Budget Cuts: An Introduction; or, How to Reduce the Burden of the National Debt without Really Trying

The November 2nd elections seemed to indicate that people are concerned about the US’s growing debt/GDP ratio. Electing new politicians is easy. Getting those politicians to make meaningful budget changes is more difficult. Ever wanting to be helpful, we here at Capitalism Today wish to offer some sound budget advice.

Facts matter. You don’t get to make up your own facts. What are the important federal budget facts? (source: OMB)

* Over the last 50 years (1960-2010) US tax collections have averaged 18.1% of GDP and government spending has averaged 20.5% of GDP. This has left the average budget deficit at 2.4% of GDP.
* The only years in the last decade where tax revenues were higher than normal (the 50 year average) were in 2000, 2001 (pre Bush tax cuts), 2006, and 2007 (booming economy).
* The only years since 1995 where government spending was higher than normal (the 50 year average) were 2008, 2009, and 2010 (2011 is also projected to be higher). Spending in 2009 was 28.1% of GDP and it was 24.4% of GDP in 2010.
* The 2009 budget deficit was 12.9% of GDP while the 2010 deficit was 8.5%
* Entitlement spending was 15.2% of GDP in 2009 compared to 10.6% of GDP in 2000
* There is $104 Trillion of unfunded liability in Social Security and Medicare (Estimate by the Dallas Federal Reserve)

Budget Suggestions:

* **Return to pre-stimulus spending levels:** “Stimulus” spending was supposed to be temporary. Returning to the 2007 level of spending/GDP (20%) would return government’s share of the economy to just below its fifty year average. The economy is bigger now than it was in 2007, so government spending will be larger in real dollars. If God can live on a 10% tithe, surely the federal government can live on twice that.
* **Reform entitlement spending:** The increase in entitlement spending from 2000 to 2010 cannot be sustained. Left unchecked, entitlement spending will become the eggplant that ate Chicago (token 1960’s reference). When unfunded liability in entitlements is eight times the national debt, it doesn’t take a rocket scientist to suggest that no meaningful budget reform can leave Social Security and Medicare unaddressed. We cannot make promises we don’t have money to pay for. By “reform” we don’t mean increase benefits. President Bush reformed Medicare by increasing benefits in 2003.
* **Reform the tax code:** Tax revenues need to increase. There are theoretically three ways to do this. Increase marginal rates, widen the tax base, or have economic growth. A growing economy is the easiest way to raise tax revenue. The key then, is reform the tax code so that you can increase tax revenues without hurting economic growth. This means lowering marginal tax rates for capital (very mobile) and increasing average tax rates on labor (less mobile). A tax reform that reduces personal deductions and exemptions and creates more taxpayers will do the trick. Today 40% of Americans have no federal income tax liability. We no longer can afford that many people paying no income tax.

We need to realize that we have both a revenue and a spending problem. It’s not just one or the other. To suggest that we can balance a budget based on cutting discretionary spending is equally disingenuous. Demographic changes will not allow us to keep piling on benefits to special interest groups just because they turn out to vote.

But where are the details? What specific cuts/ reforms should the federal government make? Well, the devil is in the details, and the devil must wait until next week’s Capitalism Today post for his details.