'Budget-balancing' is an exercise doomed to failure

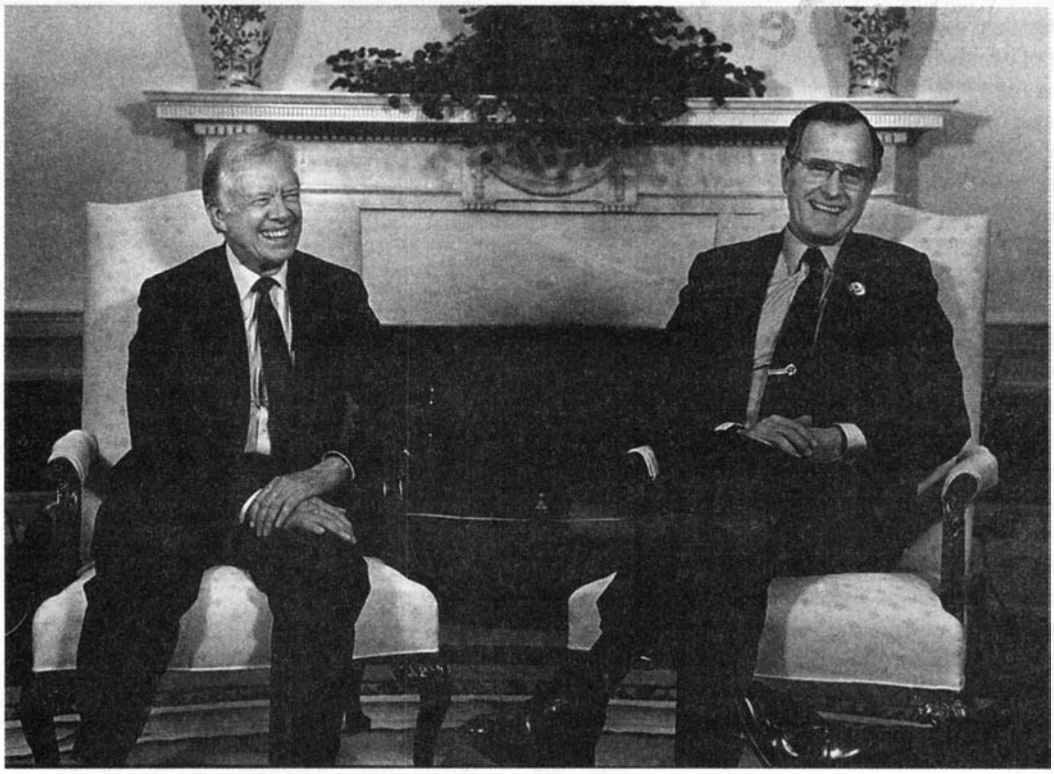
by Richard Freeman

Lyndon LaRouche proved in his Jan. 27 nationwide Presidential campaign television address, that any attempt to balance the federal government's budget deficit using the same methods employed to manage a household's budget, is a piece of insanity, doomed to failure.

Here, we are going to review the recent history of such attempts, proceeding from the 1977-80 Presidency of Georgia peanut farmer Jimmy Carter, when this approach first became institutionalized at the level of the federal government, to demonstrate that not only has the approach not worked, but that its consistent results have always been to double the budget deficit in the period immediately after the enactment of measures designed to proceed as a household would, namely, by cutting expenditures to bring them in line with apparent income.

Since those involved in the present round of budget cutting mania, such as Speaker of the House Newt Gingrich (R-Ga.) and Sen. Phil Gramm (R-Tex.), also happen to have been involved in the earlier such dismal failures, one ought really to ask what it is they think they are doing, just as LaRouche posed the question in his television broadcast. If they are doing what they say they are doing, then how come neither they, nor apparently many other people, have noticed that all their previous efforts have failed? What, after all, is the present budget deficit, if not the result of these characters' earlier, failed, efforts to reduce the budget deficit?

To continue on a course that has produced, consistently, such ludicrously ignominious results, says something about the intellectual powers, and moral qualities, of the minds that so obsessively persist. Or, maybe there is something else involved. Either the fanatical budget-cutters have to be out of their gourds, that is, if their actions are supposed to correspond with their words, or, their actions actually assert other motives, in which case they must still be considered insane, by their results. What then, though, about the rest of the population, who so regularly seem to choose the words over the actions, while re-electing lunatics whose radicalism on behalf of failed policies increases seemingly in proportion to the increasing failure of their policies?



Presidents Jimmy Carter (left) and George Bush at the White House, March 1990. Their hatred of the American System of political economy, its high rates of investment in infrastructure and science and technology, ensured that their axiomatically flawed attempts to "balance the budget" would further destroy the U.S. economy and increase the deficit.

