Why the Federal Budget Matters

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House Republicans are expected to release a budget today that includes more than $1 trillion in discretionary spending—the part of the budget that includes everything except mandatory programs like Social Security, Medicare, and interest on the debt.

Congress will debate whether discretionary spending should be $1.03 trillion or $1.05 trillion this year. This debate is like having a $50,000 a year job and quibbling over whether the Porsche you're about to put on your credit card should have leather or cloth seats. The question doesn't matter because you can't afford either one. Even if Congress were to cut discretionary spending to zero, the budget still wouldn't balance.

[See a collection of political cartoons on the budget and deficit.]

Discussions about the budget may sound boring to people living outside the Beltway, but every dollar's worth of deficit the government racks up this year will come back to you as one of three things: higher taxes, reduced benefits, or inflation. Here are a few more reasons why one should care about the budget.

Reduced Retirement and Fixed Incomes: Deficits today could mean cuts to your retirement and Medicare benefits tomorrow. Last year, the government collected $2.3 trillion in revenue and spent $2.3 trillion on Medicare, Social Security, and interest on the debt. That left a grand total of zero for everything else the government does: funding education, maintaining the courts and prisons, inspecting food, and delivering mail.

If you are living off savings, deficits mean that you're going to continue to see low interest rates, so your savings will continue to earn a near zero return. Politicians try to convince us that low interest rates are good, but they are only good for borrowers—like the federal government.

[Read the *U.S. News* debate on the Balanced Budget Amendment.]

Today the government owes $15 trillion. Just a 1 percent increase in interest rates will cost the government an extra $150 billion a year. On an annual basis, that's equivalent to the Iraq and Afghanistan wars. While the Federal Reserve held interest rates low, the government ran up such large deficits that it backed itself into a corner so that now it can't allow the Federal Reserve to raise rates.

Higher Taxes for the Middle Class: If you earn between $30,000 and $70,000, you are "middle class." There aren't enough rich people in the country to balance the budget by taxing them more—even if we raised their tax rate to 100 percent. Politicians know that the real money is with the much larger middle class who are currently taxed at lower rates.

According to the Congressional Budget Office, the middle class pay about 14 percent of their incomes in taxes compared to 30 percent for the richest 1 percent of Americans. A tax increase on the middle class can raise more revenue than the same tax increase on the rich. A value-added tax, which is added to the price of everything you buy, is a particularly clever way to tax the middle class. It makes it hard to know how much of the price you pay for a thing is due to tax and how much is due to the thing itself. Without this knowledge, people will be less likely to complain about a value-added tax.

[Check out a roundup of editorial cartoons on the economy.]

Reduced Public Pension Benefits: Governments will be looking for ways to raid employee pension funds to pay for deficit spending. Federal employee pensions are already underfunded by more than a half trillion dollars, due in part to the government withholding pension payments. Because government workers don't control their retirement accounts, it makes swapping out pension money for IOUs a breeze.

Also, the government reports on how well-funded the public pensions are, so not only does the fox guard the henhouse, but the fox also reports to the farmer on how well the hens are guarded. For example, Pennsylvania claims that its state employee pensions will be 85 percent funded within 20 years. But to get to this number, the state assumed that pension investments will earn a steady 8 percent annual return for the next 20 years. With a stock market that has been stubbornly flat, savings accounts that pay fractions of a percent, and corporate bonds that haven't earned an 8 percent return since Clinton was president, assuming a steady 8 percent return is lunacy. By maintaining this financial fiction, Pennsylvania can raid the employees' pensions and yet claim that the pensions are well funded.

The U.S. credit card is maxed out, but politicians still want to go on a shopping binge. Politicians tell taxpayers not to worry about deficits because everything will work out, and we'll pay it back later. The truth is that the politicians aren't the ones who will have to pay it back—we are. That bill is going to come due soon. If politicians don't get the federal budget under control today, we're not going to be able to pay that bill without enduring some very serious pain.

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