The U.S. Budget: "No, we can't"

Beneath the surface noise of the fiscal drama that has kept Washington on edge for months lies a serious societal choice. The model in vogue in the United States since the Reagan era—low taxes and feeble welfare support—is fast unraveling in a society undergoing major change. With a tax rate some 33 percent below the OECD average and one of the highest debt-to-GDP ratios anywhere, the U.S. government's coffers are virtually empty—leaving it ill-equipped to meet swelling demand for public programs to address such issues as rising poverty, declining geographic mobility, and a rapidly aging population.

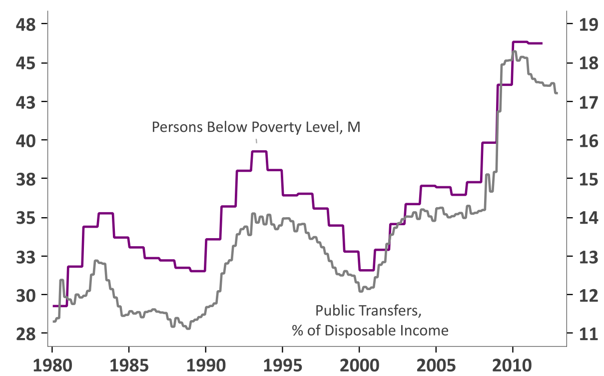
The country has two basic alternatives:

- Either the Americans stand pat in rejecting the inevitable—a hefty increase in taxation—thus accepting, in essence, greater inequality and the demise of the American Dream;
- Or, as is more likely, they eventually agree to abandon their previous credo, in which case a secular increase in payroll and income tax will be on the agenda.

But either way, the United States of tomorrow will be a very different beast from the pre-crisis United States.

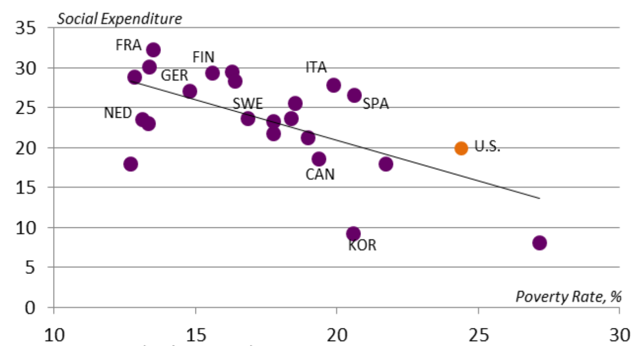
The U.S. fiscal controversy is far from over. More to the point, it has unquestionably weakened the country's ability to reverse its debt trajectory any time soon.

US Poverty and Public Social Transfers



Sources: RichesFlores Research, Macrobond

Public Social Expenditure in % of GDP and Poverty Rate, 2009



Sources: OECD, RichesFlores Research

A Model Increasingly Out of Touch with Social Reality

Which option will the Americans go for - the path towards even greater inequality, or the prospect of having to say goodbye to a fiscal policy pursued since the Reagan era? The current debate between Democrats and Republicans all boils down to this basic societal choice.

The United States has one of the lowest tax-to-GDP ratios in the developed world. But now that years of anemic growth have saddled government with the responsibility of spending more to ease the pain, the fiscal model upheld since the 1980s is coming apart at the seams.

- Since the start of the new century, the share of government transfer payments in personal income has risen by 50 percent. That rise is directly proportional to the increase in the number of people living below the poverty line—from 31 million to 46 million—over the same period (see graph on page 1). According to OECD data, per capita spending on social programs in the U.S. already reached $7,960 a year in 2009 (in 2000 prices). This was barely 15 percent lower than in France ($9,232 in 2000 prices and at PPP), where the ratio of payroll and income tax to GDP is almost twice as high as in the U.S. The OECD data further indicate that due to the surging jobless rate and Obama’s policies to assist the long-term unemployed, the cost of unemployment benefits nearly quadrupled between 2007 and 2009. Here too, the U.S. is rapidly catching up with France. Lastly, social spending by the voluntary private sector, a major contributor to the country’s welfare net, has also gone up sharply, from an average of $3,430 a year in 2000 to $4,257 a year in 2009 (in real terms). **The recession has badly battered the individual self-reliance so enshrined in the American way. In 2009, net social expenditure exceeded $19,850 per person in current dollars,** or $14,688 in 2000 dollars—a 34-percent increase over nine years in real terms. On a comparable basis, France recorded a 17-percent increase to $10,479.

