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# The U.S. 'budget process' is a symptom, not a cure

by Chris White

As finance ministers and other officials of the Group of Seven nations gathered in London in mid-February for their first "getting to know you" session with the Clinton crowd and U.S. Treasury Secretary and Texan comprador Lloyd Bentsen, it is sure that near the top of their agenda will be what is called "the apparent credibility" of the new administration's program to cut the U.S. budget deficit.

It is worth stepping back from the immediacy of the moment, to think about the fact that the so-called Group of Seven—the United States, Germany, Japan, United Kingdom, France, Italy, and Canada—whose finance and monetary officials do regularly get together to "coordinate" policy and so forth, is itself about as old as the problems, become crisis, with the U.S. budget deficit.

Both the Group of Seven and the U.S. budget deliberations were the outcome of the 1972-74 Watergate upheaval, when President Richard Nixon was forced to resign under threat of impeachment from Congress, to be replaced by the amiable gum-chewing Gerry Ford, one of the few surviving members of the Warren Commission's coverup of the Kennedy assassination.

Institutional arrangements today have become so fossilized that it is relatively easy to impute a false eternality to what has become known in the U.S. as "the budget process." The budget process, which now dominates much of the legislative calendars of both the executive and legislative branches of government, has actually been around only for the last 19 years. Prior to the Watergate reforms—out of which we got an Office of Management and Budget, attached to the White House, and a Congressional Budget Office, attached to the Congress, and the laborious process of authorization by committees in each house, followed by reconciliation in conference, and then the repeat process called appropriation, as monies authorized are allocated to be spent—there was no such thing. It may seem hard to believe, but the budget, as it has come to be known, did not exist up to that point in the country's history.

And, guess what? When we didn't have a budget, and government was not dominated by the "budget process," we didn't have a problem with a budget deficit, either. It is only over the last 19 years, when we have insisted that successive governments treat matters of national economic policy much the same way a household is supposed to treat its income and expenditures, that we have had what became the budget crisis of today.

The same goes for the Group of Seven consultations. On Aug. 15, 1971, the ill-starred Nixon, persuaded to do so by then-Treasury Secretary John Connally, and his assistant from the Department, the later Federal Reserve chief Paul Volcker, took the dollar off the collapsed Bretton Woods gold standard, and left it to float against other currencies. The Group of Seven emerged during 1974 and 1975 out of meetings held in such places as the Caribbean island of Guadeloupe and the French Château Rambouillet as the agency which was supposed to coordinate the respective countries policies on floating exchange rates, and vis-à-vis the countries of the Southern Hemisphere. In the meantime, the countries of the Southern Hemisphere have been subjected to successive waves of genocidal austerity in the name of the International Monetary Fund conditionalities policies there adopted, and the U.S. budget deficit has ballooned.

## Floating exchange rates and deficits

But what do floating exchange rates have to do with the U.S. budget deficit? The answer has to do with why policies said to be designed to cut the budget deficit, inevitably lead to the opposite result.

Over the last year, thanks to Alan Greenspan of the Feder-



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al Reserve, U.S. commercial banks were able to take advantage of declining interest rates to borrow from the Federal Reserve at between 3% and 4% and lend those borrowed funds back to the U.S. Treasury at between 7% and 8%. Commercial bank holdings of such Treasury paper increased by $100 billion over the 12 months ending Dec. 31, amounting to nearly $700 billion. Assuming 7% paid out of the U.S. Treasury, the 4% "spread" between interest rates translates into *a free gift of $4 billion from the U.S. taxpayer to those commercial banks.*

The U.S. commercial banks are not the only ones that hold U.S. government paper. The "Watergate reforms," as part of producing "the budget process," also expanded the volume and maturity ranges of marketable government paper. The two-year Treasury bill, for example, didn't exist prior to 1974. The 30-year bond, now the benchmark for calculating interest rate yields, was only introduced in 1977. Full marketability of government debt, with no proof of identity required, or even evidence that the money thus used was actually one's own, only followed in 1985.

