Econometrics

Why the EIR was able to outscore other forecasters on the U.S. budget deficit

by Richard Freeman

The U.S. federal budget deficit will reach some $100 billion in fiscal 1982. This is the now-familiar, and roughly accurate, consensus—a consensus among the same economic forecasters who totally underestimated that deficit, at a time when the *Executive Intelligence Review* warned that the revenue gap would run out of control, and specified Paul Volcker's policies as the reason why.

It is necessary to examine the record of these projections, not only to demonstrate the accuracy of *EIR*'s forecasts, although that is well worth emphasizing, but to shift the terms of national debate over fiscal policy.

What should be understood is that the econometricians who so grossly underestimated the deficit did so because they were protecting Paul Volcker and the effects of his policies, effects which were quite foreseeable even by these incompetent organizations; and when the forecasters upon whom Washington blindly depends sprang their trap by conceding the actual magnitude of the deficit, they did so to induce the White House to impose further austerity against U.S. living standards and investment, further degradation of America's vast export potential, and further stripping of the essential functions of national government under the Constitution.

They were not simply "forecasting," in short. They had no intention of telling the truth. At the point when they told some approximation of the truth about the deficit, it was because they assumed they could retain their credibility; no one would contest their record; and they could proceed to manipulate the President and the Congress into self-destruction.

Since Volcker initiated his credit massacre in 1979, *EIR* has consistently reported that high interest rates would lead to vast budget deficits through crushing the productive sectors of the economy which generate tax revenues, while hiking the Treasury's borrowing costs, swelling the numbers of those whom government is rightly obliged to assist—and, most fundamentally, wiping out the ability to regenerate U.S. capital-intensive productivity, the key to America's economic future.

Therefore, *EIR* concluded, Volcker and his policies should be ousted. The nation should be committed to a policy of low-cost credit for productive industrial and agricultural output and investment, at the expense of parasitic sectors. And Washington should not hesitate to dispatch funds that will multiply repay themselves into scientific and technological R&D and first-rate education, on the NASA-Apollo space-program model.

What is forecasting?

The low original budget-deficit forecasts by the predominant forecasting outlets (see Figure 1) were designed to soothingly reinforce Mr. Reagan's belief that he could balance the budget and reduce inflation through budget cuts, deregulation of crucial industries, and above all, high interest rates. Thus the President stated in his July 15, 1981 budget review that the fiscal 1981 deficit could be $42.5 billion.

What were Reagan's current critics saying back then? First, there is the Congressional Budget Office, the unit of Congress created by the Brookings Institution that is officially charged with working up budget projections, and the most-quoted source in budget debates on Capitol Hill. In late December 1981, CBO chief Alice Rivlin, a Carter holdover and Brookings protégée, berated President Reagan for both his policies and his erroneous budget projections for fiscal 1982 and 1983. But what is the CBO record? In July 1981, Rivlin predicted a fiscal 1983 deficit of $18.4 billion. Six months late, Rivlin revised that estimate to $150 billion, a flip-flop of $131.6 billion in less than half a year (see Figure 2).

The margin of error between Rivlin's first prediction and her second, assuming that the second is correct, is 700 percent. But as I commented in last week's report, the CBO is not alone. Between July 1981 and September 1981, Data Resources, the most prestigious of all econometric consulting units, earning the largest annual sales revenues, raised its projection of the FY82 budget

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deficit from $58.0 to $101.3 billion, an increase of almost 100 percent.

Next consider the case of Evans Economics, one of the Big Ten private econometric consulting firms, which predicted that the FY80 deficit would be $24.3 billion; in fact it was $59.5 billion.

Questions of method

The incredible flip-flop of the CBO on its fiscal 1983 budget deficit forecast was explained Jan. 12 by a spokesman for the CBO projections unit, who stated, "We do not release to the public industrial production figures, although we do release our projections for real GNP. The reason is that we can change the industrial-production numbers during the course of a year, and no one would know the difference."

In the same discussion, the CBO spokesman stated, "Our economic forecasts greatly undershot revenues. We underestimated the effects of the high interest rates and the tax-law changes dealing with leasing arrangements." To footnote the latter point: *EIR* had exposed the way in which some of the changes in 1981 tax code provided pure speculative write-offs, and leasing comes under that heading. A firm can easily have its equipment owned by a dummy corporation under its control, and lease the equipment to itself, claiming a tax break. According to the CBO, this will cost the U.S. government billions of dollars in lost revenues, without necessarily enhancing productivity at all. This is merely one example of misguided tax policy.

