

Policy Topic: Balancing a Budget

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Abstract

The public is well aware of the budget problems facing Congress. There are many reasons for the imbalance and potential effects of the imbalance project negative fortunes for the United States. The policy options for balancing a budget include tax policy changes, spending changes and discipline. Additionally, the budget has to examine current commitments for savings potentials and understand how economics plays into Federal revenues. The conditions set by proper fiscal and monetary policy will be able to flexibly handle economic swings and maintain fiscal management. This report looks at tax proposals, energy policy, health costs and some radical proposals as mechanisms for changing cost structures or raising revenue.

Policy Topic: Balancing a Budget

For decades the United States has endured budget shortfalls, and especially in the recent times, we have seen a resurgence of deficit spending. These budget shortfalls have an impact upon the government's capability, future of public policy, inflation, and monetary policy. The focus of the paper will be to review the budget deficit issue, its causes, and its effects. The paper will focus upon how efforts to balance a budget have been influenced by policy initiatives and environmental aspects like energy prices, inflation, war and catastrophe. The budget discussion will also have to include the allocations of the budget and where the funds are derived in order to discuss potential policy directions. The stakeholders, from citizen action/interest groups, the IRS, the CBO and the Congress, will also be discussed and their influence upon the process.

This report will discuss the nature of the issues in terms of costs, priorities, and effect upon monetary policy and legacy. To do this, we have to consider how we arrived at this point and identify target objectives. As well, we have to consider the public needs, industry needs, legislated commitments, stresses upon the financial markets, bureaucratic issues and political swings in the Congress and President. We have to consider what strategies have been employed before to balance budgets and their effects. In addition, environmental needs and circumstances have caused unplanned cost abrasions, and thus, a policy proposal will have to be flexible to meet unexpected situations like war and catastrophe. The discussion will focus the objective to balance the budget. The report will consider alternative tactical methods to achieve the goals of balanced budgets.

Identifying the objectives

Arguably uncontrolled debt spending has negative consequences for future attempts to do anything in policy and anchors future policy in terms of what remains after debt payments have

been collected. Thus, the objective of this proposal is to recommend a balanced budget and rein in spending especially in terms of debt spending. Further, a balanced budget will have to be accompanied by significant reduction of existing debt.

The existing budget and debt trends

The budgets since 1960 have encompassed military expenses, inflation, recessions, and have included many social insurance expenses. FY 2007 budget reveals substantial portions of the budget outlays going to military and social insurance programs (i.e. Social Security, Medicare and Medicaid). Excluding mandatory social insurance, the allotment for the military alone is more than all other discretionary expenditures. Defense spending has significantly outpaced other discretionary spending except for brief periods in late 1970s and late 1990s (Heritage Foundation, 2008; Iowans for Sensible Priorities, 2006).

Currently, social insurance outlays (are as much as military and discretionary expenses combined) and have blossomed since 1968 from 46 billion to 1.4 trillion. For only the first 8 years of Medicare were discretionary outlays more than mandatory outlays. Currently, the CBO calculates that mandatory outlays are over 60% more than discretionary spending (CBO, 2008). Inflation adjusted spending has quadrupled since the 1960s where the Federal government spends nearly \$23,000 per household (almost double the spending of 1960 at \$13,500) despite minor changes in median income.

Total government income, including personal income tax, corporate income tax, excise tax, fees and social insurance premiums, has reached over \$1.7 trillion according to The Heritage Foundation (2008).

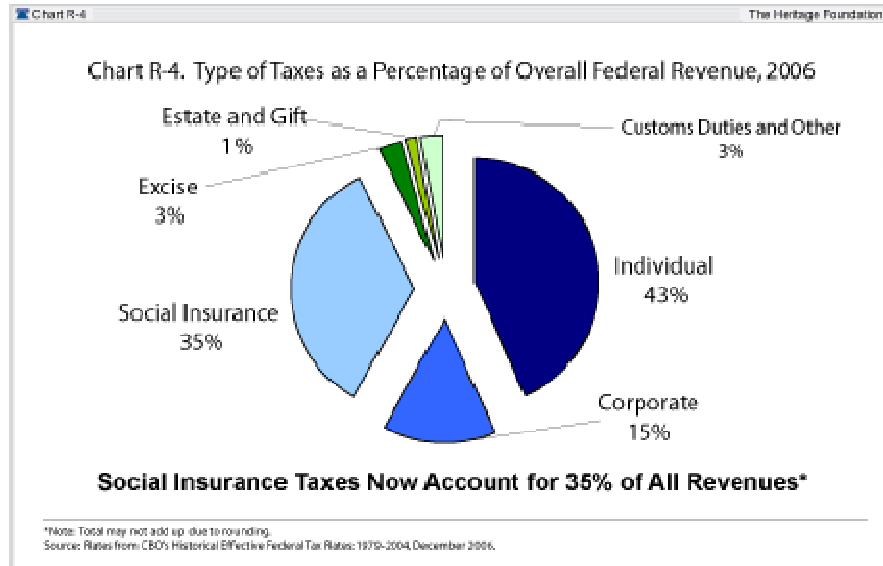


Figure 1: Federal Revenue (The Heritage Foundation, 2008 p5)

The Heritage Foundation calculates that social insurance brings in 35% of the full budget, individual income taxes 43%, corporate taxes 15% (Heritage Foundation, 2008 p5). According to their calculations, inflation adjusted household tax contribution has increased almost 60% since the Kennedy administration while the top individual tax rate has decreased almost 60% since the 1960s. Social insurance spending has increased over 600% since 1965 when Medicare was enacted. Federal spending has consistently exceeded federal revenues except briefly in the late 1960s and the late 1990s. Spending since 1974-75 has outpaced revenues by wide margins through current years (except in the late 1990s). Excessive spending was at widest margins in the 1980s and early 1990s and since 2001. CBO Budget Data suggests that the United States currently has over \$5 trillion in debt held by the public (CBO 2008).

Questions should be raised as to why have the government continued to spend debt rather than balance. Friedman suggests that deficit spending restrains the government, but Buchanan suggests that higher taxes give a stronger sense of value for the taxes (Lee & Vedder, 1992). As noted, “mandatory” spending rose significantly as a portion of the budget and currently dwarfs

the discretionary spending. Defense spending for Vietnam, Cold War rearmament and Iraq wars have also marked times of deficit spending. Yet, during the Vietnam war period 1960-1975, the budget outlays were within 1 - 2 % of revenues despite withstanding two recessions (CBO, 2008; Rizzo, 2007).

