of United Energy Systems, the national electricity company, Chubais said that for too long the attitude toward illegal capital flows had been "ban and interdict." Now there would be a "more professional" approach to offshore accounts.

On June 21, Mikhail Khodorkovsky's Yukos oil company became the first big Russian firm to publicize its ownership structure of nested offshore holding companies, based in Gibraltar and the Isle of Man. Formally, the action by Yukos was preparation for being listed on the New York Stock Exchange, but Russian media were quick to call it a sign that "our offshore capital is ready to come home." Khodorkovsky himself continues his vociferous campaign to boost Russia to the status of the world's top oil supplier, announcing that his first tanker of oil for sale in the United States is already at sea.

The *Times* of London puffed Khodorkovsky in a June 23 profile, as having "gone from being a shadowy figure associated with the alleged plunder of Russia, to the country's richest and most famous business leader." His "unusual disclosure" of Yukos ownership, the *Times* wrote, "could set a trend that would make Russia far more attractive to investors."

In case these maneuvers did not attract enough foreign investment for Russian raw materials exporters' needs, another Russian-born intimate of London financial circles has a wilder idea. Earlier this year, Mark Garber, formerly a Russian psychiatrist and now a partner in the exclusive British investment house Fleming Family & Partners (and a person who was named, then cleared in yet another Italian investigation of the illegal arms trade), presented in the weekly *Ekspert* his "five-year plan" for Russian firms to raise capital through international acquisitions. Russian companies should "become transnational not by selling themselves, but by merging with others," analogous to how Flemings shepherded the South African mining company Glencore (now BHP Billiton) to its eventual acquisition of Australia's largest mining company, BHP. The first step was to raise $8 billion through stock issues, after getting listed on the London exchange. Garber proposed that Russia's giant natural gas company, Gazprom, "not sell stocks to [the German gas company] Ruhrgas. On the contrary, Gazprom should purchase Ruhrgas. Then, Gazprom would become a transnational company, which would be traded quite differently."

On a smaller scale, the Russian oil company TNK, owned by Alpha Group, is trying to wiggle out of a serious debt crisis by "transnationalizing." Last September, it created TNK International, subsuming almost all of TNK's industrial assets. Its chairman, American citizen Simon Kukes, announced on June 13 that TNK International now has a board of trustees with two members: Sir Peter Walters, former chairman of British Petroleum, and Sir William Purvis, head of Hongkong and Shanghai Banking Corp., the famous "Dope, Inc." bank. Kukes told the Russian press that by inviting such "highly respected persons," the company will become more efficient and transparent for investors, which will "increase our capitalization."

False Axioms Blow Out California's Budget

by Mary Jane Freeman

If you build your house upon quicksand, you can be sure it will sink. Yet, this is exactly what nearly two-thirds of the states and the District of Columbia did since the mid-1990s in building their budgets on revenue streams from the speculative high-tech, Internet, housing, and stock market bubble economy. The recently declared, enormous California budget shortfall of $23.6 billion, epitomizes just how wrong the deluded assumption of relying on the bubble has been.

State budgets across the country, built on quicksand revenue from the "New Economy" and the stock market, now find "the outlook is painful, with serious problems likely ahead," as one state budget official put it. But the "problems ahead" loom larger than any leading figure, with the exception of Lyndon LaRouche, is willing to admit.