House Speaker Gingrich claims to be a former professor of history, Senator Gramm claims to be a former professor of economics; they should have seriously studied the economic history of the past 45 years. If they had, these two unbalanced minds would have realized that their view that slashing the budget will produce a balanced budget is contradicted irrefutably. The United States does not need a balanced budget amendment; as LaRouche said, it needs an amendment to balance Gingrich's and Gramm's minds.

Not a single one of the so-called theoretical arguments or kamikaze political tactics, government shut-downs, or threats to default on the federal debt that Gingrich and Gramm have been using over the past year, are in any way new. First, today's Gramm-Gingrich Newtzi effort to attempt to attach to a resolution to increase the federal debt ceiling a draconian budget-balancing bill and, in the process, to shut down the functioning of the U.S. government, is *not* the first time this has been done. The City of London and Wall Street did this before: This is exactly what was pulled in 1981 to force passage of the Kemp-Roth Act, and in 1985, to force passage of the Gramm-Rudman-Hollings Act.

Second, the attempt to specify a set number of years during which the budget will absolutely be balanced has been tried three times before. President Jimmy Carter was a major force pushing for budget-balancing. He ran his 1976 Presidential campaign on the basis that he would bring about a balanced budget within four years. He introduced, as early as 1980, a budget that would supposedly eliminate the federal deficit by 1981. In 1980, campaigning for President, Ronald Reagan promised to balance the budget in three years. In 1985, when the Gramm-Rudman-Hollings Act was passed, it promised iron-clad to balance the budget in five years, and had a detailed timetable, with dollar deficit limits, in descending size, specified for each of those five years. The budget wasn't balanced by any of these three efforts: The deficit kept growing ever larger—actually, it doubled every time.

Why? Because the underlying approach and axiomatic method of thinking about the economy and budget of Jimmy Carter; of the City of London-Wall Street boys who ran the Reagan economic policy (including the role of George Bush and Jack Kemp); and of the Gramm-Rudman-Hollings gang, was fatally flawed. It cut real economic activity and encouraged speculation. To change the outcome of a process, don't do what you were doing that was failing before, but three or four times harder. Unlike what football coaches tell you, it is not a matter of "true grit." It is a matter of changing the axioms of one's thinking.

Today, Gramm and Gingrich still employ the same flawed methodology that unbalanced the budget for the last two decades. They will tell you that the problem in the past was that liberals controlled the Congress, that government was too big, and a thousand other feeble excuses. The historical record, which is presented here, refutes them.

Who threw the budget into deficit, and how they did it

Let's go back to 1978-82. Those were the years in which the insanity was institutionalized. During those years, five events occurred which together were crucial in shifting the entire process. The series of events included:

1. The second oil hoax, of 1978-79. The first oil hoax of 1973-75 had raised the price of oil from $3 per barrel to $12 per barrel; the second hoax, like the first, orchestrated by Royal Dutch Shell and the other Seven Sisters oil companies, shot the price of oil up from $12 per barrel to $36 per barrel.

2. The Steiger Act of 1978. In 1978, Rep. William Steiger (R-Wisc.) introduced a bill, which became law in 1979, cutting the capital gains tax rate from 49% down to 28%.

3. Federal Reserve Board Chairman Paul Volcker's actions, starting in October 1979, to force up interest rates. By early 1980, the prime lending rate had reached 21.5%, and rates on Treasury bills and all other instruments were shooting upward. This implemented the policy of "controlled disintegration" advocated by the New York Council on Foreign Relations in its "Project 1980s" reports.

4. The Kemp-Roth Tax Act of 1981, formally called the Economic Recovery Tax Act, which was signed into law in August 1981. This was the underpinning of the "supply-side" push. It was the enabling legislation for huge tax breaks for real estate investments and speculation, such as the setting up of "passive tax shelters," in which one could invest $1 and, in return, get $2-4 of losses to write off against one's taxes. This kicked off a boom in the New York, Boston, and other real estate markets. The Kemp-Roth Act also lowered the top tax rate on capital gains tax further, from 28% down to 20%.

5. The Jake Garn-Ferdinand St Germain Act, formally called the Depository Institutions Act, which was signed into law in October 1982 and deregulated the entire banking system (the savings and loan institutions and the commercial banks). Vice President George Bush had been the head of a White House committee which studied, recommended, and oversaw the banking deregulation. One of the effects of deregulation, is that previously, S&Ls had been restricted by law from investing more than 5% of their loans in commercial real estate. Now that restriction was lifted entirely.

Readers of *EIR* since 1977, will remember where we stood, and where our opposition stood, on each issue. They will also know who has been proven right, repeatedly.