Debt comparison to currency and inflation.

The next part of this report is to examine the currency and inflation rates to determine if a correlation exists between inflation and currency to deficit spending. Then, we review why the trend exists or why one does not exist. Currency rates and inflation are important because these indicate individual purchase power and economic activity by taxpayers. For example, the consumer price index (CPI) measures the inflation rate of consumer products cost. From the CPI data on the Bureau of Labor Statistics, something with an average cost of \$0.099 in the year 1913 would cost \$1.82 in 2003 and \$2.02 in 2007 (Bureau of Labor Statistics, as cited by InflationData.com, 2007) . The government also makes purchases where inflation and thus affects the government spending capability. Thus, if a correlation exists between deficits and inflation, we will be able to determine that regressive purchasing power may also slow government income thus widening deficit spending.

Some economists have proposed as well that the changes in the value of the dollar affects deficit and inflation rates especially when large sections of the economy are increasingly interdependent upon foreign markets (Malpass, Spring2007). The currency exchange rate can have valuing impact upon prices and ultimately the market as a whole since a weaker dollar makes imports more expensive. With rising trade deficits (Shostak, Feb. 2, 2006), the cost of imports will impact the dollar more, as long as we continue to maintain the current levels or more of trade.

Thus, the affect of dollar value may have an impact upon deficit spending and other consequences. As well, issued treasury bills (public debt securities) may be held by foreign investors. Changes in the dollar value will also change the value of these securities especially in comparison to the foreign currencies. Interest paid to foreign held treasury bills is real money that leaving the domestic macroeconomic cycle. Arguably, this will become increasingly more important as the US economy becomes progressively more affected by foreign markets (as exhibited by the recent plunges in stock exchanges in Shanghai and Tokyo negatively affecting DOW and NASDAQ indexes) (Kumar, Jan 2008). Changes in the value will affect the price of goods that are imported and affect the inflation levels therein.

Understanding what drives inflation will also help to determine policy alternatives that would benefit the country in pursuing the balanced budget. Oil commodity prices have heavily impacted inflation in the United States in the 1970s, 1980s and 2000s. With a weaker dollar imported crude becomes more expensive to buy with American dollars.

Economic projections and possible effects

Given the current expenditures, we need to review economic projections. The CBO and OMB submit economic and inflationary projections in order to forecast the affect of spending. These projections forecast the macroeconomic activity of the U.S. and potential affects of current policy, and they help to determine potential affects of particular policy alternatives upon economic activity. There is demonstrated impact of recessions and economic “bubbles” upon federal revenues, and thus, previous impacts can help to determine future possibilities of economic activity and deficit spending.

The monetary policy also affects the sustainability of growth and inflation trends. Intervention by the Federal Reserve is limited to monetary policy and intervention may affect its

independence credibility. The Fed monetary policy has to work in correlation to fiscal policy so that policy options and decisions do not override the other (Bernanke, 2008; Braddus Jr, 2004).

Many factors can affect consumer consumption and this consumption drives the macroeconomic cycle. A basic economic principle suggest that if items cost more to buy, then consumers buy less volume and demand slows. There are major indicators of inflation (Consumer price index) consumer behavior (Consumer confidence index) and economic growth (GDP) that show the relevance of consumer buying habits in relation to the economy as a whole.

The U.S. Labor Department shows that consumer spending slows as the price index rises over the past years. Additionally, consumers are spending more of their incomes, not increasing income and saving less (Bureau of Labor Statistics & Bureau of Economic Analysis, 2007). The CPI is poised to rise over the next years which cause the economy to slow more. Thus, less money will be spent by consumer as incomes fall. Slow consumer spending triggers a slow down of macroeconomic activity and then, businesses have to become more efficient and unemployment rises.

Real GDP falls below 2.1 % preceding recessions according to Rizzo (2007). The economic slowdown in production foretells unemployment slow downs and Federal revenue shortfalls as well. Further, fiscal sustainability is questioned with regard to the price of T-bills and notes in the market as a matter of monetary policy. High interest rates on federal debt force the fiscal policy to recognize that certain policies are unaffordable if full employment and stability is the goal (Fullwiler, Dec 2007).

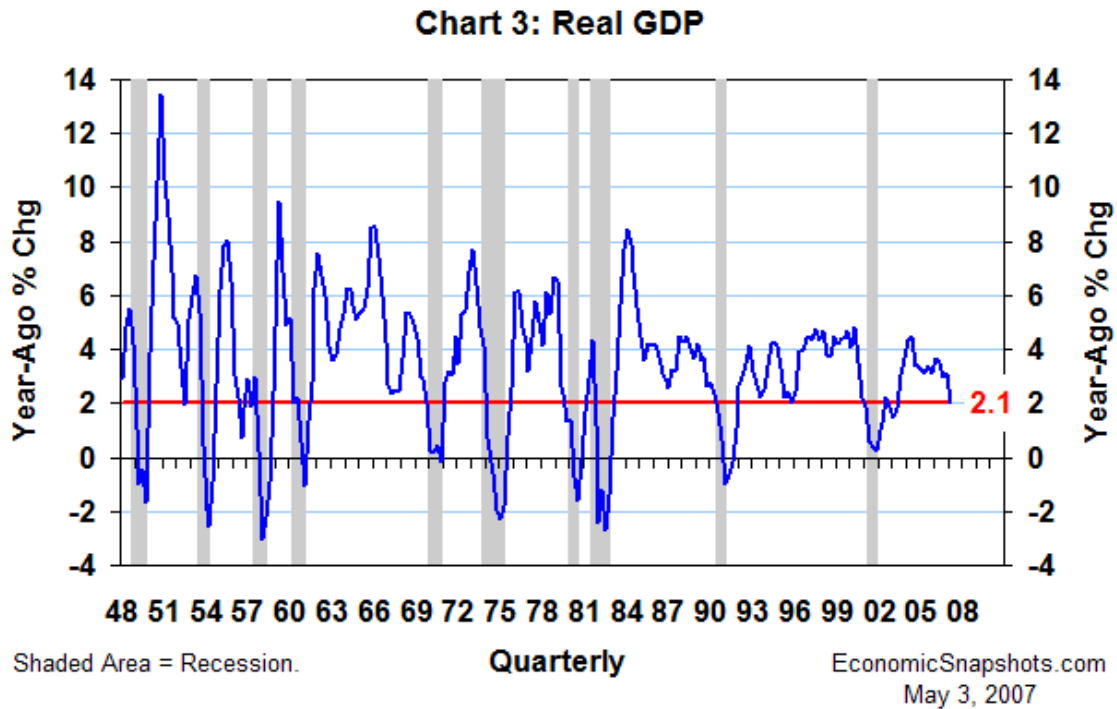


Figure 2: Real GDP Source: (Rizzo, 2007)

