EIR Economics

200% tax increase won't help budget deficit

by Chris White

Individual U.S. tax obligations could easily be doubled, and more, without substantially affecting the size of the federal budget deficit. This is the result of a just-concluded study by *EIR*. The conclusion ought to shed some light on the mental state and qualifications of those who, like President Bush and his economic team, insist that current crisis negotiations with congressional leaders on the budget deficit are without preconditions.

Their discussions are absurd. It can probably be assumed that were the assembled luminaries never to have one emergency meeting, and never to agree on anything, the budget deficit would not increase as fast as it will once they all get together and agree on what should be done.

It is no longer secret that the subject of the meetings is not the federal government's deficit per se, but rather what the administration calls the government's "contingent" and "off-budget liabilities." This was reported May 14 by Richard Darman, director of the Office of Management and the Budget (OMB).

"Contingent liabilities" are those which, it is assumed, are backed by "the full faith and credit" of the U.S. government. Within the class of "contingent liabilities," for example, fall the deposits of savings and loan institutions which meet the deposit insurance conditions of the Federal Savings and Loan Insurance Corp. and its successor organizations, and are covered by such insurance programs.

The total of such "contingent liabilities," according to the Federal Deposit Insurance Corp. (FDIC) and the OMB is around $5.6 trillion. Of the total, $2.7 trillion is made up of insured checking, savings, and credit union accounts; $1.3 trillion of insurance for pensions, floods, war risk, crops, and overseas investments; $800 billion in government-sponsored home mortgages, farming agencies, etc.; $600 billion in guarantees such as Federal Housing Administration and Veterans Administration housing loans, student loans, and small business loans; and $200 billion in agricultural and other direct loans.

Now, after five revisions so far this year, the S&L bailout is to cost around $550 billion, once estimated interest charges are added to working capital required. Of the $550 billion, $130 billion is direct cost; the other $420 billion is interest charges to finance the $130 billion. And, there will probably be still more to come.

Financial holocaust nears

In 1986, some 103 million personal income tax returns were filed, for an average return to the federal government of $4,470 per tax filing. Assume that these 103 million taxpayers had to cover the multi-year cost of the S&L bailout in one shot. It would take a 22% tax hike to bring in the $5,445 per taxpayer that would be required, if the bailout financing requirement is unloaded directly onto the taxpayers' backs.

Spread over the multi-year duration of the bailout, that is roughly what each taxpayer would be expected to cough up.

The one-shot deal isn't going to happen, of course. Nor is it what the budget summit meetings are discussing. Their subject, as Darman has admitted, is the entirety of the government's "contingent liabilities." And in this case, the highest-ranking officials of government are unable to put a bottom line to the magnitude of the cost.

Testifying before Congress on May 23, neither Treasury Secretary Nicholas Brady nor Federal Reserve Chairman

Alan Greenspan could come up with estimates. For Brady, the cost of the bailout is "a moving target." For Greenspan, "The size of this hole is astronomical."

They were talking about the S&Ls. Their uncertainty was premised on the level of interest rates, and the future of the collapsing real estate market.

The big one here is not the S&Ls. It is the commercial banking system as a whole. Fully $2.7 trillion of the $5.6 trillion "contingent liabilities" is deposit insurance of all types. Consider also that the commercial banking sector is also affected by what happens to pensions, and, above all, to mortgages and real estate finance. Speculative real estate financings have collateralized much of what the bankers call "assets" in recent years—their lending to customers.

Last year the insurance fund for the commercial banks, the FDIC, lost $851 million. This loss left the fund with only $13.2 billion in assets, or 70¢ in assets for every $100 of insured deposits. That's the lowest assets-to-deposits ratio since the fund was established in the 1930s, and far below the $1.25 per $100 the experts consider safe. In 1988, the insurance fund lost $4.3 billion. In both years, the biggest losses were in Texas.

Crisis-point: real estate

This is exacerbated by the spread of a Texas-style real estate collapse into New England, and thence, down the East Coast into the Washington, D.C. area. Since 1986, bank real estate loans have nearly doubled, from $496 billion (17% of bank assets) to $884 billion (25% of assets) at the end of 1989, during which time problem real estate assets (nonperforming loans plus repossessed property) have more than tripled, from $13.2 billion to $42.7 billion.

Some 361 of the nation's 13,121 banks have problem real estate assets that exceed their capital. At least 540 banks—4% of all banks—have bad assets greater than their capital plus loan loss reserves. Nationwide, bad assets were 30% of capital and reserves in 1989, compared to 27.3% in 1986.

According to the Federal Reserve Bank of New York, cumulative charge-offs for bad loans have exceeded income for the nation's 10 big money center bank holding companies since late 1986.

The debt is uncollectible

This is the end-result of the process under which approximately $22 trillion of combined debt and speculative claims were pyramided on the bankrupt U.S. economy. Quarterly interest charges and claims of speculative investment exceed national wealth production fourfold. Thus the banking system is doomed. And so the government is going to have to do something about the "contingent liabilities" it is supposed to back with its "full faith and credit."

Now assume, for the sake of prudence, that the government *does* have to stand behind the entire $5.6 trillion of "contingent liabilities." This does not include more than $3 trillion directly accounted as the government's debt. Not an unreasonable assumption, if these characters continue their present policy, and the national real estate market continues down the tubes, dragging the banks along in its wake.

This eventuality will bleed the 103 million 1986 taxpayers for $54,368 each. For this figure to be compared with the current estimate of $550 billion over 30 years for the S&Ls, it would have to be multiplied by four, to bring into the equation the estimated interest charges, prorated over 30 years, which comes to $217,472 per taxpayer over 30 years, or $7,249 in annual taxes, to support the government's "unfunded" or "contingent liabilities" account alone. This does not include anything for the government expenditure categories which were supposedly covered by the $4,782 average paid by each of the 103 million tax-return filers of 1986—nothing for social expenditure, nothing for defense, nothing for the federal government.

This prorating leads to the absurd conclusion that present tax levels increase by 150% to support the "contingent liabilities," while present government expenditures, including interest on its $3 trillion debt, are cut by 100%!

Not exactly a workable solution.

Assuming current expenditures are maintained, and prorating it all onto the individual, over 30 years, the tax load would come to $12,031 per average tax-return filer per year, 250% above the 1986 average return. In 1986, individual taxes accounted for about 53% of receipts. If the total were prorated between individual and non-individual taxpayers, you can be sure the result would be reflected as higher prices. The individual would be covering the same general amount, by different means. This would assume no cuts from current levels. The result is as absurd as 100% cuts in expenditure.

The total tax bite would be about 60% of the $19,996 average pay.

The calculations put into focus what administration policymakers and their financial community co-thinkers refuse to take into account.

The government's "contingent liabilities" would not be threatened if there were not a depression under way, which has been compounded by an unparalleled growth of usury and speculation. The deepening depression means it is useless to throw money in the form of increased tax receipts at "contingent liabilities," or to attempt to achieve balance by cuts. Who is going to be around to pay taxes as the banks, insurance companies, and real estate operations which the government is standing behind come crashing down? But this is the one area not under discussion at the budget summits.

If the participants were sane, they would be having emergency meetings to discuss how to revitalize the economy and put people back to work in the high-paying productive employment that would rebuild the tax base. Anything else, and the deficit will keep growing, because it will be impossible to raise taxes or cut expenditure fast enough to keep up with the effects of economic collapse.