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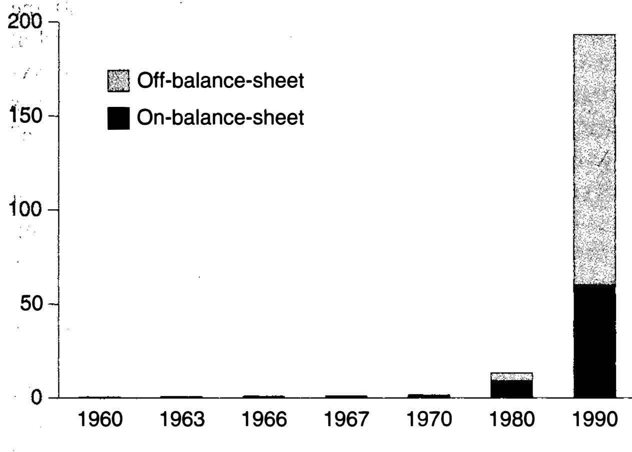
FIGURE 4
Growth of financial turnover, compared to the physical economy
(index 1967=1)



Source: Bank for International Settlements; Board of Governors of the Federal Reserve System; Public Securities Association; Chicago Board of Trade and Chicago Mercantile Exchange; United Nations "General Industrial Statistics," various years; U.S. Department of Commerce, Bureau of Economic Analysis; American industrial associations; EIR.

infrastructure, and gut hard infrastructure. The House-Senate Republican conference resolution budget, also includes $577 billion in cuts in entitlements, led by cuts of $270 billion in Medicare and $182 billion in Medicaid. These programs provide medical assistance to, respectively, 37.6 million elderly and 36 million poor persons. The minimum effect of the proposed cuts will be to double the number of Americans who are not medically insured to 80 million; close 3-4,000 hospitals and health clinics; double premium payments, for those still retaining coverage; and herd the elderly and poor into Health Maintenance Organizations, where the quality and extent of medical coverage is truncated in order to minimize costs.

Thus, the Contract gang is fighting to pass huge tax bonanzas for speculators, destroy the economy, slash the tax base, kill the elderly and poor, all in the name of a budget-balancing approach that doesn't work. But it is worse.

Figure 4 shows for the United States, the level of turnover of all financial instruments, including derivatives, bonds, stocks, etc., relative to the level of physical output, measured by the *EIR* market basket, which measures the input-flow of physical producer and consumer goods, per household and per capita. In 1990, there was $192 of financial turnover per unit of market basket. Each unit of turnover has a rate of return or yield, which is a claim on the physical economy. The hyperbolic rate of growth of this curve dictates that the economy will explode. The precise date of this explosion is not known; that it *will* explode, is certain. Under such a collapse, no one can predict accurately revenues for fiscal year 1996 or 1997, let alone past the year 2000.

Tax breaks to benefit parasites

by Richard Freeman

The Contract with America's tax package contains tax breaks worth tens of billions of dollars, for those who truly need it least: blue-blood wealthy families, Wall Street coupon-clippers and take-over artists, and speculators. The windfalls will widen the budget deficit further, demonstrating that balancing the budget is not motivating the radical Republicans' actions. The real reason for holding up the debt ceiling bill, and shutting down the government, was to get these tax breaks through. They are a rip-off for the speculators who financed the 1994 election campaigns of Gingrich's handpicked GOPAC candidates, and who stand ready to finance them again in 1996.

The Contract's tax proposals are in the tradition of the 1981 Kemp-Roth Tax Act, which was a Christmas tree of goodies for speculators. It, too, purported to spur growth and balance the budget, but wrecked the tax base and unbalanced the budget.

The principal tax bonanza contained in the Contract plan is a cut in the top rate of the capital gains tax by half. According to studies by the Treasury Department and Joint Committee on Taxation of the Congress, this tax cut will create a windfall for speculators of $36-40 billion by the year 2002, which will grow to approximately $65-80 billion by the year 2005, and $160 billion by the year 2010. There is also a proposed cut in the inheritance tax, which benefits the very wealthy.

Capital gains are realized as a result of the appreciation of an asset, whether that asset be stocks and real estate (which account for more than 70% of capital gains), or a piece of antique furniture, an art work, etc. For example, if one bought an apartment building for $50 million, and sold it two years later for $150 million, then $100 million is one's capital gain, even if the upkeep and repair of the apartment building has not been maintained, and the building, in physical terms, is really worth less than it was two years before. The object of the speculative economic process that has submerged America, has been to rig an appreciation in the market price of paper financial instruments or pieces of land, and then record profits through the instruments' sale. These are capital gains profits—part and parcel of the worldwide financial bubble.

