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The Budget for Fiscal Year 2002

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Abstract. This report provides background and analysis of the FY2002 budget including budget totals, budget action, outlays, receipts, surpluses or deficits, and a discussion of the budget and the economy.

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Summary

Congress adopted the FY2002 budget resolution (H.Con.Res. 83) on May 10, 2001. The resolution resembled President Bush's original proposals that he presented in *A Blueprint for New Beginnings* (February 28, 2001). Those proposals included a 10-year $1.6 trillion tax cut, increased spending for education, a review of defense needs, and an "Immediate Helping Hand" to provide prescription drug benefits to low income seniors. (The Administration released its complete and detailed budget on April 9, 2001.) A modified version of the tax cut (totaling $1.35 trillion over 10 years) was enacted in early June 2001.

Over the summer of 2001, preliminary work continued on appropriations for the year. In late August 2001, the Administration's *Mid-Session Review* (MSR) and the Congressional Budget Office's (CBO) *Update* contained sharply lower surplus estimates for FY2002. These surplus estimates for FY2002 ranged from $173 billion to $176 billion (down from April and May 2001 estimates of $231 billion to $257 billion).

Subsequently, after the terrorist attacks in September 2001, Congress passed emergency supplemental appropriations (P.L. 107-38; September 18, 2001) providing $20 billion immediately and directing that another $20 billion be provided in regular appropriations. Legislation also provided $15 billion ($10 billion in loan guarantees) for airline stabilization (P.L. 107-42; September 22, 2001).

In December 2001, Congress completed action on the last of the 13 regular appropriation bills for FY2002. While considering the regular appropriations during the fall, Congress adopted eight continuing resolutions on appropriations to provide interim funding. Policy disagreements, the terrorist attacks in September, and the anthrax disruptions all slowed the progress of the appropriations. The substantial deterioration in the budget outlook also made the fall budget debates more difficult.

Meanwhile, projections regarding the surplus worsened dramatically compared to the estimates in the early 2002 budget reports from the Administration (OMB) and the CBO. The very large surplus (with baseline estimates of over $300 billion) estimated for FY2002 early in 2001 disappeared and was replaced by an expected deficit. A combination of changes in policies, worsening expected economic conditions, and modified technical assumptions all contributed to the reduction and then disappearance of the surplus over the last year.

The President's *Mid-Session Review* (MSR) for FY2003 (July 15, 2002) reaffirmed the worsening budget outlook for FY2002. The MSR put the deficit at $165 billion in FY2002. CBO's budget update (August 27, 2001) included a baseline deficit of $157 billion for FY2002.

The Treasury released final budget numbers for FY2002 in late October 2002. The year ended with a deficit of $159 billion (breaking a string of four years in row with surpluses), receipts of $1,853 billion, and outlays of $2,012 billion.

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Background and Analysis

Presidents generally submit their budget proposals for the upcoming fiscal year early in each calendar year. For FY2002, the Bush Administration presented its summary budget document (*A Blueprint for New Beginnings)* on February 28, 2001. The single volume contained a general description of the Administration's policy proposals and expectations for the budget for FY2002 and for the years through FY2011. On April 9, 2001, the Administration released its full set of budget documents containing extensive and detailed budget related information, including estimates of the budget without the proposed policy changes (current service baseline estimates), historical budget data, detailed outlay and receipt data, selected analysis of specific budget related topics, and the Administration's economic forecast. These detailed budget documents are an annual basic reference source for federal budget information in addition to their use as a transmitter of the Administration's policy proposals.

The Administration's annual budget submission is followed by congressional action on the budget. This usually includes the annual budget resolution, appropriations, and, possibly, a reconciliation bill or bills. During the months of deliberation on budget related legislation, the Administration often modifies its proposals, not only because of interactions with Congress, but because of changing circumstances in the economy and the world.

Budget Totals

Table 1 contains budget estimates and proposals for FY2002 from the Congressional Budget Office (CBO), the Administration (the Office of Management and Budget – OMB), and the congressional budget resolution. Differences in totals occur because of differing underlying economic, technical, and budget-estimating assumptions and techniques as well as differences in policy assumptions. Most *policy* differences between the Administration and congressional proposals or assumptions for an upcoming fiscal year are often relatively small compared to the budget as a whole. These small one-year differences may lead to large dollar differences over extended time periods. Budget totals should be expected to change over time from those originally proposed by the President or Congress.

The terrorist attacks on the United States on September 11, 2001, the 2001 recession, changes to expected policies, and technical changes in some underlying budget-economic relationships, all contributed to the large change in the short- and long-term budget outlooks between early 2001 and 2002.

Table 1. Budget Proposals and Estimates for FY2002
(in billions of dollars)

	Receipts	Outlays	Deficit(-)/ Surplus
Actual for FY1997	*$1,579.3*	*$1,601.3*	*-$22*
Actual for FY1998	*1,721.8*	*1,652.6*	*69*
Actual for FY1999	*1,827.5*	*1,703.0*	*124*
Actual for FY2000	*2,025.2*	*1,789.0*	*236*
Actual for FY2001	*1,991*	*1,864*	*127*
CBO Baseline for FY2002 1/31/01	2,236	1,923	313
President's Budget Blueprint 2/28/01	2,190	1,959	231
House budget resolution 3/28/01	2,168	1,941	227
Senate budget resolution 4/6/01	2,177	1,979	198
President's Budget 4/9/01	2,192	1,961	231
OMB Baseline 2/28/01 & 4/9/01	2,221	1,938	283
Conference budget resolution 5/10/01	2,171	1,952	219
CBO revised baseline 5/18/01	2,226	1,922	304
CBO reestimate of President's budget 5/18/01	2,201	1,944	257
President's MSR 8/22/01	2,135	1,962	173
President's MSR baseline 8/22/01	2,135	1,949	187
CBO Update baseline 8/28/01	2,134	1,958	176
CBO B&E Outlook, baseline 1/31/02	1,983	2,003	-21
President's Budget, baseline 2/4/02	2,011	2,020	-9
President's Budget 2/4/02	1,946	2,052	-106
CBO reestimate of President's budget 3/6/02	1,942	2,033	-90
CBO revised baseline 3/6/02	2,006	2,001	5
House budget resolution 3/20/02	1,968	2,033	-66
President's MSR 7/15/02	1,867	2,032	-165
President's MSR baseline 7/15/02	1,868	2,018	-150
CBO Update 8/27/02	1,860	2,017	-157
Actual for FY2002 10/25/02	1,853	2,012	-159

a. The Senate and conference budget resolution fro FY2002 included an $85 billion tax rebate that was reflected in the Allowances function on the outlay side of the budget.
MSR – Mid-Session Review.
B&E Outlook – The *Budget and Economic Outlook: FY2003-2012*, January 31, 2002.

