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INSIDE THIS ISSUE:

Smile Time

A thief stuck a pistol in a man's ribs and said, "Give me your money." The gentleman, shocked by the sudden attack, said, "You cannot do this, I'm a congressman!" The thief replied, "In that case, give me MY money!"

Word Swamp Revisit

Static Scoring

Using an econometric model that assumes that tax revenues will increase with increasing tax rates...all the way to a 100% tax rate.

Dynamic Scoring

Using an econometric model that realizes that tax policy affects economic behavior, such as when tax rates reach a certain point, people's interest in developing more business activity wanes.

Indenture

A bond contract

On the Margin

In economics, the cost (or price) of the next item produced.

An NPV Problem and Current Political Events
Improving (Lowering) Tax Rates

The Biz Bucks Guy is very optimistic about the future of the USA. The presidential election, and President-Elect Trump's picks for his cabinet are portending good things economically. Leaving much of the campaign rhetoric aside, it appears the supply-siders will get a bill passed that will reduce the income tax rate for businesses. Does this spur the economy? Let's look at this from an NPV standpoint.

Good Ol' Amalgamated (GOA) is considering a control room change that would allow their aging paper mill to run more efficiently. The cost of the upgrade is $600,000. If installed, they believe their operating budget each year will be reduced about $100,000. This budget is on a pre-tax basis.

The Tax Rate currently is 35% for federal and 5% for state. The new president, Douglas G. Thumper, is lobbying to have Congress reduce the federal tax rate to 15%, which would yield an effective total rate of 20%, including state tax of 5%.

The "real" Weighted Average Cost of Capital for GOA is 8%. Real means the effects of inflation are excluded. This allows you, the analyst, to simply repeat the savings each year with no escalation. Real cash flows should be present valued using a real discount rate.

The Biz Bucks Guy has developed a solution spreadsheet available from his web site, www. bizbucksguy.com. The worksheet incorporates two possible tax changes, a reduction in income tax from 40% to 20%, followed by a similar layout that changes the Depreciation Tax Shield from straight line to full expensing in the first year. This second tax change was discussed in a prior Biz Bucks Quarterly in 2015.

Both calcs yield not only Net Present Value, but also Profitability Index, sometimes called Benefit Cost Ratio. NPV is the present value of the cash inflows MINUS the present value of the cash outflows. Profitability Index is essentially the same two numbers DIVIDED, instead of subtracted. For NPV, positive NPV projects create value. Likewise, PI's over 1.0 create value. It's just algebra.

Referring to the spreadsheet, there are two large NPV calcs. The first one is from Row 9 to Row 28. This NPV and PI values are for just the reduced income taxes, with the historical Depreciation Tax Shield. The second calc is from Row 31 to Row 50. It shows the same two tax rates, but with FULL EXPENSING of capital at Year = 0. This is the second idea being promulgated by the supply-siders in Washington.

See the chart on the last page to compare the results. It is clear that more capital projects will be approved with just one of these two tax reform ideas.

The NPV for 40% and normal DTS is a negative $36,353.

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A Biz Bucks Guy Opinion
Static vs Dynamic Scoring

The US Congress is in a box. There internal laws require them to use the Congressional Budget Office (CBO) to score all proposed laws. This scoring is intended to show if a proposed law is deficit neutral, whether it creates more debt or (hope springs eternal) whether it reduces debt. That makes sense on the surface. However, when examined more carefully, this is an excuse for left-wing mischief.

The CBO outsources to private econometric firms the responsibility to develop models that are used by the CBO to score such proposals. In the world of macro-economics, there are two broad camps. One are the Keynesians who believe in large governments, increased spending, and draconian taxes. The other are the Classical economists, or as The Biz Buck Guy calls them, the "Hayekians". John Maynard Keynes was a British

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Leadership Readiness Skills

This regular feature will return next issue.

This feature will help "drain the word swamp", as it is currently fashionable to say.

More on Scoring continued from Page 1

"With dynamic scoring, the short-term tax revenues would drop with lower tax rates. However, the economy would soon take off. We would bust through the 2% malaise of President Obama."

economist that encouraged government spending to spur economic growth. Fredrich Hayek was an Austrian economist that espoused the classical economic theories of Adam Smith and others, including limited government, lower taxes, and lower spending.

So here's the rub:

Classical economists believe that tax policy changes behavior. Keynesians less so. So guess who the CBO contracts with to develop their models to score legislative proposals? Yepper, the Keynesians.

Why does this matter?

It has to do with the notion of static scoring vs. dynamic scoring. What is that, you say?

