



MONTHLY BUDGET REVIEW

Fiscal Year 2006

A Congressional Budget Office Analysis

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

November 6, 2006

The federal government recorded a total budget deficit of \$248 billion in fiscal year 2006, \$71 billion less than the deficit incurred in 2005. As a share of the nation's gross domestic product (GDP), the 2006 deficit was 1.9 percent—down from the 2.6 percent share recorded in 2005.

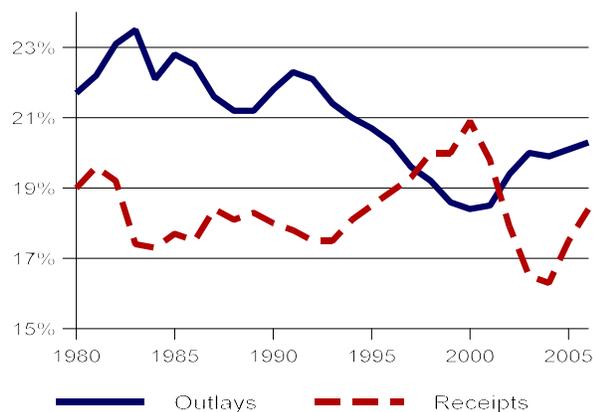
FISCAL YEAR TOTALS (Billions of dollars)

	2002	2003	2004	2005	2006
Receipts	1,853	1,783	1,880	2,153	2,407
Outlays	2,011	2,160	2,293	2,472	2,654
Deficit (-)	-158	-378	-413	-319	-248
Deficit (-) as a Percentage of GDP	-1.5	-3.5	-3.6	-2.6	-1.9

Sources: Department of the Treasury; CBO.

The federal budgetary situation improved in 2006 for the second consecutive year. As a percentage of GDP, the 2006 deficit was below the average of 2.3 percent since 1965.

RECEIPTS AND OUTLAYS AS A PERCENTAGE OF GDP



Sources: Department of the Treasury; CBO.

Receipts rose to \$2,407 billion in 2006, an increase of \$253 billion, or 11.8 percent, from 2005. That increase was lower than the 14.6 percent increase in 1981 but the second highest percentage increase since 1981. Receipts as a share of GDP rose to 18.4 percent, which is slightly above the average of 18.2 percent experienced since 1965.

Outlays also rose in 2006, up by about \$182 billion (or 7.4 percent) over their 2005 level. At 20.3 percent of

GDP, outlays reached a 10-year high in 2006 but were slightly under the average of 20.5 percent recorded between 1965 and 2005. They remain well below the levels recorded in the 1980s, when outlays averaged around 22 percent of GDP.

TOTAL RECEIPTS (Billions of dollars)

Major Source	2004	2005	2006	Percentage Change, 2005-2006
Individual Income	809	927	1,044	12.6
Corporate Income	189	278	354	27.2
Social Insurance	733	794	838	5.5
Other	148	154	171	11.3
Total	1,880	2,153	2,407	11.8
Percentage of GDP	16.3	17.5	18.4	n.a.

Sources: Department of the Treasury; CBO.

Note: n.a. = not applicable.

Receipts of individual income taxes, the largest tax source, increased by 12.6 percent in 2006. As a share of GDP, they rose for the second consecutive year, to about 8 percent in 2006, surpassing the percentages of the early 1990s but well below those experienced from the late 1990s through 2001. The fastest growing component in 2006 was nonwithheld receipts, which increased by 21 percent. That rapid increase probably resulted largely from significant growth in nonwage incomes, reflecting robust economic activity in 2005 and 2006.

Social insurance receipts rose by 5.5 percent in 2006, falling to 6.4 percent of GDP in 2006 from 6.5 percent in 2005. That share has not fluctuated much over the past 20 years.

Receipts of corporate income taxes increased by 27 percent in 2006, following growth in excess of 40 percent in both 2004 and 2005. As a result of those three strong years, corporate receipts as a share of GDP have risen from 1.2 percent in 2003, their lowest point since 1983, to 2.7 percent of GDP in 2006, their highest percentage since 1978. Investment tax incentives enacted in 2002 and

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.

2003 that expired at the end of calendar year 2004 contributed to the swing. Most of the strong growth in receipts in the past three years, however, probably reflected robust economic activity.

