THE NATION'S FISCAL OUTLOOK

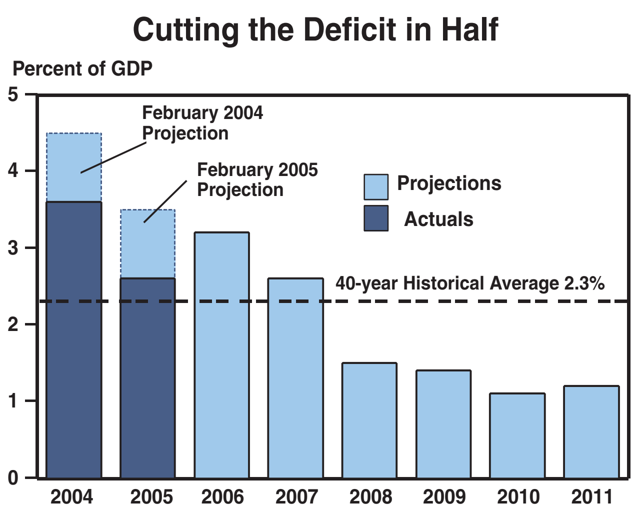
> *The first pillar of sound economic policy is spending restraint in Washington, D.C.*
>
> President George W. Bush
> February 8, 2005

The President's 2007 Budget addresses the Nation's fiscal challenges in both the near term and long term through policies that promote economic growth and restrain spending.

The prospects for improvement in the budget position in the near term are encouraging. For 2005, the most recently completed fiscal year, the deficit came in sharply below initial projections, largely due to higher-than-anticipated tax receipts. Although the deficit is projected to rise in 2006 from its 2005 level, the policies in this Budget are projected to return the deficit to its downward trajectory after 2006, keeping us on track to meet the President's goal of cutting the deficit in half by 2009.

In contrast to the trend of declining deficits in the near term, the longer-term fiscal outlook is more troubling. Without action to reform the Nation's large entitlement programs—particularly Social Security and Medicare—deficits, tax rates, or both, will increase to unprecedented levels and threaten future economic growth and standards of living.

THE NEAR-TERM OUTLOOK



The size of the deficit is best assessed in relation to the economy as a whole, as measured by Gross Domestic Product (GDP). Two years ago, with the 2004 deficit projected to peak at 4.5 percent of GDP, or $521 billion, the President set a goal of cutting the deficit in half by 2009. Since then, the deficit has declined. The 2005 deficit fell to 2.6 percent of GDP, or $318 billion, sharply below initial estimates. This reduction was largely due to the strength of tax receipts, which in 2005 grew 14.5 percent, or $274 billion, as a result of the economic expansion now under way.

In last July's Mid-Session Review, the Administration forecast a higher deficit in 2006 than in 2005 partly because of the implementation of the new Medicare prescription drug benefit, which went into effect January 1. However, the deficit for 2006 is now projected to be even larger than that prior estimate, due in significant part to the cost of the Federal response to Hurricanes Katrina and Rita, which came after the Mid-Session Review. In addition to the $84 billion the Congress has already enacted in emergency appropriations and enhanced flood insurance authority, the Budget includes the outlay effects of additional supplemental funding that will be needed to continue the hurricane recovery and rebuilding. The 2006 deficit estimate also includes the effect of $50 billion in emergency funding already enacted for operations in Iraq and Afghanistan in 2006, as well as the expected costs of an additional request for the remaining projected requirements through the end of the fiscal year. Also, the deficit forecast assumes that the Congress will pass a bill providing a one-year extension of relief from the Alternative Minimum Tax.

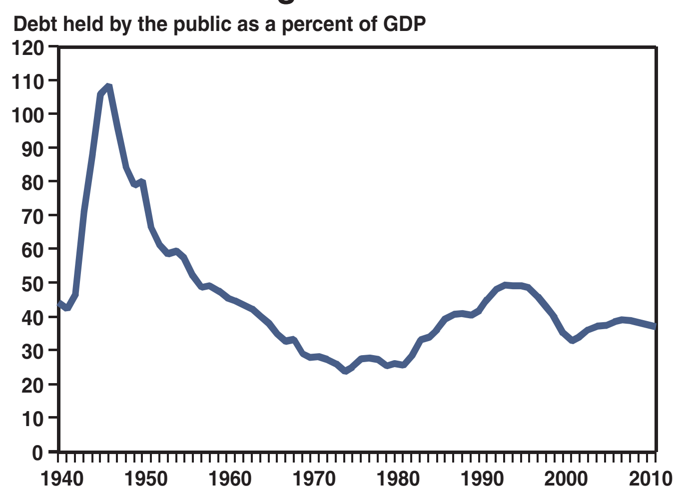
While this projected increase in the deficit is unwelcome, the resulting deficit is still well within historical range. At 3.2 percent of GDP, or $423 billion, the projected 2006 deficit would be smaller as a percent of GDP than the deficits in 11 of the last 25 years.