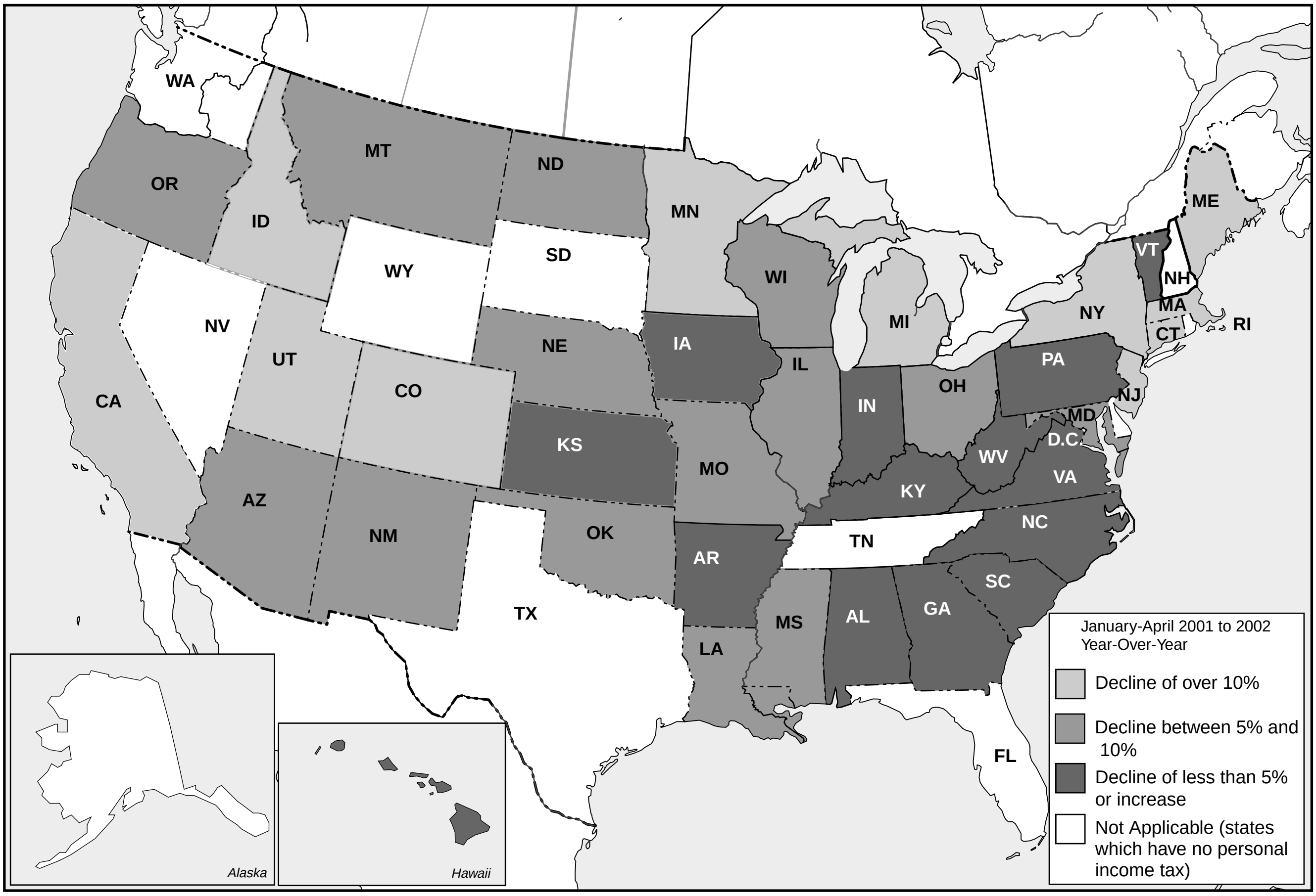
Rather than address the 30-year-long false premise embedded in the post-industrial paradigm-shift which led policymakers to assume they could take their revenues from speculation, governors and legislators across the nation are instead frantically fine-tuning budget cuts, going deeper into debt, and using accounting tricks now denounced when used on Wall Street, to survive until a "recovery" appears. They deny the underlying reason for their sudden larger revenue shortfalls, with deadly consequences for their citizens, as basic health, education, and welfare programs begin to vanish and infrastructure crumbles.

Tax Cuts Plus Depression Really Hurt

While California—the nation's most populous state with nearly 34 million people, biggest U.S. state economy, and world's fifth-largest economy—has a budget crisis of the largest magnitude, a recent national survey shows that out of 41 states and the District of Columbia responding, 32 have rapidly sinking revenues and attribute a big part of this collapse to a "drop-off in capital-gains- and stock-options-related income."

The survey, conducted by the Rockefeller Institute, the National Governors Association, the National Conference of State Legislatures, the Federation of Tax Administrators, and the National Association of State Budget Officers, also shows that April—tax month—personal income tax (PIT) revenues for all states, fell 21.4% from the April 2001 level. For the four months of January-April, PIT collections "were down an average of 14% nationwide" from the same period of 2001. Although the first quarter PIT decline averaged 14%, the sur-

FIGURE 1
States' Personal Income Tax Collections Decline



Source: National Conference of State Legislatures' State Fiscal Update, June 2002, Table 4.

vey shows "five states—California, New York, Connecticut, Massachusetts, and Idaho"—had declines "ranging from 19.1% to 28.9%."

