The real problem is collapsing revenue

by John Hoefle

The dominant theme of the debate over government budgets—federal, state, and local—is that expenditures must be cut to match revenues. Advocates of this position often compare these government budgets to the family budget, claiming that governments, like families, must learn to live within their means. It is a seductive argument, but it is a lie. Properly directed, government spending benefits the economy in ways which radiate far beyond the narrow confines of a balance sheet, both stimulating and organizing the economy, to the benefit of the citizenry as a whole.

The purpose of the federal government is defined in the Preamble of the Constitution of the United States: "We, the people of the United States, in order to form a more perfect Union, establish justice, insure domestic tranquility, provide for the common defense, promote the general welfare, and to secure the blessings of liberty to ourselves and our posterity do ordain and establish this Constitution for the United States of America."

To carry out this responsibility, the Constitution, in Article I, Section 8, assigns to Congress powers including the right to lay and collect taxes; to borrow money on the credit of the United States; to regulate commerce; to establish uniform rules of naturalization and uniform laws on bankruptcies; to coin and regulate the value of money, and fix the standard of weights and measures; to establish post-offices and post-roads; to promote the progress of science and useful arts through copyrights and patents; to provide a system of courts; to declare war; and to provide armies and navies.

Households have the responsibility to contribute to the ideas outlined in the Preamble, including ensuring that the government meet its responsibilities, but households are not invested with the powers of Congress. The federal government can, and must, provide services that households cannot, and should not. Therefore, to compare the federal budget to a household budget, is a dangerous fallacy of composition.

Government, in harmony with the principles laid out in the Declaration of Independence and the Constitution, provides the framework for securing the "unalienable rights" of "Life, Liberty, and the Pursuit of Happiness."

Budgets as public policy

Thus government expenditures play a special and critical role in the proper functioning of the country, both politically and economically. To view expenditures outside of this context, as if they were mere lines on some arbitrary budget, is to miss the forest for the trees. The decision on what to fund, and what not to fund, is a decision about the future direction of the country. Budget decisions, as an insurance actuary can demonstrate, are decisions about life or death, prosperity or collapse, freedom or servitude.

Let us take a look at total government expenditures, federal, state and local, in our selected years (**Table 1**). We have debt-service charges, the administrative costs of government, the costs of providing for the national defense, the enforcement of the law and the punishment of those who break it, and entitlements. There is also a large segment called "other," which contains a wide variety of expenses, including many of governments' directly economic expenditures, such as research and development, and non-trust fund expenditures for infrastructure projects such as roads, bridges, water supplies, sewer systems, trash pickup, energy systems, education, and the like, which are essential to a properly functioning economy.

That these expenditures have a real economic impact, is amply demonstrated by the collapse of the California economy as a result of cutbacks in defense spending. The importance of military spending, especially that portion of military spending which funds breakthroughs in science and technology, can hardly be overestimated. The scientific and technological breakthroughs made possible by ongoing space and military research and development programs, provide new technologies to make the workforce more productive, thus providing the basis for an increase in the standard of living. Cutting back R&D expenditures to save money, reduces this flow of progress, thereby undercutting the presumed attempt at resolving the economic crisis which led to the budget-cutting in the first place.

These budget expenditures represent the very infrastructure of society, our teachers and schools, our doctors and hospitals, our soliders, policemen, and firemen, our roads and urban transit systems, our water supplies and sewer systems, our defense and space workers, social aid for the disabled, the poor, and the disadvantaged, and all manner of other necessary services. Cutting these services, impairs the welfare of the population, and reduces the efficiency of the economy.

Cutting the budget throws many of these vital infrastructure workers out of their jobs; if they are lucky, some of them may find work elsewhere, usually at lower pay, and many will wind up on the welfare rolls. Essential tasks are thus stretched even thinner, or eliminated completely, hurting the productive side of the economy, and workers are thrown on the scrapheap, increasing the financial drain on the social safety net.