The combined effects of these events are not hard to find. The oil price increases, and the subsequent interest rate increases, pushed the economy below break-even, bankrupting businesses and dramatically increasing unemployment. In combination, they destroyed the wealth-producing potentials which undergirded the nation's tax base. All other opinion to the contrary, there has been no recovery since.

The legislation adopted, freed up the liquidity to invest in the real estate partnerships and trusts set up under the Kemp-Roth Act, which, thanks to Volcker forcing up interest rates, set rates of return in real estate at 20% and above per annum. The Garn-St Germain Act also shoveled money into the stock market leveraged-buyout fever, which the Steiger Act had helped unleash. The cumulative effect was to shift, radically and permanently, the economic-financial geometry of the United States and the world. Financial speculation became the ordering principle shaping the economy; capital-intensive, energy-intensive production in manufacturing, agriculture, and basic infrastructure, which had functioned until approximately the November 1963 murder of President Kennedy, and which had hung on gamely for another four to five years after that, was decapitated. The budget and the economy were destroyed.

When the Gramm-Rudman-Hollings Act was signed into law in December 1985, and put into effect in the fiscal year 1986 budget, this pushed deficits into the stratosphere. It also served as the coup de grâce of the defense industry.

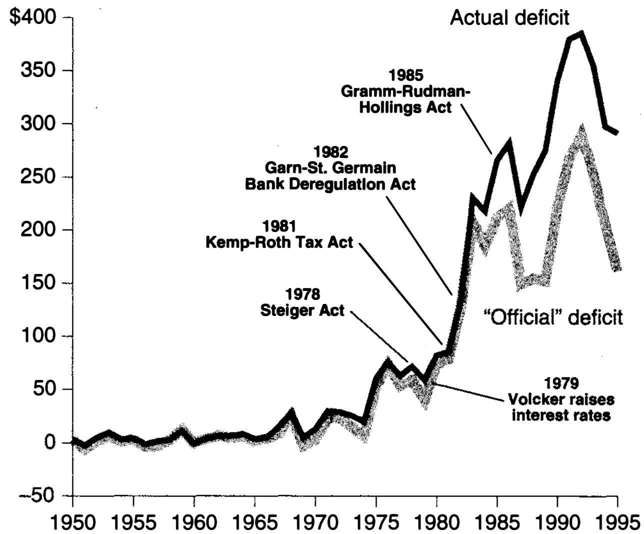
The effect of these actions on the U.S. budget deficit is depicted in **Figure 1.** (See also the box on *EIR*'s method of calculating the deficit.) Two periods are governed by two distinctly different characteristics. First, in 1950-70, the United States was not immune to speculation, but the nation was largely governed by an emphasis on investment in manufacturing, agriculture, and infrastructure. During this period, the United States recorded only three years when the budget deficit exceeded $10 billion. The highest deficit recorded was in 1968, when it reached $28.4 billion, which reflected the influence of the 1967-68 recession. By fiscal year 1969, the deficit was down to $4.9 billion. (A similar blip occurred during fiscal years 1975 and 1976, reflecting the 1973-75 worldwide depression.)

But starting in 1977, things changed radically. When President Carter took office, he was soon presenting "lean and

FIGURE 1

U.S. budget deficit, actual and 'official,' fiscal years 1950-95

(billions $)



Sources: Budget of the United States Government, Fiscal Years 1995 and 1996, Table 1.4, "Receipts, Outlays, and Surpluses or Deficits by Fund Group: 1934-2000."

EIR's method of calculating the deficit

The official deficit figure fraudulently includes the surpluses of Social Security and other government trust fund accounts. The actual deficit, which is what *EIR* uses, is the amount the on-budget, or general revenue budget, runs as a deficit. This is called by the Office of Management and Budget the "Federal Funds budget."

These trust funds include: the Social Security trust funds, the Medicare trust funds, the Civilian and Military Retirement trust funds, the Airport and Aviation trust fund, the Federal Deposit Insurance Corp., and a few others. These funds are 85% or more funded by separate revenue sources, and their revenues and expenditures are not part of the general revenue budget. For example, a payroll tax, called FICA, is dedicated just to funding the Social Security System; the Highway Trust fund is 85% funded by a gasoline tax paid by motorists, and a trucking and tire tax for trucks; and so forth. Plus, the U.S. government is also responsible for the deficit-debt of some off-budget agencies, particularly the Federal Financing Bank.