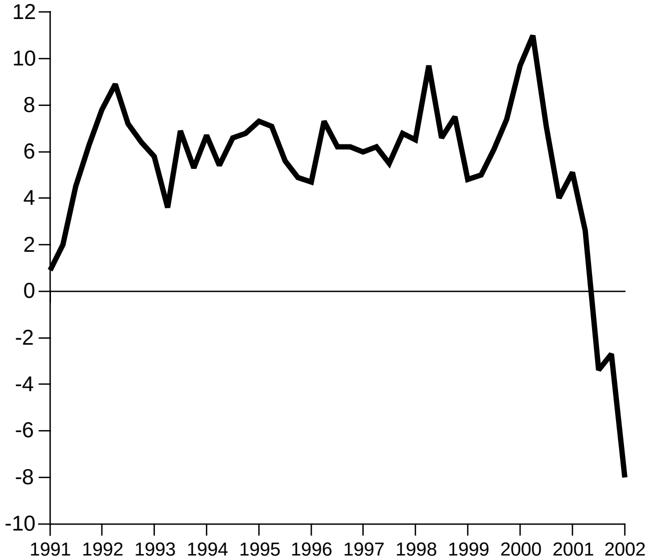
Plotting this PIT decline on a map of the United States brings into high relief that while California's revenue shortfall is by far the biggest, there is no corner of the nation untouched by unfolding depression conditions (**Figure 1**). Even of the unshaded states on the map, which have no personal income tax, all except Texas and Wyoming face shortfalls from other revenue sources. This decline was already the "third—and largest—year-over-year drop in a row," when all state revenue sources had declined by 8% for the January-March period. This was reported in mid-May before April collections were tallied by the Rockefeller Institute (**Figure 2**).

California Dreamin'—LaRouche was Right

As revenues plummeted below the direst predictions, California Gov. Gray Davis' "May Revision" budget announced that the state's two-year revenue shortfall had doubled from $12.5 billion in January, to a whopping $23.6 billion by May. This gap between expenditures and revenues is a "30% of General Fund" shortfall, according to Davis' Revision. In March 2001, Lyndon LaRouche forecast precisely this in a campaign webcast. He warned, states would experience "a probable 30% collapse across the board in the real economy" should they persist in reliance upon "the bubble economy" and fail to adopt his own Rooseveltian New Bretton Woods proposal.

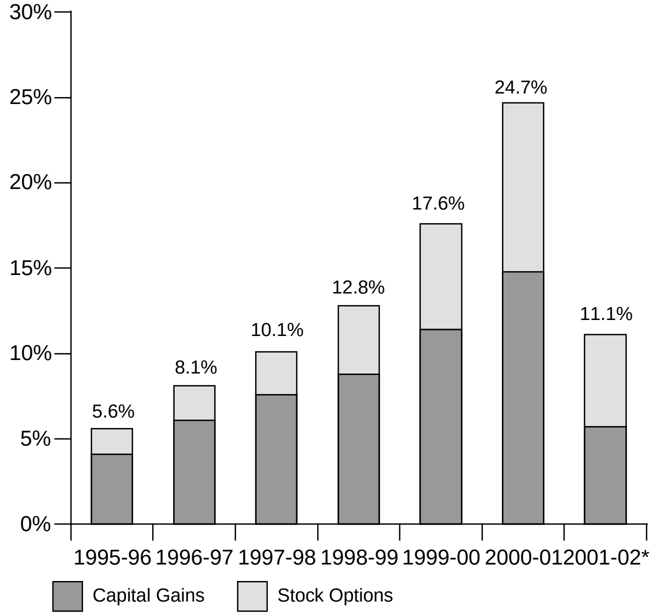
The single most dramatic decline in California has been the loss of revenue derived from capital gains and stock options. It's no wonder, as these revenue sources almost quintupled from 5.6% to 24.7% of the state's General Revenue Fund between fiscal years 1995-96 and 2000-01, and nearly doubled between 1998-99 and 2000-01 (**Figure 3**). Such dependence on these bubble revenues is plain in **Table 1,** which shows that even with the $5 billion growth in

FIGURE 2
Change in Total State Tax Revenues, 1991-1Q, 2002
(% Change, Year-Over-Year)



Source: Data compiled by the Fiscal Studies Program of the Nelson A. Rockefeller Institute, issued May 16, 2002.