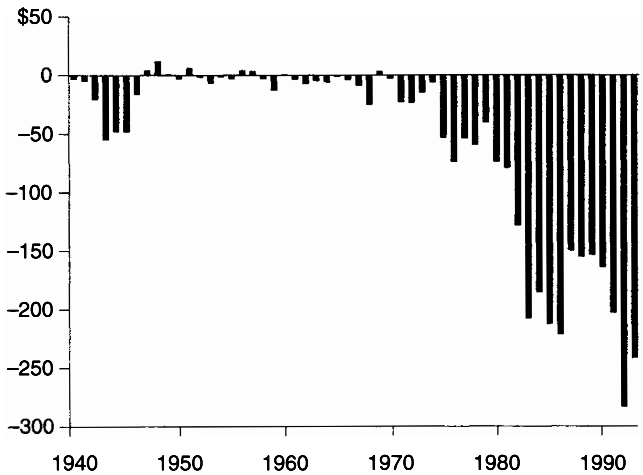
The effect of the draconian budget cuts demanded by the Conservative Revolutionaries such as Rep. Newt Gingrich (R-Ga.) and Sen. Phil Gramm (R-Tex.), is to cut the tax base, and thereby *increase the deficit,* directly the opposite

TABLE 1
Revenues versus expenditures of federal, state, and local governments combined
(billions $)

	1956	1960	1963	1966	1970	1980	1990
Revenue	**$119.65**	**$153.10**	**$179.85**	**$225.55**	**$333.81**	**$932.20**	**$2,047.00**
Taxes	91.59	113.12	130.81	160.74	232.88	574.24	1,133.89
Individual	33.73	43.18	50.86	60.21	101.22	286.15	572.52
Corporate	21.77	22.67	23.08	32.11	36.57	77.92	117.07
Sales and customs	19.16	24.45	28.66	33.73	48.62	111.96	231.86
Property	11.75	16.41	19.83	24.67	24.05	68.50	115.61
Other	5.19	6.41	8.38	10.03	12.41	14.14	26.80
Charges and miscellaneous	12.90	17.50	20.49	27.63	39.60	142.39	376.60
Utility and liquor stores revenue	3.85	4.88	5.53	6.62	8.61	25.56	58.64
Insurance Trust revenue	11.30	17.61	23.02	30.56	52.72	192.01	477.87
Expenditures	**117.50**	**153.16**	**179.10**	**230.50**	**330.00**	**958.70**	**2,219.00**
Debt-service charges	8.00	11.20	12.50	15.30	24.40	89.50	314.40
Administrative costs of government	2.24	2.86	3.36	4.11	6.37	20.70	57.55
National defense	35.55	41.34	47.97	53.77	76.55	134.00	299.33
Law enforcement and prsons	2.43	3.35	4.01	4.90	8.57	28.57	74.58
Entitlements	17.90	24.10	33.60	39.30	68.70	291.50	567.40
Other	51.38	70.31	77.66	113.12	145.41	394.44	905.74
Surplus or deficit	**2.15**	**–0.05**	**0.75**	**–4.95**	**3.81**	**26.50**	**172.00**

Sources: Bureau of the Census, *Statistical Abstract of the United States;* EIR.

FIGURE 1
Federal budget deficit
(billions $)



Source: Federal Reserve Flow of Funds.

of their claimed effect. Gramm, recall, was one of the architects of the disastrous Gramm-Rudman deficit reduction act of 1985-86. Introduced amid great fanfare, the Gramm-Rudman act was subsequently quietly dropped; its effect, like that of Ronald Reagan's budget deficit measures of 1981, served mainly to double the deficit (**Figure 1**).

Compare the expenditures of governments in 1956 and 1990 (**Figure 2**). In 1956, national defense expenditures accounted for 30% of all government expenditures; by 1990, that figure had dropped to nearly 14%. The percentage spent on debt service doubled during the period, from 7% to just over 14%. The percentage of money spent on entitlements also grew sharply, from 15% to 26%, as the strain on the social safety net increased.

