"Good" Budget News For A Change

One leading candidate for the "most under-reported story" of 2014 is the remarkable drop in the U.S. government's budget shortfall. The final numbers announced by the U.S. Treasury for fiscal 2014 (ending September 30) shows a $483 billion deficit. That's about $1 trillion lower than the record $1.4 trillion deficit recorded in 2009. As a percentage of the U.S. Gross Domestic Product, the deficit came in at 2.8%--below the average of the last 40 years.

Digging into the numbers a bit, the government collected just over $3 trillion in the past 12 months, which comes to 17.5% of America's total GDP. That's up from $2.8 trillion last year, largely the result of a stronger economy, but also reflecting higher tax rates on higher-income Americans. Meanwhile, spending was essentially flat; rising from $3.45 trillion to $3.50 trillion, reflecting decreased defense spending and cuts in the unemployment insurance program, flood insurance and disaster relief, crop insurance, the Supplemental Nutrition Assistance Program and a variety of housing programs.

If there is bad news in this picture, it's that Social Security, Medicare and Medicaid are taking over an ever-larger share of the budget, and these costs have been rising much faster than inflation. "Entitlement" expenses are not discretionary; they are basically written contracts with the American people. Medicaid in particular is worrisome; while discretionary expenditures are down almost totally across the board, Medicaid spending growth came in at 10.2% in 2014, and is projected to rise 14.3% next fiscal year.

How does all this affect you? Notice that the partisan budget bickering has quietly faded away. Congress has extended government funding several times without fanfare, and is expected to do so again during the lame duck session after the elections. This might induce the rating agencies to give American bonds back their A+ credit rating.

We may see a tax reform bill sometime next year, which will certainly lower the U.S. corporate tax rate, and may address America's tangled individual tax code. Earlier this year, a House bill proposed to repeal dozens of tax credits, deductions and tax preferences, including the mortgage interest exemption and deductions for charitable contributions. The legislation would create two individual income tax brackets at 10% and 25%. Another proposal would replace most current federal taxes with a 23% national retail sales tax.

And you may hear more about reforming Social Security, Medicare and Medicaid. The Social Security fix is relatively straightforward; for persons under the age of 50 today, full benefits would be deferred a year or two, to reflect the fact that people are living (and capable of working) longer. Medicare proposals have ranged from giving total discretionary control to states, to creating a voucher system that would cap benefits for each participant.

Finally, all of us who are recommending Roth conversions have to pause when we see proposals that would replace income taxes with a sales tax.

The premise of a Roth conversion is that you are paying, today, equal or lower taxes on the converted retirement dollars than you would be paying in the future. If future marginal tax rates go down to zero, and all government revenues are shifted to a sales tax, the Roth equation is dramatically changed. Yes, this is unlikely, but even the unlikely contingencies have to be factored into today’s financial decisions. After all, who thought the budget deficits would fall below 3% of GDP so quickly?