee collections are proposed to begin in 2007 and total $3.1 billion through 2015.

Analog spectrum lease fee. To encourage television broadcasters to vacate the analog spectrum in a timely fashion as required by law, the Administration proposes authorizing the 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 would be exempt from the fee, and fee collections would decline.

Other Proposals

Department of Agriculture

Forest Service: Administration of rights-of-way. This increase in receipts reflects a Budget proposal that would permit the Forest Service to collect fees based upon a more accurate reflection of costs incurred in the administration and monitoring of special use permits on National Forest Systems lands.

Forest Service: Facilities enhancement. The Administration proposes reforms to enhance Forest Service efforts to improve its accountability and focus on measurable results in the management of national forests. These reforms will allow for the sale of unneeded facilities, with receipts being devoted to maintenance or replacement of needed existing facilities.

Department of Energy

Power Marketing Administrations: Charge market rates. The Budget proposes to very gradually bring PMA electricity rates closer to average market rates throughout the country. According to the Government

Accountability Office, taxpayers across the Nation have borne some of the PMAs' costs and, therefore, helped subsidize the cost of PMA power purchased by electricity wholesalers. Reducing subsidies to electricity wholesalers is consistent with the Administration's policies, and this proposal will create a more level playing field for the Nation's electricity suppliers and encourage appropriate energy conservation.

Department of Homeland Security

Immigration examination fees. The Administration proposes to adjust fees for Temporary Protected Status applications to fully capture processing costs and allow the Department to charge premium service fees for certain adjudications.

Department of the Interior

Arctic National Wildlife Refuge: Collections for payments to Alaska and Federal receipts. 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. The Budget assumes that the first oil and gas lease sale would be held in 2007 and would result in $2.4 billion in new revenues. All oil and gas revenues from the 1002 Area would be shared fifty percent with the State of Alaska, including the estimated $2 million in annual rental payments. (The Federal share of revenues would be deposited in the Treasury.)

Department of Labor

Foreign labor certification fees. The Administration will propose legislation to establish a new fee for applications under the permanent labor certification program. Fee proceeds would offset the costs of administering the program and partially support backlog reduction in regional offices. Upon enactment of the fee, funding for these activities now included in the Program Administration account will be reviewed and adjusted.

Corps of Engineers—Civil Works

Additional recreation fees. The Corps of Engineers manages 4,300 recreation areas at 465 Corps projects (mostly lakes) in 43 states, used annually by millions of visitors. The Administration proposes a Corps recreation modernization initiative, based on a promising model now used by the National Park Service, the Forest Service, and other major Federal recreation providers. The agency would use a portion of the fees it collects (such as entrance fees) to upgrade the site where the fees are collected. The Corps would also seek legislative authority to operate a limited number of public/private partnerships, such as lake improvement districts, which would draw on local property owners and community leaders to help manage and finance the Corps recreation program. The Administration will use user fees as a percent of total program spending as a performance measure for this program since that is an indicator of community support for the program.

Federal Communications Commission (FCC)

Extending spectrum auction authority. The Administration proposes to extend indefinitely the FCC's authority to auction spectrum licenses, which expires in 2007. Reductions in estimated receipts in 2008 resulting from possible shifting of spectrum auctions into later years are more than offset by higher estimated receipts for those auctions in 2009 and 2010 as well as new future auctions. Estimated additional receipts from this proposal are $5.1 billion over the next ten years.

C. User Charge Proposals that are Governmental Receipts

Department of the Interior

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 June 30, 2005. 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 to clean up and reclaim in 25 years the most significant abandoned mine land problems. 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.

OTHER OFFSETTING COLLECTIONS AND RECEIPTS

Table 18–4 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 $275.8 billion in 2006. Of these, an estimated $162.0 billion are offsetting collections credited to expenditure accounts and an estimated $113.8 billion are deposited in offsetting receipt accounts.

Information on the user charges presented in Table 18–4 is available in Tables 18–2 and 18–3 and the discussion that accompanies those tables. Major offsetting collections deposited in expenditure accounts that are not user charges include collections by the Commodity Credit 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 18–5 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 $651.4 billion in 2006: $537.6 billion are intragovernmental transactions; and $113.8 billion are from the public, shown in the table as proprietary receipts from the public ($108.0 billion) and offsetting governmental receipts ($5.8 billion).

As noted above, offsetting collections and receipts by agency are also displayed in Table 21–1, "Outlays to the Public, Net and Gross," which appears in Chapter 21 of this volume.

Table 18–4. OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC

(in millions of dollars)

	Actual 2004	Estimate	
		2005	2006
Offsetting collections credited to expenditure accounts:			
User charges:			
Postal service stamps and other postal fees	68,001	67,538	67,628
Defense Commissary Agency	5,281	5,262	5,256
Employee contributions for employees and retired employees health benefits funds	7,932	8,776	9,442
Sale of energy:			
Tennessee Valley Authority	7,576	7,797	8,075
Bonneville Power Administration	3,279	3,647	3,647
All other user charges	27,539	30,828	37,665
Subtotal, user charges	119,608	123,848	131,713
Other collections credited to expenditure accounts:			
Commodity Credit Corporation fund	8,699	14,383	13,736
Supplemental security income (collections from the States)	4,168	4,318	4,520
Other collections	15,800	12,090	12,006
Subtotal, other collections	28,667	30,791	30,262
Subtotal, collections credited to expenditure accounts	148,275	154,639	161,975
Offsetting receipts:			
User charges:			
Medicare premiums	32,140	38,010	48,765
Outer Continental Shelf rents, bonuses, and royalties	5,106	5,886	7,131
All other user charges	12,354	15,667	16,315
Subtotal, user charges deposited in receipt accounts	49,600	59,563	72,211
Other collections deposited in receipt accounts:			
Military assistance program sales	11,734	10,882	11,114
Interest income	14,160	14,529	14,248
All other collections deposited in receipt accounts	25,832	13,454	16,215
Subtotal, other collections deposited in receipt accounts	51,726	38,865	41,577
Subtotal, collections deposited in receipt accounts	101,326	98,428	113,788
Total, offsetting collections and receipts from the public	**249,601**	**253,067**	**275,763**
Total, offsetting collections and receipts excluding off-budget	**181,509**	**185,457**	**208,062**
ADDENDUM:			
User charges that are offsetting collections and receipts [1]	169,208	183,411	203,924
Other offsetting collections and receipts from the public	80,393	69,656	71,839
Total, offsetting collections and receipts from the public	**249,601**	**253,067**	**275,763**

[1] Excludes user charges that are classified on the receipts side of the budget. For total user charges, see Table 18–1 or Table 18–2.

Table 18–5. OFFSETTING RECEIPTS BY TYPE

(In millions of dollars)

Source	2004 Actual	Estimate 2005	2006	2007	2008	2009	2010
INTRAGOVERNMENTAL TRANSACTIONS							
On-budget receipts:							
Federal intrafund transactions:							
Distributed by agency:							
Interest from the Federal Financing Bank	1,156	515	429	668	574	436	467
Proposed Legislation (non-PAYGO)	....	....	....	79	105	103	101
Interest on Government capital in enterprises	1,000	922	1,165	1,170	1,120	1,086	1,067
Interest received by retirement and health benefits funds	....	217	217	215	213	213	215
General fund payments to retirement and health benefits funds:							
DoD retiree health care fund	16,961	17,273	18,971	20,871	22,954	25,223	27,690
Miscellaneous Federal retirement funds	....	277	277	277	309	369	466
Proposed Legislation (non-PAYGO)	....	....	1,951	2,227	2,565	2,796	3,148
Other	2,303	2,308	2,470	2,558	2,140	2,203	2,233
Proposed Legislation (non-PAYGO)	....	....	19	97	282	495	733
Undistributed by agency:							
Employing agency contributions:							
DoD retiree health care fund	8,140	10,753	10,996	11,592	12,287	13,057	13,880
Proposed Legislation (non-PAYGO)	....	....	2,951	3,157	3,378	3,615	3,868
Total Federal intrafunds	29,560	32,265	39,446	42,911	45,927	49,596	53,868
Trust intrafund transactions:							
Distributed by agency:							
Payments to railroad retirement	5,993	4,935	6,225	6,545	6,640	6,735	6,982
Total trust intrafunds	5,993	4,935	6,225	6,545	6,640	6,735	6,982
Total intrafund transactions	35,553	37,200	45,671	49,456	52,567	56,331	60,850
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Contributions to insurance programs:							
Military retirement fund	18,189	21,358	23,241	24,112	25,015	25,955	26,927
Supplementary medical insurance	94,736	115,230	182,748	194,542	204,071	216,112	229,885
Proposed Legislation (non-PAYGO)	....	....	108	36	....	....	....
Hospital insurance	9,259	9,332	10,492	11,574	13,453	14,800	15,543
Railroad social security equivalent fund	121	118	121	132	148	153	158
Rail industry pension fund	314	323	318	330	343	357	371
Civilian supplementary retirement contributions	26,177	26,431	26,835	27,426	27,922	28,520	29,019
Unemployment insurance	1,543	802	738	715	715	714	718
Other contributions	402	550	572	573	583	585	579
Subtotal	150,741	174,144	245,173	259,440	272,250	287,196	303,200
Miscellaneous payments	2,123	1,817	1,730	1,692	1,683	1,675	1,638
Proposed Legislation (non-PAYGO)	....	....	3,808	....	....	....	....
Subtotal	152,864	175,961	250,711	261,132	273,933	288,871	304,838
Trust fund payments to Federal funds:							
Existing law	1,283	3,307	1,664	3,021	3,513	3,568	3,632
Proposed Legislation (non-PAYGO)	....	....	3,343	–459	–452	–448	–449
Subtotal	1,283	3,307	5,007	2,562	3,061	3,120	3,183
Total interfunds distributed by agency	154,147	179,268	255,718	263,694	276,994	291,991	308,021
Undistributed by agency:							
Employer share, employee retirement (on-budget):							
Civil service retirement and disability insurance	12,083	12,765	13,690	14,706	15,860	16,918	18,060
CSRDI from Postal Service	4,199	4,414	4,507	4,555	4,605	4,659	4,712
Hospital insurance (contribution as employer) [1]	2,713	2,627	2,659	2,696	2,781	2,871	2,968
Postal employer contributions to FHI	710	673	674	701	729	758	788
Military retirement fund	14,071	16,636	15,466	15,776	16,317	16,822	17,405
Other Federal employees retirement	184	211	242	278	320	368	423

Table 18–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2004 Actual	Estimate 2005	2006	2007	2008	2009	2010
Total employer share, employee retirement (on-budget)	33,960	37,326	37,238	38,712	40,612	42,396	44,356
Interest received by on-budget trust funds	67,761	71,457	73,378	76,405	79,673	83,320	86,634
Proposed Legislation (non-PAYGO)	....	....	–4	–1	–7	–9	–9
Total interfund transactions undistributed by agency	101,721	108,783	110,612	115,116	120,278	125,707	130,981
Total interfund transactions	255,868	288,051	366,330	378,810	397,272	417,698	439,002
Total on-budget receipts	291,421	325,251	412,001	428,266	449,839	474,029	499,852
Off-budget receipts:							
Interfund transactions:							
Distributed by agency:							
Federal fund payments to trust funds:							
Old-age, survivors, and disability insurance	14,342	16,388	16,066	17,716	20,512	21,422	23,156
Undistributed by agency:							
Employer share, employee retirement (off-budget)	11,331	10,911	11,357	11,802	12,475	13,190	13,907
Interest received by off-budget trust funds	86,228	91,995	98,144	106,672	117,008	128,724	141,373
Total off-budget receipts:	111,901	119,294	125,567	136,190	149,995	163,336	178,436
Total intragovernmental transactions	**403,322**	**444,545**	**537,568**	**564,456**	**599,834**	**637,365**	**678,288**
PROPRIETARY RECEIPTS FROM THE PUBLIC							
Distributed by agency:							
Interest:							
Interest on foreign loans and deferred foreign collections	411	432	415	439	354	352	350
Interest on deposits in tax and loan accounts	136	338	471	529	564	578	593
Other interest (domestic—civil) [2]	10,624	11,922	12,112	12,765	13,526	14,153	14,730
Total interest	11,171	12,692	12,998	13,733	14,444	15,083	15,673
Dividends and other earnings	2,989	1,837	1,250	1,296	1,313	1,319	1,308
Royalties and rents	2,449	3,815	3,732	3,671	3,752	3,855	3,781
Sale of products:							
Sale of timber and other natural land products	211	244	258	280	332	318	323
Sale of minerals and mineral products	35	59	65	67	65	66	67
Sale of power and other utilities	617	721	409	411	413	409	394
Proposed Legislation (PAYGO)	....	....	40	157	446	1,145	1,406
Other	79	99	97	86	103	100	89
Total sale of products	942	1,123	869	1,001	1,359	2,038	2,279
Fees and other charges for services and special benefits:							
Medicare premiums and other charges (trust funds)	32,140	38,010	48,730	54,101	56,949	60,637	64,937
Proposed Legislation related to Medicaid proposal (PAYGO)	....	....	35	12	....	....	....
Nuclear waste disposal revenues	776	749	754	757	767	767	769
Veterans life insurance (trust funds)	204	176	163	146	132	120	106
Veterans pharmaceutical copayments: Proposed Legislation (PAYGO)	....	....	176	178	180	181	183
Other [2]	3,780	3,824	10,785	13,765	14,773	15,867	17,049
Proposed Legislation (PAYGO)	....	....	1,265	1,291	1,295	1,301	1,305
Total fees and other charges	36,900	42,759	61,908	70,250	74,096	78,873	84,349
Sale of Government property:							
Sale of land and other real property [2]	621	1,321	982	985	987	967	970
Proposed Legislation (PAYGO)	....	....	–576	–576	–576	–553	–553
Military assistance program sales (trust funds)	11,734	10,882	11,114	11,044	11,243	11,446	11,651
Other	81	166	89	64	16	16	16
Total sale of Government property	12,436	12,369	11,609	11,517	11,670	11,876	12,084
Realization upon loans and investments:							
Negative subsidies and downward reestimates	8,159	5,434	1,071	1,001	990	970	845
Repayment of loans to foreign nations	88	94	108	25	28	30	33
Other	9,547	281	80	78	75	88	88

Table 18–5. OFFSETTING RECEIPTS BY TYPE—Continued

(In millions of dollars)

Source	2004 Actual	Estimate					
		2005	2006	2007	2008	2009	2010
Total realization upon loans and investments	17,794	5,809	1,259	1,104	1,093	1,088	966
Recoveries and refunds [2]	4,384	4,548	4,729	4,893	5,112	6,077	5,209
Proposed Legislation (PAYGO)	....	....	294	328	356	386	393
Miscellaneous receipt accounts [2]	2,650	2,168	2,209	2,226	2,245	2,263	2,290
Proposed Legislation (PAYGO)	....	....	33	33	31	31	29
Total proprietary receipts from the public distributed by agency	91,715	87,120	100,890	110,052	115,471	122,889	128,361
Undistributed by agency:							
Rents, bonuses, and royalties:							
Outer Continental Shelf rents and bonuses	644	646	677	669	683	662	594
Outer Continental Shelf royalties	4,462	5,240	6,454	6,074	6,085	6,438	6,727
Arctic National Wildlife Refuge:							
Proposed Legislation (PAYGO)	....	....	....	2,402	2	202	2
Sale of major assets	....	....	....	323	....	....	....
Other undistributed offsetting receipts	....	....	....	1,500	5,000	4,300	....
Total proprietary receipts from the public undistributed by agency	5,106	5,886	7,131	10,968	11,770	11,602	7,323
Total proprietary receipts from the public	**96,821**	**93,006**	**108,021**	**121,020**	**127,241**	**134,491**	**135,684**
OFFSETTING GOVERNMENTAL RECEIPTS							
Distributed by agency:							
Defense cooperation	....	17	12	13	14	15	16
Regulatory fees	4,481	5,183	5,521	5,515	5,558	5,596	5,630
Proposed Legislation (non-PAYGO)	....	....	–60	–59	–59	–58	–57
Proposed Legislation (PAYGO)	....	....	71	71	71	71	71
Other	24	122	123	123	123	123	124
Undistributed by agency:							
Spectrum auction proceeds	....	100	100	788	8,252	8,148	1,494
Proposed Legislation (PAYGO)	....	....	....	550	–433	2,936	3,989
Total offsetting governmental receipts	4,505	5,422	5,767	7,001	13,526	16,831	11,267
Total offsetting receipts	**504,648**	**542,973**	**651,356**	**692,477**	**740,601**	**788,687**	**825,239**

[1] Includes provision for covered Federal civilian employees and military personnel.
[2] Includes both Federal funds and trust funds.

19. 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 employer contributions for medical insurance, pension contributions and earnings, 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 2004–2010 using three methods of accounting: revenue effects, outlay equivalents, and present values. 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 and 2005 Budgets 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 over-tax certain items or activities. A similar review is presented in the Appendix again this year.

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, 2004. Expired or repealed provisions are not listed if their revenue effects result only from taxpayer activity occurring before fiscal year 2004. 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 2004–2010 are displayed according to the budget's functional categories in Table 19–1. 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 19–2 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 19–3 ranks the major tax expenditures by the size of their 2006–2010 revenue effect.

Interpreting Tax Expenditure Estimates

The estimates shown for individual tax expenditures in Tables 19–1, 19–2, and 19–3 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 19–1 are the totals of individual and corporate income tax revenue effects reported in Table 19–2 and do not reflect any possible interactions between individual and corporate income tax receipts. For this reason, the estimates in Table 19–1 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 19–4. 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 19–4 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 2004 which cause the deferrals or other long-term revenue effects. For instance, a pension contribution in 2004 would cause a deferral of tax payments on wages in 2004 and on pension earnings on this contribution (e.g., interest) in later years. In some future year, however, the 2004 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.

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 19–5.

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES

(in millions of dollars)

		Total from corporations and individuals							
		2004	2005	2006	2007	2008	2009	2010	2006–10
	National Defense								
1	Exclusion of benefits and allowances to armed forces personnel	2,460	2,490	2,520	2,540	2,560	2,590	2,620	12,830
	International affairs:								
2	Exclusion of income earned abroad by U.S. citizens	2,680	2,750	2,810	2,940	3,100	3,270	3,450	15,570
3	Exclusion of certain allowances for Federal employees abroad	850	900	950	1,000	1,050	1,100	1,160	5,260
4	Extraterritorial income exclusion	5,500	5,170	4,270	1,820	220	40	20	6,370
5	Inventory property sales source rules exception	1,500	1,620	1,770	1,950	2,200	2,430	2,630	10,980
6	Deferral of income from controlled foreign corporations (normal tax method)	7,240	7,000	7,440	7,960	8,510	9,100	9,730	42,740
7	Deferred taxes for financial firms on certain income earned overseas	2,130	2,190	2,260	960	....	....	....	3,220
	General science, space, and technology								
8	Expensing of research and experimentation expenditures (normal tax method)	–2,330	4,110	7,920	6,990	6,260	5,360	4,800	31,330
9	Credit for increasing research activities	4,680	5,130	2,140	910	390	180	50	3,670
	Energy								
10	Expensing of exploration and development costs, fuels	260	400	370	280	240	190	140	1,220
11	Excess of percentage over cost depletion, fuels	1,320	1,280	1,350	1,420	1,470	1,510	1,550	7,300
12	Alternative fuel production credit	1,040	1,040	1,040	1,040	420	....	....	2,500
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	70	70	80	80	100	70	60	390
15	Exclusion of interest on energy facility bonds	100	100	110	110	120	120	130	590
16	Enhanced oil recovery credit	330	340	340	350	360	370	390	1,810
17	New technology credit	330	470	620	700	800	820	690	3,630
18	Alcohol fuel credits [1]	30	30	30	30	40	40	40	180
19	Tax credit and deduction for clean-fuel burning vehicles	70	70	50	–20	–70	–80	–60	–180
20	Exclusion of conservation subsidies provided by public utilities	100	100	100	100	90	90	90	470
	Natural resources and environment								
21	Expensing of exploration and development costs, nonfuel minerals	230	230	250	250	250	270	270	1,290
22	Excess of percentage over cost depletion, nonfuel minerals	....	....	....	....	....	....	10	10
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	500	530	570	600	630	650	680	3,130
24	Capital gains treatment of certain timber income	70	70	80	80	100	70	60	390
25	Expensing of multiperiod timber growing costs	340	350	370	380	400	410	430	1,990
26	Tax incentives for preservation of historic structures	300	320	330	340	360	380	400	1,810
27	Expensing of capital costs with respect to complying with EPA sulfur regulations	....	10	....	10	20	40	10	90
28	Exclusion of gain or loss on sale or exchange of certain brownfield sites	....	....	....	–10	–30	–40	–40	–120
	Agriculture								
29	Expensing of certain capital outlays	100	110	130	130	130	140	140	670
30	Expensing of certain multiperiod production costs	50	60	70	70	80	80	80	380
31	Treatment of loans forgiven for solvent farmers	10	10	10	10	10	10	10	50
32	Capital gains treatment of certain income	670	730	760	820	990	720	580	3,870
33	Income averaging for farmers	40	40	40	40	40	40	40	200
34	Deferral of gain on sale of farm refiners	10	10	10	20	20	20	20	90
35	Bio-Diesel tax credit	....	30	30	10	....	....	....	40
	Commerce and housing								
	Financial institutions and insurance:								
36	Exemption of credit union income	1,270	1,330	1,390	1,440	1,510	1,570	1,640	7,550
37	Excess bad debt reserves of financial institutions	–20	–20	–10	–10	–10	....	....	–30
38	Exclusion of interest on life insurance savings	20,830	22,750	24,070	26,180	28,770	30,980	33,610	143,610
39	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50
40	Tax exemption of certain insurance companies owned by tax-exempt organizations	180	190	210	220	230	250	260	1,170
41	Small life insurance company deduction	80	80	80	80	80	80	80	400
	Housing:								
42	Exclusion of interest on owner-occupied mortgage subsidy bonds	1,020	1,110	1,180	1,230	1,320	1,350	1,390	6,470
43	Exclusion of interest on rental housing bonds	360	390	410	420	460	470	480	2,240
44	Deductibility of mortgage interest on owner-occupied homes	61,450	68,870	76,030	81,990	88,990	95,770	102,760	445,540
45	Deductibility of State and local property tax on owner-occupied homes	19,930	16,590	14,830	14,110	13,400	13,000	12,800	68,140
46	Deferral of income from post 1987 installment sales	1,100	1,120	1,140	1,160	1,190	1,200	1,320	6,010
47	Capital gains exclusion on home sales	29,730	32,840	36,270	40,050	44,240	54,660	71,960	247,180
48	Exclusion of net imputed rental income on owner-occupied homes	24,590	28,600	29,720	33,210	36,860	40,630	44,786	185,206
49	Exception from passive loss rules for $25,000 of rental loss	5,030	4,900	4,750	4,580	4,410	4,240	4,080	22,060
50	Credit for low-income housing investments	3,660	3,850	4,010	4,190	4,390	4,610	4,850	22,050
51	Accelerated depreciation on rental housing (normal tax method)	750	–156	–993	–1,846	–2,697	–3,961	–5,901	–15,398
	Commerce:								
52	Cancellation of indebtedness	30	30	30	40	40	40	40	190
53	Exceptions from imputed interest rules	50	50	50	50	50	50	50	250
54	Capital gains (except agriculture, timber, iron ore, and coal)	25,150	27,200	28,370	30,450	36,840	26,900	21,630	144,190
55	Capital gains exclusion of small corporation stock	160	210	250	300	350	390	430	1,720

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Total from corporations and individuals							
		2004	2005	2006	2007	2008	2009	2010	2006–10
56	Step-up basis of capital gains at death	24,200	26,140	28,760	31,630	34,790	35,560	33,680	164,420
57	Carryover basis of capital gains on gifts	210	240	290	290	310	430	850	2,170
58	Ordinary income treatment of loss from small business corporation stock sale	50	50	50	50	50	50	50	250
59	Accelerated depreciation of buildings other than rental housing (normal tax method)	–3,250	–4,180	–4,790	–6,940	–10,360	–14,740	–21,240	–58,060
60	Accelerated depreciation of machinery and equipment (normal tax method)	44,690	–11,000	–37,830	–30,920	–27,950	–26,190	–25,760	–148,650
61	Expensing of certain small investments (normal tax method)	1,520	4,820	1,650	–490	–30	140	230	1,500
62	Amortization of start-up costs (normal tax method)	80	50	....	–40	–90	–140	–170	–440
63	Graduated corporation income tax rate (normal tax method)	2,450	3,190	3,730	3,820	3,920	4,020	4,140	19,630
64	Exclusion of interest on small issue bonds	450	490	510	540	580	590	610	2,830
65	Deduction for U.S. production activities	....	3,270	5,420	8,750	11,230	11,670	15,860	52,930
66	Special rules for certain film and TV production	....	90	110	90	70	–40	–90	140
	Transportation								
67	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100
68	Exclusion of reimbursed employee parking expenses	2,470	2,590	2,730	2,880	3,030	3,180	3,330	15,150
69	Exclusion for employer-provided transit passes	410	480	550	630	710	790	880	3,560
70	Tax credit for certain expenditures for maintaining railroad tracks	....	70	140	150	110	50	30	480
	Community and regional development								
71	Investment credit for rehabilitation of structures (other than historic)	40	40	40	40	40	40	40	200
72	Exclusion of interest for airport, dock, and similar bonds	850	930	980	1,030	1,100	1,130	1,170	5,410
73	Exemption of certain mutuals' and cooperatives' income	60	60	60	70	70	70	70	340
74	Empowerment zones, Enterprise communities, and Renewal communities	1,080	1,120	1,210	1,340	1,480	1,740	1,130	6,900
75	New markets tax credit	290	430	610	830	870	790	670	3,770
76	Expensing of environmental remediation costs	80	70	20	–10	–10	–20	–10	–30
77	Deferral of capital gains with respect of dispositions of transmission property	....	–490	–620	–530	–230	100	360	–920
	Education, training, employment, and social services								
	Education:								
78	Exclusion of scholarship and fellowship income (normal tax method)	1,320	1,400	1,460	1,530	1,600	1,680	1,750	8,020
79	HOPE tax credit	3,320	3,410	3,220	3,320	3,350	3,420	3,580	16,890
80	Lifetime Learning tax credit	2,190	2,130	2,080	2,310	2,340	2,380	2,450	11,560
81	Education Individual Retirement Accounts	110	140	190	240	300	370	440	1,540
82	Deductibility of student-loan interest	760	780	800	810	820	830	840	4,100
83	Deduction for higher education expenses	1,280	1,830	1,840	....	....	....	....	1,840
84	State prepaid tuition plans	210	490	650	740	830	920	1,010	4,150
85	Exclusion of interest on student-loan bonds	290	310	340	350	370	380	390	1,830
86	Exclusion of interest on bonds for private nonprofit educational facilities	970	1,050	1,120	1,180	1,250	1,290	1,330	6,170
87	Credit for holders of zone academy bonds	90	110	130	130	140	140	140	680
88	Exclusion of interest on savings bonds redeemed to finance educational expenses	10	10	20	20	20	20	20	100
89	Parental personal exemption for students age 19 or over	3,200	2,670	2,110	1,840	1,630	1,450	1,340	8,370
90	Deductibility of charitable contributions (education)	3,690	3,420	3,680	4,030	4,260	4,550	4,870	21,390
91	Exclusion of employer-provided educational assistance	530	560	590	620	650	690	720	3,270
92	Special deduction for teacher expenses	150	160	150	....	....	....	....	150
93	Discharge of student loan indebtedness	....	20	20	20	20	20	20	100
	Training, employment, and social services:								
94	Work opportunity tax credit	280	250	280	190	60	30	10	570
95	Welfare-to-work tax credit	60	60	80	60	20	10	....	170
96	Employer provided child care exclusion	600	620	810	930	970	1,010	1,060	4,780
97	Employer-provided child care credit	....	8	10	10	10	10	10	50
98	Assistance for adopted foster children	290	310	350	380	420	460	500	2,110
99	Adoption credit and exclusion	450	500	540	560	570	580	600	2,850
100	Exclusion of employee meals and lodging (other than military)	810	850	890	930	970	1,010	1,060	4,860
101	Child credit [2]	22,400	32,710	32,810	32,900	32,860	32,790	32,670	164,030
102	Credit for child and dependent care expenses	2,990	3,140	2,810	1,900	1,800	1,710	1,630	9,850
103	Credit for disabled access expenditures	30	40	40	40	40	50	50	220
104	Deductibility of charitable contributions, other than education and health	27,370	29,670	32,550	34,500	36,790	39,410	42,210	185,460
105	Exclusion of certain foster care payments	440	440	440	450	450	460	470	2,270
106	Exclusion of parsonage allowances	430	460	480	510	540	580	610	2,720
	Health								
107	Exclusion of employer contributions for medical insurance premiums and medical care	102,250	112,160	125,690	139,060	152,560	166,190	176,740	760,240
108	Self-employed medical insurance premiums	3,330	3,780	4,330	4,800	5,260	5,760	6,250	26,400
109	Medical Savings Accounts/Health Savings Accounts	620	1,050	1,830	2,650	3,510	3,960	3,910	15,860
110	Deductibility of medical expenses	7,380	8,590	9,140	9,970	11,100	11,890	12,670	54,770
111	Exclusion of interest on hospital construction bonds	1,870	2,020	2,160	2,260	2,400	2,470	2,550	11,840
112	Deductibility of charitable contributions (health)	3,090	3,350	3,670	3,890	4,150	4,450	4,770	20,930
113	Tax credit for orphan drug research	180	210	230	260	290	330	360	1,470
114	Special Blue Cross/Blue Shield deduction	400	390	360	390	340	370	430	1,890
115	Tax credit for health insurance purchased by certain displaced and retired individuals [3]	50	60	40	40	40	50	50	220