Budget Proposals and Estimates

CBO's original FY2002 budget report, the *Budget and Economic Outlook* (January 2001), contained baseline estimates and projections for FY2001 through FY2011.[1] CBO's report estimated a FY2002 baseline surplus of $313 billion,

[1]Baseline estimates provide a foundation from which to measure proposed policy changes. They extrapolate current policies into the future based on expectations of the future economy and other factors that affect the budget. They are not meant to predict future (continued...)

receipts of $2,236 billion, and outlays of $1,923 billion. The 10-year (FY2002-FY2011) cumulative total surplus in the CBO report was $5.6 trillion; the 10-year cumulative *on-budget surplus* (the portion of the total surplus excluding Social Security and the Postal Service) was $3.1 trillion.

President Bush's FY2002 budget (both the *Blueprint* from February 2001 and the complete budget from April 2001) used the then expected positive economic and budget outlook over the 10-year budget window to support his proposals to cut taxes and increase selected spending. The proposals, as measured against the 10-year baseline, included a $1.6 trillion tax cut, increases in defense, education, and Medicare spending (totaling $172 billion, which included both increases and decreases in other federal activities). The budget implied that there would be possible additional increases in defense spending after a review of defense needs and, because the policy proposals resulted in smaller surpluses and higher levels of debt, higher interest payments (of $420 billion) over the 10 years. The policy changes, according to the Administration, would leave a cumulative $841 billion in the *on-budget surplus* over the 10-year budget horizon. The proposals would, assuming all the proposed policies were adopted and that the underlying assumptions proved correct, eliminate $2 trillion of the existing $3.4 trillion publicly held debt by FY2011.

For FY2002, the Bush Administration originally proposed a surplus of $231 billion, $52 billion below its baseline surplus and smaller than the then estimated $281 billion surplus for FY2001.[2] The reduction in the surplus from the baseline surplus resulted from approximately equally sized increases in outlays and reductions in receipts from baseline levels. The resulting original *on-budget* surplus was $59 billion in FY2002, $52 billion below the baseline estimate and smaller than the then estimated $125 billion FY2001 *on-budget* surplus. In the original Administration budget documents, the surplus reduction for FY2002 (and all 10 years) would have come from only the *on-budget* surplus – reserving the *off-budget* surplus for reducing the federal debt held by the public.

In the spring of 2001, Congress adopted the congressional budget resolution for FY2002 (H.Con.Res. 83; May 10, 2001), which contained somewhat smaller receipts, outlays, and surplus than in the President's original proposals for FY2002. The differences between the Administration's proposed amounts and those in the budget resolution were small compared to the amounts involved (although there were differences in policy choices and emphasis).

CBO's reestimates of the President's budget proposals (May 2001) differed relatively little from the Administration's numbers for FY2002. CBO's estimates of the Administration's proposed policy produced larger receipts (by $9 billion), smaller outlays (by $17 billion), and a larger surplus (by $26 billion) than the Administration. Over the 10-year budget window, CBO showed smaller cumulative receipts than the Administration (by approximately $200 billion), larger cumulative outlays (by $57

[1](...continued)
budget outcomes.

[2]The actual FY2001 surplus, the last of four years in a row, was $127 billion.

billion), and a smaller cumulative surplus (by approximately $250 billion). These differences between the CBO reestimates and the Administration's proposals were fairly small compared to the $26 trillion in cumulative receipts and $22 trillion in cumulative outlays projected over the 10 years. (The report also contained slightly revised CBO baseline estimates and projections.)

The release of the Administration's Mid-Session Review (MSR; August 22, 2001) substantially changed the short-term (and began showing negative changes to the long-term) budget outlook and, at that time, was seen as increasing the difficulty of completing the new year's budget legislation, in particular, the appropriations. The continuing economic sluggishness combined with technical adjustments to the estimates and other, less significant factors reduced the Administration's estimated total surplus for FY2002 to $173 billion (from $231 billion in April). The MSR also showed the non-Social Security surplus for FY2002 almost disappearing, falling from the $56 billion estimated in April to the $1 billion estimated in August 2001. For the full 10-year period covered by the budget window, the MSR showed a cumulative total surplus of $3.1 trillion incorporating the Administration's remaining unadopted proposals (and $3.8 trillion without the proposals).

CBO's mid-year report, the *Economic and Budget Outlook: An Update* (*Update*; August 28, 2001), mirrored the Administration's MSR. The baseline numbers in the CBO report incorporated the effects of the continuing slowing economy, the policy changes adopted since May 2001, particularly the tax cut, and technical changes. The results were much smaller surpluses for FY2002 ($176 billion) than had been estimated earlier. The revised CBO baseline numbers showed that the cumulative surplus (for FY2002 through FY2011) would be almost $3.4 trillion, slightly smaller than the Administration's baseline estimate for the same period.