The proposed capital gains tax rate cut has two objectives. First, to increase the size of, and give six months or

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more new life to the bubbles in stocks, derivatives, and real estate. The historical record shows that each time a capital gains tax cut has been enacted during the last 20 years, speculative activity has boomed. Second, it lowers the tax rate that the speculative parasite pays on his ill-gotten gain, which, meanwhile, has been enlarged through the effects of the capital gains tax cut. So the speculator pays less tax on a much bigger take. As Al Capone would say, "Nice work, if you can get it."

In 1978, Rep. William Steiger (R-Wisc.) introduced a bill which reduced the capital gains tax rate from 49% to 28%. That law took effect in 1979. Then, in 1981, the Kemp-Roth Tax Act reduced the capital gains tax further, to 20%. (In 1986, the Tax Reform Act raised the capital gains tax rate back up to 28%.)

Between 1978 and 1986, the double-dose of capital gains tax rate cuts—in combination with the 1982 deregulation of the U.S. banking system, and then-Federal Reserve Board Chairman Paul Volcker's high-interest-rate regime—fueled a further speculative boom. For example, during 1978-86, the capitalization of the New York Stock Exchange (the capitalization is the total number of shares times the stock price of each of those shares) soared from $823 billion to $2,199 billion, an increase of 2.67 times in just eight years. The real estate market also boomed.

Two incentives

The Contract proposal, thus far, contains two capital gains incentives: 1) a 50% capital gains deduction, and 2) indexation of the basis of capital assets to eliminate inflationary gains, which would go into effect in FY 2002.

For example, let us say that Mr. Boesky realizes a $2 million capital gain. Under current law, Boesky's capital gains tax would be his $2 million capital gain times the 28% capital gains tax rate, or $560,000. This would leave him an after-tax profit of $1.440 million. Under the proposed law, Boesky would deduct one-half the $2 million capital gain ($1 million), which would not be subject to tax. If Boesky is in the highest personal tax bracket (39.5%), under the proposed change, he would pay a tax on the remaining half of his capital gain ($1 million " 39.5%) of $395,000, leaving him an after-tax profit of $1.605 million. He would earn an extra $165,000 in after-tax profit.

However, historically, the way the capital gains tax works (intentionally), is that it simultaneously fuels the speculative markets. So, Boesky could realize 1.5 times (or more) as much capital gains as he currently does. Let us assume that under the Contract program, Boesky realizes $3 million in capital gains, as opposed to the $2 million currently. As a result, his capital gains taxes would be $594,500, but his after-tax profits would rise to $2.4 million—nearly twice current levels.

Indexation of capital gains to inflation, under the Contract proposal, would add a whole new element of financial scam, because it indexes the speculator's assets against the inflation rise, but the speculator can borrow money which is not indexed. For example, assume a 4% rate of inflation. Under indexation, if, over the course of a year, an asset's value rises by 7%, the speculator would pay tax on just 3% of the gain (7%-4%). However, if the speculator bought this particular asset with borrowed money, he pays the borrowed money back the next year with dollars which are worth (and thus cost him) 4% less (due to the 4% inflation rate). Indexation would significantly lower the amount of tax the speculator pays, lowering the tax revenue the U.S. government collects, and further increasing the speculator's after-tax profits.

The Treasury Department and the Joint Committee on Taxation studies, and committee personnel, place the tax revenue losses to the U.S. Treasury by the year 2005, due to the current version of the Contract capital gains tax cut proposal, at $65-80 billion. While Gingrich and his ilk claim that this tax break benefits everybody, only 8.5% of all taxpayers pay capital gains taxes, according to the U.S. Treasury Department. That means, 9 out of 10 taxpayers—the average working man—realize no capital gains whatsoever. Moreover, 65.3% of the total dollar amount of capital gains are made by those who earn $200,000 or more in income. This minuscule group, which represents less than 1% of all Americans who file tax returns, are the prime beneficiaries.

Inheritance tax breaks

But there is a second level to this. A speculator does not pay tax on the capital gain of an asset until he sells it. The sale is called realizing the capital gain of the asset. There are various ways of sheltering the realization of the asset, but this is where what is called the "death loophole" takes over. If a speculator does not realize the capital gain during his lifetime, he pays no capital gains tax. But the person or persons who inherit the speculator's estate, do not pay a capital gain. They simply pay an inheritance tax, on a sliding scale based on the size of the estate. The tax is paid as if there was no capital gain at all.

Moreover, there is an exemption on inheritance taxes. In 1981, the exemption was $175,625. The Kemp-Roth Act increased the exemption to $600,000 by 1987. The current Contract tax proposal would increase that exemption to $750,000. Most Americans do not leave behind estates valued at three-quarters of a million dollars. This strictly benefits the wealthy. The estimates are that the proposed increase in inheritance exemption, and other gift and estate tax changes, will lose the Treasury an additional $12 billion in revenue by the year 2002. There is an additional $11.7 billion that will be lost because of more generous tax rulings for Individual Retirement Accounts (IRAs).

Meanwhile, the Contract with America would eliminate the Earned Income Credit, which benefits working people with lower incomes.