The fraud in the budget forecasts

by David Goldman

The United States is heading toward a total federal borrowing bill approaching $400 billion during the fiscal year beginning next Oct. 1, and the administration and Congress appear to be in competition to produce the most incompetent imaginable lies concerning this fact. While the administration admits that the deficit for the present fiscal year ending Sept. 30 will touch $230 billion (not counting $125 billion in "off-budget borrowing), an all-time record, it nonetheless predicts that the deficit for the next fiscal year will fall to only $144 billion—exactly the target set forth in the Gramm-Rudman deficit-reduction bill. The Congressional Budget Office says the deficit will come to $184 billion, $40 billion above the Gramm-Rudman target.

Under that law, the administration would have no choice but to immediately chop $40 billion of spending out of the budget.

Both of these forecasts are nonsense, and that unfortunate fact is more important than the debate over phony data. The only difference between the administration's and the Congress's position is that the former says that Gross National Product will grow by 3.2% this year, while the latter estimates only 2.9% growth.

15% to 25% rate of decline

Two issues ago, we summarized evidence that U.S. physical output is currently declining at a 15-25% annual rate, corresponding to *EIR*'s general forecast of December 1985:

1) Aluminum production fell to an annual rate of 2,883,707 metric tons in June, from 3,349,099 metric tons in May, a 16% drop during a single month. The June level also represents an 18% drop from the June 1985 level. Production of raw steel fell to 6,729,848 tons in June from 7,616,215 tons in May, a single-month decline of 13%. The June level represents an 8% decline from June of last year. Since imports of steel declined as well, there is no ambiguity concerning the implication of these data.

2) Manufacturing orders were down 4.8% in the first six months. Transportation equipment orders were down 15.9% in June, and aircraft orders were down 47%, which helps explain why basic metals production collapsed during the same month.

3) New homes sold at a seasonally adjusted annual rate in June down more than 20% from April, the slowest since October 1985.

4) U.S. automakers reported combined sales in 1986 down 3.7% from the 4.7 million units sold in the comparable 1985 period. During the week of Aug. 8, American auto makers assembled 75,584 cars, down a staggering 21% from the previous week's 96,164 and off 33% from the year-ago period, when the industry built 112,821 cars.

Abroad, these forecasts provoke cynical laughter; well-informed observers believe that growing "disenchantment" over the U.S. economic situation will increasingly determine the issues, and results, in both U.S. 1986 congressional races and the 1988 presidential run-off. The French daily *Le Monde* reported June 9 that an earlier mood of euphoria over the much-touted Reagan "recovery" has changed as people notice that the "recovery" was financed by large federal borrowing, that unemployment rates are rising, that "entire segments of the economy are in a state of extreme weakness." No matter how popular and reassuring he may be, President Reagan, it is being increasingly realized, has no "magic recipes" to erase the debts that have been accumulated. At the same time, various signs of economic trouble—the LTV failure, the First National Bank of Oklahoma collapse—demonstrate that the "recovery" is finished.

Cheap oil, cheap dollar

With the crashing oil price and the falling dollar pushing the world into financial crisis, why should the economy grow at all? *Because of* the crashing oil price and the falling dollar, reply the administration and the Congressional Budget Office. Cheap oil is supposed to increase consumer spending, and a cheap dollar is supposed to increase U.S. exports.

Here are the assumptions behind the Congressional forecast, as published in the Congressional Budget Office's August 1986 report:

"Federal tax and spending policies are assumed to satisfy the deficit requirements of the Balanced Budget Act (Gramm-Rudman);

". . . The world price of oil is assumed to remain close to $12 per barrel through the end of 1987; and

"The exchange rate . . . is assumed to continue to decline. . . ."

On the contrary, the fall of the dollar is probably the single most important weight on the falling U.S. economy. Not that the declining dollar can be separated from the global debt crisis which has forced the dollar down; but the increased cost of imports, which is pushing this year's trade deficit to above $170 billion, represents a sharp and immediate increase of the cost of capital goods and component parts.

