Order Code IB10102

Issue Brief for Congress
Received through the CRS Web

The Budget for Fiscal Year 2003

Updated August 2, 2002

Philip D. Winters
Government and Finance Division

CONTENTS

The Budget for Fiscal Year 2002

SUMMARY

The Administration's revised budget estimates in the Mid-Session Review (July 15, 2002), reflecting the unexpected fall-off in revenues in fiscal year (FY) 2002 among other factors, raised the FY2003 estimated deficit to $109 billion from the $80 billion in the original proposals. Other analysts expect the deficit for the year to be substantially larger.

The President released his budget proposals for FY2003 on February 4, 2002, shortly after the release of the Congressional Budget Office's (CBO) annual budget report (January 31, 2002). The baseline estimates for FY2003 in these reports showed a small surplus ($41 billion) from the Administration and a small deficit ($14 billion) from CBO. The President's proposals produced an $80 billion deficit.

The deficits expected in (both FY2002 and) FY2003 would be the first since FY1997. The weak economy, the government's budgetary response to the terrorist attacks of last fall, the tax cut (P.L. 107-16, the Economic Growth and Tax Relief Reconciliation Act of 2001) adopted in June 2001, and changes in the technical components of budget models reduced or eliminated the surpluses that were forecast for this year in last year's budget documents.

The President's budget proposed tax cuts and spending increases to stimulate the economy, rapid increases in defense and homeland security spending, and a selection of other spending increases and decreases in discretionary spending.

In early March 2002, CBO released updated baselines and estimates of the President's budget using CBO's economic and technical estimating assumptions. Somewhat better than expected economic conditions and small technical changes result in a baseline surplus of $6 billion for FY2003, assuming no policy changes. The CBO estimates of the Administration's policies produced a deficit of $121 billion for the year.

The Administration's economic stimulus proposal was superseded by legislation adopted by Congress on March 7, 2002 (The Job Creation and Worker Assistance Act of 2002; P.L. 107-147), that would increase the deficit (from baseline levels) by an estimated $43 billion in FY2003.

The House Budget Committee adopted its version of the FY2003 budget resolution on March 13, 2003. The House passed the resolution on March 20. The resolution contained a deficit of $46 billion for the year. Like the President's budget, much of the focus is on waging the war on terrorism and on homeland security.

The Senate Budget Committee reported its version of the FY2003 budget resolution (S.Con.Res. 100) on March 22. Its provisions for defense and homeland security are similar to (but not the same as) those in the House resolution and the President's budget. The Senate has not considered the Senate Budget Committee's resolution. (By mid-summer 2002, many observers did not expect Congress to adopt a budget resolution for FY2003.)

The House began adopting appropriations for the new year in late June. As of August 1, the House had passed five and the Senate three of the 13 regular appropriations for the new fiscal year.

MOST RECENT DEVELOPMENTS

The Administration's Mid-Session Review (July 15, 2002) lifted the fiscal year (FY) estimated deficit to $108 billion. The increase from the President's original proposal reflected lower revenues, larger mandatory and defense spending, and lower nondefense spending than previously expected. Slightly earlier in the summer, Congress began considering the appropriation bills for the new fiscal year. By August 1, 2002, the House had cleared five and the Senate had passed three of the 13 regular appropriations bills. Congress had also cleared a $29 billion supplemental appropriations bill for FY2002 (H.R. 4775) that will generate spending in both FY2002 and FY2003.

The actions on appropriations are taking place without the guidance of a completed congressional budget resolution for FY2003. The House passed its version of the concurrent resolution (H.Con.Res. 353; H.Rept. 107-376) on March 20, 2002. The Senate Budget Committee reported its version of the budget resolution (S.Con.Res. 100; S.Rept. 107-141) on March 22. Since then, disagreements over the level of discretionary spending, additional tax cuts, and other policy disputes have bogged down, and possibly forestalled, the adoption of a budget resolution for FY2003.

Earlier, the President had presented his FY2003 budget on February 4, 2002 (prepared by the Office of Management and Budget – OMB). It proposed a deficit of $80 billion, $2,128 billion in outlays, and $2,048 billion in receipts. The recession in 2001, expectations of a slower growing economy, the decline in revenue collections, the government's response to the terrorist attacks in the fall of 2001, the economic stimulus bill adopted in March 2002, and the tax cut adopted in June 2001, all contributed to the substantial deterioration in the short- and long-term budget outlooks since the previous budget reports issued by CBO and OMB in 2001.

BACKGROUND AND ANALYSIS

Presidents generally submit their budget proposals for the upcoming fiscal year early in each calendar year. The Bush Administration presented its FY2003 budget documents on February 4, 2002. The budget documents contained 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

The annual budget cycle provides the President and Congress with the opportunity to set policy for the upcoming fiscal year and to partially determine policy in subsequent years. The decisions made for this year can and often do have repercussions for years into the future. Last year's tax cut (the Economic Growth and Tax Relief Reconciliation Act of 2001 – EGTRRA; P.L. 107-16; June 7, 2001) will change federal revenues in each year through 2010, when most of its provisions are scheduled to sunset. Although they are provided each year in appropriations bills, changes in the level of discretionary spending this year can influence future levels of discretionary spending.

Table 1 contains budget estimates and proposals for FY2002 and FY2003 from the CBO, the Administration (OMB), and, as they become available, budget proposals and estimates from Congress. Differences in totals occur because of differing underlying economic, technical, and budget-estimating assumptions and techniques as well as differences in policy proposals. Most *policy* differences between the Administration and various congressional proposals for the upcoming fiscal year are often relatively small in dollars compared to the budget as a whole. These often small changes, reflecting differing policy choices, may have large implications for the shape and content of the budget over extended time periods. As the budget works its way through Congress, budget totals may be expected to change from the amounts originally proposed.

Table 1. Budget Proposals and Estimates for FY2003 (and FY2002)

(in billions of dollars)

	Receipts	Outlays	Deficit(-)/ Surplus
Actual for FY2001	*1,991*	*1,864*	*127*
CBO Budget Outlook for **FY2002** 1/31/02	1,983	2,003	-21
President's Budget for **FY2002** 2/4/02	1,946	2,052	-106
President's Budget for **FY2002** *baseline* 2/4/02	2,011	2,020	-9
CBO revised baseline for **FY2002** 3/6/02	2,006	2,001	5
CBO estimate of President's Budget for **FY2002** 3/6/02	1,942	2,033	-90
House budget resolution for **FY2002** 313/02	1,968	2,033	-66
OMB MSR **FY2002** 7/15/02	1,867	2,032	-165
OMB MSR baseline**FY2002** 7/15/02	1,868	2,018	-150
CBO Budget Outlook for **FY2003** 1/31/02	2,070	2,085	-14
President's Budget for **FY2003** 2/4/02	2,048	2,128	-80
President's Budget for **FY2003** *baseline* 2/4/02	2,121	2,070	51
CBO revised baseline for **FY2003**[a] 3/6/02	2,086	2,080	6
CBO estimate of President's Budget for **FY2003** 3/6/02	2,013	2,134	-121
House budget resolution for **FY2003** 3/20/02	2,077	2,122	-46
Senate Budget Committee for **FY2003** 3/22/02	2,046	2,139	-92
OMB MSR **FY2003** 7/15/02	2,029	2,138	-109
OMB MSR baseline **FY2003** 7/15/02	2,035	2,097	-62

[a] These numbers exclude the effects of the economic stimulus law (P.L. 107-147) enacted on March 9, 2001
MSR – Mid-session review

Budget Proposals and Estimates

Budget proposals and estimates depend on underlying assumptions about the economy, technical components and relationships within the budget estimating models, and assumptions about current and future policies used in the budget proposals and baseline estimates. This year, possibly more so than in other recent years, both the expected underlying economic conditions and the policy choices under consideration appear less settled among the OMB, CBO, and congressional proposals and estimates than usual.

CBO's initial budget report for FY2003, the *Budget and Economic Outlook: Fiscal Years 2003-2012* (January 2002), contained baseline estimates and projections for FY2002 through FY2012.[1] CBO estimated that without any changes from current policy, the FY2003 budget would have $2,070 billion in revenues, $2,085 billion in outlays, with a (rounded) deficit of $14 billion. Over the 10-year forecast period (FY2003 - FY2012) CBO's projections produce a cumulative surplus of $2,263 billion. Of that amount, $1,078 billion is generated in the last two years of the projection period when the 2001 tax cuts fully sunset as required by current law.[2] The 5-year (FY2003 - FY2007) cumulative surplus, reflecting the deficits and relatively small surpluses expected over this period, is $437 billion.

President Bush's FY2003 budget proposed receipts of $2,048 billion, outlays of $2,128 billion, with a resulting deficit of $80 billion. The Administration's proposals produced a 10-year total cumulative surplus of $1.0 trillion. Its 5-year cumulative surplus was $157 billion. (The President's budget provided most data for the 5-year period, FY2003 through FY2007; the budget provided very little data for either the individual years beyond FY2007 or cumulatively for the 10-year period, FY2003 through FY2012.)

The Administration's current services baseline estimates (the Administration's estimate of what the budget numbers would be without policy changes) show receipts of $2,121 billion, outlays of $2,080 billion, with a resulting surplus of $41 billion.[3] The differences between these baseline numbers and the proposed amounts measure the cost, in FY2003, of the Administration's proposals. The proposals would increase outlays by $58 billion, reduce receipts by $73 billion, and move the current services baseline from a $41 billion surplus to an $80 billion deficit. Over the FY2003 through FY2007 period, the time period covered by the Administration's baseline estimates, the baseline estimates show a cumulative surplus

[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 formulated under fairly explicit rules. They are not meant to predict future budget outcomes.

[2] CBO estimated that extending the expiring provisions immediately would reduce cumulative revenues over the 10year period by $735 billion. The implication is that the cumulative surplus over the 10-years would be reduced by at least as much and probably by more if higher interest costs are included.

[3] The Administration also produced a variant of the standard baseline. The alternative assumed that the increased (mostly) emergency spending in FY2002 flowing from the September 11, 2001 terrorist attacks was a one-time event and would not be repeated. Making this assumption increases the baseline surplus to $51 billion in FY2003. The Administration measured its policy against this altered baseline. This report uses the standard baseline.

of $668 billion, meaning that the Administration's proposals reduce the cumulative baseline surplus by $511 billion over the 5 years.

CBO's estimate of the Administration's proposals (*An Analysis of the President's Budgetary Proposals for Fiscal Year 2003*, March 2002), using CBO's economic and technical assumptions, raises the estimated deficit for FY2003 (from the Administration's proposed $80 billion) to $121 billion. CBO's reestimates reduce revenues by $35 billion and increase outlays by $6 billion from the Administration's numbers, producing the $41 billion difference in the deficit estimate.

The CBO report also included updated CBO's baseline estimates that made relatively small changes in the estimates for FY2003. The updated numbers show a surplus of $6 billion for FY2003, instead of the $14 billion deficit estimated in January. Most of the change occurred because of higher expected revenues ($15 billion) and slightly smaller expected outlays ($5 billion).[4] Expectations of better short-term economic conditions produced most of the improvement in the budget outlook.[5] Over the 10-year CBO forecast period, the changes increased the cumulative surplus from $2,263 billion to $2,380 billion, a 5% increase over the January cumulative surplus estimate. The updated baseline estimates increased the cumulative 5-year (FY2003-FY2007) surplus from $437 billion to $489 billion, a 12% increase. (Unofficial early summer 2002 estimates, based on budget data for FY2002, indicate a further deterioration in the budget outlook, implying larger than previously expected deficits for the year.)

The House passed budget resolution (H.Con.Res. 353; March 20, 2002) followed, in general, the policy lead of the President's budget. Using the same underlying budget assumptions as the Administration, the resolution has revenues of $2,077 billion, outlays of $2,123 billion, with a deficit of $46 billion. The resolution, like the President's budget, contained estimates and projections for 5 years, through FY2007. The resolution expects the government to return to a small surplus in FY2004. Over the 5-year period, the resolution produces a cumulative surplus of $231 billion.

The Senate Budget Committee reported its version of the FY2003 budget resolution (S.Con.Res. 100; S.Rept. 107-141) on March 22. Using CBO's underlying assumptions (rather than the Administration's), the Senate Budget Committee resolution provides similar amounts of funding in FY2003 for defense and homeland security as the House passed resolution. Total revenues were $2,046 billion, total outlays were $2,139 billion, and the resolution had a deficit of $92 billion (most of the difference between the House and Senate Budget Committees' total for FY2003 was from differences in the underlying assumptions used rather than policy differences although there were also policy differences).

---

[4] CBO estimates that incorporating the effects of the economic stimulus package signed into law (P.L.107-147) on March 9, 2002, (and not included in CBO's revised baseline) produces a $40 billion deficit in FY2003.

[5] The $20 billion improvement in the budget balance represents only 1% of total receipts or outlays for the year. Relatively small changes in the underlying factors supporting the budget estimates can easily change receipts or outlays by larger amounts than this without any change in policy.

The Mid-Session Review (MSR) from the Administration forecast a rapid recovery for both the economy and federal revenues. Under these and other assumptions in the MSR, the deficit will fall from FY2002 to FY2003 (from $165 billion to $109 billion), a result not shared by many other analysts of the government's budget. To achieve this result, the MSR has receipts growing 8.7% between FY2002 and FY2003 (with corporate income tax receipts rebounding by 22.1% between FY2002 and FY2003 after falling 4.2% between FY2001 and FY2002), nondefense discretionary spending grows by 5.3% while defense spending grows by 11.7%, and mandatory spending increases by 5.1%.

Criticism of the budget estimates and analysis in the MSR has centered on the expected rapid recovery in revenues in the short-term, the required slow rate of growth in nondefense discretionary spending, the costs of Administration or congressional proposals that are likely to occur, and the revenue loss that can be expected from extending expiring tax credits. The critics generally believe that the MSR overstates future revenues, understates future outlays, and has smaller and shorter lasting deficits than are warranted by the data available.

Part of the annual budget debate's intensity results from the awareness that the decisions made for this year affect, in some cases substantially, the funding levels or policy choices available to Congress in future years.

Uncertainty in Budget Projections

All budget estimates and projections are inherently uncertain. Their dependence on assumptions that are themselves subject to substantial uncertainty and variation makes budget estimates and projections susceptible to fairly rapid and dramatic changes. Nonetheless, budget estimates can help differentiate alternative budget proposals and the effects and approximate magnitudes of various policy proposals even if the estimates do not match the actual outcomes.

The uncertainty of budget estimates was visibly apparent during the last year. The baseline estimates for the current fiscal year, 2002, that were produced early in 2001 projected surpluses of between $283 billion (OMB) and $313 billion (CBO). The Administration's 2001 proposals for FY2002, a combination of tax cuts and spending increases, would have reduced the surplus to an estimated $231 billion. Current baseline estimates (July 2002, MSR, OMB) for FY2002 show a deficit of $150 billion, while OMB's policy estimate for the year has a deficit of $165 billion. The large baseline surpluses expected early last year evaporated in a weak economy, the June 2001 tax cut, the spending increases in response to the terrorist attacks of September 2001, and changes in the technical components and relationships underlying the budget estimates.

