CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Peter R. Orszag, Director

May 18, 2007

The Honorable Kent Conrad
Chairman
Committee on the Budget
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

In response to your letter of May 11, 2007, the Congressional Budget Office (CBO) has reviewed the available data and analyzed the sources and underlying causes of the growth in revenues since 2003. This analysis shows that the overall increase in revenues as a share of gross domestic product (GDP) since 2003 is disproportionately accounted for by increases in corporate income tax revenues.

Growth in Federal Tax Revenues From 2003 to 2006

Total federal revenues grew by about $625 billion, or 35 percent, between fiscal year 2003 and fiscal year 2006. CBO's analysis of that increase in revenues since 2003 is necessarily preliminary because relevant data are not yet fully available. CBO examined the available data using the commonly employed method of analyzing the sources of revenue growth as a percentage of GDP. Had revenues grown at the same rate as the overall economy between 2003 and 2006, federal receipts would have increased by only $373 billion. The other $252 billion of the actual increase in revenues represents growth in excess of GDP growth. As a result, receipts as a share of GDP rose from 16.5 percent in 2003 to 18.4 percent in 2006, an increase of 1.9 percentage points (see Table 1, attached).

Sources of Growth in Tax Revenues

That increase of 1.9 percentage point of GDP can be traced to changes in different types of revenues (see Table 2). The bulk of the revenue increase was associated with corporate income taxes: Revenues from corporate income taxes rose from 1.2 percent of GDP in 2003 (their lowest level since 1983) to 2.7 percent in 2006 (their highest level since 1978). That increase of 1.5 percentage points of GDP in corporate income tax revenues accounts for the bulk of the overall 1.9 percentage-point rise in revenues. Revenues from individual income taxes increased 0.6 percentage points, from 7.3 percent of GDP in 2003 to 8.0 percent in 2006. And revenues from taxes other than corporate and individual income taxes were relatively stable over the period from 2003 to 2006, slipping 0.2 percentage points, from 7.9 percent to 7.7 percent of GDP.

Corporate Income Tax Revenues. Roughly two-thirds of the increase of 1.5 percentage points in corporate income taxes relative to GDP can be attributed to increases in corporate profits, according to current measures in the national income and product accounts (NIPAs). With the effects of legislation excluded, NIPA profits before taxes increased from about 9 percent of GDP in 2003 to about 13 percent in 2006, which, at prevailing tax rates, boosted corporate revenues by roughly 1.0 percentage point relative to GDP. In addition, legislation directly increased corporate tax receipts by 0.2 percentage points of GDP, mainly by the establishment and subsequent expiration of provisions that allowed partial expensing of investment in equipment; those provisions first reduced, and then increased, the tax base upon which the corporate tax is levied. The remaining 0.2 percentage-point increase in corporate tax revenues relative to GDP is explained by other factors that influenced the effective tax rate on profits, such as capital gains realizations by corporations.

Individual Income Tax Receipts. The 0.6 percentage-point increase in individual income tax receipts was the combined result of some factors that acted to reduce those revenues relative to GDP and others that acted to raise them. The NIPA measures of income that constitute the underlying base of the individual income tax—principally wages and salaries—fell relative to GDP, reducing receipts relative to GDP by 0.4 percentage points. With any potential macroeconomic effects excluded, the impact of legislation enacted over the period—including increases in the child credit and reduced tax rates on dividends—reduced revenues by 0.5 percentage points relative to GDP. In the other direction, higher realizations of capital gains (including any effects associated with legislated reductions in tax rates) added 0.3 percentage points to the ratio of individual income tax revenues to GDP. The remainder of the increase in individual revenues relative to GDP, measuring 1.1 percentage points, resulted from "real bracket creep" and a variety of potential factors that cannot be evaluated fully until more complete data are available. Such potential factors include shifts in the share of aggregate taxable income accruing to households with higher marginal tax rates; changes in taxable incomes relative to the NIPAs' measures of personal incomes; and changes in retirement income, the alternative minimum tax, and tax deductions.

Other Revenues. The decline of 0.2 percentage points in the remaining revenues was largely from lower wages and salaries as a share of GDP, which reduced receipts from social insurance (payroll) taxes relative to GDP.

Tax Revenues in 2007

Revenues in the first seven months of fiscal year 2007 have continued to grow faster than GDP. Overall, revenues have grown by about 11 percent compared with what they were during the first seven months of 2006, although CBO estimates that the growth is closer to 9 percent when adjusted to remove the effects of more accelerated crediting of amounts paid with personal tax returns this year. (In the first half of 2007, GDP grew by an estimated 5.3 percent from its level in the first half of 2006.) Revenues from both corporate and individual income taxes have continued to grow faster than GDP. Growth in corporate revenues, which has measured about 15 percent so far this year, remains rapid but has been been slowing throughout the year, presumably reflecting slowing increases in profits. Receipts from individual income taxes have grown by 13 percent so far this year when adjusted for accelerated payments with tax returns, CBO estimates. Final payments with tax returns grew just over 10 percent, CBO estimates, in line with expectations that called for a slowing in the growth of nonwage income in tax year 2006. The inclusion of 2007, however, does not seem to alter the fundamental conclusion that a substantial share of the revenue increase relative to GDP is associated with the corporate income tax.

Two caveats to this analysis should be noted. First, analyzing revenues as a share of GDP does not illuminate the underlying causes of GDP growth itself, including the possible influence on GDP from tax policy. Second, the detailed data required for more systematic analysis of revenue trends are not yet available. For example, detailed data based on tax returns provide the best basis for tracing sources of revenue trends, but those data are typically not available until about two years after collections occur. In addition, revisions to NIPA data can profoundly affect the interpretation of revenue trends.

If you or your staff have any questions about this analysis or would like further information, please call me at (202) 226-2700 or Tom Woodward at (202) 226-2680.

Sincerely,

Peter R. Orszag
Director

Attachment

cc: Honorable Judd Gregg
Ranking Member

Table 1.

Tax Revenues, 2003 and 2006

	2003		2006	
	Billions of Dollars	**Percentage of GDP**	**Billions of Dollars**	**Percentage of GDP**
Individual Income Taxes	794	7.3	1,044	8.0
Corporate Income Taxes	132	1.2	354	2.7
Other Taxes	857	7.9	1,009	7.7
Total Revenues	**1,783**	**16.5**	**2,407**	**18.4**

Source: Congressional Budget Office.

Note: GDP = gross domestic product.

Table 2.

Sources of Growth in Tax Revenues as a Percentage of GDP from 2003 to 2006

	Individual Income Taxes	**Corporate Income Taxes**	**Other Taxes**	**Total Revenues**
Income Growth in NIPAs	-0.4	1.0	-0.2	**0.5**
Individual Capital Gains	0.3	n.a.	n.a.	**0.3**
Legislation	-0.5	0.2	0	**-0.2**
Other	1.1	0.2	0	**1.3**
Total	**0.6**	**1.5**	**-0.2**	**1.9**

Source: Congressional Budget Office.

Note: NIPA = national income and product account; n.a. = not applicable.