U.S. Budget Deficits Headed Toward Unprecedented Heights

by Richard Freeman

Unless America's policymaking is radically and quickly changed, it is likely that the United States will register, perhaps starting this fiscal year 2003, Federal general revenue budget deficits of $400-500 billion per annum, the largest in U.S. history. Deficits of such size cannot be sustained, and indicate that the U.S. government is headed toward bankruptcy.

Examination of the FY 2002 and 2003 budgets, show unmistakably the trend of budgets that are out of control. According to the U.S. Treasury Department, the FY 2002 budget recorded an official "unified budget" deficit of $157.7 billion. However, *EIR* will show that the official budget is a sham; the real budget, which the Treasury calls the general revenue budget, recorded a $317.3 billion deficit in FY 2002, more than twice the official deficit. In any case, each of the budget deficits is very large. At the core, the budget deficit has not been caused by rising expenditures as such, but rather by the other side of the ledger: the plummeting revenues, which, in turn, has been caused by the collapse of the U.S. real physical economy, as well as the bubble economy, particularly the stock market. This is dramatically exemplified by, and is the driving force behind the FY 2002 budget deficit: Compared to the previous year, in FY 2002, U.S. individual income taxes paid fell by a stunning $138 billion, the largest absolute fall in history. The percent of fall was 13.7%, which is the greatest since 1946! Thus, the income taxes are in a free fall, and they are the largest item of taxes paid in the budget. They have sharply pulled down overall receipts.

The FY 2003 budget has accelerated this trend. The U.S. fiscal year runs from Oct. 1 to Sept. 30, and is dated the year it closes: Thus, October 2002 is the first month of the FY 2003 budget. During this October, the U.S. budget recorded a $53.99 billion deficit on the "unified" basis, and a $57.7 billion deficit on the general revenue basis. Were this trajectory to continue, the FY 2003 general revenue budget would record an unprecedented deficit of $400-500 billion.

The mounting deficits generate several dangers. They must be financed through the issuance of tremendous volumes of new U.S. debt, which already (including marketable and non-marketable debt) totals more than $6.3 trillion. Any significant risk to this debt could threaten the U.S. financial system.

Second, this creates the environment for Wall Street to unleash its shock troops, the Conservative Revolutionaries, led by Rep. Tom DeLay (R-Tex.), who will be the House Majority Leader in the new Congress. They are pushing for fierce forms of austerity, in order to "balance the budget." In one exemplary case, at the end of November, the Conservative Revolution-controlled House of Representatives delivered a "Go to Hell" Christmas message to 830,000 unemployed workers: It refused to approve a bill that would have re-extended the unemployment benefits of these workers who have already exhausted their state unemployment benefits. The workers will be cut off from Federal funds, and left penniless until Congress reconvenes in mid-January, and maybe beyond that. Further, starting Dec. 28, during each successive week, another 95,000 unemployed workers will have their benefits cut off. This is but one in a list of myriad draconian cuts of infrastructure, essential social programs, education, etc., that the Conservative Revolutionaries are considering.

Their gouging of the real physical economy, will intensify the economic downturn, which will further reduce tax revenues, and widen the deficit.

The real solution to the skyrocketting budget deficits, lies not in attempts to slash the budget, or in raising or lowering taxes, as such. What is required is to reverse the fatally flawed policy axiomatics of the "post-industrial society," and restore the economy to health. As Lyndon LaRouche has said, the bankrupt financial system must be put through a Chapter 11 bankruptcy reorganization, and replaced by a New Bretton Woods monetary system, which provides low-interest credit for the construction of development corridors of a Eurasian Land-Bridge. Within that geometry, there must be launched an interconnected package of great U.S. infrastructure projects, starting with rail programs, also involving the issuance of low-interest credit. LaRouche has called this concept a Super-TVA, based on the precedent of Franklin D. Roosevelt's Tennessee Valley Authority. (As a feature of such a thrust, a tax policy geared toward fostering production can be introduced.) As the fundamental reforms of the Super-TVA start to work, the tax revenue base will be greatly expanded, restoring budgetary health on a Federal, state, and local level.