More importantly, the deficit is expected to resume its steady decline in 2007 and each of the following three years. In 2007, the Budget projects a decline in the deficit to 2.6 percent of GDP, or $354 billion. This estimate assumes enactment of $50 billion in emergency funding for operations in Iraq and Afghanistan for 2007. While additional funding beyond this level may be required before the end of 2007, depending on conditions on the ground, the amounts are uncertain at this time.

By 2009, the deficit is projected to be cut by more than half from its originally anticipated peak of 4.5 percent of GDP in 2004, to just 1.4 percent. A deficit of this size would be well below the 40-year historical average, and lower than those in all but 5 of the last 25 years.

An important indicator of the fiscal outlook is the trend in Federal debt—essentially, the accumulation of past deficits—in relation to the economy. The ratio of publicly held debt to GDP has ranged between 33 and 49 percent over the last two decades. Recent deficits have increased this ratio modestly since 2001, with the level projected to reach 39 percent of GDP at the end of 2007. This projected level would be well below the current average debt ratio for other major industrial nations. The declining deficits projected in this Budget would bring the debt ratio down after 2007, falling to 37 percent of GDP in 2011.

Declining Federal Debt



The President has outlined a two-pronged approach to reducing the deficit:

First, he has pursued policies to promote a strong economy, a critical ingredient in generating increased revenues to the Treasury without imposing new taxes.

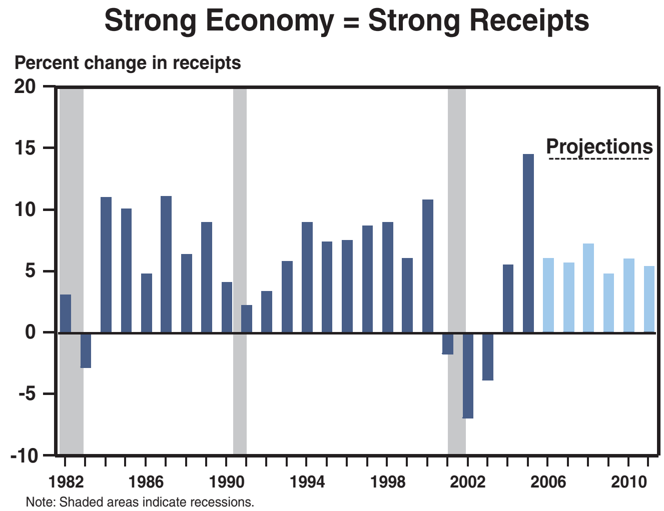
Second, he has worked with the Congress to restrain the growth of both discretionary and mandatory spending.

While the fiscal results in any particular year may vary—as reflected in the lower-than-expected deficit in 2005 and the projected increase in the deficit in 2006—this combination of pro-growth policies and spending restraint is well-designed to deliver the desired reductions in the deficit without damaging the overall economy.

Increasing Revenues through Economic Growth

The strength of the economy drives the level of tax receipts. Prior to the Administration's first term, an overvalued stock market had driven Treasury receipts to artificially high levels. Taxes from realized capital gains, stock options, and other income helped generate peak revenues of $2.025 trillion, or 20.9 percent of GDP in 2000—a level that equaled the all-time high reached during World

War II. The subsequent bursting of the stock market bubble and the recession that followed led to a massive drop in tax receipts. Receipts fell in 2001, again in 2002, and again in 2003, reaching $1.783 trillion in 2003, or 16.5 percent of GDP. This was the first time since 1923 that receipts declined for three consecutive years.



The President's program of comprehensive tax relief was well-timed to respond to the weak economy. Tax relief enacted in 2001 granted immediate tax rebates, reduced marginal tax rates, and lowered the marriage tax penalty. That tax relief, along with further tax legislation in 2002 that encouraged business investment, acted to jump-start the economy out of the recession and counter the economic headwinds from the September 11th terrorist attacks. The 2001 tax relief did not have its full potential effect because many of its provisions were to be phased in over a number of years. Tax relief in 2003 accelerated much of the remaining tax relief from 2001 and also reduced tax rates on dividends and capital gains. This full implementation of the President's tax relief gave real strength to the economic recovery that was beginning to take hold. Real economic growth in 2004 was a strong 4.2 percent, followed by estimated growth of 3.6 percent in 2005, with healthy growth in jobs and investment.