In fiscal year 1995, the actual budget deficit was $282 billion. Not accidentally, this is the amount that the U.S. debt ceiling rose. The debt ceiling limit was $4.605 trillion at the end of FY 1994, and it was $4.887 trillion at the end of FY 1995, an increase of $282 billion. This is the amount of new U.S. Treasury bonds, notes, and bills that had to be issued to cover the actual U.S. budget deficit in FY 1995.

Republican and Democratic administrations alike have included the trust funds in their calculations in order to make the deficit appear smaller. For example, in FY 1995, the trust funds, led by Social Security, ran a surplus of $120.5 billion. This was mixed in with the actual deficit of $282 billion, to arrive at a fraudulent "official" budget deficit of only $161.5 billion. To keep the surplus of the transportation (Highway, Airport and Aviation, and Waterway) trust funds at a level that is now $33 billion, over the past 15 years, administrations have held up construction of highways, roads, bridges, whose money has already been appropriated. Thus, the building up of surpluses in these trust funds has further debilitated the economy.

The Conservative Revolution Republicans project a balanced budget, showing an "official" surplus of $3 billion in fiscal year 2002. But, calculated on the actual basis, they have not produced a surplus, but a $183 billion deficit.

austere" budgets, in order to deliver on his 1976 election campaign promise. In 1981, the Kemp-Roth Act to cut taxes and balance the budget (through the trickle-down effect of speculation) was passed. In fiscal year 1982, the budget deficit was larger than $100 billion for the first time in U.S. history. By fiscal year 1984, the United States recorded the first budget deficit in excess of $200 billion in its history.

In 1985, the Gramm-Rudman-Hollings Act was passed. It specified that the budget would be balanced by the close of fiscal year 1990. However, at the end of that year, the U.S. budget deficit exceeded $300 billion for the first time in history. By fiscal year 1992, under "fiscal conservative" George Bush, the U.S. budget deficit was nearly $400 billion.

Gramm echoes John Locke

The failure of budget-cutting can be traced hereditarily to the axiom which underlies its thinking: that one can manage a national budget the way one manages the budget of a household. This insanity derives from John Locke's misbegotten conception of economics.

On Feb. 24, 1995, Sen. Phil Gramm, in announcing his intention to run for President, stated, "As President, I will balance the federal budget the way you balance the family budget." In 1691, Locke stated, in his pro-usury tract "Some considerations of the Consequences of lowering the Interest and raising the Value of money": "It is with a kingdom as with a family. Spending less than our commodities will pay for, is the only sure way to grow rich." This is the same John Locke who, as the English Commissioner of Trade from 1696 through 1701, tried to shut down all native American manufacture, and who in drafting a constitution for the colony of Carolina in 1669, called for the institutionalization of an aristocracy and of slavery (see *EIR,* Dec. 1, 1995, "The Anti-Newtonian Roots of the American Revolution").

This outlook has seeped deep into the thinking of many Americans, who do not question its underlying premise.

Constitutional government and the economy

The insane budget-cutting ideology founders on the most fundamental issue of economics: the source and process of generation of economic wealth which sustains and advances civilization. LaRouche has demonstrated that the crowning achievement of the 1439-40 Council of Florence, is the creation of the modern nation-state, which was first set up by King Louis XI in France in 1461-81. This achievement began to eliminate feudalism's dichotomy, under which 5% of the population (the so-called "elite" and their hangers-on) were supported by the 95% of the population who served as illiterate, miserable beasts of burden.

Creative discovery by man made in the image of God, expressed as revolutions in the sciences and the arts, is the abiding source for the flowering of economic wealth. These discoveries are made by the sovereign mind of the individual, but are fostered, realized, and spread throughout the economy

Entitlements are not eating up the budget

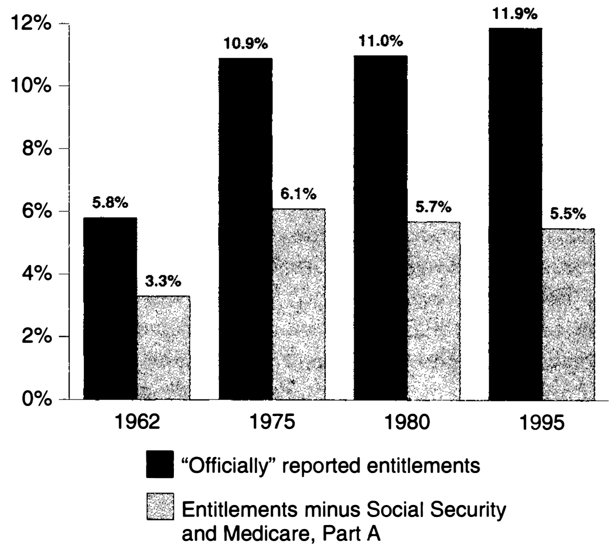
The accompanying figure shows the level of entitlement spending by the federal government, taken as a percentage of Gross Domestic Product for that year. According to the Congressional Budget Office, entitlements are "programs that make payments to any person, business, or unit of government that seeks the payments and meets the criteria set in law." Criteria often are based on age or income levels. Entitlement programs range from Social Security and Medicare, to unemployment insurance and food stamps.