Ironically, but two years ago, Wall Street had announced that the United States would run a Golden Age of ten years of Federal budget surpluses, totalling $5.4 trillion, which

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would extend from fiscal years 2001 through 2010. In only two years, that is shown to be an expoloded pipe-dream; let us see why.

Origins of the Deficit

The enormous, debilitating budget deficits stem from the City of London-Wall Street imposition of a post-industrial society policy upon the United States in the mid-1960s. This policy collapsed production in manufacturing, agriculture, and infrastructure, and fostered speculation, which built up a gigantic speculative bubble, which sucked the physical economy dry, contracting it and real living standards, by 1-2% per annum.

Three nodal policy changes of the post-industrial society policy are noteworthy.

First, President Richard Nixon severed the dollar from the gold-reserve standard on Aug. 15, 1971, which severed financial flows from physical goods flows.

Second, Federal Reserve Board Chairman Paul Volcker moved in October 1979 to apply the New York Council on Foreign Relations' explicit policy of "controlled disintegration" of the economy. Volcker sent interest rates into the stratosphere, so that the prime lending rate charged by commercial banks reached 21.5% by December 1980, which razed basic manufacturing and agriculture to the ground.

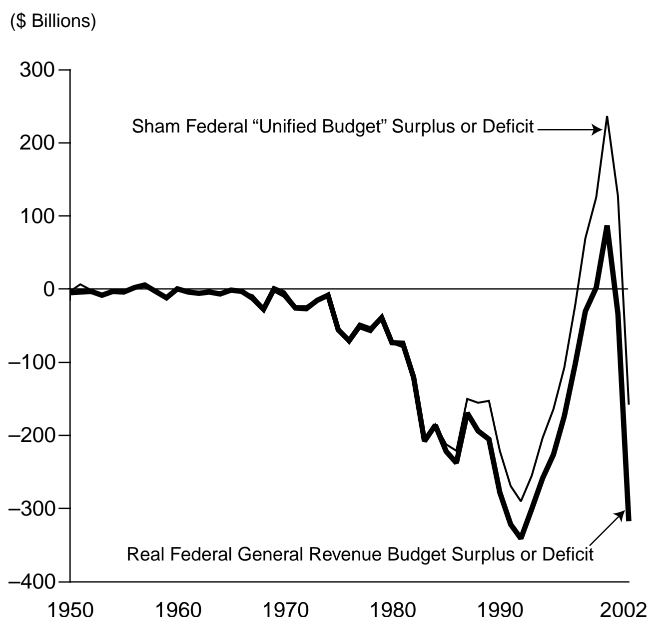
Third, Congress passed, and President Ronald Reagan signed into law two acts: in 1981, the Kemp-Roth Tax Act, which reduced the top tax rate on capital gains from 28% to 20%, to build the stock market, and created a bonanza for "investment partnerships," primarily in real estate; and in 1982, the Garn-St Germain Act, which destructively deregulated the entire banking system.

The more than three decades of post-industrial take-down reduced the rate of growth by which the productive side of the economy should have contributed to tax revenues, and it has now addicted the budget process to dependency on capital gains taxes, especially from the stock market and real estate.

Figure 1 documents how the cumulative deleterious effects of the post-industrial society sent the U.S. budget deficit shooting skyward, especially during the 1980s. To understand what happened, the reader must comprehend the distinction between the U.S. general revenue budget, and the sham U.S. unified budget.

Since 1789, the United States has used the Federal general revenue budget as the budget of the United States. This includes the traditional sources of income to the budget—individual income taxes, corporate taxes, excise taxes, estate taxes, and customs duties; and also the traditional expenditures made by the U.S. budget—infrastructure, such as building dams and waterways; agriculture, such as agricultural extension services; education; defense; etc. The general revenue budget is the standard measure of a budget, and is often called the "on-budget" budget. Figure 1 shows that under the impress of post-industrial society policies, the general

FIGURE 1
Real U.S. General Revenue Deficit Has Swelled
($ Billions)



Sources: U.S. Office of Management and Budget; U.S. Treasury Department.

revenue budget ran deficits during the second half of the 1970s, and then exploded from $74 billion in FY 1981, to $238 billion in FY 1987, more than tripling.