As a direct result of this strong economic growth, receipts to the Treasury have returned to healthy growth in the past two years, with increases of 5.5 percent in 2004 and an extraordinary 14.5 percent in 2005, more than five percentage points above the projection in last year's Budget. Growth in corporate receipts in 2005 was an astounding 47 percent. Total receipts reached 17.5 percent of GDP, up from a low of 16.3 percent of GDP in 2004. The Administration projects that receipts will increase 6.1 percent in 2006 and an average of 5.9 percent annually through 2011. This cautious forecast is far slower than the 14.5 percent growth experienced in 2005, but still faster than the projected rate of economic growth.

The revenue and deficit estimates in this Budget fully reflect the President's plan to extend tax relief enacted by the Congress in the 2001 and 2003 tax acts. Preserving this favorable low-tax environment is vital to continuing economic growth.

Spending Restraint

With receipts returning to historically healthy levels as a result of a strengthening economy, substantial deficit reduction is achievable so long as the Federal Government restrains growth in spending.

The Administration has focused resources on meeting the unavoidable costs arising from the September 11th terrorist attacks, the subsequent War on Terror, and more recently the response and rebuilding in the wake of Hurricanes Katrina and Rita. At the same time that the budget has funded these requirements, the Congress and the President have imposed enhanced restraint on the non-security, discretionary portion of the budget. From a peak of 15 percent in the final budget year of the prior Administration, the Congress and this Administration have brought the growth rate in this area of spending down each year. The Congress achieved this spending discipline by reducing funding for programs that were not getting results or were not fulfilling essential priorities.

In last year's Budget, the President proposed to hold the rate of growth in overall discretionary spending below the rate of inflation. The Congress delivered on that goal. The President also proposed an outright cut in spending on non-security discretionary programs—the first such proposed cut since the Reagan Administration—and Congress delivered appropriations bills that met that goal as well. Finally, the President proposed major reductions or outright terminations for 154 programs. The Congress responded by terminating or reducing funding for 89 of the programs.

The President's 2007 Budget continues this restraint, holding growth in overall discretionary spending below the projected rate of inflation for fiscal year 2006 of 3.3 percent, and again proposing an actual cut in non-security discretionary spending. The Budget proposes 141 major reductions and terminations in discretionary programs, saving nearly $15 billion in 2007 alone.

Spending on discretionary programs is relatively controllable because funding decisions are revisited each year in the annual appropriations process. Mandatory programs are more difficult to restrain because they operate under multi-year or permanent authority, with no requirement for annual review. While spending in mandatory programs is more difficult to control, the President has proposed to reduce the growth in this area as well. Last year's Budget proposed significant reforms in mandatory programs, totaling $61 billion in net mandatory savings over a five-year period. The Congress in its budget resolution initially committed to $35 billion in net mandatory savings over five years. As of the time of printing, both houses of the Congress had passed a reconciliation bill that achieved $40 billion in net mandatory savings. Assuming the Congress completes this work upon its return, it will have not only produced the first significant net savings from entitlement programs in eight years, but it also will have exceeded the savings called for in its own budget resolution.

This Budget continues to propose significant reforms in mandatory programs beyond those in the pending reconciliation bill. The Budget proposes $65 billion in net mandatory savings over the five-year period 2007-2011, including savings from reforms in Medicare, agriculture programs, and pension insurance programs.

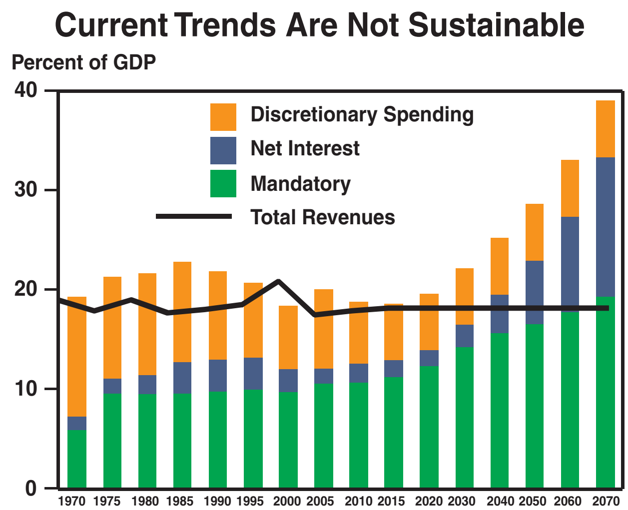
If the policies of spending restraint proposed in this Budget are adopted, outlays in 2009 are projected to fall to 19.1 percent of GDP, well below the average of the past 40 years.