The unavoidable inaccuracy of budget projections is also obvious over longer periods of time. As CBO stated in its January 2002 budget report,

> Uncertainty compounds as the projection horizon lengthens. Even small annual differences in the many key factors that influence the budget projections – factors such as inflation, increases in productivity, economic growth, the distribution of

income, and growth rates from Medicare and Medicaid spending – can add to substantial differences in the budget outcome 10 years from now.[6]

One can obtain a sense of longer-range uncertainty by comparing projections for FY2001 made in 1996 with the actual amounts for FY2001. The President's budget for FY1997 (March 1996) included projections through FY2002. CBO's *Economic and Budget Outlook: Fiscal Years 1997-2006* (May 1996) contained 10-year projections. The Administration projected a current services baseline deficit of $131 billion. The President's budget proposed eliminating the expected deficit and producing a FY2001 surplus of $8 billion through proposed policy changes. CBO projected a baseline deficit of $259 billion for FY2001.[7] The actual result for FY2001 was a surplus of $127 billion. The large turnaround in the budget balance in 5 years as well as the change in budget estimates that occurred over the last year provide a warning when considering long-term policy changes based on current projections.

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

Budget Action

Congress considered and passed an economic stimulus bill in early March 2002. The legislation, the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147; March 9, 2002) increases FY2003's expected deficit by an estimated $43 billion (plus another $3 billion in higher interest costs). The legislation, passed as an economic stimulus package, extends unemployment benefits, reduces selected business taxes, extends selected expiring tax provisions, and makes miscellaneous technical corrections to the tax code.

The House Budget Committee approved its version of the concurrent resolution (H.Con.Res. 353) on the budget for FY2003 on March 13, 2001. The resolution used a slightly modified version of OMB's economic and technical assumptions rather than CBO's. Like the President's budget this year, the resolution extended its projections 5 years into the future rather than the 10 years that had been used in the last few years.

The resolution has a $46 billion deficit for FY2003 that closely matches the estimated cost of the economic stimulus bill adopted days earlier. It includes almost $28 billion in unspecified tax cuts over 5 years (with upper limits for the size of the cuts for each year), a $46 billion year-over-year increase in budget authority for defense, close to a doubling of funding for homeland security between FY2002 and FY2003, and very small increases (overall) for remaining discretionary spending. The resolution was adopted in committee on a party-line vote. The House adopted the resolution on March 20.

---

[6] CBO, *The Budget and Economic Outlook: Fiscal Years 2003-2012*, Jan. 2002, pp. 5-6.

[7] The CBO deficit estimate assumed that discretionary spending would grow at the rate of inflation, as then estimated, after FY1998.

The Senate Budget Committee adopted its version of the budget resolution (S.Con.Res. 100) on March 22. The Committee's resolution differed substantially in policy choices, in areas other than defense and homeland security, from the one adopted by the House. Although many of the differences are relatively small in FY2003, they become more significant over the years covered by the two resolutions. The Senate Budget Committee's resolution extends through FY2012. The Senate has not considered the Committee's resolution.

To avoid delaying consideration of appropriations, the House adopted a deeming resolution (H.Res. 428) on May 22, 2002 (see CRS Report RL31443, *The "Deeming Resolution": A Budget Enforcement Tool*, by Robert Keith). This set spending levels to be followed by the Appropriations Committee. The Senate has yet to adopt the budget resolution for the year or a deeming resolution. In spite of the lack guidance from a completed budget resolution, the House has adopted five and the Senate has passed three of the 13 regular appropriations bills for FY2003 as of August 1.

Outlays

The President's budget proposed total outlays of $2.138 trillion for FY2003, $76 billion over the Administration's proposed FY2002 level.[8] The year-to-year change is composed of proposed policy changes, approximately $26 billion in the President's proposal, and relatively automatic growth in outlays in mandatory programs resulting from inflation adjustments and demand growth. CBO's estimates of the President's budget puts the year-to-year increase in outlays at $101 billion. Of that amount, CBO estimates that $22 billion resulted from proposed policy changes with the rest coming from inflation adjustment and demand growth. Outlays in the Administration's baseline estimates (excluding the effects of policy change) increase by $50 billion from FY2002 to FY2003.

The Administration's proposals would raise FY2003 outlays by $58 billion over the FY2003 baseline estimate, measuring the effect of its policy proposals on outlays for the year. The proposals include an increase in defense spending of $21 billion, proposed farm support legislation would increase outlays by another $7 billion, and the proposed "bipartisan economic security plan" would add $8 billion to the overall increase. The remaining proposed policy increases were scattered throughout other categories of spending.

Over the 5 years covered in detail in the President's budget (FY2003-FY2007), total outlays would rise from $2,052 billion in FY2002 to $2,128 billion in FY2003 to $2,468 billion in FY2007. The average annual rate of growth in outlays over the FY2003 through FY2007 period is 3.8% a year, almost the exact same rate of growth as over the previous 5-year period (FY1997-FY2002). Over the 5 years, the Administration proposes cumulative outlays of $11,431 billion. (Over 10 years, FY2003-FY2012, shown in a few tables, the Administration proposes cumulative outlays of $25,478 billion.)

