The US Economy and the Budget Deficit

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The budget deficit is a complex problem because it involves the government, businesses and the citizens. In addition, the government utilizes its revenues (taxes) for the benefit of society. Understanding some of the elements of the budget deficit allows us to form an opinion about what strategies should be followed to deal with the problem.For the purpose of simplicity, let’s divide the US economy into three components:

- Workers (any one who earns wages)
- Corporations (here, we include all organizations classified as companies such as corporations, limited liability companies, sole proprietor companies, etc.)
- Government Workers and corporations produce all goods and services and pay taxes on their income or profit. It is clear that corporations pay wages because they expect to earn more than their cost to produce those goods or services.The corporations take business risks and, when successful, are rewarded with profits. If corporations fail on a large scale, economic downturns, such as the Great Depression of the 1930s, can result in long periods of high levels of unemployment. Eventually, the US Government realized that to avoid major economic downturns, it had to step in and keep certain major corporations from failing. The actions of the US Government during the last two years, is a perfect example of this. However, the cost of saving corporations has a direct impact on the US Government’s budget (revenues vs. expenses).There has been a loud outcry both from inside and outside the USA, regarding the rapid growth of the US budget deficit. As most of us are aware, if we spend more than our income, we must borrow money to pay our bills. The obvious first course of corrective action is to identify areas where spending can be reduced. In the 2011 fiscal year, the US government will receive $2.6 trillion in revenues and will spend $3.8 to $4 trillion. Therefore, in 2011, the federal government must borrow over $1.4 trillion to pay its bills. The US Government obtains its revenues as follows:

- Income taxes 45%
- Social Security taxes 34%
- Corporate taxes 12%
- Excise taxes

(taxes on fuel, cigarettes, etc.) 9%It is interesting to note that:

- People pay 4.2% on income up to $106,000 dollars per year in Social Security taxes
- Employers pay 6.2% on each employee’s income up to $106,000 in Social Security taxes
- Any income higher than the $106,000 does not pay Social Security tax The current situation is that Corporations account for only 12% of government revenues while the working class accounts for over 60% (income taxes, plus their share of Social Security taxes, plus a share of excise taxes such as fuel taxes, etc.)There are mandatory expenses that the government must pay regardless of the deficit, and they amount to about 56% of the total Budget. The largest spending obligations in 2011 are:

- Social Security $730 Billion (19% of the Budget)
- Medicare $491 Billion (13% of the Budget)
- Medicaid $297 Billion (8% of the Budget)
- Jobs Programs $25 Billion (0.6 % of the Budget)
- Other Programs $636 Billion (16 % of the Budget)

(Food stamps, unemployment compensation, tax credits, supplemental security for the disabled, child nutrition and student loans) It is clear to see that reducing overall spending levels is a major challenge because the mandatory programs (also called entitlements) can not be easily changed. As a result, the government must continue to borrow money to meet its obligations while looking for other alternatives to reduce the deficit. The primary objective of the federal, as well as state and local governments, is to have a ‘balanced budget’ whereby total expenses do not exceed revenues. What would seem to be a simple and basic first step towards deficit reduction is to reduce the amount of funds allocated to each department of the Federal Government. The difficulty is that over half of the total budget is mandatory and there are other expenses are difficult to reduce at this time.For example the 2011 budget for the war in Iraq works out to be over $92,000 per minute, or about $121 billion for the entire fiscal year. Other expenses that cannot be reduced at this time include the war in Afghanistan, and other intelligence related activities (not made public for obvious reasons). We are faced with a large and growing deficit that is compounded by the fact that little can be done to significantly reduce government spending without addressing entitlement programs and the two ongoing wars. What is clear is that the solution to the deficit problem must include strategies to expand the economy.Two strategies that could have a positive impact on the economy.1. Increasing employment levels.More people working means more income taxes are being paid which means increased revenues for federal, state and local governments. With this in mind, the Federal Government has just announced a new program called Start Up America. Its goal is to provide assistance to help spur the creation of new companies (start-ups) and to help small businesses grow and succeed (information may be obtained at the Maryland office of the Small Business Administration at: http://www.sba.gov/about-offices-content/2/3120 or, at 410-962-6195). 2. Increasing the corporate tax from the current 12% to 15% or 18% This strategy may be accomplished by lowering the current business tax rates as proposed by the President, but, must also include a reduction or elimination of current corporate tax loopholes. Henry H. Cruz es economista y consultor internacional. Para contactarlo, envíele un correo electrónico a henry_h_cruz@hotmail.com