For example, sales of new cars built in the U.S rose 2.4% in June 1986 compared to June 1985, while imports rose 12.4%, taking almost a third of the U.S market.

Nowhere is the impact of the sliding dollar felt as directly as in car sales. Most American imports are Japanese, and the Japanese yen has risen 40% against the dollar during the past year. Imported Japanese car prices are rising correspondingly, yet sales are increasing, while American auto production has collapsed.

Overall: Production plummets

The same picture of production decline and import dependency applies to American trade and production in general; we will spend 10% more on imports this year, for 10% less in actual goods. The problem is that a great deal of American production, perhaps more than a fifth of the total, was an illusion, based on the strong dollar. America imports almost a quarter of all its capital goods, for example; at 260 yen to the dollar last year, we bought those goods at a bargain.

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But now the dollar buys only 153 yen, and American companies must spend almost as much to buy such capital goods abroad, as it would cost to manufacture them at home (except that we have given up manufacturing in many categories). The same applies to the huge inventories of auto parts, electronic components, and semi-finished goods which the United States obtains abroad. Under these conditions it is less and less profitable to produce American goods, since the subsidy to such production, in the form of low-cost foreign capital goods, components, and semi-finished goods, has disappeared with the collapsing dollar.

The Congressional Budget Office report contains the following remarkable admissions:

"So far, the depreciation of the dollar has not been reflected in an improved U.S. trade position. The real trade deficit continued to deteriorate in the first half of 1986, but at a lower pace than recorded in 1985. Most of the deterioration can be attributed to increased imports from countries whose currencies had depreciated the most in real terms against the dollar between 1980 and February 1985—major Western European countries and Japan. The share of automotive and consumer (nonfood and nonauto) goods in total merchandise imports continued to rise substantially, and the share of capital goods—even with only moderate growth in the U.S. economy—continued to rise as well. . . . Real merchandise exports have continued a relatively slow improvement; the subdued pace of economic growth overseas, and severe financial difficulties for Latin American countries appeared to offset somewhat the effects of the depreciation of the dollar."

Fourteen-dollar-a-barrel oil will wipe out roughly 7% of all U.S. industrial output, taking into account not merely the shutdown of oil production at home, but also the elimination of capital-goods industries supporting exploration and development.

Now the International Energy Agency reports that oil consumption in the Western world is likely to rise only 2.7% this year, because of the slow economic growth in the United States. In the U.S., a growth rate of only 1.1% is expected during 1986.

"Household spending," writes the CBO, "should be supported in the year ahead by three factors: the decline in interest rates, low inflation, and the huge rise in the value of financial assets over the period." The last claim is the most outrageous, since the rise in value of financial assets referred to is the paper appreciation of stock-market prices, which had already shown their awful vulnerability at the beginning of July. The CBO appears to assume that consumers will borrow against rising stock prices (if they sold their stock in order to spend, the market price would of course fall). The low rate of inflation reflects the bankruptcy of farmers, oil-producers, developing-sector importers of U.S. goods. The collapse of economic activity associated with lower raw materials prices actually removes more income from the economic stream, than the price decline adds by way of greater after-inflation spending power.

There are already indications that the recent spectacular rise in consumer debt has peaked. Consumers took on $5.1 billion more in installment credit than they paid back in June, which was less than May's increase of $6.5 billion. Consumer credit rose 10.8% at an annual rate in June, compared with 13.9% in May, the second largest monthly gain this year.

That sort of bubble cannot hold up the entire economy, and it can only continue so far. In any case, both new home sales and new car sales are down drastically since April, which shows that consumer spending, the economy's last prop, has been declining through the second quarter and into the third.

Under these conditions, next year's federal deficit will not fall from this year's $230 billion, as both Congress and the administration argue, but rise, probably above $270 billion. Add in the government's "off-budget borrowings," and total federal borrowing will exceed $400 billion. That presents Congress and the administration with a crisis which even Senators Gramm and Rudman could not contemplate in their worst nightmares.