

Schachtian Economics For The United States?

A sudden shift in the consensus of economic forecasts toward predicting a recession for the domestic economy indicates how close the United States is to adopting the economic policies of Hitler's Finance Minister, Hjalmar Schacht.

BUSINESS OUTLOOK

The most telling feature of the situation is Senate Banking Committee Chairman William Proxmire's demand for major cuts in the federal budget. In its semiannual economic policy review, the Senate Banking Committee proposed cuts in the federal budget deficit, as an alternative to further monetary tightening by the Federal Reserve.

"The restrictive stance of monetary policy taken by the Federal Reserve recently may lead to slower growth in production and employment by the end of the year," the report said.

Under pressure from Fed Chairman Miller, who has lobbed majority sentiment in the banking community into this campaign, the White House has given strong indications of susceptibility to the "fiscal austerity" proposal, to the point of circulating scenarios for a balanced budget by 1982. Carter, in a May 25 press conference, said that he could "take the heat" from pressure groups resisting budget cuts.

The apparent consensus for cuts in the federal budget — at a point when a recession is projected for the relative near-term — is totally unprecedented in the postwar period, and amounts to a fair revival of Hjalmar Schacht's 1930s economics. The late Gaullist economic theoretician Jacques Rueff described it as "inflation turned inwards against the economy." Moreover, the suggestion itself exposes another bitterly Schachtian feature: making economic policy through crisis management. The combination of rising interest rates, a weak dollar, high inflation, and apparent recession that has been thrown at the administration by the Federal Reserve puts the White House into an impossible political bind. Not even a strong Administration could hope to beat down the claimants to federal budgetary support under present conditions.

Possibly, the ostentatious public support lent to Carter's anti-inflation program by such business leaders as Irving Shapiro of Dupont, Thomas Murphy of General Motors, and Reginald Jones of General Electric, reflects the political problem at the heart of the matter. There are no illusions in those quarters that the Carter program

is anything more than the "optics, jawboning, and scapegoating" that the *Wall Street Journal* attacked in a June 1 editorial. But the business leaders fear the worst consequences for the Administration, and will stand by it, even at cost of appearing ridiculous.

Predictions of Recession

Alan C. Lerner of Bankers Trust, the economists of Manufacturers Hanover, the majority of the Federal Open Market Committee (according to the published April 18 minutes) and most other economic commentators warn that the uptrend in consumer purchases and other basic indicators is already ending. Manufacturers Hanover, describing the downward phase of an inflationary cycle, reflects the general viewpoint: "... such a boost to sales is temporary, since it is not based on any fundamental improvement in buying power, but rather, is being fueled by a decrease in the savings rate or by stepped-up use of installment credit. Thus it is possible to conclude that another part of the current surge in activity is temporary — only in this case it represents not a makeup from the past, but borrowing from the future. It is going to take some mighty good luck to prevent the ongoing boom from developing into a bust late this year."

The only "good luck" that would fit the requirement would be G. William Miller walking into a manhole. The effect of Miller's tourniquetting of interest rates already showed up in the powerful boost given to consumer price inflation by the increased cost of home and other consumer credit, a major factor in the 0.9 percent Consumer Price Index increase in April. Miller's interest rate operation created a borrowers' panic, the most extreme form of "inflationary expectations," with the aid of such Wall Street seers as Salomon Brothers' Henry Kaufman. Kaufman told the *New York Times* May 26 that he advised clients to raise all the funds they would need this year immediately, to "beat" the rise in interest rates.

Now that the combination of high interest rates and inflation fears is about to ruin the economy, Miller, Proxmire, and the blind men at the commercial banks' economics departments propose more of the same treatment — the next ratchet down.

