

Summary

The budget deficit expected for this year has grown and the surpluses anticipated for the coming decade have diminished under the Congressional Budget Office's (CBO's) new baseline projections. A sharp decline in tax revenues coupled with double-digit growth in spending will produce a deficit of about \$157 billion in fiscal year 2002, CBO estimates. If current tax and spending policies are maintained, deficits are likely to persist for a few years before giving way to small surpluses. Between 2003 and 2009, those annual deficits and surpluses would generally equal less than 1 percent of the nation's gross domestic product (GDP) and roughly balance out. For the 10-year period from 2003 through 2012, CBO's baseline projects a total surplus of \$1.0 trillion. However, most of that amount would be realized after 2010, when the tax cuts enacted last year are scheduled to expire.

CBO constructs its baseline according to rules specified in law. Basically, those rules involve extending current

laws and policies into the future and estimating their effect on the budget. The resulting baseline projections serve as a neutral benchmark that lawmakers can use to measure the effects of proposed changes in revenue and spending policies.

Those projections should be viewed cautiously, however. They are not intended to be a forecast of future outcomes. Indeed, actual budget figures will almost certainly differ from CBO's baseline projections because of future economic developments, legislative actions, and technical errors in estimating.

The Budget Outlook

After four consecutive years of budget surpluses, CBO is projecting a series of gradually declining deficits for 2002 through 2005 under current policies (*see Summary Table 1*). Those deficits add up to about \$450 billion—or about 1 percent of GDP. The surpluses projected

Summary Table 1.

The Budget Outlook Under Current Policies

(In billions of dollars)

	Actual 2001	2002	2003	2004	2005	2006	2007	Total, 2003- 2007	Total, 2003- 2012
On-Budget Surplus or Deficit (-)	-34	-314	-315	-299	-246	-209	-190	-1,259	-1,513
Off-Budget Surplus ^a	<u>161</u>	<u>157</u>	<u>170</u>	<u>188</u>	<u>207</u>	<u>224</u>	<u>242</u>	<u>1,031</u>	<u>2,527</u>
Total Surplus or Deficit (-)	127	-157	-145	-111	-39	15	52	-229	1,015

Source: Congressional Budget Office.

a. Off-budget surpluses comprise surpluses in the Social Security trust funds as well as the net cash flow of the Postal Service.

Summary Table 2.**Changes in CBO's Baseline Projections of the Surplus Since March 2002**

(In billions of dollars)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003- 2007	Total, 2003- 2012
Total Surplus as Projected in March 2002	5	6	61	111	135	175	213	263	309	454	653	489	2,380
Changes													
Revenues													
Legislative	-43	-40	-30	-4	15	16	16	13	10	7	4	-43	7
Economic	*	-22	-35	-32	-20	-10	1	10	20	31	41	-119	-16
Technical	-104	-61	-61	-62	-61	-62	-66	-72	-74	-74	-75	-307	-668
Total	-146	-124	-126	-98	-66	-56	-50	-49	-45	-36	-30	-469	-678
Outlays													
Discretionary spending													
Supplemental													
appropriations	6	23	23	25	26	27	28	28	28	30	30	123	268
Other	-4	-2	-3	-4	-4	-3	-2	-2	-1	*	2	-16	-19
Subtotal	2	21	19	21	22	24	25	26	28	30	32	108	250
Debt service	1	13	23	27	33	40	49	57	64	71	78	136	456
Other	13	-6	4	5	-1	4	*	-2	-5	-7	-9	5	-18
Total	16	28	47	52	54	68	75	81	87	95	102	249	688
Total Effect on the Surplus	-162	-151	-173	-150	-120	-123	-124	-130	-132	-131	-131	-718	-1,366
Total Surplus or Deficit (-) as Projected in August 2002	-157	-145	-111	-39	15	52	88	133	177	323	522	-229	1,015
Memorandum:													
Changes in Outlays Because of Supplemental Appropriations, by Type of Discretionary Spending													
Defense	5	15	14	14	14	15	15	16	16	17	17	73	153
Nondefense	1	7	8	10	12	12	13	13	13	13	14	50	116

Source: Congressional Budget Office.

Note: * = between -\$500 million and \$500 million.

for the following few years are relatively small, averaging 0.5 percent of GDP from 2006 through 2009. (By comparison, the surpluses recorded from 1998 through 2001 averaged 1.5 percent of GDP.) For the 2003-2012 period, the baseline projects a cumulative surplus of \$1.0 trillion, of which \$845 billion occurs in 2011 and 2012. Over those 10 years, the Social Security trust funds are projected to accumulate a surplus of \$2.5 trillion, while the rest of the budget records a deficit totaling \$1.5 trillion.

The total surplus projected for the 2003-2012 period is nearly \$1.4 trillion smaller than CBO estimated in March, when it published its previous baseline (*see Summary Table 2*). That change is almost equally divided between reductions to revenue estimates and increases in spending estimates.

CBO is projecting \$678 billion less in federal revenues for the 10-year period than it did in March. Much of that reduction reflects tax collections so far in 2002,

which have been much lower than anticipated. CBO will not have data to analyze the sources of that shortfall until later this year, but both temporary and permanent factors were probably involved. Among the temporary factors, the drop in the stock market seems likely to have reduced tax receipts from realizations of capital gains. In addition, taxpayers appear to have paid more of their taxes than usual through withholding in 2001 and less in final payments in 2002. But the drop in revenues went far beyond what can be explained either by such temporary factors or by the reported weakness of incomes during the recent recession. That additional shortfall could persist and possibly even grow over time.

CBO has raised its projection of federal spending during the 2003-2012 period by a similar amount: \$688 billion. More than one-third of that increase stems from enactment of the 2002 Supplemental Appropriations Act for Further Recovery From and Response to Terrorist Attacks on the United States, which provided \$24 billion in additional budget authority in 2002.¹ Under the rules of the Deficit Control Act, baseline projections must assume that annual appropriations for discretionary programs will continue at the current level, with increases for the rates of inflation projected each year. As a result, enactment of those supplemental appropriations causes discretionary outlays in CBO's baseline to rise by a total of \$268 billion from 2003 through 2012.

About two-thirds of the increase since March in projected outlays over the 10-year period stems from higher projections of federal interest costs (because of the reduction in revenue estimates and the increase in other outlays). By 2012, debt held by the public is projected to total \$2.7 trillion, more than double the \$1.1 trillion figure in the March baseline. As a result, interest payments are projected to be \$456 billion higher over 10 years than CBO estimated in March.

1. The supplemental appropriation law also included \$5.1 billion in budget authority that was designated by the Congress as contingent emergency funding. That money would have become available only if the President had agreed to the designation. Because he did not make that designation, the money was not released and therefore is not included in CBO's projections.

The Administration also recently updated its baseline budget estimates.² CBO and the Office of Management and Budget (OMB) anticipate similar budget totals for this year, but their projections diverge—sometimes significantly—for the following 10 years. Some of that divergence reflects the timing of the two sets of estimates. The economic forecast underlying OMB's current-services estimates was completed before the stock market dropped precipitously and the Bureau of Economic Analysis revised economic data for the past three years. Also, the Administration's budget projections were prepared before enactment of the recent supplemental appropriation law.

OMB is projecting a deficit of \$71 billion for 2003 and a tiny surplus (\$1 billion) for 2004, whereas CBO's baseline projections do not show a surplus until 2006. For the 10-year period, OMB estimates a cumulative surplus of \$2.3 trillion—nearly \$1.3 trillion greater than CBO's projection.

That difference in the cumulative surplus is almost equally attributable to differences in projections of revenues and of outlays. Most of the variation in revenue projections occurs because CBO is forecasting slower growth of GDP and its major income component, wage and salary disbursements, through 2005. CBO's higher spending projection for the 2003-2012 period mostly reflects the supplemental appropriation law and higher debt-service costs.

The Economic Outlook

CBO believes that the economy will continue its modest recovery this year and strengthen next year. Real (inflation-adjusted) GDP is forecast to grow by 2.3 percent in calendar year 2002 and by 3.0 percent in 2003 (see *Summary Table 3*). A moderate but steady rise in consumer spending will continue to provide the foundations for that growth—augmented, CBO estimates, by the rapid upswing in federal spending in 2002 and by a

2. See Office of Management and Budget, *Mid-Session Review, Budget of the United States Government, Fiscal Year 2003* (July 15, 2002).

gradual recovery in corporate spending by the end of the year, which will continue through 2003.

The unemployment rate is expected to remain around 6 percent until the second half of 2003 but then decline slightly. Inflation, as measured by the consumer price index for all urban consumers, is projected to rise from 1.7 percent this year to a still-modest 2.4 percent in

2003. Interest rates on 10-year Treasury notes are expected to average 4.9 percent in 2002 and 5.4 percent in 2003.

The persistence and strength of the economic recovery are uncertain, however. A major question is whether the large drop that the stock market has experienced since March will depress consumption and investment. Other

Summary Table 3.

CBO's Current and Previous Economic Projections for Calendar Years 2002 Through 2012 (Corrected, August 26, 2002)

	Forecast		Projected Annual Average	
	2002	2003	2004-2007	2008-2012
Nominal GDP (Billions of dollars)				
August 2002	10,429	10,912	13,414 ^a	17,358 ^b
March 2002	10,521	11,092	13,639 ^a	17,532 ^b
Nominal GDP (Percentage change)				
August 2002	3.4	4.6	5.3	5.3
March 2002	3.1	5.4	5.3	5.1
Real GDP (Percentage change)				
August 2002	2.3	3.0	3.2	3.1
March 2002	1.7	3.4	3.2	3.1
GDP Price Index (Percentage change)				
August 2002	1.1	1.6	2.0	2.1
March 2002	1.4	2.0	2.0	2.0
Consumer Price Index ^c (Percentage change)				
August 2002	1.7	2.4	2.5	2.5
March 2002	1.8	2.5	2.5	2.5
Unemployment Rate (Percent)				
August 2002	5.9	5.9	5.3	5.2
March 2002	6.1	5.9	5.2	5.2
Three-Month Treasury Bill Rate (Percent)				
August 2002	1.7	2.9	4.9	4.9
March 2002	2.2	4.5	4.9	4.9
Ten-Year Treasury Note Rate (Percent)				
August 2002	4.9	5.4	5.8	5.8
March 2002	5.0	5.5	5.8	5.8

Source: Congressional Budget Office.

Notes: The March 2002 values for GDP and its components are based on data from the national income and product accounts before the July 2002 revision. However, some of the numbers for March 2002 in the printed version of this table were inadvertently drawn from CBO's January forecast. They are corrected here.

Percentage changes are year over year.

Year-by-year economic projections for calendar years 2002 through 2012 appear in Appendix B.

a. Level in 2007.

b. Level in 2012.

c. The consumer price index for all urban consumers.

unknowns about the economy include the extent to which the collapse in investment that occurred during the recent recession eliminated companies' excess capacity and the implications of volatility in the confidence of businesses, consumers, and investors.

CBO's economic projections for years after 2003 have changed little since March. Real GDP is still estimated to grow at an average rate of 3.2 percent a year through 2012. The projections for inflation, unemployment, and interest rates are also virtually the same as in March. As a result, the updating of CBO's economic outlook has had little overall effect on the budget projections for the 2003-2012 period.