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collapse.

To alleviate this collapse the authors propose to turn the crisis back against the advanced-sector economies themselves; the thinking is identical (but less honest) than the similar demands by Federal Reserve chairman Arthur Burns, and Assistant Secretary of Treasury C. Fred Bergsten, for massive cuts in U.S. energy consumption to ease the strain of the U.S. payments deficit.

Since the McCracken-Carli study contains layer on layer of deception that must be stripped away before it becomes intelligible, it is fair to insist that there is an element crucial to their proposal that they have failed to mention altogether. This is the sine qua non of Hjalmar Schacht's system, arms production. Not the economists, but their employer, Nelson Rockefeller, is trying to steer the NATO countries towards a medium-term buildup of armaments with a perspective of confronting the Soviet Union sometime around 1980. There is no coincidence in the simultaneous emergence of the OECD report, and President Carter's first signals in favor of building the B-1 bomber on which U.S. conservatives place so many false hopes. Nothing intrinsic to the OECD report proves this allegation (see The Spirit of Camp Pocantico, *EIR* Volume IV No. 24). But it does explain two anomalies that stand out like flashing red lights. One is the inadvertently-betrayed expectation of hyperinflation, to be cured through indexation. The authors clearly expect their "budgetary targets" and the "difference between private savings and private domestic investment" to be huge.

The second, the one the *Financial Times* complained of, is the assumed 5.5 percent growth rate potential. This figure is plucked out of thin air, as the editors say, "a ghost in the machine." But if Paul McCracken, Guido Carli, and Robert Marjolin are not merely gibbering, but have a thought-out reason for making such a projection, they are projecting 5.5 percent growth to occur on the same basis that Schacht achieved high "growth" in Germany between 1933 and 1937. The "ghost in the machine" the *Financial Times* fears speaks fluent German.

— David Goldman

Inflation Vs. Illiquidity

BUSINESS OUTLOOK

While the bulk of the bank and investment house market letters are painting a rosy picture of the U.S. economy — bubbling over about the favorable technical conditions in the money markets, the coming boom in business spending, and so forth — insiders at the same institutions are operating on the basis of an entirely different set of economic expectations. The insiders' view does leak out into the public from time to time — for example, in *New York Times'* Leonard Silk's column June 23. Silk there promoted the views of Harvard Professor Daniel Bell, one of the authors of the "quality of life" Triple Revolution doctrine. Bell, says Silk, finds "striking parallels" between today and the 1920s and 30s, and says that today's insoluble crisis is inflation. Bell then asks blithely whether democracy has a future.

The inflation specter was also high on the agenda of a recent private meeting of government and private sector financial leaders, where the use of interest rate manipulations for psychological effect was freely discussed.

But the scope of this insiders' meeting was much broader. After admitting that the LDC debt situation was a "difficult" one, the attendees hammered out a strategy of getting the U.S. government, not the banks, to underwrite the risks of the upcoming debt rollovers and of manipulating upward commodity prices — on the model of coffee — to support debt repayments. Part of the international strategy involves mixing the straight refinancing with loans for some Third World "development" projects, both to attract the capital of regional and other conservative bankers and to provide the countries with some means of earning foreign exchange to repay their debts.

On the domestic side, the program is energy conservation and austerity — specifically the elimination of "cost of living clause-induced inflation." Energy "development" e.g., coal gasification, which according to sources at the Washington Federal Reserve is Fed chief Arthur Burns' latest all-consuming interest — will be thrown out as the capital formation bone.

Inflation vs. Illiquidity

But anyone who looks beyond the barrage of government economic statistics every month fully appreciates the Silk-Bell 1930s analog. The U.S. economy is caught in a bind, where it faces either inflation, on the one hand, or illiquidity, on the other. In May the rise in consumer prices slowed to a 7.2 percent annual pace. The slowing of both industrial and now food prices, however, threatens to plunge both of those sectors into bankruptcy. The big change in consumer prices last month came in the break in food prices. Fresh vegatable prices dropped 13.5 percent, while supermarket prices of fresh fruits, eggs, and beef also fell. The threat that wheat prices might go through the ceiling is over; wheat prices fell below government support price levels last week on the news of the harvesting of an unusually large and rich wheat crop. However, the other side to this good news is the fact that a record harvest, taken together with the drop in grain exports, threatens the heavily indebted farm sector — and its regional banks creditors — with extreme illiquidity.