THE LONG-TERM OUTLOOK

While the near-term outlook for shrinking deficits is encouraging, the long-term picture presents a major challenge due to the expected growth in spending for major entitlement programs. In only two years, the leading edge of the baby boom generation will become eligible for early retirement under Social Security. In five years, these retirees will be eligible for Medicare. The budgetary effects of these milestones will be muted at first. But if we do not take action soon to reform both Social Security and Medicare, the coming demographic bulge will drive Federal spending to unprecedented levels and threaten the Nation's future prosperity.

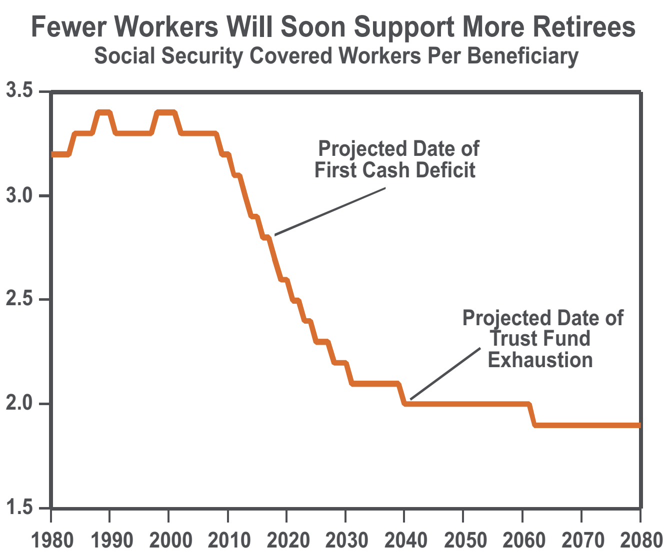
No plausible amount of cuts to discretionary programs or tax increases can help us avert this major fiscal challenge. As the accompanying chart shows, assuming mandatory spending continues on its current trajectory and the tax burden is held at historical levels, by 2040 Federal spending will accelerate to a level at which mandatory outlays and debt service would consume *all* Federal revenue. By 2070, if we do not reform entitlement programs to slow their growth, the rate of taxation on the overall economy would need to be more than doubled, placing a crushing burden on the economy that is required to produce the revenues to support the Government programs in the first place.

Social Security



Social Security was designed to be a self-financing program, in which current workers pay taxes to support benefits received by current retirees. In the early years of the program, there were more than 16 workers for every beneficiary, which allowed the program to be financed with a very low payroll tax rate. Currently, there are 3.3 workers for every beneficiary, and a much higher tax rate. As the baby boom generation retires, the ratio of workers to beneficiaries will shrink further, to an estimated 2.9 workers in 2015 and 2.2 workers in 2030. As a result, starting in 2017, Social Security will collect less in dedicated taxes than it pays out in benefits, creating a gap that grows progressively wider over time. By 2030, revenues will be sufficient to finance only 79 percent of promised benefits, falling to 68 percent by 2080.

The President has called for Social Security reform that would place the program's finances on a sustainable basis for future generations, while preserving full scheduled benefits for those already in or near retirement. The benefits that can be paid out of future payroll taxes are well below the levels in existing benefit schedules, creating uncertainty for current and future workers and virtually guaranteeing that these workers will receive even lower rates of return on their payroll taxes than now projected based on current benefit schedules.



In order to put the program on a sustainable footing without increasing tax rates and damaging the economy, the President has embraced the idea of indexing future benefits for wealthier workers to inflation, rather than wage growth. Even with such indexing of future benefits, even the wealthiest workers would receive more benefits in real terms than today's seniors. At the same time, by indexing benefits for those workers to inflation rather than wages, the Government would save significant sums in future decades, money that could be used to provide low-income seniors with promised benefits, which exceed what the system can currently afford to pay. By complementing this reform with voluntary personal retirement accounts for each worker born after 1949, with the money coming from a portion of a worker's payroll taxes, younger workers would have an opportunity to earn higher yields than are possible in the current system, while building a retirement asset they can call their own.