The reason for the hoax called the "unified budget," is that Ronald Reagan won the 1980 U.S. Presidency, promising that he would balance the U.S. budget within four years of taking office in 1981. Figure 1 shows that he failed horribly. The question that the Reagan Administration economic "brain trust" considered, was, could a source of funds be tapped to cover some or all of the gaping general revenue budget deficit, and at the same time, present a smaller apparent deficit to the public. The brain trust hit on the idea of attaching the Social Security Trust Fund (officially the Old Age Survivors and Disability Insurance fund), which as a result of Social Security reform laws, must run a surplus that gets bigger every year. Thus was born the "unified budget," which the Reagan Administration created by mixing together the on-budget general revenue budget, with the off-budget items, the most important of which was the "golden egg": the Social Security Trust Fund.

But this was strictly illegal! The Social Security Trust Fund was created in 1935 specifically outside the general revenue budget. It has a dedicated income stream, the Social Security tax. Its funds cannot be siphoned off and used to balance the general revenue budget, because they must be there to be used in the future to pay the elderly who qualify

for Social Security. Though the "unified budget" does not immediately take the funds from the Social Security Trust Fund, ultimately, it does the same thing by the way that the budget process works.

The unified budget is a sham.

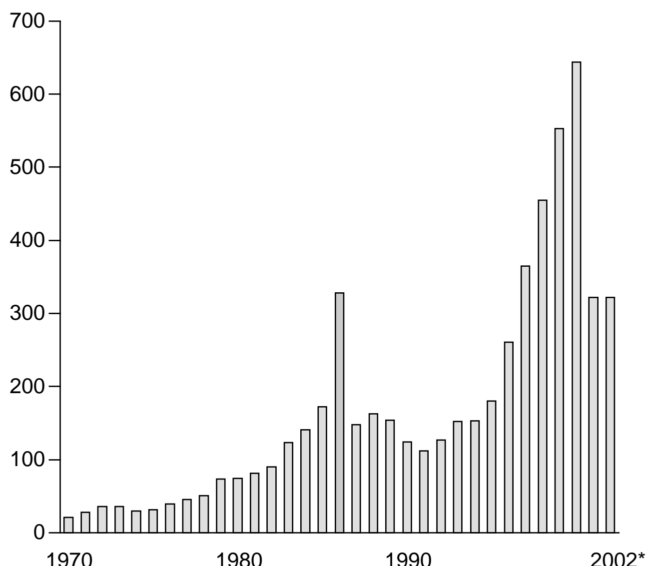
The gap between the general revenue budget and the unified budget is the amount that is illicitly diverted principally from the Social Security Trust Fund. Figure 1 shows that the gap progressively widens throughout the 1980s, the 1990s, and the first two years of the 2000s.

Three points in Figure 1 are important for further discussion. First, during the FY 1992 budget, the last prepared by President George H.W. Bush, the general revenue budget leapt to $340.5 billion in deficit, the highest in history.

Second, when the Clinton Administration claimed that it had achieved a "budget surplus" in fiscal years 1998 and 1999, that did not occur: According to the real standard of the general revenue, it had achieved no significant surplus at all. Immediately below is a discussion of the risky and volatile measures by which the Clinton Administration achieved an apparent and fleeting budget surplus of FY 2000.

Third, in fiscal years 2001 and 2002, when the risky measures used by the Clinton Administration vaporized, the budget plunged into deficit. The FY 2002 general revenue budget deficit swelled to $317.3 billion, the second highest in history. The FY 2003 budget is poised to exceed that.

FIGURE 2
Realized Capital Gains, By Year
($ Billions)



*Estimated

Source: EIRNS.

Dependency on Speculative Capital Gains

The 1990s was the decade of the gigantic run-up in the speculative value of the stock market and the home real estate market. This is especially true in the second half of the 1990s. The U.S. government collected an increasing level of taxes from the capital gains realized in the stock and home real estate markets. In turn, taxes on capital gains provided an increasing portion of the revenue of the U.S. budget. The U.S. government became quite dependent on taxes from capital gains, which was a highly risky strategy.

