reduction" program linking any increased defense spending to tax increases, putting the White House in a bind. Under the Senate version, a $7 billion increase in defense spending, already less than the rate of inflation, would be paid for by $7 billion of a total of $18.3 billion in new taxes.

The budget-cutting faction ridicules these proposals as inadequate in any event. The Committee for a Responsible Federal Budget wants much more. Susan Joy, executive director of the group, notes that a large portion of the cuts, too small in any case, is to be derived from asset sales and similar one-shot devices, including changes in accounting, which "will not take the budget off its long-term glide." She predicts that the budget debate next September may "roll the debt ceiling, Gramm-Rudman, and deficit reduction all into one," in a final showdown with the White House.

An internal White House analysis surfaced in press accounts, showing that the Fiscal Year 1988 deficit will be $135 billion, up $37 billion from previous projections. Neither this nor previous projections have much to do with the real world, since the standard private estimate puts the FY 1988 deficit at $170 billion—without counting, say, $100 billion to bail out FSLIC and other bankrupt agencies. Nonetheless, "Disclosure of the analysis also will embarrass the administration," notes the May 14 *Wall Street Journal*. "President Reagan has been criticizing Democratic lawmakers for drafting budgets that fail to adhere to Gramm-Rudman, and Democrats have fired back by contending that the President's own budget—which purports to hit the law's deficit target on the nose—actually misses it by billions of dollars."

The consequences

"Most people were able to take Peru's partial default in stride, and even Brazil's, but how would the world feel about a U.S. default?" asked the May 8 *Wall Street Journal*. "The [federal debt] ceiling will be raised ultimately. The only question is whether some temporary delay will further damage the world's confidence in the ability of the U.S. Congress to manage its affairs. In other words, how much will Congress cost the country in higher interest rates and a further flight from the dollar?"

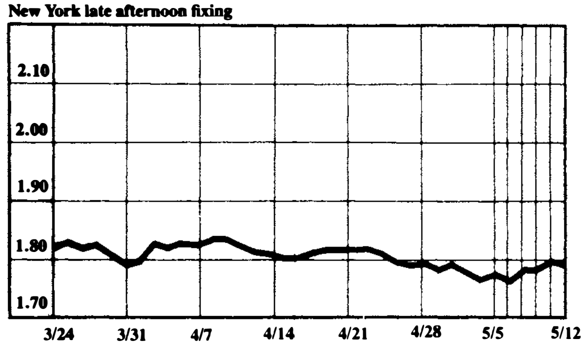
Recall that the dollar and the bond market survived the May 6 Treasury debt auction, only because Japan's government virtually assigned quotas to major Japanese institutions purchasing U.S. government securities. City of London observers believe that a Treasury default would explode the government securities market.

At the point that the flight from the dollar runs out of control, Paul Volcker will step into the breach, as he did in October 1979, and conduct a new "Columbus Day massacre." Wall Street wants a sharp rise in interest rates, not merely to stabilize the dollar, but to force the administration and Congress to adopt banana-republic measures. A sharp rise in U.S. interest rates following the Venice summit will coincide with either the aftermath, or preparations for, Treasury default.

Currency Rates

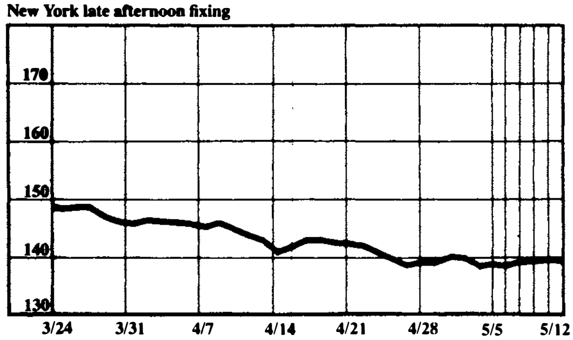
The dollar in deutschemarks

New York late afternoon fixing



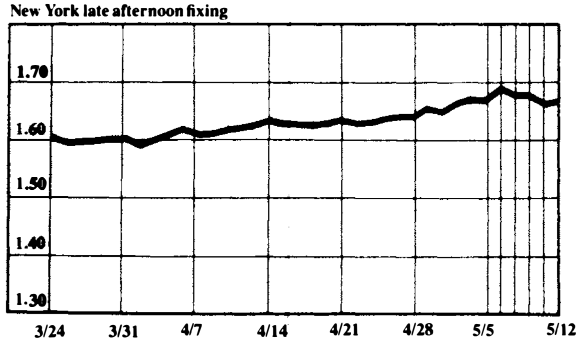
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing