

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release

February 5, 2007

PRESS BRIEFING
BY OMB DIRECTOR ROB PORTMAN
ON THE BUDGET

Room 450
Eisenhower Executive Office Building

12:04 P.M. EST

DIRECTOR PORTMAN: Well, thank you all for braving the cold and joining us this morning. As you probably know, earlier today the President transmitted to the Congress the FY 2008 five-year budget. It contains good news for the American people. It includes a balanced budget over five years, while meeting the nation's priorities.

It's a credible and more transparent budget. Instead of painting a rosy scenario on revenues to get to balance, we take a cautious approach. We've shown full war costs for the rest of this administration and some of 2009. We've also included these war costs as war supplementals as part of the budget this year, in a more transparent, timely and comprehensive way than ever before. And by the way, all of those war costs are included in our balanced budget calculations.

We changed our projections from past years to include a slight increase in non-security discretionary spending, consistent with what Congress and the President have actually enacted for the past three years.

In our budget we also begin to address our biggest fiscal challenge, the unsustainable growth in entitlement programs such as Medicare, Medicaid and Social Security. Although the fiscal house is getting in order short-term, frankly these looming challenges are the biggest budget problem we face. We take a good first step by proposing sensible reforms, primarily in Medicare, that are less than a 1 percent deduction in the annual rate of growth. Instead of Medicare increasing 7.4 percent per

year over the next 10 years, for instance, it would increase 6.7 percent.

While restraining growth overall in spending, the President's budget also provides new resources for key priorities. It increases funding for our national security to combat terrorism and to protect the homeland. It includes new policies to address critical issues that concern America's families, including educating their children, access to affordable health care, and reducing energy costs.

Over the past two years we have worked with Congress to reduce the deficit by \$165 billion. We've been able to make progress on this for two primary reasons: first, the strong and growing economy; and second, a little better restraint of non-security spending. It is exactly these elements -- a solid economy and restraint on spending -- that will enable us to achieve a balanced budget.

As you see from this first chart, our budget reduces deficits every year and results in a surplus in 2012. In FY07, we project that deficit will decline to \$244 billion, a reduction of \$95 billion since our last estimate in July 2006; \$244 billion is the difference between total spending of just under \$2.8 trillion, and total receipts of just over \$2.5 trillion.

The deficit in 2008 falls again. This projected deficit is 1.6 percent, as a percent of our economy, which is really the key measurement, because it shows the impact of government deficits on economic activity. The projected FY08 deficit is lower than 18 of the past 25 years as a percent of our economy. The deficit then continues to decline each year, both in nominal terms and as a percent of the economy until we reach a budget surplus of \$61 billion in 2012.

You'll recall that three years ago, President Bush established the goal of cutting the federal budget deficit by half in five years from its projected peak in 2004. At the time, many expressed skepticism this goal could be met. But we achieved the goal last September, three years ahead of schedule. We'll now build on that success and work with Congress to balance the budget within five years.

Again, getting the balance requires keeping the economy strong and sensible and realistic spending restraint. The President's budget is able to achieve both of these goals while funding critical priorities, including our national security.

To keep our economy vibrant, we continue the pro-growth policies that have helped fuel the robust economy and the increased revenues. The 2008 budget continues to support growth, innovation and investment by making permanent the President's tax relief which would otherwise expire in 2010.

In addition to tax policy, the budget will also strengthen our ability to compete in the global economy. It advances the American Competitiveness Initiative to increase our investment in critical basic research, ensures the United States continues to lead the world in innovation, and provides American children with a stronger foundation in math and science. And it will promote the continued opening of new export markets for America's farmers, workers, and service providers.

As you can see from this next chart, since the tax relief took full effect in 2003, we've seen a strong and steady growth in the economy. We've seen steady job growth, with the creation of 7.4 million new jobs since 2003. We've also seen a pretty dramatic increase in business investment during that period. Productivity is strong, paychecks are growing, with real hourly wages growing 1.7 percent in 2006, which is above the average of the late 1990s.