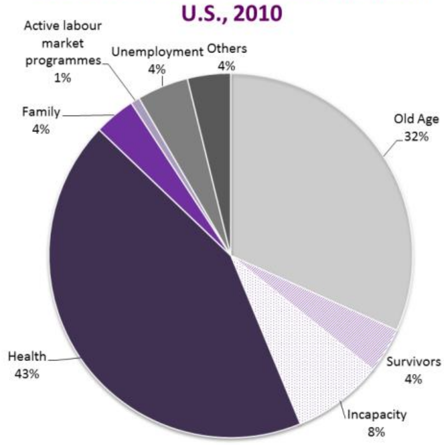
Per Capita Social Expenditure in the U.S. and France, 2000–2009, in USD at Constant 2000 Prices and PPP

		U.S.		France		Growth 2000-2009	
Origin		2000	2009	2000	2009	U.S.	France
Public sector	Old Age	1992	2526	2924	3532	*27%*	*21%*
	Survivors	322	321	418	528	*0%*	*26%*
	Incapacity	425	637	481	568	*50%*	*18%*
	Health	2339	3453	2228	2587	*48%*	*16%*
	Family	290	292	840	921	*1%*	*10%*
	Labor market	60	64	331	285	*6%*	*-14%*
	Unemploy ment	93	365	404	440	*290%*	*9%*
	Housing	-		244	244	*-*	*0%*
	Other	183	306	90	128	*67%*	*42%*
	Total	**5704**	**7962**	**7961**	**9232**	***40%***	***16%***
Mandatory private sector	**Total**	**154**	**135**	**80**	**98**	***-12%***	***23%***
Voluntary private sector	Old age	1485	1621	15	21	*9%*	*38%*
	Health	1849	2469	356	454	*33%*	*28%*
	Other	95	106	285	318	*76%*	*11%*
	Total	**3430**	**4257**	**656**	**793**	**24%**	**21%**
Overall total		**10984**	**14688**	**8973**	**10479**	***34%***	***17%***

Sources: OCDE, RichesFlores Research

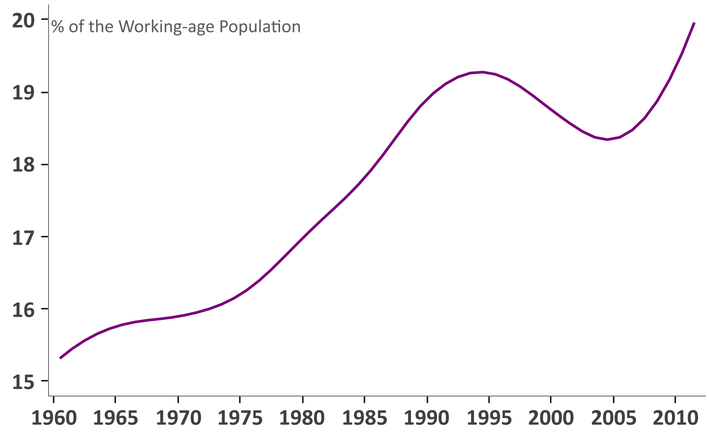
• Moreover, the increasing demographic weight of the elderly has already begun to upset the fiscal applecart. Not only does 75 percent of government social expenditure now go to pensions and health care (32 percent and 43 percent, respectively); the aging population is also shrinking the tax base. Assuming no change in the government's tax intake, this trend will necessarily leave younger Americans with a weaker social safety net and therefore more exposed to hardship in times of economic slump.

Structure of Public Social Expenditure, U.S., 2010



Sources: OECD, RichesFlores Research

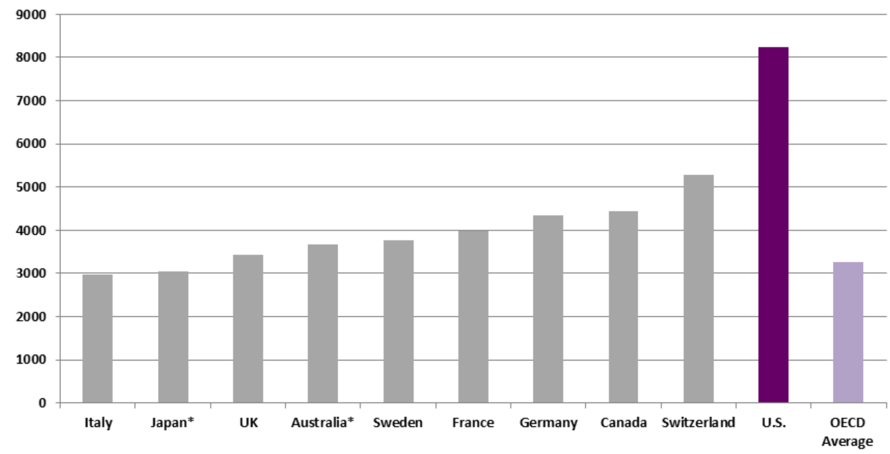
Age Dependency Ratio (65 and over)



Sources: RichesFlores Research, Macrobond

• The high cost of health care in the United States imposes a further, sizable constraint on the Federal budget. Health-care spending in America is more than double the OECD average. So even with a level of coverage that places the country near the bottom rung among advanced nations, the U.S. government still has to devote a much larger share of its resources to health care than most of its peers.