Between 1990 and the start of 2000, the market capitalization of all stocks in the United States, driven by the New Economy bubble, quintupled, to nearly $19 trillion. In the same period, in many parts of the country, home values more than doubled. A capital gain is realized when one buys an asset at one price and, after holding it a while, sells it at a higher price. For example, if one buys a stock at $70 per share, and two years later sells it for $170 per share, then one has made a realized capital gain of $100. Likewise, buying a house for $150,000, and selling it for $300,000, yields a realized capital gain of $150,000.

Figure 2 depicts that realized capital gains rose from $124 billion in 1990, to $180 billion by 1995, a significant, but not spectacular level; but reflecting the overheated stock and home markets, which leapt up to $664 billion in 2000, more than triple their 1995 level.

Taxes paid on realized capital gains would parallel, but not strictly duplicate, the trajectory of the volume of realized capital gains. **Figure 3** depicts that the taxes paid on realized capital gains rose from $32 billion in 1990, to $40 billion in 1995, and then exploded to $121 billion in 2000. Two points on this are crucial. In 1990, capital gains taxes constituted 7% of individual income taxes paid; by 2000, capital gains taxes constituted a stunning 12% of individual income taxes paid. As individual income taxes are the largest element of total receipts of the U.S. government general revenue receipts—more than 60%—this constituted an important U.S. government dependency on capital gains. Second, if one compares the level of capital gains taxes in 1995 and 2000, there was an increase of $81 billion in capital gains taxes in 2000. This comprised a significant amount of what we described above as the "apparent and fleeting" general revenue budget surplus that President Clinton achieved in the FY 2000 budget. Remove the increment of capital gains tax receipts, and a few other speculative items, and there would have been no surplus at all, but a significant deficit.

Relying upon capital gains tax revenues was a very dicey proposition. Should the capital gains bubble pop, there was only one direction that the U.S. budget could go: down.

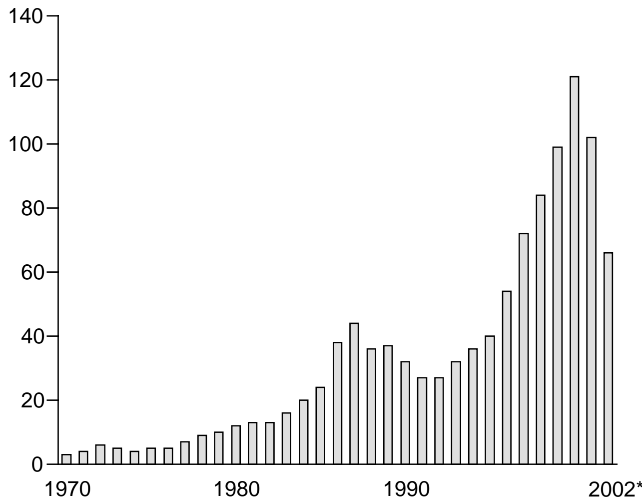
Individual Income Taxes Plunge

To understand the debacle of the U.S. budget of the last two years, one has to understand what has happened to indi-

FIGURE 3

Capital Gains Taxes Paid to Federal Government

($ Billions)



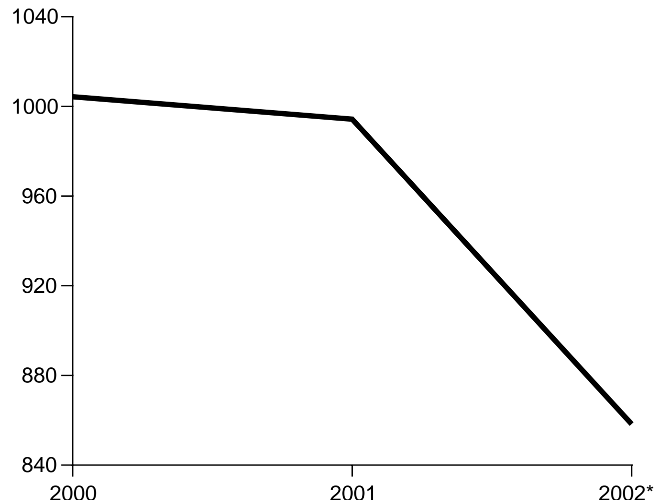
*Estimated

Source: EIRNS.