GDP has steadily risen over the last two major recessions despite high unemployment and slow consumer consumption as evidenced in the GDP spending numbers (Rizzo, 2007). The GDP stability has helped the federal budget have viable revenues. Yet, stagnant incomes, rising costs and higher energy costs will factor to lower productivity with less savings to extend new investments. Rising credit issues will also reduce consumer spending capacity.

Energy: the commodity that defines our economy and warnings

Given the current environment of stagnant incomes for the past few years and the fiscal policy by the Federal Government in the same timeframe, we are facing a slow down as energy prices further reduce the already low disposable incomes. The 2005 disasters in the Gulf region had an affect on the economy though not as extensive as originally thought, but they revealed major liabilities in the U.S. economy (Williams, 2005).

The disasters showed vulnerability of the U.S. economy with regard to energy prices. The gas hikes caused temporary panics as they were offset by release of the SPR to lessen the supply problem, but hikes left people worried of the coming winter energy needs. Edward Jones Investments discusses this aspect and energy as a major part of their investment perspective. Skrainka explains how high energy costs will have a significant impact upon our economy (Skrainka, 2005) and his theories are paralleled with the inflation data cited on InflationData.com (Inflation.com, 2008). This investment perspective gives a potential forecast as investment strategy and how the macroeconomic picture can change because of the energy prices. The changes in macroeconomics will affect the government ability to balance a budget

Oil prices affect how we see prices in the market. The United States economy thrives on oil and gas consumption. Everything we do and how we market is based on the assumption of undeterred availability of commodities like food, water and fuel. Fuel consumption has become convenient to consume. Besides the cost of driving vehicles, we are driving more vehicles that consume more fuel than ever before. Delivery services and freight are rooted in fuel consumption. Agri-business requires low fuel prices to produce low price yields. Additionally, consider that the standard business districts evolved into major shopping complexes and events that require automobile traffic to patronize. Of course, they accommodate for large traffic volumes and transportation rather than alternative means. Oil is another means by which some utilities deliver power to the public. Thus, costs here can drive basic utility costs. Without oil, the economy will have to seek alternative energy where a supply disruption can have a significant impact.

Since oil is a commodity, significant changes in the supply and price can produce a dramatic affect upon CPI, the economy, and government revenue as shown in figures 2-5.

Production costs rise because of the shortfall of supply and incomes will drop as a result. As well, federal revenue dips can be observed in 2003, 2004, 1981, 1982, 1975, 1976, 1991, and 1992 which correlate with years proceeding significant spikes in oil prices, inflation and interest rates. Considering, crude oil rising past \$101 a barrel in February 2008 and according to the figures 3-5, the rise correlates with higher inflation and lower revenue in proceeding years.

Additionally, the "Coming Energy Crisis" discusses the similarities between current oil production issues and those of the 70s which caused major energy hikes. This examination discusses the release of Strategic Petroleum Reserve (SPR) as evidence of "further increasing US vulnerability to supply interruptions" (Williams & Alhajji, pg 6). They contend that the US is heading for another energy crisis by 2010. Even if one discredits the crisis theory, one has to recognize the significant impact that energy prices have had upon the economy and the worldwide demand increase is going to push oil prices upwards.

Rapid innovation of alternative energy and rapid implementation of such may offset the affect of any sort of potential crisis and international demand increase. Such implementation would require a long term strategy and quick delivery mechanism for transitioning the country to an alternative source at reasonable costs. Investments made in this area may have significant impact on the ability of the country to withstand upheavals in oil prices and better project long-term revenues that are independent of foreign alliances for oil supply.

Interest rates: the cost of debt

Interest rates have an impact upon deficit spending. Fullwiler (Dec 2007) argues that interest rates are driven by fiscal policy. He cites Kotliff and Burns that suggest "history is replete with examples of what happens when countries can not pay their bills." (Kotliff and Burns, as cited by Fullwiler, 2004, p10) which argues against Friedman's point. Tatom (2006)

argues that interest rates are not raised by deficits. Fullwiler and the charts show a correlation between mortgage rates and deficit spending, but Tatom agrees that spending is a problem.