Total Health Expenditure per capita, US$ PPP, 2010

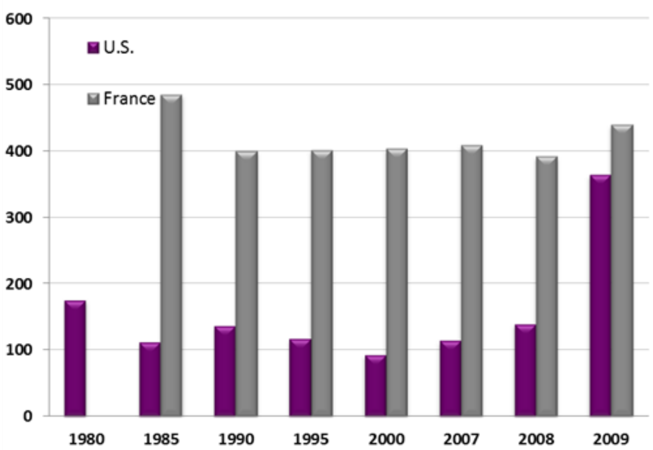


Sources: OECD, RichesFlores Research,
*2009

In 2009, annual per capita public health-care spending in the U.S. was $3,453, a figure one third higher than France's $2,587 (in 2000 prices and at PPP). And this doesn't include voluntary private-sector health insurance, which added another $2,500 to spending per person. Nor will the health-care reform pushed through in 2010 by the

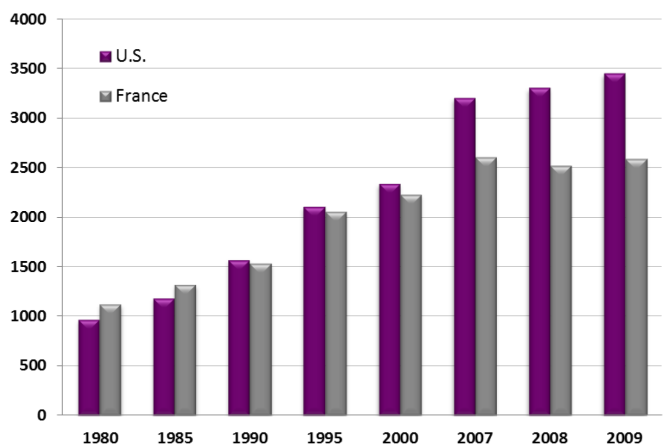
Obama administration—with the aim of putting a stop to the unsustainable escalation in costs—make much of a difference. It is projected to bring the average annual increase in the government's health-care spending down from 6.1 percent in 2014, when the new law comes into effect, to 5.7 percent in 2019

Public unemployment spending,
per capita, $ constant prices and PPPs (2000)



Sources : OCDE, RichesFlores Research

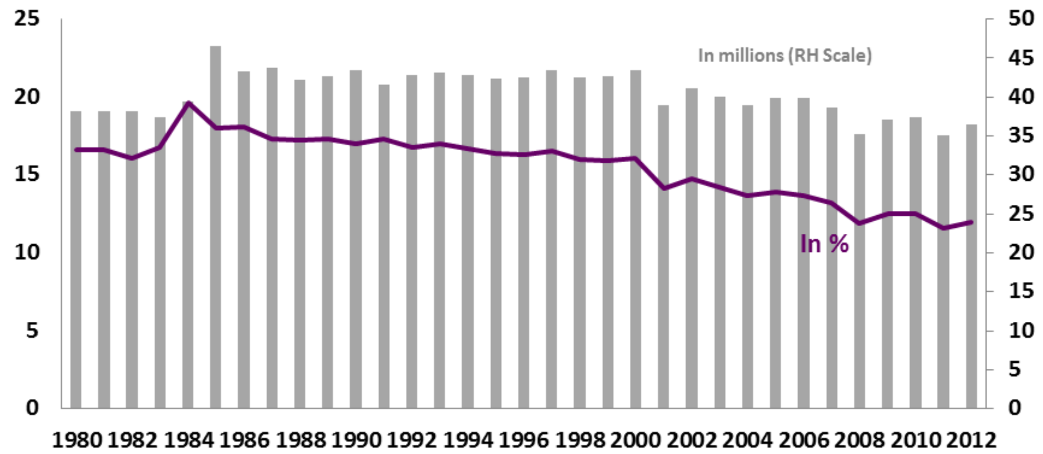
Public health spending,
per capita, $ constant prices and PPPs (2000)