At the end of January 2002, CBO released revised FY2002 budget estimates as part of its FY2003 budget report. Reflecting the sharp changes in the budget outlook over the last year, CBO's revised estimates expected a *deficit* of $21 billion in FY2002. The policy changes proposed for FY2002 as part of the Administration's FY2003 budget (February 4, 2002) would increase the size of the expected deficit to $106 billion (from the Administration's $9 billion deficit baseline estimate). Most of the Administration's proposed changes for FY2002 in the FY2003 budget were tied to the Administration's proposed "Bipartisan Economic Security Plan," which would increase spending and cut taxes and was presented as an economic stimulus package.[3]

A subsequent budget report from CBO (*An Analysis of the President's Budgetary Proposals for Fiscal Year 2003*, March 2002) revised its baseline, showing a slightly improved budget outlook, and provided reestimates of the President's proposals based on CBO's economic and technical assumptions. The revised CBO baseline had a $5 billion surplus for FY2002. The reestimates of the Administration's policy had a $90 billion deficit for the year, smaller than the amount in the President's budget.

[3]The Bipartisan Economic Security Plan, if adopted as proposed, would have increased outlays by $27 billion and reduced revenues by $64 billion in FY2002.

The President's Mid-Session Review (for FY2003, July 15, 2002) contained the Administration's final official budget estimates for FY2002. The estimates reaffirm the deterioration in the budget outlook for the year. The deficit jumped to $165 billion from a combination of much lower than expected receipts and somewhat higher spending. Policy changes and changes in technical budget assumptions produced most of the recent changes in budget expectations since the previous Administration estimates.

CBO's *Budget and Economic Outlook: Update* (August 27, 2002), put the FY2002 deficit at $157 billion. The substantial change from an expected baseline surplus of $5 billion in March 2002, mostly resulted from reductions in expected revenues. CBO estimated that $43 billion of the revenue reduction came from the adoption of the economic stimulus legislation in March 2002 and $104 billion came from technical reestimates.[4] The technical component of the reestimates measured a change in the relationship between federal revenues and personal and corporate income. CBO's estimate of baseline outlays increased by $16 billion between March and August 2002.

The Treasury released final budget for the year (subject to minor adjustments) on October 25, 2002. The year ended, as forecast in the August 2002 budget reports, with a deficit, breaking the string of surpluses in the previous four years. The deficit was $159 billion, receipts were $1,853 billion, and outlays were $2,012 billion.

Uncertainty in Budget Projections

All budget estimates and projections are inherently uncertain. Their dependence on assumptions that are themselves subject to substantial variation makes budget estimates and projections susceptible to fairly rapid and dramatic changes. The changes in the budget estimates for FY2002 between January 2001 and the summer of 2002 illustrate this volatility. The estimates stretching over five to 10 years into the future are subject to even greater volatility. The September 2001 attacks on the United States, the legislation adopted in response, the weakened economy, and a shift in critical underlying relationships, all show how changes in the budget's environment can substantially alter the budget path from the one originally expected or proposed.

CBO devotes a chapter to budget uncertainty in its annual budget report.[5] To illustrate the uncertainty of budget estimates, it provides two alternative budget path scenarios to its baseline estimate. These alternative optimistic and pessimistic scenarios reflect changes to the conditions (mostly economic variables but including some technical assumptions) underlying the budget estimates. The result of the CBO exercise, especially over the 10-year budget window, shows a very large difference,

[4]As CBO states in its August report, "Technical changes represent all other modifications to the baseline not directly related to enacted legislation or to revision in the variables in CBO's economic forecast." *The Budget and Economic Outlook: Update*, Aug. 27, 2002, p. 15.

[5]See chapter 5 in the Budget and Economic Outlook: Fiscal Years 2003-2012, Jan. 2002.

of almost $1 trillion in FY2012, between the size of the estimated surplus in the optimistic scenario and the deficit in the pessimistic scenario.

Budget projections are very dependent on the underlying assumptions about the direction of the economy and future government policy and how these interact. Any deviation from the expected underlying assumptions, such as faster or slower economic growth, higher or lower inflation, differences from the assumed spending and tax policies, or changes in the technical components of the budget models can have substantial effects on the budget estimates and projections and eventual budget outcomes.

Budget Action

During the first five months of 2001, the House adopted a series of bills (H.R. 3, March 8; H.R. 6, March 29; H.R. 8, April 4; and H.R. 10, May 2) that would have, if enacted into law, implemented various parts of President Bush's proposed $1.6 trillion 10-year tax-cut proposal. While the House was passing the tax bills, the House and Senate were also considering the congressional budget resolution for FY2002, which eventually included tax cut instructions of its own. On March 21, 2001, the House Budget Committee adopted, along party lines, a budget resolution (H.Con.Res. 83; H.Rept. 107-26), that closely followed the Administration's proposals for FY2002 through FY2011.[6] On March 28, 2001, the House adopted the House Budget Committee budget resolution (222-205) mostly along party lines. The House rejected four alternative budget resolutions, three from the Democrats and one from conservative Republicans, before passing the House Budget Committee version. The resolution authorized a series of tax bills to implement the Administration's tax-cut plan.

The Senate began debating the FY2002 budget resolution on April 2. The Senate Budget Committee did not develop its own budget resolution for the upcoming fiscal year (expected problems in getting the evenly divided committee to agree on a resolution discouraged the attempt). Instead, the Senate used the House-passed budget resolution as the starting point for the debate. The Senate modified the House passed resolution by among other changes, reducing the size of the proposed $1.6 trillion tax cut to approximately $1.2 trillion over 10 years and speeded up discretionary spending growth in FY2002. The Senate passed (65-35) the modified resolution, on April 6.

[6]The budget numbers in the resolution differ somewhat from those in the Administration's proposals mostly because of differences in the underlying baselines and assumptions used by the Committee and the Administration rather than any fundamental differences in policy proposals. The House Budget Committee used the January 2001 CBO budget report, and its baseline, to generate its budget resolution numbers; the President's proposals were derived from OMB's baseline estimates and projections. CBO and OMB differ, although only slightly, in their respective underlying assumptions used in creating their respective budget baselines.

A conference to resolve the differences between the House and Senate version of the resolution began on April 24, 2001. The conference reached agreement on May 2, 2001. The agreement included an 11-year tax cut of $1.35 trillion (below the House budget resolution and the amount the President proposed, but above the amount in the Senate budget resolution). This included an immediate advance tax rebate of approximately $100 billion over FY2001 and FY2002.