Total entitlement program spending doubled, from 5.8% of GDP in 1962, to 11.9% in 1995. But what the Contract with America gang doesn't tell the public, is that two of the biggest entitlement programs are trust funds which are *self-financing,* with their own dedicated tax base. Every week, your paycheck is debited for the Social Security System, formally called the "Federal Old-Age and Survivors Disability Insurance trust funds" (OASDI), and Medicare, Part A, formally called the "Federal Hospital Insurance trust fund" (HI). Technically, they do not draw revenues from the general budget (except for a small part of Medicare, Part A). Therefore, to say that these funds are "busting the budget," when they don't draw any funds from the general budget, is absurd.

The remaining entitlement programs (called "on-budget entitlements") are largely financed from the general revenue budget. But these entitlements today, at 5.5% of GDP, constitute a lower share of GDP than they did 20 years ago in 1975, when they were 6.1%. If anything, the so-called "burden" of entitlements has been shrinking.

Corrected on-budget entitlement expenditures, as a percent of GDP, have been shrinking since 1975

(percent of Gross Domestic Product)



Sources: Budget of the United States, Fiscal Years 1995 and 1996, "Historical Tables;" Congressional Budget Office, "The Economic and Budget Outlook: Fiscal Years 1996-2000."

by the nation-state. The fostering of the transmission of scientific ideas by the nation-state into the economy is the source for the profit of the economy, which accounts for the explosive increase in the rate of potential relative population density since 1439-40. Prior to that, feudal society was incapable of producing sustained social surplus or profit. It constantly collapsed, imploding from within. The nation-state injects scientific revolutions into the economy through the capital-intensive, power-intensive configuration of the machine tool sector and infrastructure, in particular.

A nation-state has responsibilities which no individual or family has. A nation-state has the power to issue and regulate credit, to coin currency, to regulate trade. It has the authority (and responsibility) to develop the full range of infrastructure, the *sine qua non* of economic activity, including hard infrastructure (transportation, power supplies, and fresh water management) as well as soft infrastructure (education, health services, and scientific research). The family has none of these functions, or powers.

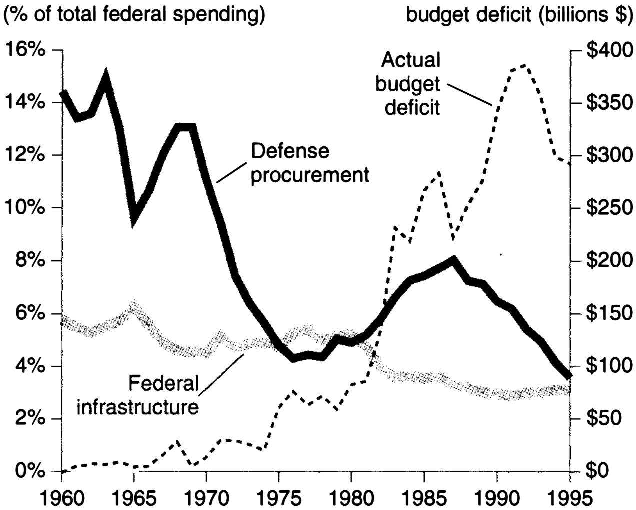
The nation-state mobilizes the creation of credit, through a national banking system, to stimulate manufacture, agriculture, and other productive activities.

This defines the difference in budget functions between the family and the nation-state. A State does not try to decide how to allocate a fixed income, like a household does. It does not try to balance budget inflows and outflows. The State's function, if properly implemented, ensures the margin of profit in the economy. *The State's budget deliberations, carried on by Congress, decide the credit, infrastructure, and general welfare policies that will lawfully create a desired range of increased economic activity.* Alexander Hamilton, America's first treasury secretary, stated in his series of the *Federalist Papers* and his 1791 "Report on the Subject of Manufactures," that if the State, acting dirigistically, providing indispensable functions which only the nation-state can provide, successfully increases economic activity, this will generate greatly increased flows of tax revenue, which more than cover the spending functions of the State. The budget will balance itself.