Table 19–1. ESTIMATES OF TOTAL INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Total from corporations and individuals							
		2004	2005	2006	2007	2008	2009	2010	2006–10
	Income security								
116	Exclusion of railroad retirement system benefits	400	400	400	400	400	400	400	2,000
117	Exclusion of workers' compensation benefits	5,490	5,730	5,940	6,100	6,300	6,520	6,730	31,590
118	Exclusion of public assistance benefits (normal tax method)	410	430	450	470	490	510	480	2,400
119	Exclusion of special benefits for disabled coal miners	60	50	50	50	40	40	40	220
120	Exclusion of military disability pensions	100	100	110	110	110	120	120	570
	Net exclusion of pension contributions and earnings:								
121	Employer plans	46,970	50,330	51,050	52,570	47,530	45,310	44,570	241,030
122	401(k) plans	47,730	45,870	48,140	51,800	56,140	60,930	66,400	283,410
123	Individual Retirement Accounts	7,450	7,340	7,310	6,990	6,680	6,220	5,650	32,850
124	Low and moderate income savers credit	970	1,100	1,170	700	....	....	....	1,870
125	Keogh plans	8,830	9,380	9,980	10,650	11,610	12,650	13,780	58,670
	Exclusion of other employee benefits:								
126	Premiums on group term life insurance	2,070	2,090	2,110	2,110	2,150	2,180	2,200	10,750
127	Premiums on accident and disability insurance	260	280	290	300	310	320	330	1,550
128	Small business retirement plan credit	80	100	120	140	150	150	140	700
129	Income of trusts to finance supplementary unemployment benefits	20	20	20	20	20	20	20	100
130	Special ESOP rules	1,920	2,060	2,220	2,400	2,580	2,780	3,000	12,980
131	Additional deduction for the blind	30	40	40	40	40	40	40	200
132	Additional deduction for the elderly	1,700	1,810	1,960	1,940	1,900	1,930	1,950	9,680
133	Tax credit for the elderly and disabled	20	20	20	20	10	10	10	70
134	Deductibility of casualty losses	550	250	270	280	290	300	320	1,460
135	Earned income tax credit [4]	4,890	4,980	5,420	5,170	5,290	5,480	5,600	26,960
	Social Security								
	Exclusion of social security benefits								
136	Social Security benefits for retired workers	19,200	19,480	19,770	20,470	20,900	21,260	23,720	106,120
137	Social Security benefits for disabled	3,580	3,740	3,870	4,110	4,290	4,500	4,910	21,680
138	Social Security benefits for dependents and survivors	4,140	4,120	3,990	4,030	3,880	3,920	4,060	19,880
	Veterans benefits and services								
139	Exclusion of veterans death benefits and disability compensation	3,300	3,560	3,750	4,030	4,190	4,360	4,520	20,850
140	Exclusion of veterans pensions	110	120	120	120	120	130	140	630
141	Exclusion of GI bill benefits	130	150	160	170	180	190	200	900
142	Exclusion of interest on veterans housing bonds	50	50	50	60	60	60	60	290
	General purpose fiscal assistance								
143	Exclusion of interest on public purpose State and local bonds	26,150	26,530	26,610	26,350	27,140	27,950	28,790	136,840
144	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	45,290	39,090	34,620	32,890	31,850	31,760	32,120	163,240
145	Tax credit for corporations receiving income from doing business in U.S. possessions	1,000	900	500	50	....	....	....	550
	Interest								
146	Deferral of interest on U.S. savings bonds	50	50	50	50	60	70	70	300
	Addendum: Aid to State and local governments								
	Deductibility of:								
	Property taxes on owner-occupied homes	19,930	16,590	14,830	14,110	13,400	13,000	12,800	68,140
	Nonbusiness State and local taxes other than on owner-occupied homes	45,290	39,090	34,620	32,890	31,850	31,760	32,120	163,240
	Exclusion of interest on State and local bonds for:								
	Public purposes	26,150	26,530	26,610	26,350	27,140	27,950	28,790	136,840
	Energy facilities	100	100	110	110	120	120	130	590
	Water, sewage, and hazardous waste disposal facilities	500	530	570	600	630	650	680	3,130
	Small-issues	450	490	510	540	580	590	610	2,830
	Owner-occupied mortgage subsidies	1,020	1,110	1,180	1,230	1,320	1,350	1,390	6,470
	Rental housing	360	390	410	420	460	470	480	2,240
	Airports, docks, and similar facilities	850	930	980	1,030	1,100	1,130	1,170	5,410
	Student loans	290	310	340	350	370	380	390	1,830
	Private nonprofit educational facilities	970	1,050	1,120	1,180	1,250	1,290	1,330	6,170
	Hospital construction	1,870	2,020	2,160	2,260	2,400	2,470	2,550	11,840
	Veterans' housing	50	50	50	60	60	60	60	290
	Credit for holders of zone academy bonds	90	110	130	130	140	140	140	680

[1] In addition, the partial exemption from the excise tax and excise credits for alcohol fuels result in a reduction in excise tax receipts (in millions of dollars) as follows: 2004 $1,450; 2005 $1,490; 2006 $1,550; 2007 $1,590; 2008 $1,620; 2009 $1,650; and 2010 $1,680.

[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: 2004 $8,857; 2005 $13,516; 2006 $13,180; 2007 $12,549; 2008 $12,040; 2009 $11,693 and 2010 $11,364

[3] In addition to the receipts shown, there are outlays of $70 million in 2004, $90 million in 2005, $100 million in 2006, $120 million in 2007, $130 million in 2008, and $140 million in 2009 and $150 million in 2010 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: 2004 $33,134;2005 $33,790; 2006 $34,132; 2007 $34,481; 2008 $34,723; 2009 $35,517; and 2010 $36,099.

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 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES

(in millions of dollars)

		Corporations								Individuals							
		2004	2005	2006	2007	2008	2009	2010	2006–10	2004	2005	2006	2007	2008	2009	2010	2006–10
	National Defense																
1	Exclusion of benefits and allowances to armed forces personnel	....	....	....	....	....	....	....	....	2,460	2,490	2,520	2,540	2,560	2,590	2,620	12,830
	International affairs:																
2	Exclusion of income earned abroad by U.S. citizens	....	....	....	....	....	....	....	....	2,680	2,750	2,810	2,940	3,100	3,270	3,450	15,570
3	Exclusion of certain allowances for Federal employees abroad	....	....	....	....	....	....	....	....	850	900	950	1000	1050	1100	1160	5,260
4	Extraterritorial income exclusion	5,500	5,170	4,270	1,820	220	40	20	6,370	....	....	....	....	....	....	....	....
5	Inventory property sales source rules exception	1,500	1,620	1,770	1,950	2,200	2,430	2,630	10,980	....	....	....	....	....	....	....	....
6	Deferral of income from controlled foreign corporations (normal tax method)	7,240	7,000	7,440	7,960	8,510	9,100	9,730	42,740	....	....	....	....	....	....	....	....
7	Deferred taxes for financial firms on certain income earned overseas	2,130	2,190	2,260	960	....	....	....	3,220	....	....	....	....	....	....	....	....
	General science, space, and technology																
8	Expensing of research and experimentation expenditures (normal tax method)	–2,280	4,010	7,770	6,850	6,140	5,250	4,700	30,710	–50	100	150	140	120	110	100	620
9	Credit for increasing research activities	4,630	5,080	2,100	910	390	180	50	3,630	50	50	40	....	....	....	....	40
	Energy																
10	Expensing of exploration and development costs, fuels	230	350	320	240	210	160	120	1,050	30	50	50	40	30	30	20	170
11	Excess of percentage over cost depletion, fuels	1,210	1,180	1,240	1,310	1,350	1,390	1,430	6,720	110	100	110	110	120	120	120	580
12	Alternative fuel production credit	1,000	1,000	1,000	1,000	400	....	....	2,400	40	40	40	40	20	....	....	100
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	....	....	....	....	....	....	....	....	70	70	80	80	100	70	60	390
15	Exclusion of interest on energy facility bonds	20	20	20	20	20	20	20	100	80	80	90	90	100	100	110	490
16	Enhanced oil recovery credit	300	310	310	320	330	340	350	1,650	30	30	30	30	30	30	40	160
17	New technology credit	330	470	620	700	800	820	690	3,630	....	....	....	....	....	....	....	....
18	Alcohol fuel credits [1]	20	20	20	20	30	30	30	130	10	10	10	10	10	10	10	50
19	Tax credit and deduction for clean-fuel burning vehicles	20	30	40	20	–10	–20	–10	20	50	40	10	–40	–60	–60	–50	–200
20	Exclusion of conservation subsidies provided by public utilities	....	....	....	....	....	....	....	....	100	100	100	100	90	90	90	470
	Natural resources and environment																
21	Expensing of exploration and development costs, nonfuel minerals	210	210	230	230	230	250	250	1,190	20	20	20	20	20	20	20	100
22	Excess of percentage over cost depletion, nonfuel minerals	....	....	....	....	....	....	10	10	....	....	....	....	....	....	....	....
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	110	110	110	120	120	120	130	600	390	420	460	480	510	530	550	2,530
24	Capital gains treatment of certain timber income	....	....	....	....	....	....	....	....	70	70	80	80	100	70	60	390
25	Expensing of multiperiod timber growing costs	230	240	250	260	280	290	300	1,380	110	110	120	120	120	120	130	610
26	Tax incentives for preservation of historic structures	230	240	250	260	270	290	300	1,370	70	80	80	80	90	90	100	440
27	Expensing of capital costs with respect to complying with EPA sulfur regulations	....	10	....	10	20	40	10	90	....	....	....	....	....	....	....	....
28	Exclusion of gain or loss on sale or exchange of certain brownfield sites	....	....	....	–10	–20	–30	–30	–90	....	....	....	....	–10	–10	–10	–30
	Agriculture																
29	Expensing of certain capital outlays	20	20	20	20	20	20	20	100	80	90	110	110	110	120	120	570
30	Expensing of certain multiperiod production costs	10	10	10	10	10	10	10	50	40	50	60	60	70	70	70	330
31	Treatment of loans forgiven for solvent farmers	....	....	....	....	....	....	....	....	10	10	10	10	10	10	10	50
32	Capital gains treatment of certain income	....	....	....	....	....	....	....	....	670	730	760	820	990	720	580	3,870
33	Income averaging for farmers	....	....	....	....	....	....	....	....	40	40	40	40	40	40	40	200
34	Deferral of gain on sale of farm refiners	10	10	10	20	20	20	20	90	....	....	....	....	....	....	....	....
35	Bio-Diesel tax credit	....	....	....	....	....	....	....	....	....	30	30	10	....	....	....	40
	Commerce and housing																
	Financial institutions and insurance:																
36	Exemption of credit union income	1,270	1,330	1,390	1,440	1,510	1,570	1,640	7,550	....	....	....	....	....	....	....	....
37	Excess bad debt reserves of financial institutions	–20	–20	–10	–10	–10	....	....	–30	....	....	....	....	....	....	....	....
38	Exclusion of interest on life insurance savings	2,010	2,180	2,270	2,570	2,880	3,070	3,330	14,120	18,820	20,570	21,800	23,610	25,890	27,910	30,280	129,490
39	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50	....	....	....	....	....	....	....	....
40	Tax exemption of certain insurance companies owned by tax-exempt organizations	180	190	210	220	230	250	260	1,170	....	....	....	....	....	....	....	....
41	Small life insurance company deduction	80	80	80	80	80	80	80	400	....	....	....	....	....	....	....	....
	Housing:																

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2004	2005	2006	2007	2008	2009	2010	2006–10	2004	2005	2006	2007	2008	2009	2010	2006–10
42	Exclusion of interest on owner-occupied mortgage subsidy bonds	220	230	230	240	250	250	260	1,230	800	880	950	990	1,070	1,100	1,130	5,240
43	Exclusion of interest on rental housing bonds	80	80	80	80	90	90	90	430	280	310	330	340	370	380	390	1,810
44	Deductibility of mortgage interest on owner-occupied homes									61,450	68,870	76,030	81,990	88,990	95,770	102,760	445,540
45	Deductibility of State and local property tax on owner-occupied homes									19,930	16,590	14,830	14,110	13,400	13,000	12,800	68,140
46	Deferral of income from post 1987 installment sales	290	290	300	300	310	310	320	1,540	810	830	840	860	880	890	1,000	4,470
47	Capital gains exclusion on home sales									29,730	32,840	36,270	40,050	44,240	54,660	71,960	247,180
48	Exclusion of net imputed rental income on owner-occupied homes									24,590	28,600	29,720	33,210	36,860	40,630	44,786	185,206
49	Exception from passive loss rules for $25,000 of rental loss									5,030	4,900	4,750	4,580	4,410	4,240	4,080	22,060
50	Credit for low-income housing investments	2,930	3,080	3,210	3,350	3,510	3,690	3,880	17,640	730	770	800	840	880	920	970	4,410
51	Accelerated depreciation on rental housing (normal tax method)	–10	–50	–100	–140	–200	–280	–390	–1,100	760	–110	–900	–1,700	–2,500	–3,690	–5,510	–14,300
	Commerce:																
52	Cancellation of indebtedness									30	30	30	40	40	40	40	190
53	Exceptions from imputed interest rules									50	50	50	50	50	50	50	250
54	Capital gains (except agriculture, timber, iron ore, and coal)									25,150	27,200	28,370	30,450	36,840	26,900	21,630	144,190
55	Capital gains exclusion of small corporation stock									160	210	250	300	350	390	430	1,720
56	Step-up basis of capital gains at death									24,200	26,140	28,760	31,630	34,790	35,560	33,680	164,420
57	Carryover basis of capital gains on gifts									210	240	290	290	310	430	850	2,170
58	Ordinary income treatment of loss from small business corporation stock sale									50	50	50	50	50	50	50	250
59	Accelerated depreciation of buildings other than rental housing (normal tax method)	–2,980	–3,850	–4,340	–6,170	–9,220	–12,620	–17,320	–49,670	–280	–330	–450	–760	–1,140	–2,110	–3,930	–8,390
60	Accelerated depreciation of machinery and equipment (normal tax method)	37,080	–8,780	–32,880	–26,480	–23,310	–21,260	–20,290	–124,220	7,610	–2,220	–4,950	–4,440	–4,640	–4,930	–5,470	–24,430
61	Expensing of certain small investments (normal tax method)	680	1,780	680	–390	–140	–30	–10	110	840	3,040	970	–100	110	170	240	1,390
62	Amortization of start-up costs (normal tax method)	70	40		–40	–80	–120	–150	–390	10	10			–10	–20	–20	–50
63	Graduated corporation income tax rate (normal tax method)	2,450	3,190	3,730	3,820	3,920	4,020	4,140	19,630								
64	Exclusion of interest on small issue bonds	100	100	100	100	110	110	110	530	350	390	410	440	470	480	500	2,300
65	Deduction for U.S. production activities		2,560	4,330	7,110	9,130	9,470	12,860	42,900		710	1,090	1,640	2,100	2,200	3,000	10,030
66	Special rules for certain film and TV production		70	90	70	60	–30	–70	120		20	20	20	10	–10	–20	20
	Transportation																
67	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100								
68	Exclusion of reimbursed employee parking expenses									2,470	2,590	2,730	2,880	3,030	3,180	3,330	15,150
69	Exclusion for employer-provided transit passes									410	480	550	630	710	790	880	3,560
70	Tax credit for certain expenditures for maintaining railroad tracks		70	140	150	110	50	30	480								
	Community and regional development																
71	Investment credit for rehabilitation of structures (other than historic)	20	20	20	20	20	20	20	100	20	20	20	20	20	20	20	100
72	Exclusion of interest for airport, dock, and similar bonds	180	190	190	200	210	210	220	1,030	670	740	790	830	890	920	950	4,380
73	Exemption of certain mutuals' and cooperatives' income	60	60	60	70	70	70	70	340								
74	Empowerment zones, Enterprise communities, and Renewal communities	280	290	310	340	370	420	190	1,630	800	830	900	1,000	1,110	1,320	940	5,270
75	New markets tax credit	70	110	150	210	220	200	170	950	220	320	460	620	650	590	500	2,820
76	Expensing of environmental remediation costs	70	60	20	–10	–10	–20	–10	–30	10	10						
77	Deferral of capital gains with respect of dispositions of transmission property		–490	–620	–530	–230	100	360	–920								
	Education, training, employment, and social services																
	Education:																
78	Exclusion of scholarship and fellowship income (normal tax method)									1,320	1,400	1,460	1,530	1,600	1,680	1,750	8,020
79	HOPE tax credit									3,320	3,410	3,220	3,320	3,350	3,420	3,580	16,890
80	Lifetime Learning tax credit									2,190	2,130	2,080	2,310	2,340	2,380	2,450	11,560
81	Education Individual Retirement Accounts									110	140	190	240	300	370	440	1,540
82	Deductibility of student-loan interest									760	780	800	810	820	830	840	4,100
83	Deduction for higher education expenses									1,280	1,830	1,840					1,840
84	State prepaid tuition plans									210	490	650	740	830	920	1,010	4,150
85	Exclusion of interest on student-loan bonds	60	60	70	70	70	70	70	350	230	250	270	280	300	310	320	1,480

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2004	2005	2006	2007	2008	2009	2010	2006–10	2004	2005	2006	2007	2008	2009	2010	2006–10
86	Exclusion of interest on bonds for private nonprofit educational facilities	210	210	220	230	230	240	250	1,170	760	840	900	950	1020	1050	1080	5,000
87	Credit for holders of zone academy bonds	90	110	130	130	140	140	140	680								
88	Exclusion of interest on savings bonds redeemed to finance educational expenses									10	10	20	20	20	20	20	100
89	Parental personal exemption for students age 19 or over									3,200	2,670	2,110	1,840	1,630	1,450	1,340	8,370
90	Deductibility of charitable contributions (education)	510	540	560	590	620	660	700	3,130	3,180	2,880	3,120	3,440	3,640	3,890	4,170	18,260
91	Exclusion of employer-provided educational assistance									530	560	590	620	650	690	720	3,270
92	Special deduction for teacher expenses									150	160	150					150
93	Discharge of student loan indebtedness										20	20	20	20	20	20	100
	Training, employment, and social services:																
94	Work opportunity tax credit	240	210	240	160	50	30	10	490	40	40	40	30	10			80
95	Welfare-to-work tax credit	50	50	70	50	20	10		150	10	10	10	10				20
96	Employer provided child care exclusion									600	620	810	930	970	1010	1060	4,780
97	Employer-provided child care credit		8	10	10	10	10	10	50								
98	Assistance for adopted foster children									290	310	350	380	420	460	500	2,110
99	Adoption credit and exclusion									450	500	540	560	570	580	600	2,850
100	Exclusion of employee meals and lodging (other than military)									810	850	890	930	970	1,010	1,060	4,860
101	Child credit [2]									22,400	32,710	32,810	32,900	32,860	32,790	32,670	164,030
102	Credit for child and dependent care expenses									2,990	3,140	2,810	1,900	1,800	1,710	1,630	9,850
103	Credit for disabled access expenditures	10	10	10	10	10	20	20	70	20	30	30	30	30	30	30	150
104	Deductibility of charitable contributions, other than education and health	1,170	1,230	1,290	1,360	1,430	1,500	1,570	7,150	26,200	28,440	31,260	33,140	35,360	37,910	40,640	178,310
105	Exclusion of certain foster care payments									440	440	440	450	450	460	470	2,270
106	Exclusion of parsonage allowances									430	460	480	510	540	580	610	2,720
	Health																
107	Exclusion of employer contributions for medical insurance premiums and medical care									102,250	112,160	125,690	139,060	152,560	166,190	176,740	760,240
108	Self-employed medical insurance premiums									3,330	3,780	4,330	4,800	5,260	5,760	6,250	26,400
109	Medical Savings Accounts/Health Savings Accounts									620	1,050	1,830	2,650	3,510	3,960	3,910	15,860
110	Deductibility of medical expenses									7,380	8,590	9,140	9,970	11,100	11,890	12,670	54,770
111	Exclusion of interest on hospital construction bonds	400	410	430	440	450	460	480	2,260	1,470	1,610	1,730	1,820	1,950	2,010	2,070	9,580
112	Deductibility of charitable contributions (health)	150	160	160	170	180	190	200	900	2,940	3,190	3,510	3,720	3,970	4,260	4,570	20,030
113	Tax credit for orphan drug research	180	210	230	260	290	330	360	1,470								
114	Special Blue Cross/Blue Shield deduction	400	390	360	390	340	370	430	1,890								
115	Tax credit for health insurance purchased by certain displaced and retired individuals [3]									50	60	40	40	40	50	50	220
	Income security																
116	Exclusion of railroad retirement system benefits									400	400	400	400	400	400	400	2,000
117	Exclusion of workers' compensation benefits									5,490	5,730	5,940	6,100	6,300	6,520	6,730	31,590
118	Exclusion of public assistance benefits (normal tax method)									410	430	450	470	490	510	480	2,400
119	Exclusion of special benefits for disabled coal miners									60	50	50	50	40	40	40	220
120	Exclusion of military disability pensions									100	100	110	110	110	120	120	570
	Net exclusion of pension contributions and earnings:																
121	Employer plans									46,970	50,330	51,050	52,570	47,530	45,310	44,570	241,030
122	401(k) plans									47,730	45,870	48,140	51,800	56,140	60,930	66,400	283,410
123	Individual Retirement Accounts									7,450	7,340	7,310	6,990	6,680	6,220	5,650	32,850
124	Low and moderate income savers credit									970	1,100	1,170	700				1,870
125	Keogh plans									8,830	9,380	9,980	10,650	11,610	12,650	13,780	58,670
	Exclusion of other employee benefits:																
126	Premiums on group term life insurance									2,070	2,090	2,110	2,110	2,150	2,180	2,200	10,750
127	Premiums on accident and disability insurance									260	280	290	300	310	320	330	1,550
128	Small business retirement plan credit	40	50	60	70	80	80	70	360	40	50	60	70	70	70	70	340
129	Income of trusts to finance supplementary unemployment benefits									20	20	20	20	20	20	20	100
130	Special ESOP rules	1600	1720	1870	2030	2190	2390	2610	11,090	320	340	350	370	390	390	390	1,890
131	Additional deduction for the blind									30	40	40	40	40	40	40	200
132	Additional deduction for the elderly									1,700	1,810	1,960	1,940	1,900	1,930	1,950	9,680
133	Tax credit for the elderly and disabled									20	20	20	20	10	10	10	70
134	Deductibility of casualty losses									550	250	270	280	290	300	320	1,460
135	Earned income tax credit [4]									4,893	4,983	5,423	5,168	5,287	5,480	5,597	26,955

Table 19–2. ESTIMATES OF TAX EXPENDITURES FOR THE CORPORATE AND INDIVIDUAL INCOME TAXES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2004	2005	2006	2007	2008	2009	2010	2006–10	2004	2005	2006	2007	2008	2009	2010	2006–10
	Social Security																
	Exclusion of social security benefits																
136	Social Security benefits for retired workers	....	....	....	....	....	....	....	....	19,200	19,480	19,770	20,470	20,900	21,260	23,720	106,120
137	Social Security benefits for disabled	....	....	....	....	....	....	....	....	3,580	3,740	3,870	4,110	4,290	4,500	4,910	21,680
138	Social Security benefits for dependents and survivors	....	....	....	....	....	....	....	....	4,140	4,120	3,990	4,030	3,880	3,920	4,060	19,880
	Veterans benefits and services																
139	Exclusion of veterans death benefits and disability compensation	....	....	....	....	....	....	....	....	3,300	3,560	3,750	4,030	4,190	4,360	4,520	20,850
140	Exclusion of veterans pensions	....	....	....	....	....	....	....	....	110	120	120	120	120	130	140	630
141	Exclusion of GI bill benefits	....	....	....	....	....	....	....	....	130	150	160	170	180	190	200	900
142	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	40	40	40	50	50	50	50	240
	General purpose fiscal assistance																
143	Exclusion of interest on public purpose State and local bonds	6,210	6,390	6,580	6,780	6,990	7,190	7,410	34,950	19,940	20,140	20,030	19,570	20,150	20,760	21,380	101,890
144	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	45,290	39,090	34,620	32,890	31,850	31,760	32,120	163,240
145	Tax credit for corporations receiving income from doing business in U.S. possessions	1,000	900	500	50	....	....	....	550	....	....	....	....	....	....	....	....
	Interest																
146	Deferral of interest on U.S. savings bonds	....	....	....	....	....	....	....	....	50	50	50	50	60	70	70	300
	Addendum: Aid to State and local governments																
	Deductibility of:																
	Property taxes on owner-occupied homes	....	....	....	....	....	....	....	....	19,930	16,590	14,830	14,110	13,400	13,000	12,800	68,140
	Nonbusiness State and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	45,290	39,090	34,620	32,890	31,850	31,760	32,120	163,240
	Exclusion of interest on State and local bonds for:																
	Public purposes	6,210	6,390	6,580	6,780	6,990	7,190	7,410	34,950	19,940	20,140	20,030	19,570	20,150	20,760	21,380	101,890
	Energy facilities	20	20	20	20	20	20	20	100	80	80	90	90	100	100	110	490
	Water, sewage, and hazardous waste disposal facilities	110	110	110	120	120	120	130	600	390	420	460	480	510	530	550	2,530
	Small-issues	100	100	100	100	110	110	110	530	350	390	410	440	470	480	500	2,300
	Owner-occupied mortgage subsidies	220	230	230	240	250	250	260	1,230	800	880	950	990	1,070	1,100	1,130	5,240
	Rental housing	80	80	80	80	90	90	90	430	280	310	330	340	370	380	390	1,810
	Airports, docks, and similar facilities	180	190	190	200	210	210	220	1,030	670	740	790	830	890	920	950	4,380
	Student loans	60	60	70	70	70	70	70	350	230	250	270	280	300	310	320	1,480
	Private nonprofit educational facilities	210	210	220	230	230	240	250	1,170	760	840	900	950	1,020	1,050	1,080	5,000
	Hospital construction	400	410	430	440	450	460	480	2,260	1,470	1,610	1,730	1,820	1,950	2,010	2,070	9,580
	Veterans' housing	10	10	10	10	10	10	10	50	40	40	40	50	50	50	50	240
	Credit for holders of zone academy bonds	90	110	130	130	140	140	140	680	....	....	....	....	....	....	....	....

[1] In addition, the partial exemption from the excise tax and excise credits for alcohol fuels result in a reduction in excise tax receipts (in millions of dollars) as follows: 2004 $1,450; 2005 $1,490; 2006 $1,550; 2007 $1,590; 2008 $1,620; 2009 $1,650; and 2010 $1,680.

[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: 2004 $8,857; 2005 $13,516; 2006 $13,180; 2007 $12,549; 2008 $12,040; 2009 $11,693 and 2010 $11,364

[3] In addition to the receipts shown, there are outlays of $70 million in 2004, $90 million in 2005, $100 million in 2006, $120 million in 2007, $130 million in 2008, and $140 million in 2009 and $150 million in 2010 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: 2004 $33,134;2005 $33,790; 2006 $34,132; 2007 $34,481; 2008 $34,723; 2009 $35,517; and 2010 $36,099.