The rise in industrial prices has been slowing down since early March. Between last October and early March, the Bureau of Labor Statistics index of 13 industrial materials prices rose 11.6 percent; but early March through mid-May the index was flat, and in the last four weeks it has lost 4.9 percent. The *Journal of*

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Commerce index of 15 industrial materials prices rose 11.6 percent; but early March through mid-May the index was flat, and in the last four weeks it has lost 4.9 percent. The *Journal of Commerce* index of 15 industrial materials puts current dollar prices today over ten percent below where they were a year ago.

The effect of falling industrial materials prices is already evident in the copper industry, where the U.S. producers are clearly trying to provoke a lengthy strike — with an offer of ten cents over three years and indexing of the workers' COL to the plunging copper price — to work off world copper stockpiles and raise the plunging price. During the Great Depression, the copper cartel was one of the first to break.

In his latest market letter J. Roger Wallace of Gilbert Haas, Inc., the only Wall Street economist to predict the 1974 inventory bust, points out just how miserable corporate profits really are. Adjusted for inflation, first quarter 1977 earnings of $87.6 billion (seasonally adjusted annual rate) were slightly below similarly adjusted fourth quarter 1976 earnings! "This was the first such decline since the first quarter of 1975, where business was in a tailspin," writes Wallace. Wallace also points out, incidentally, that the much touted rise in business equipment expenditures in the first quarter (the bulk of "plant and equipment" expenditures) was approximately 70 percent due to purchases of new autos and trucks for business use!

Our own analysis shows that during the first quarter of the year the internal cash flow situation of U.S. nonfinancial corporations continued to worsen. While the aggregate of nonfinancial corporations were running a negative cash-flow position of approximately $20 billion over 1976, in the first quarter that figure jumped to over $25 billion. This exercise, which measures retained earnings against plant and equipment and inventory expenditures, where both are adjusted to reflect inflated replacement costs, underlines the effect of inflation on corporate operations. Under conditions where corporations are forced to pass along price increases to each other, their plant and equipment and inventory expenditures outstrip their earnings at an accelerating pace.

The only way out of this bind is a new credit system and conditions of worldwide development and demand for U.S. capital goods exports. Short of this, there are only a variety of swindles. One leading New York investment house is investigating the legality of selling foreign securities to pension funds — presumably, bailing out their foreign investments.

More conventional is the push to extract profits out of wages — stop "COL-induced inflation." But this is no less a swindle than the above scheme to universalize the Big MAC principle. Depressing the standard of living of the workforce will at the very best produce a short-term, one-time boost to profits — at the expense of long-term destruction of productivity and real profits.

Mediterranean, Scandinavian Countries Bankrupt; OECD Paralyzed

FOREIGN EXCHANGE

The annual ministerial meeting of the Organization for Economic Cooperation and Development (OECD) has started in Paris with the insoluble problem of debt affecting the smaller member countries of the Mediterranean region and Scandinavia at the top of its agenda. There is now no way for some of the 24 more developed nations of the West to pay their debts in 1977 without ruining whole sectors of their economies and destroying their ability to survive as industrial entities. The official debt-service ratios in 1977 — percentage of annual debt-payments to annual exports — cannot be met by such OECD countries as Turkey, Greece, Spain, Portugal, Finland, or even Norway, whose figures vary between an incredible 93 percent for Turkey to 23 percent for Norway. (*See Table on Page 8*)

Mediterranean Bankruptcy

The more spectacular cases are Greece and Turkey, but Spain and Portugal are not in a much better shape.

Up to the 1973 oil embargo hoax, those countries were building up a relatively viable industrial sector, balancing their imports of equipment goods for that purpose with exports of "Mediterranean" agricultural products and resources based upon tourism and remittances sent by guestworkers employed in Western Europe, mainly in France, Belgium, and West Germany. Since then, the increase in oil prices has sent their trade balances into high deficits, and their current account resources have been drastically cut as a result of the world crisis. Tourism has decreased and guestworkers bear the heaviest burden of unemployment in Western Europe.

Countries making the greatest industrial effort have reached unbearable balance of payments deficits: Turkey's is estimated at $2.5-3 billion and Spain's at $4-4.5 billion. In the case of Spain, this is an amount equivalent to that of its foreign exchange reserves; in the case of Turkey, five to six times the reserve. Portugal and Greece are in a relatively better financial position, only due to the fact that their industrial effort has been in the preceding period. Greece's debt is therefore more evenly distributed in the future than Turkey's, which has for the past two years based its industrialization and long-term infrastructure equipment on short-term capital inflows through accounts in "convertible lira" favorable to speculation which now come due. Portugal has a heavy $1.1 billion balance of payment deficit and a quickly expanding debt, but its debt-service ratio is still