Conversely, the slashing of the budget, especially for in-

FIGURE 2

Infrastructure and defense collapse as percent of total federal spending, while budget deficit soars



Sources: Budget of the United States Government, Fiscal Years 1995 and 1996; Congressional Budget Office, "Public Infrastructure Spending and an Analysis of the President's Proposals for Infrastructure Spending from 1996 to 2000," issued June 1995; U.S. Department of Commerce, "Statistical Abstract of The United States," various years; Office of Management and Budget.

frastructure, the procurement side of defense spending, and services providing for the health and education of the citizenry, wipes out the physical reproduction of the economy, in the present and the potential for the future. The reduced economic activity blows out tax revenues. Thus, budget-cutting achieves the opposite of its stated purpose: Instead of balancing the budget, it explodes the deficit. This lawfully follows from the monetarists' conception of economics.

Infrastructure and defense

Figure 2 plots the federal government's spending for hard infrastructure and for defense procurement, which is the portion of the defense budget spent on capital goods and defense building. Both are represented as a percentage of total budget outlays, on a year-by-year basis. The U.S. budget deficit is plotted against these two curves. The contrast is striking. As spending for infrastructure and defense spending decline, showing a reduction of total federal spending, contrary to the "common sense" view that the budget deficit should decline—because a "boondoggle expense" has been eliminated—the deficit skyrockets.

Defense procurement spending has an analogous function to infrastructure. Defense spending is not productive: the final product is wasteful, from the standpoint of the reproduction of the physical economy. But through the ages, defense spending, with its high technological attrition, has often embodied the most advanced technological concepts and designs. By

TABLE 1

Defense spending plays a large role in several manufacturing industries

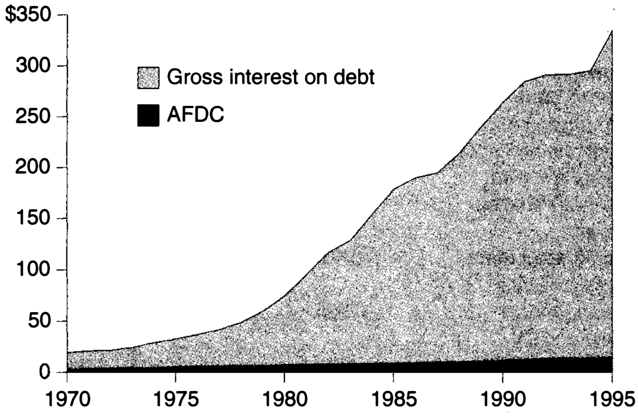
	SIC code	Purchases (millions $)	Purchases (% of industry)
Ammunition, except small arms	3483	$3,733	84.5%
Shipbuilding and repair	3731	$8,111	79.0%
Ordnance and accessories	3489	$2,298	72.2%
Guided missiles, space vehicles	3761	$8,678	71.9%
Aircraft	3721	$17,104	55.3%
Aircraft equipment	3728	$11,542	54.3%
Tanks and tank components	3795	$2,445	52.1%
Radio and TV communication equipment	3662	$32,610	50.9%
Aircraft engines and engine parts	3724	$7,174	50.7%
Primary nonferrous metals, except copper and aluminum	3339	$786	49.3%
Electronic measuring instruments	3825	$6,517	48.8%
Electronic resistors	3676	$605	42.1%
Small arms ammunition	3482	$399	40.4%
Explosives	2892	$416	39.7%
Nonferrous forgings	3463	$504	36.7%
Electronic capacitors	3675	$480	35.7%
Engineering and scientific instruments	3811	$1,618	34.6%
Electronic coils and transistors	3677	$431	30.9%
Industrial trucks and tractors	3537	$1,086	29.5%
Semiconductors and related items	3674	$4,065	27.6%
Electronic connectors	3678	$901	25.1%

Sources: Office of Technology Assessment of the U.S. Congress, "Redesigning Defense; Planning the Transition to the Future U.S. Industrial Base," issued July, 1991, p. 48. Figures are for 1987.

pushing those advances into the machine tool sector, and because defense industry engages a sizable part of the manufacturing capacity of the nation (see **Table 1**), it has a net beneficial effect on the economy overall.

Federal spending on infrastructure (which for purposes of this study includes highways, mass transit, rail, aviation, water transportation, water resources, and wastewater treatment) as a percentage of federal government outlays was 5.77% in 1960. It rose to 6.27% in 1965, under the Kennedy economic development programs of 1961-63. By 1970, it fell to 4.51%; rose again, but then under the assault of Carter, fell so that, by 1982, it was below 4%. It has drifted down progressively, so that today, at $47.2 billion, federal hard infrastructure spending is only 3.07% of federal outlays. This is less than half its Kennedy-generated peak achieved in 1965.

