



On this Independence Day we may be rushing headlong to another type of “independence:” independence from BIG GOVERNMENT and BIG DEFICITS.

The supposed August 2 deadline is fast approaching and there does *not* seem to be any progress being made to a debt ceiling resolution. Both sides seem to have dug in their heels and in a grand “blame fest” are each pointing to the other side as being “inflexible.”

Is this just positioning in a big game of chicken? OR will *major* changes in taxes and spending come out of this showdown?

Since nobody appears ready to roll over, we’ll probably *at least* go right down to the deadline, just like in the “continuing resolution” process a few months ago.

What if we go beyond the deadline? Then parts of the federal government may actually shut down. In late-1995 and early-1996, non-essential federal government workers were placed on furloughs while a budget dispute between President Clinton and a Republican-controlled Congress was hashed out.

What might be affected this time? The entire federal government does *not* need to shut down. The federal government takes in revenues, estimated to be about \$2.3T this year, *and these can be spent*. Furthermore, as the national debt matures, the Treasury can roll debt *as long as it stays within the debt ceiling*.

I have listed the federal government’s FY2011 budget below. I placed the first few items in my own subjective order of importance. What the table indicates is that even if we hit the debt ceiling wall, we *can* continue to pay interest on the nation debt (and roll maturing issues). Hence, *the U.S. need not default* on its most significant obligation. Next, we can keep the Department of Defense operating; it is unthinkable to stiff our military personnel. We would presumably also want to keep our Justice Department operating (FBI, marshals, prosecutors, and judges). General government can be kept in operation. Finally we could keep making payments to our senior citizens, their Social Security payments. Perhaps with only a few days’ disruptions, ALL these items can be covered with current revenues.



Dr. Ken Mayland was previously the Chief Economist of First Pennsylvania Bank and KeyCorp. He

graduated with degrees in economics from MIT and the University of Pennsylvania (M.A. and Ph.D.). Dr. Ken has been a past member of the Economic Advisory Committee for the State of Ohio and has held several leadership positions with the National Association for Business Economics. For a complete bio, visit [www.cvecon.com](http://www.cvecon.com).



ECONOMIC TRENDS SPECIAL REPORT

The break point comes with Medicare payments: most can be covered, but not all, on any timely basis. Past that, *everything* else is shut down.

Obviously, there can be much *politics* on what is covered and what is not. Would Social Security payments (earned through a *lifetime* of work *and payments into the system*) be held hostage so that food stamps and unemployment benefits be paid (for people sitting on their asses), together with international assistance (to countries whose citizens do not like us)? In other words, if Social Security recipients are stiffed, it will be due to *politics*, not economics.

You make the judgments, but at least you have the *facts*.

***The FY2011 Budget of the United States (Bil. \$)***

Area/Item	Amt.	Cumul.
Interest	206.7	206.7
National Defense	768.2	974.9
Administration of Justice	60.7	1035.6
General Government	32.1	1067.7
Social Security	748.4	1816.1
Medicare	494.3	2310.4
Income Security	622.7	2933.1
Health	387.6	3320.7
International Affairs	55.2	3375.9
General Science, Space, Tech	33.3	3409.2
Energy	27.9	3437.1
Natural Resources, Environ.	49.0	3486.1
Agriculture	25.1	3511.2
Commerce and Housing	17.4	3528.6
Transportation	94.5	3623.1
Community and Regional Dev.	25.7	3648.8
Education, Training, Employment & Soc. Services	115.1	3763.9
Veteran Benefits	141.4	3905.3
Undistributed Receipts	-89.7	3815.6
Total (Bil. \$)	3818.8	



Dr. Ken Mayland was previously the Chief Economist of First Pennsylvania Bank and KeyCorp. He

graduated with degrees in economics from MIT and the University of Pennsylvania (M.A. and Ph.D.). Dr. Ken has been a past member of the Economic Advisory Committee for the State of Ohio and has held several leadership positions with the National Association for Business Economics. For a complete bio, visit [www.cvecon.com](http://www.cvecon.com).



ECONOMIC TRENDS SPECIAL REPORT

But understand, if even a partial government shutdown occurs, it could be *the mother of all Keynesian contractionary policies*. The difference between revenues coming in (\$2.3T) and intended/planned spending (\$3.8T) is *immense*. There has never been a \$1.5T (annual rate) contractionary policy.

While many people feel the government should spend less (maybe, a lot less), you *must* realize that through the “circular flow of income and spending” (a basic economic *principle*) that spending represents somebody’s income. Being cut off even if it is good in the long run *will hurt*.

OF COURSE, some deal will be hashed out. Maybe in a month. Maybe in two weeks. But even this loss of spending will move the needle on the economy.

*So be prepared.*

And what lies on the other side of a deal? Probably some combination of *significant* tax increases *and* spending cuts. BOTH are contractionary!

This is the corner that we have painted ourselves into. There is *no* easy way out. You can run (from fiscal drag), but ultimately, you cannot hide. IF the current problem is papered over it will only make the future problem that much (more catastrophically) worse, think chaos and anarchy.

If the problem is directly confronted, there will be pain, but there might also be a future.



Dr. Ken Mayland was previously the Chief Economist of First Pennsylvania Bank and KeyCorp. He

graduated with degrees in economics from MIT and the University of Pennsylvania (M.A. and Ph.D.). Dr. Ken has been a past member of the Economic Advisory Committee for the State of Ohio and has held several leadership positions with the National Association for Business Economics. For a complete bio, visit [www.cvecon.com](http://www.cvecon.com).