In no respects does this represent an economic policy, although some of the commercial bankers delude themselves that it will buy a short respite of "stability." Miller's recession has set the dollar up for butchery. In particular, the effect of dollar outflows on interest rates, which depend heavily on foreign financing of the U.S. treasury deficit, will be devastating when the Miller

bubble goes. A New York City bankruptcy could trigger it in the next week. The standard argument that the absence of foreign central bank intervention to support the dollar — which financed \$31 billion of the deficit during 1977 — will automatically force interest rates up is fallacious. Foreign funds will not be available to finance the deficit if the stock market bubble and the currency fluctuations that favor the dollar reverse themselves, which is precisely what Miller is driving at. In this case the U.S. economy will end up with high inflation, reduced output, and skyrocketing interest rates simultaneously! The ultimate beneficiary could be Fed Chairman Miller's colleague — Sen. Ted Kennedy.

—David Goldman

How Long Will It Last?

Money Markets, the newsletter of the First Pennsylvania Corporation, May 25:

We estimate that we are currently in the third phase, or expansion phase, of the business cycle. Sales and inventories are both growing at a robust pace, consumer debt burdens are mounting, and interest rates are rising making it increasingly expensive to fund inventories. Even though the economy seems to be expanding briskly, economists recognize we are living on borrowed time. . . .

Should the economy and inflationary expectations continue to advance at the current feverish pace, however, it makes it increasingly likely that robust business expectations will not be fulfilled, both consumer and business debt burdens will become unmanageable, and the tax cut could very well be shelved (in the interest

of cooling off inflationary pressures) putting us into the fourth, or downturn, stage of the business cycle by year-end.

No Cause for Optimism

Financial Digest, the newsletter of Manufacturers Hanover Trust, May 29:

. . . a lot of sales that were made in April and May might have been made during the first quarter, had the winter been less severe or the coal strike non-existent. Since these sales are bunched with sales that would ordinarily occur at this time, they give the illusion to many businessmen that business is booming. Accordingly, there is an effort to build inventories, in the belief that the current rate of sales (which includes some make-up sales from the first quarter) is the true ongoing rate. This could lead to some disappointments later on, once these makeup sales are finished; it could result in an involuntary accumulation of inventories in some sectors, and a need to cut back.

If this were not enough, there is growing evidence that a large proportion of sales being made today is because of fears of higher prices. As was observed at the beginning of this month (*Financial Digest* — May 1, 1978), consumers appear to have developed a "buy-in-advance" attitude toward big-ticket items. Reinforcing an earlier finding, the University of Michigan Research Center said last week that the nearly half of the people who now believe that it is a good time to buy durables represents "the highest recorded proportion of respondents to indicate a buy-in-advance price rationale since the surveys were started" in the early 1950s. . . .

Miller, Rohatyn Steer New York City Toward Bankruptcy

The New York City fiscal crisis this week entered its "countdown month," with the city "closer to a bankruptcy than ever before," according to informed sources in the financial community.

BANKING

A city default would trigger a chain-reaction collapse of the more than \$14 billion in outstanding city, New York State, and MAC paper; it would panic the security markets and send the U.S. economy plunging toward the worst depression in its history.

What makes a New York City bankruptcy likely is that the triumvirate effectively controlling its future — Lazard Freres general partner and Municipal Assistance Corp. chairman Felix Rohatyn, Federal Reserve Chairman William Miller, and Treasury Secretary Werner Blumenthal — have apparently decided that it is a "prime option."

"I have absolutely no doubt that Rohatyn, Miller and Blumenthal would take a bankruptcy at this point," said a banking source. "Their problem is to deflect the blame off them..."

Viewed From the Outside

Fed Chairman Miller last week effectively lobbied for a bankruptcy, telling the Senate Banking Committee that a New York default could be handled "smoothly and efficiently" by the Fed and would definitely "not cause a national crisis." Blumenthal, meanwhile, has told a major newspaper's editorial board that he would welcome a bankruptcy.

The New York commercial banks, some of whom have over 30 percent of their total equity tied up in worthless New York paper, are apparently falling for this faulty reasoning. "The city can go under," said one deluded banker late this week. "We'll still have MAC. . . it won't be so bad, because the Fed will help out. . ."

The banks are being set up. Aides to Senator William Proxmire (D-Wisc.), the Fabian chairman of the Senate