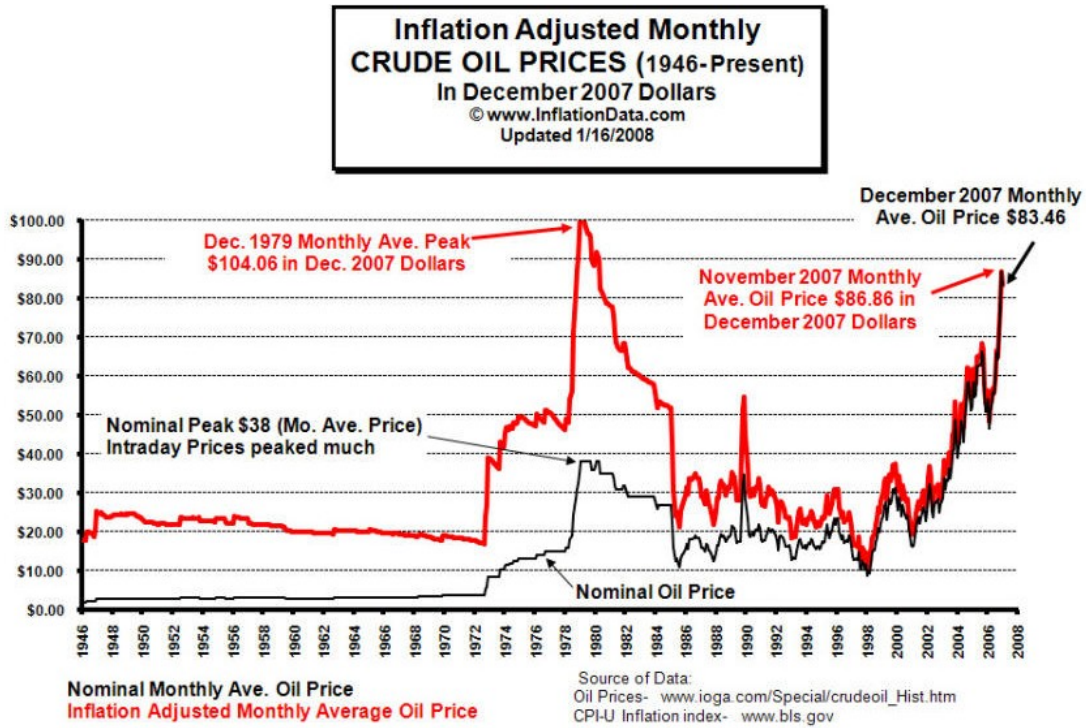


Figure 3: Historical Oil prices (InflationData.com, 2007)

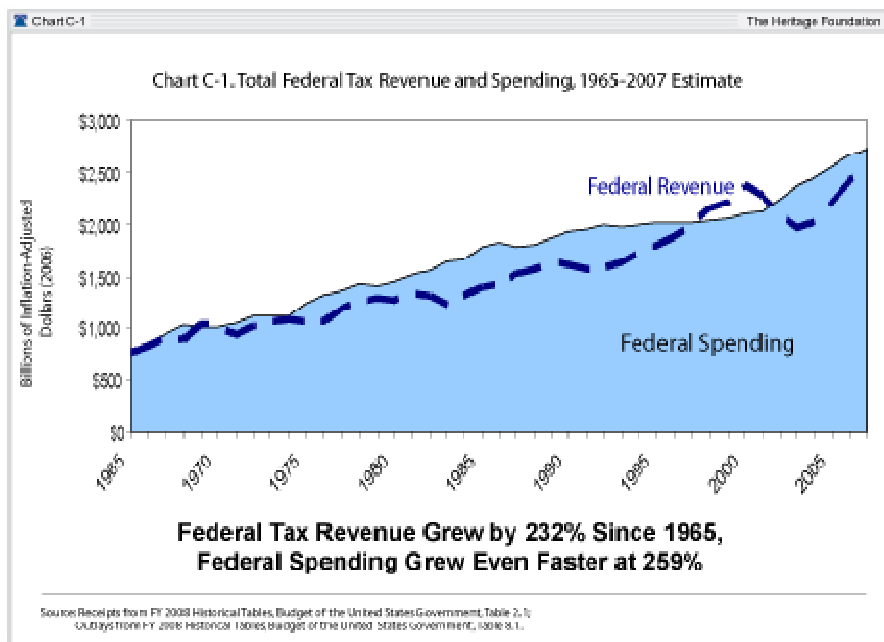


Figure 4: Total Federal spending and revenue Source: (The Heritage Foundation, 2008)

Average Annual Inflation by Decade

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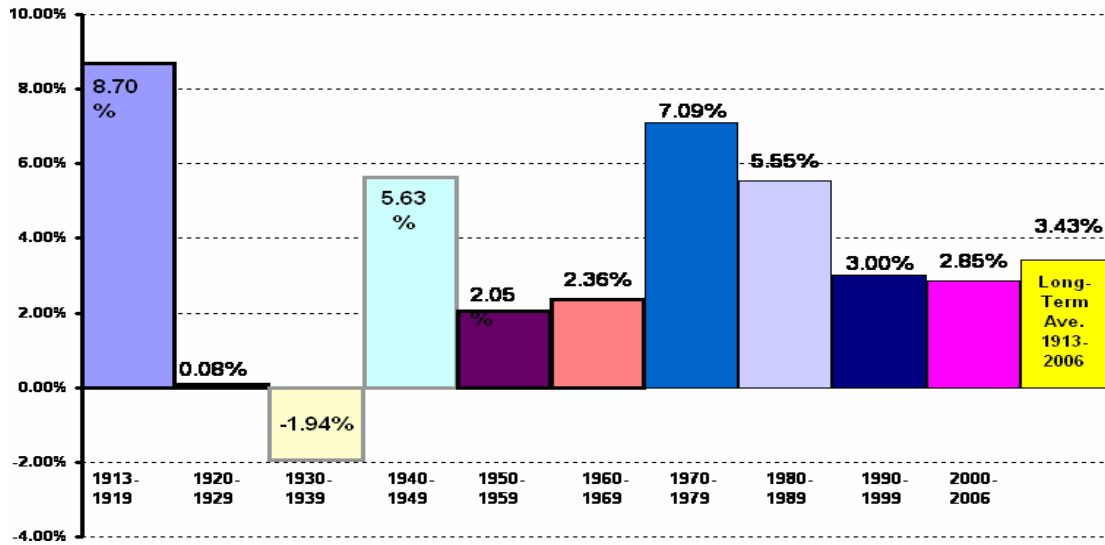


Figure 5: Inflation by decade: (InflationData.com, 2006)

