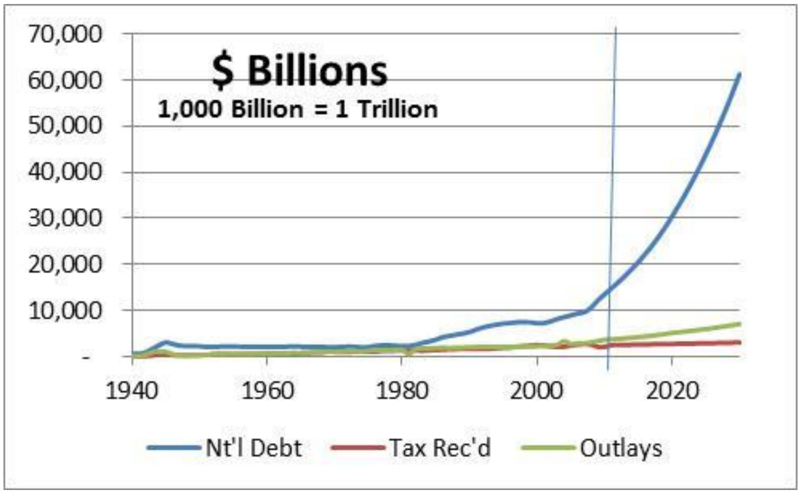
King for a Day

(This paper uses the program with the same name from www.analyzenow.com as graphics source.)

Suppose you were made King for a day. Then, as King, the first thing you do was to get all members of Congress to pledge their allegiance to you. Then you fire both the Secretary of the Treasury and the Chairman of the Federal Reserve Board. This is sheer fantasy, of course, but it allows us to see how our country' financial outlook would improve if politicians stopped worrying about getting reelected.

Next you call in the new Bureau of the Budget chief and ask him to give you an HONEST perspective of the way this country is going without artificial rules imposed by Congress to get a projection supporting their political ambitions. He presents the following picture showing the growth of the national debt to $60 trillion by 2030:



He explains that the past history has been adjusted for inflation so that all past amounts are in 2010 dollar values. Also, the projection of the future debt is in constant 2011 dollars. If the chart were in then-year dollar values, the past values would be substantially smaller and the future dollars would be substantially larger. As shown, a dollar has the same purchasing power in every year.

When asked why such things got so out of control, he says it's the incredible growth in government spending. The largest single item is entitlement growth, particularly Medicare which had a major cost jump after including drug benefits and now faces another large increase as we add immigrants and the baby boomers retire. But all of the other entitlements have grown appreciably as well: Medicaid, Social Security, government pensions, etc.

Although entitlements are the major factor, the fact is that more recently we've taken on the need to fund multiple wars and unemployment has increased. Compounding that, we've added extra years for unemployment compensation.

You ask him what it would take to bring the national debt back to a debt level of about ten years ago.

He says that you would have to take extraordinary actions. You would have to increase tax receipts by about 20% and reduce government spending by about 30% or, as an alternative, increase tax receipts by 10% but reduce government spending by about 35%. The latter approach would more likely have less impact on the economy and therefore provide a better environment for our children and their children.

You say, "As King, I can order all sources of federal taxes be increased by 10%. I can also order that all departments and agencies each now have 35% less to administer and spend. As a chairman of a privately owned company I could do this both with prices and by budget fiat for those working for me. I've had to do that numerous times in the past, sometimes with larger price increases and cost reductions than we're talking about now with the government."

You, having had this experience before in business, know that the first thing to do is to set an example by going the extra mile. So you fire all of the Czars working for you, reduce all other of your administrative staff by 50%, cut the travel budget by 70%, reduce your own compensation by 50% and the compensation of those still in your office by 20%. Your order that Bus One and half of the Administration's car fleet be sold. And you personally will approve of any first class airplane tickets.

Then you call in all of the Department and Agency heads and tell them they have to take the same kind of actions. No exceptions. There will be no distinguishing between fixed, variable, mandatory and discretionary budget items. We're going sell surplus buildings and equipment. Overall, you say, they have to reach 40% cost reduction in each department and agency within the next six months—and I don't want to hear that some other department or agency is less important. If you don't do this, you'll be replaced with an accountant with a green eye-shade, pinze nez glasses and ice water in her veins. There are plenty of experienced business people who would gladly take your job. And, by the way, I want you to show me that you've made an even larger percentage cut In supervision.

