

U.S.

Economic Watch

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Economic Research

Hakan Danış

hakan.danis@bbvacompass.com

President's 2012 Budget

Proposal Projects \$1.1tr Deficit in 2012

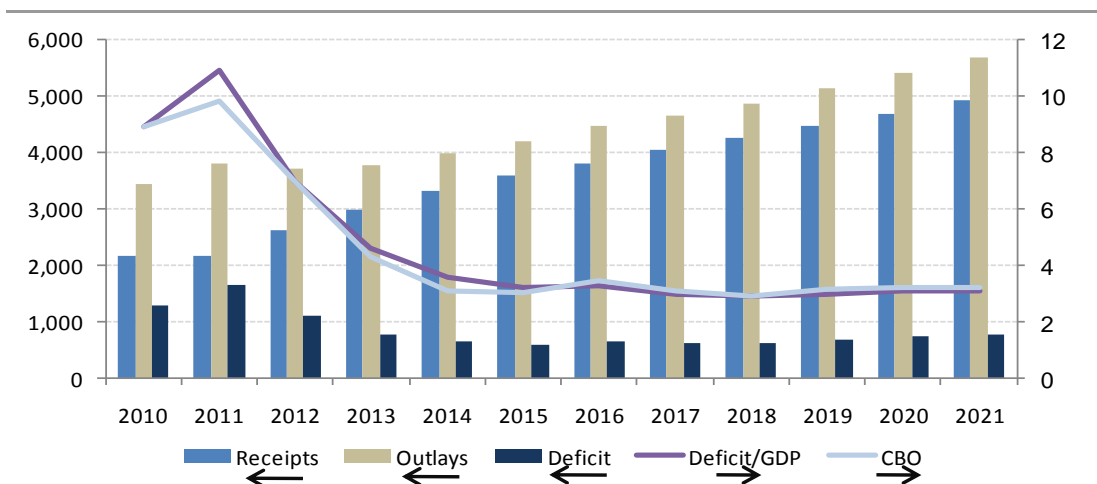
- Cuts military spending, freezes non-security discretionary spending and terminates many government programs
- New fees to financial institutions and eliminates tax credits for oil, gas and coal companies
- Calls for corporate tax and social security reforms

On Monday, President Obama announced the U.S. budget for 2012, which includes higher taxes and fees for certain industries and lower spending. If the proposal is enacted, the U.S. budget deficit is expected to reach \$1.1tr in 2012 (compared to \$1.6tr in 2011). Under the Administration's economic growth assumptions the budget deficit will decline to 3.6% in 2014 and reach 2.9% in 2018. However, since the current proposal does not solve structural issues such as Medicaid and Medicare, the budget deficit is expected to rise starting in 2019.

President Obama's budget proposal is significantly different from proposals by the Debt Reduction Task Force (see our [Economic Watch on Nov 23](#)) and bipartisan Fiscal Commission (see our [Economic Watch on Dec 6](#)) which aim to tackle long-term problems and put both the fiscal deficit and public debt on track. The proposed budget leaves structural problems in Medicaid and Medicare programs for future negotiations and calls for corporate tax reform. Yesterday, President Obama acknowledged these problems, which his budget does not solve, and expects that both parties would continue debating on a solution for these long-term problems of the fiscal policy.

Graph 1

Budget Totals (\$bn & %)



Source: CBO & White House

The proposal cuts spending, eliminates some of the tax credits and introduces new fees to certain industries. Here are the main elements of the proposed budget with Administration's projections:

- Cuts military spending over the next 5 years by cutting some of the weapons programs and bringing U.S. troops home from Iraq. It is projected that the cuts will generate \$78bn over a five year period.
- Freezes non-security discretionary spending for the next 5 years. The proposal is the extension of the 2011 budget and expected to save around \$400bn over a decade.
- Freezes Federal civilian worker pay for 2 years. It will save \$2bn in 2011 and \$60bn over a decade.
- Cuts or consolidates many government programs. The proposal will terminate or reduce more than 200 programs and is expected to save around \$30bn in 2012. For example, the proposal will suspend new year-round Pell Grants and eliminate in-school interest subsidies to graduate students. It will also eliminate many Department of Education programs and consolidate some of the K-12 programs. However, the budget of the Education Department will increase by 4.3% in 2012. The Low Income Home Energy Assistance Program will be lowered to its 2008 level, which will save \$2.5bn. A significant portion of the savings (or revenue) will come from eliminating 12 tax breaks for oil, gas, and coal companies and closing loopholes. The projected saving is \$46bn over the next 10 years.
- Eliminates earmarks: Obama pledges to veto any bill with earmarks in it.
- Requires the Financial Services industry to pay back taxpayers. The Administration is keen to collect Troubled Asset Relief Program (TARP) costs and other assistances. The proposal also includes a Financial Crisis Responsibility Fee which will generate \$30bn over a decade. The fee will be charged to financial firms with assets over \$50bn and will remain in effect until all TARP costs have been recovered.
- Limits itemized deductions for the highest income earners and pays for the Alternative Minimum Tax.
- Includes incentives for Research and Development (R&D), clean energy, and spending on high-speed rail and wireless infrastructure, as Obama underscored in his State of the Union speech. The administration anticipates \$148bn of tax credits for R&D investments and clean energy.
- Suspends States' interest payments on their debt owed to the Federal government for two years to give some room for the States to pay their debt. The proposal also increases the maximum wages subject to unemployment insurance taxes in 2014.
- Reduces investment portfolios and loans guaranteed by Fannie Mae and Freddie Mac and therefore plans to diminish government involvement in the mortgage market gradually over time.

In summary, President Obama's 2012 Budget Proposal includes a mix of spending cuts and increased taxes for financial institutions, oil, gas and coal companies. Although the budget cuts spending on many items, the projected decrease in fiscal deficit is gradual due to new incentives for Research and Development (R&D), clean energy, and high-speed rail and wireless infrastructure. Furthermore, the President's budget acknowledges structural long-term problems facing U.S. fiscal policy, but does not include solutions and defers this to future negotiations with the GOP.

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