Click here for Full Issue of EIR Volume 7, Number 47, December 2, 1980

A challenge to the President: Friedmanism or economic growth?

by Kathy Burdman

Federal Reserve Board chairman Paul Volcker is presenting the incoming Ronald Reagan administration with an economic fait accompli: a full-scale U.S. recession.

Since the Nov. 4 election alone, Volcker has, with deliberation, raised the U.S. prime lending rate from 14 percent to 16¼ percent, and money market analysts expect the prime to go to 17-18 percent before the end of November. Volcker has acted in this way to directly provoke what economists uniformly agree will be a second or "double dip" recession next year, in spite of the American electorate's overwhelming vote on Election Day against the Carter administration's high-interest rate policy.

The partisans of Chicago School monetarist Milton Friedman are moving to take over the new Reagan administration. Volcker's actions are part of the coup, forcing Reagan before he begins into a framework of tight money and economic austerity.

Already, former Nixon-Ford Treasury Secretary William Simon has let it be known that he will "definitely" return as treasury secretary in the Reagan administration, nationally syndicated columnists Evans and Novak reported recently. Simon, a self-proclaimed devotee of Milton Friedman, is leading a group of Friedman's followers in an attempted takeover of the top economic posts in the new Reagan administration itself.

Eleven economic advisers met with President-elect Reagan this week at the Los Angeles Beverly Hilton. The meeting was dominated by Friedman, Simon, and former Fed chairman Arthur Burns, former Treasury Secretary George Shultz, and other proponents of tight money austerity.

Thatcher—or Hoover?

These actions by Volcker on the outside and Friedman on the inside of the Reagan administration constitute an attempt by the Anglo-American policy elite to maintain the United States in the same policy framework of zero economic growth now being implemented by British Prime Minister Margaret Thatcher, where industrial production has plummeted by over 11 percent during the past year under a Bank of England credit squeeze conducted in coordination with Volcker's U.S. crunch. The Carter administration, from the anglophile President to his London School of Economics-trained Fed chairman on down, has been of one mind with London in opposition to basic industrial growth.

Although the U.S. population overwhelmingly voted this un-American policy out of office Nov. 4, Britain has made clear its desire for the new Reagan government to continue what Volcker has begun. "I certainly hope that Reagan will be Thatcherized," William Rees-Mogg, editor of the *London Times*, told *EIR*, noting that the British government holds this view. "We will tell him to enact a large stablization crisis, to deflate very rapidly."

As the British government and Milton Friedman have often publicly pointed out, the Thatcher program was written in consultation with Friedman, who still consults with London on its implementation.

To ensure that Reagan follows the desired course, Volcker is proceeding to "Hooverize" the President-elect, Federal Reserve sources close to Volcker told *EIR* this week. Given the way the already-accomplished interest rate squeeze will turn down the U.S. economy, "Reagan won't be able to do anything," the source said, about the economic crisis, and will be stuck in Volcker's mode.

As the New York *Journal of Commerce* editorial "Doomed at the Start" put it on Nov. 18, "the danger is that this credit tightening is more than likely to throw the economy into a new downturn next year. The voters have already confirmed President Carter as the Democrats' Hoover. Unless President Reagan moves swiftly to counter the boat-rocking proclivities of the Federal Reserve—something none of his advisers have warned of publicly—like his predecessor, he could be doomed at the start."

Milton Friedman, William Simon, and Reagan's other anglophile advisers have no intention of warning Governor Reagan. Instead, the aim is to stock Reagan

© 1980 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

administration posts with a group of holdovers from the 1969-76 Nixon and Ford administrations, the source close to Volcker said, who will follow the Friedman doctrine with the same disastrous results Nixon had. "The people coming in are just a rehash of the Nixon administration," said the Fed source, "the same individuals—and with weaker leadership on top. Reagan is completely inexperienced; at least Nixon was a Vice-President. And the Nixon group didn't do a very good job of running economic policy the last time. Inflation went wild."

The holdovers are, almost to a man, Friedmanites. Milton Friedman himself, of the Nixon Council of Economic Advisers, and his professor and collaborator Arthur Burns, who ran the Nixon-Ford Federal Reserve by Friedmanite principles, will be senior advisers to the new government. The Friedman group seeks the top cabinet posts of secretary of state, secretary of the treasury, and chairman of the Council of Economic Advisers for three self-professed Friedman partisans from the Nixon years. They are George Shultz, Nixon's treasury secretary, William Simon, Ford's treasury secretary, and Alan Greenspan, Nixon's CEA chief. We document their dismal record in this issue (see page 30).

The current squeeze

Volcker, meanwhile, is proceeding to put the United States into the type of recession British Chancellor of the Exchequer Sir Geoffrey Howe recently described as "painful but necessary," from which the Anglo-Americans hope Reagan will be unable to recover.

Since the presidential election, Volcker has acted to force the average federal funds rate at which banks lend their excess reserves at the Fed to each other from 12 percent to over 15½ percent at this writing, a short-term tightening of the basic cost of funds unparalleled since Volcker's original early 1980 credit control measures which sent the U.S. economy into its first quarter tailspin. This has produced a prime lending rate of 16¼ percent, but money market analysts say that if fed funds settle at 17 percent, an 18 percent prime rate will soon follow.

Questioned closely by an angry House Banking Committee Domestic Monetary Policy subcommittee chairman Parren Mitchell on Capitol Hill this week as to why he persists in his credit squeeze, Volcker cited the Friedman doctrine. "The deceleration of inflation requires that excessive monetary expansion must be avoided," he said flatly. "That basic tenet of monetary policy, on which all economists can agree, is reflected in the broad concepts of monetary targeting," the fixed targets for monetary aggregates first defined for modern practice by Milton Friedman in the 1950s, which Volcker has been using as a deflationary guide.

