



MONTHLY BUDGET REVIEW

Fiscal Year 2002

A Congressional Budget Office Analysis

Based on the *Monthly Treasury Statement* for September and the *Daily Treasury Statements* for October

November 8, 2002

The federal government recorded a total budget deficit of \$159 billion in fiscal year 2002, marking the end of five consecutive years of budget surpluses. The on-budget deficit of \$318 billion was \$285 billion larger than the on-budget deficit recorded in 2001 while the \$160 billion off-budget surplus, which encompasses transactions of the Social Security trust funds and the Postal Service, was about \$1 billion less than the corresponding figure for 2001.

FISCAL YEAR TOTALS (In billions of dollars)

	Actual 2000	Actual 2001	Actual 2002	Change from 2001
Receipts	2,025	1,991	1,853	-138
Outlays	1,789	1,864	2,012	148
Surplus/Deficit (-)	236	127	-159	-286
On-budget	87	-33	-318	-285
Off-budget	150	161	160	-1

SOURCE: Department of the Treasury.

The total deficit for fiscal year 2002 was \$159 billion, a net reversal of \$286 billion from the \$127 billion surplus recorded in fiscal year 2001. Receipts fell by \$138 billion, or almost 7 percent, the largest percentage decline since 1946. This was the second consecutive year of falling revenues, following increases averaging more than 8 percent per year from 1994 through 2000. Outlays topped the \$2 trillion level for the first time in 2002, increasing by almost 8 percent over the 2001 level. Excluding net interest costs, which fell by 17 percent, spending rose by a total of \$184 billion since 2001, an increase of more than 11 percent.

TOTAL RECEIPTS (In billions of dollars)

Major Source	Actual FY2001	Actual FY2002	Percentage Change
Individual Income	994	858	-13.7
Corporate Income	151	148	-2.0
Social Insurance	694	701	1.0
Other	<u>152</u>	<u>146</u>	-3.6
Total	1,991	1,853	-6.9

SOURCE: Department of the Treasury.

The decline in receipts in 2002 resulted primarily from a drop in individual income taxes and was caused by a

combination of factors, including a weak economy, a fall-off in capital gains realizations, and tax cuts enacted in the past two years. Even without those tax cuts, however, CBO estimates that receipts would have declined by 5.7 percent.

Receipts from individual income taxes declined by \$136 billion, or 13.7 percent. About \$105 billion of the decline occurred in nonwithheld receipts and refunds between February and May, when taxpayers filed their returns for tax year 2001. Information should become available over the next several months to explain the types of income that fell in 2001 and the distribution of income among taxpayers. Capital gains realizations are expected to play a prominent role in the decline, and other types of income probably fell as well. Changes in the distribution of income may also have contributed to the decline in receipts, and the tax cuts in 2001 played a small role. The remaining decline in individual income taxes—about \$30 billion—was mostly in withheld taxes or quarterly estimated payments. That decline was largely attributable to economic weakness in 2002 and the tax cuts enacted in the past two years.

The tax cuts in 2001 and 2002 held down growth in individual income taxes in 2002 because the personal tax cuts enacted partway through 2001 were in place for all of 2002, and some of the business tax cuts enacted in 2002 affected individual income taxes as well. Without those cuts, CBO estimates that individual receipts would have fallen by a smaller amount—10.1 percent—in 2002.

Receipts from sources other than individual income taxes were generally in line with their levels in 2001. Corporate receipts fell by \$3 billion, or 2 percent, in 2002. They were boosted early in the fiscal year by the legislated \$23 billion shift in estimated payments into October 2001, but they were reduced in the second half of the year by the business tax cuts. Without those effects from legislation, corporate receipts would have fallen by 8.2 percent in 2002, CBO estimates. Corporate receipts averaged annual growth of 8 percent from 1994 through 2000 but fell off sharply after corporate profits began declining in 2000.

NOTE: Unless otherwise indicated, the figures in this report include the Social Security trust funds and the Postal Service fund, which are off-budget. Numbers may not add up to totals because of rounding.

