Carter Team After Inflationary Boom In U.S.

BUSINESS OUTLOOK

In a display of unabashed double-speak, Treasury Secretary W. Michael Blumenthal said in a television interview last Sunday that he was fearful of an inflationary "boom during the second quarter of 1977." Blumenthal and the other Carter economic counselors are, in fact, trying to stampede U.S. businessmen into an inflationary "upswing," for the sole purpose of underpinning escalating world commodity prices and Third World debt repayments. The Carter advisors are not in the least concerned that their $31 billion two-year plan for reflating the U.S. economy — the domestic counterpart of the "economic stimulus" programs they are trying to force on West Germany and Japan for the same reason — will lead to spiralling interest rates and prices and a new collapse of the economy later in the year.

February's 10.8 percent annual rate of inflation of wholesale prices, due largely to scarce buying of raw materials by corporations in anticipation of future price rises and commodity-market speculation, financed by the New York banks, is the first fruit of the Carter policy.

Economists linked to the Administration, like former top Carter economic advisor Albert Sommers, are encouraging the "boom" scenario by advising corporations in private to buy raw materials, build inventories, and raise prices as fast as possible, before the wage-price control lid comes down later in the year.

The Administration received a vote of no confidence March 17 from the Senate Finance Committee, which only narrowly backed Carter's inflationary tax rebate plan.

Such opposition could wreck the Administration's delicate "recovery," whose fragility is the real content of the February economic statistics released last week. Carter and his economic advisors couldn't have been too happy about the vaunted 1 percent month-to-month increase in industrial production in February, which pushed industrial output a mere 1.4 percent above last summer's "recovery" levels. February's 1.8 percent rise in retail sales and the jump in auto sales in the first ten days of March to an 11 million annual rate are being held up by the most massive expansion of consumer credit since the days preceding the 1974-75 recession everyone knows.

Business' View

Whether Carter and the Rockefeller banks can succeed in forcing inflation on the U.S. depends in large part on the subjective decisions of U.S. business in the coming weeks. It is possible that industry executives will go in for a major new binge of inventory building. But the howls of protest against the Carter program in the editorial columns of the Wall Street Journal and the Journal of Commerce and the bitter public statements of business organizations make the Carter program's success questionable.

A glance at the books of U.S. corporations pinpoints why they may not be willing or able to go along with the Administration's "upswing" fantasy. While reported pre-tax profits of U.S. corporations were about $149 billion in 1976, almost a 30 percent increase over 1975, no corporate executive takes such figures the least bit seriously anymore. Corporations in the process of applying the Financial Accounting Standards Board's "replacement cost" accounting procedures for the first time are alarmed to realize that their real cash flow is sharply *negative*. Last year the retained earnings of nonfinancial corporations fell approximately $20 billion *short* of expenditures on added plant and equipment and inventories, when those expenditures were adjusted to reflect the current cost of replenishing plant and equipment and inventories.

Analysis of the Flow of Funds Accounts published by the Federal Reserve Board shows that in the fourth quarter of 1976 the internal funds shortfall ran about $22 billion on a seasonally adjusted annual basis. This startling negative cash flow position is arrived at by adjusting new plant and equipment expenditures to reflect the current cost of replacing the depreciated plant and equipment (through the government's Capital Consumption Adjustment) and by adjusting expenditures on added inventories to reflect the cost of replenishing all inventories at the current inflated prices (the Inventory Valuation Adjustment). (See Table.) Of course, the $22 billion shortfall is an extremely conservative figure. The Capital Consumption Adjustment merely adjusts standard depreciation to reflect the cost of replacing the same plant and equipment at current prices — it in no way takes into account the need to introduce higher technology.

The only reason fourth quarter cash flow was not some $30 billion in the hole was that inventory accumulation was nearly flat. If corporations begin rebuilding stocks — as the Carter Administration is urging them — they will have to tremendously expand their bank borrowing — what they have been avoiding for the last two years. at that point negative cash flow will return to 1974 levels, when corporations were stockpiling raw materials and commodity prices were soaring.

Business loans are already expanding at a "healthy" rate. In the six weeks which ended March 9, bank loans (excluding bankers acceptances) and commercial paper borrowing of nonfinancial corporations increased some $3.5 billion, compared to a 4.4 billion decline in 1975. However, it is too early to tell whether this is a reflection of significant inventory building or a function of higher fuel costs and involuntary accumulation also stemming from the cold wave.

Negative Cash Flow Of Non Financial Corporations

(BILLIONS OF DOLLARS-SEASONALLY ADJUSTED ANNUAL RATES)

	1973	1974	1975	1976	I	II	III	IV
1. RETAINED EARNINGS (AFTER TAXES AND DIVIDENDS)	32.5	40.3	30.7	45.8	43.6	45.5	46.5	47.7
2. PLANT AND EQUIPMENT ADDED, NET (A)	35.5	41.4	25.1	31.8	27.8	30.6	35.5	33.4
3. INVENTORY ADDED (B)	31.9	51.8	- 5.0	26.8	22.1	29.8	27.3	27.9
4. FOREIGN NON-CASH INVESTMENT	5.7	9.8	8.3	7.0	6.7	3.3	9.2	8.8
5. INTERNAL FUNDS SHORTFALL 1-(2+3+4)	-40.6	-62.7	2.3	-19.8	-13.0	-18.2	-25.5	-22.4

	1973	1974	1975	1976	I	II	III	IV
(A)								
PLANT AND EQUIPMENT EXPENDITURES	105.4	118.4	109.2	123.0	116.2	120.8	127.5	127.4
LESS DEPRECIATION WRITE-OFF FOR TAXES	68.1	80.0	95.7	106.7	103.1	105.6	107.7	110.4
PLUS CAPITAL CONSUMPTION ADJUSTMENT	- 1.8	3.0	11.6	15.5	14.7	15.4	15.7	16.4
EQUALS PLANT AND EQUIPMENT ADDED, NET	35.5	41.4	25.1	31.8	27.8	30.6	35.5	33.4
(B)								
INVENTORY CHANGE	13.3	12.0	- 16.4	12.2	10.6	15.4	14.7	7.9
PLUS INVENTORY VALUATION ADJUSTMENT	18.6	39.8	11.4	14.6	11.5	14.4	12.6	20.0
EQUALS INVENTORY ADDED	31.9	51.8	- 5.0	26.8	22.1	29.8	27.3	27.9

SOURCE: BASED ON FOURTH QUARTER FLOW OF FUNDS ACCOUNTS OF THE FEDERAL RESERVE BOARD

New York Speculation Aided By War And Drought Rumors

RAW MATERIALS

An atmosphere of "boom" dominated world commodity markets last week. Cocoa futures rebounded from the panic selling that followed the March 9 increase in margin requirements on the London markets. Other prices were pushed up by the prospect of world catastrophes including war in southern Africa and continued drought in California. Markets with basically thin volume are experiencing a professional "bull"