

Domestic Credit by David Goldman

Declare a recession and go home?

An officially recognized recession may be the only way out of the Gramm-Rudman bind.

Toughened Gramm-Rudman budget restrictions attached to legislation to expand the federal debt ceiling may leave the administration no way out except to admit that the economy is in recession.

It now appears that the administration will not obtain congressional approval for additional federal borrowing—without which the Treasury will go broke by the end of July—unless it accepts some form of “automatic sequestration,” i.e., a mechanism by which across-the-board cuts become automatic the moment that spending exceeds levels approved under Gramm-Rudman-Hollings.

A form of “automatic sequestration,” under which a lowly official of the General Accounting Office of Congress would interdict federal spending, was ruled unconstitutional in a 1986 Supreme Court decision. But Senator Gramm and other legislators have re-rigged the plan to make it appear legal, and President Reagan has officially endorsed the mechanism.

“Automatic sequestration” is the economic-policy equivalent of Oral Roberts’s threat that God would total him, if contributors failed to send in \$8 million. How, precisely, does the administration cut soldiers’ pay, weapons procurement, civil service salaries, and so forth, at the push of a button?

A way out, humiliating as it would be for President Reagan, might be to exercise the economic loophole in Gramm-Rudman-Hollings, and report Gross National Product growth at less than 1% per annum for two suc-

cessive quarters. Economist Philip Braverman at Irving Securities believes that the second-quarter GNP report which the Commerce Department will issue July 24 may well come in at less than 1%. “The only question is why GNP growth should be above zero,” Braverman says, citing dead consumer spending, poor capital investment, flat construction, and inventory disaccumulation.

As a “solution” to the administration’s budget dilemma, reporting two quarters of less-than-1% growth, inverts former Sen. George Aitken’s old plan to end the Vietnam War: Declare victory, and then leave!

In fact, the Commerce Department has enormous discretion to make the GNP numbers do anything it wants them to. The Commerce Department, among other relevant agencies, is also known to exercise that discretion quite freely when political expediency warrants. It need only bring its inflation estimate (the “GNP deflator”) a couple of percentage points closer to the truth, to wipe out any appearance of growth.

It is expected that Senator Gramm’s revised plan for automatic sequestration will be incorporated into a Senate bill, to be passed before the present debt ceiling expires July 17, and that similar legislation will be passed by the House before the end of July, sources say. The new bills will replace the version struck down as unconstitutional by the Supreme Court last year.

The President has already backed off from his silly “108 in ‘88” slogan,

i.e., a deficit reduction to \$108 billion in fiscal 1988, from the present \$180-190 billion level. Since about \$20 billion of the deficit reduction from last year’s \$220 billion level came from one-shot “windfall” tax receipts built into the 1986 tax bill, and tax rates will begin to fall in coming years, that deficit level would require spending cuts of close to \$100 billion.

The administration is now negotiating a deal, including military spending cuts of about 6%, and domestic cuts of about 7.5%, the *Wall Street Journal* reported July 15. Such cuts are likely to be impossible: About \$40 billion of taxpayers’ money will be needed to deal with the existing (let alone a worsened) savings bank crisis, not to mention bailing out other bankrupt federal programs, e.g., the Farm Credit System and the Pension Benefit Guarantee Board.

For the same reason, the government’s plan to raise money by selling off its loan portfolio has collapsed ignominiously. The quality of federally sponsored loans is not much better than Brazil’s foreign debt, by market valuation. \$100 billion of federal obligations, i.e., loans made directly or guaranteed by the federal government, are down the drain, one government economist estimates, and the total could run much higher.

When the federal government solicited bids to buy out loans which it holds in portfolio, investment banks offered only 60-70¢ on the dollar—about what they pay for Brazilian debt on the secondary market. That suggests that the investment banks are discounting for losses in the range of \$300 to \$500 billion, out of federal guarantees totaling in the low trillions.

There may be no choice left but to throw in the towel and admit that the nonexistent economic recovery does not, in fact, exist.