Adding voluntary personal retirement accounts to Social Security requires financing the transition from today's unsustainable "pay-as-you-go" system. Although this transition financing is incorporated into the deficit projections in this Budget, financing personal accounts should not have the same effect on capital markets as traditional Federal borrowing. First, such financing essentially brings forward obligations already present in the form of promised future Social Security benefits, and as a result, would reduce existing future obligations by a nearly equivalent amount. Second, unlike debt issued to fund Government spending, there would be no impact on net national saving, because every dollar of transition financing would be saved in a personal account and invested in the capital markets. Comprehensive reform that includes both personal accounts and other measures like progressive indexing of future benefits will reduce accumulated benefit obligations by far more than the near-term transition financing, substantially improving the Government's overall financial position over the long term.

Health Care Entitlements

As the Nation's largest health care entitlement programs, Medicare and Medicaid face similar demographic challenges as Social Security, and those challenges are compounded by the particular economics of health care. Our Nation's $1.9 trillion health care system provides an increasing level of technology and supply of innovation that has allowed Americans to lead longer and healthier lives—but at increasing cost to anyone who pays for health care. The Federal Government pays for about a third of U.S. health care spending and as a result, health care inflation is a major Federal fiscal issue. Medicare and Medicaid face problems not only larger in dollar terms than those faced by Social Security, but significantly more complex. Unlike Social Security, which could be reformed and strengthened with relatively simple adjustments to the terms by which the program operates, the challenges of these programs require a broader range of strategies, some of which relate to the Nation's health care system as a whole.

The Administration has taken steps and proposed additional reforms designed to reduce health care inflation, expand health care coverage, and improve the quality of care. Many of these initiatives are predicated on the policy goal of returning more control and choice to health care consumers—patients and their families. Under the Medicare Modernization Act of 2003, the President signed into law the creation of Health Savings Accounts (HSAs), which permit individuals to combine a high-deductible health insurance policy, offering preventive coverage and protection against emergencies, with a tax-free account for all other health care expenses. HSAs belong to the individual, giving that individual greater financial resources to shop for health care carefully, and to save for future expenses.

The creation of HSAs is leading to a major shift in health care spending in America. More employers are able to afford high-deductible health insurance combined with HSAs, so an increasing number of workers are gaining control over their health care dollars. In addition, HSA-based insurance allows more workers to have insurance for major medical events, which should reduce the financial burden currently carried by various government and non-profit entities in essentially providing care for free. The Budget proposes to expand HSAs to allow every worker to receive tax treatment comparable to those workers who today receive employer-provided health insurance.

The President has also proposed the creation of Association Health Plans (AHPs), which will allow employers to purchase health insurance across State boundaries and to reap the benefits of buying insurance in bulk—bringing greater price efficiencies to the health insurance market and reducing the impact of State-by-State regulations. By allowing small businesses to band together and negotiate on behalf of their employees, AHPs would give working families greater access to affordable health care.

Medical liability reforms would protect America's patients, doctors, and hospitals from the staggering costs of out-of-control lawsuits and help reduce the likelihood that doctors and hospitals would order more tests or procedures than clinically necessary, a common cause of health care inflation. Such defensive medicine tends to be used by practitioners to help protect against liability claims, but it has little or no medical benefit. President Bush continues to call for medical liability reforms that would protect a patient's right to sue and would place reasonable limits on the extent of such lawsuits.

In his first term, the President pressed for, and signed into law, reforms to help speed the introduction of generic pharmaceuticals into the market. Generic drugs provide a more cost-effective way to deliver much-needed medicine to patients, but have often been blocked in the past by loopholes in patent law. Since the reforms, generics are more likely to reach the marketplace without delay after a patent has expired, helping reduce inflation in the drug market.

And finally, the President and the Congress have aggressively supported innovations in health care information technology. Such technology has the capacity to link together doctors, patients, and hospitals in seamless, digital environments, making it possible for a patient's record to be transferred accurately and with all necessary privacy protections in an emergency to new doctors. The technology has already developed to the point that many hospitals and medical systems use it as a means to track patient records, lab tests, drug administration, and follow-up care. Federal efforts to aid harmonization and implementation of such technologies are expected to improve efficiency and accuracy of care, which would reduce the need for redundant medical tests, as well as the likelihood of expensive and often fatal errors.

