Will U.S. States' Bankruptcies Provoke a Move to Sanity?

by Mary Jane Freeman

The props for two-thirds of recent U.S. economic activity, the consumer credit and housing bubbles, are near bursting. In October and November, U.S. vehicle sales crashed, despite 0% financing, sometimes combined with zero down and zero payment for months, among other incentives. The lowest mortgage-financing rates in decades have kept the housing bubble inflated, but it is showing signs of collapse. Across the nation, the reality of our economy's depression conditions is writ large by multibillion-dollar deficits now emerging in city and state budgets. Revenues have plummeted 10-30% in the states since March 2001, as our manufacturing sector has been idled, resulting in hundreds of thousands of layoffs; corporations have slashed jobs to puff up bottom-line profits; and the "New Economy" and stock market bubbles have burst. This severe contraction of the real economy puts even greater demands on government to provide services at a time when more Americans find themselves jobless and unable to care for their families.

It is "the most dire fiscal situation since World War II," declared the National Governors Association in a press release on Dec. 3. A mere five months into the new fiscal year for most states, "Nearly every state is in fiscal crisis," as revenues have collapsed and spending pressures increase, "creating massive budget shortfalls," reports the Governors Association and the National Association of Budget Officers (NASBO) in their November 2002 "Fiscal Survey of States."

Amidst the vanishing revenues on the state and Federal level, governors, state legislators, President George Bush, and the Congress, each blaming the other for the loss, have failed to address the true problem: the need to restart the wealth-producing physical economy. The President refuses to aid the failing rail and air industries and vetoed a 4% pay raise for Federal workers; the lame-duck Congress callously recessed and left town, without passing 11 appropriation bills; and governors and legislators bicker over how to cut the budget or get the Federal government to pay. Bush's Council of Economic Advisers Chairman Glenn Hubbard dismissed the states' fiscal crises, saying that "Federal taxpayers" should not "be on the hook for states' budget problems."

This is a crisis of leadership. The Bush Administration's negligence makes Herbert Hoover a model of alacrity by comparison. Faced with the 1930s Depression, the American people rejected Hoover, and brought Franklin Delano Roosevelt into office to lead the nation out of its misery, and lead he did. Roosevelt's infrastructure-centered, anti-Wall Street policies succeeded. Today, Lyndon H. LaRouche, Jr., a 2004 Democratic Presidential pre-candidate, has taken the initiative to launch a Roosevelt-style economic recovery. Such an initiative requires two primary acts:

1. A bankruptcy reorganization of the world monetary-financial system, by means of a New Bretton Woods arrangement; and

2. Elimination of the past 30 failed years of deregulation and post-industrial society policies to facilitate a massive infrastructure-building drive.

A Fiscal Year Older, and Deeper in Deficit

By June 30, the end of their fiscal year 2002, forty-six states had an aggregate deficit of $37.5 billion which, by law, had to be eliminated through cuts and/or accounting tricks to balance the budgets. Aggregate budget gaps, then, for fiscal year 2003, beginning July 1, 2002, were estimated at $49.1 billion. To close these gaps in enacting fiscal 2003 budgets, 26 states cut spending, 23 tapped earmarked funds, 16 borrowed against tobacco settlement monies, 12 drew down rainy day funds, and 10 raised users fees. But by mid-October, three months into fiscal 2003, thirty-one states reported that new deficits, totaling $18 to $20 billion, had opened because revenues were anemic.

Now in December, revenue declines continue to be reported, prompting governors to call their legislatures into emergency session, and/or to announce mid-year budget cuts, hoping to balance the current year budget and mitigate next year's mushrooming deficits. Foolishly assuming that a "recovery" was on the way, lawmakers and governors cut more, in order to balance a fiscal 2003 budget. But it wasn't enough. Now, either they go with LaRouche's economic recovery package, or the blood of the budget knives will be on their hands, as they make one savage austerity cut after another.