The House began its deliberations on the conference report on May 3, but halted them when a technical problem with the resolution – two pages were missing – cropped up in its printed version. The agreement was resubmitted to the conference. After further deliberations over the weekend of May 5 and 6 and Monday, May 7, the further modified conference agreement on the budget resolution (H.Rept. 107-60) went back to the House. The House passed it on May 9. The Senate followed on May 10. The individual tax cut bills previously passed by the House were overtaken by the adoption of the conference report on the congressional budget resolution and its included reconciliation instructions for a $1.35 trillion 10-year tax cut.

Almost immediately after the adoption of the budget resolution, legislation to implement the tax cut instructions in the budget resolution cleared the House (H.R. 1836; May 16). The Senate Finance Committee reported its version of the tax legislation (S.896) on May 16. The Senate in considering the legislation (beginning on May 21), substituted the text of S. 896 for the text of the House bill and adopted the amended bill on May 23. A conference to resolve the differences began shortly thereafter and reached agreement on May 26. The conference report (H.Rept. 107-84) was agreed to by both chambers on May 26 and cleared for the President. The President signed the legislation into law on June 7, 2001 (P.L. 107-16).

Additional legislation beyond the adopted tax-cut reconciliation bill was necessary to fulfill the budget outline contained in the budget resolution. Congress began implementing the spending parts of the budget resolution by beginning consideration of the 13 regular appropriations bills in early June. Appropriations are needed each year to fund the discretionary activities of the government and other activities not covered by some type of permanent funding (appropriations fund approximately one-third of total federal spending).

As the summer wore on, disputes over how to divide up the amount provided in the budget resolution for discretionary spending among the 13 regular appropriations bills delayed their adoption. The terrorist attacks in September set back the already delayed consideration and adoption of the appropriations bills for FY2002.

In response to the attacks, President Bush requested a $20 billion (relatively) unfettered emergency supplemental appropriations to be used to respond to the terrorist attacks. Congress doubled the amount to $40 billion, added some oversight restrictions, and passed the legislation (H.R. 2888) on September 14, 2001; it was signed into law on September 18 (P.L. 107-38). The second $20 billion was to be allocated in the regular appropriations bills.

The disrupted consideration of appropriations legislation resulted in none of the regular appropriations having been enacted into law when the new fiscal year began on October 1, 2002. To avoid a funding crisis, Congress passed (H.J.Res. 65; September 28) and the President signed (P.L. 107-44; September 28) a continuing resolution on appropriations (CR) that provided funds for appropriations-dependent federal activities through October 16, 2001. Congress continued considering the regular appropriations bills through October, November, and into December. The anthrax threat on Capitol Hill and continuing disagreements over policy further delayed adoption of the regular appropriations bills. Seven more CRs were adopted (P.L. 107-48, October 12; P.L. 107-53, October 22; P.L. 107-58, October 31; P.L. 107-70, November 17; P.L. 107-79, December 7; and P.L. 107-97, December 20) continuing funding through January 10, 2002 (the last to give the President time to consider the last of the regular appropriations bills adopted by Congress). Congress adopted the remaining regular appropriation bills on December 20 and then recessed.

Congress responded to the Administration's economic stimulus proposal (in the FY2003 budget – the bipartisan economic security plan) by passing, on March 8, 2002, the Job Creation and Worker Assistance Act of 2002 (H.R. 3090). The legislation would increase the deficit in FY2002 by an estimated $51 billion, mostly through tax cuts. The President signed the bill on March 9 (P.L. 107-147).

The House adopted its version of the FY2003 budget resolution containing modifications to the budget for FY2002 on March 20, 2002. The modifications reflected the changes to the budget over the last nine months and the possibility of further changes for the fiscal year. The Senate Budget Committee adopted its version of the budget resolution (S.Con.Res. 100) on March 22, which did not contain revised numbers for FY2002. The full Senate has not considered (and may not consider) the committee's reported budget resolution.

The House passed supplemental appropriations for FY2002 (H.R. 4775) of $29 billion on May 24. The Senate adopted its slightly larger ($31 billion) supplemental appropriations bill (S. 2551) on June 3. It substituted the text of S. 2551 for the text of H.R. 4775. A conference to resolve the differences between the two versions of the legislation began in mid-June and finished on July 18. The legislation (with a compromise amount of $29 billion) cleared Congress on July 24, 2002, and was signed by the President on August 2, 2002 (P.L. 107-206). Much, if not most of the spending flowing from these appropriations will occur in FY2003.

Outlays

The Administration originally proposed total outlays of $1.96 trillion for FY2002, an increase of $105 billion over the then estimated FY2001 level. Proposed policy changes accounted for approximately $23 billion of the increase, with the remaining increases the result of automatic growth (cost-of-living-adjustments or expansion of eligible populations) in a variety of federal programs. Over the 10-year budget horizon (FY2002-FY2011), total outlays were originally projected to increase by $745 billion with approximately $592 billion of the increase resulting from the President's policy proposals (with $420 billion of the policy increase due to higher interest payments mostly the result of the proposed tax cut). Although total outlays would have grown by 5.7% from FY2001 to FY2002, their average annual rate of increase over the 10-year period (through FY2011) was 3.8%. (The 4% increase proposed by the Administration referred to the increase in budget authority for discretionary spending; the expectations of falling interest payments held down the rate of growth in outlays.)

Revised numbers in the August 2001 MSR increased projected outlays in most years, but not by very large amounts. Outlays in FY2002 were expected to be only $2 billion larger than in the April budget. Over the 10 years, outlays, cumulatively, would have been 1.7% larger in the MSR projections than the April proposal. (Most of the changes in the budget numbers between April and August occurred in receipts.) CBO's *Update* (August 2001) baselines were similar to the Administration's baseline (current services) estimates in the MSR, with cumulative outlays differing by less than 1%, although individual years differ by greater amounts. Outlays in FY2002 were expected to reach $1,962 billion in the MSR, and $1,958 billion in CBO's *Update* (see Table 2). The emergency supplemental (P.L. 107-38, September 2001) would add close to an estimated $40 billion in outlays to the FY2002 total. The increased overall level of appropriations agreed to by Congress and the President in early October 2001 would also increase FY2002 outlays. The possibility of higher outlays from an economic stimulus package never materialized before the first session ended.