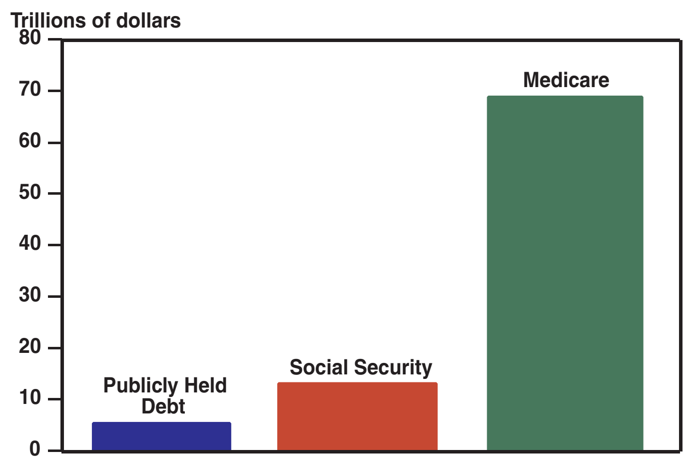
These reforms are expected to help moderate the effect of health care inflation on the Federal Medicare and Medicaid programs in coming years. Even so, direct measures will continue to be essential to bringing the cost pressures on these programs under control.

Medicare

Medicare is similar to Social Security in that it is tied to the number of retirees in the general population. But because its costs are also tied to health care inflation, its fiscal challenges are greater than Social Security's in nature, magnitude, and complexity.

Medicare's dedicated revenues—consisting primarily of payroll taxes and premiums paid by beneficiaries—currently finance 62 percent of benefits. The remaining gap of 38 percent is covered by the transfer of general revenues into Medicare Parts B and D. By 2030, however, dedicated taxes and premiums are projected to finance less than 40 percent of total benefits, creating a "financing gap" of more than 60 percent that would need to be paid for by the general fund of the Treasury.

Social Security and Medicare Unfunded Obligations Far Exceed Current Debt



Filling gaps of this size with general revenues would require dangerously high tax increases, and borrowing to finance the gaps would bring debt to unprecedented and unsustainable levels. In fact, the accumulated size of Medicare's financing gap is more than 14 times as large as today's publicly held debt. The only realistic solution is to bring the program's costs into line with available resources.

As a starting point, any policies that control overall health care inflation will have direct benefits for Medicare's finances. Trends in the larger health-care market are already improving the fiscal position of the Medicare program. Lower-than-projected growth in prescription-drug inflation has reduced estimated net Medicare spending for the drug program by nearly $10 billion in 2006, the first year of the program, and by $130 billion from 2006 through 2015. Beneficiary premiums for the drug benefit are lower than expected as well—an average of $25 per month, rather than the $37 per month initially estimated. In addition, plan participation in the Medicare drug benefit is robust, and plans are competing to attract beneficiaries. Vigorous competition among firms has led to innovative benefit and cost-sharing options. As a result, beneficiaries can choose among a wide variety of plans, picking the drug-coverage option that best meets their individual needs.

The 2007 Budget includes proposals to moderate Medicare spending growth by addressing a range of issues and challenges in Medicare and focusing on promoting high-quality and cost-efficient care for beneficiaries. In total, the Medicare proposals in the Budget will save $36 billion over five years.

For example, the Budget proposes to continue the Administration's support for quality initiatives by ensuring that patients are served in the most medically appropriate and cost-efficient setting for high-quality post-acute care.

In order to foster greater competition in the Medicare program, the Budget proposes to establish competitive bidding for clinical laboratory services. The Administration also plans to use existing authority to implement competitive bidding of certain physician-administered drugs and medical supplies and equipment.

In addition, the Budget proposes to consider advances in medical technologies and the delivery of care, as well as other management improvements, in making productivity adjustments to provider updates. As part of a comprehensive package of reforms to make Medicare more sustainable, it is prudent to adjust payment rates to encourage efficiency.

The Budget also focuses on longer-term challenges to Medicare's fiscal status. The Medicare Modernization Act of 2003 (MMA) took an important first step toward improving Medicare sustainability by requiring the Medicare trustees' report to include a new, comprehensive fiscal analysis of the program's financing and issue a warning if this analysis projects that the share of Medicare expenditures funded through general revenues will exceed 45 percent within the next seven years. However, while this warning requires the President to propose legislation to restore Medicare spending to sustainable levels, it does not mandate congressional action to do so.

The Budget proposes to strengthen the MMA provision by automatically slowing the rate of Medicare growth if the MMA threshold is exceeded. The lower growth would be achieved through a four-tenths of a percent reduction to all payments to providers beginning the year the threshold is exceeded. The reduction would grow by four-tenths of a percent every year the shortfall continues to occur. This provision is designed to encourage the President and the Congress to reach agreement on reforms to slow Medicare spending and bring it back into line with the threshold established by the MMA.

Medicaid

In the deficit reduction bill pending before the Congress at the time of printing, the Congress has addressed the Administration's goals of reducing inappropriate spending and giving States flexibility to provide health care services through Medicaid more efficiently. The bill reduces Medicaid overpayments for prescription drugs, encourages citizens with considerable assets to plan and pay for their long-term-care expenses rather than rely on Medicaid, and allows States to tailor health care services and cost sharing to the needs of their populations. These reforms will help increase the efficiency and effectiveness of the Medicaid program.