FIGURE 3
California: Capital Gains and Stock Options Taxes as Percent of General Fund Revenue



*Estimate

Source: California Department of Finance.

capital gains and stock option taxes, overall revenues fell from $71.9 billion in fiscal year 1999-2000 to $71.4 billion in 2000-01. Thus the speculative revenues masked the underlying demise of the real economy. When these speculative revenues evaporated by more than half between FY 2000-01 and 2001-02, down to an estimated 11.1% of the budget, its foundation sank.

Nowhere else do these myopic, greed-driven fantasies of a "New Economy" nirvana so clash with human need, as in California. 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-glove with the dot.com revolution came the stock market and housing bubble revenues. Yet this transformation to a speculative revenue base widened the gap between rich and poor. According to U.S. Census data, average wages across the state barely grew in the 1990s. The average household income in Los Angeles County dropped from $40,300 in 1989 to $36,700 in 1999.

The labor force in California dramatically changed in composition: From 1990 to May 2002, a net gain of 2.2 million non-agricultural jobs occurred; but 75%, or 1,654,000, of the gain came from the non-productive sectors, retail and services! The manufacturing sector was decimated with a net loss of 245,000 jobs (**Figure 4**).

TABLE 1
California: Capital Gains and Stock Options Taxes as Percent of General Fund Revenue
($ Billions)

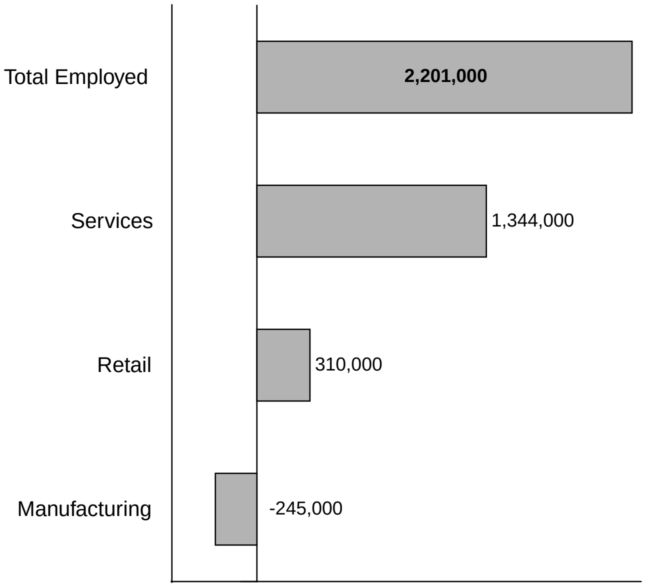
	Revenue From Tax on			
	Capital Gains	Stock Options	Total	General Fund Revenue
1995-96	$1.9	$0.7	$2.6	$46.3
1996-97	3.0	1.0	4.0	49.2
1997-98	4.2	1.4	5.6	54.9
1998-99	5.2	2.3	7.5	58.6
1999-00	8.2	4.5	12.7	71.9
2000-01	10.6	7.1	17.7	71.4
2001-02*	4.2	4.0	8.2	73.8

*Estimate
Source: California Department of Finance data.

California Cuts

Hoping to close the growing gap, Governor Davis has proposed $7.59 billion in program cuts over two years' budgets—FY 2001-02, which ended June 30, and FY 2002-03

FIGURE 4
California Employment Net Gain or Loss, Total and by Category, 1990-May 2002



Source: California Department of Finance, Statistical Abstract 2001.

(**Figure 5**). On the revenue side, Davis proposed a $16 billion package of new loans, shifting special funds, securitization of tobacco settlement revenues, and tax increases. Pinning down exactly the amount to be cut in each primary category of the budget was extremely difficult. But based on one set of recent data from the California Department of Finance, about $2.45 billion in program cuts have already been made in the current fiscal year, leaving $5.14 billion to be axed in the next. Using this data, 45%, or $2.354 billion, of the new budget year's cuts will target Health and Human Services (HHS) programs. For the two-year budget, HHS cuts are 35% of all General Fund cuts.