Unemployment remains low at 4.6 percent. Gas prices are down. Inflation remains low. Interest rates have moderated. And the stock market has reached new highs, showing that investors have confidence in America's economic future. And investors should be optimistic. In the most recent quarter, when there was a lot of talk of a slowdown, real GDP grew by a very strong 3.5 percent. The U.S. economy has now grown faster than the G7 industrialized countries for the past four quarters, and remains the envy of the world, in part because of its resilience in the face of some very significant headwinds. A healthy economy is a testament to the work ethic and ingenuity of the American people, but also to the effectiveness of pro-growth policies, including the tax relief.

This chart shows that after 2003 the economy not only strengthened, but federal revenues also surged, hitting record levels in the past two years. The President's 2008 budget uses five-year economic projections that are in line with forecasts by outside experts. As you'll see from this chart, we assume GDP growth will average about 3 percent over the budget window. This closely tracks the forecast of the blue chip forecasters. This year, our 2.7 percent growth you see for 2007 is now below most outside forecasts and market expectations.

As you'll see from this next chart, with solid economic growth, total receipts for 2006 were slightly above the historical average of 18.3 percent as a share of the economy, and we project receipts remain at this historical average for much of the five-year period, in fact, slightly above the historical average.

We have what I would term a cautious revenue forecast for this fiscal year and going forward. We forecast revenue growth will be 5.5 percent in fiscal year 2007 and average 5.4 percent through 2012. This is below the 40-year average of 7.6 percent and well below the dramatic 11.8 percent and 14.5 percent revenue growth we've seen over the last two fiscal years. In fact, it's below the actual first quarter FY07 revenue increase of 8.2 percent over the same period last year.

As in the past, our revenue projections are produced by the career professionals at the Office of Tax Analysis at the U.S. Department of Treasury. And I will say this morning, as was the case in the past two years, we may well find that our revenue projections are not rosy, but pessimistic.

Even with the a conscious forecast on revenues, this budget demonstrates we can balance by 2012 without raising taxes. In addition, we have plans to more effectively and efficiently collect the taxes owed, help to close the tax gap. Our budget helps close the tax gap in two ways. First, we improve the effectiveness of IRS activities with a \$410 million package of new initiatives to enhance enforcement and taxpayer service, and to improve IRS's technology. Second, we include in the budget 16 carefully targeted tax law changes that promote compliance while maintaining an important balance between taxpayers and their government. These tax law changes alone are estimated to raise \$29 billion over the next 10 years out of the tax gap.

The success of our growing economy following the enactment of the President's tax relief also underscores exactly why it's important to balance the budget without raising taxes, as others have suggested. By raising taxes, we could put the growth of jobs and our economy at risk. Now is the time instead to focus our energy on spending restraint.

To keep spending under control, our budget provides realistic spending restraint for the annually appropriated day-to-day government spending that isn't focused on national security. It strengthens our efforts to better manage taxpayer resources, and it proposes significant budget reforms to eliminate wasteful and unnecessary spending. And as noted

earlier, it also takes an important first step in implementing changes needed to address our long-term challenge, the unsustainable growth in entitlement programs.

The 2008 budget proposes to hold the rate of growth for non-security discretionary spending to 1 percent, well below the rate of inflation. We believe this is both fiscally prudent and realistic. As noted earlier, Congress and the President have done a better job restraining spending in this area over the past few years. In fact, the average growth in this area of non-security spending has been about 1.2 percent for the past three years, including spending growth in the roughly 1 percent range in this long-term continuing resolution the House just passed.

We believe this level of non-security discretionary spending is not only what we've been able to do the last three years, but it's adequate to fund the nation's priorities. One way to judge this restraint is to look at our total government spending as a percent of the economy. We're moving in the right direction. While tax revenues as a percent of the economy are about 18.3 percent, total spending drops from 20.2 percent of the economy in FY 2007 to 18.3 percent in 2012.

One of the ways we're achieving smart spending restraint is by closely examining each federal program to determine if it's a priority, whether it's effective in producing the intended results. Based on these thorough reviews, the budget proposes to terminate or reduce 141 discretionary spending programs, for a savings of \$12 billion in 2008. These reforms will help us reduce the deficit and channel resources to higher priorities and more effective programs.

