Click here for Full Issue of EIR Volume 13, Number 1, January 3, 1986

Domestic Credit by Stephen Pepper

U.S. Treasury at the brink

Panic swept the markets as the deadline approached for the Treasury to start bouncing checks.

1985 will be known as the year the United States almost went broke. 1986 will probably be known as the year the United States *did* go broke. The near default of the U.S. Treasury—for the first time since Alexander Hamilton rescued the credit of the young American nation—sent shudders through the world markets.

The crisis emerged in November and continued into the second week of December. At the suggestion of White House Chief of Staff Don Regan, three senators, Phil Gramm (R-Tex.), Warren Rudman (R-N.H.), and Ernest Hollings (D-S.C.), attached an amendment to the debt ceiling bill then being considered by the Senate, calling for a balanced budget by 1991 through stepped reductions each year. The first target was to be a deficit of $144 billion in FY 1986. By attaching the amendment to the debt ceiling, and playing Russian Roulette with the credit-rating of the Treasury, pressure was kept on Congress to pass the amendment. This was done on Dec. 12, and the bill was signed into law by President Reagan.

During the recurring crises, the government resorted to various tricks to evade the debt limit. The most ominous for the future is that it breached the inviolability of the Social Security fund, borrowing securities from it to keep the doors open for a little while longer. This cost Social Security at least $10 million.

The 1985 budget crisis highlighted the debt-service component of the budget. Present debt service is $180 billion annually, and it will rise by another $60 billion over the period the Gramm-Rudman amendment allows to balance the budget. Thus, while the Congress is reducing expenditures by $200 billion, one portion of the budget, invulnerable to any cutting whatsoever, will continue to grow. It is this constant increase of debt service as a percentage of the total budget that is the real crisis, and not the deficit itself.

The federal budget crisis and the related credit crisis were the tip of a pyramid that reached down to the most modest level of domestic credit. The Farm Credit Administration admitted that it was nearly illiquid, and its executives went to Capitol Hill to ask for $10 billion in new funds to keep the system afloat. What they got instead did not resemble new funds, but it was called a bailout nonetheless. The savings and loan institutions were in trouble all year, and in Ohio and Maryland, 1930s-style runs on the banks forced the governors to close the state-insured thrifts. In Maryland, up to 100,000 depositors have still not been able to withdraw funds. At the same time, the federal pension insurance plan was $2 billion in deficit, when it was being asked to take on private pension plans abandoned by Allis Chalmers and Wheeling-Pittsburgh.

In each of these situations, crises passed from individual institutions to engulf entire subsystems of the domestic credit system. It is no longer the individual banks that are being bailed out by the federal insurance program; the insurance programs themselves are facing illiquidity, seeking relief from Congress. And now Congress has thrown up its hands and, by allowing the country to verge on default and by introducing "automatic" budget-cutting mechanisms, abdicates any responsibility to deal with the crisis reasonably.

Two solutions have emerged to this impending collapse. First is the prescription of the Interim Committee of the International Monetary Fund, which is applied by Treasury Secretary James Baker.
Reserve chairman Paul Volcker calls "controlled disintegration"; it is the "useless eaters" policy of Adolf Hitler. We don't need farmers anyway, the argument goes, so let us restrict credit in order to eliminate them. That was the so-called bailout of Farm Credit. We also eliminate up to 200 savings and loan institutions, merging the rest with the money-center banks, to insure the solvency, not of the economy, but of the "big boys."

The other solution has been proposed by economist Lyndon LaRouche. Domestic credit can only be saved by reorganizing the world monetary system, resuming orderly credit expansion through government bond-issues backed by gold, with credit channeled where we need it most—to agriculture, heavy industry, and construction.

In the 1930s, the financial institutions of the country were bankrupt, and domestic credit had collapsed. Starting in 1940, stimulated by the urgency of war preparations, the government channeled credit to the most critical industries, and by 1943 we had created the most powerful economic engine in history. There will be those who object to recreating that success because it is not based on "free enterprise." The answer to these cavilers is, "You're damn right it isn't."

© 1986 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.