What balanced budget? Exposing the hoax

The claims from Washington policymakers that the FY 1999 U.S. federal budget will show a surplus, are absurd. Richard Freeman reports.

Since the beginning of this year, there has been much self-congratulation by both Democrats and Republicans in Washington, for what they claim will be a $9 billion budget surplus for fiscal year 1999 (which begins on Oct. 1, 1998). But, in fact, the so-called balanced budget is a hoax; what's worse, everybody involved knows it's a hoax.

The actual—as opposed to the official, and quite doctored—U.S. budget, will register a deficit for fiscal year 1999 of $150-200 billion. The data to prove this exist in the public domain, published by the Office of Management and Budget in its official "U.S. Government Budget for Fiscal Year 1999," and its "Historical Tables" compendium volume.

The so-called "balancing of the budget" employs sleights of hand and outright fraud that would make a common mountebank proud. The two principal gimmicks are: The Social Security Trust Fund surplus is used to mask the deficit. And, a portion of U.S. government expenditures, namely, those that are made to U.S. military and civil service retirement funds, as well as Medicare Part A and other programs, is simply not counted.

At the same time, there has been a reduction of the budget deficit through meat-cleaver methods: The Newt Gingrich-led fascist "Contract on America" gang has cut $175-200 billion from the past four budgets, mostly in infrastructure and essential services. While this reduces the budget deficit *in the short run,* it unleashes long-term effects that destroy the physical economy and unbalance the budget, as we prove below.

While there is much "fiscal conservative" talk of how important it is to balance the budget, it was the high-interest-rate policy of Federal Reserve Board Chairman Paul Volcker in 1979, and the adoption of supply-side economics by the Reagan-Bush administrations starting in 1981, which sent the budget deficit, and the interest on the public debt, skyrocketting.

We start by looking at the real deficit, giving a first approximation of the actual size of the U.S. budget deficit using the OMB's "Historical Table 1.1," and then a second, more complete assessment of the deficit. Next, we examine the effect of budget-cutting on "reducing" the deficit; and finally, we examine the gross interest on the debt, the largest item in the budget, which in fiscal year 1999 will account for *one-quarter* of all expenditures.

A first approach

Table 1 presents what the Office of Management and Budget calls the "on-budget," "off-budget," and "unified" U.S. budget surplus or deficit. The "on-budget" column we shall tentatively label the "actual" U.S. budget surplus or deficit. This is the difference between *the general revenue supplied to the U.S. government,* mostly through taxation (individual and corporate income taxes, capital gains taxes, excise taxes, and so on), and *the general expenditures of the U.S. government* (for education, defense, infrastructure, debt service, and so forth).

The "off-budget" part of the U.S. budget consists of two items: the yearly surplus or deficit of the funds spent by the U.S. government to subsidize the U.S. Postal Service, and the yearly surplus or deficit of the trust fund of the Social Security System. The amounts spent for the Postal Service are relatively small, and thus, the "off-budget" part of the U.S. budget refers overwhelmingly to what is happening to the Social Security Trust Fund.

The Social Security Trust Fund (or Old Age Survivors and Disability Insurance trust fund, OASDI) has its own "dedicated" revenue tax, which is collected separately from the general revenue payroll withholding tax, because the OASDI is a separate fund and is not part of the budget. In the "reform" of Social Security in 1983-85, the Social Security tax rate was increased, in order to build up a surplus in the trust fund, so that by about the years 2010-12, when it is expected that the trust fund will have greater Social Security pay-outs to retirees than Social Security tax pay-ins—largely because of demographics and lack of productive jobs—there will then be a surplus. This cushion is supposed to prevent the trust fund from going broke until the year 2030. By design, the Social Security Trust Fund is building up a surplus, *which eventually will have to be paid out*.