Already between mid-November and December, as prelude to huge mid-year cuts once legislatures resume, some governors used discretionary powers to make initial spending cuts, thinking it would stem the hemorrhaging:

- California froze all agencies' spending;
- Colorado added 6% cut to all agencies, on top of 4% two months ago;

• Connecticut cut $68 million to all agencies, with state aid to localities taking the biggest hit, $22.4 million;

• Kansas made a $78 million cut to agencies and $48 million cut to localities;

• Massachusetts made an emergency $99 million cut to its Medicaid program, affecting 600,000 people; b››››• Michigan cut $460 million on Dec. 5, of which $337 million is from agencies, programs, cities, and higher education;

• Virginia will cut another $1 billion before June 30, on top of $835 million made in October; and

• West Virginia has made $30 million, about 2%, cuts to agencies.

Case Study: California

On Dec. 3, California Gov. Gray Davis (D) issued a proclamation calling the legislature into emergency session. It declared that the "expected economic recovery . . . has not materialized" and due to the "continuing decline of the stock market" and "weak demand abroad" for California goods and services, the legislature must act "to reduce expenditures . . . reorganize and consolidate state operations." This extraordinary measure was taken when the $23.6 billion deficit, which had been closed in the enacted fiscal 2003 budget—using $7.5 billion in program cuts, $6.5 billion in loans, and many other accounting tricks—blew open, with an additional $5 billion "or more" shortfall. On top of that, the next fiscal year's deficit is expected to soar to $30 billion.

Davis was set to lay out his $5 billion-plus mid-year cuts on Dec. 6; but in fact, when he did announce the reductions that day, they had to total $10 billion! This disaster is to be debated at the Dec. 9 emergency session. Prior cuts have magnified problems in transportation and port maintenance; in water management, where cities and farmers face water shortfalls; in electricity production, where consumers face soaring prices *and* shortages, even as the state still recovers from the damage of the Enron pirates; and in health care, where hospital trauma centers and whole public hospitals have been closed.

Clinging to delusions, both Democratic and Republican lawmakers are posturing over "tax hikes" vs. "no tax hikes," with some calling for bipartisan cooperation in wielding the budget axe. But the magnitude of the problem is amplified, since whatever one-time revenue sources or accounting manipulations have already been used, are no longer available. Moreover, the failure by the U.S. Congress to pass the Medicaid matching funds appropriation, means that California will not get $400 million that it expected for its state program.

California's economy is the fifth largest in the world, and the largest state economy of the United States. In the 1990s, the state's industrial base, from aerospace to basic manufacturing, contracted, while the new Internet high-tech-driven companies mushroomed. Hand-in-hand with the high-tech and dot.com revolution, came the stock market and housing bubbles. From late 2000 to November 2002, the manufacturing sector had a net loss of 230,000 jobs—the steepest two-year decline in its history.

IN HIS MIND'S EYE

President Roosevelt surveys his Tennessee Valley Authority and other infrastructure projects, in a contemporary cartoon. Today, Lyndon LaRouche advocates that sane approach, against the budget-cutting mania which is driving U.S. states and cities deeper and deeper into insolvency.

This transformation from a producer to consumer-based economy had huge consequences. By fiscal year 2001, nearly 25% of its budget relied upon tax revenues garnered from capital gains and stock options income. When the stock market blew, tax revenues fell by over $10 billion in fiscal 2002, which led to the huge deficit heading into fiscal 2003 and the cuts made to balance the budget. More significantly, embedded in the budget plans has been an expectation that $10 billion or more of such bubble-money would be in state coffers to fund operations and services. Just how vulnerable the state was, is shown by the fact that these revenues fell an unprecedented 66% from its peak of $17 billion in fiscal 2001 to under $6 billion in fiscal 2002.