Social insurance receipts rose by \$7 billion, or 1 percent, in 2002, roughly in line with growth in wages and salaries in the national income accounts. Those receipts grew steadily in the period from 1994 through 2001, averaging annual growth of 6 percent. Receipts from other tax sources fell in 2002 by \$6 billion, or 3.6 percent. Receipts from those sources averaged 7 percent growth from 1994 to 2000 but fell in 2001.

TOTAL OUTLAYS
(In billions of dollars)

Major Category	Actual FY2001	Actual FY2002	Percentage Change	
			Actual	Adjusted ^a
Defense—Military	291	332	14.1	13.0
Social Security				
Benefits	426	448	5.2	5.2
Medicare	241	256	6.0	8.8
Medicaid	130	148	13.2	13.2
Unemployment				
Insurance	32	55	72.3	72.3
Other Programs and Activities	<u>528</u>	<u>594</u>	12.6	11.7
Subtotal	1,648	1,832	11.2	11.1
Net Interest on the Public Debt	<u>216</u>	<u>179</u>	-16.8	-16.8
Total	1,864	2,012	7.9	7.9

SOURCES: Department of the Treasury; CBO.

a. Excludes the effects of payments that were shifted because of week-ends, holidays, or legislative action.

A sharp increase in outlays for unemployment benefits and large increases in both defense and nondefense spending led to the largest percentage increase in noninterest spending since 1981. Such spending grew by about 7 percent in 2001 and by an average of about 4 percent per year from 1995 to 2000 (adjusted for shifts in payment dates).

After increasing at an average annual rate of 6 percent from 1999 to 2001, defense outlays grew by 13 percent in 2002 (after adjustments for shifts in payment dates). More than half of that growth was due to initiatives that were planned or funded before the September 11 attacks, CBO estimates. Most of the remaining growth probably supported the war on terrorism. The fastest growing components of defense spending were operations and maintenance (up by 16 percent), procurement (up by 14 percent), and military personnel (up by 13 percent).

The three major entitlement programs—Social Security, Medicare, and Medicaid—together accounted for about \$55 billion of additional spending, after adjusting for

timing shifts. Outlays for both Social Security and Medicare grew more slowly than they did last year, rising by 5.2 percent and 8.8 percent in 2002 compared with 5.8 percent and 9.2 percent, respectively, in 2001. But the 13.2 percent jump in Medicaid outlays was the biggest yearly increase since 1992.

Payments for unemployment benefits increased by \$22 billion, or 72 percent, as the unemployment rate rose from 4.4 percent in 2001 to 5.7 percent in 2002.

Outlays for other programs and activities, which are a mix of discretionary and mandatory programs, rose by \$66 billion, or almost 12 percent on an adjusted basis. Among the agencies posting the biggest gains were the departments of Education (18 percent), Transportation (13 percent), Health and Human Services—other than Medicare and Medicaid (13 percent), and Justice (16 percent). Much of that growth was fueled by significant increases in nondefense discretionary appropriations, which have increased by an average of 15 percent per year over the past two years. (Additional spending in response to the attacks of September 11 accounts for only a small portion of the 2002 outlay increase.)

Some smaller mandatory programs also grew rapidly, including student loans, refundable tax credits, Food Stamps, and veterans' benefits. Outlays also climbed because reductions in the estimated subsidy cost of various credit programs were smaller in 2002 than in 2001. Higher spending in those areas was partially offset by lower outlays for the Postal Service and for farm commodity programs.

ESTIMATES FOR OCTOBER
(In billions of dollars)

	Actual FY2002	Preliminary FY2003	Estimated Change
Receipts	157	124	-33
Outlays	165	177	13
Deficit (-)	-8	-53	-46

SOURCES: Department of the Treasury; CBO.

The deficit in October was about \$53 billion, CBO estimates, \$46 billion larger than the deficit in October 2001. Receipts were \$33 billion below last year's level, in part because receipts in October 2001 were bolstered by legislation that allowed corporations to delay about \$23 billion in estimated payments from September 2001. Estimated payments were back on their normal schedule this fiscal year. Outlays were about \$13 billion higher in October 2002 than in the same month last year, CBO estimates. Most of the increase was for defense, Social Security, Medicare, and unemployment benefits.