The Primary Deficit From 1962 to 2004

By Elizabeth Bell and Gene Steuerle

The primary surplus or deficit equals government receipts minus all outlays other than net interest. By excluding net interest, the primary surplus or deficit provides a more direct measure of overall government spending and taxing for a given fiscal year, as opposed to interest costs arising from past years.

The figure below illustrates historical changes in the primary surplus or deficit since 1962. The most striking aspect of the graph is the rapid rise and even more abrupt fall of the primary surplus/deficit from the late '90s to 2002 and 2003. Previous rises and drops, though frequent, have clearly been more moderate.

Not surprisingly, the sharper drops usually coincide with periods of recession. The period from 1974 to 1975 saw the trough of a business cycle, causing a drop in all major revenue categories. From 1982 to 1983, there was not only a recession, but those were also the primary years in which the individual tax rate cuts from the 1981 tax legislation were implemented, and the faster write-off of depreciation allowances began to have their maximum impact.

The period from 2000 to 2003 stands out as the greatest increase in the primary deficit in the nation’s history outside of World War Two. The fall from a surplus of 4.8 percent of GDP to a deficit of -2 percent is equal to over one-third the size of government, if measured by either total revenues or total spending. Notably, the surplus accumulation that began in the late '90s was due only slightly to decreased spending; the primary factor was a very large increase in personal income taxes, buoyed by large capital gains realizations. Much like the latter two historical periods mentioned above, the period from 2001 to 2002 — where the largest and most abrupt part of the drop occurred — saw both a recession and a tax cut, prompting a considerable 14 percent drop in individual income tax revenues. Compared to previous recessions, the 2001 downturn was relatively mild, but an increase in mandatory spending contributed to the drop as well.

After a three-year decline in revenues (as a percentage of GDP), CBO predicts that total revenues will begin to grow in 2004, albeit at a slower rate than nominal GDP. This slow recovery is unique to the 2001 recession: while in previous recessions the primary surplus began increasing again after one or two years, the deficit to GDP ratio has continued to decrease since 2000, and an upswing is not predicted until 2005.