Big Bite Out of the Big Apple

New York City has a current budget of $42.3 billion, comparable in size to many large states. As with most states, it faced a deficit; so, in order to adopt a balanced fiscal 2003 budget, New York City cut its planned spending and used one-time fixes, such as selling off one of its water tunnels for $100 million, allowing a depreciation tax write-off to the buyer. But, the $5 billion cuts and accounting tricks in June weren't enough. In November, the new Mayor, Michael Bloomberg (R), announced that the city faced an additional $1.1 billion shortfall, and he proposed a "slash and burn" mid-term financial plan to close the gap. The draconian plan included cuts and tax hikes to close the projected $6.4 billion deficit for fiscal 2004 as well. On Dec. 2, Bloomberg signed the new budget bill, slightly revised, which was passed by the City Council.

Bloomberg, harkening back to the "1975 fiscal crisis" as the "benchmark against which all other budget" crises are to be "measured," tries to distance himself from the fascist Emergency Financial Control Board, or "Big MAC" takeover of the city by the Lazard Frères bankers. He argues that while the city is "still paying $500 million annually" in Municipal Assistance Corporation (MAC) debt service from almost 30 years ago, unlike then, today "the economic foundation . . . remains strong." His "kinder, gentler" austerity plan seeks $600 million in "productivity" concessions from city employees, such as increased health insurance co-payments and pension contributions, as well as longer work weeks. "Productivity savings," he boasts, are a "smarter approach" than the "large-scale layoffs" of the Big MAC era. If not agreed to, he would, however, make the job cuts.

The "November Financial Plan" sought $844 million new agency cuts and $1.1 billion in new property taxes. In the budget deal passed by the City Council and signed by the Mayor, $50 million of the cuts were restored to some vital programs and taken out of others. The 25% property tax increase he sought was lowered to 18.5%, which will generate $837 million. The agency cuts included: layoffs in police, firefighter, school teacher, and sanitation workforces; closure of 15 senior citizens centers; another $115 million from city schools; 7.5% from public libraries; closure of five community health clinics and ten dental clinics; halting some ambulance shifts; and other social service program reductions. The City Council's redistribution of $50 million of cuts restored: some ambulance shifts; a seniors food program; two youth services programs; a scholarship program; a few senior centers; and some health/mental health aid. The deal redistributed the $50 million cuts to: bus subsidies, children's services administration; debt service refinancing; and heating and electricity costs in city buildings.

As with California, New York City has become a post-industrial bubble economy. For example, comparing the third quarter of calendar 2002 to the second quarter, the city lost 4,200 manufacturing jobs. Bloomberg's Plan states, "One-third of the City's economy and 20% of its wage income is tied either directly or indirectly to the securities industry," i.e., Wall Street. Because Wall Street firms' profits are expected to fall from $12 to $8 billion, the corresponding tax payments to the city had been expected to be $2.3 billion, but will be $1.8 billion instead, further deepening the budget hole. In fiscal 2000, the city reaped $831 million from capital gains taxes—just about the size of the cuts—but these plummeted to $443 million in fiscal 2001, a $388 million loss. Adding to this fiscal year's deficit, the November Plan estimated that these taxes will fall to $279 million—a $552 million collapse since 2000, or 66%!

The TVA's increased revenue generation from burgeoning real economic activity, much doubted by FDR's detractors, worked, as this contemporary cartoon registers.

Further reflecting the instability of the city's economic dependence on being Wall Street's hometown, Bloomberg news service reports that from July to October, the only category of tax revenues which has been on target, were the real estate transaction taxes, i.e., the housing bubble. All other taxes—personal, corporate, sales, etc.—were below budget.

Both Governor Davis and Mayor Bloomberg ask their citizens to "make sacrifices," because the fiscal crisis is so great (however, temporary, they promise). State legislators and city councilmen, too, chime in with better ways to tighten the budget belt: Slash programs, say the Republicans. Raise taxes, say the Democrats. Sacrifice on these terms, means destroying the future existence of the population.

The demand from conservative, Mont Pelerin think-tank types, like the Manhattan Institute, is to "reform"—meaning to privatize—government. Only LaRouche's "Super-TVA" infrastructure-vectored job-creation plan will rebuild the necessary tax base to launch a recovery.