In static scoring, espoused by Keynesians, increased tax rates always increase tax revenues for the government. That is baloney, of course. If tax rates are increased to 100%, no one would work. The tax revenues would be zero. In fact, some 25 years ago, a right wing senator asked CBO to score a tax proposal to move the tax rate to 100%. The CBO, using Keynesian models, returned an answer of several billion dollars flowing into the federal coffers. That was precisely the reason this senator did what he did, to show how ridiculous their scoring models were. Using the Keynesian approach, the more the tax rate the more the tax revenues. It is a STATIC slope to the tax revenue curve.

Given the obvious nonsense of static scoring, what is DYNAMIC scoring? In dynamic scoring, the models predict the point at which the tax revenues begin to drop off with increased tax rates. That is, of course, a matter of subjective thinking. The fact that economists don't agree on the point of diminishing tax revenues is one reason the Keynesians argue for static scoring. But that argument is just as goofy as their models themselves. As Dr. Alan Shapiro of USC's Marshall School of Business taught The Biz Bucks Guy, "It is better to be vaguely right than absolutely wrong!" Static scoring is absolutely wrong. In recent times, the CBO is beginning to see the light. On occasion, they have mentioned two answers to proposal legislation, one based on their static models and another based on a dynamic approximation.

OK, so what the rub?

Currently, President Elect Trump and many others are advocating a large drop in business tax rates. We currently have one of the highest tax rates in the world, at 35%. The proposal is to cut the corporate rate to 15%. However, there is a problem. The House, led by Speaker Paul Ryan, will easily approve the 15% level. But when the bill gets to the Senate, their rules are different.

In the Senate, it takes 60 votes to pass general legislation. With only 52 Senators on the Republican side, getting 60 may be a problem. The Dems can block any bill they want to, if they hold together and vote with one clear voice. This is the case EXCEPT for certain budget measures. These are called Budget Reconciliation. For budget reconciliation bills, only 50 votes are needed to send the measure to the president.

Here's the problem:

The CBO must score any budget reconciliation measures to be deficit neutral. The 15% rate, according to static scoring, is not deficit neutral. If the bill was written for a 20% corporate tax rate, it would score as deficit neutral, and could pass with only 50 votes. Why neutral? Because the law will close many loopholes provided to crony capitalists currently.

So the CBO static model may drive the tax policy to be less effective than it otherwise would be.

With dynamic scoring, the short-term tax revenues would drop with lower tax rates. However, the economy would soon take off. We would bust through the 2% malaise of President Obama. Thus, on a long term basis, tax revenues would increase.

Who knows how much the economy would grow with a tax-reduction policy? Many believe it could match the Reagan response when GDP growth was 4.9%, after he broke the 1980 recession he inherited. The deficit would drop because business would be more profitable and grow.

To understand more, read about the Laffer Curve (which is the basis for dynamic scoring) in The Biz Bucks Blog.

Time will tell. Perhaps, the GOP will garner eight Dem votes and get the 15% level passed. That is doubtful. At least, 20% corporate tax rate will be a giant step in the right direction.

FROM *LEADERSHIP FOR THE RECOVERING QUANTOID*

LEADERSHIP LANDMINES

The following is taken from Chapter 17 of Leadership for the Recovering Quantoid.

In Enterprise, Alabama, in 1915, a tragic event took place. The cotton crop, which was the mainstay of economic stability for many in the area, failed. An infestation of boll weevils destroyed the livelihood of the community. This led one entrepreneur farmer to plant a new crop—peanuts. The peanut crop was a success, and soon the entire county's income was more diversified. The economic well being of the area was vastly improved.

In 1919, the citizens of Enterprise erected a beautiful statue in the town square. A lovely Greek goddess, draped in a flowing gown, held up an ornate plate on which was a very large boll weevil. The historical marker reads, "In profound appreciation to the Boll Weevil and what it has done as [our] herald of prosperity." The statue remains the only such monument dedicated to an agricultural pest. Without the boll weevil, the town would not have prospered.

Sometimes talented leaders run into career boll weevils. The existence of really bad bosses is not funny, particularly if you are reporting to one.

Most of the truly bad bosses have some deep-rooted psychological hang-up. One mean-spirited boss was finally decoded by his new administrative assistant. Her Caesar-esque boss could not read…yes, he was illiterate! He made up for it by being a tyrant to keep everybody off guard. What a revelation it was to understand the *why* behind the *what*.

