Lord What Fools These Mortals Be

“Lord, What Fools These Mortals Be!”
Puck, *A Midsummer Night’s Dream*

Twenty-four, Seven, Three Hundred Sixty-five; all day, every day, all year, we are inundated with information. How are we to make sense of it all so we can make intelligent, wise decisions? What are substantive facts and what can we discard as simply tangential sound bytes? (Isn’t there an app for that?).

Members of Congress are struggling with how to balance the budget. Everyone appears to have an idea on what popular (or unpopular) programs to cut or eliminate. “If we terminated Funding for the Arts, scuttled the NASA Space Program and eliminated salaries and benefits for members of Congress, then surely we could balance the budget. Right?” Wrong.

A typical taxpayer with a 2009 median income of $34,140 paid a total of $5,400 in combined federal income tax and federal payroll taxes (FICA). If we apply this $5,400 to the Federal budget, where did the money go?

Well, out of the $5,400 in tax payments, 19.27% ($1041) went to Social Security; 11.58% ($625) was applied to Medicare; and 7.13% ($385) helped fund Medicaid. Interest on the National Debt claimed 5.32% ($287); combat operations in Iraq and Afghanistan took another 4.24% ($229) and military personnel required 3.57% ($193).

All together, just these five items consumed over 50% of our (your) taxpayer’s payments. OK, so let’s get to the good stuff. How much could we save in taxes if we cut Arts, NASA and Congressional pay? The answer is: not much. These three line items consumed $0.24 (0.004%), $28.09 (0.52%) and $0.19 (0.004%) of the federal budget respectively. In other words $28.52 (approximately 0.53%) out of the $5,400 total is used to fund these items.

I am not suggesting these items should or should not be funded. What I am suggesting is that we should engage in a national dialogue about truly meaningful budgetary reform. Spending the next two years in heated rhetoric over small items like these while being afraid of taking on the big-ticket expenses (entitlements and national debt) can lead to only one conclusion: Puck is right.

The Fed Changes Course

About two weeks ago, the Federal Reserve decided to allow major banks to increase their dividends and to buy back outstanding shares of stock. From a shareholder perspective, one could argue that this is a good thing. A dividend represents income (a “reward” so to speak) on the shareholder’s investment.

The buy back reduces the numbers of shares, which should enhance the value of the remaining shares. What’s not to like?

The heads of these major banks like the Fed’s decision. The Fed’s green light signals a release from the remaining restrictions imposed on these same banks as a result of the taxpayer funded bailout from the financial crisis that exploded in 2007-2008.

The Fed had limited these banks from paying out dividends and from using profits to buy back stock because the Fed wanted these banks to have some of the bank’s own money invested in the bank’s operations. In essence, the more bank money is retained, the less leverage the bank has available. This means the bank has more of its own money (equity) at risk. This in turn means that if this bank stumbles, it has more to lose.

You might think that the people who run these big banks would have an incentive to keep equity at a high level providing a cushion against future losses and effectively protecting creditors. (Somewhat like you and I maintaining a rainy day fund.) Banking did operate in this fashion back when government was much smaller and for all practical purposes unable to save large financial institutions. Back then, there was no such

thing as “too big to fail”. Banks routinely had capital (equity) levels of 30-50 percent (somewhat akin to buying a house with 30—50% down payment).

With earnings (equity) now available for distribution, these major banks are returning to equity levels of less than 5%; many have only 2%; thus leveraging themselves once again up to 50:1.

Why should you care? Well, if you saw the value of your investment portfolio decline, the value of your home fall; if you or someone you know lost a job or if the price you pay for food or gas has increased, then you should care. Because, without increasing the major banks capital requirements, we are rapidly recreating the same set of circumstances that lead up to the financial crisis.

Could Puck be right again?

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