Table 2. Outlays for FY2000-2006 and FY2011

(in billions of dollars)

	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2011
OMB Clinton Baseline 1/16/01	*$1,789* [a]	$1,868	$1,933	$1,994	$2,058	$2,145	$2,204	$2,623
CBO Baseline 1/31/01		1,853	1,923	1,984	2,056	2,137	2,184	2,558
President's Budget Blueprint 2/28/01		1,856	1,959	2,012	2,071	2,164	2,221	2,709
House budget resolution 3/28/01		1,857	1,941	2,007	2,086	2,176	2,237	2,718
Senate budget resolution 4/6/01 [b]		1,949	1,979	2,046	2,123	2,209	2,271	2,776
President's Budget 4/9/01		1,856	1,961	2,016	2,077	2,169	2,224	2,706
OMB Baseline 4/9/01		1,853	1,938	1,991	2,051	2,130	2,182	2,580
Conference budget resolution 5/10/01 [b]		1,948	1,952	2,021	2,103	2,196	2,256	2,742
CBO revised baseline 5/18/01		1,839	1,922	1,985	2,054	2,133	2,181	2,564
CBO reest. of Pres.'s budget 5/18/01		1,843	1,944	2,013	2,084	2,177	2,234	2,725
President's MSR 8/22/01		1,855	1,962	2,025	2,111	2,208	2,272	2,761
Pres. MSR baseline 8/22/01		1,855	1,949	2,011	2,084	2,172	2,231	2,697
CBO Update 8/28/01		1,858	1,958	2,024	2,106	2,194	2,254	2,713
CBO Outlook 1/31/02		*1,863* [c]	2,003	2,085	2,152	2,238	2,319	2,838
OMB FY2003 baseline 2/4/02		—	2,020	2,070	2,126	2,197	2,266	NA
OMB FY2003 prop., 2/4/02		—	2,052	2,128	2,189	2,277	2,369	NA
CBO reestimate of Pres.'s budget, 3/6/02		—	2,033	2,134	2,201	2,291	2,394	2,993
CBO revised baseline, 3/6/02		—	2,001	2,080	2,148	2,231	2,312	2,825
House budget res. 3/20/02		—	2,033	2,122	2,192	2,289	2,383	NA
OMB MSR 7/15/02		—	2,032	2,138	2,217	2,298	2,390	NA
OMB MSR baseline 7/15/02		—	2,018	2,097	2,163	2,232	2,301	NA
CBO Update 8/27/02		—	2,017	2,107	2,195	2,283	2,366	2,920

a. Actual outlays for FY2000.

b. The Senate and conference budget resolutions called for an $85 billion tax rebate in FY2001, which was accounted for in the Allowances function (920) on the outlay side of the budget.
c. Actual outlays for FY2001
MSR – Mid-Session Review.
NA – Not available.

The conference report on the congressional budget resolution for FY2002 showed federal outlays increasing by a little over $3 billion between FY2001 and FY2002. But this small increase was somewhat misleading. Outlays for FY2001 were increased in the resolution by the $85 billion needed to accommodate the advance tax rebate checks as part of the later-adopted tax cut. Without that one-time $85 billion increase in FY2001 outlays, the conference report's outlay growth was similar to that in the President's proposals.

The emergency supplemental appropriations in the fall of 2001 raised total outlays above the levels in the budget resolution or the revised estimates in the August budget reports from the Administration and CBO. The $15 billion airline stabilization legislation (P.L. 107-42) will add up to $5 billion in outlays to the FY2002 total (some of the money from this legislation was spent in the last days of FY2001). The loan guarantee portion of the law ($10 billion), if used, will direct financial market resources to the airlines but will generate outlays for the government only if a borrower defaults.

Both CBO and Administration estimates from early 2002, reflecting changed circumstances, pushed total outlays for FY2002 slightly above $2 trillion. The Administration's July 2002 MSR actually lowered FY2002 outlay estimates (by $11 billion) from the February 2002 estimates. Some of this reduction came from policy changes that raised outlays by less than the Administration expected and some came from differences between the earlier and the current economic and technical assumptions underlying the budget estimates. The Administration's FY2002 outlay estimate (in the MSR of July 2002), $2,033 billion, is $74 billion larger than the President's original outlay proposal ($1,959 billion) in February 2001. CBO's August 2002 Budget and Economic Outlook: Update (B&E 2002) showed a $16 billion increase in outlays for FY2002 since its March budget report, raising its estimates of total outlays for the year to $2,017 billion.

Receipts

The Administration's February 2001 original budget proposals (in the *Blueprint* and in the April *Budget*) included a proposed $1.6 trillion tax cut over 10 years. The President's proposals would lower marginal rates, address the marriage penalty issue, and change a host of other federal taxes (see CRS Report RS20819, *President Bush's Tax Proposal: A Brief Overview*, for more information).

Congress adopted (May 26, 2001) an 11-year, $1.35 trillion tax cut bill (H.R. 1836) that the President signed on June 7 (P.L. 107-16). The legislation flowed from the reconciliation instructions contained in the congressional budget resolution for FY2002 (H.Con.Res. 83; H.Rept. 107-60). The tax cut was estimated to reduce FY2001 revenues by $74 billion, FY2002 taxes by $38 billion, and as it phased in over time, reduce revenues by larger amounts. As passed, all provisions of the legislation would expire at the end of calendar year 2010.[7]

Even with the tax cuts, the August 2001 MSR estimated that FY2002 receipts would be larger (by $122 billion, 6.1%) than in FY2001.[8] CBO's 2001 mid-year report showed similar increases in receipts between FY2001 and FY2002. The August 2001 MSR showed that the changes in policy and economic assumptions between the April and August budget reports reduced receipts in the next few years (from what had been expected) but increased them in FY2005 and beyond. The net result was a $74 billion increase in 10-year cumulative receipts in the August estimates compared to the April estimates.