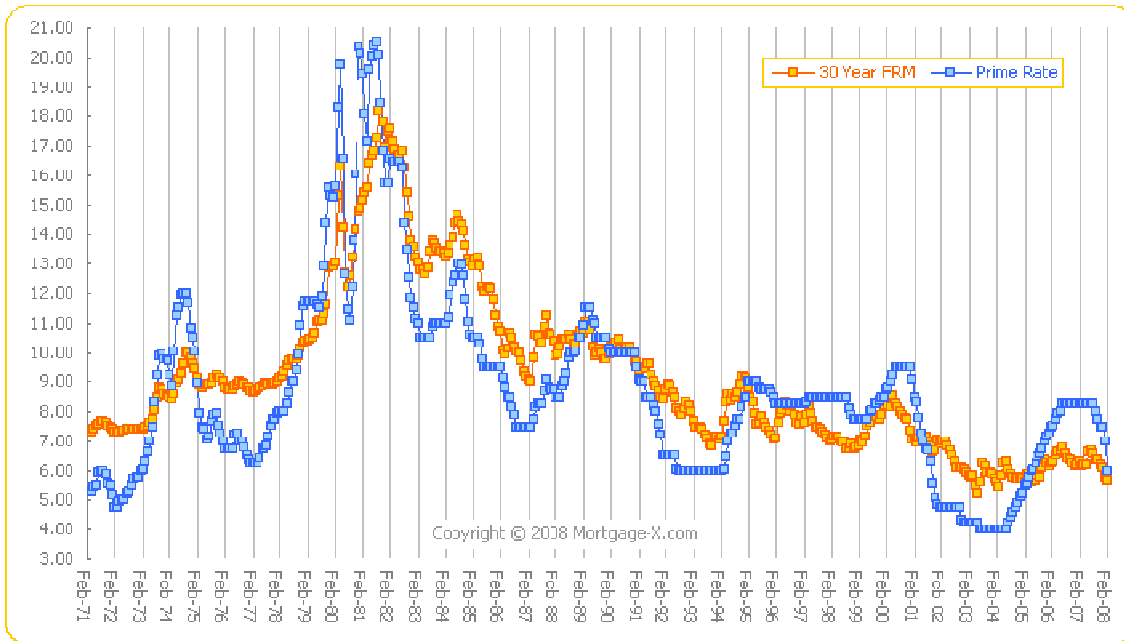


Figure 6: 30 Year FRM Trend (Mortgage-x.com, 2008)

Figure 1. Real Three-Month U.S. T-bill Rate and the Budget Surplus/Deficit, 1959–Q1 2004

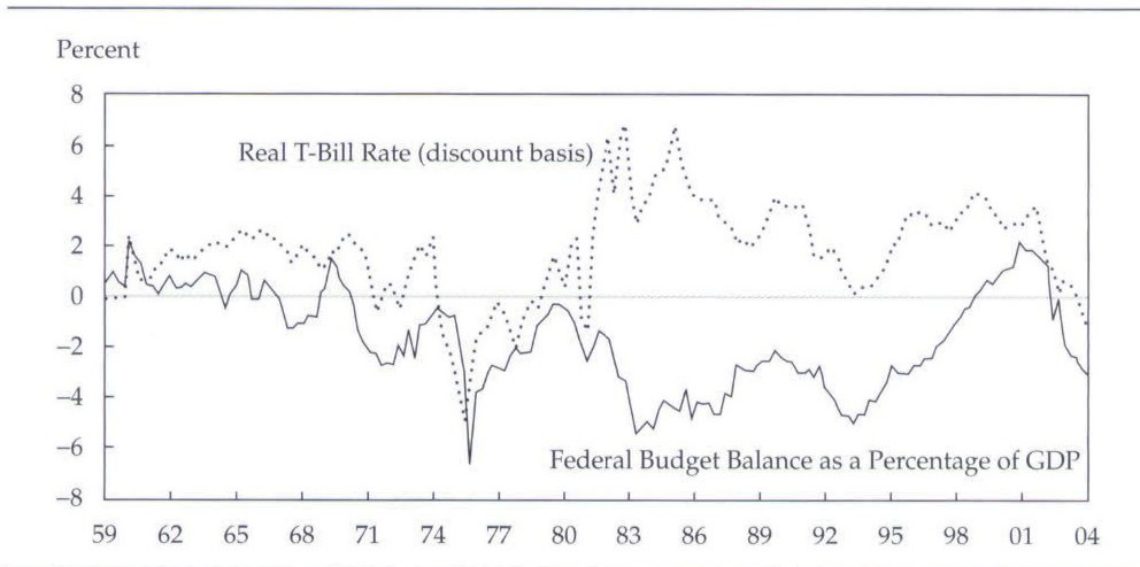


Figure 7: Budget to T-bill Rate (Tatom, 2006)

Despite the revenue reductions, spending rarely saw similar drops and debt offered at these times have more expensive interest rates. Along with oil prices rising, interest rates and inflation can cause slow down in economic activity which further erodes the government income stream.

Budgetary concerns: Social Security and Medicare

The Department of Health and Human Services (DHHS) takes up over 50% of budget outlays as stated previously. This fact compels that any discussion involving balancing the budget has to consider the social insurance costs. If we can not balance our budget, such items like SSA may be in danger of being removed from the scene anyway when deficit spending rises and dollar values fall. In addition, some believe that the impending retirement of the “baby-boomer” generation will cause SSA to be insolvent (AARP, 2007). They project a wipeout of the current Social Security trust fund since there will be less money being put into the system

than being paid out (Malpass, Spring 2007). Few proposals address these potential issues and some refute the insolvency claim altogether in order. AARP and many Americans are resistant to many proposals of the government changing (especially reducing) SSA or Medicare benefits. Yet, AARP recognizes that a problem exists with the trust fund (AARP, 2007).

Given the large growth of social insurance spending, rising costs of health care, rising inflation and current revenue premiums of FICO, there is a real possibility that SSA and Medicare will be under-funded and unable to meet these growing demands if left unchecked. This is partially due to aggressively rising health care costs (NCHC, 2008; Collins et al, Sep 14, 2006) that impacts insurance premiums including Medicare and Medicaid.

A PriceWaterhouseCoopers study suggests that there are three main factors affecting health care prices and premiums: 1) general inflation, 2) prices increases in excess of inflation, and 3) increased utilization (PWC, 2006). Medicare and Medicaid procedures can be honed to reduce fraud and the effect of excessive price increases where inflation-adjusted health premiums are enough to cover outgoing costs. This program has to become more efficient in order to meet eminently growing demands from the baby-boomer generation as they begin to use the programs. Fullwiler (Dec2007) also argues that Treasury bond markets may be negatively impacted by a realization of unfunded SSA and Medicare funds where lost confidence in the federal government would drive rates higher with a riskier treasury note.

DHHS eligibility requirements (such as Medicare eligibility at 65), fees and premiums have to be examined to determine if adjusting these could provide cost savings and better revenue streams. According to Malpass, SSA outlays will far exceed receipts by 2015 and suggests that government spending will as well rise significantly over the course of the forecasted years if left unchecked (Malpass, Spring2007).

When workers lose coverage, they will turn to government and nonprofit sources for health care especially for children, but if the health services are not available through the government, people may forego treatment regardless of need, reduce income due to inability to work, and force hospital write offs for later emergency care. The additional strain will cause more economic anxiety. Thus, rising costs directly and indirectly influence the government spending for health care.