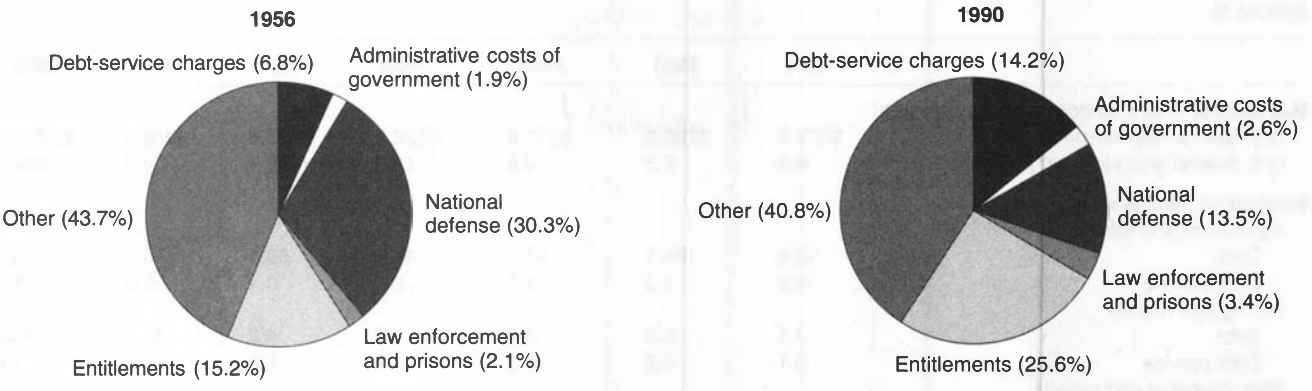
The result of all this budget-cutting, is that the federal government now pays more money for debt service, than it does for national defense (**Figure 3**), a picture that would be even worse had not the Federal Reserve lowered interest rates from 1989 to 1994, in an attempt to bail out the bankrupt U.S. banking system.

One is compelled to conclude, after studying the disastrous effects of this budget-cutting mania, that the budget-cutters are pushing a hidden agenda, under the protective coloration of alleged fiscal responsibility.

Revenue for whom?

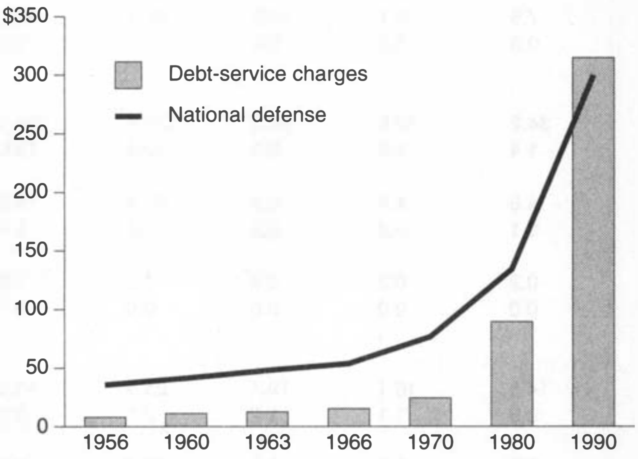
Let us turn our attention to the revenue side of the budget equation (**Figure 4**). The governments get their revenues from taxes, individual and corporate, sales taxes and customs duties, property taxes, user fees, and the like. These taxes and fees are taken out of the incomes of households and businesses. In addition to a multitude of fees and sales taxes, households and businesses pay taxes on their income. For a business, income is gross earnings minus the cost of production, sales, and overhead. In the case of an individual, it

FIGURE 2
Expenditures of federal, state, and local governments



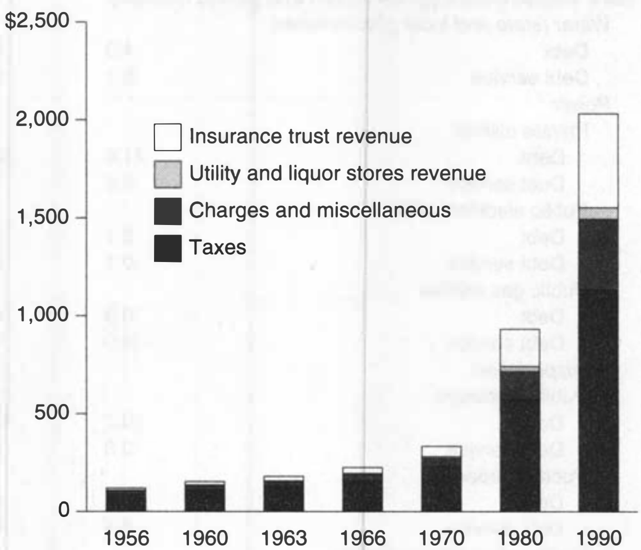
Source: Statistical Abstract of the U.S. Bureau of the Census.

FIGURE 3
U.S. government expenditures on debt service and national defense
(billions $)



Source: Statistical Abstract of the U.S.

FIGURE 4
Government revenues
(billions $)



Source: Statistical Abstract of the U.S.

comes out of wage or salary, and perhaps dividends or interest and capital gains.

The combined incomes of households and businesses form the tax base, the pool of income upon which governments can draw to support their operations. When times are prosperous—which they haven't been for a generation or more—the tax base rises and the burden on the social safety net lessens, making it easier for governments to meet their responsibilities. In the bad times with which we have become all too accustomed over the last 30 years, the tax base shrinks at the same time that the burden on the social safety net increases, making it more difficult for governments.