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 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2006–2010 PROJECTED REVENUE EFFECTS

(in millions of dollars)

Provision	2006	2006–10
Exclusion of employer contributions for medical insurance premiums and medical care	125,690	760,240
Deductibility of mortgage interest on owner-occupied homes	76,030	445,540
Net exclusion of pension contributions and earnings: 401(k) plans	48,140	283,410
Capital gains exclusion on home sales	36,270	247,180
Net exclusion of pension contributions and earnings: Employer plans	51,050	241,030
Deductibility of charitable contributions, other than education and health	32,550	185,460
Exclusion of net imputed rental income on owner-occupied homes	29,720	185,206
Step-up basis of capital gains at death	28,760	164,420
Child credit	32,810	164,030
Deductibility of nonbusiness State and local taxes other than on owner-occupied homes	34,620	163,240
Capital gains (except agriculture, timber, iron ore, and coal)	28,370	144,190
Exclusion of interest on life insurance savings	24,070	143,610
Exclusion of interest on public purpose State and local bonds	26,610	136,840
Social Security benefits for retired workers	19,770	106,120
Deductibility of State and local property tax on owner-occupied homes	14,830	68,140
Net exclusion of pension contributions and earnings: Keough plans	9,980	58,670
Deductibility of medical expenses	9,140	54,770
Deduction for U.S. production activities	5,420	52,930
Deferral of income from controlled foreign corporations (normal tax method)	7,440	42,740
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	7,310	32,850
Exclusion of workers' compensation benefits	5,940	31,590
Expensing of research and experimentation expenditures (normal tax method)	7,920	31,330
Earned income tax credit	5,423	26,955
Self-employed medical insurance premiums	4,330	26,400
Exception from passive loss rules for $25,000 of rental loss	4,750	22,060
Credit for low-income housing investments	4,010	22,050
Social Security benefits for disabled	3,870	21,680
Deductibility of charitable contributions (education)	3,680	21,390
Deductibility of charitable contributions (health)	3,670	20,930
Exclusion of veterans death benefits and disability compensation	3,750	20,850
Social Security benefits for dependents and survivors	3,990	19,880
Graduated corporation income tax rate (normal tax method)	3,730	19,630
HOPE tax credit	3,220	16,890
Medical Savings Accounts / Health Savings Accounts	1,830	15,860
Exclusion of income earned abroad by U.S. citizens	2,810	15,570
Exclusion of reimbursed employee parking expenses	2,730	15,150
Special ESOP rules	2,220	12,980
Exclusion of benefits and allowances to armed forces personnel	2,520	12,830
Exclusion of interest on hospital construction bonds	2,160	11,840
Lifetime Learning tax credit	2,080	11,560
Inventory property sales source rules exception	1,770	10,980
Premiums on group term life insurance	2,110	10,750
Credit for child and dependent care expenses	2,810	9,850
Additional deduction for the elderly	1,960	9,680
Parental personal exemption for students age 19 or over	2,110	8,370
Exclusion of scholarship and fellowship income (normal tax method)	1,460	8,020
Exemption of credit union income	1,390	7,550
Excess of percentage over cost depletion, fuels	1,350	7,300
Empowerment zones, Enterprise communities, and Renewal communities	1,210	6,900
Exclusion of interest on owner-occupied mortgage subsidy bonds	1,180	6,470
Extraterritorial income exclusion	4,270	6,370
Exclusion of interest on bonds for private nonprofit educational facilities	1,120	6,170
Deferral of income from post 1987 installment sales	1,140	6,010
Exclusion of interest for airport, dock, and similar bonds	980	5,410
Exclusion of certain allowances for Federal employees abroad	950	5,260
Exclusion of employee meals and lodging (other than military)	890	4,860
Employer provided child care exclusion	810	4,780
State prepaid tuition plans	650	4,150
Deductibility of student-loan interest	800	4,100
Capital gains treatment of certain income	760	3,870
New markets tax credit	610	3,770
Credit for increasing research activities	2,140	3,670
New technology credit	620	3,630
Exclusion for employer-provided transit passes	550	3,560
Exclusion of employer-provided educational assistance	590	3,270
Deferred taxes for financial firms on certain income earned overseas	2,260	3,220
Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	570	3,130
Adoption credit and exclusion	540	2,850
Exclusion of interest on small issue bonds	510	2,830

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2006–2010 PROJECTED REVENUE EFFECTS—Continued

(in millions of dollars)

Provision	2006	2006–10
Exclusion of parsonage allowances	480	2,720
Alternative fuel production credit	1,040	2,500
Exclusion of public assistance benefits (normal tax method)	450	2,400
Exclusion of certain foster care payments	440	2,270
Exclusion of interest on rental housing bonds	410	2,240
Carryover basis of capital gains on gifts	290	2,170
Assistance for adopted foster children	350	2,110
Exclusion of railroad retirement system benefits	400	2,000
Expensing of multiperiod timber growing costs	370	1,990
Special Blue Cross/Blue Shield deduction	360	1,890
Low and moderate income savers credit	1,170	1,870
Deduction for higher education expenses	1,840	1,840
Exclusion of interest on student-loan bonds	340	1,830
Tax incentives for preservation of historic structures	330	1,810
Enhanced oil recovery credit	340	1,810
Capital gains exclusion of small corporation stock	250	1,720
Premiums on accident and disability insurance	290	1,550
Education Individual Retirement Accounts	190	1,540
Expensing of certain small investments (normal tax method)	1,650	1,500
Tax credit for orphan drug research	230	1,470
Deductibility of casualty losses	270	1,460
Expensing of exploration and development costs, nonfuel minerals	250	1,290
Expensing of exploration and development costs, fuels	370	1,220
Tax exemption of certain insurance companies owned by tax-exempt organizations	210	1,170
Exclusion of GI bill benefits	160	900
Small business retirement plan credit	120	700
Credit for holders of zone academy bonds	130	680
Expensing of certain capital outlays	130	670
Exclusion of veterans pensions	120	630
Exclusion of interest on energy facility bonds	110	590
Work opportunity tax credit	280	570
Exclusion of military disability pensions	110	570
Tax credit for corporations receiving income from doing business in U.S. possessions	500	550
Tax credit for certain expenditures for maintaining railroad tracks	140	480
Exclusion of conservation subsidies provided by public utilities	100	470
Small life insurance company deduction	80	400
Capital gains treatment of royalties on coal	80	390
Capital gains treatment of certain timber income	80	390
Expensing of certain multiperiod production costs	70	380
Exemption of certain mutuals' and cooperatives' income	60	340
Deferral of interest on U.S. savings bonds	50	300
Exclusion of interest on veterans housing bonds	50	290
Ordinary income treatment of loss from small business corporation stock sale	50	250
Exceptions from imputed interest rules	50	250
Tax credit for health insurance purchased by certain displaced and retired individuals	40	220
Exclusion of special benefits for disabled coal miners	50	220
Credit for disabled access expenditures	40	220
Investment credit for rehabilitation of structures (other than historic)	40	200
Income averaging for farmers	40	200
Additional deduction for the blind	40	200
Cancellation of indebtedness	30	190
Alcohol fuel credits	30	180
Welfare-to-work tax credit	80	170
Special deduction for teacher expenses	150	150
Special rules for certain film and TV production	110	140
Income of trusts to finance supplementary unemployment benefits	20	100
Exclusion of interest on savings bonds redeemed to finance educational expenses	20	100
Exception from passive loss limitation for working interests in oil and gas properties	20	100
Discharge of student loan indebtedness	20	100
Deferral of tax on shipping companies	20	100
Expensing of capital costs with respect to complying with EPA sulfur regulations	....	90
Deferral of gain on sale of farm refiners	10	90
Tax credit for the elderly and disabled	20	70
Treatment of loans forgiven for solvent farmers	10	50
Special alternative tax on small property and casualty insurance companies	10	50
Employer-provided child care credit	10	50
Bio-Diesel tax credit	30	40

Table 19–3. INCOME TAX EXPENDITURES RANKED BY TOTAL 2006–2010 PROJECTED REVENUE EFFECTS—Continued

(in millions of dollars)

Provision	2006	2006–10
Excess of percentage over cost depletion, nonfuel minerals	....	10
Expensing of environmental remediation costs	20	–30
Excess bad debt reserves of financial institutions	–10	–30
Exclusion of gain or loss on sale or exchange of certain brownfield sites	....	–120
Tax credit and deduction for clean-fuel burning vehicles	50	–180
Amortization of start-up costs (normal tax method)	....	–440
Deferral of capital gains with respect of dispositions of transmission property	–620	–920
Accelerated depreciation of buildings other than rental housing (normal tax method)	–4,786	–58,061
Accelerated depreciation of machinery and equipment (normal tax method)	–37,830	–148,650

Table 19–4. PRESENT VALUE OF SELECTED TAX EXPENDITURES FOR ACTIVITY IN CALENDAR YEAR 2004

(in millions of dollars)

	Provision	2004 Present Value of Revenue Loss
1	Deferral of income from controlled foreign corporations (normal tax method)	6,360
2	Deferred taxes for financial firms on income earned overseas	2,160
3	Expensing of research and experimentation expenditures (normal tax method)	2,220
4	Expensing of exploration and development costs—fuels	160
5	Expensing of exploration and development costs—nonfuels	....
6	Expensing of multiperiod timber growing costs	200
7	Expensing of certain multiperiod production costs—agriculture	140
8	Expensing of certain capital outlays—agriculture	180
9	Deferral of income on life insurance and annuity contracts	25,020
10	Accelerated depreciation on rental housing	5,210
11	Accelerated depreciation of buildings other than rental	543
12	Accelerated depreciation of machinery and equipment	39,380
13	Expensing of certain small investments (normal tax method)	670
14	Amortization of start-up costs (normal tax method)	50
15	Deferral of tax on shipping companies	20
16	Credit for holders of zone academy bonds	200
17	Credit for low-income housing investments	3,870
18	Deferral for State prepaid tuition plans	1,310
19	Exclusion of pension contributions—employer plans	85,040
20	Exclusion of 401(k) contributions	82,400
21	Exclusion of IRA contributions and earnings	3,460
22	Exclusion of contributions and earnings for Keogh plans	3,000
23	Exclusion of interest on public-purpose bonds	14,650
24	Exclusion of interest on non-public purpose bonds	5,680
25	Deferral of interest on U.S. savings bonds	230
26	Expensing of capital costs with respect to complying with EPA sulfur regulations	....

Table 19–5. OUTLAY EQUIVALENT ESTIMATES OF INCOME TAX EXPENDITURES

(in millions of dollars)

		Corporations								Individuals							
		2004	2005	2006	2007	2008	2009	2010	2006–10	2004	2005	2006	2007	2008	2009	2010	2006–10
	National Defense																
1	Exclusion of benefits and allowances to armed forces personnel									2,860	2,880	2,920	2,950	2,980	3,010	3,040	14,900
	International affairs																
2	Exclusion of income earned abroad by U.S. citizens									3,530	3,640	3,700	3,880	4,100	4,320	4,560	20,560
3	Exclusion of certain allowances for Federal employees abroad									1,100	1,150	1,210	1,280	1,350	1,410	1,490	6,740
4	Extraterritorial income exclusion	8,470	7,950	6,570	2,800	330	50	30	9,780								
5	Inventory property sales solurce rules exception	2,310	2,490	2,720	3,000	3,390	3,740	4,050	16,900								
6	Deferral of income from controlled foreign corporations (normal tax method)	7,240	7,000	7,440	7,960	8,510	9,100	9,730	42,740								
7	Deferred taxes for financial firms on certain income earned overseas	2,130	2,190	2,260	960				3,220								
	General science, space, and technology																
8	Expensing of research and experimentation expenditures (normal tax method)	–2,280	4,010	7,770	6,850	6,140	5,250	4,700	30,710	–50	100	150	140	120	110	100	620
9	Credit for increasing research activities	7,120	7,820	3,230	1,400	590	270	70	5,560	80	80	60					60
	Energy																
10	Expensing of exploration and development costs, fuels	230	350	330	250	210	180	140	1,110	40	70	60	50	40	30	30	210
11	Excess of percentage over cost depletion, fuels	1,570	1,570	1,690	1,760	1,820	1,880	1,910	9,060	140	140	150	150	170	170	180	820
12	Alternative fuel production credit	1,330	1,330	1,330	1,330	530			3,190	70	70	70	70	30			170
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	100	110	110	140	100	90	550
15	Exclusion of interest on energy facility bonds	30	30	30	30	30	30	30	150	120	120	130	130	140	140	160	700
16	Enhanced oil recovery credit	400	410	420	430	440	450	460	2,200	10	10	10	10	10	10	10	50
17	New technology credit	470	680	880	1,000	1,130	1,160	970	5,140								
18	Alcohol fuel credits [1]	20	20	20	20	30	30	30	130	10	10	10	10	10	10	10	50
19	Tax credit and deduction for clean-fuel burning vehicles	30	40	50	30	–10	–30	–10	30	70	50	10	–50	–80	–80	–70	–270
20	Exclusion of utility conservation subsidies									130	130	130	130	130	120	120	630
	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	280	280	300	300	320	320	340	1,580	20	20	30	30	30	30	30	150
23	Exclusion of interest on bonds for water, sewage, and hazardous waste facilities	150	150	150	170	170	170	180	840	560	610	670	700	740	770	800	3,680
24	Capital gains treatment of certain timber income									100	100	110	110	140	100	90	550
25	Expensing of multiperiod timber growing costs	310	320	330	350	370	380	400	1,830	140	140	140	150	150	150	150	740
26	Tax incentives for preservation of historic structures	230	240	250	260	270	290	300	1,370	70	80	80	80	90	90	100	440
27	Expensing of capital costs with respect to complying with EPA sulfur regulations		20		10	30	70	10	120								
28	Exclusion of gain or loss on sale or exchange of certain brownfield sites				–10	–20	–30	–50	–110					–10	–10	–20	–40
	Agriculture																
29	Expensing of certain capital outlays	20	30	30	30	30	30	30	150	100	110	130	130	130	140	140	670
30	Expensing of certain multiperiod production costs	10	10	20	20	20	20	20	100	50	60	70	70	80	80	80	380
31	Treatment of loans forgiven for solvent farmers									10	10	10	10	10	10	10	50
32	Capital gains treatment of certain income									960	1,040	1,090	1,170	1,410	1,030	830	5,530
33	Income averaging for farmers									40	40	40	40	50	50	50	230
34	Deferral of gain on sale of farm refiners	20	20	20	20	20	20	20	100								
35	Bio-Diesel tax credit										40	40	10				50
	Commerce and housing																
	Financial institutions and insurance:																
36	Exemption of credit union income	1,620	1,690	1,760	1,840	1,920	2,000	2,080	9,600								
37	Bad debt reserves of financial institutions	–30	–30	–10	–10	–10			–30								
38	Exclusion of interest on life insurance savings	2,280	2,450	2,520	2,840	3,180	3,380	3,660	15,580	21,380	23,090	24,260	26,130	28,560	30,690	33,310	142,950
39	Special alternative tax on small property and casualty insurance companies	10	10	10	10	10	10	10	50								
40	Tax exemption of certain insurance companies owned by tax-exempt organizations	270	290	320	330	350	380	400	1,780								
41	Small life insurance company deduction	120	120	120	120	120	120	120	600								
	Housing:																
42	Exclusion of interest on owner-occupied mortgage subsidy bonds	310	320	320	330	350	350	360	1,710	1,160	1,270	1,380	1,430	1,550	1,590	1,640	7,590

Table 19–5. OUTLAY EQUIVALENT ESTIMATES OF INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2004	2005	2006	2007	2008	2009	2010	2006–10	2004	2005	2006	2007	2008	2009	2010	2006–10
43	Exclusion of interest on rental housing bonds	110	110	110	110	120	120	120	580	410	450	480	490	540	550	560	2,620
44	Deductibility of mortgage interest on owner-occupied homes									61,450	68,870	76,030	81,990	88,990	95,770	102,760	445,540
45	Deductibility of State and local property tax on owner-occupied homes									19,930	16,590	14,830	14,110	13,400	13,000	12,800	68,140
46	Deferral of income from post 1987 installment sales	290	290	300	300	310	310	320	1,540	810	830	840	860	880	890	890	4,360
47	Capital gains exclusion on home sales									34,980	38,630	42,670	47,120	52,050	68,320	89,950	300,110
48	Exclusion of net imputed rental income									32,790	38,130	39,630	44,280	49,150	54,170	59,710	246,940
49	Exception from passive loss rules for $25,000 of rental loss									5,030	4,900	4,750	4,580	4,410	4,240	4,240	22,220
50	Credit for low-income housing investments	3,910	4,110	4,290	4,470	4,680	4,920	5,170	23,530	1,050	1,100	1,150	1,200	1,250	1,320	1,380	6,300
51	Accelerated depreciation on rental housing (normal tax method)	–8	–46	–98	–143	–197	–275	–389	–1,102	758	–110	–895	–1,703	–2,500	–3,686	–5,512	–14,296
	Commerce:																
52	Cancellation of indebtedness									30	30	30	40	40	40	40	190
53	Exceptions from imputed interest rules									50	50	50	50	50	50	50	250
54	Capital gains (except agriculture, timber, iron ore, and coal)									35,930	38,860	40,530	43,500	52,620	38,430	30,900	205,980
55	Capital gains exclusion of small corporation stock									220	270	340	400	460	530	610	2,340
56	Step-up basis of capital gains at death									32,260	34,860	38,340	42,180	46,390	47,410	44,910	219,230
57	Carryover basis of capital gains on gifts									250	280	340	350	370	530	1,060	2,650
58	Ordinary income treatment of loss from small business corporation stock sale									60	60	60	60	60	60	60	300
59	Accelerated depreciation of buildings other than rental housing (normal tax method)	–2,980	–3,850	–4,340	–6,170	–9,220	–12,620	–17,320	–49,670	–280	–330	–450	–760	–1,140	–2,110	–3,930	–8,390
60	Accelerated depreciation of machinery and equipment (normal tax method)	37,080	–8,780	–32,880	–26,480	–23,310	–21,260	–20,290	–124,230	7,610	–2,220	–4,950	–4,440	–4,640	–4,930	–5,470	–24,430
61	Expensing of certain small investments (normal tax method)	680	1,780	680	–390	–140	–30	–10	120	840	3,040	970	–100	110	170	240	1,400
62	Amortization of start-up costs (normal tax method)	70	40		–40	–80	–120	–150	–390	10	10			–10	–20	–20	–50
63	Graduated corporation income tax rate (normal tax method)	3,760	4,910	5,730	5,880	6,030	6,180	6,360	30,180								
64	Exclusion of interest on small issue bonds	140	140	140	140	150	150	150	730	510	560	590	640	680	700	720	3,330
65	Deduction for U.S. production activities		3,420	5,780	9,480	12,170	12,620	17,150	57,200		950	1,460	2,180	2,800	2,940	4,000	13,380
66	Special rules for certain film and TV production		70	90	70	60	–30	–70	120		20	20	20	10	–10	–20	20
	Transportation																
67	Deferral of tax on shipping companies	20	20	20	20	20	20	20	100								
68	Exclusion of reimbursed employee parking expenses									3,190	3,350	3,530	3,710	3,900	4,100	4,300	19,540
69	Exclusion for employer-provided transit passes									510	600	690	790	890	980	1,100	4,450
70	Tax credit for certain expenditures for maintaining railroad tracks		100	190	200	140	70	30	630								
	Community and regional development																
71	Investment credit for rehabilitation of structures (other than historic)	20	20	20	20	20	20	20	100	20	20	20	20	20	20	20	100
72	Exclusion of interest for airport, dock, and similar bonds	250	260	260	280	290	290	310	1,430	970	1,070	1,140	1,200	1,290	1,330	1,380	6,340
73	Exemption of certain mutuals' and cooperatives' income	70	70	70	80	80	80	80	390								
74	Empowerment zones, Enterprise communities and Renewal communities	280	290	310	340	370	420	190	1,630	800	830	900	1,000	1,110	1,320	940	5,270
75	New markets tax credit	70	110	150	210	220	200	170	950	220	320	460	620	650	590	500	2,820
76	Expensing of environmental remediation costs	90	80	20	–20	–20	–20	–20	–60	20	20						
77	Deferral of capital gains with respect of dispositions of transmission property		–490	–620	–530	–230	100	360	–920								
	Education, training, employment, and social services																
	Education:																
78	Exclusion of scholarship and fellowship income (normal tax method)									1,450	1,540	1,610	1,680	1,760	1,840	1,930	8,820
79	HOPE tax credit									4,260	4,380	4,130	4,260	4,300	4,380	4,590	21,660
80	Lifetime Learning tax credit									2,800	2,730	2,660	2,960	3,000	3,050	3,150	14,820
81	Education Individual Retirement Accounts									130	180	240	310	390	470	570	1,980
82	Deductibility of student-loan interest									900	930	960	970	980	990	1,000	4,900
83	Deduction for higher education expenses									1,640	2,340	2,360					2,360
84	State prepaid tuition plans									270	620	830	950	1,070	1,180	1,300	5,330
85	Exclusion of interest on student-loan bonds	80	80	100	100	100	100	100	500	330	360	390	410	430	450	460	2,140
86	Exclusion of interest on bonds for private nonprofit educational facilities	290	290	310	320	320	330	350	1,630	1,100	1,220	1,300	1,380	1,480	1,520	1,560	7,240
87	Credit for holders of zone academy bonds	130	160	180	190	200	200	190	960								

Table 19–5. OUTLAY EQUIVALENT ESTIMATES OF INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2004	2005	2006	2007	2008	2009	2010	2006–10	2004	2005	2006	2007	2008	2009	2010	2006–10
88	Exclusion of interest on savings bonds redeemed to finance educational expenses									20	20	20	20	20	20	20	100
89	Parental personal exemption for students age 19 or over									3,550	2,960	2,340	2,040	1,800	1,600	1,480	9,260
90	Deductibility of charitable contributions (education)	510	540	560	590	620	660	700	3,130	3,180	2,880	3,120	3,440	3,640	3,890	3,890	17,980
91	Exclusion of employer-provided educational assistance									650	690	730	770	810	850	890	4,050
92	Special deduction for teacher expenses									190	200	180					180
93	Discharge of student loan indebtedness										20	20	20	20	20	20	100
	Training, employment, and social services:																
94	Work opportunity tax credit	240	210	240	160	50	30	10	490	40	40	40	30	10			80
95	Welfare-to-work tax credit	50	50	70	50	20	10		150	10	10	10	10				20
96	Exclusion of employer provided child care									800	830	1,080	1,240	1,290	1,350	1,410	6,370
97	Employer-provided child care	6	11	13	15	17	18	20	83								
98	Assistance for adopted foster children									330	350	390	430	470	520	570	2,380
99	Adoption credit and exclusion									570	640	690	710	730	750	760	3,640
100	Exclusion of employee meals and lodging (other than military)									990	1,030	1,080	1,130	1,180	1,230	1,290	5,910
101	Child credit [2]									25,950	39,010	32,280	31,960	31,450	31,450	31,450	158,590
102	Credit for child and dependent care expenses									3,990	4,190	3,750	2,530	2,400	2,280	2,170	13,130
103	Credit for disabled access expenditures	20	20	20	20	20	20	20	100	30	30	40	40	40	40	40	200
104	Deductibility of charitable contributions, other than education and health	1,170	1,230	1,290	1,360	1,430	1,500	1,570	7,150	26,200	28,440	31,260	33,140	35,360	37,910	37,910	175,580
105	Exclusion of certain foster care payments									510	510	510	510	520	530	540	2,610
106	Exclusion of parsonage allowances									520	550	590	630	660	710	750	3,340
	Health																
107	Exclusion of employer contributions for medical insurance premiums and medical care									126,660	139,650	158,980	177,050	195,850	214,730	228,090	974,700
108	Self-employed medical insurance premiums									4,140	4,730	5,480	6,110	6,700	7,360	7,990	33,640
109	Medical Savings Accounts Health Savings Accounts									520	1,040	1,670	2,450	3,150	3,540	3,520	14,330
110	Deductibility of medical expenses									7,930	9,280	9,880	10,780	12,050	12,910	13,750	59,370
111	Exclusion of interest on hospital construction bonds	560	570	600	610	620	640	670	3,140	2,130	2,330	2,510	2,640	2,820	2,910	3,000	13,880
112	Deductibility of charitable contributions (health)	150	160	160	170	180	190	200	900	2,940	3,190	3,510	3,720	3,970	4,260	4,260	19,720
113	Tax credit for orphan drug research	280	310	350	390	430	480	540	2,190								
114	Special Blue Cross/Blue Shield deduction	570	560	510	560	490	530	610	2,700								
115	Tax credit for health insurance purchased by certain displaced and retired individuals [3]									50	60	40	40	50	50	50	230
	Income security																
116	Exclusion of railroad retirement system benefits									400	400	400	400	400	400	400	2,000
117	Exclusion of workers' compensation benefits									5,490	5,730	5,940	6,100	6,300	6,520	6,730	31,590
118	Exclusion of public assistance benefits (normal tax method)									410	430	450	470	490	510	480	2,400
119	Exclusion of special benefits for disabled coal miners									60	50	50	50	40	40	40	220
120	Exclusion of military disability pensions									100	100	110	110	110	120	120	570
	Net exclusion of pension contributions and earnings:																
121	Employer plans									57,280	61,380	62,260	64,110	57,960	55,260	54,350	293,940
122	401(k) plans									58,210	55,940	58,710	63,170	68,460	74,300	80,980	345,620
123	Individual Retirement Accounts									8,470	9,300	9,140	9,120	8,730	8,340	7,790	43,120
124	Low and moderate income savers credit									1,150	1,310	1,380	830				2,210
125	Keogh plans									11,170	11,800	12,500	13,290	14,490	15,780	17,200	73,260
	Exclusion of other employee benefits:																
126	Premiums on group term life insurance									2,660	2,690	2,700	2,700	2,750	2,790	2,830	13,770
127	Premiums on accident and disability insurance									350	370	390	400	410	430	440	2,070
128	Small business retirement plan credit	60	70	90	100	110	110	100	510	50	70	80	100	100	100	100	480
129	Income of trusts to finance supplementary unemployment benefits									20	20	20	20	20	20	20	100
130	Special ESOP rules	2,550	2,740	2,970	3,210	3,460	3,750	4,070	17,460	510	540	550	590	620	610	610	2,980
131	Additional deduction for the blind									40	40	50	40	50	50	50	240
132	Additional deduction for the elderly									2,060	2,190	2,370	2,350	2,290	2,330	2,360	11,700
133	Tax credit for the elderly and disabled									20	20	20	20	20	10	10	80
134	Deductibility of casualty losses									610	270	290	280	290	300	320	1,480
135	Earned income tax credit [4]									5,437	5,536	6,026	5,742	5,874	6,089	5,868	29,599
	Social Security																
	Exclusion of social security benefits:																

Table 19–5. OUTLAY EQUIVALENT ESTIMATES OF INCOME TAX EXPENDITURES—Continued

(in millions of dollars)

		Corporations								Individuals							
		2004	2005	2006	2007	2008	2009	2010	2006–10	2004	2005	2006	2007	2008	2009	2010	2006–10
136	Social Security benefits for retired workers	....	....	....	....	....	....	....	....	19,200	19,480	19,770	20,470	20,900	21,260	23,720	106,120
137	Social Security benefits for disabled	....	....	....	....	....	....	....	....	3,580	3,740	3,870	4,110	4,290	4,500	4,910	21,680
138	Social Security benefits for dependents and survivors	....	....	....	....	....	....	....	....	4,140	4,120	3,990	4,030	3,880	3,920	4,060	19,880
	Veterans benefits and services																
139	Exclusion of veterans death benefits and disability compensation	....	....	....	....	....	....	....	....	3,300	3,560	3,750	4,030	4,190	4,360	4,520	20,850
140	Exclusion of veterans pensions	....	....	....	....	....	....	....	....	110	120	120	120	120	130	140	630
141	Exclusion of GI bill benefits	....	....	....	....	....	....	....	....	130	150	160	170	180	190	200	900
142	Exclusion of interest on veterans housing bonds	10	10	10	10	10	10	10	50	60	60	60	70	70	70	70	340
	General purpose fiscal assistance																
143	Exclusion of interest on public purpose State and local bonds	8,620	8,870	9,130	9,410	9,700	9,980	10,280	48,500	28,880	29,170	29,010	28,340	29,180	30,070	30,970	147,570
144	Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	45,290	39,090	34,620	32,890	31,850	31,760	32,120	163,240
145	Tax credit for corporations receiving income from doing business in U.S. possessions	1,430	1,290	720	70	....	....	....	790	....	....	....	....	....	....	....	....
	Interest																
146	Deferral of interest on U.S. savings bonds	....	....	....	....	....	....	....	....	50	50	50	50	60	70	70	300
	Addendum: Aid to State and local governments:																
	Deductibility of:																
	Property taxes on owner-occupied homes	....	....	....	....	....	....	....	....	19,930	16,590	14,830	14,110	13,400	13,000	12,800	68,140
	Nonbusiness State and local taxes other than on owner-occupied homes	....	....	....	....	....	....	....	....	45,290	39,090	34,620	32,890	31,850	31,760	32,120	163,240
	Exclusion of interest on State and local bonds for:																
	Public purposes	8,620	8,870	9,130	9,410	9,700	9,980	10,280	48,500	28,880	29,170	29,010	28,340	29,180	30,070	30,970	147,570
	Energy facilities	30	30	30	30	30	30	30	150	120	120	130	130	140	140	160	700
	Water, sewage, and hazardous waste disposal facilities	150	150	150	170	170	170	180	840	560	610	670	700	740	770	800	3,680
	Small-issues	140	140	140	140	150	150	150	730	510	560	590	640	680	700	720	3,330
	Owner-occupied mortgage subsidies	310	320	320	330	350	350	360	1,710	1,160	1,270	1,380	1,430	1,550	1,590	1,640	7,590
	Rental housing	110	110	110	110	120	120	120	580	410	450	480	490	540	550	560	2,620
	Airports, docks, and similar facilities	250	260	260	280	290	290	310	1,430	970	1,070	1,140	1,200	1,290	1,330	1,380	6,340
	Student loans	80	80	100	100	100	100	100	500	330	360	390	410	430	450	460	2,140
	Private nonprofit educational facilities	290	290	310	320	320	330	350	1,630	1,100	1,220	1,300	1,380	1,480	1,520	1,560	7,240
	Hospital construction	560	570	600	610	620	640	670	3,140	2,130	2,330	2,510	2,640	2,820	2,910	3,000	13,880
	Veterans' housing	10	10	10	10	10	10	10	50	60	60	60	70	70	70	70	340
	Credit for holders of zone academy bonds	130	160	180	190	200	200	190	960	....	....	....	....	....	....	....	....