We're able to make these judgments of how to spend taxpayer dollars more wisely in part with tools that we've developed through the President's management agenda. Last year, to ensure greater government accountability, we launched a new website -- here it is -- ExpectMore.gov. The site includes information for taxpayers, and the programs have been assessed for their effectiveness, using the program assessment rating tool, commonly known as "the part." With this website, Congress and the public now have an unprecedented view into which programs work, which do not, and what they're doing to try to improve. It's another way we're providing greater transparency, holding ourselves accountable and demanding results.

With the new and improved version of this website, launched today, we now have program-level information about the performance of nearly 1,000 federal programs, representing 96

percent of government and \$2.5 trillion of federal spending. I encourage you to go online and check it out.

With our changes to the functionality, users can now more easily search for programs by their rating or topic, or conduct a key word search. They can also look broadly at how each agency's programs are performing and find detailed evidence to support the program's rating. I want a nod to Clay Johnson, who is here with us this morning, the Deputy Director of OMB for Management, for his good work in leading the charge in the President's management agenda and on launching ExpectMore.gov.

The President's 2008 budget also outlines a comprehensive series of budget reforms that will improve fiscal restraint, transparency, and accountability in government spending. There's been a lot of discussion about earmarks, provisions added by Congress that direct funding to specific recipients or locations without being subject to competition or merit-based selection processes.

Often, these earmarks are not subject to adequate legislative or public scrutiny, and they often lead to wasteful federal spending. Earmarks have grown dramatically, as you know. They've nearly tripled in the last decade. And that's why the President has outlined three key reforms: First, full disclosure of all earmarks; second, putting earmarks in actual legislative language rather than a report language so they can actually get voted on; and third, cutting the number and amount of money provided in earmarks by half by the end of this year.

The President has also called on Congress to enact a legislative line-item veto. This would be a powerful tool. It complements the earmark reforms to help the executive and legislative branches work together to strike unwarranted earmarks and other wasteful and unnecessary spending from the budget. Both the House and the Senate have now demonstrated by a majority vote that each chamber supports this legislation. It's time to enact this sensible budget reform.

Our budget also shows how we can work with Congress to achieve a balanced budget by 2012 by dealing with the entitlement issue. Accomplishing a balance would be short-lived without addressing our long-term budgetary challenge, which is the unsustainable growth in these important programs -- Medicare, Medicaid and Social Security.

As you can see from this chart, mandatory spending is overwhelming the rest of the budget. In the space of four

decades, mandatory spending -- also called entitlement spending - has grown from 26 percent of the budget in 1962 to 53 percent of the budget by 2006, and it's growing. As this next chart shows, the current trends are simply not sustainable. Under current law, we estimate that by 2040, as you'll see on this bar chart, spending on these three important programs alone will crowd out all other spending -- no defense spending, no education spending, no homeland security spending -- unless we are willing to make the necessary reforms.

It seems to me there's now near universal and bipartisan agreement that the unchecked growth of these programs presents real long-term threats to beneficiaries, to our federal budget, to our economy. The choices without reform are pretty stark: massive benefit cuts, enormous deficits, or huge tax increases. We should not leave these problems for our children and grandchildren to solve. We now face a \$32 trillion unfunded obligation in Medicare over the 75-year horizon.

The balanced budget is important in part because it better positions our country to address these looming fiscal challenges, but our five-year budget proposal also makes an important down payment towards sensible reform of mandatory spending, reducing spending growth by \$96 billion over five years. These reforms are primarily in the Medicare program, but also in Medicaid and other programs. The proposals that we are submitting today are very similar in character to what this administration and the prior administration have offered in the past.

To put the reforms in context, you can see from this next chart the size of our budget proposal is considerably smaller than the savings in the balanced budget agreement of 1997 when I was in Congress, and the last time that Congress attempted to balance the budget. Although an important first step, the savings in this proposal would only reduce the unsustainable annual growth rates of mandatory spending by less than one percentage point. Specifically, again, over 10 years, the annual growth of Medicare would be reduced from 7.4 percent to 6.7 percent. However, these proposals do deliver more savings over time. The changes we have proposed to Medicare would reduce the unfunded obligation of the program by almost 25 percent, or \$8 trillion, over the 75-year horizon.

