Volcker's Schachtian program for the United States

Credit controls over the American economy, which the President may impose under 1969 legislation without congressional approval, may be in place within weeks. There is now a consensus among Wall Street economists that mere increases in interest rates, or tightening of monetary aggregates, will not prevent private-sector credit from continuing to expand at the 20 percent annual rate registered in the first weeks of this year. At deadline Feb. 27, the bond market had turned up sharply in anticipation of such controls, and the editorial drumming for this action in the financial press had become deafening.

If this is the short-term resolution to the inflationary crisis in the United States since wage/price controls are out of the question and budget-cutting takes too long the American economy will have moved a step further toward a literal repetition of Nazi Finance Minister Hjalmar Schacht's program for Germany in 1936. The elements of the Schacht program were:

- Suppression of household consumption through high rates of taxation and statutory limitations;
- A "national autarky" energy program, concentrating on coal-based synthetic petroleum;
- Diversion of all available industrial resources to military production;
- Central direction of state finances, initially through the notorious Mefo-Institut, to accomplish these goals.

The chaos on the bond and raw materials markets during the past several weeks, and the resulting impression of leaderlessness and drift at the top in Washington, tend to mask the steady movement of the United States toward Schachtianism. Carter's FY 1981 budget proposes a Schachtian reorganization of the economy not so much on the official "on-budget" side as in the distribution of more than $50 billion of federally-guaranteed and similar borrowing. In the most important civilian-sector of the "off-budget" budget, allocations for housing financing are down $10 billion, breaking the back of a five-year trend toward federal support of the secondary mortgage market. This is matched by a $10 billion rise in spending related to energy autarky, including the synthetic fuels plants, the Louisiana salt domes, and so forth. (See "Carter's Schachtian Budget Proposals," *EIR*, Feb. 6-12).

The total federal borrowing requirement for calendar 1980 is $91 billion, by Carter administration estimates. It is probably higher by $20 billion or more, given the administration's overly optimistic projections for the economy. The figure was kept low only through a $40 billion tax increase. Including the rise in defense spending, the tax cuts, and the shifts in the "off-budget" sections of the budget, the net shift away from the civilian economy totals $75 billion.

However, the impossibility of financing that federal borrowing requirement under current financial market conditions implies a much bigger shift—in a single year—away from civilian economic resources. The shift will be accomplished either through price or nonprice rationing, i.e. "crowding out" on the financial markets or credit controls, and through budget cuts.

The magnitude of the additional shift is difficult to estimate. If the budget is cut, the first sections to go, given Carter's discretionary recommendations in the FY 1981 budget proposals, will be inflation adjustments in social security and veterans benefits; pay raises for federal employees; the general revenue-sharing program for state and local governments; and a handful of similar items. Those proposals would reduce projected spending by $14.1 billion. That is not a significant figure relative to the bond markets crisis, particularly since Defense Secretary Harold Brown announced in congressional testimony Feb. 27 that he would be forced to spend more (by an undisclosed sum) for defense than the $14.2 billion requested due to inflation, and the exigencies of the Afghanistan crisis.

Mortgage issuance, which during 1978 was the single largest element of the entire credit system, are now down

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What Carter and Volcker have done

by Kathy Stevens

Two announcements on Feb. 22—18 percent annual growth in consumer prices and a record-shattering 16.5 percent prime rate at big commercial banks—show that Federal Reserve Chairman Paul Volcker has "broken the back of the American economy," as a senior congressional staffer put it.

The big jump in the prime rate, which will rise to 17 percent within the next two weeks, is an immediate response to Carter appointee Volcker's increase in the discount rate of the Federal Reserve just a short week before. Other interest rates, including the rate the federal government pays to borrow money, have risen out of control. The value of the federal government's paper has fallen by one-quarter since Jan. 1. A federal long-term bond worth $1,000 last year is now worth $750.

Two features of Volcker's depression policy must be emphasized before we show what that policy has done to the U.S. economy. First, high interest rates are not merely a reaction to inflation but the principle cause of inflation, including both short-term and structural inflation. Debt service on the economy's $5 trillion of outstanding debt—$750 billion of it at 15 percent interest—is the single biggest cost to the economy. Except for defense spending, federal debt service, at $80 billion, is the largest item on the federal budget.