[1] In addition, the partial exemption from the excise tax and excise credits for alcohol fuels results in a reduction in excise tax receipts (in millions of dollars) as follows: 2004 $1,450; 2005 $1,490; 2006 $1,550; 2007 $1,590; 2008 $1,620; 2009 $1,650; and 2010 $1,680.

[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: 2004 $8,857; 2005 $13,516; 2006 $13,180; 2007 $12,549; 2008 $12,040; 2009 $11,693 and 2010 $11,364

[3] In addition to the receipts shown, there are outlays of $70 million in 2004, $90 million in 2005, $100 million in 2006, $120 million in 2007, $130 million in 2008, and $140 million in 2009 and $150 million 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: 2004 $33,134;2005 $33,790; 2006 $34,132; 2007 $34,481; 2008 $34,723; 2009 $35,517; and 2010 $36,099.

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 lower tax rate on dividends and capital gains on corporate shares as discussed 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.

In the case of income taxes, 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, under the normal and reference tax baselines:

- 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.
- Tax rates are allowed to vary with marital status.
- 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.

Double Taxation of Corporate Profits

In a gradual transition to a more economically neutral tax system where corporate income is subject to a single layer of tax, the lower tax rates on dividends and capital gains on corporate equity have not been considered tax preferences since the 2005 Budget. Thus, the difference between ordinary tax rates and the lower tax rates on dividends, introduced by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA), does not give rise to a tax expenditure. Similarly, the lower capital gains tax rates applied to gains realized from the disposition of corporate equity do not give rise to a tax expenditure as well. As a

[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.

consequence, tax expenditure estimates for the lower tax rates on capital, step-up in basis, and the inside build-up on pension assets, 401k plans, IRAs, among others, are limited to capital gains from sources other than corporate equity. The Appendix provides a greater discussion of alternative baselines.

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 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 operation of 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 decision-making. 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

[3] Committee on Government Affairs, United States Senate, "Government Performance and Results Act of 1993" (Report 103–58, 1993).

[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.

quickly than tax expenditures, because they can often be changed as needed 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 degree 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. When measured against a comprehensive income tax, for example, 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. 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 imputed net rental income from owner-occupied housing is excluded from the tax base. The mortgage interest deduction and property tax deduction on personal residences also are reported as tax expenditures 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, 2004, and do not reflect proposals made elsewhere in the Budget. Nine additional provisions are considered when compared to the 2005 Budget. These are: (1) Expensing of capital costs with respect to complying with EPA sulfur regulations, (2) Exclusion of gain or loss on sale or exchange of certain brownfield sites, (3) Bio-Diesel tax credit, (4) Imputed net rental income on owner occupied housing, (5) Deduction for US production activities, (6) Special rules for certain film and TV production, (7) Tax credit for certain expenditures for maintaining railroad tracks, (8) Deferral of capital gains with respect of dispositions of transmission property, and (9) Discharge of student loan indebtedness.

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 may exclude up to $80,000 in foreign earned income from U.S. taxes. 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 ($74,335 in 2004).

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.

[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.

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 January 1, 2006 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 deduct 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 (indexed for inflation) is provided per kilowatt hour of electricity produced from certain renewable resources. Generally, qualifying sources include wind, closed-loop biomass, open-loop biomass including agricultural livestock waste nutrients, geothermal energy, solar energy, small irrigation, landfill gas, and trash combustion used to produce electricity at a facility placed in service before January 1, 2006. For facilities using open-loop biomass, small irrigation, landfill gas, or trash combustion, the credit rate is reduced by half. In addition, refined coal produced at a facility placed in service before January 1, 2009 cn claim a credit at a rate of $4.375 per ton (indexed for inflation).

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 through 2010. 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 ex-

ceed $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 deduction and credit are reduced by 75 percent for vehicles placed in service in 2006 and are not available for vehicles placed in service after December 31, 2006.

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 sales 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.

27. ***Expensing of capital costs with respect to complying with EPA sulfur regulations.***—Small refiners are allowed to deduct 75 percent of qualified capital costs incurred by the taxpayer during the taxable year. This provision was introduced by the American Jobs Creation Act (AJCA) enacted in 2004.

28. ***Exclusion of gain or loss on sale or exchange of certain brownfield sites.***—This provision was introduced by the AJCA enacted in 2004. This exclusion applies to taxpayers who have incurred remediation expenditures in an amount which exceeds the greater of $550,000 or 12 percent of the fair market value of the property at the time such property was acquired by the eligible taxpayer, determined as if there were not a presence of a hazardous substance, pollutant, or contaminant on the property which is complicating the expansion, redevelopment, or reuse of the property.

Agriculture

29. ***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.

30. ***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.

31. ***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.

32. ***Capital gains treatment of certain income.***—Certain agricultural income, such as unharvested crops, can be treated as capital gains rather than ordinary income.

33. ***Income averaging for farmers.***—Taxpayers can lower their tax liability by averaging, over the prior three-year period, their taxable income from farming and fishing.

34. ***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.

35. ***Bio-Diesel tax credit.***—An income tax credit of $0.50, similar to Ethanol benefits, is available for each gallon of biodiesel used or sold. Biodiesel derived from virgin sources (agri-biodiesel) receives an increased credit of $1.00 per gallon. The provision was introduced by the AJCA in 2004, and is set to expire on after December 31, 2006.

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.

36. ***Credit union income.***—The earnings of credit unions not distributed to members as interest or dividends are exempt from income tax.

37. ***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.

38. ***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.

39. ***Small property and casualty insurance companies.***—For taxable years beginning before January 1, 2004, insurance companies that were not life insurance companies and which had annual net premiums of less than $350,000 were exempt from tax; those with $350,000 to $1.2 million of annual net premiums could elect to pay tax only on the income earned by their taxable investment portfolio. For taxable years beginning after December 31, 2003, stock non-life insurance companies are generally exempt from tax if their gross receipts for the taxable year do not exceed $600,00 and more than 50 percent of such gross receipts consists of premiums. Mutual non-life insurance companies are generally tax-exempt if their annual gross receipts do not exceed $150,000 and more than 35 percent of gross receipts consist of premiums. Also, for taxable years beginning after December 31, 2003, non-life insurance companies with no more than $1.2 million of annual net premiums may elect to pay tax only on their taxable investment income.

40. ***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.

41. ***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.

42. ***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.

43. ***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.

44. ***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.

45. ***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.

46. ***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.

47. ***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.

48. ***Imputed net rental income on owner occupied housing.***—The implicit rental value of home ownership, net of expenses such as mortgage interest and depreciation, is excluded from income. The appendix provides a greater explanation of this new addition to the tax expenditure budget.

49. ***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.

50. ***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.

51. ***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.

52. ***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.

53. ***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.

54. ***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 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 partially adjusts for 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.

55. ***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.

56. ***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.

57. ***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.

58. ***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.

59. ***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.

60. ***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.

61. ***Expensing of certain small investments.***—As of 2003, under prior law, qualifying investments in tangible property up to $25,000 could have been expensed rather than depreciated over time. The amount eligible for expensing was decreased to the extend the taxpayer's qualifying investment during the year exceeded $200,000. For 2003, however, the expensing limit was temporarily increased to $100,000, the phase-out limit was temporarily increased to $400,000, and computer software became temporarily eligible for expensing treatment. For 2004, through 2007, these higher limits are indexed for inflation, and computer software continues to be an eligible investment. In all years, the amount expensed cannot exceed the taxpayer's taxable income for the year. The prior rules will apply for taxable years beginning after 2007.

62. ***Business start-up costs.***—Business start-up costs are costs incurred prior to the creation of an active trade or business that would be deductible if incurred in connection with the operation of an existing trade or business. If the start-up costs were incurred on or before October 22, 2004, a taxpayer could elect to amortize them over 60 months. For costs incurred after that date, a taxpayer may elect to deduct up to $5,000 of start-up costs, but this deductible amount is reduced (but now below zero) by the amount by which the taxpayer's total start-up costs for the year exceed $50,000. Non-deducted start-up costs incurred after October 22, 2004 are amortized over a 15-year period. The normal-tax method treats the 60-month amortized amounts and the deducted amounts as tax expenditures; the reference tax method does not.

63. ***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.

64. ***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.

65. ***Deduction for U.S. production activities.***—This provision was introduced by the AJCA in 2004 and allows for a deduction equal to a portion of taxable income attributable to domestic production. For taxable years beginning in 2004, 2005, 2006, 2007, and 2008, the amount of the deduction is 5, 5, 5, 6, and 7 percent, respectively. For taxable years beginning after 2008, the amount of the deduction is 9 percent.

66. ***Special rules for certain film and TV production.***—Taxpayers may deduct up to $15 million ($15 million in certain distressed areas) per production expenditures in the year incurred. Excess expenditures may be deducted over three years using the straight line method. This provision was introduced by the AJCA enacted in 2004. Under prior law, production expenses were depreciated.

Transportation

67. ***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.

68. ***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. In 2004,

the maximum amount of the parking exclusion is $195 (indexed) per month. The tax expenditure estimate does not include parking at facilities owned by the employer.

69. ***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. In 2005, the maximum amount of the exclusion is $105 (indexed) per month.

70. ***Tax credit for certain expenditures for maintaining railroad tracks.***—Eligible taxpayers may claim a credit equal to the lesser of 50 percent of maintenance expenditures and the product of $3,500 and the number of miles of track owned or leased. This provision was introduced by the AJCA in 2004.

Community and Regional Development

71. ***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.

72. ***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.

73. ***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.

74. ***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, the Working Families Tax Relief Act of 2004 extended the District of Columbia Enterprise Zone and the District of Columbia first time homebuyer credit by two years through 2005.

75. ***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.

76. ***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 Working Families Tax Relief Act of 2004 extended this provision for two years, allowing remediation expenditures incurred before December 31, 2005 to be eligible for expensing.

77. ***Deferral of capital gains with respect of dispositions of transmission property.***—This provision, introduced by the AJCA, provides for the deferral of gains from sales or dispositions to implement Federal Energy Regulatory Commission or State electric restructuring policy.

Education, Training, Employment, and Social Services

78. ***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).

79. ***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 2004, the credit is phased out ratably for taxpayers with modified AGI between $85,000 and $105,000 ($42,000 and $52,000 for singles), indexed.

80. ***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 $85,000 and $105,000 ($42,000 and $52,000 for singles) (indexed beginning in 2002). The credit applies to both undergraduate and graduate students.

81. ***Deduction for Higher Education Expenses.***—The maximum annual deduction for qualified higher education expenses is $4,000 in 2004 for taxpayers with

adjusted gross income up to $130,000 on a joint return ($65,000 for singles). 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.

82. ***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 2004 is $2000 per beneficiary. The maximum contribution is phased down ratably for taxpayers with modified AGI between $190,000 and $220,000 ($95,000 and $110,000 for singles).

83. ***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 2004, 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.

84. ***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.

85. ***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.

86. ***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.

87. ***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 2005.

88. ***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 $89,750 and $119.750 ($59,850 and $74,850 for singles) in 2004.

89. ***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.

90. ***Charitable contributions to educational institutions.***—Taxpayers may deduct contributions to nonprofit educational institutions. Taxpayers who donate capital assets to educational institutions can deduct the asset's 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.

91. ***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).

92. ***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).

93. ***Discharge of student loan indebtedness.***—Certain professionals who perform in underserved areas, and as a consequence get their student loans discharged, may not recognize such discharge as income. This provision was expanded by the AJCA to include health professionals.

94. ***Work opportunity tax credit.***—Employers can claim a tax credit for qualified wages paid to individuals who begin work on or before December 31, 2005 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.

95. ***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, 2005.

96. ***Employer-provided child care exclusion.***—Up to $5,000 of employer-provided child care is excluded from an employee's gross income even though the em-

ployer's costs for the child care are a deductible business expense.

97. ***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.

98. ***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.

99. ***Adoption credit and exclusion.***—Taxpayers can receive a nonrefundable tax credit for qualified adoption expenses. The maximum credit is $10,390 per child for 2004, and is phased-out ratably for taxpayers with modified AGI between $155,860 and $195,860. 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.

100. ***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.

101. ***Child credit.***—Taxpayers with children under age 17 can qualify for a $1,000 refundable per child credit. The maximum credit 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).

102. ***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.

103. ***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.

104. ***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.

105. ***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.

106. ***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

107. ***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.

108. ***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.

109. ***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, Improvement,

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.

110. ***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.

111. ***Hospital construction bonds.***—Interest earned on State and local government debt issued to finance hospital construction is excluded from income subject to tax.

112. ***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.

113. ***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.

114. ***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.

115. ***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 coverage by individuals eligible for Trade Adjustment Assistance and certain PBGC pension recipients.

Income Security

116. ***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.

117. ***Workers' compensation benefits.***—Workers compensation provides payments to disabled workers. These benefits, although income to the recipients, are not subject to the income tax.

118. ***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.

119. ***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.

120. ***Military disability pensions.***—Most of the military pension income received by current disabled retired veterans is excluded from their income subject to tax.

121. ***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.

122. ***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 2004, an employee could exclude up to $14,000 of wages from AGI under a qualified arrangement with an employer's 401(k) plan. This increases to $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.

123. ***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 is $3,000 in 2004, $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 $75,000 ($55,000 for non-joint filers) in 2004 can claim a deduction for IRA contributions. The IRA deduction is phased out for taxpayers with AGI between $65,000 and $75,000 ($45,000 and $55,000 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 591/2, (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.

124. ***Low and moderate income savers' credit.***—The Tax Code provides an additional incentive for lower-income taxpayers to save through a nonrefundable credit of up to 50 percent on IRA and other retirement contributions of up to $2,000. 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.

125. ***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.

126. ***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, but only to the extent that the employer's share of the total costs does not exceed the cost of $50,000 of such insurance.

127. ***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.

128. ***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.

129. ***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.

130. ***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.

131. ***Additional deduction for the blind.***—Taxpayers who are blind may take an additional $1,200 standard deduction if single, or $950 if married in 2004.

132. ***Additional deduction for the elderly.***—Taxpayers who are 65 years or older may take an additional $1,200 standard deduction if single, or $950 if married in 2004.

133. ***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.

134. ***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.

135. ***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 $7,660 of earned income in 2004. The credit is 40 percent of the first $10,750 of income for a family with two or more qualifying children. The credit is phased out beginning when the taxpayer's income exceeds $14,040 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 $30,338 ($34,458 if two or more qualifying children are present), $31,338 (or $35,458) for those married.

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 2004, the credit is 7.65 percent of the first $5,100 of earned income. When the taxpayer's income exceeds $6,390 (7,390 if married), the credit is phased out at the rate of 7.65 percent. It is completely phased out at $11,490 ($12,490 for married) 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

136. ***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.

137. ***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.

138. ***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

139. ***Veterans death benefits and disability compensation.***—All compensation due to death or disability paid by the Veterans Administration is excluded from taxable income.

140. ***Veterans pension payments.***—Pension payments made by the Veterans Administration are excluded from gross income.

141. ***G.I. Bill benefits.***—G.I. Bill benefits paid by the Veterans Administration are excluded from gross income.

142. ***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

143. ***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.

144. ***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.

145. ***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

146. ***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 a presentation of the Treasury Department's continuing review of the tax expenditure 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 new estimates of the tax expenditure caused by accelerated depreciation and by the tax exemption of the return earned on owner-occupied housing, and an alternative estimate of the tax expenditure for the 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. Many large tax expenditures would continue to be tax expenditures were the baseline taken to be comprehensive income, although some would be 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 profits.

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 individual tax provisions relative to 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 provision in isolation. Nonetheless, Appendix Table 1 attempts such a classification for each of the thirty largest tax expenditures from the Budget.

We classify fifteen 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. Given current law's corporate income tax, the reduction or elimination of individual level tax on income from investment in corporate equities might not be a tax expenditure relative to a comprehensive income baseline. Rather, an individual income tax preference might undo the corporate tax penalty (i.e., the double tax). This perspective is reflected in adjustments that have been made to the calculation of the tax expenditures for pensions and several other items in the 2006 budget (as discussed above). However, these adjustments have not been made in all tax expenditure calculations, e.g., no adjustment was made in the exclusion of interest on life insurance saving. A similar line of reasoning could be used to argue that in the case of corporations, expens-

[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.

ing[7] of R&E is not a tax expenditure because it serves to offset the corporate tax penalty.

In contrast to treatment in previous budgets, the 2006 budget includes as a tax expenditure the failure to tax net rental income from owner-occupied housing. Because net rental income (gross rents minus depreciation, interest, taxes, and other expenses) would be in the homeowner's tax base under a comprehensive income tax baseline, this item would be a tax expenditure relative to a comprehensive income baseline.

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).[8] 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.

Veteran's death and disability benefits seem likely to represent a tax expenditure. This is clearly the case to the extent they are seen as deferred wages or as transfers. It also is the case to the extent that they are seen as insurance benefits, since the premiums, which come in the form of foregone wages, were not included in taxable income.[9]

Panel B deals with items that probably are tax expenditures, but that raise issues. Current law allows deductions for home mortgage interest and for property taxes on owner-occupied housing. The tax expenditure budget includes both of these deductions. From one perspective, these two deductions would not be considered tax expenditures relative to a comprehensive tax base; a comprehensive base would allow both deductions. However, this perspective ignores current law's failure to impute gross rental income. Conditional on this failure, the deductions for interest and property taxes might be viewed as inappropriate, because they move the tax system away from rather than towards a comprehensive income tax base.[10] Indeed, the sum of the tax expenditure for these two deductions, plus the tax expenditure for the failure to include net rental income, sums to the tax expenditure for owner-occupied housing relative to a comprehensive income tax base. Consequently, there is a strong argument for classifying them as tax expenditures relative to a comprehensive income baseline.

The deduction of nonbusiness State and local taxes other than on owner-occupied homes also is included in this section. These taxes include income, sales, 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.[11] The idea is that these taxes represent (or serve as proxies for) consumption expenditures for which current law makes no imputations to income.[12]

In contrast to the view in the official Budget, however, 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.[13] 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. Nonetheless, imputing the value of State and local services is difficult and is not done under current law. Consequently, a deduction for taxes might sensibly be viewed as a tax expenditure relative to a comprehensive income baseline.[14]

To the extent that the personal and dependent care exemptions and the standard deduction properly remove from taxable income all expenditures that do not yield suitably discretionary consumption value, or otherwise appropriately adjust for differing taxpaying capacity, 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 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

[7] Expensing means immediate deduction. Proper income tax treatment requires capitalization followed by annual depreciation allowances reflecting the decay in value of the associated R&E spending.

[8] 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.

[9] The treatment of insurance premiums and benefits is discussed more completely below.

[10] If there were no deduction for interest and property taxes, the tax expenditure base (i.e., the proper tax base minus the actual tax base) for owner-occupied housing would equal the homeowner's net rental income: gross rents—(depreciation+interest+property taxes+other expenses). With the deduction for interest and property taxes, the tax expenditure base rises to gross rents minus (depreciation+other expenses).

[11] *Fiscal Year 2003 Budget of the United States Government, Analytical Perspectives* (Washington, D.C.: U.S. Government Printing Office, 2002) p. 127.

[12] Property taxes on owner-occupied housing also might serve as a proxy for the value of untaxed local services provided to homeowners. As such, they would be listed in the tax expenditure budget (as configured, i.e., building on the estimate for the failure to tax net rents) twice, once because current law does not tax rental income and again as a proxy for government services received. Property taxes on other consumer durables such as automobiles also might be included twice, owing to current law's exclusion from income of the associated service flow.

[13] U.S. Treasury, *Blueprints for Basic Tax Reform* (Washington, D.C.: U.S. Government Printing Office, 1977) p. 92.

[14] 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.

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).[15] 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 Social Security 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[16] reflect exemptions for lower income beneficiaries from the tax on 85 percent of Social Security benefits.[17] 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 intended to tax upon distribution the remaining amount of the retirement benefit payment—the portion 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 a comprehensive income baseline, which would additionally account for the deferral of tax on the employer's contributions and on the rate of return (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,[18] 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.

The deduction for U.S. production activities also raises some problems. To the extent it is viewed as a tax break for certain qualifying businesses ("manufacturers"), it would be a tax expenditure. In contrast, the deduction may prove to be so broad that it is available to most U.S. businesses, in which case it might not be seen as a tax expenditure. Rather, it would represent a feature of the baseline tax rate system, because the deduction is equivalent to a lower tax rate. In addition, to the extent that it is viewed as providing relief from the double tax on corporate profits, it might not be a tax expenditure.

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.[19] 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.[20]

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

[15] 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.

[16] 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.

[17] 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.

[18] 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.

[19] 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.

[20] 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.

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, however, 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.[21]

Medical expenditures may or may not be an element of income (or consumption). Some argue that medical expenditures don't represent discretionary spending, and so aren't really consumption. Instead, they are a reduction of net worth and should be excluded from the tax base. In contrast, others argue that there is no way to logically distinguish medical care from other consumption items. Those who view medical spending as consumption point out that there is choice in many 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. This element of choice makes it more difficult to argue, at least in many cases, that medical spending is more "necessary" than, or otherwise different from, other consumption spending.

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. 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 ½ of the premium might suggest that ½ 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.[22]

The final category (panel D) includes items that would not be tax expenditures under a comprehensive income tax base. 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.

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 certain consumer durables (e.g., automobiles), the imputed return to consumption of financial services (e.g., checking account services received in kind and paid for by accepting a below market interest rate on deposits), 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 foodstamps, Medicaid, and public housing, the value of payouts from insurance policies,[23] 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

[21] If recipients tend to be in lower tax brackets, then the tax expenditure is smaller than when measured at the donor's tax rates.

[22] 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.

[23] To the extent that premiums are deductible.

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.[24] 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 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.[25] 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.[26]

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. The classification below suggests that medical spending and charitable contributions might be included in the definition of consumption, but also considers an alternative view.

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

[24] 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.

[25] See Bradford, Untangling the Income Tax, p. 41.

[26] 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.

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 investment 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. The inability to save on a similar tax-favored basis irrespective of the ultimate purpose to which the saving is applied potentially distorts 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.

In addition, provisions can interact even once an appropriate treatment is determined. For example, suppose that it is determined that financial flows are out of the tax base. Then the deduction for home mortgage interest would seem to be a tax expenditure. However, this conclusion is cast into doubt because current law generally taxes interest income. When combined with the homeowners' deduction, this results in a zero tax rate on the interest flow, consistent with consumption tax treatment.

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 judgments 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 classify properly, while others may serve as proxies for properly measured tax expenditures.

Appendix Table 2 shows thirty large official tax expenditures from the Budget classified according to whether they would be considered a tax expenditure under a consumption tax. Two of the thirty items clearly would be a tax expenditure (shown in panel A) under a consumption tax, while an additional seven (those in panel B) probably would be tax expenditures.

A consumption tax would include in the homeowners' tax base the value of the implicit (gross) rental income from owner-occupied housing. Net rental income is a component of this, and so would be included as a tax expenditure, relative to a consumption tax baseline.[27]

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.

Consider next the deductibility of home mortgage interest and of property taxes on owner-occupied housing. Both items would seem to be strong candidates for inclusion as a tax expenditure, given current law's failure to impute the consumption value of housing. That is, focusing on the homeowner's tax base, these deductions move the tax system away from rather than towards the proper treatment of housing services.[28]

However, with respect to the home mortgage interest deduction, some ambiguity is introduced by the taxation of interest income to lenders. In a sense, the homeowner's deduction offsets the lenders inclusion, leaving (for equal tax rates) no net tax due on the interest flow, as would be appropriate under a consumption tax. Hence, from the perspective of the entire tax system, it is less clear that the home mortgage interest deduction represents a tax expenditure.[29]

Some ambiguity also is introduced by the variable treatment of financial flows possible under a consumption tax. That is, the proper treatment of interest under a consumption tax depends on whether financial flows are in or out of the consumption tax base. 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.

With respect to property taxes on housing as well as other State and local taxes, some ambiguity arises because the tax might not represent consumption—it might be considered a reduction in net worth. Considered alone, this argument perhaps has some merit. However, there are two problems with this argument when viewed from the context of the entire tax system. First, the deduction for property taxes would seem to be inappropriate when there is no imputation for the associated consumption value, as discussed above. Second, the current tax system does not impute the consumption value of State and local services, and tax payments might serve as a proxy for that value, making their deduction unnecessary for the proper measurement of consumption.

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.

There is a strong case for viewing the child credit and the earned income tax credit as social welfare programs (transfers). As such, they would be tax expenditures relative to a consumption baseline. Nonetheless, these credits could alternatively be viewed as relieving tax on "nondiscretionary" consumption, and so not properly considered a tax expenditure.

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. Medical care is widely held to be consumption, except perhaps the medical care that actually raises, rather than simply sustains the individual's ability to work. Charitable giving, on the other hand, may be considered to be a reduction in net worth that should be excluded from the tax base because it does not yield direct satisfaction to taxpayer who makes the expenditure. In this case, the tax expenditure lies not with the individual making the charitable deduction, but with the exclusion from taxation of the amounts received by the recipient.

There also is the issue of how to tax medical insurance premiums. Under current law, employees do not

[27] Suppose that the rental value of a house is $100 per year, and that depreciation is $20, interest is $15, property taxes are $10, and other expenses are $5. Net rental income is $50 (gross rents less all items of expense). Hence, net rental income is a component of the gross rent, which is the consumption value of the housing services. Under a real based cash flow tax, in which financial flows are outside the tax base, the homeowner's net tax base would be $85: gross rents—(property taxes + other expenses), assuming that property taxes are viewed as a reduction in net worth and that he makes no new investment (which would be deductible).

[28] Using the figures from the example in the previous footnote, the homeowner would pay tax on gross rents minus property taxes minus other expenses, or on $85. If property taxes and mortgage interest were not deducted, then this would be the size of the tax expenditure. However, current law allows these deductions, which raises the tax expenditure base to $110.

[29] One must guard against double counting here, however, to the extent that current law's general taxation of capital income is calculated elsewhere in the tax expenditure budget as a negative tax expenditure.

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.

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 reduces the income tax bias against investment 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.

The deduction for U.S. production activities is not classified as a tax expenditure. This reflects the view that it represents a widespread reduction in taxes on capital income or an offset to the corporate income tax. In contrast to this classification, however, it would be a tax expenditure to the extent that it is viewed as a targeted tax incentive.

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 financial services received in kind, 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 gives 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 and NOL carry-forward provisions also might generate negative tax expenditures, because the change in net worth requires a deduction for losses (consumption = income—the change in net worth). 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.[30] 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.[31] The estimates are shown in tables in the body of the main text, e.g., Table 19–1.

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.[32] 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 2006–2010 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.[33]

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 the homeowner's tax base this gross rental flow, and would allow the homeowner a deduction for expenses such as interest, depreciation, property taxes, and other costs associated with earning the rental income. Thus, a comprehensive tax base would include in its base the homeowner's implicit net rental income (gross income minus deductions) earned on investment in owner-occupied housing.

In contrast to a comprehensive income tax, current law makes no imputation for gross rental income and allows no deduction for depreciation or for other expenses, such as utilities and maintenance. Current law does, however, allow a deduction for home mortgage interest and for property taxes. Consequently, relative to a comprehensive income baseline, the total tax expenditure for owner-occupied housing is the sum of tax on net rental income plus the tax saving from the de-

[30] 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.

[31] 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.

[32] Estimates under the old methodology are no longer shown in the tables.

[33] 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.

duction for property taxes and for home mortgage interest.[34]

Prior to 2006, the official list of tax expenditures did not include the exclusion of net implicit rental income on owner-occupied housing. Instead, it included as a tax expenditure deductions for home mortgage interest and for property taxes. While these deductions are legitimately considered tax expenditures, given current law's failure to impute rental income, they are highly flawed as estimates of the total tax advantage to housing; they overlook the additional 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. The treatment of owner-occupied housing has been revised in the 2006 budget, which now includes an item for the exclusion of net rental income of homeowners.[35]

Appendix Table 3 as well as the Tables in the body of the main text, e.g., Table 19–1 show estimates 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.[36]

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 forgone revenue may easily turn into a revenue gain 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 cascade 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 2006 through in 2010. 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.