Budgetary concerns: Energy

With oil reaching \$100 a barrel (Marketwatch.com, 2008) and given the correlation with energy prices to inflation and economic slowdowns, finding alternative or more efficient means of energy will be key to balancing future budgets. Worldwide demand rising for oil will cause price pressures from OPEC and Russia as they stretch supply emerging markets.

As demonstrated in the previous figures regarding oil price correlation to US economic slowdown, energy prices (specifically oil) will affect the ability of the government to collect revenue, and cost more for the government to provide a service. Energy initiatives to make alternative sources more efficient and deliverable may offset the effect of oil prices upon inflation and government receipts. As previously discussed, oil drives the US economy (Department of Energy, 2008) currently, but this does not have to always be the case.

Budgetary concerns: War and emergency

Defense spending for WWII, Korea, Vietnam and for the Iraqi wars caused burgeoning outlays for defense. When the United States goes into war anytime, except for this second Persian Gulf and Afghanistan campaigns, taxes have been raised to pay for the military efforts (Rosenbaum, Mar 2003). In 2002, taxes were lowered and rebates were sent to the public as a package to help end a recession. Meanwhile, the military required heavy expenses to support the

missions in the two countries as well as the ongoing military operations around the globe (over \$1 trillion since 2002 while deficits soared to \$250-300 billion each year) (CBO, 2008; MSNBC, Mar 2006, zFacts.com, 2008).

Hurricane and disaster devastation have impacted the federal budget by requiring emergency funding for areas to help rebuild. In 1992, Hurricane Andrew cost \$20 billion. In 2005, Hurricane Katrina and Rita cost over \$150 billion. Flood, hurricane and drought emergency management has to include emergency injection of “rainy day funds” or supplemental budgets so that such catastrophes are able to be managed financially without significant strain upon the remainder of the budget.

We also have to consider what constitutes an emergency and how we prepare for such events financially. In 2005, President Bush released Strategic Petroleum Reserves (SPR) oil reserves to ease the burgeoning price of oil in the US in the wake of Hurricane Katrina and Rita. This release of emergency reserves for an arguably, non-emergency situation suggests that the definition of “emergency” has broadened to include economic stimulus. In 2001 and 2008, the Federal government voted to give “rebates” to Americans. These rebates were meant to stimulate the economy as a recession looms in order to keep the cycle moving. These rebates were first introduced in addition to tax cuts, and thus, less money was being collected while more money was being sent out. Again, these were done while the military was pursuing missions in the Middle East, which directly contrasts previous tax policy during wars.

One could question this rebate program (\$160 billion cost) from the theory that recessions are part of the natural economic cycle (Brue, Nov2006). The Economist argues that recessions are a necessary part of the cycle to help business and consumer, among many things, become more aware of risk (Economist, Aug 2007). The rebates were argued to help stimulate

the cycle, but Furman suggests that the injection of money in 2001 helped to lessen the impact when the recession was almost over (Furman, Jan. 24, 2008). Meanwhile the cycle continued, the treasury paid out the rebates, raised borrowed money for military actions, and received less money from tax revenue. This policy decision appears to be short-sighted and disregarding of long-term impacts since the spending gap has not reduced significantly since 2001.

Proposal: Maintaining current levels

One policy alternative is to maintain the status quo of government revenue and spending. Understanding the consequences of this policy will help us to understand the benefits and potentials of alternative proposals. We have examined so far existing cost structures in general detail with respect to how the budget has come to be allotted over the course of the past 40 years. Thus, the next section will examine the potential ramifications if we freeze current spending and revenue levels.

Milton Friedman argues that taxes takes money out of the economic cycle and that deficits serve a purpose of restraining government (Lee & Vedder, 1992). James Buchanan argues that deficit spending provides taxpayers with a false sense of value for their tax dollar (Lee & Vedder, 1992). Thus, Friedman advocates that tax cuts help to promote economic activity while the deficit spending keeps the government from spending too much. While Buchanan suggests that taxes give people a real perception of what the taxes are doing. Of the G7 nations, the United States has the second lowest debt percentage to GDP (Malpass, Spring2007). Overall, deficit spending costs the government and forces future governments to help pay for what the current government is financing.

If we maintain current levels of revenue and outlay portions, we rely upon a notion that economic activity will increase at some point where revenues will from increased GDP will

intersect or surpass spending lines. As well, the policy relies upon timely ending of financial commitments like the military missions in Iraq. When, and if, this will occur and how much debt will be accumulated in the process will have to be projected. The question is then begged to ask if there are methods that we can use to help to reduce outlays and increase revenues.

A timetable for Middle East military commitment has not been set and for the foreseeable political future, the United States is committed to military support in Iraq and Afghanistan. The costs of this support, thus, remain as part of the budget and defense spending can not be cut without reducing other global support positions like Europe or the Far East.

Since recessions are part of the economic cycle (Brue, Nov2006), we can reasonably consider that economic activity will improve and thus government revenue will rise with the increased economic activity. CBO best scenarios do not project dramatic economic changes (CBO, 2008). Also, the 2002 tax cuts are scheduled to lapse in 2010 which would return the tax revenue potential to the late 1990s levels (unless Congress votes to keep the cuts).

We also have to consider the rising health care cost issue especially with respect to Medicare and Medicaid spending, and as well, the increased participation anticipated by the baby-boomer generation will raise the costs of these programs. CBO baseline projections suggest that government spending will increase over the next decade, and entitlement spending will eclipse receipts (Malpass, Spring2007).

Given the rising costs of social insurance, the present commitments in Iraq and Afghanistan, and the tax provisions, the current trend would only succeed if the tax cuts were lapsed. In addition, agencies and programs would have to hold spending to keep control of existing agency budgets. The current budget outlays will be reduced further by reductions in military activity. As well, cost controls would have to be implemented for health insurance

programs to contain the explosive health care costs especially with the addition of Part D Medicare in 2003. This would essentially return the budget to the Gingrich-Clinton budget levels but maintain an emphasis on military spending. Yet, the current budget, if left unchecked, is not sustainable for adequate long-term fiscal policy since the projections almost require constant growth in economic activity and resistance to inflation. The tax implications for future generations could rise from current 15% of GDP to 25% of GDP (Malpass, Spring2007).

