Pattern for Disaster

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Once you see the information, the problem is easy to diagnose. Our national finances are headed for disaster. We have an ever-increasing percent of our population over 65 that is forecasted to continue to grow. This means more taxes and less savings for each remaining working individual to support the ever-aging population. Older people demand more medical and other assistance as well as contribute disproportionately less taxes.

First look at the Personal Income & Consumption figure. You'll see that personal income is growing at a 5.8% annual rate. Yet, disposable income is growing at only a 5.2% rate. The difference is largely taxes. Those are taxes from all sources. In fact, taxes have grown at a 10.2% rate over this same period. Perhaps a tax reduction will help a little, but it's really hard to actually reduce the main tax driver: public spending. More likely over the long-term we'll see substantial hikes in the Medicare tax.

Then look at consumption. Not only is it growing at an unconscionable rate of 6.3%, it has finally exceeded disposable income!

So what we have is a collision. High taxes are reducing disposable income on the top side. On the bottom side, consumption greed has overtaken savings prudence. What will be left for savings to help support the ever increasing older part of our population? Unless there is better recognition of the problem and a subsequent turnaround, the long-term answer may be ever increasing tax losses for the working population and poverty for a large part of the aging population.

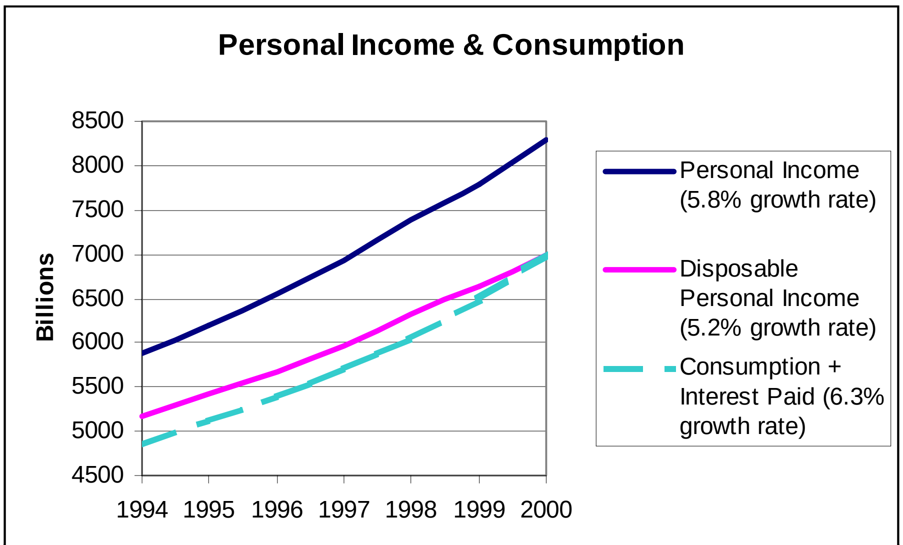
You can help yourself!

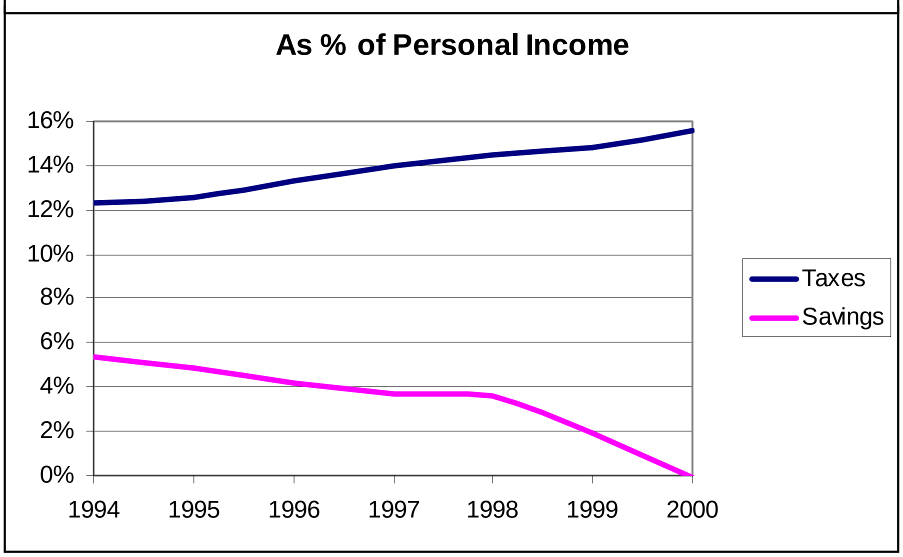
The figure showing taxes and savings as a percent of personal income emphasizes these points. Savings as a percent of personal income is, of course, a little less than as a percent of disposable income which was 6.1% in 1994. This shows how badly the population as a whole is disregarding the need to save. What should the savings *rate be? Probably higher than the 12.4% savings for Social Security from individuals and their employers considering Social Security was intended to cover only about 40% of a person's retirement expenses.

Since it's very difficult to turn national statistics very much, those who understand the problem can help themselves by doing two things. The first is obvious. Save a large fraction of their disposable personal income. The second thing is to reduce vulnerability to future taxes.

The most vulnerable retirement savings for taxes are tax-deferred savings plans. Although this may still be one of the best ways to save, especially when an employer matches savings, it may well be time to start saving more in non tax-deferred assets like taxable or tax-exempt mutual funds and real estate. If a (temporary?) tax reduction comes soon, it will make it easier to switch out of deferred-tax accounts.

The other long-range protection may be to defy conventional wisdom and put the fastest growing assets (usually stocks) outside the deferred-tax investments. A buy-and-hold philosophy won't guarantee low future capital gains taxes, but at least it will avoid the onerous ordinary income tax rates.





Source: Department of Commerce