Table 3. Receipts for FY2000-2006 and FY2011

(in billions of dollars)

	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2011
OMB Clinton Baseline 1/16/01	$2,025 [a]	$2,125	$2,210	$2,301	$2,401	$2,525	$2,649	$3,434
CBO Baseline 1/31/01		2,135	2,236	2,343	2,453	2,570	2,689	3,447
President's Budget Blueprint 2/28/01		2,137	2,190	2,258	2,339	2,436	2,528	3,233
House budget resolution 3/28/01		2,129	2,168	2,260	2,344	2,437	2,521	3,206
Senate budget resolution 4/6/01		2,134	2,177	2,284	2,380	2,474	2,565	3,279
President's Budget 4/9/01		2,137	2,192	2,258	2,339	2,438	2,529	3,233
OMB Baseline 4/9/01		2,137	2,221	2,324	2,438	2,569	2,698	3,483
Conference on budget resolution 5/10/01		2,135	2,171	2,267	2,369	2,473	2,551	3,256
CBO revised baseline 5/18/01		2,115	2,226	2,338	2,453	2,570	2,689	3,447
CBO reest. of Pres.'s budget 5/18/01		2,115	2,201	2,275	2,359	2,440	2,517	3,165
President's MSR 8/22/01		2,013	2,135	2,220	2,328	2,463	2,553	3,245
Pres. MSR baseline for FY2002 8/22/01		2,013	2,135	2,222	2,334	2,476	2,573	3,383
CBO Update 8/28/01		2,011	2,134	2,196	2,307	2,438	2,543	3,341
CBO Outlook 1/31/02		*1,990*[b]	1,983	2,070	2,206	2,342	2,447	3,277
OMB FY03 baseline est. 2/4/02		—	2,011	2,121	2,234	2,366	2,461	NA
OMB FY03 prop., est. 2/4/02		—	1,946	2,048	2,175	2,338	2,455	NA
CBO reestimate of Pres.'s budget, 3/6/02		—	1,942	2,013	2,150	2,314	2,442	3,143
CBO revised baseline, 3/6/02		—	2,006	2,086	2,209	2,342	2,448	3,279
House budget res. 3/20/02		—	1,968	2,077	2,200	2,356	2,471	NA
OMB MSR 7/15/02		—	1,867	2,029	2,169	2,351	2,451	NA
OMB MSR baseline 7/15/02		—	1,868	2,035	2,180	2,369	2,475	NA
CBO Update 7/27/02		—	1,860	1,962	2,083	2,244	2,381	3,243

a. Actual receipts for FY2000.
b. Actual receipts for FY2001.
MSR – Mid-Session Review.
NA – Not available

[7]In 2002, the Administration and some in Congress proposed making the tax cuts permanent.

[8]The large uncertainties currently surrounding the budget outlook at that time, made the August 2001 estimates a poor guide to the budget's future look.

CBO's January 2002 estimates reflected the deterioration in the receipt outlook as part of the worsening of the overall budget outlook. In these estimates, receipts *fall* by $8 billion between FY2001 and FY2002 (both years have smaller receipts than previously estimated). OMB's updated numbers from February 2002 also showed receipts falling (by $45 billion) between FY2001 and FY2002. The expectations of a weaker economy (than expected in earlier estimates) and changes in the technical relationships in the budget models generated much of the change in receipt outlook between August 2001 and early 2002.

Congress passed the Job Creation and Worker Assistance Act of 2002 on March 8, 2002 (H.R. 3090; P.L.107-147, March 9, 2002), further reducing FY2002 estimated receipts by $43 billion. The Administration's MSR for FY2003 (July 15, 2002) incorporated this policy change along with the steep fall-off in receipts in FY2002 as well as other changes in deriving its revised (and final) estimate for FY2002. FY2002 receipts in the MSR are down to $1,867 billion, $80 billion less than the Administration's February 2002 estimate and $120 billion below receipts in FY2001. CBO's August 2002 *Update* put FY2002 receipts at $1,860 billion, $146 billion below its March 2002 baseline estimate and $350 billion below its original baseline revenue estimate in January 2001.

Surpluses or Deficits

Surpluses or deficits are the residuals left after Congress and the President determine the level of spending and receipts. Reducing the deficit and eventually reaching a balanced budget or generating and keeping a surplus (the government had its first surplus in 30 years in FY1998) has been a major focus of the budget debate for over a decade. The original baseline projections from both OMB and CBO (in early 2001 for FY2002) showed substantial and growing surpluses, both on- and off-budget, through FY2011. The question at that time became, what to do with the surpluses? Policy changes such as tax cuts or spending increases can be used to reduce surpluses. External events such as an economic downturn, unexpected events, and changes in underlying technical assumptions can (and have over the last year) reduce surpluses. If surpluses are not reduced by these actions or events, they will be used to reduce federal debt held by the public. The President's original FY2002 proposals and the congressional budget resolution for FY2002 would have combined the three: cut taxes, raised spending for selected activities (while cutting others), and reduced federal debt held by the public by attempting to reserve an amount equal to the Social Security surplus and, originally, some of the non-Social Security (or on-budget) surplus for reducing debt held by the public.

The events and policy changes of 2001 drastically altered the surplus outlook that had been forecast early in 2001. Instead of large and growing surpluses, the early and mid-year 2002 budget estimates from the Administration and CBO (contained in their FY2003 budget proposals or reports) now expected *deficits* over the next few years after which small but growing surpluses return. The originally estimated (early in 2001) baseline FY2002 surplus of $283 billion (OMB) to $313 billion (CBO) has become an expected deficit exceeding $150 billion (OMB, July 2002 and CBO, August 2002).

The first reported indication that the expectation of large and growing surpluses was faltering came in the summer 2001 budget reports from OMB and CBO. These two reports indicated that there would be little or no non-Social Security surplus available in FY2002 for any purpose. In CBO's estimates, the total surplus fell below the estimated size of the Social Security surplus in FY2001, FY2003, and FY2004 (by relatively small amounts; a total surplus smaller than the reported size of the Social Security surplus leaves the government with a surplus and the ability to reduce the amount of outstanding debt held by the public.) OMB's MSR from August 2001 put the total surplus barely above the Social Security surplus for FY2002.