Thus, the Social Security Trust Fund is a "dedicated," committed fund. But, the government and Congress have been using it to mask the deficit of the actual budget. Illegally, they mix the deficit of the actual budget, which the OMB

projects will be $95.7 billion in fiscal year 1999 , with the "off-budget," segregated surplus of (mainly) the Social Security Trust Fund, of $105.3 billion, and *voilà,* they produce a strange animal called the "unified budget." In fiscal year 1999, the "unified budget" is supposed to run a surplus of $9.5 billion. The entire accounting operation is a fraud.

It can be seen in Table 1 that until the 1983-85 "reform" of Social Security, the "off-balance" surplus was tiny. But it has grown steadily since then, and now is a major factor in the alleged balancing of the budget.

Every Congressional office uses this OMB Historical Table 1.1. In the past, some Congressmen, when the purpose has suited them, have pointed to the fact that the Social Security and other trust fund surpluses have been used to mask the true U.S. budget deficit. Now, they have collective amnesia.

A complete statement

But, the annual U.S. budget deficit is bigger still. The FY 1999 budget deficit will total in the range of $194.5 billion, as opposed to $95.7 billion ("on-budget" column of Table 1). Smoking this discrepancy out requires a little work, but all the information is available in the OMB's Historical Tables, principally Table 7.1.

In addition to the Social Security Trust Fund—which is the only major off-budget trust fund that OMB's Historical Table 1.1 reports—there are other major off-budget trust funds, including the Medicare, Part A Trust Fund, which pays for the hospitalization portion for Medicare recipients; the retirement trust fund for the U.S. military; the retirement trust fund for the U.S. civil service; and the Highway Trust Fund.

The U.S. government also uses these other trust funds to mask the deficit. Of the above-cited trust funds, some derive their funding from their own separate, dedicated tax streams; others are paid for by the U.S. government out of its general revenue budget.

Let us take the case of a trust fund which is paid for directly out of the U.S. government general budget revenues (a parallel, but slightly different process occurs when the revenue is supplied by a dedicated, separate tax stream), for example, the U.S. military retirement trust fund. The U.S. government sets aside and accounts an amount, each year, for the retirement of military personnel. The amount is an incurred expense of the U.S. government, but, in effect, the U.S. government denies it has made this expense, or a portion of this expense, for purposes of reporting the U.S. budget deficit or surplus.

"Impossible," you say? Here's how an expense is hidden. The U.S. government accounts for a payment of money to the military retirement trust fund. If that trust fund accrues a surplus, by virtue of paying out less in retirement benefits than it took in from the government, it invests that surplus. By law, such trust funds can only buy U.S. Treasury securities. The U.S. government counts the trust funds' purchase of Treasury securities as money coming back into the U.S. government (even though that money is coming back on only a temporary basis, because it must eventually be paid out for the retirement of military men and women). The government "nets out" the expense, on the grounds that the money it pays out of the general revenue budget to the military retirement trust fund comes back into the government, in the form of a purchased U.S. Treasury security. It is as if the expense had not occurred.

This is duplicitous. The U.S. government is accounting an obligation, whether for an immediate pay-out, or for a future pay-out. The fact that the trust fund invests the money in a U.S. Treasury security is irrelevant. At some point, when the trust fund must pay out to a retiree, if it is short of cash, it would have to sell the Treasury back to the government, and the government will then have to make good on the obligation. This is an obligation/liability of the U.S. government; it should be counted either as part of the government's "on-budget" expense, or at least, its "off-budget" expense. Currently, it is counted on neither.