FIGURE 3
Gross interest, not welfare (Aid to Families with Dependent Children), is the real problem
(billions $)



Sources: Congressional Budget Office, "Federal Debt and Interest Costs," issued May, 1993; Congressional Budget Office Budget Analysis Division, Projections Unit; House of Representatives Ways and Means Committee "Green Book;" Budget of the United States, Fiscal Years 1995 and 1996.

In 1963, before the Vietnam War really got going, defense procurement spending represented 14.91%, that is, one-sixth, of all government spending. This level fell sharply after the end of the Vietnam War in 1969-70. By 1978, it was down to 4.36%. It rose some during the Reagan administration, reflecting in part the positive impact of the Strategic Defense Initiative program. But, contrary to the myth that the Reagan defense buildup was huge, it achieved its highest level in 1987 at 8.04%, only half the level in 1963. The Gramm-Rudman-Hollings Act specifically targeted defense procurement spending. Today, it is 3.57% of total federal spending.

The federal deficit is the mirror image of infrastructure and defense procurement spending. As the latter two plummet, the deficit soars upward. Is this just an interesting correlation? No, it is lawful. The close-down of the defense industry, and the lack of new or replacement infrastructure, has cost the economy as a whole, counting the multiplier effect, millions of jobs, and tens of billions of annual tax revenues.

At the same time that they are slashing the budget, Gingrich and Gramm are encouraging speculation, through the capital gains tax rate cut and other bonanzas for Wall Street. The history of the past 20 years shows, it is this speculation, conjoined to usury, that has blown out the spending side of the budget. On this, Gingrich, Gramm et al. are mum.

Figure 3 shows the gross interest on the debt, and payments under Aid to Families with Dependent Children (AFDC), the dominant welfare program, for fiscal years 1970-95.[1] In fiscal year 1995, gross interest on the public debt, at $335.6 billion, constituted 21.8% of all U.S. government outlays, more than one in five dollars spent. It got that way through usury. In October 1979, Federal Reserve Board Chairman Volcker began jacking up interest rates, so that by February 1980, the prime lending rate charged by commercial banks stood at 21.5%, and the interest rate charged on U.S. Treasuries skyrocketed. Volcker said he was "fighting inflation"; he was actually carrying out the policy of "controlled disintegration" of the economy.

Over 1979-85, the interest-rate yield charged on 30-year U.S. Treasury bonds averaged 11.59%. Such bonds are callable after 25 years, meaning that after 25 years, the Treasury can call in the bonds, pay off the principal owing, and retire them, but until then it must pay the stated interest-yield on the bond. A billion dollars of debt, at an 11.59% interest rate, means that over 25 years, $2.897 billion in interest must be paid in addition to the principal, an amount nearly three times the face value of the bond. This was done with trillions of dollars of debt, both long- and short-term, ratcheting up the federal budget deficit at lightning speed. Banks, insurance companies, private partnerships and trusts, which hold a great deal of the Treasury debt, made out like bandits.

In fiscal year 1979, the gross interest on the debt was $48.7 billion. By the end of FY 1985, it was $178.9 billion: a near quadrupling in only seven years. Nothing like this had ever been done in American history. Gingrich and associates never speak of this. Yet, this is one of the principal causes holding the United States hostage to a deficit over the past 15 years.

Instead, Gingrich and associates blame welfare recipients. But in FY 1995, spending for AFDC was $14.7 billion. *The federal government outlay for gross interest on the public debt is a staggering 22.8 times greater than that for AFDC recipients.*

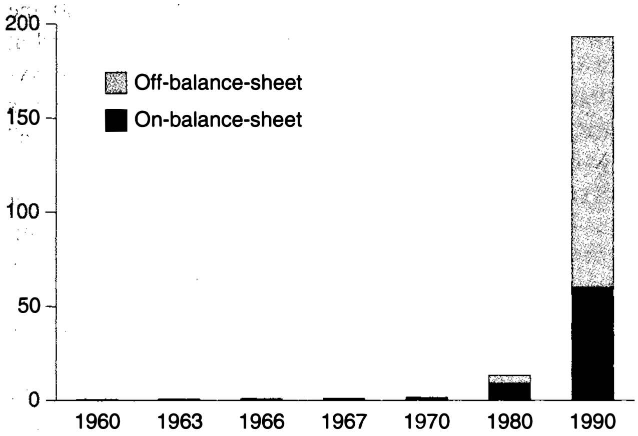
The latest round

The Contract with America gang now proposes cuts in the federal budget over the next seven fiscal years totaling between $969 billion, based on the December 1995 Congressional Budget Office baseline projection numbers, and $1.117 trillion, based on the earlier, less optimistic August 1995 Congressional Budget Office baseline projection.