Table 4. Surpluses/Deficits(-) for FY2000-FY2006 and FY2011

(in billions of dollars)

	FY2000	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2011
OMB Clinton Baseline 1/16/01	*$236* [a]	$256	$277	$307	$343	$380	$446	$810
CBO Baseline 1/31/01		281	313	359	397	433	505	889
President's Budget Blueprint 2/28/01		281	231	246	268	273	307	524
House budget resolution 3/28/01		272	227	253	259	261	285	488
Senate budget resolution 4/6/01		186	198	238	257	265	294	503
President's Budget 4/9/01		281	231	242	262	269	305	526
OMB Baseline 4/9/01		284	283	334	387	439	515	903
Conference on budget resolution 5/10/01		186	219	247	266	277	295	514
CBO revised baseline 5/18/01		275	304	353	400	437	508	883
CBO reest. of Pres.'s budget 5/18/01		272	257	262	274	262	283	440
President's MSR 8/22/01		158	173	195	217	254	281	484
Pres. MSR baseline 8/22/01		158	187	211	250	304	342	686
CBO Update 8/28/01		153	176	172	201	244	289	628
CBO Outlook for 1/23/02		*127* [b]	-21	-14	54	103	128	439
OMB FY2003 baseline 2/4/02		—	-9	51	109	169	196	NA
OMB FY2003 prop., 2/4/02		—	-106	-80	-14	61	86	NA
CBO reestimate of Pres.'s budget 3/6/02		—	-90	-121	-51	24	48	150
CBO revised baseline, 3/6/02		—	5	6	61	111	135	454
House budget res. 3/20/02		—	-66	-46	8	67	89	NA
OMB MSR 7/15/02		—	-165	-109	-48	53	60	NA
OMB MSR baseline 7/15/02		—	-150	-62	17	137	174	NA
CBO Update 7/27/02		—	-157	-145	-111	-39	15	323

a. Actual surplus for FY2000.
b. Actual surplus for FY2001.

The original policy proposals from the Administration reduced the baseline surplus by $52 billion in FY2002 (from $283 billion to $231 billion) and by a cumulative $2.2 trillion over the projection period.[9] Reductions in the total surplus would come from the then expected on-budget part of the surplus – the

[9]The Administration released its initial proposals in *A Blueprint for New Beginnings* in February 2001 and released the full, multi-volume set of budget documents in April 2001.

Administration did not propose any changes in the off-budget surplus in FY2002 (and only insignificant changes throughout the budget forecast years). Since the congressional budget resolution adopted many of the President's proposals, the surpluses were similar in both. (Even with the expected return of deficits, the off-budget accounts, mainly Social Security, remain in surplus.)

Table 5. Projected Cumulative On-Budget Surpluses/Deficits (-); FY2002-2006 and FY2002-2011

(in billions of dollars)

	FY2002-FY2006	FY2002-FY2011
OMB Clinton Baseline 1/16/01	$694	$2,447
CBO baseline 1/31/01	988	3,122
President's Budget Blueprint 2/28/01	261	842
House budget resolution 3/28/01	264	754
Senate budget resolution 4/6/01	234	787
President's Budget 4/9/01	244	841
OMB baseline 2/28/01	895	3,045
Conference budget resolution 5/10/01	283	897
CBO revised baseline 5/18/01	980	3,141
CBO reest. of Pres.'s budget 5/18/01	321	698
President's MSR 8/22/01 [a]	60	575
President's MSR baseline 8/22/01	235	1,304
CBO Update 8/28/01	49	847
CBO Outlook 1/31/02	-722	-742
President's FY03 budget baseline 2/4/02	-459	NA
President's FY03 budget 2/4/02	-1,027	NA
CBO reestimate of President's budget, 3/6/02	-1,155	-1,950
CBO revised baseline, 3/6/02	-645	-590
House budget resolution 3/20/02	-922	NA
OMB MSR 7/15/02	-1,181	NA
OMB MSR baseline 7/15/02	-859	NA
CBO Update 8/27/02	-1,383	-2,011

a. Includes the Postal Service accounts, which have a minimal affect on the totals for the periods.
MSR – Mid-Session Review.
NA – Not available

At the beginning of 2001, the prospect of very large *on-budget* surpluses continuing into the next decade produced a general agreement among budget participants to reserve for debt reduction at least that portion of the total surplus attributed to the Social Security accounts. Some suggestions were made at the time to expand the reserved amount to include Medicare's surplus. The revised budget outlook from August 2001 ended the effort to expand the reserved amount and made more difficult the effort to reserve even the Social Security surplus exclusively for debt reduction. These revised estimates did not provide much room to finance new spending or additional tax reduction initiatives during these years without using the Social Security surpluses or finding offsets within existing spending or receipts. The revised estimates in 2002 showing budget in deficit means that none of the Social

Security surplus can be used to reduce federal debt held by the public. Table 5 shows estimates and projections for cumulative on-budget surpluses for FY2002– FY2006 and for FY2002 – FY2011 from OMB, CBO and the congressional budget resolutions.

The President's original proposals and the congressional budget resolution would have reserved the off-budget portion (Social Security) of the surplus for reducing the debt. Approximately two-thirds of the then estimated on-budget baseline surplus (somewhat over $2 trillion) in the President's budget and the congressional budget resolution would be used for tax cuts and higher spending (a substantial portion of the expected higher spending would be higher-than-baseline interest costs) over the 10 years. The remaining portion of the on-budget surplus would be reserved for contingencies or additional debt reduction. The August 2001 revised estimates showed that the adopted tax cut (P.L. 107-16) used about as much of the on-budget surplus as earlier estimates expected; changes in the underlying budget assumptions (the economic and technical assumptions) eliminated most of the rest of the previously expected on-budget surpluses.