[8] The Administration proposed a $32 billion increase in FY2002 outlays above baseline levels, most of which was for its proposed "bipartisan economic security plan." The FY2002 estimate also did not include any outlays that might flow from the adoption of the Administration's $27 billion (in budget authority) supplemental spending request sent to Congress on March 21, 2002.

Table 2. Outlays for FY2001-2007
(in billions of dollars)

	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007
CBO Outlook 1/31/02	*$1,864* [a]	$2,003	$2,085	$2,152	$2,238	$2,319	$2,402
President's Budget 2/4/02		2,052	2,128	2,189	2,277	2,369	2,468
OMB Baseline 2/4/02		2,020	2,080	2,142	2,218	2,289	2,366
CBO Revised Baseline[b] 3/6/02		2,001	2,080	2,148	2,231	2,312	2,394
CBO Estimate of Pres.'s Budget 3/6/02		2,033	2,134	2,201	2,291	2,394	2,493
House Budget Resolution 3/13/02		2,033	2,123	2,192	2,289	2,383	2,479
SBC Budget Resolution 3/22/02		—	2,139	2,207	2,313	2,403	2,496
OMB MSR 7/15/02		2,032	2,138	2,217	2,298	2,390	2,483
OMB MSR baseline 7/15/02		2,018	2,097	2,163	2,232	2,301	2,376

SBC = Senate Budget Committee
a. Actual outlays for FY2001.
b. These numbers exclude the effects of the economic stimulus law (P.L. 107-147) enacted on March 9, 2001

CBO's estimates of the Administration's proposals raise FY2003 total outlays by $6 billion. CBO's 5-year cumulative estimate of the President's policy proposals differs by only $81 billion, of which $44 billion results from higher net interest payments.[9] Over the longer 10-year period, CBO's estimates increase cumulative outlays above the President's budget by $296 billion, slightly over a 1% increase. Most of the annual differences between the OMB and CBO estimates of the President's outlay proposals are also relatively small compared to total outlays in those years.

The outlays proposed in the House passed budget resolution (H.Con.Res. 353) are similar to the ones contained in the President's budget. The House Budget Committee, in producing the resolution, used the Administration's underlying assumptions and followed many of the policy proposals, ensuring a close similarity between the two proposals. The Committee report (H.Rept. 107-376) compares the budget resolution to the President's proposals (see pages 74-75 in the report). Total outlays in the budget resolution are $5 billion smaller than the President's proposed total outlays for FY2003, but larger in each subsequent year. Over the 5 years covered by the two proposals, cumulative outlays in the House budget resolution are $35 billion larger than the President's proposed cumulative outlays, with both increases and decreases to components of the budget – compared to the President's proposals – scattered throughout the budget.

The Senate Budget Committee's budget resolution used CBO's underlying assumptions, in contrast to the House's use of OMB assumptions. This difference by itself would assure somewhat different numbers in the two budget resolutions even if they contained the same policy assumptions (which they do not). The Senate Budget Committee's budget resolution follows the policies of the House and Administration outlay levels for defense and homeland security in FY2003 and FY2004, and in general the spending levels for mandatory programs,

---

[9] CBO's larger deficits and smaller surpluses in its estimates of the President's budget policies slow the reduction in federal debt held by the public compared to the level in the Administration's budget. The larger debt held by the public in the CBO estimate raises the amount of net interest that the government must pay.

although the proposed policies for mandatory programs differ. Spending for non-defense, non-homeland security discretionary spending in the Senate Budget Committee budget resolution differs from the allocations found in the House passed budget resolution and the amounts contained in the President's budget. Many of these differences are relatively small in FY2003 but grow over time.

The House passed and the Senate Budget Committee reported budget resolutions, as well as the President's budget, would all provide a large boost in defense outlays from FY2002 to FY2003 of approximately 9%, using each proposal's own numbers. Between FY2003 and FY2007 (the last year shown in the House and presidential budget proposals) the President's budget and the House budget resolution show defense outlays growing by almost 4% annually. The Senate Budget Committee passed budget resolution has defense outlays growing annually by 2% during these years.

Non-defense discretionary spending also gets a larger boost between FY2002 and FY2003 than in subsequent years in the three proposals. The President's budget shows these outlays growing by 4.5%, the House budget resolution by 5.0%, and the Senate Budget Committee budget resolution by 8.2% between FY2002 and FY2003. The average rate of growth for non-defense discretionary spending in subsequent years in all three proposals is less than 2%, a rate that will not maintain spending for these programs against inflation or population growth. (By comparison, the CBO March baseline estimates of non-defense discretionary spending shows them growing by 2.7% annually in subsequent years, a rate designed to adjust spending for inflation but not population growth.)

The Administration's MSR raised total outlay by $10 billion over the original proposal in February 2002. Two-thirds of the increase results from adopted or proposed policy changes and the remaining third is attributed to economic and technical estimating changes. Over the five-year period (FY2003-FY2007) covered in the MSR, cumulative outlays are 0.8% higher than in the February budget proposals. Compared to the original February proposals, discretionary spending shrinks (by 1.2%) while mandatory spending increases (by 1.6%) and net interest increases (by 3.4%) over the five years.