The $1.117 trillion in cuts include $440 billion in cuts in discretionary programs.This will slash education and soft

1. Gross interest on the debt has been chosen, rather than the more commonly used net interest on the debt. They both follow the same trajectory for the same period, but with net interest at a lower absolute level. The net interest represents the amount of interest the U.S. government must pay to public holders of U.S. Treasury debt: banks and insurance companies, foreigners, trust funds, etc. The gross interest on the debt includes the interest owed to the public, and to primarily U.S. agency trust funds (such as the Social Security trust funds, the Medicare, Part A trust fund) which hold U.S. government debt. Clever Wall Street accountants say that these latter obligations are just inter-governmental interest obligations, so they don't have to be taken account of. But, trust funds, like Social Security, have obligations to pay monthly payments to recipients of their programs, (i.e., retired people), which requires, at some point, drawing down the interest they have earned from holding U.S. Treasury securities. This is a real payment, and the interest the U.S. government pays had better be real to cover it. Therefore, gross interest on the debt must be counted.

FIGURE 4
Growth of financial turnover, compared to the physical economy
(index 1967=1)



Source: Bank for International Settlements; Board of Governors of the Federal Reserve System; Public Securities Association; Chicago Board of Trade and Chicago Mercantile Exchange; United Nations "General Industrial Statistics," various years; U.S. Department of Commerce, Bureau of Economic Analysis; American industrial associations; EIR.

infrastructure, and gut hard infrastructure. The House-Senate Republican conference resolution budget, also includes $577 billion in cuts in entitlements, led by cuts of $270 billion in Medicare and $182 billion in Medicaid. These programs provide medical assistance to, respectively, 37.6 million elderly and 36 million poor persons. The minimum effect of the proposed cuts will be to double the number of Americans who are not medically insured to 80 million; close 3-4,000 hospitals and health clinics; double premium payments, for those still retaining coverage; and herd the elderly and poor into Health Maintenance Organizations, where the quality and extent of medical coverage is truncated in order to minimize costs.

Thus, the Contract gang is fighting to pass huge tax bonanzas for speculators, destroy the economy, slash the tax base, kill the elderly and poor, all in the name of a budget-balancing approach that doesn't work. But it is worse.

Figure 4 shows for the United States, the level of turnover of all financial instruments, including derivatives, bonds, stocks, etc., relative to the level of physical output, measured by the *EIR* market basket, which measures the input-flow of physical producer and consumer goods, per household and per capita. In 1990, there was $192 of financial turnover per unit of market basket. Each unit of turnover has a rate of return or yield, which is a claim on the physical economy. The hyperbolic rate of growth of this curve dictates that the economy will explode. The precise date of this explosion is not known; that it *will* explode, is certain. Under such a collapse, no one can predict accurately revenues for fiscal year 1996 or 1997, let alone past the year 2000.

Tax breaks to benefit parasites

by Richard Freeman

The Contract with America's tax package contains tax breaks worth tens of billions of dollars, for those who truly need it least: blue-blood wealthy families, Wall Street coupon-clippers and take-over artists, and speculators. The windfalls will widen the budget deficit further, demonstrating that balancing the budget is not motivating the radical Republicans' actions. The real reason for holding up the debt ceiling bill, and shutting down the government, was to get these tax breaks through. They are a rip-off for the speculators who financed the 1994 election campaigns of Gingrich's handpicked GOPAC candidates, and who stand ready to finance them again in 1996.

The Contract's tax proposals are in the tradition of the 1981 Kemp-Roth Tax Act, which was a Christmas tree of goodies for speculators. It, too, purported to spur growth and balance the budget, but wrecked the tax base and unbalanced the budget.

The principal tax bonanza contained in the Contract plan is a cut in the top rate of the capital gains tax by half. According to studies by the Treasury Department and Joint Committee on Taxation of the Congress, this tax cut will create a windfall for speculators of $36-40 billion by the year 2002, which will grow to approximately $65-80 billion by the year 2005, and $160 billion by the year 2010. There is also a proposed cut in the inheritance tax, which benefits the very wealthy.

Capital gains are realized as a result of the appreciation of an asset, whether that asset be stocks and real estate (which account for more than 70% of capital gains), or a piece of antique furniture, an art work, etc. For example, if one bought an apartment building for $50 million, and sold it two years later for $150 million, then $100 million is one's capital gain, even if the upkeep and repair of the apartment building has not been maintained, and the building, in physical terms, is really worth less than it was two years before. The object of the speculative economic process that has submerged America, has been to rig an appreciation in the market price of paper financial instruments or pieces of land, and then record profits through the instruments' sale. These are capital gains profits—part and parcel of the worldwide financial bubble.

The proposed capital gains tax rate cut has two objectives. First, to increase the size of, and give six months or