U.S. Credit Collapse-- The Last Fortress Goes

Sept. 13 (IPS) — U.S. Under-Secretary for Monetary Affairs, Edwin Yeo III, admitted this week that the relation between Federal Government tax receipts and spending requirements is completely out of control. The admission came in a press conference announcement that the borrowing needs of the Treasury had jumped by $6 billion in one month's time.

For the last 400 years, capitalists have regarded such a loss of control in State financial management as the most direct evidence of national bankruptcy. Thus minutes after the Treasury disclosure, a wave of panic hit the government market — the cornerstone of the dollar credit sector — and threatened to interrupt billions of dollars in credit transactions of the more financially bankrupt states, municipalities, and corporations. Treasury note prices instantly dropped nearly one point before the markets shut down Wednesday afternoon and, according to a bond trader at Morgan, Stanley, would have fallen through the floor Thursday had government dealers had notes on hand to dump.

Friday morning, the cash-depleted Treasury flooded the market with several billion dollars in IOU's. With few buyers, prices again collapsed, until the Federal Reserve sopped them up with freshly printed, inflationary greenbacks. New York and Chicago commercial banks, previously the buyers of Treasury debt, waited for prices to drop further, before snatching them up a nicle on the dollar like the assets of a bankrupt corporation.

The Treasury's frustration in the sale of its own paper at other than bargain basement prices has been compounded by its inability to liquidate its real assets. Interior Department sources revealed this week that it has only found buyers for one-tenth of the 10 million acres of off-shore oil leasing rights scheduled for sale this year, and this at a loss of $4 billion.

Immediate Repercussions

Panic in the government market spilled over into the tax-exempt market threatening a chain reaction of service shutdowns and defaults among states and municipalities. New York State's $750 million note issue, designed, in part, to bail out New York City, went for an astronomical 8.7 per cent only after the already bankrupt New York commercial banks rushed in to absorb them at the last minute. The issue is still not completely sold. Thus New York State is faced with a default on its own current debt obligations.

Against this background, the New York State Housing Finance Agency, faced with a $100 million in borrowing needs over the next month is, according to a top level official, "living from day-to-day." Simultaneously, the Massachusetts Housing Finance Authority, unable to raise $148 million through note issues, faces the prospect of default on $108 million in debt obligations due for payment on Monday.

These developments, however, are only the tip of the iceberg. Presently 90 per cent of net new investments in the municipal bond markets are by individuals in the middle and upper-middle income brackets. With the exception of New York, the commercial banks, casualty companies and savings institutions have completely withdrawn. As prices on Treasury bills collapse and their interest rates balloon, the last remaining individual investors will move into the relatively more safe, liquid and profitable Treasury debt. The collapse of the municipal market on Thursday and Friday in response to the plunge in Treasury prices indicates that this process is already at work.

Traditionally, the finance of trade and production has depended entirely upon the capacity of a Central Bank to discount and rediscount (convert into cash) bills of exchange and letters of credit. Such cash, in the form of Federal Reserve notes, and otherwise known as greenbacks, has itself depended on the income generating capacity of the U.S. Treasury. Its collapse calls into question the value of Federal Reserve paper and now threatens the complete shutdown of all trade transactions. With the contraction of Treasury income greenbacks will be used to finance the State debt — not production and trade.

On With Inflation

Federal Reserve Board Chairman Arthur Burns' announcement on Thursday that the Federal Government will bail out the New York commercial banks is itself a joke in this regard. Previous to this week's market collapse in government debt, the U.S. Treasury ran up against a cash squeeze unparalleled in recent history. Its emergency checking accounts exhausted by three months of government spending overruns, the Treasury was hit by cash claims of over $800 million due to foreign central bank dumping of non-marketable Treasury securities of the same amount. In response, the Treasury flooded the market an emergency issue of 13- and 18-day paper absorbed by commercial banks with overnight money made available by the Fed itself. Commercial banks, themselves bankrupt, are now refusing to buy now in anticipation of greater profits later — a speculative move governed by their own illiquidity crisis.

The Treasury estimate of $6 billion in additional borrowing requirements for the remainder of this year however, is wide of the mark. Its own revised estimate is attributed entirely to overrun in government spending presumably due to defense industry bailouts, and to revenue losses due to the elimination of oil import fees. It does not include what will be a massive short-fall in Sept. 15 tax receipts caused by the depression collapse of corporate profits, and additional government costs caused by the return of double-digit inflation.

Furthermore, the renewed collapse of production anticipated by the last sharp downturn in retail sales will dramatically diminish tax receipts and increase government spending. President Ford has already resigned himself to a tax-cut extension that will mean $10 billion in revenue losses. It is no exaggeration that the Treasury will be revising its budget deficit upward at a rate of $6 billion a month.

A self-aggravating crisis, the collapse of the economy will contract federal tax receipts and, in turn, will require greater borrowing at higher interest. These higher interest rates will attract such funds only at the expense of states, municipalities, and the entire private sector economy.

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