[34] The homeowner's tax base under a comprehensive income tax is net rents. Under current law, the homeowner's tax base is–(interest + property taxes). The tax expenditure base is the difference between the comprehensive income base and current law's tax base, which for homeowners is the sum of net rents plus interest plus property taxes.

[35] This estimate combines the positive tax expenditure for the failure to impute rental income with the negative tax expenditure for the failure to allow a deduction for depreciation and other costs.

[36] *National Income and Production Accounts,* Table 2.4.

Appendix Table 1. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE INCOME TAX [1]

Description	Revenue Effect 2006
A. Tax Expenditure Under a Comprehensive Income Tax	
Net exclusion of pension contributions and earnings: Employer plans	51,050
Net exclusion of pension contributions and earnings: 401(k) plans	48,140
Capital gains exclusion on home sales	36,270
Exclusion of net imputed rental income on owner-occupied housing	29,720
Capital gains (except agriculture, timber, iron ore, and coal)	28,370
Exclusion of interest on public purpose State and local bonds	26,610
Exclusion of interest on life insurance savings	24,070
Net exclusion of pension contributions and earnings: Keogh plans	9,980
Expensing of research and experimentation expenditures (normal tax method)	7,920
Deferral of income from controlled foreign corporations (normal tax method)	7,440
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	7,310
Exclusion of workers' compensation benefits	5,940
Extraterritorial income exclusion	4,260
Credit for low-income housing investments	4,010
Exclusion of veterans death beenfits and disability compensation	3,750
B. Possibly a Tax Expenditure Under a Comprehensive Income Tax, But With Some Qualifications	
Deductibility of mortgage interest on owner-occupied homes	76,030
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	34,620
Child credit	32,810
Step-up basis of capital gains at death	28,760
Exclusion of Social Security benefits for retired workers	19,770
Deductibility of State and local property tax on owner-occupied homes	14,830
Earned income tax credit	5,423
Deduction for U.S. production activities	5,420
Exclusion of Social security benefits of dependents and survivors	3,990
C. Uncertain	
Exclusion of employer contributions for medical insurance premiums and medical care	125,690
Deductibility of charitable contributions, other than education and health	32,550
Deductibility of medical expenses	9,140
Deductibility of self-employed medical insurance premiums	4,330
Social Security benefits for disabled	3,870
D. Probably Not a Tax Expenditure Under a Comprehensive Income Tax	
Exception from passive loss rules for $25,000 of rental loss	4,750

[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 19–2, Tax Expenditure Budget.

Appendix Table 2. COMPARISON OF CURRENT TAX EXPENDITURES WITH THOSE IMPLIED BY A COMPREHENSIVE CONSUMPTION TAX [1]

Description	Revenue Effect 2006
A. Tax Expenditure Under a Consumption Base	
Exclusion of net imputed rental income on owner-occupied housing	29,720
Exclusion of workers' compensation benefits	5,940
B. Probably a Tax Expenditure Under a Consumption Base	
Deductibility of mortgage interest on owner-occupied homes	76,030
Deductibility of nonbusiness state and local taxes other than on owner-occupied homes	34,620
Child credit	32,810
Exclusion of Social Security benefits for retired workers	19,770
Earned income tax credit	5,423
Exclusion of Social Security benefits of dependents and survivors	3,990
Exclusion of veterans death beenfits and disability compensation	3,750
C. Uncertain	
Exclusion of employer contributions for medical insurance premiums and medical care	125,690
Deductibility of charitable contributions, other than education and health	32,550
Deductibility of State and local property tax on owner-occupied homes	14,830
Deductibility of medical expenses	9,140
Deductibility of self-employed medical insurance premiums	4,330
Extraterritorial income exclusion	4,260
Credit for low-income housing investments	4,010
Social Security benefits for disabled	3,870
D. Not a Tax Expenditure Under a Consumption Base	
Net exclusion of pension contributions and earnings: Employer plans	51,050
Net exclusion of pension contributions and earnings: 401(k) plans	48,140
Capital gains exclusion on home sales	36,270
Step-up basis of capital gains at death	28,760
Capital gains (except agriculture, timber, iron ore, and coal)	28,370
Exclusion of interest on public purpose State and local bonds	26,610
Exclusion of interest on life insurance savings	24,070
Net exclusion of pension contributions and earnings: Keogh plans	9,980
Expensing of research and experimentation expenditures (normal tax method)	7,920
Deferral of income from controlled foreign corporations (normal tax method)	7,440
Net exclusion of pension contributions and earnings: Individual Retirement Accounts	7,310
Deduction for U.S. production activities	5,420
Exception from passive loss rules for $25,000 of rental loss	4,750

[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 19–2, Tax Expenditure Budget.

Appendix Table 3. REVISED TAX EXPENDITURE ESTIMATES [1]

Provision	Revenue Loss						
	2004	2005	2006	2007	2008	2009	2010
Imputed Rent On Owner-Occupied Housing	24,590	28,600	29,720	33,210	36,860	40,630	44,786
Double Tax on corporate profit [2]	–23,730	–30,170	–29,600	–30,330	–31,540	–33,260	–35,074

[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

20. 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 2004 with the current services estimates shown in the 2004 Budget published in February 2003.

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 2004

This part of the chapter compares the actual receipts, outlays, and deficit for 2004 with the current services estimates[2] shown in the 2004 Budget published in February 2003. 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 2004 previously published by the Department of the Treasury.

Receipts

Actual receipts for 2004 were $1,880 billion, $151 billion less than the $2,031 billion current services estimate in the 2004 Budget (February 2003). As shown in Table 20–1, 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. In the interest of cautious and prudent forecasting, the February 2003 estimate included a downward adjustment beyond what the economic and receipts models were forecasting. This adjustment, which was not distributed by source of receipt, reduced the estimate of 2004 receipts by $15 billion.

Policy differences. Enactment of the Jobs and Growth Tax Relief Reconciliation Act in May 2003 reduced 2004 receipts by $138 billion. This reduction was partially offset by enactment of the Pension Funding Equity Act in April 2004, which increased 2004 receipts by $3 billion.

Table 20–1. COMPARISON OF ACTUAL 2004 RECEIPTS WITH THE INITIAL CURRENT SERVICES ESTIMATES

(in billions of dollars)

	February 2003 estimate	Enacted legislation/administrative actions	Different economic conditions	Technical factors	Net change	Actual
Individual income taxes	954	–109	–29	–7	–145	809
Corporation income taxes	174	–26	14	27	16	189
Social insurance and retirement receipts	765	*	–23	–8	–31	733
Excise taxes	71	....	–*	–1	–1	70
Estate and gift taxes	24	....	*	1	1	25
Customs duties	21	–*	*	*	*	21
Miscellaneous receipts	38	1	–6	–1	–6	33
Adjustment for revenue uncertainty	–15	....	....	15	15	....
Total	2,031	–135	–43	27	–151	1,880

* $500 million or less.

[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 25, "Current Services Estimates." For mandatory programs and receipts the February 2003 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 2004 receipts of $43 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 $29 billion and $23 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 2003 estimate. These reductions were only partially offset by a $14 billion increase in corporation income taxes, attributable to higher-than-expected corporate profits.

Technical reestimates. Technical factors increased 2004 receipts a net $27 billion above the February 2003 current services estimate. This net increase was primarily attributable to higher-than-anticipated collections of corporation income taxes of $27 billion, which were partially offset by lower-than-anticipated collections of other sources of receipts (net of the adjustment for revenue uncertainty) of $1 billion. Different collection patterns and effective tax rates than assumed in February 2003 were primarily responsible for the higher-than-anticipated collections of corporation income taxes. Lower-than anticipated collections in other sources of receipts were in large part captured by the adjustment for revenue uncertainty, resulting in a net reduction in collections from these sources of receipts of $1 billion.

Outlays

Outlays for 2004 were $2,292 billion, $103 billion more than the $2,189 billion current services estimate in the 2004 Budget (February 2003).

Table 20–2 distributes the $103 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 or changes in authorizing legislation, which may reflect responses to changed economic conditions. For 2004, policy changes increased outlays an estimated $136 billion relative to the initial current services estimates.

Policy changes increased discretionary outlays by $105 billion. Defense discretionary outlays increased by $63 billion and nondefense discretionary outlays increased by $42 billion. A significant portion of both defense and nondefense outlay increases resulted from enactment of the Emergency Wartime Supplemental Appropriations Acts in 2003 and 2004. Policy changes increased mandatory outlays by $27 billion above current law. Medicare outlays increased an estimated $11 billion, largely due to the Prescription Drug and Medicare Improvement Act of 2003. In addition, outlays for temporary state fiscal relief increased by another $11 billion—$6 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 largely consists of unemployment compensation outlays resulting from extensions of temporary extended unemployment benefits. Debt service costs increased by $4 billion due to outlay and revenue policy changes.

Economic conditions that differed from those forecast in February 2003 resulted in a net decrease in outlays of $21 billion. This decrease consists almost entirely of a $22 billion decrease in net interest due to lower-than-expected interest rates.

[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 20–2. COMPARISON OF ACTUAL 2004 OUTLAYS WITH THE INITIAL CURRENT SERVICES ESTIMATES

(outlays in billions)

	Current Services (Feb. 2003)	Changes				Actual
		Policy	Economic	Technical	Total changes	
Discretionary:						
Defense	383	63	....	8	71	454
Nondefense	412	42	....	–12	29	441
Subtotal, discretionary	795	105	....	–5	100	895
Mandatory:						
Social Security	493	....	*	–2	–1	492
Other programs	728	27	1	–11	17	745
Subtotal, mandatory	1,221	27	1	–13	15	1,237
Net interest	173	4	–22	5	–13	160
Total outlays	2,189	136	–21	–13	103	2,292

* $500 million or less.

Table 20–3. COMPARISON OF THE ACTUAL 2004 DEFICIT WITH THE INITIAL CURRENT SERVICES ESTIMATE

(in billions)

	Current Services (Feb. 2003)	Changes				Actual
		Policy	Economic	Technical	Total changes	
Receipts	2,031	–135	–43	27	–151	1,880
Outlays	2,189	136	–21	–13	103	2,292
Deficit	158	271	22	–39	254	412

Note: Deficit changes are outlays minus receipts. For these changes, a plus indicates an increase in the deficit.

Technical estimating differences and other changes resulted in a net decrease in outlays of $13 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 $5 billion, due to slower-than-expected outlays for nondefense programs. Outlays for mandatory programs decreased an estimated $13 billion. This largely reflects lower-than-anticipated outlays for Medicaid, farm subsidy programs, and unemployment compensation, partially offset by higher-than-anticipated outlays for mortgage credit programs and Medicare. Net interest outlays increased by $5 billion largely due to technical factors compared to the February 2003 estimates.

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 2004. This section combines these effects to show the net impact of these differences.

As shown in Table 20–3, the 2004 current services deficit was initially estimated to be $158 billion. The actual deficit was $412 billion, which was a $254 billion increase from the initial estimate. Receipts were $151 billion less than the initial estimate and outlays were $103 billion more. The table shows the distribution of the changes according to the categories in the preceding two sections.

The net effect of policy changes for receipts and outlays increased the deficit by $271 billion. Economic conditions that differed from the initial assumptions in February 2003 accounted for an estimated $22 billion increase in the deficit. Technical factors reduced the deficit by an estimated $39 billion.

Comparison of the Actual and Estimated Outlays for Mandatory and Related Programs for 2004

This section compares the original 2004 outlay estimates for mandatory and related programs under current law in the 2004 Budget (February 2003) 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 20–4 shows the differences between the actual outlays for these programs in 2004 and the amounts originally estimated in the 2004 Budget, based on laws in effect at that time. Actual outlays for mandatory spending and net interest in 2004 were $1,397 billion, which was $2 billion more than the initial estimate of $1,394 billion, based on existing law in February 2003.

Actual outlays for mandatory human resources programs were $1,273 billion, $20 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 $2 billion less than originally estimated. Undistributed offsetting receipts were $2 billion higher than expected.

Outlays for net interest were $160 billion or $13 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 2004

Table 20–5 provides a reconciliation of the receipts, outlays, and deficit totals published by the Department of the Treasury in the September 2004 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 and outlays by $22 million and $291 million, respectively. Additional adjustments for this budget increased receipts by $294 million and outlays by $154 million. Several financial transactions that are not reported to the Department of the Treasury, including those for the Public Company Accounting Oversight Board, the receipt of

Table 20–4. COMPARISON OF ACTUAL AND ESTIMATED OUTLAYS FOR MANDATORY AND RELATED PROGRAMS UNDER CURRENT LAW

(in billions of dollars)

	2004		
	Feb. 2003 estimate	Actual	Change
Mandatory outlays:			
Human resources programs:			
Education, training, employment, and social services	10	13	3
Health:			
Medicaid	177	176	–1
Other	18	16	–1
Total health	194	192	–2
Medicare	249	265	16
Income security:			
Retirement and disability	95	95	–*
Unemployment compensation	40	42	2
Food and nutrition assistance	38	41	3
Other	99	103	4
Total, income security	273	281	8
Social security	493	492	–1
Veterans benefits and services:			
Income security for veterans	32	31	–1
Other	3	*	–2
Total veterans benefits and services	34	31	–3
Total mandatory human resources programs	1,253	1,273	20
Other functions:			
Agriculture	15	10	–5
International	–2	–7	–4
Deposit insurance	–1	–2	–1
Other functions	13	21	8
Total, other functions	24	22	–2
Undistributed offsetting receipts:			
Employer share, employee retirement	–52	–53	–1
Rents and royalties on the outer continental shelf	–4	–5	–1
Other undistributed offsetting receipts	–*	....	*
Total undistributed offsetting receipts	–56	–59	–2
Total, mandatory	1,221	1,237	15
Net interest:			
Interest on Treasury debt securities (gross)	349	322	–28
Interest received by trust funds	–164	–154	10
Other interest	–12	–7	4
Total net interest	173	160	–13
Total outlays for mandatory and net interest	1,394	1,397	2

* $500 million or less.

accounting oversight fees and their payment to the Standard Setting Body, and the United Mine Workers of America benefit funds, are included in the budget. Other significant conceptual differences in reporting are for the National Railroad Retirement Investment Trust (NRRIT) and the Exchange Stabilization Fund. Reporting to the Department of the Treasury for NRRIT is done with a one month lag, so that the fiscal year total provided in the Treasury Combined Statement covers September 2003 through August 2004. The budget has been adjusted to reflect transactions that occurred during the actual fiscal year, which begins in October. For the Exchange Stabilization Fund, reporting for the budget excludes the gains and losses in the valuation of foreign currencies held in the fund.

Table 20–5. RECONCILIATION OF FINAL AMOUNTS FOR 2004

(in millions of dollars)

	Receipts	Outlays	Deficit
Totals published by Treasury (September 30 MTS)	1,879,799	2,292,352	–412,553
Miscellaneous Treasury adjustments	–22	–291	269
Totals published by Treasury in Combined Statement	1,879,777	2,292,061	–412,284
National Railroad Retirement Investment Trust	....	–231	231
Exchange stabilization fund	....	140	–140
Public Company Accounting Oversight Board	119	68	51
Standard Setting Body	38	38	....
United Mine Workers of America benefit funds	127	127	....
Other	10	12	–2
Total adjustments, net	294	154	140
Totals in the budget	1,880,071	2,292,215	–412,144
MEMORANDUM:			
Total change since year-end statement	272	–137	409

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 20–6 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 2004 differs from that shown in Table 20–3, 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 20–6 are on this basis.

On average, the estimates for the budget year underestimated actual deficits (or overestimated actual surpluses) by $30 billion over the 23-year period. Policy outcomes that differed from the original proposals increased the deficit by an average of $28 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 $10 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 $137 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

Table 20–6. COMPARISON OF ESTIMATED AND ACTUAL 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	–0	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	–153
1990	–91	–21	–31	–79	–131	–221
1991	–63	21	–85	–143	–206	–269
1992	–281	–36	–21	48	–9	–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	73	119	236
2001	184	–129	32	41	–56	128
2002	231	–104	–201	–84	–389	–158
2003	–80	–86	–34	–177	–297	–378
2004	–307	–122	–22	39	–105	–412
Average	....	–28	–12	10	–30	....
Absolute average [2]	....	32	42	58	100	....
Standard deviation	....	42	59	79	137	....

[1] Surplus or deficit estimate includes the effect of the budget's policy proposals.
[2] Absolute average is the average without regard to sign.

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 12 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 20–7 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 $16 billion, but underestimated the deficit in the budget year by $30 billion. The budget estimates understated the deficit in the years following, by amounts growing from $65 billion for BY+1 to $99 billion for BY+4. While these results suggest a tendency to underestimate defi-

Table 20–7. DIFFERENCES BETWEEN ESTIMATED AND ACTUAL SURPLUSES OR DEFICITS FOR FIVE-YEAR BUDGET ESTIMATES SINCE 1982

(In billions of dollars)

	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]	16	–30	–65	–86	–95	–99
Average absolute difference [2]	51	100	156	201	223	240
Standard deviation	64	137	210	253	258	271

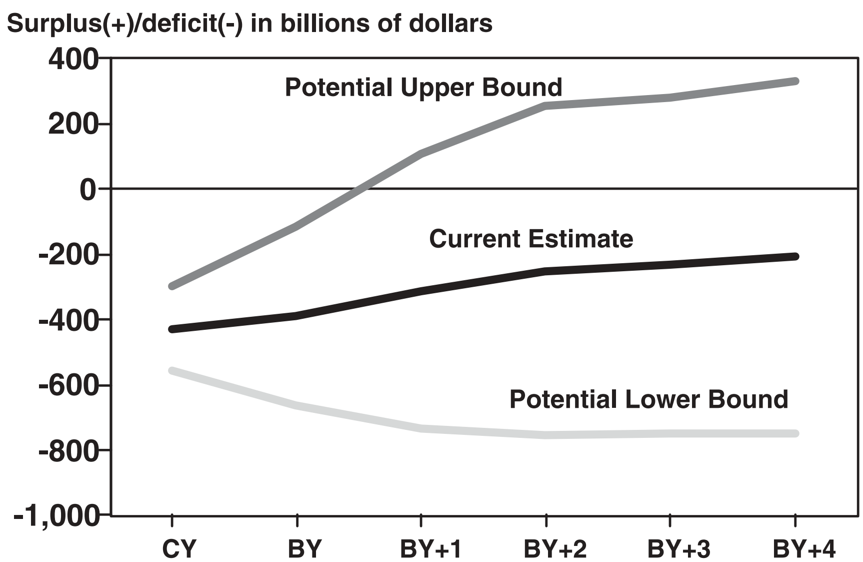
[1] A positive figure represents an underestimate of the surplus or an overestimate of the deficit.
[2] Average absolute difference is the average difference without regard to sign.

cits 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 $51 billion in the current year to $100 billion for the budget year, to $240 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 $64 billion for current year estimates to $137 billion for the budget year estimates and continues to increase steadily as the estimates extend further out, reaching $271 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 percent of the time. Chart 20–1 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.

Chart 20-1. Illustrative Range of Budget Outcomes



21. OUTLAYS TO THE PUBLIC, NET AND GROSS

Table 21–1 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 net outlay totals in order to show outlays and receipts that measure governmental activity rather than a combination of governmental and market activity. As a result, the budget totals represent the amount of resources allocated and distributed by political decision making rather than by private choice and the market mechanism. 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. Offsetting collections and receipts are discussed in more detail in chapter 18 of this volume, "User Charges and Other Collections," and chapter 26, "The Budget System and Concepts."

Table 21–1. TOTAL OUTLAYS, NET AND GROSS OF OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, BY AGENCY, 2004–2006

(In millions of dollars)

Department or Other Unit	2004			2005			2006		
	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	3,885	74	3,959	4,083	64	4,147	4,356	66	4,422
Judicial Branch	5,392	38	5,430	5,741	44	5,785	6,145	48	6,193
Executive Branch									
Department of Agriculture	71,769	19,474	91,243	94,912	23,753	118,665	94,590	22,103	116,693
Department of Commerce	5,850	2,177	8,027	6,278	1,781	8,059	6,500	1,912	8,412
Department of Defense—Military	437,116	11,492	448,608	444,068	11,511	455,579	426,315	11,643	437,958
Department of Education	62,816	961	63,777	70,953	1,394	72,347	64,272	2,123	66,395
Department of Energy	19,972	5,770	25,742	22,178	6,649	28,827	21,969	6,554	28,523
Department of Health and Human Services	543,389	34,789	578,178	585,772	40,350	626,122	643,886	57,937	701,823
Department of Homeland Security	26,537	7,351	33,888	33,259	8,790	42,049	33,284	11,044	44,328
Department of Housing and Urban Development	45,019	2,596	47,615	42,614	1,699	44,313	40,185	1,385	41,570
Department of the Interior	8,914	4,654	13,568	9,433	6,726	16,159	9,812	6,401	16,213
Department of Justice	28,954	834	29,788	21,171	747	21,918	23,380	923	24,303
Department of Labor	56,706	2,291	58,997	50,034	4,063	54,097	51,713	7,548	59,261
Department of State	10,934	2,199	13,133	11,934	938	12,872	14,109	1,051	15,160
Department of Transportation	54,547	440	54,987	58,215	316	58,531	60,585	176	60,761
Department of the Treasury	374,817	16,233	391,050	402,972	17,233	420,205	441,198	17,721	458,919
Department of Veterans Affairs	59,554	6,110	65,664	68,046	5,280	73,326	68,281	4,769	73,050
Corps of Engineers-Civil Works	4,838	1,257	6,095	4,891	1,001	5,892	4,643	1,215	5,858
Other Defense Civil Programs	41,730	38	41,768	43,460	19	43,479	44,489	21	44,510

Table 21–1. TOTAL OUTLAYS, NET AND GROSS OF OFFSETTING COLLECTIONS AND RECEIPTS FROM THE PUBLIC, BY AGENCY, 2004–2006—Continued

(In millions of dollars)

Department or Other Unit	2004			2005			2006		
	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
Environmental Protection Agency	8,334	223	8,557	7,862	124	7,986	8,202	170	8,372
Executive Office of the President	3,308	....	3,308	5,765	....	5,765	7,192	....	7,192
General Services Administration	–403	286	–117	459	288	747	54	280	334
International Assistance Programs	13,737	13,367	27,104	14,754	12,676	27,430	17,022	12,085	29,107
National Aeronautics and Space Administration	15,189	–19	15,170	15,719	119	15,838	15,744	79	15,823
National Science Foundation	5,118	....	5,118	5,641	....	5,641	5,666	....	5,666
Office of Personnel Management	56,535	9,738	66,273	60,964	10,661	71,625	64,259	11,439	75,698
Small Business Administration	4,075	336	4,411	3,036	615	3,651	790	56	846
Social Security Administration	530,205	6,879	537,084	559,048	7,072	566,120	583,492	7,394	590,886
Export-Import Bank of the United States	–1,903	2,640	737	–376	1,271	895	183	271	454
Federal Deposit Insurance Corporation	–1,555	763	–792	214	666	880	–395	908	513
Postal Service	–4,070	68,001	63,931	–442	67,538	67,096	4,125	67,628	71,753
Railroad Retirement Board	2,569	3,005	5,574	4,079	1,825	5,904	4,967	1,223	6,190
Other Independent Agencies	10,863	20,498	31,361	16,196	11,868	28,064	13,727	12,359	26,086
Allowances	....	....	....	34,899	....	34,899	24,168	....	24,168
Undistributed Offsetting Receipts	–212,526	5,106	–207,420	–228,428	5,986	–222,442	–241,291	7,231	–234,060
Totals:	**2,292,215**	**249,601**	**2,541,816**	**2,479,404**	**253,067**	**2,732,471**	**2,567,617**	**275,763**	**2,843,380**

22. 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 estimates in this chapter do not reflect the impact of social security reform.

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 Treasury borrowing.

Table 22–1. RECEIPTS, OUTLAYS, AND SURPLUS OR DEFICIT BY FUND GROUP

(In billions of dollars)

	2004 actual	Estimate					
		2005	2006	2007	2008	2009	2010
Receipts:							
Federal funds cash income:							
From the public	1,152.6	1,271.9	1,347.2	1,470.9	1,595.5	1,695.3	1,797.6
From trust funds	1.3	3.3	5.0	2.6	3.1	3.1	3.2
Total, Federal funds cash income	1,153.9	1,275.2	1,352.2	1,473.5	1,598.6	1,698.4	1,800.7
Trust funds cash income:							
From the public	828.8	879.4	944.2	1,001.3	1,052.3	1,106.0	1,170.3
From Federal funds:							
Interest	155.7	165.2	173.4	185.2	199.0	214.6	230.8
Other	210.8	238.9	313.4	327.3	345.2	363.3	383.5
Total, trust funds cash income	1,195.2	1,283.4	1,431.1	1,513.7	1,596.5	1,683.9	1,784.5
Offsetting receipts	–469.1	–505.8	–605.7	–643.0	–688.0	–732.4	–764.4
Total, unified budget receipts	1,880.1	2,052.8	2,177.6	2,344.2	2,507.0	2,650.0	2,820.9
Outlays:							
Federal funds cash outgo	1,758.7	1,928.2	2,009.2	2,057.0	2,136.0	2,229.1	2,327.1
Trust funds cash outgo	1,002.6	1,056.9	1,164.1	1,242.3	1,309.9	1,386.2	1,465.5
Offsetting receipts	–469.1	–505.8	–605.7	–643.0	–688.0	–732.4	–764.4
Total, unified budget outlays	2,292.2	2,479.4	2,567.6	2,656.3	2,757.8	2,882.9	3,028.2
Surplus or deficit (–):							
Federal funds	–604.8	–653.0	–657.0	–583.5	–537.4	–530.7	–526.4
Trust funds	192.6	226.5	267.0	271.4	286.6	297.8	319.1
Total, unified surplus/deficit (–)	–412.1	–426.6	–390.1	–312.1	–250.8	–232.9	–207.3

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 of the fund group 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 owns them and 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, these funds 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 22–1 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 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 16, "Federal Borrowing and Debt."

Table 22–2. INCOME, OUTGO, AND BALANCES OF TRUST FUNDS GROUP

(In billions of dollars)

	2004 actual	Estimate					
		2005	2006	2007	2008	2009	2010
Total Trust Funds							
Balance, start of year	2,719.5	2,910.2	3,134.4	3,396.1	3,667.5	3,954.0	4,251.8
Income:							
Governmental receipts	780.5	827.4	874.8	923.6	970.5	1,019.3	1,078.0
Proprietary receipts	59.7	65.2	83.6	92.5	97.5	103.4	110.0
Receipts from Federal funds:							
Interest	155.7	165.2	173.4	185.2	199.0	214.6	230.8
Other	242.7	273.9	350.6	366.2	386.5	407.0	429.8
Subtotal, income	1,238.5	1,331.7	1,482.4	1,567.5	1,653.5	1,744.3	1,848.6
Outgo:							
To the public	1,044.6	1,101.9	1,210.5	1,293.5	1,363.9	1,443.4	1,526.4
Payments to Federal funds	1.3	3.3	5.0	2.6	3.1	3.1	3.2
Subtotal, outgo	1,045.9	1,105.2	1,215.5	1,296.1	1,367.0	1,446.5	1,529.5
Change in fund balance:							
Surplus or deficit (–):							
Excluding interest	37.0	61.3	93.5	86.2	87.6	83.1	88.3
Interest	155.7	165.2	173.4	185.2	199.0	214.6	230.8
Subtotal, surplus or deficit (–)	192.6	226.5	267.0	271.4	286.6	297.8	319.1
Adjustments:							
Transfers/lapses (net)	–*	–0.1	*	....	....	....	....
Other adjustments	–1.9	–2.2	–5.3	....	....	....	....
Total, change in fund balance	190.7	224.2	261.7	271.4	286.6	297.8	319.1
Balance, end of year	2,910.2	3,134.4	3,396.1	3,667.5	3,954.0	4,251.8	4,570.9

* $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 22–1 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 of the fund or included in 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 the normal 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 22–1 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 22–1 consists of outlays gross of offsetting receipts, 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 22–3 reconciles, for fiscal year 2004, 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 22–1), and with the unified budget's receipt total.