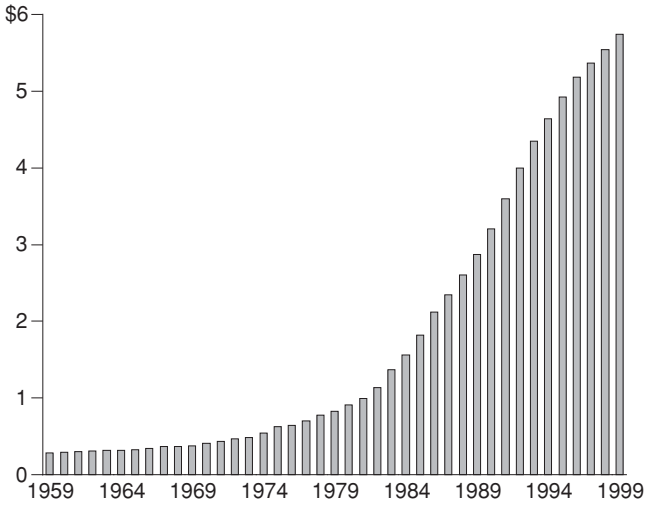
How, then, do we determine this amount? According to an analyst at the Congressional Budget Office, the OMB's

TABLE 1
The U.S. budget, surplus or deficit
(billions $)

	On-budget, or actual budget	Off-budget	So-called "unified" budget
1975	–55.260	2.018	–53.242
1980	–72.715	–1.120	–73.835
1983	–208.030	0.212	–207.818
1984	–185.650	0.262	–185.650
1985	–221.698	9.363	–212.334
1986	–237.976	16.731	–221.245
1987	–169.399	19.570	–149.769
1988	–193.986	38.800	–155.187
1989	–205.235	52.754	–152.481
1990	–277.784	56.590	–221.194
1991	–321.557	52.198	–269.359
1992	–340.489	50.087	–290.402
1993	–300.360	45.347	–255.013
1994	–258.758	55.654	–203.104
1995	–226.314	62.415	–163.899
1996	–174.038	66.588	–107.450
1997	–103.307	81.364	–21.943
1998*	–106.273	96.316	–9.957
1999*	–95.747	105.266	9.519
2000*	–104.947	113.477	8.530

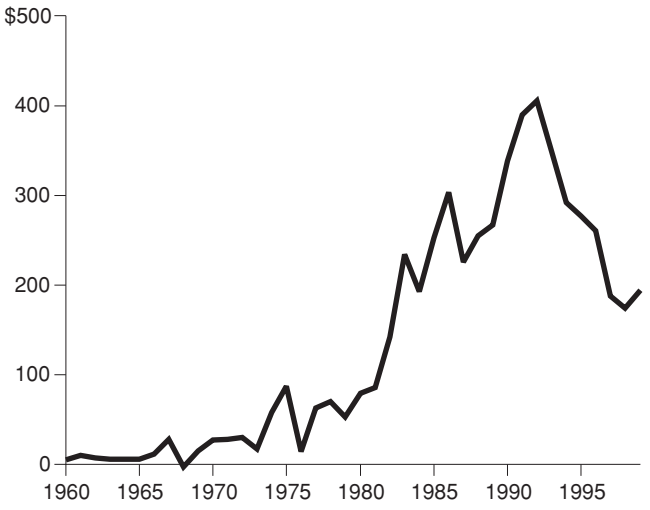
* estimated by the OMB
Source: Budget of the U.S. government, fiscal year 1999, Historical Tables, Table 1.1, published by the Office of Management and Budget.

FIGURE 1
Gross Federal debt outstanding, 1960-99
(trillions $)



Source: "Budget of the U.S., Historical Tables," Table 7.1, pp. 110-111.

FIGURE 2
Actual U.S. budget deficit, fiscal years 1960-98
(billions $)