Gradual 5 to 10 year plans

A gradual five to ten year plan would strategically plan fiscal policy to return to a balanced budget. Such a plan would institute phased approaches to spending reductions and enhancement of tax policy. Spending reductions will still have to contend with the expenses surrounding military actions, entitlements and current tax policy. A ten year plan would require the cooperation of proceeding administrations and at least five Congress sessions to have discipline over the plan. Additionally, balanced budget plans would also require commitments from future governments to maintain balanced budget needs. This portion of the report will discuss some options for tax policy and for spending policy.

Among principle consideration for balancing the budget is the tax structure. Many Americans agree that the tax structure is unfair for one reason or another. We have to examine how tax structures influence social inequities (fair duty) and how much is raised with a particular tax structure. Cutting taxes, flat taxes, sales/consumption taxes, or progressive tax strategies have been examined as potential alternatives to current tax code in order to balance a budget. We have to consider what else has to be done besides changing the tax structure.

Simplifying the tax code by cutting out deductions and raising the proportion of higher income earners to 39% would raise Federal income tax revenues. Depending upon which

deductions were removed like the charity deduction/credit, non-profits might have a harder time getting funds if deductions were closed.

The Federal Reserve Bank of Kansas City released a study about alternative tax policies and the effect upon macroeconomic policy. Some want to consider a regressive flat tax or a sales tax to replace the current tax policy and Slemrod (Mar 2006) found a majority invite these proposals to replace the current tax system. Garner suggests that such a switch of tax policy could have dramatic consequences to the economy and a different tax would have to raise the \$1.3 trillion to cover existing expenses (Garner, 2005).

A flat tax proposal suggests that government implements a single marginal tax rate for all income levels and eliminates tax loopholes and deductions. In January 2001, Russia imposed a 13% flat tax rate, and in the following year, arguably incomes increased by almost 20% (Owens, May 2007). A flat tax rate would suppose that reporting taxes be much simpler and tax everyone equally (Owens, May2007; Garner, 2007). Yet, 13% of \$12,000 income has a more dramatic effect upon an earner than 13% on \$120,000. The flat tax proposals do not discuss how Roth IRA, or other tax shelter, savings would be taxed or if these accounts would keep their exemptions.

A sales tax or consumption tax is another option and would be collected through sales of items all across the country similar to current state and local sales taxes. Garner suggests that a national retail sales tax would have to be 23% to cover income taxes, Medicare and SSA payroll taxes (Garner, 2007). These types of tax system require significant transitions in order for people to budget for the taxes in their purchases. This would also put anyone making domestic purchases an American taxpayer, and thus negates the argument that only taxpayers should

receive government services will be questioned. Expected revenue from sales would fall victim to recessions and dollar valuations when less purchases (commercially or residential) are made.

Whether we use consumption or a flat tax, Garner suggests that the long term impact would be to raise real GDP and that such proposals would be better without significant deductions or transitions impeding the policy potentials (Garner, 2007). Raising the GDP would also raise government receipts overall.

The corporate tax structure is similar to personal taxes and reflects a progressive scale (not including the deductions). Many companies, like Wal-Mart and Exxon, in the highest brackets already get many public financed incentives (i.e. public transportation services, infrastructure improvements, or TIF credits) to do business in particular communities. Deductions and tax cuts in the last six years have reduced this revenue source of the budget. This portion of the revenue should be examined, but may face opposition from well-funded corporations that would claim higher corporation taxes would stifle private investments.

Accompany the tax policy with spending reductions (like a 15% defense reduction suggested by Iowans for Sensible Priorities), and then, the tax policy affect is augmented by lower outlays. Outdated program terminations, reduction of “pork spending” and health care cost controls would make an alternative tax policy more effective to control the excessive spending while raising constant revenues and GDP.

Another proposal for the government to consider is to offer to the public in addition to current T-bill and notes, “common stock” in the government as a method of gaining additional revenue, in a similar way of publicly traded corporations. Thus, finances of the government would be under stricter scrutiny by the free markets in publicly traded stock markets like NASDAQ or the Dow. Companies want to produce profit where profit by the federal

government would be questioned via tax methods. This idea would require significant scrutiny to insure that fairness and equality would be implemented since such a practice would have to guard against significant foreign investment or investor manipulation. Yet, this puts the government value at the mercy of the markets and the political leanings of investors, even though current T-bills and treasury notes (public debt) are publicly offered and traded currently.

A more radical proposal to reduce the federal debt

There is a specific intent and movement by some federal lawmakers to reduce the size of the federal government. This example uses principles of libertarianism that follows a “strict constitutional” ideology and believe that the federal government should do as little as possible. Libertarians suggest that involvement by the government (except in the case of human rights), other than expressly written in the Constitution is unconstitutional and therefore illegal. They contend that the existence of the federal bureaucracy impedes civil liberties and therefore should be eliminated (Libertarian National Committee, 2008). The radical policy alternative to consider, then, is to reorganize the federal government to an arguably more explicit constitutional definition. The radical proposal has some potential, but sweeping reform like this requires severe scrutiny.

Consider eliminating the bureaucracy as a means to end excessive spending. What could this do for America, what are the benefits and what are the costs of pursuing the policy? This policy is radical in that tactics require a dramatic shift of conventional thinking over the past centuries of government. This policy may be the most difficult to gain public support due to the unorthodox methods (essentially a reversal of centuries of policy) prescribed and also due to the level of personal responsibility sought by the policy. As well, this policy options would require that commitments by previous administrations be re-examined or overturned.

This proposal suggests to remove all non-essential or “unconstitutional” elements of federal government. Every agency of the federal government is subject to being discretionary, so we have to consider what defines mandatory (or essential). Mandatory tasks are those specific tasks the federal government has to do in order to function and to maintain the constitutional process. Generically, that includes managing affairs with other countries, defending the country, maintaining order internally, collecting revenue to pay for public expenses, and specifically, from the standpoint of the Constitution, run the post office. The post office, as currently set up, would remain and fund its own activities through postmark fees and internal operations. Everything else is derived from the list of powers delegated to the legislature. We can concentrate upon other areas of government.

The bureaucracy was organized as an extension of the executive branch over the years to foresee the executive needs of legislation. If we use the four processes listed above however, we have only the Attorney General/Justice, State/Foreign Affairs, Treasury and Defense/War departments. These were, coincidentally, the original cabinet positions under President George Washington. Again, this reduction suggests a complete reversal of over 200 years of bureaucratic growth. The size of the Federal government would be reduced from 15 departments (22 if one counts other cabinet agencies) to 4.