Second, high interest rates undermine productive investment and promote speculative swindles. It costs $60,000 in capital goods to employ a skilled industrial worker and only $4,000 to employ a clerical worker. High rates shut off longer-term industrial investment in favor of quick turnaround "service industry" employment. This process erodes the nation's basic productivity, producing structural inflation.

Throughout 1979, both households and corporations ran "deficits"—a gap between income and necessary levels of expenditure—of close to 10 percent. Households first made up the gap by borrowing and, when Volcker shut off consumer borrowing last October, lived off their savings. Normal U.S. household savings rate in 5.5 to 6.0 percent and this rate was maintained in the first half of 1979. But it crashed to 3.3 percent in the final quarter of 1979 and to 2.6 percent in December.

Corporations also tried to fill the gap by borrowing every penny they could get. Now the lid has slammed down on that too.

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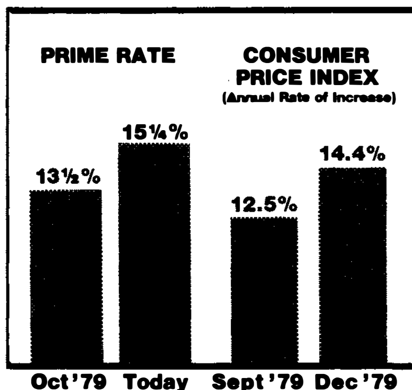

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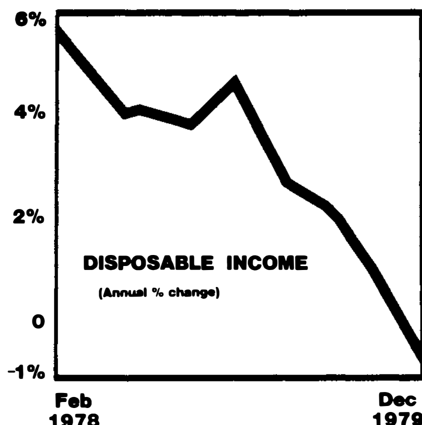

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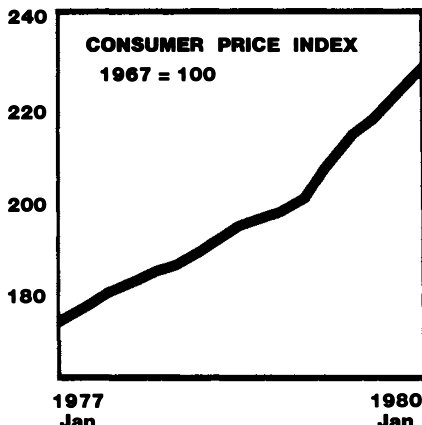

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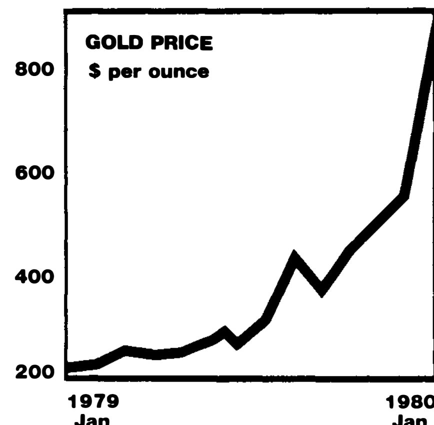

By deliberate design of the Carter administration, the American economy has entered a Second Great Depression.

Here's what Carter and Volcker have done to the U.S. economy in the three short months since the October Massacre.

1 Their anti-inflation policy has given the U.S. the worst inflation ever. In the first round of credit tightening, the prime lending rate (the rate banks charge their best commercial customers) stood at 13.5 percent. Consumer price inflation, measured by the consumer price index was at 12.5 percent, almost the worst level in American history. On Feb. 22, the Commerce Department announced that consumer price inflation was the worst in American history, at an annual rate of 17 percent during January. The prime was at an all-time record of 16.5 percent and expected to rise higher. This is the basic index of the effectiveness of the Volcker policy.