"Let us recognize that slowing of growth of money and credit in an inflation-prone economy is not a simple painless job," Volcker stated. "Let us also recognize that it must be done. And it will be done."

Asked about his future plans for U.S. interest rates, Volcker indicated that he will continue to raise them. The broadly defined U.S. money supply measure M1-B is now growing at a fast pace, in spite of Volcker's tightening, as U.S. corporations borrow to refinance short-term debts incurred in the continuing recession

Opposition to Volcker

In a statement published in the Nov. 14 Congressional Record, Ohio Congressman Ronald Mottl called on President-elect Reagan to "seek Volcker's resignation unless the chairman commits himself to bring down the exorbitant level of interest rates." Mottl is a conservative Democrat who hails from Ohio's 23rd CD, the heavily auto-industry area of Parma. Mottl's full statement from the record follows: "Mr. Speaker, outrageously high interest rates are crushing the nation's hopes of pulling out of the recession and putting the unemployed back to work. After peaking at 20 percent last spring, interest rates declined to lower but still intolerable levels. Now, interest rates have again crept above 15 percent. The result is that our economic recovery is being unmercifully choked at a tremendous human expense.

"Auto workers cannot work because people do not buy cars when they cannot afford the financing.

"Young families can only dream of buying the home they could have afforded before skyrocketing interest rates ballooned their monthly mortgage payment.

"While big corporations can weather financial market ups and downs, the small businessman who needs to borrow is swept away in a tide of red ink.

"It is well known that the Federal Reserve Board policy is to wring inflation from the economy by tightening the money supply. But we must spread the burden of fighting inflation beyond monetary policy, or risk more economic devastation and human misery.

"Therefore I urge President-elect Reagan to seek the resignation of Fed Chairman Volcker unless the chairman commits himself to bringing down the exorbitant level of interest rates."

without regard to rates. In the week to Nov. 5, M1-B rose by $1.4 billion, which money market economists note brings the average annual rate of growth over the past four weeks to 14 percent, more than twice Volcker's target of 6-7 percent.

Asked if he would continue to reach for his target at the congressional hearings, Volcker stated that he intends to "lean against the monetary aggregates quite hard." If so, U.S. interest rates can only be headed up.

Endorsements

Nevertheless, the leading Friedman followers seeking to control the Reagan administration continue their endorsements of Volcker. "Nobody considers Paul Volcker the enemy," William Simon told the *Wall Street Journal* last week, and urged the Fed chairman to "take even stronger action" than he has so far to continue to drive up interest rates.

Paul McCracken, head of the Reagan Transition Team Task Force on Inflation, also endorsed Volcker in a *Wall Street Journal* op-ed Nov. 13, saying that low interest rates are the cause of inflation. "No concern about the plight of auto dealers or of those wanting to buy or build homes" can be allowed to deter the Fed chairman from his course, McCracken wrote.

"The implications of this Simonesque austerity being so close to the [Reagan] throne may have contributed to the vaporization of the U.S. bond market" soon after Simon's statement, commented Jude Wanniski, a prominent anti-Friedman "supply-side" Reagan economist. "Is Mr. Reagan being Thatcherized?"

The fight for Ronald Reagan's economic soul is not over. It is true that the 11 advisers present at Reagan's Los Angeles economic summit this week were almost entirely members of the Friedman faction, led by George Shultz, William Simon, Paul McCracken, Arthur Burns, Alan Greenspan, and Friedman himself. Other Friedman partisans present included Walter Wriston, the self-avowed "monetarist" chairman of New York's Citibank, and radical libertarian economist Murray Weidenbaum, who works closely with Friedman.

As the comments of Mr. Wanniski, a former *Wall Street Journal* editor, emphasized, however, there is a group of younger Republican economists dedicated to economic growth who deplore Mr. Friedman's influence and aim to take control over Reagan economic policy themselves. These "supply-siders," as they call themselves, in reference to supplying tax credits to stimulate production, are led by New York Congressman Jack Kemp, who also joined the Los Angeles summit. Mr. Kemp refers to Mrs. Thatcher's policy as "root-canal economics." "The fight is far from over," he told *EIR* when asked whose policy would ultimately prevail.

II. CAREER RECORDS

What Friedman did to Nixon

Most of Ronald Reagan's first-string team of economic advisers played star roles in the Nixon administration's economic disasters, by following the same policy prescriptions that they are currently offering the new administration.

Although he had no official role in Nixon's cabinet, Milton Friedman, still on the Reagan advisory team, was the pivot of Nixon's economics. Advising Nixon were Friedman protégé George Shultz, then Office of Management and Budget Chairman and fresh from the University of Chicago, and Arthur Burns, Friedman's old sponsor from undergraduate school and the National Bureau of Economic Research.

Friedman's intemperate statements concerning the advisability of winding down Social Security and all but eliminating trade unions had been a major factor in Barry Goldwater's 1964 defeat.

This makes even more astonishing Richard Nixon's decision to make Friedman his unofficial economic adviser in 1969.

Nixon, however, had been a wartime pal of Friedman's at the Office of Price Stability at Treasury, and learned his economics at the White House at Arthur Burns's knee. Burns now moved back to the White House from Columbia as Counselor to the President. The next year, Burns replaced the aging William McChesney Martin as Chairman of the Federal Reserve's Board of Governors.

Put to the test

During the first half of 1969, the Federal Reserve held the rate of money-supply growth to 4.4 percent per year, right in the middle of Friedman's recommended range of 3 to 5 percent.

Prices rose by an annual rate of 5.8 percent, faster than they had during what Nixon considered a period