Receipts

The President's February budget proposal showed that receipts would increase by $102 billion from FY2002 to FY2003, reflecting the Administration's proposed tax reductions in both FY2002 and FY2003. Without the Administration's proposed tax reduction of $65 billion in FY2002 and $73 billion in FY2003, receipts would increase by $110 billion between the two years (see **Table 3**). CBO's estimates of the President's proposals put the year-to-year increase at $71 billion.

The President's budget also proposed making much of the tax cut adopted last year, the EGTRRA, permanent, along with extending a number of tax provisions scheduled to expire during the next 10 years. Under current law, most provisions of last year's tax cut would expire at the end of calendar year 2010, although some expire sooner. Making the tax cuts permanent would have little effect in FY2003, but would reduce receipts substantially in FY2011 and 2012 from baseline levels.

The Administration estimates that its EGTRRA proposals would reduce revenues by $7 billion between FY2003 and FY2007 and by $343 billion between FY2003 and FY2012. CBO and the Joint Committee on Taxation estimate that extending the provisions expiring in 2010 would reduce revenue by $9 billion between FY2003 and FY2007 and by $374 billion between FY2003 and FY2012 (most of the revenue reduction, $356 billion, occurs in the last two years).[10] The Administration also proposed extending the research and experimentation (R&E) tax credit, which would reduce revenues by an estimated $14 billion to $15 billion over the FY2003 to FY2007 period and by $51 billion to $54 billion over the FY2003 to FY2012 period. CBO and the Joint Committee on Taxation estimate that extending all the other expiring tax provisions expiring through FY2012 (including the R&E tax credit) would reduce revenues by an estimated $78 billion between FY2003 and FY2007 and by $205 billion between FY2003 and FY2012.[11]

Table 3. Receipts for FY2001-2007

(in billions of dollars)

	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007
CBO Outlook 1/31/02	*$1,991* [a]	$1,983	$2,070	$2,206	$2,342	$2,447	$2,568
President's Budget for FY2003 2/4/02		1,946	2,048	2,175	2,338	2,455	2,571
OMB Baseline 2/4/02		2,011	2,121	2,234	2,366	2,461	2,581
CBO Revised Baseline [b] 3/6/02		2,006	2,086	2,209	2,342	2,448	2,569
CBO Estimate of Pres.'s Budget 3/6/02		1,942	2,013	2,150	2,314	2,442	2,560
House Budget Resolution 3/13/02		1,968	2,077	2,200	2,356	2,472	2,593
SBC Budget Resolution 3/22/02		—	2,046	2,180	2,338	2,464	2,586
OMB MSR 7/15/02		1,867	2,029	2,169	2,351	2,451	2,567
OMB MSR baseline 7/15/02		1,863	2,035	2,180	2,369	2,475	2,595

SBC = Senate Budget Committee.

a. Actual receipts for FY2001.

b. These numbers exclude the effects of the economic stimulus law (P.L. 107-147) enacted on March 9, 2001

The House passed budget resolution would increase receipts by $110 billion between the two years, with both FY2002 and FY2003 showing higher revenues than the President's budget. The House resolution reflected the revenue effects of the adoption of the Job Creation and Worker Assistance Act of 2002 (JCWAA), which reduces receipts by $43 billion in FY2002 and $39 billion in FY2003 (as estimated by the Joint Committee on Taxation). The resolution accommodates $28 billion in unspecified additional tax reductions through FY2007. It also accepts, although with relatively little effect because of the assumed offsets in the years covered by the resolution, the Administration's proposals to remove EGTRRA's sunset provisions.

[10] Making permanent the provisions of the 2001 tax cut expiring before 2010 produce estimated revenue reductions of $36 billion between FY2002 and FY2007 and $194 billion between FY2003 and FY2012.

[11] The reduced revenues in thee various estimates increase deficits or reduce surpluses raising the federal debt above the level under current law. This increases the government's net interest payments over the period.

The Senate Budget Committee's reported budget resolution shows receipts increasing by $83 billion between FY2002 to FY2003. Like the House resolution, the Senate Budget Committee resolution reflects the revenue effects of the adoption of the JCWAA. The Senate Budget Committee resolution assumes no changes to the existing sunset provisions of EGTRRA. The resolution further assumes that any proposed revenue reductions be offset to avoid a net reduction in receipts.

The estimates in the Administration's MSR reflected the deterioration in revenue collections (in FY2002) as well as policy , economic, and technical changes since the February proposals. Receipts for each year in the MSR estimate are below those in the February proposals except for FY2005 when they are somewhat higher. For FY2003, changes in the underlying economic and technical assumptions reduced receipts by $51 billion below the February proposal. Enacted legislation and changed proposals raised receipts by $1 billion (compared to February proposals – the Administration's economic stimulus proposal contained larger tax cuts than the legislation that became law). The combined effect dropped receipts for FY2003 by almost $20 billion from earlier in the year. (Revised FY2002 estimated receipts in the MSR, reflecting the substantial fall in receipts so far in FY2002, dropped much more than the FY2003 numbers, shrinking by almost $91 billion from the February estimate). The five-year (FY2003-FY2007) reduction in receipts in the MSR was $105 billion out of total estimated cumulative receipts of over $11.6 trillion.