The critical element in the collapse of the tax base, has been the collapse of wage levels. Governments can't tax, what people don't earn.

Over the recent years, as businesses have "downsized" to be "lean, mean, and competitive," effective wage levels have dropped. In 1992, 11% of the income-earning population over age 14 earned less than $2,500, while 19% earned less than $5,000, and 36% earned less than $10,000. Just under half, 49%, earned less than $15,000, while 70% earned less than $25,000, and 92% earned less than $50,000. The median income for men in 1992 was $20,654, while for

TABLE 2
Growth of debt and debt service
(billions $)

	1956	1960	1963	1966	1970	1980	1990
U.S. federal debt and debt service charges							
U.S. federal debt outstanding	$272.8	$290.5	$310.8	$328.5	$380.9	$908.5	$3,206.3
U.S. federal gross interest payments	6.8	9.2	9.9	12.0	19.3	74.8	264.7
Production debt and debt service for:							
Agriculture and related							
Debt	18.8	24.8	31.7	41.6	58.1	178.7	145.1
Debt service	0.9	1.3	1.7	2.4	3.4	16.3	14.5
Mining and related							
Debt	2.1	2.9	3.9	2.9	4.2	42.1	73.8
Debt service	0.1	0.2	0.2	0.2	0.5	4.3	7.8
Manufacturing and related							
Debt	26.1	33.2	53.2	87.5	110.0	453.1	1,386.7
Debt service	1.4	2.2	2.8	4.7	12.7	54.8	153.6
Construction							
Debt	0.7	1.5	6.4	7.7	5.2	46.2	92.4
Debt service	0,1	0.2	0.3	0.6	0.7	5.3	9.2
Debt	**47.7**	**62.4**	**95.2**	**139.7**	**177.5**	**720.2**	**1,698.0**
Debt service	**2.4**	**3.8**	**5.0**	**7.9**	**17.2**	**80.7**	**185.1**
Hard infrastructure (government and public utilities)							
Water (state and local governments)							
Debt	4.0	6.3	7.5	9.1	10.2	21.1	45.7
Debt service	0.1	0.2	0.3	0.3	0.4	1.1	2.9
Power							
Private utilities							
Debt	21.6	30.1	34.2	39.8	57.6	127.4	194.1
Debt service	0.6	1.1	1.4	2.6	3.5	10.4	13.0
Public electrical utilities							
Debt	2.1	2.7	4.0	4.9	5.8	29.0	76.3
Debt service	0.1	0.1	0.1	0.2	0.2	1.5	5.4
Public gas utilities							
Debt	0.3	0.2	0.2	0.2	0.4	0.6	1.2
Debt service	0.0	0.0	0.0	0.0	0.0	0.0	0.1
Transportation							
Public highways							
Debt	10.7	13.2	14.8	16.1	19.1	25.9	41.8
Debt service	0.3	0.5	0.6	1.1	1.2	2.1	3.0
Public railroads							
Debt	9.1	8.7	8.2	8.1	8.0	12.7	9.6
Debt service	0.4	0.4	0.4	0.4	0.6	0.9	1.0
Public urban transportation							
Debt	1.6	2.0	2.2	2.7	3.2	4.5	11.4
Debt service	0.0	0.1	0.1	0.1	0.1	0.2	0.8
Other state and local government obligations							
Debt	0.0	6.8	16.3	26.2	39.3	114.5	477.7
Debt service	0.0	0.3	0.7	1.7	2.4	9.3	32.0
Debt	**49.4**	**70.0**	**87.5**	**107.1**	**143.6**	**335.6**	**858.0**
Debt service	**1.6**	**2.6**	**3.5**	**6.4**	**8.4**	**25.6**	**58.2**

(continued on following page)

women it was just $10,774, with a household median wage of just over $31,000.

Since many of the governments' revenue streams are dedicated to specific expenditures—Social Security and toll road fees, for example—the individual and corporate income taxes play an important role. The 90 million income-earning people who earn less than $15,000 a year, are unable to pay much in the way of income taxes, and another 15 million people or so don't even have incomes. Were these people to earn decent wages, many—but not all—of the governments' budget problems would be solved.