Even with these reforms, Medicaid spending growth continues to be high, with average annual growth projected to exceed seven percent over the next decade. During the coming year, the Administration will take further actions to improve the fiscal integrity of Medicaid. These actions include payment reforms to shore up the integrity of the Medicaid matching rate system between the Federal Government and States, reform of reimbursement policies for certain services that are prone to claims abuse, and further reductions in overpayments for prescription drugs. These proposals will strengthen the Federal-State partnership and improve Medicaid's long-term financial stability.

BUDGET PROCESS REFORMS AND MANAGEMENT AGENDA

The current budget process makes it difficult to confront the Nation's near-term and long-term fiscal challenges. During the 1990s, the budget process was controlled by the now-expired Budget Enforcement Act (BEA). The BEA imposed year-by-year limits on discretionary budget authority and outlays and required that all other legislation not increase the deficit. Violations of these provisions led to across-the-board spending reductions. The BEA helped to restrain spending until the emergence of budget surpluses in the late 1990s eroded spending discipline.

As part of its 2007 Budget, the Administration proposes a number of reforms to control spending, including limits on discretionary and mandatory spending, a line-item veto, and reforming programs to deliver results. The Administration's proposals are based in part on the spending controls in the BEA.

Mandatory Spending Restraint

Less than half of spending each year is subject to the appropriations process and must be enacted into law year by year. The majority of spending, in what are known as "mandatory" or "entitlement" programs, takes place automatically under standing authority, and this form of spending is growing far faster than the rest of the budget.

Because of the emphasis on discretionary programs in the annual budget process, those programs tend to receive greater scrutiny than mandatory programs. Recently, the Administration and the Congress have worked together to hold discretionary spending to fixed spending limits, but holding mandatory spending to such limits is difficult, as most mandatory programs grow automatically by formula according to permanent law.

Efforts to restrain mandatory spending are further complicated by an upward bias in the design and treatment of entitlement spending programs. While changes to discretionary spending are measured relative to the previous year's level, changes to mandatory spending are measured from a "baseline" that builds in automatic spending growth under current law. This difference allows critics of mandatory spending restraint to characterize a reduction in the scheduled rate of growth of entitlement spending as an actual cut in the level of entitlement spending. For example, the Administration last year proposed to slow average annual growth in Medicaid and the State Children's Health Insurance Program (SCHIP) from 7.4 percent to 7.2 percent over the next 10 years. The proposal would still have allowed funding for these two programs to double from $194 billion in 2005 to $387 billion in 2015. Because the Administration's proposed growth was less than what was built into the baseline, it was characterized as a "cut" by some critics.

The Budget proposes to place limits on new mandatory spending. In addition to the enhanced fiscal control mechanism for the Medicare program described earlier, the Administration would require that any legislated increases in mandatory spending be offset by a reduction in other mandatory spending. Legislation that violated this requirement would be subject to a three-fifths point of order in the Senate. In the event that cumulative legislation enacted during a Congressional session had the effect of causing a net increase in mandatory spending, the Office of Management and Budget (OMB) would be required to reduce such spending across-the-board in non-exempt programs to eliminate the overage.

Another goal of the Budget is to address the challenge created when minor changes to a benefit formula are made. In some cases, these minor changes can have small costs in the short run but much greater costs in the longer term, outside the 10-year window used for budget scoring. The Budget proposes to establish a new measure to analyze the impact of legislation on unfunded obligations of major entitlement programs beyond the usual 10-year scoring window. If legislation caused an increase in these obligations, it would require a three-fifths vote of the Senate.

In addition to these legislative proposals, the Administration has augmented its own controls on mandatory spending. On May 23, 2005, OMB established an internal review process that requires agencies, when proposing substantial administrative actions that increase mandatory spending, to propose at the same time offsetting administrative actions that reduce mandatory spending by a comparable amount.

Discretionary Spending Limits

As noted earlier, the Congress has made important progress over the past 5 years in applying budget discipline to discretionary spending. The 2007 Budget proposes to strengthen our ability to continue this discipline through statutory limits on discretionary spending each year through 2011 that would control action throughout the budget process. Any appropriations bill that caused these limits to be exceeded would be subject to a three-fifths vote of the Senate. If cumulative appropriations action breached the spending limits, OMB would be required to make across-the-board cuts to eliminate the excess spending.