These cuts will decimate the already-weakened safety net. Some 24%, or $1.255 billion, is slated to come out of kindergarten through 12th grade, and higher education programs. Other programs to be hit in varying amounts are youth and adult corrections, housing, local government, resources/environment, and capital outlay projects, among others.

There is no question but that the 45% hit against HHS will severely disadvantage the state's most vulnerable citizens. The California Healthcare Foundation's Medi-Cal Policy Institute released a report discussing the impact of the cuts on the state's health-care delivery system. It reports that "more than half of the General Fund" cuts to HHS programs target Medi-Cal. Almost $800 million in cuts are planned for this Medicaid program servicing low-income, elderly, and disabled citizens. "California already spends less per Medi-Cal enrollee than any other state Medicaid program," says the foundation's report. "The proposed cuts are a blow to counties, hospitals, physicians, dentists, and others who serve this vulnerable population."

Davis' budget calls for a rollback of an eligibility expansion program, and to reinstate a quarterly reporting requirement, which combined are estimated by medical professionals would "reduce the number of low-income adults and children enrolled in Medi-Cal by nearly 400,000." The California Medical Association (CMA) points out, if one adds to this the "7 million uninsured Californians . . . this impact will push the ER [emergency room] crisis to a dangerous new level." CMA asserts that "both cuts [eligibility and provider payments] mean more patients will be turning up in overcrowded emergency rooms, which are on the brink of bankruptcy."

EIR has previously reported that from 1990 to 1999, 50 emergency rooms closed outright in California, while emergency room visits shot up from 8.4 million to 9.4 million. Davis' cuts would reduce payments to Medi-Cal providers by 16.7%, putting rates back to the 1985 level. This would cause many doctor-providers to stop taking Medi-Cal patients or stop practicing in the state.

Cuts directed at public hospitals will hit low-income families directly. To reduce General Fund outlays, hospitals would be required to pay higher fees to participate in the Disproportionate Share Hospital program, a Federal-state reimbursement program for hospitals that accept Medicaid patients. Another big cut is a 20% reduction in Medi-Cal funds to counties for their coordinating program caseloads; 2,000 layoffs will result.

The combined impact of low reimbursement levels, the growing uninsured, and unfunded mandates, such as retrofitting hospitals to meet earthquake standards or maintaining nurse-patient ratios, compounded by Davis' proposed cuts and a $184 million loss in Federal monies due to the Balanced Budget Act of 1997, means the California healthcare system is "converging on an overall financial meltdown," said Jan Emerson, a vice president of the California Healthcare Association. The proposed cuts will trigger loss of Medi-Cal's matching Federal dollars, and force "hospitals to pare down programs and services," the CHA spokeswoman noted.

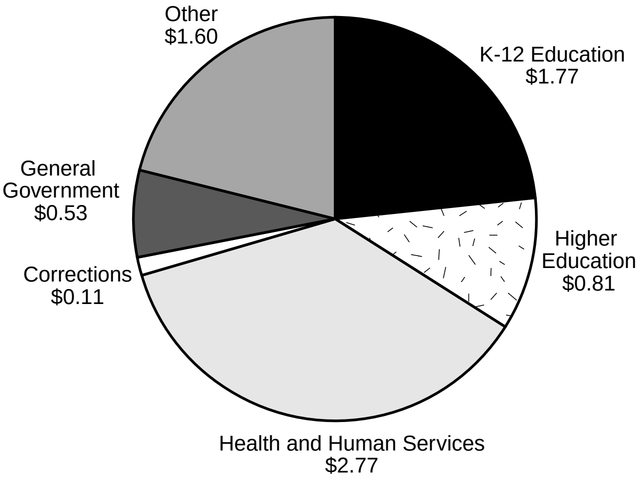
Imitating Wall Street's Accountants?