Regardless of their underlying motives, sometimes, these psyche cases win. They can exhibit enormous power because of their position. Some very talented leaders can find their successful career in leadership scuttled by a bad boss. As we tell our children as they grow up, "Sometimes, bad things happen to good people."

If this happens to you, just remember, you will land on your feet. You are the one with the ability. You will someday look back and see that your boll weevil did you a favor although it did not seem like it at the time. If you don't let such an all-too-common scenario knock you down, someday you will see your career boll weevil was your herald of prosperity.

The Biz Bucks Guy knows this firsthand. He is grateful for a boll weevil that temporarily ruined his career many years ago. The past fifteen years of creative, meaningful, difference-making, exciting professional life is the result of being awoken by a boll weevil.

Land Mines of Leadership

Those considering leadership should not be overwhelmed with this chapter. It considers the dark side of careers in leadership (The next chapter will focus on a more optimistic side of leadership). Sometimes things just don't work out. You can be right and ready for leadership, as discussed in chapter 1, but careers are long. There is ample time to accidentally step on a career land mine. The higher your leadership visibility goes, the more opportunity there is for career-fatal mistakes. This chapter summarizes several ways careers in leadership get scuttled.

In addition to running into a boll weevil, a leader may have their title changed to former leader for a variety of reasons. These include issues of the following:

- performance
- culture
- unimpressive moments
- ineffectively managing up
- sabotage
- bad luck
- lack of technical growth
- poor health
- discrimination
- reverse discrimination
- personal preference
- ethics.

Of all the ways your leadership career may get scuttled, unethical behavior is the most pathetic. In the final analysis, your integrity is one of the few things in life that you can completely control. It is up to you and no one else. Learn to lean to the right and avoid the wrong.

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The final leadership land mine is ethical lapses. This topic demands more focus than any of the others, so fasten your seat belt. The Biz Bucks Guy calls this section *business Sunday school*.

This section is intended to be helpful to two groups:

1. Those who attempt to be ethical in their personal and professional lives. They will understand that ethical behavior is not always easy. Situations occasionally arise in leadership where the right direction is not clear.

2. Those who attempt to navigate on the edge or even across the edge of ethical behavior. Perhaps these people have been suckered into believing Hollywood, which always portrays business people as the villains. They should learn that it is easy for their low ethical standards to be discovered. If you are in this group, it is time to seriously review your *modus operandi*.

Dr. Alan Shapiro, professor of economics at the Marshall School of Business at the University of Southern California, says that two ingredients are necessary for capitalism to work. One is a properly functioning accounting and legal system. The other is honest people.

Ethics count.

"(T)wo ingredients are necessary for capitalism to work. One is a properly functioning accounting and legal system. The other is honest people."

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We're on the web at BizBasicsOnline.com in April!

The Biz Bucks Guy has now taught or facilitated business-acumen and related principles to 5799 participants (thru December 2016)!

BIZBasics ONLINE

The BBO Quarterly *is published quarterly (surprise) by Bob Llewellyn, the "Biz, Bucks Guy" 1) to support past participants in BizBasics Online.com or "Biz Bucks" live training, allowing them to review the principles taught; 2) to possibly entice other unsuspecting victims into the class room or the online learning experience…and 3) to give the Biz, Bucks Guy something to do between gigs.*

BizBasics Online offers a <u>quick</u>, <u>affordable</u>, and <u>effective</u> way to gain the quantitative skills of business, being statistics, accounting, finance, and economics. BBO courses teach the BBO Decision Making Methodology for improved decision making.

One popular "live" course is Biz, Bucks & Blastoff, *a two-day course in financial decision making. This course is designed for engineers and other technical professionals who make or recommend financial decisions.*

Lowering Tax Rates

CONTINUED FROM PAGE 1

The project does not "number out". The project is killed.

When the 20% tax rate us used, the NPV turns positive to $17,327. The project is approved. The economy begins to improve.

With full expensing (the tax deduction is taken not over ten years but immediately), the NPV become even more positive. Even with a 40% tax rate, the NPV is $42,605. With the 20% tax rate, the NPV become more positive, at $56,807. Referring to the green table, the improved NPV is $93,160.

Using the PI view in blue, the improved PI is from 0.94 to 1.09, with both tax changes. These two tax changes will start our economy rolling like the millennials have never seen. Tax policy matters!

SUMMARY	Two Tax Rates	With DTS	With Full Expensing
Comparing NPV's	@40%	(36,353)	42,605
	@20%	17,327	56,807
Comparing difference in NPV	@40%	BASE	78,958
	@20%	53,681	93,160
Comparing PI's	@40%	0.94	1.07
	@20%	1.03	1.09