FIGURE 4

Federal Government's Individual Income Tax Revenues, Fiscal Years 2000-02

($ Billions)



*Estimated

Sources: U.S. Office of Management and Budget; U.S. Treasury Department.

vidual income, and the taxes that are collected from that individual income. During the past two years, the taxes from individual income have plunged, and that has sealed the fate of the U.S. budget.

There are two broad parts to individual income: a speculative part, and a part based on non-speculative wages and salaries. We have discussed above one element of the speculative part of individual income: capital gains. There are other elements, such as stock options (which are categorized not as part of capital gains, but as part of wage compensation, albeit speculative wage compensation). What happened to the capital gains bubble was inevitable: It popped! No data officially exists on the reported level of realized capital gains for FY 2001, but several knowledgeable sources in government have told *EIR,* that realized capital gains fell in half between fiscal years 2000 and 2001, and that in FY 2002, they are no higher than FY 2001. This is represented in Figure 2. Based on the formula on which years realized capital gains taxes are paid, it is estimated that capital gains taxes were $102 billion in FY 2001, and $66 billion in FY 2002 (see Figure 3). That is, they fell $46 billion in FY 2002 relative to FY 2001.

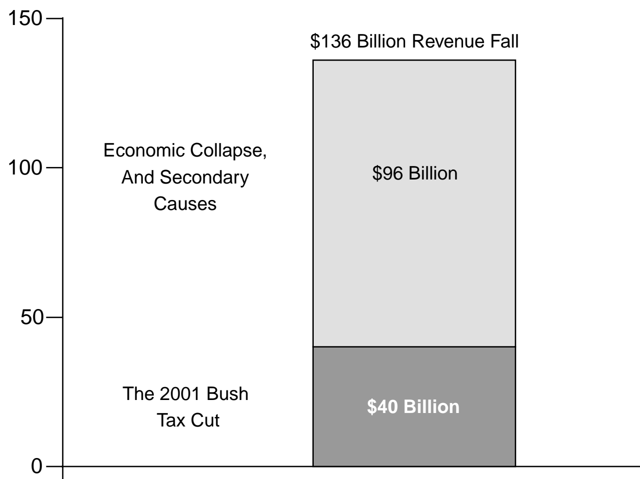
Let us now look at what happened to that part of individual income that is non-speculative wages and salaries. According to the U.S. Department of Labor's Bureau of Labor Statistics (BLS), during the past two years, more than 1.5 million jobs have been lost. In actuality, the job loss has been much higher. Laid-off workers pay little or no individual income tax. Plus, in industries such as airlines, and many high-tech sectors, there has been extensive wage-cutting, which reduces taxes paid on these wages. It is estimated that the fall in taxes on non-speculative wages and salaries may total several tens of billions of dollars.

Thus, as the deepening worldwide financial-economic disintegration popped the speculative U.S. stock market and severely damaged the U.S. economy, the volume of taxes on individual income plunged. **Figure 4** documents the catastrophe that unfolded. In FY 2000, individual income taxes totalled $1.005 trillion. They fell to $994 billion in FY 2001, a fall of 1.1%. But then the bottom fell out: In FY 2002, individual income taxes totalled $858 billion, which is a fall, relative to FY 2001, of $136 billion, or 13.9%. This is the largest absolute amount fall in U.S. history, and one of the largest percent falls ever (*EIR* is checking the records of the 19th Century). The only comparable percentage fall in modern times, was the fall in FY 1946, and that was as a result of the demobilization from World War II.