Table 22–3. RELATIONSHIP OF TOTAL FEDERAL FUND AND TRUST FUND RECEIPTS TO UNIFIED BUDGET RECEIPTS, FISCAL YEAR 2004

(In billions of dollars)

Gross trust fund receipts	1,201.2
Gross Federal fund receipts	1,183.5
Total of trust fund receipts and Federal fund receipts	2,384.7
Deduct intrafund receipts (from funds within the same fund group):	
Trust intrafund receipts	–6.0
Federal intrafund receipts	–29.6
Subtotal, intrafund receipts	–35.6
Total of trust funds cash income and Federal funds cash income	2,349.2
Deduct offsetting receipts: [1]	
Trust fund receipts from Federal funds:	
Interest in receipt accounts	–154.0
General fund payment to Medicare Parts B and D	–94.7
Employing agencies' payments for pensions, Social Security, and Medicare	–45.3
General fund payments for unfunded liabilities of Federal employees retirement funds	–44.4
Transfer of taxation of Social Security and RRB benefits to OASDI, HI, and RRB	–24.0
Other receipts from Federal funds	–4.1
Subtotal, trust fund receipts from Federal funds	–366.5
Federal fund receipts from trust funds	–1.3
Proprietary receipts	–101.3
Subtotal, offsetting receipts	–469.1
Unified budget receipts	1,880.1

[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 22–2 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 22–1 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 22–1. 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 $43 billion in 2004. Table 22–2, 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. The balances are estimated to double again by the year 2010, rising to $4.6 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 program expenditures 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 advance 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 retirement benefits earned by employees. Since many years will pass between the time when benefits are earned and when they are paid, 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 22–4, on the CD-ROM included with this volume, shows estimates of income, outgo, and balances for 2004 through 2010 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 22–2 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 22–5 (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 newly-established special fund of the same general type: a fund for military retirees' health benefits. All these funds are similar to trust funds in that they are financed by earmarked receipts, the excess of income over outgo is 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.

23. 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 is a financial plan for proposing, deciding, and controlling the allocation of resources by the Federal Government. It does not include activities that are related to the Federal Government but that are nonbudgetary 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; or because they involve funds that are privately owned, such as the deposit funds owned by Indian tribes and managed on their behalf by the Government in a fiduciary capacity. 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 23–1. 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	270.8	61.6	–53.2	–54.1	0.9
1976	298.1	231.7	66.4	371.8	301.1	70.7	–73.7	–69.4	–4.3
TQ	81.2	63.2	18.0	96.0	77.3	18.7	–14.7	–14.1	–0.7
1977	355.6	278.7	76.8	409.2	328.7	80.5	–53.7	–49.9	–3.7
1978	399.6	314.2	85.4	458.7	369.6	89.2	–59.2	–55.4	–3.8
1979	463.3	365.3	98.0	504.0	404.9	99.1	–40.7	–39.6	–1.1
1980	517.1	403.9	113.2	590.9	477.0	113.9	–73.8	–73.1	–0.7
1981	599.3	469.1	130.2	678.2	543.0	135.3	–79.0	–73.9	–5.1
1982	617.8	474.3	143.5	745.7	594.9	150.9	–128.0	–120.6	–7.4
1983	600.6	453.2	147.3	808.4	660.9	147.4	–207.8	–207.7	–0.1
1984	666.5	500.4	166.1	851.9	685.7	166.2	–185.4	–185.3	–0.1
1985	734.1	547.9	186.2	946.4	769.4	176.9	–212.3	–221.5	9.2
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	809.3	194.8	–149.7	–168.4	18.6
1988	909.3	667.8	241.5	1,064.5	860.1	204.4	–155.2	–192.3	37.1
1989	991.2	727.5	263.7	1,143.8	932.9	210.9	–152.6	–205.4	52.8
1990	1,032.0	750.3	281.7	1,253.1	1,028.1	225.1	–221.1	–277.7	56.6
1991	1,055.0	761.2	293.9	1,324.3	1,082.6	241.7	–269.3	–321.5	52.2
1992	1,091.3	788.9	302.4	1,381.6	1,129.3	252.3	–290.3	–340.4	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	–203.2	–258.9	55.7
1995	1,351.8	1,000.8	351.1	1,515.8	1,227.2	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	1,601.2	1,290.6	310.6	–21.9	–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	125.5	1.9	123.7
2000	2,025.2	1,544.6	480.6	1,789.1	1,458.3	330.8	236.2	86.3	149.8
2001	1,991.2	1,483.7	507.5	1,863.0	1,516.2	346.8	128.2	–32.5	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	2,159.9	1,796.9	363.0	–377.6	–538.4	160.8
2004	1,880.1	1,345.3	534.7	2,292.2	1,912.7	379.5	–412.1	–567.4	155.2
2005 estimate	2,052.8	1,491.5	561.4	2,479.4	2,080.0	399.4	–426.6	–588.5	162.0
2006 estimate	2,177.6	1,584.4	593.2	2,567.6	2,144.3	423.3	–390.1	–559.9	169.9
2007 estimate	2,344.2	1,715.0	629.2	2,656.3	2,221.4	434.9	–312.1	–506.4	194.3
2008 estimate	2,507.0	1,842.5	664.6	2,757.8	2,308.1	449.8	–250.8	–465.6	214.8
2009 estimate	2,650.0	1,949.3	700.7	2,882.9	2,412.3	470.6	–232.9	–463.0	230.1
2010 estimate	2,820.9	2,077.7	743.2	3,028.2	2,537.3	490.9	–207.3	–459.6	252.3

[1] Off-budget transactions consist of the social security trust funds and the Postal Service fund for all years.

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 much smaller 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 the Social Security and Postal Service transactions are classified as off-budget for all years, in order to provide consistent comparison over time. 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 2006, the off-budget receipts are an estimated 27 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 $390 billion—a $560 billion on-budget deficit partly offset by a $170 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, "The Nation's Fiscal Outlook," and in chapter 13 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 16 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."

Deposit funds.—Deposit funds are non-budgetary accounts that record amounts held by the Government

[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 26 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.

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 26 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 19 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 19 have important ambiguities. Although partly patterned on a comprehensive income tax, they are subjective, as explained in the tax expenditure chapter in recent years, and are open to question in a number of respects. The Treasury Department has therefore begun to review the tax expenditure presentation. The appendix to chapter 19 provides a review, focusing on three issues: (1) using a comprehensive income tax as a baseline, (2) using a comprehensive consumption tax as a baseline, and (3) defining negative tax expenditures (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).

Government-sponsored enterprises.—The Federal Government has established several 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, and their activities are analyzed in chapter 7 of this volume, "Credit and Insurance."

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, *Progress in Regulatory Reform,* was released in December 2004 and also includes a report on unfunded mandates.[4] The report estimates the total costs and benefits of major Federal regulations reviewed by OMB from October 1993 through September 2003 and the impact of Federal regulation on state, local, and tribal governments. It also reviews the international literature on the effects of regulation on national economic growth and performance, reviews the economic literature on the impacts of regulation on manufacturing, and summarizes the Administration's regulatory reform accomplishments. The draft of the 2005 report will be published in February 2005 for public comment.

[3] The most recent publication was issued by the Regulatory Information Service Center in December 2004 and printed in the Federal Register of December 13, 2004 (vol. 69, no. 238).

[4] Office of Information and Regulatory Affairs, Office of Management and Budget, Progress in Regulatory Reform: 2003 Report to Congress on the Costs and Benefits of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities (2004).

24. 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

For budgetary purposes, 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. Tables 24–1 and 24–3 show FTE data, while Table 24–2 shows end strength or "positions filled" data as of September 30th.

Significant Changes in Civilian Employment

Although immediate security requirements cause near-term increases in Federal employment, the Administration continues its efforts to improve government effectiveness and efficiency in order to better serve the American people with a smaller Federal workforce. While current projections show an increase in the number of employees in the Executive Branch, it is expected that efforts to improve government effectiveness and efficiency will result in a reduction in the number of Federal government employees over the next four years.

The *Department of Commerce* grows 4,400 FTE between FY 2004 and FY 2006 due to increased workload associated with the American Community Survey in the Bureau of the Census. The U.S. Patent and Trademark Office (PTO) is also increasing personnel in an effort to reduce a large backlog of patent and trademark submissions. The increase in PTO FTEs is fee funded.

At the *Department of Health and Human Services*, an increase of over 2,800 FTEs between FY 2004 and FY 2006 is due to the following: 1) Additional staff to provide actuarial, health administration, and contracting expertise to support the implementation of the Medicare Modernization Act (MMA) at the Centers for Medicare and Medicaid Services; 2) Expanded staff at the Indian Health Service health care facilities; 3) Increase in scientific research positions at the National Institutes of Health; 4) Pre-market review of new drugs, medical devices, animal drugs, and other products regulated at the Food and Drug Administration (FDA) and the FDA Office of Drug Safety; and 5) Work related to Medicare appeals and health information technology at the Office of the Secretary.

Total FTEs for the *Department of Homeland Security* increase by six percent between FY 2004 and FY 2006 as this new department's employment settles into a more steady state. The new growth of 8,500 FTE is primarily driven by increases in U.S. Customs and Border Protection Officers, Border Patrol Agents, and Transportation Security Administration screener personnel.

Department of Justice FTEs increased by 18 percent between FY 2004 and FY 2006 due to increases in security-related programs. Growth of 18,100 FTE is largely driven by increases in the Federal Bureau of Investigation, federal prison system, legal activities, Bureau of Alcohol, Tobacco, Firearms, and Explosives, and the U.S. Marshals.

Department of State FTE increases are principally within their diplomatic and consular programs, the Department's main operating account. Total Department FTEs increase by over 600 between FY 2004 and FY 2006. These new positions are for additional security personnel, consular personnel to facilitate new visa security requirements, staffing for new requirements overseas, such as Iraq, Sudan, and Libya, and to strengthen reconstruction and stabilization capabilities.

The *Office of Personnel Management's* increases in FY 2005 and FY 2006 FTE, as compared to FY 2004, include the transfer of approximately 1,800 DOD's Defense Security Service investigative personnel to OPM.

The roughly 500 FTE increase reflected in the *Smithsonian Institution* (encompassing the Smithsonian Institution, National Gallery of Art, John F. Kennedy Center for the Performing Arts and the Woodrow Wilson Center for International Scholars) between FY 2004 and FY 2006 primarily reflect additional staff for security and facilities operations. Both the National Gallery of Art and the Smithsonian Institution are working to reduce the turnover associated with their respective security forces and hire a force sufficient to accommodate today's homeland security challenges. In FY 2005, the Smithsonian will continue to supplement its security and facility operations staff to support the recent openings of the National Museum of the American Indian on the National Mall and the National Air and Space Museum's Steven F. Udvar-Hazy Center.

The *Social Security Administration* is projecting growth in hiring of about 1,700 FTE between FY 2004 and FY 2006. The agency requires new hires to meet its responsibilities in implementing the Medicare prescription drug benefit. SSA is in charge of determining eligibility for low-income subsidies for the drug benefit.

Significant Changes in Military Employment

As shown in Table 24–3, the *Department of Defense* estimate reduces over 55,000 FTE by FY 2006. The Services continue to increase their use of technology resulting in less military personnel requirements. In addition, contracted labor is on the rise within the Services. Lastly, personnel retention was previously high among those military members with aircraft-related skills due to reduced hiring by the commercial airlines. However, the Services anticipate this retention rate will decrease as the economy continues to improve.

Personnel Compensation and Benefits

Table 24–4 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.

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 24–1. FEDERAL EMPLOYMENT IN THE EXECUTIVE BRANCH

(Civilian employment as measured by Full-Time Equivalents, in thousands)

Agency	Actual			Estimate		Change: 2002 to 2006	
	2002	2003	2004	2005	2006	FTE's	Percent
Cabinet agencies:							
Agriculture	97.0	101.4	100.5	103.3	100.5	3.5	3.6%
Commerce	34.9	34.5	34.6	37.9	39.0	4.1	11.7%
Defense—Military functions	649.9	648.9	650.4	659.9	664.6	14.7	2.3%
Education	4.5	4.5	4.4	4.5	4.4	–0.1	–2.2%
Energy	15.8	15.6	15.1	15.9	15.8	....	....
Health and Human Services	59.0	60.0	59.3	62.3	62.1	3.1	5.3%
Homeland Security	81.3	144.5	137.3	143.9	145.8	64.5	79.3%
Housing and Urban Development	10.0	10.4	10.2	10.0	9.9	–0.1	–1.0%
Interior	70.3	71.0	70.7	71.0	70.9	0.6	0.9%
Justice	97.3	99.4	101.4	116.5	119.5	22.2	22.8%
Labor	17.0	16.9	16.5	16.8	16.9	–0.1	–0.6%
State	28.6	29.5	30.0	30.3	30.6	2.0	7.0%
Transportation	61.2	59.0	57.3	57.4	57.7	–3.5	–5.7%
Treasury	115.9	115.4	113.6	113.0	113.6	–2.3	–2.0%
Veterans Affairs	208.9	211.8	218.7	221.9	218.1	9.2	4.4%
Other agencies—excluding Postal Service:							
Agency for International Development	2.4	2.3	2.2	2.3	2.6	0.2	8.3%
Broadcasting Board of Governors	2.4	2.4	2.3	2.3	2.4	....	....
Corps of Engineers—Civil Works	25.0	24.5	23.5	23.5	23.5	–1.5	–6.0%
Environmental Protection Agency	17.5	17.5	17.3	17.6	17.6	0.1	0.6%
EEOC	2.8	2.6	2.5	2.4	2.4	–0.4	–14.3%
FDIC/RTC	6.0	5.4	5.3	5.2	4.9	–1.1	–18.3%
General Services Administration	12.4	12.9	12.6	12.7	12.2	–0.2	–1.6%
NASA	18.7	18.7	18.8	19.4	19.0	0.3	1.6%
National Archives and Records Administration	2.8	2.8	2.8	2.9	2.9	0.1	3.6%
National Labor Relations Board	1.9	1.9	1.9	1.9	1.8	–0.1	–5.3%
National Science Foundation	1.2	1.2	1.3	1.3	1.3	0.1	8.3%
Nuclear Regulatory Commission	2.8	2.9	3.0	3.1	3.2	0.4	14.3%
Office of Personnel Management	2.8	2.8	2.8	4.1	5.0	2.2	78.6%
Peace Corps	1.0	1.0	1.1	1.2	1.2	0.2	20.0%
Railroad Retirement Board	1.2	1.1	1.1	1.0	1.0	–0.2	–16.7%
Securities and Exchange Commission	3.0	3.1	3.6	3.9	3.9	0.9	30.0%
Small Business Administration	4.0	3.8	3.4	4.2	3.3	–0.7	–17.5%
Smithsonian Institution	5.0	5.2	5.1	5.6	5.6	0.6	12.0%
Social Security Administration	63.1	63.1	63.9	64.2	65.6	2.5	4.0%
Tennessee Valley Authority	13.5	13.1	12.0	12.0	12.1	–1.4	–10.4%
All other small agencies	15.0	15.1	14.9	15.7	15.7	0.7	4.7%
Total, Executive Branch civilian employment*	**1,755.9**	**1,826.2**	**1,821.1**	**1,871.2**	**1,876.8**	**120.9**	**6.9%**
Subtotal, Defense	649.9	648.9	650.4	659.9	664.6	14.7	2.3%
Subtotal, Non-Defense	1,106.0	1,177.3	1,170.7	1,211.3	1,212.2	106.2	9.6%

*Totals may not add due to rounding.

Table 24–2. TOTAL FEDERAL EMPLOYMENT

(As measured by total positions filled)

Description	Actual as of September 30			Change: 2002 to 2004	
	2002	2003	2004	Positions	Percent
Executive branch civilian employment:					
All agencies except Postal Service and Postal Rate Commission:					
Full-time permanent	1,632,663	1,646,688	1,662,990	30,327	1.9%
Other than full-time permanent	185,597	220,288	218,953	33,356	18.0%
Subtotal	1,818,260	1,866,976	1,881,943	63,683	3.5%
Postal Service: [1]					
Full-time permanent	645,758	634,709	609,579	–36,179	–5.6%
Other than full-time permanent	165,933	164,539	158,083	–7,850	–4.7%
Subtotal	811,691	799,248	767,662	–44,029	–5.4%
Subtotal, Executive branch civilian employment	2,629,951	2,666,224	2,649,605	19,654	0.7%
Military personnel on active duty: [2]					
Department of Defense	1,411,634	1,434,377	1,426,836	15,202	1.1%
Department of Transportation (Coast Guard)	38,238	37,472	40,230	1,992	5.2%
Commissioned Corps (HHS, NOAA, EPA)	6,221	6,200	6,357	136	2.2%
Subtotal, military personnel	1,456,093	1,478,049	1,473,423	17,330	1.2%
Subtotal, Executive Branch	4,086,044	4,144,273	4,123,028	36,984	0.9%
Legislative branch:					
full-time permanent	12,097	12,044	11,614	–483	–4.0%
Other than full-time permanent	18,789	19,070	18,435	–354	–1.9%
Subtotal, Legislative Branch	30,886	31,114	30,049	–837	–2.7%
Judicial Branch:					
Full-time permanent	31,286	30,955	30,537	–749	–2.4%
Other than full-time permanent	3,413	3,304	3,324	–89	–2.6%
Subtotal, Judicial Branch	34,699	34,259	33,861	–838	–2.4%
Grand total [3]	**4,151,629**	**4,209,646**	**4,186,938**	**35,309**	**0.9%**
ADDENDUM					
Executive branch civilian personnel (excluding Postal Service):					
DOD civilians—Military functions	644,817	636,454	644,251	–566	–0.1%
All other executive branch	1,173,443	1,230,522	1,237,692	64,249	5.5%
Total	**1,818,260**	**1,866,976**	**1,881,943**	**63,683**	**3.5%**

[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 24–3. TOTAL FEDERAL EMPLOYMENT

(As measured by Full-Time Equivalents)

Description	2004 Actual	Estimate		Change: 2004 to 2006	
		2005	2006	FTE's	Percent
Executive branch civilian personnel:					
All agencies except Postal Service and Defense	1,170,678	1,211,305	1,212,216	41,538	3.5%
Defense—Military functions (civilians)	650,441	659,889	664,569	14,128	2.2%
Subtotal, excluding Postal Service	1,821,119	1,871,194	1,876,785	55,666	3.1%
Postal Service [1]	755,260	740,974	729,395	–25,865	–3.4%
Subtotal, Executive Branch civilian personnel	2,576,379	2,612,168	2,606,180	29,801	1.6%
Executive branch uniformed personnel: [2]					
Department of Defense	1,430,607	1,404,918	1,375,250	–55,357	–3.9%
Department of Homeland Security (Coast Guard)	40,230	40,706	41,332	1,102	2.7%
Commissioned Corps	6,357	6,503	6,515	158	2.5%
Subtotal, uniformed military personnel	1,477,194	1,452,127	1,423,097	–54,097	–3.7%
Subtotal, Executive Branch	4,053,573	4,064,295	4,029,277	–24,296	–0.6%
Legislative Branch: 3 Total FTE [3]	31,764	32,240	32,737	973	3.1%
Judicial branch: Total FTE	33,802	33,505	34,728	926	2.7%
Grand total	**4,119,139**	**4,130,040**	**4,096,742**	**–22,397**	**–0.5%**

[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 2004 FTE data not available for the Senate (positions filled were used).

TABLE 24–4. PERSONNEL COMPENSATION AND BENEFITS

(In millions of dollars)

Description	2004 Actual	2005 Estimate	2006 Request	Change: 2004 to 2006	
				Dollars	Percent
Civilian personnel costs:					
Executive Branch (excluding Postal Service):					
Direct compensation:					
DOD—Military functions	39,139	40,139	41,758	2,619	6.7%
All other executive branch	79,711	85,770	87,696	7,985	10.0%
Subtotal, direct compensation	118,850	125,909	129,454	10,604	8.9%
Personnel benefits:					
DOD—Military functions	10,008	10,419	10,898	890	8.9%
All other executive branch	32,627	34,332	34,902	2,275	7.0%
Subtotal, personnel benefits	42,635	44,751	45,800	3,165	7.4%
Subtotal, executive branch	161,485	170,660	175,254	13,769	8.5%
Postal Service:					
Direct compensation	37,921	38,447	39,134	1,213	3.2%
Personnel benefits	12,854	13,220	14,488	1,634	12.7%
Subtotal	50,775	51,667	53,622	2,847	5.6%
Legislative Branch: [1]					
Direct compensation	1,761	1,805	1,918	157	8.9%
Personnel benefits	460	481	517	57	12.4%
Subtotal	2,221	2,286	2,435	214	9.6%
Judicial Branch:					
Direct compensation	2,494	2,604	2,799	305	12.2%
Personnel benefits	682	728	807	125	18.3%
Subtotal	3,176	3,332	3,606	430	13.5%
Total, civilian personnel costs	217,657	227,945	234,917	17,260	7.9%
Military personnel costs:					
DOD—Military Functions:					
Direct compensation	75,729	67,137	69,103	–6,626	–8.7%
Personnel benefits	32,517	34,930	37,377	4,860	14.9%
Subtotal	108,246	102,067	106,480	–1,766	–1.6%
All other executive branch, uniformed personnel:					
Direct compensation	2,343	2,487	2,628	285	12.2%
Personnel benefits	571	615	653	82	14.4%
Subtotal	2,914	3,102	3,281	367	12.6%
Total, military personnel costs [2]	111,160	105,169	109,761	–1399	–1.3%
Grand total, personnel costs	**328,817**	**333,114**	**344,678**	**15,861**	**4.8%**
ADDENDUM					
Former Civilian Personnel:					
Retired pay for former personnel	53,412	56,896	59,883	6,471	12.1%
Government payment for Annuitants:					
Employee health benefits	7,326	7,831	8,401	1,075	14.7%
Employee life insurance	35	36	36	1	2.9%
Total Former Civilian Personnel.					
Former Military personnel:					
Retired pay for former personnel	37,153	39,135	40,915	3,762	10.1%
Military annuitants health benefits	5,197	5,887	6,254	1,057	20.3%

[1] Excludes members and officers of the Senate.
[2] Excludes reserve components not on active duty.

CURRENT SERVICES ESTIMATES

25. 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 corrects 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. 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 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 2004 through 2010. 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.

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 2005 through 2010, 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 2005 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, 2005. 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

Table 25–1. BASELINE CATEGORY TOTALS

(In billions of dollars)

	2004	2005	2006	2007	2008	2009	2010
Receipts	1,880.1	2,053.0	2,177.9	2,347.2	2,518.3	2,668.0	2,841.0
Outlays:							
Discretionary:							
DoD-Military	436.3	443.1	416.7	416.1	427.8	439.2	453.0
Homeland security	25.3	30.2	33.1	33.9	34.5	35.2	36.0
Other discretionary	433.8	456.8	464.3	472.7	480.2	487.1	497.0
Subtotal, discretionary	895.4	930.0	914.2	922.7	942.5	961.5	986.0
Mandatory:							
Social Security	491.5	515.1	540.1	566.7	595.8	629.9	665.5
Medicare	264.9	290.3	340.2	381.5	406.5	432.8	460.3
Medicaid and SCHIP	180.8	193.6	198.0	210.6	228.8	249.0	270.8
Other mandatory	299.3	336.9	337.4	326.5	327.0	332.9	355.3
Subtotal, mandatory	1,236.5	1,335.9	1,415.7	1,485.3	1,558.1	1,644.6	1,751.9
Net interest	160.2	177.5	209.3	242.1	269.0	290.7	309.8
Total outlays	2,292.2	2,443.4	2,539.1	2,650.1	2,769.6	2,896.8	3,047.8
Unified deficit	–412.1	–390.4	–361.2	–302.8	–251.3	–228.8	–206.8
On-budget	–567.4	–552.4	–534.3	–500.3	–469.4	–462.2	–462.3
Off-budget	155.2	162.0	173.1	197.5	218.1	233.3	255.6
Memorandum:							
BEA baseline deficit	–412.1	–390.7	–368.8	–314.6	–256.2	–213.3	–211.5
Do not extend emergencies	....	....	5.3	9.0	10.7	12.0	12.7
Correct growth rates for pay	....	....	2.0	2.4	2.5	2.7	2.8
Remove special rule for administrative expenses of selected programs	....	....	0.1	0.2	0.4	0.5	0.6
Extend certain tax provisions	....	0.3	–*	–0.4	–9.6	–31.5	–11.9
Related debt service	....	*	0.1	0.5	0.9	0.7	0.5
Current baseline deficit	–412.1	–390.4	–361.2	–302.8	–251.3	–228.8	–206.8

*$50 million or less.

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 reductions in individual income taxes on capital gains and dividends, and increased expensing for small businesses. Unlike the two extensions discussed above, the BEA baseline definitions, developed before the enactment of the 2001 and 2003 tax acts, do not provide for extension of these provisions.

Discretionary spending.—Discretionary programs differ in one important aspect from direct spending programs—Congress provides spending authority for almost all 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 2005, the current services estimates for discretionary programs are equal to enacted 2005 appropriations. For 2006 through 2010, funding for most accounts is equal to this 2005 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. Also, the estimates presented here exclude the special adjustment for administrative expenses for certain benefit programs required by the BEA. This provision is inconsistent with the baseline rules for other accounts that fund administrative costs. In addition, the baseline estimates presented here assume that emergency appropriations enacted for 2005, largely in response to the Florida hurricanes, are one-time only events. 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 baseline 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.
- *Do not extend any authorizing laws that expire.* If all mandatory programs were assumed to expire as scheduled, the deficit in 2005 would be $8 billion lower than the current estimates and deficits for 2006 through 2010 would be $280 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 $224 billion higher over the period 2006 through 2010. If certain provisions of the 2001 and 2003 Tax Acts were assumed to expire, the deficit would be $57 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 $14 lower in 2006 and $325 billion lower over the period 2006 through 2010.
- *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, under a strict "current law" approach, 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 2006 would be reduced by $497 billion relative to the current estimates. Clearly this would provide an unrealistic estimate of future spending and the government's future fiscal position.

Table 25–2 provides estimates for a variety of changes in baseline definitions that could be considered.

Table 25–2. ALTERNATIVE BASELINE ASSUMPTIONS [1]

(in billions of dollars)

	2005	2006	2007	2008	2009	2010	2006–2010
Current baseline surplus	–390	–361	–303	–251	–229	–207	–1,351
Alternative assumptions (surplus impact):							
Extend provisions affecting parts of mandatory programs	–*	–2	–2	–2	–2	–2	–10
Do not extend any authorizing laws:							
Mandatory spending	8	21	22	72	79	86	280
Trust fund excise taxes	....	–32	–34	–49	–52	–56	–224
Certain provisions of the 2001 and 2003 Tax Acts	–*	*	*	10	33	14	57
Straightline appropriations	....	14	36	62	91	121	325
Do not extend any appropriations	....	497	827	961	1,056	1,144	4,485

[1] Estimates provided here are the totals for the illustrative provisions shown in Table 25–5. This is not a complete listing of all provisions that expire.
*500 million or less.

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 25–3. The economic outlook underlying these assumptions is discussed in greater detail in Chapter 12 of this volume.

Table 25–3. SUMMARY OF ECONOMIC ASSUMPTIONS

(Fiscal years; dollar amounts in billions)

	2005	2006	2007	2008	2009	2010
Gross Domestic Product (GDP):						
Levels, dollar amounts in billions:						
Current dollars	12,227	12,907	13,617	14,349	15,111	15,906
Real, chained (2000) dollars	11,137	11,528	11,916	12,298	12,685	13,078
Percent change, year over year:						
Current dollars	5.8	5.6	5.5	5.4	5.3	5.3
Real, chained (2000) dollars	3.7	3.5	3.4	3.2	3.1	3.1
Inflation measures (percent change, year over year):						
GDP chained price index	2.0	2.0	2.1	2.1	2.1	2.1
Consumer price index (all urban)	2.7	2.2	2.4	2.4	2.4	2.4
Unemployment rate, civilian (percent)	5.4	5.2	5.1	5.1	5.1	5.1
Interest rates (percent):						
91–day Treasury bills	2.4	3.4	3.8	4.0	4.1	4.2
10–year Treasury notes	4.5	5.1	5.4	5.5	5.6	5.6
MEMORANDUM						
Related program assumptions:						
Automatic benefit increases (percent):						
Social security and veterans pensions	2.7	2.3	2.3	2.4	2.4	2.4
Federal employee retirement	2.7	2.3	2.3	2.4	2.4	2.4
Food stamps	5.8	1.4	2.3	2.4	2.4	2.4
Insured unemployment rate	2.3	2.2	2.2	2.2	2.2	2.2

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 25–4. Assumptions about various automatic cost-of-living-adjustments are shown in Table 25–3.