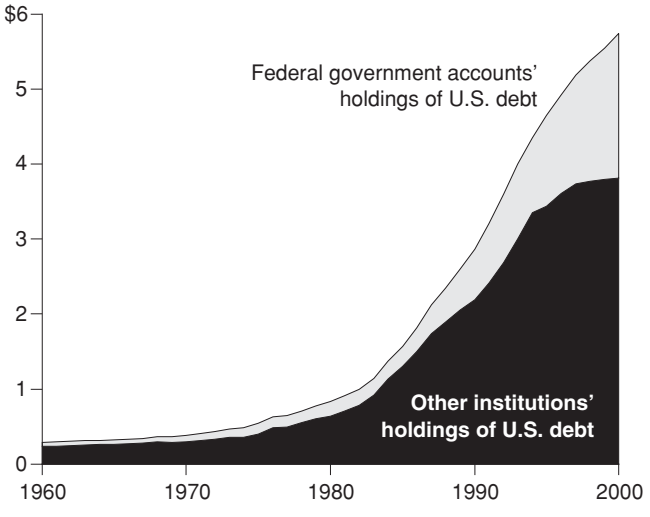
Source: "Budget of the U.S., Historical Tables," Table 7.1, pp. 110-111.

Historical Table 7.1 solves this detective work. Table 7.1 reports the amount of gross U.S. Treasury debt outstanding (**Figure 1**). For any given year, the annual increment in U.S. Treasury debt outstanding represents the amount of new Treasury debt issued that year to, in effect, cover the U.S. government's deficit. This deficit represents both the U.S. government's on-budget expenditures over revenues, plus the U.S. government's off-budget expenses, which the government has fancifully decided not to account for.

Figure 2 shows the yearly increment in U.S. Treasury debt which is issued to cover the U.S. budget deficit for that year. This is the real budget deficit. Using the OMB's own projected numbers, FY 1998 will have a deficit of $173.9 billion, and FY 1999 will have a deficit of $194.5 billion. Quite a difference from the publicly announced surplus of $9.5 billion.

Figure 3 adds a new element to the total U.S. Treasury debt outstanding in Figure 1: the amount of debt held by U.S. Government Accounts. It can be seen that the United States is covering up its deficit by issuing debt and having the U.S. government entities (mostly the trust funds) buy the lion's share of the debt. Some of the money that the U.S. government has given out of the general budget to the trust funds, and all of the interest that the U.S. government has accounted as paid to the trust funds, is not counted as a U.S. government expense. But, if the Treasuries were held by the private sector, at least the interest payments by the U.S. government would have to be so accounted. This procedure, which went into high gear 15 years ago, helps cover up the real U.S. budget deficit.

FIGURE 3
'Federal government held accounts' are one-third of all holdings of U.S. debt
(trillions $)

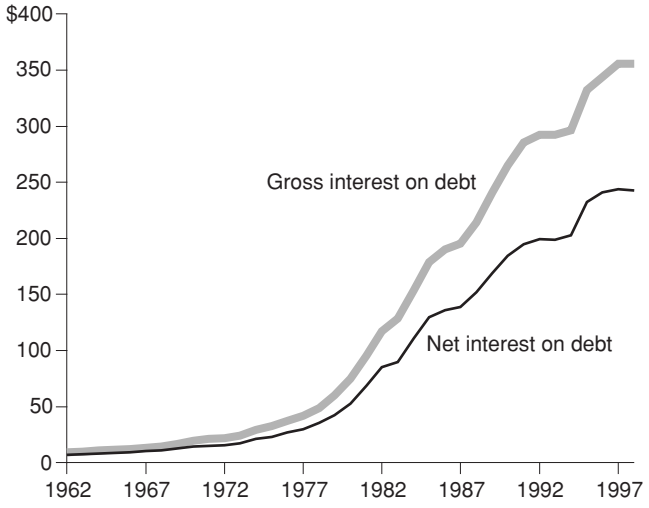


Source: "Budget of the U.S., Historical Tables," Table 7.1, pp. 110-111.