Surpluses Or Deficits

Surpluses or deficits are the residuals left after Congress and the President determine the general 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 2002 for FY2003 through FY2007 or FY2012) showed modest deficits in the early years and small, but growing, surpluses in the years through FY2007 or FY2012.

In general, surpluses reduce federal debt held by the public (the government is able to retire some of the debt it created when it had deficits). An expected surplus can also be used to finance spending increases or tax reductions, either of which will reduce (or eliminate) the previously forecast surplus. The Treasury in its normal debt management operations will use the surplus to reduce federal debt held by the public. The Treasury has over the four years of surplus (FY1998-FY2001) taken an active role in retiring debt held by the public by purchasing securities on the market and retiring some callable federal bonds. (The Treasury also could retain the cash generated by a surplus and build up government cash balances, but this would make little sense for the government or the economy and seems unlikely.)

The President's proposals and the House passed budget resolution for FY2003 would use the then forecast baseline surpluses to increase spending and cut taxes. The small remaining surpluses in future years in these proposals would be used to reduce the debt held by the public. The budget resolution passed by the Senate Budget Committee would have used the surplus for some spending increases and the rest for reducing the debt held by the public. None of the proposals reserved the entire Social Security surplus for debt reduction (a goal striven for in the budget proposals last year).

The budget outlook-changing events of 2001 (the terrorist attacks, the weakened economy, and policy changes), as reflected in revised budget forecasts in 2002, ended the 2001 forecasts of substantial and growing surpluses throughout the forecast period. The early 2002 budget estimates and forecasts expected a small ($14 billion – CBO) baseline deficit or a small ($41 billion – OMB) surplus in FY2003. The President's budget proposal included a deficit of $80 billion. CBO later (March 2002) estimated that the President's proposals would produce a $121 billion deficit in FY2003. The MSR raised the Administration's estimate of the deficit to $109 billion in FY2003 (with a baseline deficit of $62 billion for the year). The continued deterioration in the FY2002 budget outlook, particularly the slow-down in revenue collections, produced much of the change in the Administration's estimate for FY2003. (CBO's mid-year budget update is expected late in August 2002).

Table 4. Deficits(-)/Surpluses for FY2001-FY2007
(in billions of dollars)

	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007
CBO Outlook 1/31/02	*$127* [a]	-$21	-$14	$54	$103	$128	$166
President's Budget for FY2003 2/4/02		-106	-80	-14	61	86	104
OMB Baseline 2/4/02		-9	41	92	148	172	215
CBO Revised Baseline [b] 3/6/02		5	6	61	111	135	175
CBO Estimate of Pres.'s Budget 3/6/02		-90	-121	-51	24	48	68
House Budget Resolution 3/13/02		-66	-46	8	67	89	113
SBC Budget Resolution 3/22/02		—	-92	-27	26	60	90
OMB MSR 7/15/02		-165	-109	-48	53	60	80
OMB MSR baseline 7/15/02		-150	-62	17	137	174	219

SBC = Senate Budget Committee.
a. Actual surplus for FY2001.
b. These numbers exclude the effects of the economic stimulus law (P.L. 107-147) enacted on March 9, 2001
MSR – Mid-Session Review

In early 2001, the prospect of very large surpluses, including *on-budget* surpluses, continuing through the 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.[12] Some suggestions were made at the time to expand the reserved amount to include the Medicare surplus. The revised budget outlooks released by OMB and CBO in 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. The 2002 budget forecasts ended any remaining efforts to retain the Social Security surplus (or any surplus) for reductions in the debt held by the public.

[12] The off-budget accounts include the Social Security and Postal Service Accounts. The surpluses or deficits of the Postal Service accounts are very small compared to the Social Security surpluses.

The Budget and the Economy

The budget and the economy affect each other. The relationship is an unequal one, with the economy influencing the budget with every economic twinge while even substantial policy changes may disappear in the overall economy with little notice or consequence.

Until the release of the revised, more negative budget estimates in August 2001, the earlier positive budget forecasts in 2001 had been buoyed by the continuation of favorable economic conditions into future years. The previous (to August 2001) economic outlook supported the expectations of continuing overall improvement in the budget situation since the early 1990s. Much of the budget improvement since the mid 1990s came from strong and sustained economic growth along with the congressional and presidential efforts to balance the budget. If those favorable economic conditions should falter (as they did last year), so would a major underpinning 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, the start of a recession in March 2001, (along with the budgetary responses to the September 2001 terrorist attacks and the weakened economy along with policy changes), have raised outlays, reduced receipts, and substantially changed the budget balance expectations and magnitude from what was forecast a year ago.

CBO's budget report, *The Budget and Economic Outlook: Fiscal Years 2003-2012* (January 2002) in its chapter on *The Uncertainties of Budget Projections*, indicated how significantly the budget outlook can be altered by changing the underlying in economic assumptions. The chapter contains optimistic and pessimistic alternative scenarios, along with its baseline projection (see **Table 5**). The optimistic scenario assumes that the positive underlying economic and other factors of the last few years would continue indefinitely. The pessimistic scenario assumes that the favorable conditions of the last few years have been an aberration and that the economy and other underlying factors revert to the conditions that prevailed previously.