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 at the end of March 2005. The baseline does not assume additional spending under this authority beyond that point. Table 25–5 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 25–5 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 25–4. BENEFICIARY PROJECTIONS FOR MAJOR BENEFIT PROGRAMS

(Annual average, in thousands)

	2004 Actual	Estimate					
		2005	2006	2007	2008	2009	20010
Farmer direct payments	1,596	1,856	1,840	1,826	1,822	1,811	1,811
Federal family education loans	6,612	6,972	6,892	6,584	6,927	7,286	7,658
Federal direct student loans	2,152	2,275	2,303	2,312	2,425	2,543	2,667
Medicaid/State Children's Health Insurance Program	47,600	48,900	50,200	50,300	50,500	50,800	51,200
Medicare-eligible military retiree health benefits	1,679	1,710	1,734	1,734	1,734	1,734	1,734
Medicare:							
Hospital insurance	41,078	41,677	42,292	43,014	43,851	44,750	45,701
Supplementary medical insurance	38,706	39,237	39,751	40,339	41,051	41,822	42,615
Railroad retirement	610	597	584	573	563	554	547
Federal civil service retirement	2,393	2,421	2,455	2,487	2,519	2,551	2,586
Military retirement	1,787	1,802	1,819	1,838	1,852	1,862	1,869
Unemployment compensation	8,770	8,610	8,970	9,070	9,240	9,340	9,420
Food stamps	23,854	26,417	29,059	28,187	27,201	26,113	26,061
Child nutrition	31,693	32,603	33,115	33,642	34,168	34,675	35,162
Foster care and adoption assistance	565	584	600	617	636	656	678
Supplemental security income (SSI):							
Aged	1,133	1,118	1,107	1,102	1,100	1,099	1,099
Blind/disabled	5,533	5,703	5,913	6,071	6,165	6,230	6,291
Subtotal, SSI	6,666	6,821	7,020	7,173	7,265	7,329	7,390
Child care and development fund (CCDF) [1]	2,300	2,200	2,200	2,100	2,100	2,000	2,000
Social security (OASDI):							
Old age and survivor insurance	39,488	39,813	40,263	40,770	41,375	42,118	43,011
Disability insurance	7,696	8,005	8,302	8,576	8,835	9,088	9,318
Veterans compensation:							
Veterans	2,518	2,594	2,688	2,818	2,911	2,979	3,069
Survivors (non-veterans)	316	328	335	343	351	359	368
Subtotal, veterans compensation	2,834	2,922	3,023	3,161	3,262	3,338	3,437
Veterans pensions:							
Veterans	343	336	330	323	317	311	305
Survivors (non-veterans)	219	210	203	195	188	181	174
Subtotal, veterans pensions	562	546	533	518	505	492	479

[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.

Table 25–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE

(In millions of dollars)

Category	Estimate 2005	2006	2007	2008	2009	2010
REGULATIONS						
Foster care program:						
Administrative claims for children in unlicensed relative homes	....	–82	–87	–91	–96	–101
Old age and survivors insurance (OASI) and disabilty insurance (DI):						
Ticket to Work and Self-Sufficiency	18	26	27	18	5	–14
Reduction of Title II benefits under family maximum in cases of dual entitlement	16	17	18	19	20	21
Trial work period	4	3	3	2	1	1
Medicare, HI: [1]						
Inpatient Rehabiliation Facilities	–50	–70	–70	–180	–230	–260
Inpatient Hospital Post-Acute Transfers	....	–740	–900	–960	–1,010	–1,080
Skilled Nursing Facility Case Mix Refinement	....	–1,520	–1,980	–2,040	–2,230	–2,360
Medicare, HI and SMI: [1]						
Bad debt reimbursement	....	–10	–50	–80	–90	–100
Supplemental security income (SSI):						
Ticket to Work and Self-Sufficiency	–12	–12	–6	–3	–7	–19
Title XVI cross-program recovery	–30	–15	–15	–15	–15	–20
Student earned income exclusion	4	4	4	4	5	5
EPA Pesticides tolerance fee	....	....	....	....	–21	–22
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	....	....	....	....	....	369
State administrative expenses	....	....	....	....	....	184
CCC market access, bioenergy and commodity programs:						
Counter-cyclical payment program	....	....	....	....	1,072	912
Dairy price support program	....	....	....	50	50	50
Dairy export incentive program	....	....	....	45	67	67
Direct payment program	....	....	....	2,621	5,303	5,303
Marketing assistance loan and loan deficiency payment program	....	....	....	1,042	132	88
Conservation reserve program	....	....	....	2,319	2,505	2,506
Farm security and rural investment:						
Conservation security program	....	....	....	559	648	693
Environmental quality incentives program	....	....	....	1,184	1,253	1,276
Farm and ranch lands protection program	....	....	....	91	96	97
Ground and surface water conservation	....	....	....	68	63	62
Wildlife habitat incentives program	....	....	....	77	83	85
Wetlands reserve program	....	....	....	287	281	279
Food stamps:						
Benefit costs	....	....	....	32,728	32,248	33,061
State administrative expenses	....	....	....	2,638	2,730	2,825
Employment and training	....	....	....	308	317	321
Other program costs	....	....	....	60	61	63
Nutrition assistance for Puerto Rico	....	....	....	1,586	1,624	1,663
Food donations on Indian reservations	....	....	....	83	85	87
The emergency food assistance program commodities	....	....	....	140	140	140
Promoting safe and stable families	....	....	305	305	305	305
Secure rural schools—payments to Oregon and California counties	....	....	....	117	118	120
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	1,000	....	....	....	....	1,000
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	....	....	....	499	971	1,043
Trade adjustment assistance—farmers	....	....	....	90	90	90
Veterans compensation—annual cost of living adjustment	....	478	1,008	1,709	2,464	3,269
Revenues:						
Excise taxes dedicated to trust funds:						
Airport and Airway trust fund taxes	....	....	....	11,897	12,566	13,271
Aquatic resources trust fund taxes	....	319	328	336	346	355
Highway trust fund taxes	....	31,468	32,163	32,783	33,366	33,940
Certain provisions for the 2001 tax cut and 2003 jobs and growth tax cut	313	–48	–363	–9,647	–31,462	–11,901

Table 25–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued

(In millions of dollars)

Category	Estimate					
	2005	2006	2007	2008	2009	2010
Provisions not extended in the baseline (effect of extension):						
Spending:						
Biomass research and development	....	....	....	14	14	14
EPA pesticides maintenance fee	....	....	....	....	–15	–15
Loans for broadband services in rural areas	....	....	....	1	6	9
Medicare, SMI:						
Medicare low income premium assistance [2]	....	230	255	280	300	320
Medicaid:						
Transition benefits [3]	221	488	524	554	580	601
Milk income loss contract program (CCC)	....	600	600	600	600	600
TANF:						
Supplemental grants	128	319	319	319	319	319
Welfare research	7	15	15	15	15	15
Veterans programs:						
Income verification match	....	....	....	....	–6	–11
Contract disability medical exams	....	....	....	....	9	103
Native American veterans housing loans	....	....	....	....	....	–1
Hybrid adjustable rate mortgages	....	....	....	....	4	4
Enhanced loan asset sales	....	....	....	....	....	–89
Loan guarantees for multifamily transitional housing for homeless veterans	....	....	....	....	....	11
Wool research, development, and promotion	....	....	2	2	2	2
OTHER IMPORTANT PROGRAM ASSUMPTIONS						
Child support enforcement (CSE):						
Alternative penalties for Family Support Act systems and Statewide Disbursement Unit requirements	–208	–208	164	7	....	....
Effect of enhanced rate of paternity testing	7	7	7	7	8	8
Food stamps:						
Tax offset, recoupment, and general claims collection	–154	–154	–154	–154	–154	–154
Quality control liabilities	....	–18	–18	–16	–12	–12
Allocation of administrative costs between public assistance programs	–197	–197	–197	–197	–197	–197
Medicare:						
Medicare Advantage Risk Adjustment	....	2,200	2,100	1,800	1,400	800
Physicians	56,096	56,345	55,152	54,483	53,745	52,638
Prescription Drug Benefit [4]	1,155	45,846	64,839	70,905	77,417	84,328
Data Processing Improvement for Overpayments	....	–90	–100	–110	–120	–100
Contracting Reform	....	....	....	–70	–280	–550
Medicaid: [5]						
Financial management recoveries	–480	–491	–524	–570	–622	–678
Vaccines for Children, total program costs	1,635	1,502	1,271	1,259	1,280	1,309
Allocation of administrative costs between public assistance programs	471	509	549	593	640	692
Institutional long term care	34,290	36,245	38,744	41,391	44,404	47,629
Home and community based institutional alternatives	20,273	23,078	25,766	28,630	31,893	35,381
Pharmaceuticals (FFS, net of rebates)	19,643	11,464	9,159	9,933	10,857	11,811
Managed care (including Medicaid MCOs, PHPs, PCCM)	30,466	33,914	38,182	42,731	47,915	53,452
State Children's Health Insurance Program (Title XXI)	5,343	5,434	5,438	5,267	5,251	5,423
Approved Demonstrations: [6]						
Medicare, HI:						
Mercy Medical SNF						
Baseline estimate	6	1	....	....	....	....
Demonstration estimate	6	1	....	....	....	....
Premier—Hospital Quality Incentive						
Baseline estimate	3,052	3,265	....	....	....	....
Demonstration estimate	3,064	3,277	12	....	....	....
Rural Community Hospital [7]						
Baseline estimate	63	66	69	73	76	80
Demonstration estimate	67	79	83	87	91	90
New York Graduate Medical Education						
Baseline estimate	53	53	53	53	....	....
Demonstration estimate	45	37	26	13	....	....
Utah Graduate Medical Education						
Baseline estimate	5	6	6	....	....	....
Demonstration estimate	5	6	6	....	....	....
Medicare, SMI:						
Municipal Health						
Baseline estimate	20	22	6	....	....	....
Demonstration estimate	39	43	12	....	....	....

Table 25–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued

(In millions of dollars)

Category	Estimate					
	2005	2006	2007	2008	2009	2010
Diabetes (Telemedicine)						
Baseline estimate	8	7	4			
Demonstration estimate	8	7	4			
United Mine Workers Program—Prescription Drug Benefits [8]						
Baseline estimate						
Demonstration estimate	120					
Smoking Cessation						
Baseline estimate	*					
Demonstration estimate	*					
BIPA Disease Management						
Baseline estimate	1,134	1,279	640			
Demonstration estimate	1,134	1,279	639			
Case Management/Lovelace						
Baseline estimate	2					
Demonstration estimate	2					
Coordinated Care						
Baseline estimate	188	95				
Demonstration estimate	163	82				
Medicare Replacement Drug						
Baseline estimate						
Demonstration estimate	400	100				
Disease Management for Chronically Ill Dual Beneficiaries (Lifemasters)						
Baseline estimate	280	603	634	152		
Demonstration estimate	251	541	568	136		
Medicare Lifestyle Modification Program						
Baseline estimate	1	1				
Demonstration estimate	1	1				
Influenza Medication						
Baseline estimate						
Demonstration estimate	200					
United Mine Workers Program—Health Benefits						
Baseline estimate	442					
Demonstration estimate	411					
Oncology/quality of care						
Baseline estimate						
Demonstration estimate	200	100				
Medicare, HI and SMI:						
Evercare						
Baseline estimate	88					
Demonstration estimate	88					
Home Health Third Party Liability						
Baseline estimate	110	85	62	59		
Demonstration estimate	110	85	62	59		
Homebound						
Baseline estimate						
Demonstration estimate	9	10				
Medicare+Choice Phase I						
Baseline estimate	137					
Demonstration estimate	141	3				
Medicare+Choice Phase II						
Baseline estimate	1,215	350	28			
Demonstration estimate	1,310	395	30			
SHMO-ESRD						
Baseline estimate	18	5				
Demonstration estimate	20	6				
S/HMO I—Medicare						
Baseline estimate	925	969	1,010	336		
Demonstration estimate	1,160	1,210	1,260	425		
S/HMO II—Medicare						
Baseline estimate	440	461	480	160		
Demonstration estimate	550	575	600	195		
Physician Group Practice						
Baseline estimate	1,216	1,680	1,761	445		
Demonstration estimate	1,181	1,596	1,634	450	77	
Medicaid: [6]						
Alabama Family Planning	92					
Arizona AHCCCS	2,929	3,300				

Table 25–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued

(In millions of dollars)

Category	Estimate 2005	2006	2007	2008	2009	2010
Arkansas (ARKids B)	59					
Arkansas Family Planning Services	207	35				
Arkansas Cash & Counseling	9	9	2			
Arkansas TEFRA	28	30	32	8		
California Family Planning	53					
California In-Home Supportive Services Plus	242	280	325	378	357	
California—LA County [9]	65					
Colorado Consumer Directed Attendant Support	14	17	19	3		
Delaware—Diamond State Health Plan	456	504	129			
District of Columbia HIV	5	8	11	14	4	
District of Columbia Childless Adults 50–64	5	5	3			
Florida Cash & Counseling	53	57	61	26		
Hawaii Health QUEST	277					
Illinois Family Planning	339	362	387	414		
Kentucky Health Care Partnership Program	378	33				
Maine HIV	8	9	7			
Maryland (Health Choice)	929					
Massachusetts MassHealth	1,885					
Minnesota (Prepaid Med. Assist. Project Plus)	101					
Mississippi Family Planning	122	134	146			
Mississippi—Healthier Mississippi	59	65	71	78	86	
Missouri Managed Care Plus	205	204	86			
Montana Basic Medicaid for Able-Bodied Adults	29	32	35	39	13	
New Jersey Cash & Counseling	4	4	5	3		
New Mexico—Family Planning Expansion	9	11				
New York (Partnership Plan)	9,753	5,252				
Oklahoma Sooner Care	843	906	230			
Oregon Family Planning	65	76	6			
Oregon Independent Choices	2	3	*			
Rhode Island Rite Care (Medicaid)	111					
South Carolina Family Planning	10					
TennCare II	3,488	3,865	3,124			
Utah (Primary Care Network)	87	97	79			
Vermont Health Access Plan	204	218	57			
Virginia—Family Planning	165	171	176			
Washington (Take Charge/Family Planning)	200	160				
Wisconsin Badger Care (Medicaid)	40	42	18			
Wisconsin Family Planning	28	34	40	10		
Pharmacy Plus (demonstration estimate): [10]						
Wisconsin Pharmacy Plus	183	218	260			
Florida Pharmacy Plus	95	105	93			
Illinois Pharmacy Plus	298	357	277			
South Carolina Pharmacy Plus	153	179	208	52		
State Children's Health Insurance Program (Title XXI) (demonstration estimates): [10]						
Alaska	9	9	10			
Maryland Health Choice [11]	121					
Minnesota Care	47					
Missouri MC+c [11]	93	108	117			
New Jersey FamilyCare [12]						
New Mexico SCHIP [11]	24	25	26			
Rhode Island (SCHIP RiteCare)	10					
Wisconsin (BadgerCare)	123	132	142			
Health Insurance Flexibility and Accountability (HIFA) (demonstration estimate):						
Arizona HIFA (SCHIP funds)	41	43				
Colorado HIFA (SCHIP funds)	4	11				
Idaho HIFA	20	23	25	26	24	
Illinois HIFA (KidCare Parent Coverage)						
Baseline estimate (Medicaid funds)	5	5	6			
Demonstration estimate (SCHIP funds)	129	180	191			
Maine HIFA (Maine Care for Childless Adults—Medicaid funds)						
Baseline estimate	102	102	102			
Michigan HIFA	110	112	117	123	31	
Oregon HIFA (Oregon Health Plan 2)						
Baseline estimate (Medicaid funds)	1,349	1,467	1,603			
Demonstration estimate (SCHIP funds)	18	15	16			

Table 25–5. IMPACT OF REGULATIONS, EXPIRING AUTHORIZATIONS, AND OTHER ASSUMPTIONS IN THE BASELINE—Continued

(In millions of dollars)

Category	Estimate					
	2005	2006	2007	2008	2009	2010
Joint Medicare and Medicaid:						
Minnesota-Dual Eligibles						
Baseline estimate	154	174	194	54	....	....
Demonstration estimate	160	180	200	55	....	....
Wisconsin-Dual Eligibles						
Baseline estimate	130	176	45	....	....	....
Demonstration estimate	130	176	45	....	....	....
Massachusetts—Dual Eligibles						
Demonstration estimate	20	28	34	9	....	....
Baseline estimate	21	29	35	9	....	....
OASI, DI, SSI:						
Performance of continuing disability reviews (baseline levels) (OASI, DI, SSI)	–105	–525	–1,030	–1,630	–2,230	–2,845
OASDI:						
Payments to states for vocational rehabilitation	80	104	112	121	130	138
DI:						
Research and demonstration projects	17	42	55	27	....	....
SSI:						
Payments from states for state supplemental benefits	–4,318	–4,520	–4,755	–4,895	–5,060	–5,224
Payments for state supplemental benefits	4,650	4,520	4,355	4,885	5,045	5,210
Fees for administration of State supplement:						
Treasury share	–142	–142	–145	–146	–148	–149
SSA share	–124	–131	–128	–128	–129	–129
Research and demonstration projects	44	46	27	26	27	27
Payments to states for vocational rehabilitation	52	67	71	76	81	84
Performance of non-disability redeterminations	–310	–990	–1,340	–1,440	–1,510	–1,590
State grants and demonstrations—health care:						
Ticket to work grant programs:						
Infrastructure grant program	15	17	17	20	20	32
Demonstration to maintain independence and employment	28	21	21	22	22	10
High risk pools:						
Initial seed grants	1	....	....	....	....	....
Operation of pools	22	40	....	....	....	....
Emergency health services for undocumented aliens	63	250	250	250	187	....
Pilot program for national and state background checks	9	8	8	....	....	....
State pharmaceutical assistance programs	62	63	....	....	....	....

* = $500,000 or less.
NA = Not available.
[1] Medicare regulations reflect gross outlays.
[2] Current law extends program through September 30, 2005.
[3] Current law extends program through March 31, 2005.
[4] Net mandatory outlays.
[5] Not shown on table are anticipated collections from various state liabilities under current law.
[6] Baseline estimates reflect costs absent the demonstration; demonstration estimate reflects costs of the demonstration. The differences represent the net impact of the demonstration.
[7] Costs of this demonstration are offset annually by a reduction to inpatient hospital prospective payment rates.
[8] Estimate for 2006 is currently unavailable.
[9] Budget modified from original agreement for phase-out of waiver funding.
[10] Beginning in 2006, Pharmacy Plus estimates may be affected by Part D.
[11] Estimates reflect costs for SCHIP children under the State's Medicaid 1115.
[12] For 2005 and 2006, the state will revert to Medicaid funds for this demonstration.

Current Services Receipts, Outlays, and Budget Authority

Receipts.—Table 25–6 shows baseline receipts by major source. Total receipts are projected to increase by $125 billion from 2005 to 2006 and by $663 billion from 2006 to 2010, largely due to assumed increases in incomes resulting from both real economic growth and inflation.

Individual income taxes are estimated to increase by $71 billion from 2005 to 2006 under current law. This growth of 7.9 percent is primarily the effect of increased collections resulting from rising personal incomes. Individual income taxes are projected to grow at an annual rate of 9.0 percent between 2006 and 2010.

Corporation income taxes under current law are estimated to decline by $4 billion or 1.6 percent between 2005 and 2006, in large part due to the timing and magnitude of tax changes provided in the 2003 jobs and growth tax cut. Corporation income taxes are projected to increase at an annual rate of 4.8 percent from 2006 to 2010, reflecting higher corporate profits.

Social insurance and retirement receipts are estimated to increase by $45 billion between 2005 and 2006, and by an additional $198 billion between 2006 and 2010. The estimates reflect assumed increases in total wages and salaries paid, and scheduled increases in the social security taxable earnings base from $90,000 in 2005 to $111,300 in 2010.

Excise taxes are estimated to increase by $9 billion from 2005 to 2010, 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 $26 billion from 2005 to 2010.

Table 25–6. BASELINE RECEIPTS BY SOURCE

(In billions of dollars)

	2004 Actual	Estimate					
		2005	2006	2007	2008	2009	2010
Individual income taxes	809.0	893.9	964.8	1,070.0	1,170.5	1,252.1	1,361.5
Corporation income taxes	189.4	226.6	222.9	234.2	251.5	263.3	268.9
Social insurance and retirement receipts	733.4	773.7	818.8	866.2	911.7	959.2	1,016.9
On-budget	198.7	212.4	225.6	237.0	247.2	258.6	273.7
Off-budget	534.7	561.4	593.2	629.2	664.6	700.7	743.2
Excise taxes	69.9	73.9	75.5	77.2	79.1	81.1	83.0
Other	78.5	84.9	95.8	99.5	105.5	112.3	110.7
Total	1,880.1	2,053.0	2,177.9	2,347.2	2,518.3	2,668.0	2,841.0
On-budget	1,345.3	1,491.6	1,584.7	1,718.0	1,853.8	1,967.3	2,097.8
Off-budget	534.7	561.4	593.2	629.2	664.6	700.7	743.2

Outlays.—Current services outlays are estimated to grow from $2,443 billion in 2005 to $2,539 billion in 2006, a 3.8 percent increase. Between 2005 and 2010, they are projected to increase at an average annual rate of 4.5 percent. Because the baseline assumes no spending for the war beyond what is already enacted, outlays for discretionary programs decline from $930 billion in 2005 to $914 billion in 2006. The assumed decline in spending for the war more than offsets increases to keep pace with inflation. Discretionary outlays increase each year from 2006 through 2010, reflecting increases in resources to keep pace with inflation, reaching $986 billion in 2010. Entitlement and other mandatory programs are estimated to grow from $1,336 billion in 2005 to $1,416 billion in 2006, and to $1,752 billion in 2010, 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 $515 billion in 2005 to $666 billion in 2010, an average annual rate of 5.3 percent. Medicare and medicaid are projected to grow at annual average rates of 7.1 and 9.7 percent, respectively, outpacing inflation. Other areas of growth are federal employee retirement (average rate of 4.5 percent) and unemployment compensation (5.3 percent). Offsetting growth in other areas, after surging in 2005 spending for farm programs is nearly halved between 2005 and 2010, reflecting anticipated changes in market supply and demand.

Net interest payments to the public total $177 billion in 2005 and $209 billion in 2006. They rise each year reaching $310 billion in 2010. This pattern reflects increased borrowing requirements as well as changes in the mix of debt issuance and interest rates over the period.

Tables 25–8 and 25–9 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 25–10 and 25–11 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 25–7. CHANGE IN BASELINE OUTLAY ESTIMATES BY CATEGORY

(Dollar amounts In billions)

	2005	2006	2010	Change 2005 to 2006		Change 2005 to 2010	
				Amount	Percent	Amount	Average Annual Rate
Outlays:							
Discretionary:							
DoD-Military	443.1	416.7	453.0	–26.3	–5.9%	9.9	0.4%
Homeland security	30.2	33.1	36.0	3.0	9.9%	5.9	3.6%
Other discretionary	456.8	464.3	497.0	7.5	1.6%	40.2	1.7%
Subtotal, discretionary	930.0	914.2	986.0	–15.9	–1.7%	56.0	1.2%
Mandatory:							
Farm programs	25.2	21.0	12.5	–4.1	–16.5%	–12.6	–13.0%
Medicaid	188.3	192.6	265.4	4.3	2.3%	77.1	7.1%
Medicare	290.3	340.2	460.3	49.9	17.2%	170.0	9.7%
Federal employee retirement and disability	94.1	98.9	117.4	4.8	5.1%	23.3	4.5%
Unemployment compensation	35.4	37.0	45.8	1.6	4.4%	10.4	5.3%
Other income security programs	167.8	171.0	181.8	3.3	1.9%	14.1	1.6%
Social Security	515.1	540.1	665.5	25.0	4.9%	150.5	5.3%
Other mandatory programs	78.0	81.7	84.0	3.7	4.8%	6.0	1.5%
Credit subsidy reestimates	6.7	....	....	–6.7	NA	–6.7	NA
Undistributed offsetting receipts	–65.0	–66.8	–81.0	–1.8	2.8%	–16.0	4.5%
Subtotal, mandatory	1,335.9	1,415.7	1,751.9	79.8	6.0%	416.1	5.6%
Net interest	177.5	209.3	309.8	31.8	17.9%	132.3	11.8%
Total outlays	2,443.4	2,539.1	3,047.8	95.7	3.9%	604.4	4.5%

Table 25–8. CURRENT SERVICES OUTLAYS BY FUNCTION

(in billions of dollars)

Function	2004 Actual	Estimate 2005	2006	2007	2008	2009	2010
National defense:							
Department of Defense—Military	436.5	443.9	418.6	417.9	429.8	441.2	455.1
Other	19.4	22.0	21.9	22.2	22.2	22.6	23.1
Total, National defense	455.9	465.9	440.6	440.1	451.9	463.9	478.2
International affairs	26.9	32.0	37.3	33.9	33.1	30.9	31.3
General science, space, and technology	23.1	24.0	24.3	25.1	25.7	26.3	26.8
Energy	–0.2	1.4	2.5	2.2	2.7	2.8	3.1
Natural resources and environment	30.7	31.0	32.8	34.0	34.6	35.7	36.7
Agriculture	15.4	30.5	26.8	24.3	21.6	19.7	19.3
Commerce and housing credit	5.3	10.7	8.2	2.4	1.7	0.4	–0.2
On-Budget	(9.4)	(11.7)	(7.3)	(6.0)	(6.0)	(4.7)	(4.5)
Off-Budget	(–4.1)	(–1.0)	(1.0)	(–3.5)	(–4.3)	(–4.3)	(–4.8)
Transportation	64.6	68.6	72.3	73.1	74.2	75.8	77.6
Community and regional development	15.8	20.1	19.4	18.1	16.9	15.5	15.3
Education, training, employment, and social services	87.9	95.7	86.8	91.7	92.9	94.6	96.7
Health	240.1	257.3	266.0	280.6	301.2	323.3	346.9
Medicare	269.4	295.4	344.8	385.6	410.8	437.2	464.9
Income security	332.8	350.9	360.5	365.9	379.2	388.7	400.9
Social security	495.5	519.7	544.7	571.4	600.7	635.0	670.8
On-Budget	(14.3)	(16.4)	(16.1)	(17.7)	(20.5)	(21.4)	(23.2)
Off-Budget	(481.2)	(503.3)	(528.6)	(553.7)	(580.2)	(613.6)	(647.7)
Veterans benefits and services	59.8	68.2	69.0	69.6	75.6	78.8	82.3
Administration of justice	45.5	40.7	42.7	42.9	43.8	46.1	47.6
General government	21.8	18.8	17.9	18.3	18.9	19.4	20.0
Net interest	160.2	177.5	209.3	242.1	269.0	290.7	309.8
On-Budget	(246.5)	(269.5)	(307.4)	(348.8)	(386.0)	(419.4)	(451.2)
Off-Budget	(–86.2)	(–92.0)	(–98.1)	(–106.7)	(–117.0)	(–128.7)	(–141.4)
Allowances	....	....	....	0.2	0.4	0.5	0.6
Undistributed offsetting receipts:							
Employer share, employee retirement (on-budget)	–42.1	–48.1	–48.2	–50.3	–52.9	–55.5	–58.2
Employer share, employee retirement (off-budget)	–11.3	–10.9	–11.4	–11.8	–12.5	–13.2	–13.9
Rents and royalties on the Outer Continental Shelf	–5.1	–5.9	–7.1	–6.7	–6.8	–7.1	–7.3
Sale of major assets	....	....	....	–0.3	....	....	....
Other undistributed offsetting receipts	....	–0.1	–0.1	–2.3	–13.3	–12.4	–1.5
Total, Undistributed offsetting receipts	–58.5	–65.0	–66.8	–71.5	–85.4	–88.2	–81.0
On-Budget	(–47.2)	(–54.1)	(–55.5)	(–59.7)	(–72.9)	(–75.0)	(–67.1)
Off-Budget	(–11.3)	(–10.9)	(–11.4)	(–11.8)	(–12.5)	(–13.2)	(–13.9)
Total	**2,292.2**	**2,443.4**	**2,539.1**	**2,650.1**	**2,769.6**	**2,896.8**	**3,047.8**
On-Budget	(1,912.7)	(2,044.0)	(2,119.0)	(2,218.4)	(2,323.2)	(2,429.5)	(2,560.1)
Off-Budget	(379.5)	(399.4)	(420.1)	(431.7)	(446.5)	(467.3)	(487.6)

Table 25–9. CURRENT SERVICES OUTLAYS BY AGENCY

(in billions of dollars)

Agency	2004 Actual	Estimate					
		2005	2006	2007	2008	2009	2010
Legislative Branch	3.9	4.1	4.1	4.1	4.2	4.4	4.5
Judicial Branch	5.4	5.7	5.8	6.0	6.2	6.4	6.6
Agriculture	71.8	94.9	96.4	94.0	92.8	91.9	93.7
Commerce	5.8	6.3	6.6	6.9	7.0	7.2	7.4
Defense—Military	437.1	444.1	418.7	417.9	429.8	441.2	455.1
Education	62.8	70.4	61.2	65.7	66.3	67.2	68.8
Energy	20.0	22.2	22.6	23.1	23.7	24.2	24.7
Health and Human Services	543.4	585.5	642.5	697.1	742.2	790.4	841.4
Homeland Security	26.5	33.3	34.1	32.8	33.4	32.8	32.9
Housing and Urban Development	45.0	42.6	39.3	38.8	38.1	37.8	37.7
Interior	8.9	9.4	10.2	10.9	10.8	11.2	11.6
Justice	29.0	21.2	23.5	23.7	24.0	25.6	26.4
Labor	56.7	50.0	51.7	53.8	56.4	59.4	62.2
State	10.9	11.9	13.3	14.1	14.0	13.6	13.6
Transportation	54.5	58.4	61.5	62.2	62.8	64.0	65.4
Treasury	374.8	402.5	444.3	490.6	533.0	571.5	609.2
Veterans Affairs	59.6	68.0	68.9	69.5	75.5	78.7	82.2
Corps of Engineers—Civil Works	4.8	4.9	4.9	4.9	4.9	5.1	5.3
Other Defense Civil Programs	41.7	43.5	44.5	45.5	46.6	47.3	47.7
Environmental Protection Agency	8.3	7.9	8.3	8.6	8.8	8.8	9.0
Executive Office of the President	3.3	5.8	7.2	1.9	–2.3	–3.9	0.4
General Services Administration	–0.4	0.5	0.3	0.3	0.2	0.3	0.2
International Assistance Programs	13.7	14.8	16.6	16.6	16.5	16.9	17.3
National Aeronautics and Space Administration	15.2	15.7	16.0	16.6	17.2	17.5	17.9
National Science Foundation	5.1	5.6	5.6	5.7	5.8	6.0	6.0
Office of Personnel Management	56.5	61.0	64.5	67.4	70.7	73.9	77.4
Small Business Administration	4.1	3.0	0.8	0.6	0.6	0.7	0.7
Social Security Administration	530.2	559.0	583.5	608.6	642.6	677.5	715.8
On-Budget	(49.0)	(55.8)	(54.9)	(54.9)	(62.4)	(63.9)	(68.2)
Off-Budget	(481.2)	(503.3)	(528.6)	(553.7)	(580.2)	(613.6)	(647.7)
Other Independent Agencies	5.9	19.7	20.6	15.0	14.8	14.8	14.8
On-Budget	(10.0)	(20.7)	(19.6)	(18.5)	(19.0)	(19.1)	(19.6)
Off-Budget	(–4.1)	(–1.0)	(1.0)	(–3.5)	(–4.3)	(–4.3)	(–4.8)
Allowances	....	....	....	0.2	0.4	0.5	0.6
Undistributed Offsetting Receipts	–212.5	–228.4	–238.3	–253.1	–277.2	–296.1	–309.1
On-Budget	(–115.0)	(–125.5)	(–128.8)	(–134.6)	(–147.7)	(–154.1)	(–153.8)
Off-Budget	(–97.6)	(–102.9)	(–109.5)	(–118.5)	(–129.5)	(–141.9)	(–155.3)
Total	**2,292.2**	**2,443.4**	**2,539.1**	**2,650.1**	**2,769.6**	**2,896.8**	**3,047.8**
On-Budget	(1,912.7)	(2,044.0)	(2,119.0)	(2,218.4)	(2,323.2)	(2,429.5)	(2,560.1)
Off-Budget	(379.5)	(399.4)	(420.1)	(431.7)	(446.5)	(467.3)	(487.6)

Table 25–10. CURRENT SERVICES BUDGET AUTHORITY BY FUNCTION

(in billions of dollars)

Function	2004 Actual	Estimate					
		2005	2006	2007	2008	2009	2010
National defense:							
Department of Defense—Military	471.0	402.0	412.9	424.5	436.7	449.1	462.0
Other	19.6	21.6	21.8	22.0	22.4	22.8	23.3
Total, National defense	490.6	423.6	434.6	446.5	459.0	471.9	485.2
International affairs	45.2	25.8	28.2	30.4	31.3	32.2	33.0
General science, space, and technology	23.4	24.4	24.8	25.4	26.1	26.6	27.2
Energy	3.2	1.3	2.5	2.5	3.0	3.2	3.5
Natural resources and environment	32.7	32.2	32.5	34.0	34.7	36.1	37.3
Agriculture	32.7	29.1	26.6	24.1	21.3	19.4	19.0
Commerce and housing credit	14.2	14.4	15.6	13.6	14.0	13.1	12.8
On-Budget	(12.1)	(13.6)	(11.8)	(13.0)	(13.4)	(12.5)	(12.8)
Off-Budget	(2.1)	(0.9)	(3.8)	(0.6)	(0.6)	(0.5)	(0.1)
Transportation	71.1	72.4	66.0	66.4	67.0	67.9	68.7
Community and regional development	18.1	23.0	15.1	15.5	15.8	16.2	16.6
Education, training, employment, and social services	92.0	96.3	92.8	92.8	94.7	96.7	98.9
Health	252.3	255.8	288.7	283.6	304.4	329.4	351.8
Medicare	271.7	294.3	344.7	385.4	410.8	437.7	464.6
Income security	334.2	345.5	356.7	365.0	378.3	388.3	404.5
Social security	496.0	520.2	546.7	573.5	603.0	637.7	673.6
On-Budget	(14.3)	(16.4)	(16.1)	(17.7)	(20.5)	(21.4)	(23.2)
Off-Budget	(481.7)	(503.8)	(530.6)	(555.8)	(582.5)	(616.3)	(650.5)
Veterans benefits and services	60.5	67.6	68.9	72.9	76.3	79.6	83.2
Administration of justice	45.7	39.9	42.6	42.7	44.1	46.6	48.2
General government	23.2	18.1	18.6	18.9	19.6	20.3	21.0
Net interest	160.2	177.5	209.3	242.1	269.0	290.7	309.8
On-Budget	(246.4)	(269.5)	(307.4)	(348.8)	(386.0)	(419.4)	(451.2)
Off-Budget	(–86.2)	(–92.0)	(–98.1)	(–106.7)	(–117.0)	(–128.7)	(–141.4)
Allowances	....	....	....	1.2	1.2	....	....
Undistributed offsetting receipts:							
Employer share, employee retirement (on-budget)	–42.1	–48.1	–48.2	–50.3	–52.9	–55.5	–58.2
Employer share, employee retirement (off-budget)	–11.3	–10.9	–11.4	–11.8	–12.5	–13.2	–13.9
Rents and royalties on the Outer Continental Shelf	–5.1	–5.9	–7.1	–6.7	–6.8	–7.1	–7.3
Sale of major assets	....	....	....	–0.3	....	....	....
Other undistributed offsetting receipts	....	–0.1	–0.1	–2.3	–13.3	–12.4	–1.5
Total, Undistributed offsetting receipts	–58.5	–65.0	–66.8	–71.5	–85.4	–88.2	–81.0
On-Budget	(–47.2)	(–54.1)	(–55.5)	(–59.7)	(–72.9)	(–75.0)	(–67.1)
Off-Budget	(–11.3)	(–10.9)	(–11.4)	(–11.8)	(–12.5)	(–13.2)	(–13.9)
Total	**2,408.3**	**2,396.5**	**2,548.0**	**2,665.1**	**2,788.5**	**2,925.2**	**3,078.0**
On-Budget	(2,022.1)	(1,994.7)	(2,123.1)	(2,227.2)	(2,335.0)	(2,450.3)	(2,582.8)
Off-Budget	(386.2)	(401.8)	(424.9)	(437.9)	(453.6)	(474.9)	(495.2)
MEMORANDUM							
Discretionary budget authority:							
National defense	485.7	421.3	431.7	443.7	456.2	469.1	482.4
International	49.3	29.6	30.2	30.9	31.6	32.4	33.2
Domestic	372.6	384.5	384.7	396.4	407.6	419.2	430.5
Total, discretionary	**907.6**	**835.4**	**846.5**	**871.0**	**895.5**	**920.7**	**946.0**

Table 25–11. CURRENT SERVICES BUDGET AUTHORITY BY AGENCY

(in billions of dollars)

Agency	2004 Actual	Estimate					
		2005	2006	2007	2008	2009	2010
Legislative Branch	3.9	3.9	4.0	4.2	4.3	4.5	4.7
Judicial Branch	5.4	5.7	5.9	6.1	6.3	6.6	6.8
Agriculture	93.1	94.7	98.9	97.8	95.9	95.2	97.1
Commerce	5.9	6.5	6.7	6.9	7.1	7.4	7.6
Defense—Military	471.9	402.0	412.9	424.5	436.7	449.1	462.0
Education	67.2	70.9	66.9	66.4	67.7	69.1	70.6
Energy	22.1	21.5	22.5	23.0	24.0	24.6	25.2
Health and Human Services	556.7	581.6	662.3	698.7	744.4	793.3	847.2
Homeland Security	32.5	38.3	30.1	30.8	31.8	35.0	33.8
Housing and Urban Development	35.1	35.5	35.4	35.9	36.6	37.5	38.4
Interior	10.5	9.9	10.1	10.6	10.9	11.2	11.7
Justice	27.4	21.6	23.6	23.4	24.1	25.9	26.7
Labor	56.9	50.7	52.2	54.0	56.6	59.2	61.9
State	12.0	11.9	12.2	12.6	12.9	13.2	13.6
Transportation	60.5	61.7	55.4	55.2	55.5	55.9	56.3
Treasury	375.9	403.7	445.7	491.8	534.1	572.9	610.6
Veterans Affairs	60.3	67.5	68.7	72.7	76.2	79.5	83.1
Corps of Engineers—Civil Works	4.7	5.1	4.6	4.8	5.0	5.1	5.3
Other Defense Civil Programs	41.8	43.6	44.6	45.7	46.7	47.5	47.9
Environmental Protection Agency	8.4	8.0	8.2	8.4	8.6	8.9	9.1
Executive Office of the President	18.8	0.4	0.3	–1.1	–4.6	–3.9	0.4
General Services Administration	0.1	0.3	0.3	0.3	0.3	0.3	0.4
International Assistance Programs	15.7	14.1	15.4	17.1	17.6	18.1	18.5
National Aeronautics and Space Administration	15.4	16.2	16.4	16.9	17.4	17.7	18.1
National Science Foundation	5.6	5.6	5.7	5.8	6.0	6.1	6.2
Office of Personnel Management	59.9	63.9	67.4	70.4	73.9	77.5	81.2
Small Business Administration	4.2	3.3	0.7	0.6	0.7	0.7	0.7
Social Security Administration	531.6	558.9	584.7	611.1	644.9	680.2	718.7
On-Budget	(49.9)	(55.0)	(54.1)	(55.3)	(62.4)	(64.0)	(68.2)
Off-Budget	(481.7)	(503.8)	(530.6)	(555.8)	(582.5)	(616.3)	(650.5)
Other Independent Agencies	17.2	17.8	24.1	22.3	22.9	23.0	23.1
On-Budget	(15.2)	(17.0)	(20.4)	(21.8)	(22.3)	(22.4)	(23.1)
Off-Budget	(2.1)	(0.9)	(3.8)	(0.6)	(0.6)	(0.5)	(0.1)
Allowances	....	....	....	1.2	1.2	....	....
Undistributed Offsetting Receipts	–212.5	–228.4	–238.3	–253.1	–277.2	–296.1	–309.1
On-Budget	(–115.0)	(–125.5)	(–128.8)	(–134.6)	(–147.7)	(–154.1)	(–153.8)
Off-Budget	(–97.6)	(–102.9)	(–109.5)	(–118.5)	(–129.5)	(–141.9)	(–155.3)
Total	**2,408.3**	**2,396.5**	**2,548.0**	**2,665.1**	**2,788.5**	**2,925.2**	**3,078.0**
On-Budget	(2,022.1)	(1,994.7)	(2,123.1)	(2,227.2)	(2,335.0)	(2,450.3)	(2,582.8)
Off-Budget	(386.2)	(401.8)	(424.9)	(437.9)	(453.6)	(474.9)	(495.2)

THE BUDGET SYSTEM AND CONCEPTS

26. 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 and between the Federal Government and the private sector. 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 receipts and 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 2006. (Fiscal year 2006 will begin on October 1, 2005 and end on September 30, 2006.) 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 2005, 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 2004, 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 program performance 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 12, "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 on-budget budget authority and outlays provided in the resolution to the Appropriations Committees and the other committees that

[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) and Introduction to the Federal Budget Process (Congressional Research Service Report 98–721 GOV).

have jurisdiction over spending. (See COVERAGE OF THE BUDGET, later in this chapter, for more information on on-budget and off-budget amounts.) 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 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 22 of the last 24 fiscal years, including 2005, 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. The budget resolution directs each designated committee to report amendments to the laws under the committee's jurisdiction that would achieve changes in the levels of receipts and reductions in direct 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. A reconciliation instruction may also specify the total amount by which the statutory limit on the public debt is to be changed.

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. Congress typically enacts an omnibus budget reconciliation act, which combines the amendments to implement reconciliation directives in a single act.

Such a large and complicated bill would be difficult to enact under normal legislative procedures because it usually involves changes to tax rates or to popular social programs in order to achieve budgetary savings. The Senate considers such omnibus reconciliation acts under expedited procedures that limit total debate on the bill. As a result, there are significant restrictions with respect to the substantive content of the reconciliation measure itself, as well as amendments to the measure. Any material in the bill or amendment to the bill that is not germane, would add extraneous material, would cause deficit levels to increase, or that contains changes to the Federal Old-Age and Survivors Insurance and the Federal Disability Insurance programs is not in order under expedited reconciliation procedures.

Reconciliation 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 laws 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 spending.

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. However, 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 procedure, 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 meant 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 and to establish mandatory spending controls. The Administration also proposes to establish a new mechanism to measure the Federal Government's long-term unfunded obligations and to prohibit increases in those obligations. In April, 2004 the Administration transmitted a comprehensive budget enforcement legislation package to Congress. The Administration plans to repropose that legislation, with appropriate updates and revisions, after the budget is transmitted. These proposals are discussed in more detail in Chapter 15, "Budget Reform Proposals."

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 2004, 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 2004, 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.

COVERAGE OF THE BUDGET

Federal Government and Budget Totals

Table 26–1. TOTALS FOR THE BUDGET AND THE FEDERAL GOVERNMENT

(In billions of dollars)

	2004 actual	Estimate 2005	Estimate 2006
Budget authority:			
Unified	2,407	2,477	2,548
On-budget	2,021	2,076	2,123
Off-budget	386	402	425
Receipts:			
Unified	1,880	2,053	2,178
On-budget	1,345	1,491	1,584
Off-budget	535	561	593
Outlays:			
Unified	2,292	2,479	2,568
On-budget	1,913	2,080	2,141
Off-budget	380	399	423
Surplus or deficit (–):			
Unified	–412	–427	–390
On-budget	–567	–589	–560
Off-budget	155	162	170

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, OMB normally follows 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, the United Mine Workers Combined Benefits Fund, and the Telecommunications Development Fund.

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 summary 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 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 27.

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 28. 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 Government itself 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 22, "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 legally obligated to buy the asset, and the asset is being constructed or manufactured. 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 and the law that established the collection, they are recorded as either:

- ***Governmental 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 calculate net outlay figures.

Governmental Receipts

Governmental receipts are collections that result from the Government's exercise of its sovereign power to tax or otherwise compel payment and from gifts of money to the Government. Sometimes they are called receipts, 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 26–1, "Totals for the

Budget and the Federal Government," which appears earlier in this chapter.) Chapter 17, "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, such as 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. The budget records these amounts as *offsetting collections from non-Federal sources* (for offsetting collections) or as *proprietary receipts* (for offsetting 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* (for offsetting collections) or as *intragovernmental receipts* (for offsetting receipts). For example, the General Services Administration rents office space to other Government agencies and records their rental payments as offsetting collections from Federal sources in the Federal Buildings Fund. These transactions are exactly 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* (for offsetting collections) or as *offsetting governmental receipts* (for offsetting receipts).

A table in Chapter 21, "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.

Offsetting collections credited to expenditure accounts automatically offset the outlays at the expenditure account level. 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 employee 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 18, "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 or to make grants or other payments. 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 the 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;
- ***Borrowing authority***, 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 and does not require current action by Congress. Much of the permanent budget authority is for trust funds, interest on the public debt, and the authority to spend offsetting collections credited to appropriation or fund accounts. For most trust funds, the budget authority is automatically appropriated under existing law from the available balance of their receipts and equals the estimated annual obligations of the funds. For interest on the public debt, budget authority is automatically provided under a permanent appropriation enacted in 1847 and equals interest outlays.

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

[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

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 2005 appropriations act extends the availability of unobligated budget authority that expired at the end of 2004, new budget authority would be recorded for 2005.

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. 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. Outlays are also classified as discretionary or mandatory according to the classification of the budget authority from which they flow (see "Outlays" below).

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, as explained previously, 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 withheld, 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.

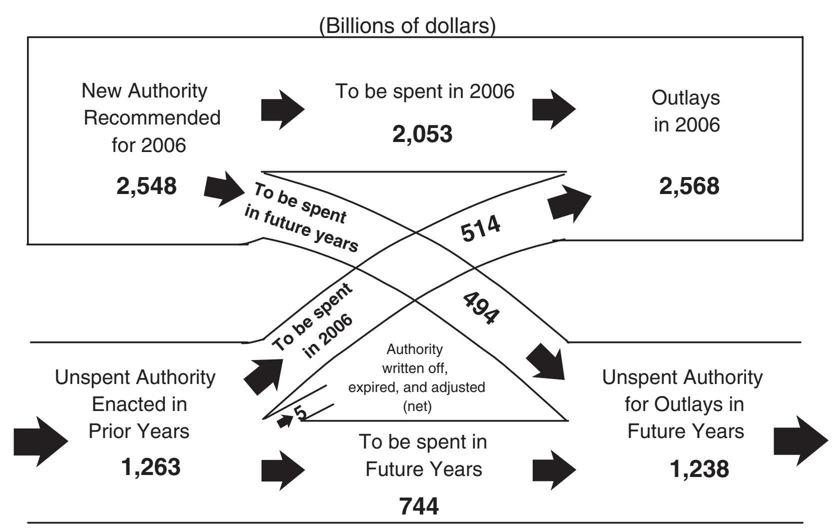
For Federal credit programs, outlays are equal to the subsidy cost of direct loans and loan guarantees and are recorded as the underlying loans are disbursed (see FEDERAL CREDIT below).

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 2006 will be obligated or spent in 2006. 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, $514 billion of outlays in 2006 (20 percent of the total) will be made from budget authority enacted in previous years. At the same time, $494 billion of the new budget authority proposed for 2006 (19 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 26-1. Relationship of Budget Authority to Outlays for 2006



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. Nearly 40 percent of total outlays ($895 billion in 2004) are discretionary; the remainder ($1,397 billion in 2004) is mandatory spending and net interest. Such a large portion of total spending is nondiscretionary because authorizing legislation determines net interest ($160 billion in 2004) and the spending for a few programs with large amounts of spending each year, such as Social Security ($492 billion in 2004) and Medicare ($265 billion in 2004).

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 will 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.[3] 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

[3] 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.

budget documents display the transactions of the financing accounts, together with the related program accounts, for information and analytical purposes.

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 accounts, 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 2004, the Government borrowed $382 billion from the public. This financed nearly all of the $412 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 2004, the debt held by the public was $4,296 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 16, "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 was 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 form 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 transferable 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. In 2004, the remaining balance of $56 million was redeemed.

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 $56 million redeemed in 2004 was 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 24, "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 24, "Federal Employment and Compensation," provides more information on this subject.)

BASIS FOR BUDGET FIGURES

Data for the Past Year

The past year column (2004) 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 20, "Comparison of Actual to Estimated Totals," for a summary of these differences).

Data for the Current Year

The current year column (2005) 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 (2006) 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 (2007 through 2010) in order to reflect the effect of budget decisions on longer term objectives and plans.

Classification of Tricare Accruals

Section 725 of the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005 (Public Law No. 108–375) changes the Department of Defense contributions to the Department of Defense Medicare-Eligible Retiree Health Care Fund (the Retiree Health Care Fund) for the cost of Tricare benefits earned by active duty service members. The changes take place at the beginning of 2006. Table 26–2 summarizes the major features of the contributions before and after the changes.

The Act replaces annual appropriations to the military personnel accounts of the Department of Defense with permanent, indefinite appropriations from the General Fund. Accrual payments will be made at the beginning of each year, instead of at the end of each month, and will be based on planned troop levels within the enacted Department of Defense budget, instead of

Table 26–2 DEPARTMENT OF DEFENSE CONTRIBUTIONS FOR TRICARE BENEFITS EARNED BY MILITARY PERSONNEL

	2005	2006
Source of funding	Annual appropriations from the General Fund to the military personnel accounts	Permanent, indefinite appropriations directly from the General Fund
Frequency of contributions	Monthly	Annually at the beginning of the year
Basis for payments	Actual end strength	Budgeted average strength
Government official who causes the payments to be made	Secretary of Defense pays	Secretary of the Treasury pays upon certification of the amount by the Secretary of Defense
Annual action by Congress that controls the total amount of the payments	Appropriations to the Military Personnel accounts	Same
Government official who determines total amount of the payments	Secretary of Defense	Same
Government official who determines per-member amount	Secretary of Defense but using methods and assumptions approved by the Board of Actuaries, who are appointed by Secretary of Defense	Same
Calculation of total amount	Per-member amount times number of military personnel	Same
Contributions for which agency	Law describes as "Department of Defense contribution" and for funding "liabilities of the Department of Defense"	Same
Employees who are compensated	Active duty uniformed service members	Same
Type of expenditure	Deferred compensation	Same
Recipient of contributions	Department of Defense Medicare-Eligible Retiree Health Care Fund	Same

on the actual number of military personnel at the end of the month. The budget reflects this change by recording the new type of funding in 10 new budget accounts within the Department of Defense, beginning in 2006. Each account shows the amount of the annual Tricare accrual payment that is made for the military services members who are paid by the corresponding military personnel account. For example, the Medicare-Eligible retiree health contribution, Navy account records the payment of Tricare accruals for service members who are paid by the Military Personnel, Navy account. The Tricare accrual payments are classified within the National Defense function and as discretionary, consistent with the classification of the payments prior to 2006. These classifications were determined in consultation with the House and Senate Budget Committees and the Department of the Treasury. They are consistent with the views expressed by the Department of Defense Medicare-Eligible Retiree Health Care Board of Actuaries in a June 8, 2004 letter, which stated that the accruals should remain in the Department of Defense discretionary budget. A brief summary of the reasons for these classifications follows.

Agency: DoD Military.—The payments are recorded in Department of Defense-Military budget accounts because this is the agency that carries out the operations for which the cost is incurred. The Secretary of Defense has the substantive responsibility for the annual contributions for Tricare accruals. The contributions are made as deferred compensation on behalf of service members who contribute to Department of Defense-Military operations; the per-member contribution amount is calculated using assumptions and methods approved by the independent Department of Defense Medicare-Eligible Retiree Health Care Board of Actuaries, which is appointed by the Secretary; the total amount of the payments are directly based on decisions made by Congress in determining the appropriations for military personnel within the Department of Defense and decisions made by the Secretary of Defense about the number of troops within the level of appropriations for military personnel; and the payments are made only upon certification by the Secretary of Defense. Indeed, the Act describes the annual payments as a "Department of Defense contribution."

An alternative would be to locate the new budget accounts within the Department of the Treasury, because the Act specifies that the Secretary of the Treasury will pay the contributions from the General Fund of the Treasury to the Retiree Health Care Fund. Under this logic, all spending by the General Fund would be classified in budget accounts recorded within the Department of the Treasury because Treasury, as the Government's cash manager, makes all payments out of the General Fund. However, if all General Fund spending was classified in accounts within the Department of the Treasury instead of the agencies that are substantively responsible for the programs, it would not be a meaningful system of budget accounts.

The General Fund consists of Federal income taxes and all other receipts and collections not earmarked by law to finance specified programs, the proceeds of general Treasury borrowing, and the expenditure of these amounts. It includes roughly 60 percent of gross Federal spending and 70 percent of all budget expenditure accounts. These budget accounts are routinely classified as part of the agency that carries out the operations that generate the cost. For example, the annual payment for the accruing portion of the concurrent receipt of military retired pay and veterans disability compensation benefits authorized by the National Defense Authorization Act for Fiscal Year 2004 (Public Law 108–136) is recorded as a budget account of the military programs of the Department of Defense, even though the Secretary of the Treasury is directed by law to make the payment from the General Fund. Similarly, the Secretary of the Treasury is directed by law to fund the amortization of the unfunded liability of a number of Federal employee retirement trust funds by making annual payments to the trust funds, which are recorded as payments from accounts within the agencies that operate the trust funds. Also, most funds that invest their balances trust funds, special funds, public enterprise funds, deposit funds are by law administered by the Secretary of the Treasury, but are recorded as funds within the respective agencies.

Functional classification: subfunction 051 of the national defense function.—The functional classification divides the budget into functions and subfunctions based on the primary purpose or national need served by the spending. Each account is classified in the subfunction that best describes its purpose. Contributions for Tricare accruals are part of the current compensation of military service members, which is recorded in various accounts within subfunction 051, Department of Defense-Military. This subfunction includes the military personnel accounts, which record the pay and allowances of military personnel and the accruing cost of their pensions and education benefits. Through 2005, the military personnel accounts also make the Tricare accrual payments, and the payments are classified in this subfunction. Health benefits for current service members are paid by the defense health program account in this subfunction. Also, the annual payment for the accruing portion of the concurrent receipt benefits authorized by the National Defense Authorization Act for 2004 (Public Law 108–136) is recorded as a budget account in this subfunction.

An alternative would be to classify the contributions for Tricare accruals within subfunction 054, Defense-related activities, as is the payment to the Retiree Health Care Fund for the amortization of its unfunded liability. However, subfunction 054 is used to record the cost of military compensation that was earned in past years, while subfunction 051 records the cost of deferred compensation earned in each current year. In order to measure the cost of current defense operations, the budget distinguishes between (a) the cost of services provided by uniformed service members in the current year (contributions for military retirement accruals in subfunction 051) and (b) the amortization of the unfunded liability for military retirement, which is attributable to past years (in subfunction 054).

BEA classification: discretionary.—The total amount of the annual contribution for accrued Tricare benefits is the product of the per-member accrual charge that is calculated using methods and assumptions approved by the Board of Actuaries times the number of military personnel. The number of military personnel is controlled directly by the amount of discretionary appropriations provided to the various military personnel accounts and decisions made by the Secretary of Defense about the number of troops within the level of those appropriations. Hence, the total amount of the annual accrual payment will vary directly with changes in the amount of discretionary appropriations for military personnel. Because of this direct linkage, the contribution for Tricare accruals is classified as discretionary.

This conclusion is not affected by advancing the timing of the payments, by reducing the frequency of making the payments to one per year instead of twelve, or by using a single estimate of the number of military service members instead of twelve estimates. These changes simplify the calculation of the payment and reduce the number of bookkeeping transactions reported by the Department of Defense to the Treasury. However, they do not sever the links between the annual appropriations for military personnel, the number of military personnel, and the total amount of the payment for Tricare benefits earned during the year. The annual payments, like the current monthly payments, will continue to vary directly with number of military service members that are funded in annual appropriations acts.

An alternative would be to classify the contributions for Tricare accruals as mandatory because the authority is provided in an authorizing Act, and the Act provides permanent, indefinite appropriations for the contributions. These are true of the annual payments to amortize the unfunded liability, which are described in the discussion about functional classification and are classified as mandatory.

However, BEA classification decisions are not made solely or primarily on the basis of the type of bill that provides the funding or on the basis of the type of funding. Instead, the primary basis for the classification is whether the level of spending is effectively controlled by authorizing Acts (mandatory) or by appropriations Acts (discretionary). Usually, control is exercised in the same Act that appropriates funds for the program. However, occasionally programs are funded by one type of Act, but the spending level is determined by provisions contained in the other type of Act. In those cases, the BEA classification is based on the type of Act that determines the spending level. For example, Medicaid, food stamps, veterans disability compensation, and other "appropriated entitlements" are funded in annual appropriations Acts but are classified as mandatory because their spending levels are determined ultimately by the entitlement and benefits formula specified in authorizing Acts. Similarly, the levels of various fees collected by the Securities and Exchange Commission are specified by sections of the Securities Exchange Act of 1933, its authorizing Act, but the fees are classified as discretionary because the authority to collect them is triggered by appropriation of the fees in annual appropriations Acts.

The payment for the amortization of the unfunded liability bolsters the case for classifying the Tricare accruals as discretionary. The unfunded liability results from benefits earned but not funded prior to the beginning of the accrual funding system in 2003, and from differences between actuarial estimates and fund performance since 2003. Unlike Tricare accrual payments, the payment for the unfunded liability does not vary as a result of any appropriation for goods or services provided in the current year. For example, Congress could not reduce the unfunded liability, and hence the amortization, by reducing appropriations for military personnel. Hence, it is appropriate to have different BEA classifications for the two types of payments.

Non-DoD uniformed services.—Tricare benefits are also earned by uniformed service members of the Coast Guard, the National Oceanic and Atmospheric Administration, and the Public Health Service. The Act creates the same funding structure for all of these agencies. Each agency's contribution to the Retiree Health Care Fund for the accruing Tricare benefits of its employees is comparable to the treatment of the Department of Defense contribution for DoD uniformed service members. Beginning in 2006, the contribution will be funded by permanent, indefinite authority for each agency. The new payments will be classified as discretionary and in the same subfunction as the existing annually funded contributions. Since these payments are relatively small and to simplify bookkeeping, they will be merged into the existing accounts that pay retirement benefits.

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 25, "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, 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 (2 USC 661–661(f))***, 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 (Public Law 103–62, as amended)***, 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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