For businesses to pay better wages, they have to be

TABLE 2 (continued)

Growth of debt and debt service

(billions $)

	1956	1960	1963	1966	1970	1980	1990
Soft infrastructure							
Health-care delivery systems							
Debt	na	na	$ 0.6	$ 0.9	$ 2.7	$ 22.1	$ 111.6
Debt service	$ 0.0	$ 0.0	0.0	0.1	0.2	1.8	7.5
Elementary and secondary public education							
Debt	9.9	14.3	21.4	24.9	31.5	32.3	51.4
Debt service	0.3	0.5	0.9	1.7	1.9	2.6	3.4
Public colleges and universities							
Debt	0.9	2.7	4.4	6.8	11.0	21.6	43.3
Debt service	0.0	0.1	0.2	0.5	0.7	1.8	2.9
Private colleges and universities							
Debt	0.5	1.0	2.1	3.0	4.5	7.0	27.1
Debt service	0.0	0.0	0.1	0.2	0.3	0.6	1.8
Trade schools							
Debt	0.1	0.1	0.2	0.3	0.4	0.8	3.2
Debt service	0.0	0.0	0.0	0.0	0.0	0.1	0.2
Debt	**11.3**	**18.1**	**28.7**	**35.9**	**50.1**	**83.8**	**236.6**
Debt service	**0.3**	**0.7**	**1.1**	**2.4**	**3.1**	**6.8**	**15.9**
Corporate and analogous debt, other							
Non-productive corporate							
Debt	68.3	87.0	86.9	113.4	212.6	236.4	681.2
Debt service	5.8	7.3	8.6	10.5	15.4	20.6	45.1
Real estate (non-household) mortgage debt	45.7	67.0	94.0	125.5	176.2	495.3	1,146.2
Debt-service on real estate	2.9	4.5	6.5	8.9	14.2	50.9	108.4
Other financial debt	40.4	55.7	70.4	101.7	158.8	786.7	3,239.5
Debt-service on other financial debt	2.6	3.8	4.8	7.2	12.8	80.8	306.2
Debt	**154.4**	**209.7**	**251.3**	**340.6**	**547.6**	**1,518.4**	**5,066.9**
Debt service	**11.3**	**15.6**	**19.9**	**26.6**	**42.4**	**152.3**	**459.7**
Household debt							
Mortgage and real estate debt							
Debt	99.8	145.7	191.2	243.1	309.0	949.5	2,732.2
Debt service	4.1	6.9	9.1	11.8	16.0	75.0	217.8
Medium- and long-term debt, other than real estate							
Debt	4.3	7.5	9.8	14.4	28.6	100.9	239.1
Debt service	0.4	0.7	0.9	1.4	3.0	10.9	24.9
Short-term debt							
Debt	49.2	65.1	82.6	109.6	134.0	355.4	809.2
Debt service	4.7	6.3	7.9	10.6	13.8	38.5	84.4
Debt	**153.3**	**218.3**	**283.6**	**367.1**	**471.6**	**1,405.8**	**3,780.5**
Debt service	**9.2**	**13.9**	**18.0**	**23.8**	**32.8**	**124.4**	**327.1**
Total debt	**688.9**	**869.0**	**1,057.1**	**1,318.9**	**1,771.3**	**4,972.2**	**14,846.3**
Total debt service	**31.7**	**45.7**	**57.4**	**79.1**	**123.1**	**464.7**	**1,310.6**

profitable, which requires economic expansion, the proverbial rising tide which lifts all boats.

However, the U.S. economy has been collapsing at a rate of 2% a year over the last 30 years, which means revenues are also falling.

Governments have made up some of this revenue shortfall by increasing the taxes on households. While overall government tax revenue grew 12-fold between 1956 and 1990, individual taxes grew 17-fold. By comparison, business taxes grew just fivefold.

Governments have made up the rest of the revenue by borrowing, which is where the deficit comes in. As revenues continue to drop, the borrowing increases and the economy spirals downward. The governments are trapped in this whirlpool, being sucked ever faster toward the abyss, because of their failure to address the economic collapse which has

FIGURE 5
Total debt in the U.S. economy
(trillions $)