Why this fraud needs to be exposed

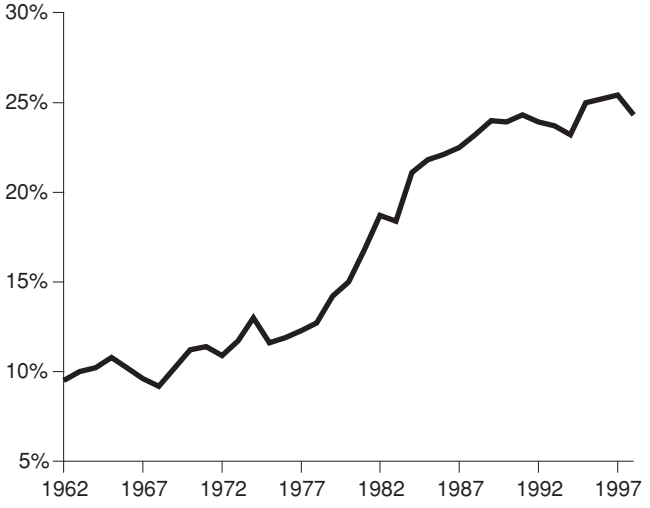
It is important to expose this fraud, for at least two reasons. First, monetarist budget-cutting is praised as a suc-

FIGURE 4
Bankers' welfare: gross interest on the debt
(billions $)



Source: Historical Tables of the U.S., Fiscal Year 1999, pp. 60-64.

FIGURE 5
Interest payments as percent of U.S. budget expenditures



Source: Historical Tables of the U.S., Fiscal Year 1999, p. 20.

cessful way to balance the budget. But, monetarist budget-cutting cuts part of the physical economy to the bone, which reduces the current and future productivity of the economy taken as a whole. This leads to a reduction of the tax revenue base, worsening the deficit over the longer term. It will also increase future costs for projects that should have been repaired or replaced, but were not because of the budget cuts.

Second, the so-called balanced budget is also attributed to the economy "doing so well" that it created new tax revenues. Some tax revenues have gone up, but, as we will show in a future article, some of the increase in tax payments came from increased capital gains paid on the appreciation of stocks in the stock market bubble. The shifting of the U.S. income profile to dependence on a stock bubble is not a smart step to take.

Galloping interest on the public debt

While Gingrich and his wrecking crew have reduced useful and essential spending in the budget, he and his allies have made the budget increasingly a vehicle to pay interest on the Federal debt. The gross interest on the U.S. public debt took off during two periods (**Figure 4**). In 1979, the gross interest on the public debt stood at $50 billion. During October of that year, Federal Reserve Board Chairman Volcker sent interest rates into the stratosphere; by February 1980, they were 21.5%. By 1981, just two years later, interest on the public debt had doubled to $100 billion.

In 1981, with the Volcker high interest rates still in effect, the Reagan-Bush administration came into office. It followed the insane Mont Pelerin Society "supply-side economics" policy of economists Art Laffer and Robert Mundell, and of *Wall Street Journal* editor Robert L. Bartley. By the time Bush left office, in January 1993, the gross interest on the debt had risen to nearly $300 billion—thanks to "fiscal conservatism."

However, the U.S. government similarly tries to cover up the extent of its actual debt payments, by counting only what it considers to be "net interest on the debt." It does not count the interest that the U.S. government is obligated to pay on U.S. Treasury securities held by Federal Government Accounts, such as the Social Security Trust Fund.

However, if the U.S. government owes interest to the Social Security Trust Fund, when the trust fund has to pay out payments to a retiree, that money had better be there. (In Figure 4 we have depicted both gross and net interest on the debt.) By 1998, gross interest on the debt, at $362.1 billion, exceeded net interest, at $242.7 billion, by $119.4 billion. By such accounting tricks, the U.S. government says it is paying out less.

Figure 5 shows gross interest on the debt as a percentage of the U.S. "on-budget" expenditures. (We have added in the amount by which the gross interest exceeds the net interest on the debt to the denominator of U.S. government expenditures; this lowers the percentage of gross interest to expenditures, but it is more consistent.) Thus, by 1998, one-quarter of all U.S. "on-budget" expenditures goes simply to pay interest on the debt.