Frankly, under the budget we have proposed, we can achieve balance within the five-year window without making any of these mandatory savings changes. But we would only be digging a deeper hole by ignoring it for another year. Balance is not coming at the expense of our nation's commitment to seniors and low-income

Americans; quite the opposite. We must begin the reform of these programs now in order to protect those commitments. Addressing entitlement spending is the right thing to do because small changes now can have a big impact later. I urge Congress to take a careful look at these sensible reforms.

As we restrain spending, we're investing in our nation's highest priorities: combating terrorism, protecting the homeland, and addressing pocketbook issues that affect the standard of living for America's families.

The 2008 budget supports our troops fighting terrorism abroad, strengthens our military for the future, supports our efforts on the diplomatic front, and protects our homeland from attack. It invests substantial resources to maintain high levels of military readiness and to continue the transformation of our military to meet the new threats of the 21st century.

I want to make this point very clear, because it's often misunderstood: The cost of the war is reflected in the administration's deficit projections. In fact, there has been a \$165 billion decrease in our deficit over the past two years, and that includes all of the war costs that we've incurred during that time.

As noted earlier, the administration supports greater transparency and accountability. And this budget improves the timeliness and specificity of the information provided to Congress and to the American public about the cost of the war.

With the 2008 budget, the administration goes further than we have in the past to show the full cost of the war -- Iraq, Afghanistan and the global war on terror, generally -- for the rest of the President's term. We are providing our requests for the full cost of the war in both FY 2007 and 2008, and for the first time, including account-level detail and justifications. Specifically we're requesting additional resources of \$99 billion for FY 2007 to support our troops, \$145 billion for 2008, and an allowance of \$50 billion for anticipated war costs in 2009.

The administration welcomes oversight of its war spending, and we hope these details will help Congress more fully understand our war-related request. This is our good-faith effort to be as transparent as possible in what we anticipate the needs will be as far out as we can possibly and reasonably project.

The President's budget also addresses three key issues that are on the minds of many American families: the quality and cost of their kid's education, access to affordable health care, and our nation's dependence on foreign sources of energy from unstable parts of the world.

Regarding our schools, No Child Left Behind is already working to achieve the goal of all students performing at or above grade level in reading and math by 2014. It's raised student achievement for millions of children in schools across our country. The 2008 budget directs more funding to high schools to better prepare our students for college or the work force. It offers new school choice options, so children in low-performing schools can have a chance to attend a school where they can learn and succeed. To help low-income families afford college, the 2008 budget substantially increases the Pell grant maximum awards.

The 2008 budget also improves America's access to affordable health care through a number of proposals. It proposes a significant change in the tax treatment of health care to expand coverage and bring greater fairness to the system. With more transparency and competition, it will also slow the rate of growth of health care costs, all of which will help reduce the number of uninsured Americans.

The budget also provides for an affordable health care initiative with the states, improves access to health care by allowing small businesses and civic and community groups to band together to leverage their bargaining power, and it helps reduce frivolous lawsuits that increase patient's costs.

The budget includes a number of proposals to increase our energy security, while improving our environment. As noted in the State of the Union speech, the President is proposing to increase the current standards for alternative fuels use, and for fuel economy in order to cut our domestic gasoline consumption by 20 percent over the next 10 years, thereby reducing projected air pollution, and projected CO2 emissions.

The budget also continues the Advanced Energy Initiative to make alternative sources of fuel and electrical energy -- like cellulosic, hydrogen, solar, nuclear, and clean coal more cost-competitive.

And in a continued effort to preserve our environment and national treasures, we are proposing today an exciting new plan, called the National Parks Centennial Initiative. This new

program will provide up to \$3 billion over the next 10 years in new federal and private spending to help achieve new levels of excellence in our national parks.

The budget shows that we can achieve balance by keeping the economy strong and by imposing realistic spending restraint, while investing in our nation's priorities. We are committed to the hard work ahead, to ensure that our fiscal house is in order, for the near-term and for the longer-term. I am optimistic we can do it across party lines, as the American people expect and deserve.

I've just outlined the broad structure of the President's budget and touched on some of the key priorities. Greater detail on every aspect of this budget is available online. If you go to our website, www.omb.gov, you will find lots of detail. In the meantime, I'm happy to try to answer any questions you might have.

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12:59 P.M. EST