TOTAL OUTLAYS
(Billions of dollars)

Major Category	2004	2005	2006	Percentage Change, 2005-2006	
				Actual	Adjusted ^a
Defense—Military	437	474	499	5.3	6.1
Social Security					
Benefits	487	514	545	6.0	6.3
Medicare	300	336	378	12.6	16.5
Medicaid	176	182	181	-0.6	-0.6
Other Programs and Activities	<u>724</u>	<u>775</u>	<u>815</u>	5.2	6.5
Subtotal	2,125	2,281	2,418	6.0	7.3
Net Interest on the Public Debt	<u>168</u>	<u>191</u>	<u>237</u>	23.6	23.9
Total	2,293	2,472	2,654	7.4	8.6
Percentage of GDP	19.9	20.1	20.3	n.a.	n.a.

Sources: Department of the Treasury; CBO.

Note: n.a. = not applicable.

a. Excludes the effects of payments that were shifted because of weekends or legislated payment delays. Also excludes the August 2006 adjustment involving withheld taxes on Social Security benefits; instead, corrects the figures on a month-by-month basis.

After adjusting for shifts in the timing of certain payments, federal spending rose by 8.6 percent in 2006, the fastest rate of growth since 1990. As a result, outlays accounted for a growing share of GDP, rising from 20.1 percent last year to 20.3 percent in 2006. That growth was largely driven by higher interest costs on the public debt, payments for flood insurance and disaster assistance in response to the 2005 hurricanes, and Medicare's net costs for the new prescription drug benefit. Excluding those three areas, outlays represented 17.9 percent of GDP in 2006, below the 18.4 percent level for the same programs and activities last year.

The Department of Defense spent \$499 billion on military activities in 2006, 6.1 percent more than last year. Those activities have accounted for about 3.8 percent of GDP for the past three years, up from 2.9 percent in 2001. The Army posted the greatest growth in 2006—up by 8 percent, compared with 6 percent and 4 percent for the Navy and Air Force, respectively—primarily because of higher procurement costs related to operations in Iraq and Afghanistan.

Social Security outlays grew at roughly the same rate as the economy in 2006, leaving the program's share of GDP—4.2 percent in 2006—close to the 4.3 percent level averaged over the previous 10 years. By contrast, outlays

for the two major health care programs—Medicare and Medicaid—have grown rapidly since 2000, averaging annual gains of about 9 percent. Those two programs accounted for 4.3 percent of GDP in 2006, the highest level since the programs began in 1965. Over half of the 16.5 percent increase in Medicare outlays in 2006 was due to spending for the new prescription drug program. In contrast, Medicaid outlays declined slightly, in part because some costs previously paid by Medicaid were shifted to Medicare. It is not yet clear what other factors contributed to that decline.

Most of the increase in outlays for other programs and activities—up by \$50 billion on an adjusted basis—was due to higher spending by the Federal Emergency Management Agency (up by \$29 billion relative to its 2005 level in response to the 2005 Gulf Coast hurricanes) and by the Department of Education (up by \$21 billion mostly because of an increased volume of consolidated student loans and adjustments in the estimated subsidy costs of loans made in previous years). Apart from the higher spending for those two agencies, net spending for this category was unchanged relative to its level in 2005, because the increases for various agencies were largely offset by higher receipts from Medicare premiums, reductions in the estimated subsidy cost of several credit programs, and an increase in receipts from intragovernmental interest payments. The negligible change also reflects the modest growth in appropriations for nondefense programs in 2006, which increased by about 1 percent (excluding disaster-related funding).

Outlays for net interest on the public debt rose by 24 percent in 2006, primarily as a result of rising interest rates and higher inflation. Interest costs accounted for 1.8 percent of GDP in 2006, the highest level since 2001 but well below the 3.7 percent recorded in 1985.

ESTIMATES FOR OCTOBER
(Billions of dollars)

	Actual FY2006	Preliminary FY2007	Estimated Change
Receipts	149	167	18
Outlays	197	216	19
Deficit (-)	-47	-49	-1

Sources: Department of the Treasury; CBO.

CBO estimates that the government recorded a deficit of \$49 billion in October 2006, similar to the deficit recorded in the same month last year. Receipts for October 2006 were about \$18 billion, or 12 percent, higher than receipts last October, CBO estimates. Nonwithheld receipts rose by about \$6 billion (or 60 percent). That substantial increase was probably due in large part to a change in the Internal Revenue Service's procedures. Upon request, it now grants taxpayers an automatic six-month extension after mid-April to file their returns, rather than the previous four-month extension.