2 They've slashed income. Disposable, after-tax income plunged deeply into the red at the end of 1979 taking living standards with them. The government's "disposable income" category actually understates the decline in real incomes under the Carter presidency. Households have been able to avoid declines in spending on food, clothing, and other short-term essentials only by giving up purchases of homes and automobiles.

3 They've sent prices soaring. Since Jimmy Carter took office, the consumer price index has taken a sharp turn. The curve of consumer prices made a sudden change into double digit inflation around the beginning of 1979—the result of two years of disastrous economic policies. The CPI rose at a 13.3 percent annual rate, the highest since World War II and outstripping the growth of wages by 5.3 percent. Starting with January 1980,the rate of inflation (shown by the slope of the line) will take an even more dramatic turn upward as inflation heads above 20 percent.

4 What they did to the dollar is shown in gold's rise. Gold, the basic measure of the dollar's value, in terms of the most-trusted central bank reserve asset, is the only category that has stabilized during January 1980 for extremely short-term and extraordinary reasons. Since the Soviet military move into Afghanistan the United States has made it a point of Atlantic Alliance loyalty that the dollar must be propped up. This is ironic, since Carter's former Treasury Secretaries W. Michael Blumenthal and G. William Miller spent the last three years "talking down the dollar," by calling for its abandonment as a reserve currency. However, the current inflation rates ensure a new collapse of the dollar early this year.

5 The decline in industry shows there is worse ahead. During 1979, there was a sharp decline in the nation's three biggest goods-producing industries: steel, auto and housing. In each case, October 1979 marks a sharp downturn, followed by a plateau at low levels of activity during December. As of the last figures available, housing starts had fallen an additional 6 percent, and auto production remained 23 percent below previous year's levels, during the month of January. The shut off of funds to auto dealers, builders, and consumers as a result of the recent extreme rise in interest rates means a much faster rate of collapse. Auto dealers' swollen inventories and weak balance sheets are no better off than before the big production downturn this winter, and the housing market has virtually shut down, as bankers withdrew mortgage credit in response to Volcker's discount rate increase.

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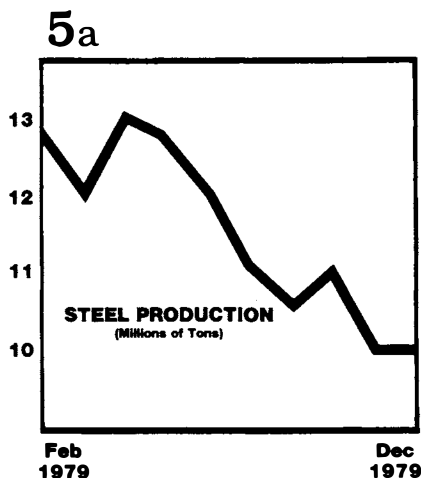

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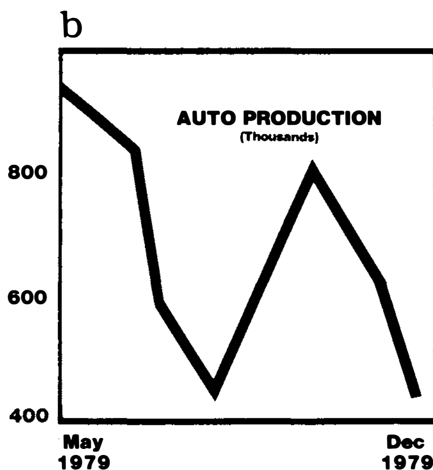

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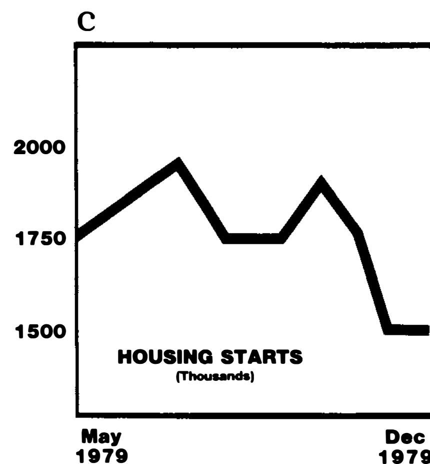

Volcker's program . . .

