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ECONOMIC SECURITY vs. PERSONAL FREEDOM

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The primary purpose of budgeting and financial reporting is transparency – letting everyone know what's going on. It's what we expect from every publicly-traded corporation, investment firm, and public agency.

At times, however, the purpose is to mislead or deceive in order to cover up mistakes and scams as in the case of Arthur Anderson's cooking the books for Enron, Bernie Madoff fleecing his investors, and advocates of Obamacare claiming more than \$100 billion in savings by counting ten years of revenues against six years of expenditures.

Our interest in the following is with federal government budgeting and reporting because of the sheer magnitude of current expenditures according to the U.S. Treasury: \$3,456,000,000,000 in FY 2010 or 23.8 percent of GDP. The budget deficit was \$1,294,000,000,000. There is no official budget for the current fiscal year because of gridlock in Washington.

The problem for many Washington outsiders centers around the terms used in the budgeting and reporting process such as revenue neutral, unfunded liability, operating budget, capital budget, baseline budgeting, zero-based budgeting, earmarks, PAYGO, discretionary and nondiscretionary spending. Each is defined briefly below.

Revenue neutral refers to a change in taxes that has no net impact on tax revenues.

Unfunded liability means that a public agency has future entitlement obligations that are greater than expected revenues.

An operating budget lists the ordinary sources of revenues and expenditures for routine agency operations. A capital budget lists all of the special sources of revenues and expenditures for infrastructure improvements and investments. The federal government does not prepare a capital budget.

Baseline budgeting begins with last year's budget and revises expenditures and revenues as deemed necessary. Zero-based budgeting begins the budgeting process entirely anew each year

without reference to last year's budget. The federal government does baseline budgeting.

An earmark is a special expenditure inserted in a bill by a member of Congress to address a perceived need of a constituent or interest group.

PAYGO requires that any increase in expenditures must be offset dollar-for-dollar by a decrease somewhere else in the budget.

Discretionary spending is spending over which there is some Congressional control to increase or decrease from one year to the next. Nondiscretionary spending is spending which is locked in by some entitlement or regulation and cannot be changed without new legislation.

Is there a difference between an *investment* and *spending*? NO, in the sense that both involve disbursement of public funds. YES, in that there is an expected return from an investment, but not all spending produces a return in the future. Compensating Japanese Americans who were interred during WWII is not an investment because it is intended to make amends for a wrong committed in the past. Providing vocational training to the unemployed is an investment because a return is expected in the future.

Some public investments have been hugely successful as with land-grant colleges and the interstate highway system. Others have failed miserably such as the Corps of Engineers MRGO (Mississippi River Gulf Outlet) and the virtual fence built by Homeland Security along the border with Mexico. Others such as the postal service and Federal Reserve facilities for clearing checks slowly give way to technological change. To be successful, a public investment must be both visionary and restrained. It must be based on an authentic public need that cannot be met through private investment, and it must be cut off when it no longer serves any useful public purpose.

In the past, public investment was defined as an expenditure for an infrastructure improvement such as a highway, port facility, or levee system. Over the years, however, investment has been applied to expenditures on programs intended for human improvement such as early child development and school lunches for needy children. For that reason, most federal expenditures can be called investments. Even so, whatever they are called, all of them are expenditures.

Is there a difference between a *subsidy* and a *loophole*? NO, in the sense that both provide special advantages for certain persons or private organizations. YES, in the sense that a subsidy may help support some desired public or private investment whereas a loophole may not.

More than 40 percent of persons filing federal income tax returns pay no taxes thereby opening the door to using the federal budget as an income redistribution device. Thus, to the extent that the non-payers take advantage of federal expenditures that subsidize rental housing, vaccinate children, provide meals to the elderly, and the like, income in effect is

redistributed from persons who pay income taxes to those who do not.

Moral hazard occurs whenever a government guarantee such as deposit insurance invites a financial institution to take on even riskier ventures because it knows that its depositors will be protected even if the institution fails.

Hold harmless is a provision that assures persons and organizations they will not be made worse off by some proposed change. One example is the Social Security Administration's provision that most of the retired will not have their monthly benefit reduced whenever there is an increase in their Medicare contribution. A waiver is one way to implement the hold-harmless rule as with the waivers regarding limits on coverage and administrative costs that some companies and unions have been awarded so that Obamacare will not impact their employees and members negatively.

Two hundred years ago, Thomas Jefferson warned that "the price of freedom is eternal vigilance," which for two principal reasons applies even more so in our times than in his. First, more than 80 million Americans cling to an economic security blanket woven from federal spending, investments, subsidies, loopholes, and waivers. Second, the growth of the public debt has made America more dependent on foreign sources of credit. A dependent America is an unstable nation because it is built on a fault line of public debt.

It will be shaken and collapse when we no longer can sell the new bonds necessary to redeem the old ones as they mature, we cannot pay the interest owed on the bonds outstanding in stable dollars, and we fall back on debasing the currency that produces the appearance of meeting our obligations to our creditors but in essence means defaulting on the public debt, thereby paving the way for demagogues who will promise to restore stability in exchange for our freedom.

All is not lost, however. We can restore stability and protect our freedom if we are willing to do the heavy lifting required to relocate America to a fault-free zone by budgeting for deep cuts in spending not to reduce the burden of taxation but to pay down the public debt.

What will the next generation of historians say about today's Americans? Did we settle for the security blanket promised by the demagogues or the personal freedom that comes from heavy lifting?

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