Table 5. CBO's Alternative Scenarios, Cumulative Surpluses/Deficits(-); FY2003-2007 and FY2003-2012

(in billions of dollars)

	FY2003-FY2007	FY2003-FY2012
CBO Optimistic Scenario Total Surplus 1/31/02	$1,448	$5,926
CBO Baseline 1/31/02	416	2,243
CBO Pessimistic Scenario Total Surplus 1/31/02	-732	-1,979

The result of CBO's exercise is a wide range of possible budget outcomes. Under the optimistic scenario, the surpluses accumulate over the 10-year period (FY2003-2012) to almost $6 trillion. Under the pessimistic scenario, a string of deficits appear, accumulating to almost $2 trillion over the same 10 years. The two scenarios' budget balances diverge over the 10 years by $8 trillion. Even for FY2003, the differences between the two scenarios is relatively wide, ranging from a surplus of $61 billion in the optimistic scenario to a deficit of $101 billion in the pessimistic scenario.[13]

In addition to the alternative scenarios, CBO provides estimates of the effects on the budget of changes in selected economic assumptions underlying the budget estimates and projections (see appendix A in the *Budget and Economic Outlook: Fiscal Years 2003-2012*, January 2002). OMB provides similar measures in the President's budget (see chapter 1 in the Analytical Perspectives volume of the *Budget of the United States Government for FY2003*). Both CBO and OMB estimate that a sustained reduction of 1% in the real rate of GDP growth beginning in early 2002, would reduce the surplus by approximately $30 billion in FY2003 and by growing amounts in subsequent years. Estimates are provided in both reports for the effects on the budget of selected economic variables – real economic growth, inflation, unemployment, and interest rates. Larger changes in the underlying economic variables would produce larger changes in the budget numbers.

LEGISLATION

H.Con.Res. 353

The Concurrent Resolution on the Budget for Fiscal Year 2003. Adopted by the House Budget Committee (H.Rept. 107-376) on March 15, 2001, on a party line vote after rejecting numerous amendments. It follows most of the proposals of the Administration. It was adopted by the House on March 20.

S.Con.Res. 100

The Concurrent Resolution on the Budget for Fiscal Year 2003. Adopted by the Senate Budget Committee (H.Rept. 107-141) on March 22, 2001, on a party line vote. Its proposals for defense and homeland security were similar to those of the Administration, but differed in many other areas of the budget.

CONGRESSIONAL HEARINGS, REPORTS, AND DOCUMENTS

U.S. Congress. House. Committee on the Budget. *Concurrent Resolution on the Budget – FY2003; Report to Accompany H.Con.Res. 353*. March 15, 2002 Washington, U.S. G.P.O., 2002. (107th Congress, 2nd session. H.Rept. 107-376).

— Senate. Committee on the Budget. *Concurrent Resolution on the Budget – FY2003; Report to Accompany S.Con.Res.100*. April 11, 2002 Washington, U.S. G.P.O.., 2002. (107th Congress, 2nd session. S.Rept. 107-141).

[13] The $160 billion range in FY2003 approximates 8% of receipts or outlays in that year. Between January 2001 and January 2002, CBO's baseline estimate of receipts for FY2003 fell by 11.7% and its estimate of outlays rose by 5.1%. Between August 2001 and January 2002, CBO's estimate of receipts for FY2003 fell by 5.7% and outlays rose by 3.0%.

FOR ADDITIONAL READING

Also see the CRS Electronic Briefing Book on Taxation at:
[http://www.congress.gov/brbk/html/ebtxr1.shtml]

U.S. Congressional Budget Office. *An Analysis of the President's Budgetary Proposals for FY2003.* Washington, March, 2002.

——*The Budget and Economic Outlook: Fiscal Years 2003-2012*. Washington, U.S. Govt. Print. Off., January 31, 2001.

U.S. Office of Management and Budget. *The Budget of the United States Government for Fiscal Year 2002*. Washington, U.S. Govt. Print. Off., February 4, 2002.

——*Fiscal Year 2003 Mid-Session Review*. July 15, 2002.

U.S. Council of Economic Advisors. *Economic Report of the President*. Washington, U.S. Govt. Print. Off., February 2002.

CRS Products

CRS Report RL31406. *Supplemental Appropriations for FY2002: Combating Terrorism and Other Issues*, by Amy Belasco and Larry Nowels

CRS Issue Brief IB10096. *Congressional Budget Actions in 2002*, by Bill Heniff Jr.

CRS Report 95-543. *The Financial Outlook for Social Security and Medicare*, by David Koitz and Geoffrey Kollmann.

CRS Report RL30839. *Income Tax Cuts, the Business Cycle, and Economic Growth: A Macroeconomic Analysis*, by Marc Labonte and Gail Makinen.

CRS Report 98-720. *Manual on the Federal Budget Process*, by Robert Keith and Allen Schick.

CRS Report RL30854. *Uncertainty in Budget Projections*, by Philip Winters.