Surpluses not used for increased spending or tax cuts and that actually occur are used by the Treasury, pretty much automatically, to reduce federal debt held by the public, which is what happened to the surpluses generated during the FY1998 through 2001 period. The Treasury can also take, and has taken, a more active role in retiring debt held by the public by purchasing securities from the financial markets and retiring some callable federal bonds.

One result of the originally expected large surpluses was the then expected disappearance of much federal debt held by the public sometime in the latter half of the decade.[10] The August 2001 budget reports, like the earlier ones, showed much of the debt disappearing late in the decade. Such an eventuality would have presented the government with the problem of what to do with surplus cash that cannot be used for debt reduction. CBO called these cash balances "uncommitted funds" which both it and OMB assumed would be invested in unspecified ways in the private sector to provide a financial return to the government. The re-emergence of deficits and relatively small surpluses in the future have made moot the possibility of eliminating most federal debt held by the public in the next 10 years.

The Budget and the Economy

The budget and the economy affect each other. The relationship is an unequal one, with the economy shoving and pushing around the budget with every economic twinge while even substantial changes in policy may disappear in the economy with little notice or consequence. The influence that economic conditions can have on the

[10]Somewhere between $800 billion and $1.2 trillion in federal debt held by the public was expected to remain outstanding by the end of FY2011. The amount outstanding at the end of FY2001 (September 30, 2001) was $3.32 trillion. Federal debt held by federal government accounts, which is not affected by the government's overall surplus (or deficit) will continue to increase throughout the period.

budget became obvious over the past year. The deterioration in the economy and its negative effects on the budget became apparent in the budget reports from CBO and OMB August 2001. Both reports reflected the economic slump's effect on the budget. The worsening economic outlook (along with policy changes and changes in technical assumptions) reduced the size of the expected surplus for FY2002.

Until the revised budget estimates in August 2001 (and the subsequent ones in 2002), the original positive budget outlook for FY2002 had been buoyed by the favorable economic conditions that were then expected. Such a trend would have continued the overall improvement in the budget situation since the early 1990s. Much of the improvement had come from strong and sustained economic growth. When those favorable economic conditions faltered over the last year, so did a portion of the good budget fortunes of the previous few years. What good economic conditions give, bad economic conditions can take away. The unexpectedly lengthy economic sluggishness in 2000, the start of a recession in March 2001, the continuing economic uncertainty, the lengthy fall in the stock market, the policy responses to the September 2001 terrorist attacks, along with negative changes in the technical components of the budget estimates have raised outlays, reduced receipts, and eliminated the surplus for FY2002.

CBO's budget report, *The Budget and Economic Outlook: Fiscal Years 2002-2011* (January 2001), in its chapter on *The Uncertainties of Budget Projections*, indicated how significantly the budget can be altered by changes in economic conditions and related technical factors. CBO repeated this analysis in its January 2002 report, *The Budget and Economic Outlook: Fiscal Years 2003-2012* (January 2002). The chapters contain optimistic and pessimistic alternative scenarios for its baseline projection. The optimistic scenario assumes that the very good economic and budget conditions of the last few years would continue indefinitely (which has been proven incorrect by events, at least in the short-term). The pessimistic scenario assumes that the favorable conditions of the last few years have been unusual and that the economy (and the budget) revert to the conditions that are less positive (which may be overly pessimistic).

Table 6. CBO's Alternative Scenarios, Cumulative Surpluses/Deficits(-); FY2002-2006 and FY2002-2011
(in billions of dollars)

	FY2002-FY2006	FY2002-FY2011
CBO Optimistic Scenario Total Surplus 1/31/01	$2,927	$8,856
CBO Baseline 1/31/01	2,007	5,610
CBO Pessimistic Scenario Total Surplus 1/31/01	920	1,627
CBO Optimistic Scenario Total Surplus 1/31/02	956	4,589
CBO Baseline 1/31/02	250	1,602
CBO Pessimistic Scenario Total Surplus 1/31/02	-538	-1,795

Source: CBO, *The Budget and Economic Outlook: Fiscal Years 2003-2012*, Jan. 2002.

The numbers in Table 6 are from both the January 2001 and January 2002 CBO budget reports. The optimistic scenario from January 2002 has a smaller cumulative surplus for the FY2002 through FY2011 period ($4,589 billion) than the *baseline* scenario had in the January 2001 report ($5,610 billion). The pessimistic scenario in the current report shows cumulative *deficits* over the 10-year period, while the one from last year projected cumulative surpluses. (CBO's *Update* from August 2002 shows a cumulative surplus for these years of $336 billion, a substantial move towards the January 2002 pessimistic scenario.)

The data in Table 6 reflect the wide range of possible budget outcomes resulting from differences between the assumed and actual conditions underlying the budget and that these conditions tend to shift over time. The differences reflected in one year's set of scenarios result from the different assumptions about economic and other underlying conditions rather than any difference in policy assumptions. The same policies are assumed in each set of scenarios.

The presidential budget documents usually include a table showing the budget's sensitivity to economic assumptions (in recent years, this is found in an early chapter of the Analytical Perspectives volume of the budget). The effects of the variables are generally symmetrical. A higher rate of economic growth has approximately the same effect on the budget as same-sized slower rate of economic growth has, but in the opposite direction. If a 1% lower rate of economic growth reduces the surplus (or increases the deficit) by $26 billion in one year (an approximate amount from the OMB table; Table 2-6, p. 30, *The budget of the United States Government, Fiscal Year 2003, Analytical Perspectives*), a 1% higher rate of economic growth would increase the surplus (or reduce the deficit) by $26 billion. For FY2002, the President's FY2003 budget indicates that sustained reduction of 1% in the real rate of real gross domestic product (GDP) growth would increase the currently estimated deficit by $11.5 billion (a sustained 1% *higher* rate of real economic growth would have a similar effect on the surplus in the opposite direction). Changes in other variables generally have smaller estimated effects on the budgetary balance than changes in real GDP growth. Larger or sustained changes in the underlying economic variables tend to produce larger changes in the budget numbers.

For Additional Reading

CRS Electronic Briefing Book, *Taxation*, [http://www.congress.gov/brbk/html/ebtxr1.shtml]

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