The state's budget blowout will strike much further than health care. In the education area, it is higher education programs which will carry the brunt of the cuts. The University of California will lose $162.4 million from various programs; California State University will lose $50.4 million; and $103.7 million will come out of the Student Aid, Post-Secondary Education Commissions, and Scholarshare Investment

FIGURE 5

California's Proposed $7.6 Billion in Budget Cuts

($ Billions, FY 2001-02 and 2002-03)



Source: California Department of Finance, and Gov. Davis' "May Revision" Budget Document.

Board combined.

Social Service programs to get reduced funding include CalWorks, Foster Care, and Food Stamps, as well as some cost-of-living adjustments for SSI/SSP Social Security programs. Three Public Safety programs (Gang, Crime, and Violence Prevention; Spousal Abuser Prosecution; and Department of Justice Programs) are to be cut $12.3 million. Housing aid for farmworkers and indigents is to lose $14.5 million. Other local government cuts, in some cases impacting fire and police services, total about $1.34 billion.

Governor Davis' $16 billion mish-mash funding schemes combine "creative" accounting tricks with new taxes. The state's indebtedness will grow by more than $8.5 billion in various ways. For example, it will issue $4.5 billion in bonds backed by the state's tobacco settlement funds (TSF). As the interest and principal on these bonds must be paid back, the loan will reduce TSF available for their intended original purpose—health-care costs—for years to come. Ironically, Davis also proposed a cigarette tax increase, hoping to raise $475 million; but this tax could diminish TSF if it results in less smoking!

Another $1.3 billion is designated as "fund shifts." Translated, this means, in almost all cases, that monies will be loaned from designated special funds to the General Fund. The largest such shift/loan, $1.1 billion, is from the Traffic Congestion Relief Fund, and must be repaid over three to four years. Some $277 million is to be shifted out of Infrastructure and Economic Development; and other loan/shifts total over $300 million more.

A proposed car tax increase, from $64 to $148 per car per year, is planned to raise $1.2 billion, and a two-year delay in net-operating-loss write-offs, to "save" $1.2 billion.

There are some potentially fatal assumptions underlying this budget. First and foremost is the "imminent economic recovery" assumption, which says that revenues will rise again, along with business spending in the high-tech sectors. Another is that by September or October, agreement will finally be reached to allow the state to issue $12 billion in bonds to aid in repaying a $7 billion-plus outlay made to buy power at the height of the 2000-01 energy crisis. These bonds have been stalled for over a year, and now a short-term $7.5 billion revenue anticipation warrant will be sought, to avoid default on the state's obligation to repay the General Fund for the "loan" it made to buy the power for its citizens. Although this is nowhere mentioned in the budget documents, it is a factor.

The California Legislative Analyst's Office also argues that a $600 million overstatement of the General Fund's reserves is factored into the May Revision due to an accrual issue involving bank and corporate refunds. (A small pittance of the multibillion-dollar accounting errors of the WorldComs, Enrons, etc., but a $600 million hole nonetheless.) These are but a few.

Budget Brawl Is Still Ahead

The likelihood of an approved budget by July 1 was slim to nil, as this went to press. Since the May Revision was announced, legislative review, redrafting, and revised budget plans have been worked on. A joint Senate/Assembly budget conference committee agreed to restore many of Davis' cuts, but failed to find new revenues to cover the restorations! In this election year, disagreement over Davis' proposed new taxes, has provoked typical ideological bickering over the best way to spread the pain. Democrats propose higher taxes on high-end income earners, while Republicans demand *quid pro quo* deals on the education funds.

A two-thirds vote by each house is required to pass a new budget. By June 14, negotiations had halted. The Democrat-dominated Senate pressed ahead with a vote on June 25 on their version of a budget which included the hike to high-end taxpayers. This failed by one vote. The Assembly will vote on their version on June 27, but they need four Republicans in order to have a two-thirds vote, a highly unlikely occurrence. The entire proceeding of this huge state whose economy is one-sixth of the nation's, eerily mirrors the Federal paralysis on the same front in Washington, D.C.

Even with a budget, the underlying reality will continue to maul California, as no one is talking about jump-starting the physical economy to generate real wealth and jobs. As the state budget official quoted at the outset noted, "The unsustainable bubble that formed in the late '90s/early 2000s . . . was larger than expected. Bigger bubble equals bigger pop."