Sources: OECD, RichesFlores Research

- At the same time, the "graying" of America, recession and real estate slump have together produced a secular decrease in geographic mobility. The percentage of U.S. inhabitants who changed residences fell to 11.2 percent in 2011, a record low since the Census Bureau began collecting mobility data in 1948. With a population less able to move in search of new opportunities, local governments will likely come under pressure to expand welfare programs—making it even harder to get social expenditure under control.

Population mobility in the U.S.



Sources: U.S. Census Bureau, RichesFlores Research

No Alternative to Higher Payroll and Income Tax

The stark truth is that the U.S. system is simply not equipped to handle ballooning social welfare costs. Health care, education and social assistance account for a growing share of government spending—nearly two thirds of the total to date. And since the government already has so little to spend on economic programs and public services, any cutbacks in those areas would produce little in the way of savings. So that leaves the Department of Defense—except that trimming military spending at a time of rising global geopolitical tension is easier said than done…

US General Government Expenditures, 2011, Trn $

Sources : RichesFlores Research, Macrobond

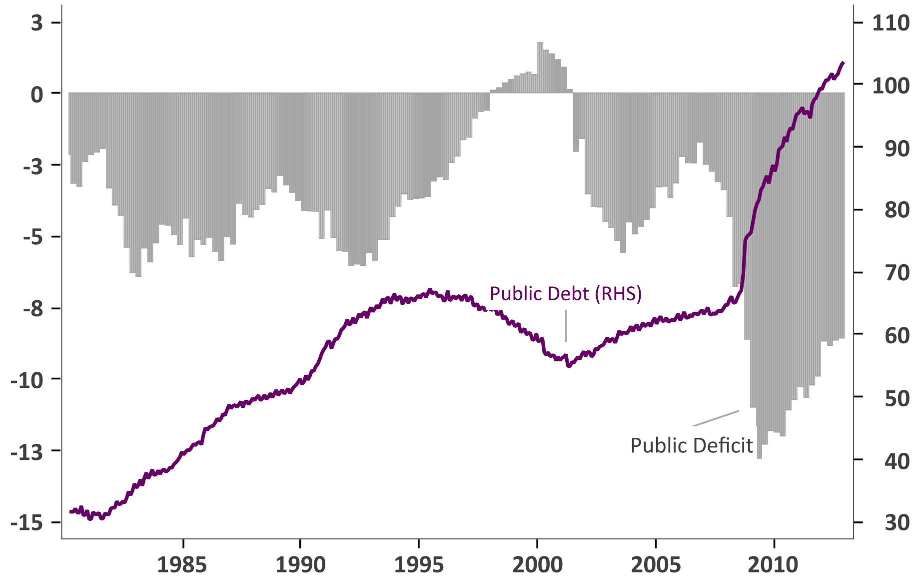
In any event, with debt now equal to nearly 110 percent of GDP, the U.S. government has essentially run out of options. The United States is one of the most highly indebted Western countries, and not only based on its debt-to-GDP ratio. Even more disturbing is how many years of tax receipts are required to pay it back; only Greece will take longer. Shrinking the deficit, which still exceeded 8 percent of GDP in September 2012—the latest official figure—is an obligation that the country's policy-makers can put off for only so long.

National Debt

National debt	Greece	U.S.	Portugal	Spain	Italy	U.K.	Belgium	Germany	France
% of GDP	162	105.0	121.0	88.5	127.1	89.2	99.8	81.6	90.3
Years of tax receipts	3.7	3.3	2.9	2.4	2.6	2.1	2.0	1.8	1.7

Sources : Ameco, Macrobond

US Government Debt and Deficit, % of GDP



Sources: RichesFlores Research, Macrobond

The numbers tell an unambiguous story: with one of the lowest tax rates in the developed world, the United States can no longer afford the social welfare standards that go with maintaining its status as the leading world power..

However strong the opposition may currently be to substantial tax increases, that, in all likelihood, is where American fiscal policy will be heading in the years to come.

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