Defense	510
State	30.2
Justice	21
Treasury	11.5
Branches of government	9.4
Total	582.1 billion

Source: CBO 2007

This proposal to reform the federal government to the four departments has to consider the outlays going to those departments (in billions of dollars). Currently, total debt of the country is \$7.8 trillion and growing (CBO, 2008). Using current budget receipts of \$2.2 trillion and outlays, the full accumulated debt would be fully paid in less than 4 years. This can be even sooner, if we start looking at what is in the budgets of each remaining department.

Additionally, social insurance brings in over \$841 billion of revenue that will be removed through the reform since the SSA and Medicare would part of the cuts. Iowans for Sensible Priorities (2006) estimated that the Defense department is spending is bloated to 15% excess on antiquated materials and equipment. OMB projects cost savings in the four departments as well through program termination and other reductions. Considering the heavy revenue that could be assumed and lowered services, taxpayers will be quick to ask for reduced taxes for the reduced services as well.

The significant reduction in spending has dramatic consequences that would have to be considered and would affect the projection of income and services for the population. The pathway to spending reduction also has an economic multiple effect upon the public. If the government no longer is spending money and takes away the “social safety net”, the multiple affect will be a negative regression as well. This would be noticed especially in those receiving Medicare or SSA benefits. A larger issue would be to determine what to do with the existing entitlement money if no one is overseeing the funds.

The trust funds would have to be paid back to the public prior to removal of the programs. The consequences of doing this would have an immediate short-term economic impact upon people receiving large sums rather than the funds being used as retirement accounts. Those same people may be more interested in spending their short-term wealth rather than the

original intention of saving for retirement, and thus, the long-term impact would cause aging Americans to reduce (or to lose) their retirement savings. As well, the economics suggest that the short-term demand from the sudden consumer spending would drive prices upwards.

Another aspect to consider with this proposal is the new unemployed. The people that were doing these government jobs are now unemployed and not producing tax income to help pay for the remaining government. Services would be dramatically reduced from OSHA work inspections, USDA meat inspections, public health research, NASA technology, road safety, SEC securities and national parks would be removed from federal services. The benefits from these programs would have to be managed or be replaced by state governments or private services. Thus, a shifting of the service burden would occur if a replacement could be found. In many of the cases, the absence of programs may cause severe regulation abuses since the government is not providing oversight anymore.

Businesses that depend upon federal financing or grants (especially many non-profits) will be forced to look elsewhere for assistance. Immediately, anyone on a dependant fixed income like Social Security (SSA) will be negatively affected and consumer confidence would plummet since people would be forced to plan for such times as retirement without SSA benefits. The sudden removal of the social protections might catalyst a depression that would rival the 1930s depression. This particular proposal would most likely be rejected by the public in search of a more moderate approach that does not require such drastic changes in lifestyle. There are considerations here that need to be further discussed.

Summary

The proposals reviewed here against historical data and information give potential pathways and directions for public policy with respect to balancing the federal budget. There are key concerns that must be weighed into the decisions.

- 1) Balancing a budget will have to be mindful of inflation and fuel prices as long as oil is a major commodity to the country.
- 2) Excessive spending has to end and as we spend more we get accustomed to the flow of money, the perceived value of our taxes is more vague (Lee & Vedder, 1992).
- 3) Removal or reduction of social services or insurance will have “multiple” impacts if they can not be funded or replaced effectively.
- 4) Valuable policy initiatives cannot be short-sighted (like tax cuts during war).
- 5) Health care costs have to be controlled since social insurance outlays are heavily impacted by rising health care.
- 6) Tax revenues have to cover spending costs
- 7) Fiscal policy has to work in conjunction with monetary policy (Bernanke, 2008)
- 8) More debt causes more interest payments and ignoring the issue will make the issue significantly worse for future generations.

Buchanan’s idea that perceived value of tax dollars seems to have more credence than Friedman’s idea that deficits help restrain government. Friedman is correct to suggest that budget deficits restrain government spending for current and future governments, but the excessive spending puts the critical budget items at the mercy of dollar valuation, inflation, energy prices and health care costs. The seeming non-restraint of recent governments towards debt and spending suggests that governments are outright ignoring deficit spending. The deficits

lend to politicians a sense of invulnerability to costs and tax policy where the gradually growing crisis has not affected the country in a significantly catastrophic manner.

Poor capital structure of a company (high debt-to-assets) and low price to earnings (P/E) rules could be applied to deficit spending of the government. Excessive deficits suggest poor management of finances where if this were done in a publicly traded company, stockholders would demand firing the CEO and board of directors if the company was able to stay in business. They also limit the ability of future governments to provide needed services. Current safety nets implemented, like SSA, Medicare and Medicaid, are threatened if the government does nothing to sway the deficit spending and could hasten the decline of these trust funds (AARP, 2008).

Observed in this production are alternatives to current policy in addition to a serious look at the current expenditure structure. From a libertarian proposal, maintain current trends and graduated reductions, they all recognize impending issues with excessive government spending. If we are not to maintain current spending, then we require discipline in pursuing policy changes. Radical policy changes like complete bureaucratic reductions or a 23% sales tax would require more transitional efforts to keep the public from having an economic shock due to changes in personal budgeting or government services.

This work will be helpful and relevant to current political discussions for presidential selections. The work will be presented to legislators and candidates seeking office so that they comprehend the complexity of the issue. Malpass quotes former Federal Reserve Chairman Alan Greenspan, "... I will urge them... to make sure that the choices they make are internally consistent, and consistent with long-term responsibility in ... our fiscal finances" (Greenspan as quoted by Malpass, 2007).

The policy choices we make today always have long-term as well as short-term implications that must be considered to proclaim the success or failure of a policy. Additionally, in order to examine the budget issue thoroughly, every part of the budget must be included in the discussion (especially social insurance). Then, the discussion can broaden to include whether additional programs will be affordable as well. The path to fiscal prosperity and funded government services begins with a complete examination of the cost drivers like inflation, energy and health care. Few disagree that continued excessive spending will further erode confidence in American economic stability. Discipline towards spending and recognition of the costs of deficits will help the country find that prosperity.

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