The Bush Tax-Cut

The collapse in individual income taxes is so great, that both major political parties want to ignore it. The Republican Party is pretending that it didn't happen. The Democratic Party is repeating, mantra-like, that whatever has happened, is a result of the Bush tax-cut, meaning the Economic Growth and Tax Relief Reconciliation Act of 2001. The Bush tax-cut does have some real problems: To a large extent, it benefits the wealthy, and did cause some revenue loss. According to

FIGURE 5
Economic Collapse Is Principal Cause of Fall in Individual Income Taxes in FY 2002



Sources: U.S. Treasury Department; Congressional Budget Office; *EIR*.

the Congressional Budget Office, the Bush tax-cut reduced individual income taxes by $40 billion in FY 2002. This represented 29% of the total $138 billion fall in individual income taxes in FY 2002, as shown in **Figure 5.** But, that means that the remaining 71% of the fall in individual income taxes is attributable principally to economic collapse. This is the percent that neither Democrats nor Republicans want to talk about.

This is, however, exactly what Lyndon LaRouche has talked about: It is the economic breakdown that is driving everything, including the U.S. budget.

The collapse of individual income taxes in FY 2002 sent the U.S. general revenue budget to a deficit of $317.3 billion, the second highest in history. Then, on Nov. 21, the U.S. Treasury Department reported that in October 2002, the first month of the FY 2003 budget, the U.S. registered a $57.7 billion general revenue budget deficit. This is an incredibly large single month budget deficit. Based on the accelerated collapse of the U.S. economy, it is possible that the entire FY 2003 general revenue budget deficit will be between $400 and $500 billion.

The Conservative Revolutionaries in the Congress, as evidenced by their refusal to extend basic unemployment benefits, are on a slash-and-burn budget-cutting warpath. But such cuts reduce economic activity, which reduces tax revenues, the very problem gripping the budget.

What is needed is to break the vicious cycle of mounting budget deficits and deeper cuts, by rebuilding the economy in a fundamental way, and thus restoring revenues. Uniquely, Lyndon LaRouche is the one talking about that.

Bank of Japan Warns Of 'Unprecedented' Bank Stock Crash

by Kathy Wolfe

Bank of Japan Governor Masaru Hayami said on Nov. 21 that an "unprecedented" plunge in bank shares has the BOJ on an alert to provide cash to the banks. "Stock prices, especially those of banks, have fallen in an unprecedented manner," he told the press. "The fall in bank shares is extremely troubling. I think it's the first time in the post-war period that we've seen such a situation. I don't recall any such rapid falls in bank share prices since I entered the BOJ in 1947—that's been 55 years." The BOJ tweaked monetary policy on Nov. 19, announcing that it would raise system funds to the top of its $122-163 billion range.

Shares of the $700 billion UFJ Bank have fallen 52% in November alone, and 72% since Sept. 30, amid a barrage of media reports that it will be nationalized soon; they plunged 10% the last week in November. Moody's warned that it may soon downgrade UFJ stock to "Ba1"—junk—from "Baa2." Shares of the world's largest bank, the $1.3 trillion Mizuho Holdings, have fallen 46% in November, and 51% since Sept. 30. Since Heizo Takenaka became Japan's top financial regulator, shares of Mizuho Bank alone have lost $12 billion in equity. The $700 billion Sumitomo Mitsui Bank has lost 34% in November, and 51% since September; the $900 billion Mitsubishi Tokyo Bank has dived 19% and 28% in those time frames. The Tokyo Stock Exchange's banking index has fallen 18.7% in November.

With UFJ's total capitalization now shrunk to $4 billion, and Mizuho's to $8 billion, these banks "are now buyout targets for cash-rich financial institutions in Europe and the U.S.," Nikkei news agency reported Nov. 19. There are no Japanese buyers.

Japanese industrial companies, which, under the traditional "cross-share" system, still hold a lot of stock in their main lender-bank partners, are desperate now to unload bank stocks before they have to declare major losses. According to an estimate from Daiwa Institute of Research, non-financial companies had unrealized portfolio losses of some $17 billion in bank stock holdings over the last six months.

Market Forces Not Working

Japan must "take seriously" the Nov. 21 decision by London Fitch IBCA to downgrade the nation's debt rating, as