Currently, there are inadequate incentives in budget scoring rules to fund programs to collect overdue taxes owed to the Government, eliminate the estimated $37 billion in improper payments, and combat other fraud and abuse in Government spending. For example, if the Budget allocates $100 million for the collection of $500 million in delinquent tax payments, the savings of $400 million are not counted for purposes of evaluating the budgetary effects of the proposal. Thus, neither the Congress nor the Administration has a budget scoring incentive to fund programs that actually improve the overall fiscal position of the Government. The Administration proposes to properly align incentives for these activities by allowing an increase in the discretionary caps in the amount of additional funding needed for programs that save the Government money, such as the Social Security Administration's continuing disability reviews, health care fraud detection, unemployment insurance integrity programs, and Internal Revenue Service delinquent tax collections.

Focusing Spending on Priorities

Notwithstanding the recent progress in restraining discretionary spending, there is a widespread public perception that the number of earmarked spending items is excessive, and that too many of them are difficult to justify on the merits. The large number of earmarks, the lack of transparency, and the lack of a rigorous justification process make it difficult to assure taxpayers that their dollars are being spent wisely. The Administration looks forward to working with the Congress to reform the current approach to earmarks so that citizens can have greater confidence that their tax dollars are funding important National priorities.

As a further tool to focus spending on priorities, the President proposes that the Congress provide him and future Presidents with a line-item veto that is designed to withstand constitutional challenge. From the Nation's founding, Presidents have exercised the authority not to spend appropriated sums. However, the 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. The Line-Item Veto Act of 1996 attempted to give the President the authority to cancel spending authority and special interest tax breaks, but the U.S. Supreme Court found that law unconstitutional. The President's proposal is designed to correct the constitutional flaw in the 1996 Act.

Specifically, the President's Budget 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 it is not an essential Government priority. All savings from the line-item veto would be used for deficit reduction, and could not be applied to augment other spending.

The Administration would also support enhanced rescission authority as a supplement or alternative to this line-item veto. While the Impoundment Control Act contains provisions for the expedited consideration of proposed rescissions, these procedures are flawed and have almost never been used to enact a rescission. The Budget proposes these procedures be strengthened to ensure a vote on the President's proposed rescissions.

Sunset and Results Commissions

Statutory and other barriers make it difficult to reform programs to ensure agencies can maximize results for the American people at the lowest cost to the taxpayer. On June 30, 2005, the Administration transmitted the Government Reorganization and Program Performance Improvement Act, proposed legislation that would create bipartisan Results Commissions and a Sunset Commission to improve agency and program performance and reduce unnecessary costs to taxpayers. Results Commissions would consider proposals to restructure or consolidate programs or agencies in areas where duplication and overlapping jurisdictions hinder improvements in performance. Proposals from Results Commissions would be approved by the President and taken up in the Congress under expedited procedures. The Sunset Commission would consider Presidential proposals to retain, restructure, or terminate agencies and programs according to a schedule set by the Congress. Agencies and programs would automatically terminate according to the schedule unless reauthorized by the Congress.

Other Reforms

The Administration also proposes to improve the budget process with a joint budget resolution, Government shutdown prevention, and biennial budgeting. The current budget resolution does not require the President's signature and therefore does not have the force of law. A joint budget resolution would bring the President into the process at an early stage, allowing the President and the Congress to reach agreement on overall fiscal policy before individual tax and spending bills are considered, and could be enforced through automatic across-the-board spending cuts if its provisions were not honored.

The Administration's proposed provision to prevent Government shutdowns would address the chronic practice of using "continuing resolutions" to provide temporary funding for the Government when the Congress fails to enact appropriation bills by the October 1st start of the fiscal year. Under the President's proposal, if an appropriations bill has not been enacted, funding would be automatically provided at the lower of the President's Budget or the prior year's level. Important Government functions should not be held hostage simply because of an impasse over temporary funding bills.

Finally, biennial budgeting would free up time in the Congress now spent debating annual appropriations bills so that lawmakers could devote more attention to oversight responsibilities to ensure that taxpayers' money is spent wisely and efficiently. A biennial budget process, under which two-year appropriations bills would be enacted in each odd-numbered year, would also promote longer-range planning and improved fiscal management in the Executive Branch.

THE PATH FORWARD

With a commitment to spending restraint and with continued focus on strengthening the economy, we can make significant reductions in the deficit over the next several years. In the longer term, unconstrained spending in the Nation's large entitlement programs poses a serious threat to the Federal budget and to the health of the economy. If we take action to restrain spending, reform entitlements, and improve the budget process, the Nation's longer-term fiscal outlook will improve markedly.