

Payments deficit: another milestone in collapse

by Chris White

The United States has passed another milestone on its route to financial disaster. Beginning with the third quarter of 1987, interest payments on externally held U.S. indebtedness exceeded the interest income that the United States is sucking in from the looting of the rest of the world. It's apparently the first time since the recession of 1957-58 that this has been the case.

Back in 1957-58, however, the United States was not a net debtor nation. That milestone, as is well known, was passed early in 1987, as the United States entered the status of net debtor to the rest of the world for the first time since World War I. The growth of the charge on the U.S. economy, in the form of the net transfer to foreign holders of the debt, is what has many in the banking sector abroad quite worried. In their view, the domestic austerity that's now being touted as an "export boom" by administration spokesmen like Special Trade Representative Clayton Yeutter, will not be savage enough to offset the mounting claims of foreign-held debt service. Thus, the expectation is that, over the second quarter of the year, a new wave of crises will begin to smash against the shaky U.S. dollar.

The interest outflow is compounded by the accelerating rate of increase of the federal budget deficit for fiscal year 1988. You know how bad things are when the Democrats in the House of Representatives tell you that they are adopting the administration's estimates on the deficit as they put together the budget for fiscal 1989. They don't want, in an election year, to cut the extra \$30 billion that is the difference between the Office of Management and the Budget's \$170 billion estimate and the Congressional Budget Office's \$140 billion. Both estimates are still way off.

The point though is that for the first three months of the 1988 fiscal year, October through December, the budget

deficit had increased 25% above the level for the year before. It is argued that the patterns of the first three months of the year are not typical of the flow of revenues into the Treasury for the year as a whole. This can readily be admitted, without prejudice to the simple reality that the drain on the revenue base resulting from the stock market wipe-out between Aug. 27 and Oct. 20 of last year has also not made its presence felt. It will, over the same time-frame that the growth in interest payments abroad begins to impact on the dollar.

The increase in the deficit translates into bigger demands for foreign financing, and still faster growth in the outflow in the form of interest payments, while demonstrating, once again, the utter futility of attempting to balance the budget through cutting expenses. The growth in the deficit has already wiped out the \$20 billion or so cuts the Congress and administration spent three months haggling over between October and December.

Germany and Japan for Bush?

The combination of the growth in outflow of funds to the account of servicing foreign-held debt, and the growth in the financing requirements of government, show that there is not too much basis in reality for the joke that's going around some European circles, to the effect that West Germany's Bundesbank and the Bank of Japan are constituting themselves as political action committees for George Bush's 1988 election campaign. Such kinds of humor are prompted by, for example, Japan continuing to pick up the tab for a sizable portion of the new debt put into circulation by the Baker Treasury Department. That appeared again to be the pattern for the Treasury's \$27 billion quarterly financing package in the first week of February.

Baker and his friends in the financial community would,

no doubt, like nothing better than for Japan and Germany to do that. Whether they have or will is one question. Whether doing it would make any difference to what has been unleashed is entirely different. If Japan and Germany are doing it, then why has Treasury Secretary Baker agreed to put the question of gold back onto the international monetary agenda? The outcome of the Treasury Secretary's meeting with German Finance Minister Gerhard Stoltenberg, during the Treasury's debt auction, was an agreement between the two that such should be done. So the monetary role of gold, taboo since Aug. 15, 1971, will now, in all probability, be on the agenda for the IMF's Interim Committee meeting in April, and again for the annual bash in Washington at the end of September.

That's not exactly testimony to the enthusiasm of the rest of the world to do their bit in support for George Bush's presidential aspirations. It's evidence for exactly the opposite. The foreign creditors of the United States, including the surplus countries, Japan and West Germany, are increasingly reluctant to continue to throw their money at a problem which is only going to get worse.

This was made abundantly clear at the annual conference of the European Management Forum in Davos, Switzerland. Not only in proposals, like those of Yasuhiro Nakasone, former prime minister of Japan, that the United States begin to finance its deficit by issuing bonds denominated in foreign currencies, so that those doing the financing will no longer have to take dollars. But also in the themes struck by the representatives of European finance, like IMF policy committee chairman, the Dutch finance minister, Onno Ruding, and Helmut Schlesinger, the number-two at Bundesbank, who insist that the number-one problem in the world is that the United States has yet to draw the appropriate conclusions from its new status as the world's biggest debtor nation.

Baker's raising of the relatively unmentionable gold question, together with George Bush's new alliance, as in the Michigan caucuses, with Jack Kemp, for several years a spokesman for that circle in the United States which has backed the Bank for International Settlements' efforts to revive a 19th-century imperial-style gold exchange standard, are therefore to be seen as desperation-fueled efforts to keep the Europeans and Japanese in line, by beginning to concede that all is not well with the dollar and U.S. finances, and that something might have to be done.

In the perspective of the *Wall Street Journal*, which has backed Kemp's stand on gold, this is something which would properly be the work of the next President of the United States. Thus, the offer to discuss such matters now is not the same as the intent to do something now. Except to the extent that what is done contributes to convincing those who finance the U.S. deficit to give the U.S. financial system a little more time. Talk about gold, and meanwhile, through savage internal austerity, and yard-sale type export promotion from dying industries, reduce the trade deficit fast enough to permit the financing of the growing federal deficit, without increasing

internal U.S. interest rates.

The latter is supposed to be a package that is politically acceptable in a U.S. election year, as opposed to the bug-a-boo of increasing interest rates. Whether there's anyone out there who will buy U.S. exports is hardly the point, the savage austerity will reduce the Treasury's revenue stream by more than would have been the case without it, and thereby ensure that the growth in the government's financing requirements outstrips what are planned to be reductions in the trade deficit.

This zero-sum game assumes the existence of a pool of foreign funds, say, for argument's sake, about \$180 billion, which will, whatever happens, end up in the United States, and that it's basically irrelevant whether that money finances the trade deficit or the government's deficit. Thus, if the United States exports a bit more, and imports a bit less, more of the pool of funds will be available for the government.

Overlooked is the reality that there is a political decision involved in investing in the United States, and that such decisions involve security considerations, as well as so-called interest earnings. What the U.S. financial crowd is proposing to do to keep the foreign funds coming, on top of the "peace in our time" perspective of further appeasement and capitulation to the Russians, is exactly what will encourage the foreign creditors to pull out.

The imports that are to be reduced come primarily from West Germany and Japan. For them, the reductions mean layoffs, closures of plants, elimination of capacity beyond the tribute that's supposed to be paid to the United States. The German auto industry has already been severely hit. The steel industry is being hit. The European aerospace consortium, Airbus Industrie, is being hit. On the U.S. side, the perspective also means layoffs and closures, in industry as well as in the so-called services sector, like the banks. The layoffs and closures mean both a reduction in the funds available to the government, and an increase in government expenditures like unemployment benefits. The combination increases the deficit, and therefore increases the demands for foreign finance to cover that deficit, from countries which are themselves being forced up against the wall.

It doesn't work. It won't work for a whole year. And it probably won't work for more than a few weeks. Then the next phase of the crisis will hit. But when it does, it will be worse by far than last October. For next time around, chunks of the commercial banking system will be on the line. Already, the securities of those banks has been discounted to the levels which have come to be associated with what's called "non-investment grade paper," junk bonds. Dealers, like Morgan Stanley and Mellon Bonds, have told their clients to get out of such paper, and they have. They expect government bail-outs of sections of the commercial banks within the next months, that is, they expect collapses of such banks within that time-frame. Such is what could well hit, when, as leading foreign bankers expect, the next phase of the dollar crisis begins to hit.