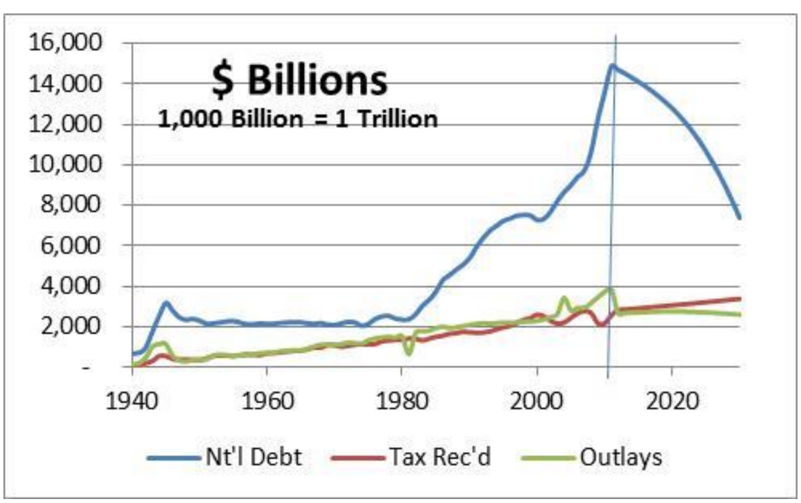
This kind of direction is old-hat to many business people, but unheard of in government. The author has experienced the same reductions twice in his working career—and heard the same speech about the accountant.

Congress members complain that these actions will definitely hurt their chance for reelection. You explain to them that this likely will be their last term anyway, so they should start looking for other employment. In the meantime, you want legislation that will help the economy in the long run, not budgets and legislation that benefits your next reelection.

Shortly thereafter, you ask for progress reports. Importantly, the IRS reports back that the new plan from the Congress will, as a matter of fairness, change the taxes so that the highest income taxpayers will get taxed 50% more, the next 10% highest income people will get taxed 25% more, and the remaining will get taxed 10% more. The IRS tells you that 47% of the wage earners who pay no income tax, but are subject to payroll tax, will get hit by the 10% increase in payroll tax and the elimination of refundable tax credits.

The IRS chief also reports that the Congress has directed that corporate taxes be reduced to zero, but there will be a 2% value added tax on all their products to compensate. That value added tax will not apply to exports but will to imports. This, he explains will increase job growth appreciably as work gradually returns to the U.S. and our exports compete better with foreign producers. We will be accused by some of unfair foreign trade practices, but that will fade after a while.

Your new chief economist reports that all of these actions will reduce growth of the economy for a number of years, which in turn will have a negative effect on future tax revenues. Also, unemployment will increase slightly for a while, but that many will return to work, though at lesser paying jobs, when government welfare is reduced. After a while, the growth in jobs from more exports and lower imports will add enough work to more than compensate for early job losses. He displays his projection below:



Your economist explains that one of the largest drivers will be the growth of the economy, and he has assumed that the high taxes will mean only 1% real economic growth and therefore small subsequent tax growth. However, we should be able to achieve the reductions in the debt you seek if we can keep subsequent government inflation-adjusted spending growth to no more than 0.25%. The major force driving government spending growth will be wars, more immigrants in Medicare/Medicaid and the number of people retiring relative to the numbers of those working. Our population will be aging rapidly as baby boomers leave the workforce and retire—and have longer life expectancies.

This also means that we have to restrain the growth of interest on the debt going gradually from current rates to about a 5% rate. Our foreign holders of bonds will be more receptive to rolling over our bonds when they know we are on a path toward debt reduction. And that will improve our credit rating.

The economist continues, "The alternative to this would be to increase taxes greatly, say to 20%, and reduce government spending by 30%. Either approach will hurt the economy in the near term, but my judgment is that this alternative would reduce economic growth by at least another 1% since people have less discretionary income. A reduction in discretionary income means less consumption, hence lower economic growth. Since they would also save less, it would really be hard on future generations.

"OK," your say. "We're editing a 10% increase in our taxes and a 35% cut in government costs. Our new government budget will have about the same dollar spending as we had five years ago, but the taxes will be somewhat higher. Our children and grandchildren will fare much better with only $8 trillion in debt by 2030 rather than $60 trillion if we do nothing."

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Charts from analyzenow.com's "King for a Day," a simplified free program to estimate national debt growth by changing tax, spending and interest growth. Download it, and try your own pet solution. (You need MS Excel or equivalent.) You can also simulate cost reductions or tax increases spread out over a number of years as politicians are wont to do—because future promises seldom materialize. The program also has lots of valuable federal spending and tax receipt details as well as history which will provide better perspective.