The Volcker issue is the major one why most projections are "off the wall." If one regards interest rates as merely an additional charge to the economy, which may hurt industrial production but can be compensated for by growth in "sunrise" sectors of the economy, such as the so-called information sectors, then Volcker's policies are either advantageous or of secondary importance. In this regard, the method that distinguishes *EIR* from the rest of the lot in economics is not the accuracy of its forecasts per se, although the record shows these forecasts are highly reliable. Of greater importance is the method of the forecasts, embodied in the LaRouche-Riemann economic model. Instead of treating the economy as an indiscriminate agglomeration of objects, some useful, some useless, as is done with the Gross National Product metric, *EIR* rejected GNP and treated the economy as a physical system.

Such systems have the ability to reproduce themselves at higher technological levels, embodying further potentials for economic growth, and enriching their citizen's mental powers, or they can degenerate in a spiral of economic collapse. At each point in an economy's evolution, the *EIR* staff weighs the potential in either of these two directions. Using the LaRouche-Riemann economic model, the *EIR* staff was immediately alerted to the dangers inherent in high interest rates as they intersected a heavily indebted and industrially run-down U.S. economy. Each new increment in

Figure 1
Comparison of federal fiscal year budget projections (in billions of dollars)

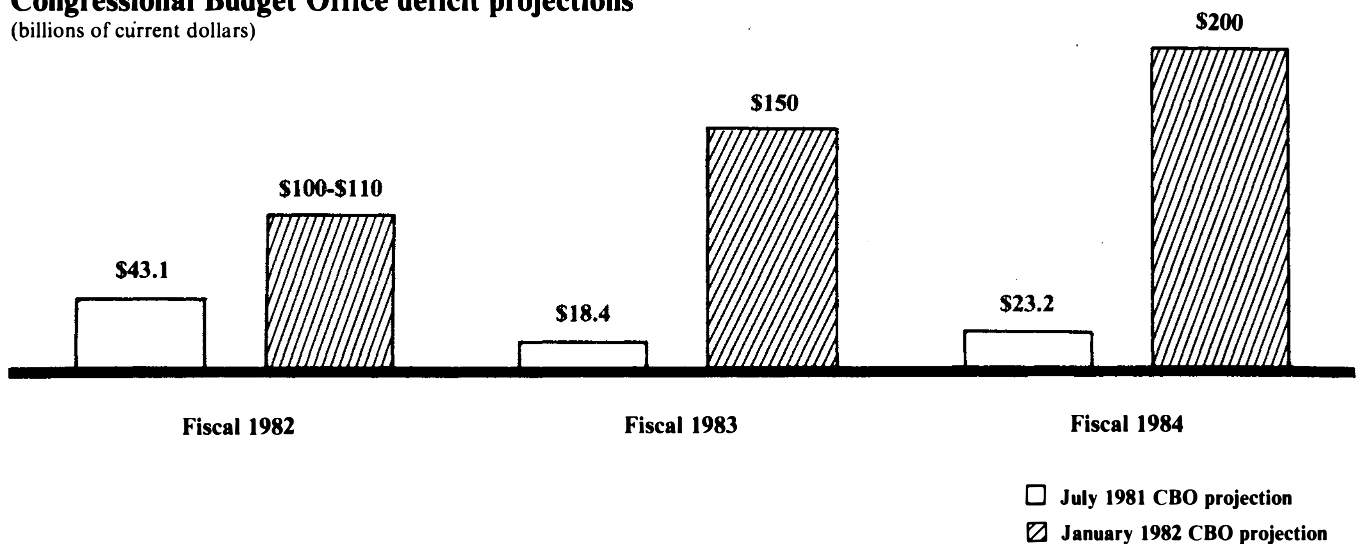
Fiscal year	Actual budget deficit	Institutions making projections (dates are time of publication of projections)					
		Data Resources Inc.	Wharton Econometrics	Office of Management and Budget	Fidelity Bank Econometrics	Evans Econometrics	EIR
		Sept. 1980 for 1981; Sept. 1981 for 1982-85	Aug. 31, 1981 for 1983-84	July 15, 1981 for 1982-85	June 29, 1980 for 1981-82	Oct. 23, 1980 for 1980-82; Sept. 1981 for 1983-85	Feb. 9, 1979 for 1980; Feb. 17, 1981 for 1981 Oct. 1981 for 1982
** 1980	−59.5					−24.2	−58.5*
1981	−57.9	−46.6	--		−35.5	−49.4	−65.0
1982		−58.4	−83.4	−42.4	−33.5	−13.6	−97.5 to −102.5
1983		−55.2	−84.9	−22.9	--	−65.2	
1984		−60.9		+0.5	--	−57.5	
1985		−48.2		+5.4		−33.4	

Source: Office of Management and Budget, and the reported statements of each institution cited.
* The *EIR* projection of the federal budget deficit for FY1979 includes on and off-budget items.
** Oct. 1, 1980-Sept. 30, 1981

Figure 2

Congressional Budget Office deficit projections

(billions of current dollars)



interest rates would mean, *EIR* predicted, a new increase in debt service that would have to be drawn directly out of the productive capacity of the economy.