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44 percent below the early 1979 level. The rate of consumer credit issuance was down 40 percent from the third to the fourth quarter of 1979. These figures, of course, correspond to the disintegration of the auto and housing sectors of the economy, two of the economy's most important sectors. The comparisons between the 1974-1975 business and the present are extraordinary. Then, corporations borrowed massively to speculate on inventory stockpiles, lost, and liquidated inventories in a long, bitter runoff. Corporations are now borrowing merely to maintain the same inventory levels under conditions of near-20 percent inflation—which is where the rate of commercial borrowing stands.

What is particularly onerous about the Carter budget deficit is *not* its mere size, but its composition. Of course, policymakers have long since stopped listening to Keynesian economists babble about the "mutliplier" effect of government spending. There is no "multiplier" for the economy in this deficit, only deductions. This has everything to do with its Schachtian nature. Military spending is a drain on the most vulnerable, shortage-prone sectors of the economy, especially capital goods, as *EIR* demonstrated using the LaRouche-Riemann computer econometric model.

Under conditions of, for example, a three-year backlog in machine tool orders, and a 14 month backlog in orders for most steel forgings, increased military production is an inflationary bottleneck-maker. Production of Schacht-style synthetic fuels plants, which will churn out dirty energy many years from now at $40 per barrel oil (in terms of the 1979 relative price of petroleum) to replace $26 oil from Saudi Arabia, are similarly an inflationary drain on the economy.

Assuming that the shift away from productive activity is merely equal to the $75 billion implied by the budget plus the $26 billion asked by the Senate, the inflationary addition to Gross National Product would imply an additional 5 percent or so on top of the current 20 percent inflation rate. However, the spinoff effects of the Schachtian shift make this kind of estimate useless. What has to go is the civilian economy.

Bankers Trust, in a Feb. 25 commentary, is blunt on this point: "Talk of controls has helped the markets to function again. ...The major concern of market participants over the near term, however, will not be the money supply or inflation, but the economy. The Fed is in the midst of another struggle similar to last October's. The goal is a sharp reduction in economic activity."

What will remain after the dust settles is those "national priority" areas funded directly by the Department of Defense or the Energy Security fund, precisely as in Schacht's Germany.

The Republican endorses fascist

by Lyndon H. LaRouche, Jr.

The following statement was issued in February 1980 by Citizens for LaRouche, the campaign organization of the author, a Democratic presidential candidate. We reprint the statement here in full.

The darling of the Republican Party, Nobel prize-winner Milton Friedman, is a self-confessed promoter of the economic policies of Nazi Germany. Unfortunately, every leading Republican candidate for the presidency is committed to the Nazi-modeled "fiscal austerity" policies of the type pushed by Friedman.

It is true that the Carter administration is also committed to economic policies modeled on those of Hitler's Germany, but it is the Republican National Committee which is presently committed to a more vicious continuation of Carter's Nazi-modeled policies for the 1980s.

Milton Friedman

As an "economist," University of Chicago's Milton Friedman is a bad joke. Even most professional economists of Friedman's own faction share the contempt for Friedman's mental abilities voiced in print by Cambridge University's Mrs. Joan Robinson. Mrs. Robinson characterized Friedman, quite correctly, as a degenerate Keynesian, and correctly sneered at Friedman's method of analysis as representing the "post hoc ergo propter hoc" school of monetary doctrine.

One could say more or less the same of another Nobel prize-winning pseudo-economist, Paul Samuelson of Massachusetts Institute of Technology. Samuelson made a fortune from the sale of his college undergraduate textbook. This textbook was used to indoctrinate millions of credulous college undergraduates and others in the dogma that the Keynesian "built-in stabilizers" would assure, eternally, that a development such as the August 1971 collapse of the U.S. dollar could never occur. Samuelson was given his Nobel award months prior to the total discrediting of his dogma by the events of August 1971.

However, the discredited Samuelson is unimportant