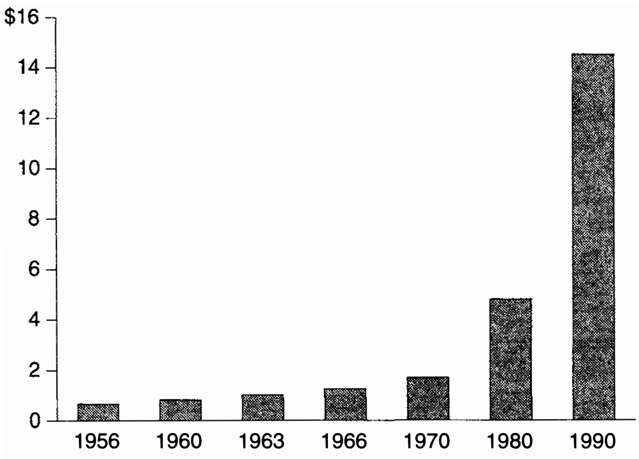
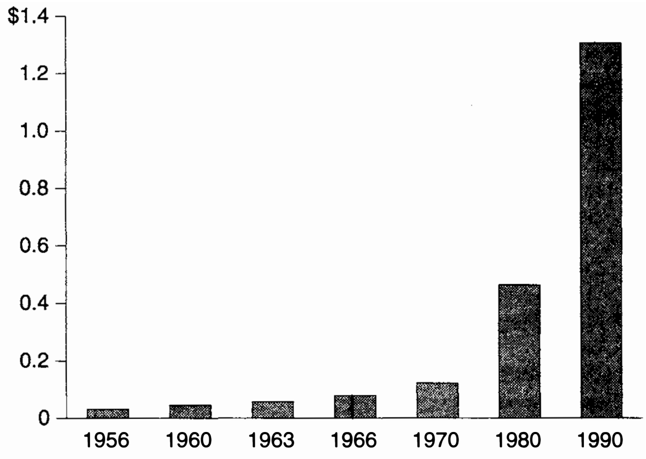


FIGURE 6
Annual debt service
(trillions $)



destroyed their tax base. One of the reasons for this collapse, is that governments have not spent enough on the productive sector of the economy.

It's not just government debt which is a problem, either (**Table 2**). Everybody is borrowing to make up for the revenue shortfall, going ever deeper into unpayable debt, in a desperate attempt to survive (**Figures 5** and **6**).

The federal government paid $265 billion in gross interest payments in 1990, nearly as much as the entire federal debt in 1956. Federal debt more than tripled in the 1980s, under the rule of the budget-cutters.

Households paid twice as much in debt service in 1990, as their entire debt in 1956; the giant increases in credit card and installment debt, are a direct result of the shortfalls in household income. And these are just the households which qualify for loans! Those households whose incomes were too low to qualify for mortgages or credit cards, just sink from sight.

Compounding the problem, is that the structure of the debt has shifted. Prior to the 1970s, most government debt was tied to specific development projects, and the federal government was prohibited from issuing long-term bonds paying interest rates higher than 4.9%. In the 1970s, this shifted, and governments began issuing new debt to refinance old debt and old interest payments. The federal government began issuing what Congress called "notes," to get around the restrictions on interest payments. The result is that governments, which used to borrow to fund development, are now borrowing just to meet their debt-service payments, and have stopped most development (and with it, the potential to build their way out of this mess). Debt outstanding for hard and soft infrastructure projects, public and private, came to $1,095 billion in 1990, equal to about one-third of the federal debt.

If the economy were really booming, as the putative economic experts tell us (how many times have you heard the line that the economy was in danger of overheating?), why do we have all this debt? How can the holders of this unpayable debt, banks and other financial institutions, be anything but totally bankrupt?

Kill people, save the bubble

Some of these "experts" claim that the government's borrowing to cover unfunded expenditures is the big problem, and that government borrowing must be cut so that others can borrow the money instead. There's not enough money to go around, so the Conservative Revolutionaries, like Gingrich and Gramm, demand that the government services which keep the poor, the elderly, and the disabled alive, be cut, so there will be more money for Wall Street to borrow, to roll over its own debt, and keep the bubble aloft.

Under such circumstances, it is ludicrous to talk of "balancing the budget" in the way in which the subject is discussed today. The "Contract on America" budget cuts, is an attempt to balance the budget over the dead bodies of the aged and sick, the young and poor, an effect which can be actuarially demonstrated. The cutters may not understand it—some of them, at least—but that doesn't absolve them of responsibility, and it won't help their victims.

To find the motive for this murderous policy, one should turn to the usual suspects when it comes to genocide: the international financial oligarchy. These are the people who, through the International Monetary Fund and similar agencies, have looted the nations of Africa, Ibero-America, eastern Europe, and the former Soviet Union. Now that same weapon is being turned upon the population of the United States, with results that will be similar, if it is not stopped.