Let us go back for a moment to the Oct. 8-9, 1979 Columbus Day weekend when Volcker, two months into his job as Fed chairman, drastically raised interest rates. These are the comments at the time of the leading economic experts:

- **Rep. Henry Reuss** (D-Wisc.), the long-time chairman of the congressional Joint Economic Committee: "I applaud the Fed and the Treasury for their actions on Saturday."
- **Alan Greenspan,** economic adviser to Presidents Nixon, Ford, and Reagan: "The Fed had no alternative."
- **Robert Triffin,** then professor of economics at Yale University: "Controlling the money supply is the best way to fight a recession."
- **Murray Weidenbaum,** now chairman of Reagan's Council of Economic Advisers: "I really don't have any criticism of Volcker's approach."
- **The *Washington Post,*** Oct. 14, 1979: "If the President can 'hang tough' long enough for the Fed's harsh medicine to work . . . then the move could help cool speculative fever and dampen inflation."
- **Sen. Edward Kennedy:** "One of the leading problems in the country at present is inflation. The steps the Fed has taken are not steps that I would differ with."
- **George Bush,** now Vice-President: "The action by Federal Reserve Board Chairman Volcker is a necessary step to curb the staggering growth in the rate of inflation."

While Volcker claimed that he would reduce inflation, during the 30 months since he has been in office, the inflation rate, as underestimated by the Consumer Price Index, has averaged 11.65 percent, the highest sustained rate in the last 35 years.

In response to this public avalanche of support for Volcker, *EIR* published a special four-page editorial by founder Lyndon H. LaRouche, Jr. in its Oct. 30-Nov. 5, 1979 issue, entitled, "Is the Fed's Volcker Actually Insane?" stating that: "The time has come to balance the accounts on Federal Reserve Chairman Volcker's current depressing measures. No matter what the deceptive label Volcker and the Carter administration chose to stick on the bottles of Dr. Volcker's horse liniment, Volcker's package is by no means 'anti-inflationary.' Directly opposite, it is the old 'stagflation' President Nixon's Friedmanite period carried to extreme. . . . There is only one way in which Volcker's measures could lead to a halt in inflation: a depression worse than that of the 1930s depression." That is now happening.

The results of the *EIR* projection released in the Oct. 23-29 issue of *EIR* are valid today. The projection made three main points:

1) The trough of the forecast depression is much lower than that of the 1973-74 recession, a conclusion clear from the computer graphs showing rate of surplus production between 1973 and 1981.

2) The rate of decline of productive activity will be considerably faster than the 1973-74 recession—which represents the second fastest decline on record, second only to the 1921 recession.

3) At least through the end of 1981, there is

> no reason to expect the economy will enter into a recovery, according to the computer analysis. The economy is much weaker than it was in 1974, the last time the Federal Reserve put the brakes on credit creation.

Several times between October 1979 and the present, many economists proclaimed that "the recession is over" and "the U.S. economy has learned to live with high interest rates." In September 1980, *EIR* ran a special projection showing why the United States may make what appears to be a recovery, but which would soon end in a collapse.

What fundamentally determines a budget is 1) whether productive expenditures are being made by the government or encouraged by the budget, to add revenues through expanded profits and activity; 2) what level of activity the economy is operating at to provide the tax base to finance the budget; and 3) whether deficits are therefore sustainable in the short term until the United States recovers economically.

If Volcker destroys the economy, no matter how much the budget is cut, the budget will fall into an unviable deficit. In fact, budget-cutting can subvert economic activity and thus *widen* the federal deficit.

Thus, in a private consulting report in October 1981, *EIR* predicted that the deficit for FY82 would be $55 to $60 billion above the level of the Reagan administration's projected $42.5 billion, on the same grounds of added Volcker tack-on expenses to the budget.

And earlier, in our Feb. 17, 1981 issue, *EIR* declared that the consensus projection of $35 billion FY81 deficit was $30 billion too low. We said:

> The *Executive Intelligence Review* projects that the policies of Federal Reserve Board Chairman Paul Volcker will add an extra $30 billion to the fiscal 1981 budget deficit of the United States. This amount is larger by half than all the cuts that Office of Management and Budget director David Stockman and his associates have proposed—and some are very dangerous budget cuts.
>
> Volcker's policy has added between $20 and $22 billion to the fiscal year 1981 budget's payment of interest on the public debt. On top of this, the United States carries into fiscal 1981 an extra $5 billion in unemployment benefit disbursements not there in fiscal year 1979. They were added because of the Volcker-induced recession in 1980. On top of this $27 billion, there are other costs Volcker's high interest-rate policy has built into the budget which have swelled the deficit.
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> The lead item here is the sharp loss in federal tax revenues caused by Volcker's recession. All told, the total amount of extra cost built into the federal budget deficit for fiscal year 1981—with some carryover from fiscal year 1980—is at least $30 billion.

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