## Huge paper profits, paid by U.S. taxpayer

Foreign banks, chief among them British and Japanese, account for about 40% of the financial business of the New York banking community. Since the "big bang" opening of London markets in 1986, U.S. banks and others have been able to operate in London on pretty much the same terms as the British themselves. Now, suppose that during 1992, as the pound sterling was rising toward $2.00 to the pound, banks or investment houses were borrowing devalued dollars, at the prevailing low interest rates offered by Greenspan, in order to lend those borrowed funds to either the U.S. Treasury Department at 7-8%, or to the German Bundesbank, at in excess of 8%. What happened around Sept. 15, when the pound devalued by 15% against the dollar and the deutschemark? In sterling terms, the 7% dollar yields became 22% yields, and the 8%-plus German yields became 23% yields. I.e., after charging off the 3% owed to the Fed, floating currency rates produce near 20% returns—all backed up implicitly by the U.S. taxpayer, and by U.S. treasury secretaries, who, as Bentsen is evidently learning how to do, play the floating rate swindle.

Bear in mind that during that same period, Citibank "made" $1 billion on foreign exchange transactions, the partners in George Soros's Quantum Fund made $1 billion, and Chemical Bank made over $300 million—$2.3 billion between the three outfits, over a few days, compared to the $4 billion handed to commercial bank holders of the $100 billion treasury debt added over the year.

Were the excesses of the summer a one-time affair? Far from it. This is actually the epitome of what the floating rate exchange system has become, as the U.S. government debt, and tax base has been swung into line as underlying security for such transactions.

For example, to start with, in the first phase of the floating rate system, the British pound floated with the dollar. This lasted through the beginning of Margaret Thatcher's tenure as prime minister in 1978, when exchange controls were ended on the pound, and the currency was enabled to float against the dollar, not with it. When Jimmy Carter devalued the dollar, remembered as "benign neglect," and appointed Paul Volcker chairman of the Federal Reserve, U.S. assets were sold off cheap to holders of over-valued pounds sterling, starting with the Hong Kong and Shanghai Bank's drug money takeover of Marine Midland in 1978.

The pound has floated against the dollar ever since. That means that when the pound is going up, the dollar is going down, and vice versa. The float has been managed, at least up to this point, such that within a year the currencies will move within a band of, say, from $1.50-1.60 to $1.90 against the pound. The peaks and troughs of either currencies' movements roughly correspond with the tax or fiscal years of the respective countries. The dollar typically rises against the pound, beginning September-October, as the fiscal year begins, reaching a peak prior to the start of the British tax year in the weeks before April 1, only to then decline over the summer. For, as the two currencies move opposite to each other, so, too, the respective bonds associated with financing the two governments move opposite to the currencies.

## Enter the derivatives

The pattern has everything to do with the financial phenomenon known as "derivative" securities. These are always seen through the eyes of, say, the commodities trader, or the futures trader, as "hedges" against adverse movements in what is being dealt at the moment. But that is not what is involved.

Here we have two economically bankrupt powers, the U.S. and Britain, with evaporating political and military clout. They are, effectively, one single power with two currencies, as a result of what has happened since 1974, and then 1978, and more so since 1982, when Reagan backed Thatcher and the British Navy against the Monroe Doctrine and U.S. Constitution. In this, rates, black market, criminal, and just plain speculative funds are effectively secured against the U.S. tax base, and are transformed into a means for extracting wealth from those countries, chief among them Germany and Japan, who have not, until recently, followed so willingly down the primrose path leading to insanity and disaster.

George Soros and his friends might give an opposite impression. But there is a geopolitical objective, not financial returns per se. In this arrangement, derivatives are not simply "hedges" against risk; there is very little risk. Trading of derivatives permits speculative gains moving from one currency and its securities to be maximized across the full range of transactions. Such windfalls can then be thrown back into the warfare as added leverage the next time around.