'The U.S. economy needs a good recession'

Business Week and Atlantic Council say it's grown too fast

In the Sept. 25 issue of *Business Week* economics editor William Wolman claimed that the only remedy for the rapidly depreciating U.S. dollar is slower economic growth through belt tightening — "and the notch chosen for the belt must be one that substantially escalates the risk of recession."

Wolman may be more brazen than most in thus openly calling for a recession, but he is not alone. As reported elsewhere in this issue, the thrust of the new policy paper issued by the Atlantic Council Sept. 17 is identical. And Irving Shapiro, chairman of du Pont and cochairman of the Business Roundtable is telling the business community that stringent wage and price guidelines are "inevitable," reports *Washington Post* columnist Hobart Rowen. "Realist" Shapiro got the business community to endorse the Anti-Defamation League-sponsored "antiboycott" legislation by the same ruse in the spring of 1977, despite the fact that every executive knew that the legislation would crimp U.S.-Arab trade relations.

Recession the only solution?

Business Week's Wolman now acknowledges that the steep depreciation of the dollar over the last year has worsened, not improved, the nation's balance of trade deficit — despite what Treasury Secretary Michael Blumenthal promised us. He dismisses the famous "J-curve" theory, according to which a currency devaluation leads first to the widening of a country's trade deficit as its imports become more costly and only later to a narrowing of the deficit — after the country can no longer afford to import anything. Wolman argues that this reversal will not happen naturally. Demand for imports must be peremptorily cut by collapsing the economy.

The assumption that underlies the recommendations of Wolman, the Atlantic Council, Shapiro and others who are talking like them is the absurd notion that the U.S. economy has been growing too quickly. Far from growing "too fast," the U.S. economy has been stagnating since the 1973-74 recession, a situation which accounts for all the ills of the economy and the dollar — inflation, obsolescence of plant and equipment, lack of competitiveness of its exports, and so on. Prescriptions like *Business Week's* will push the economy over the edge — and are meant to.

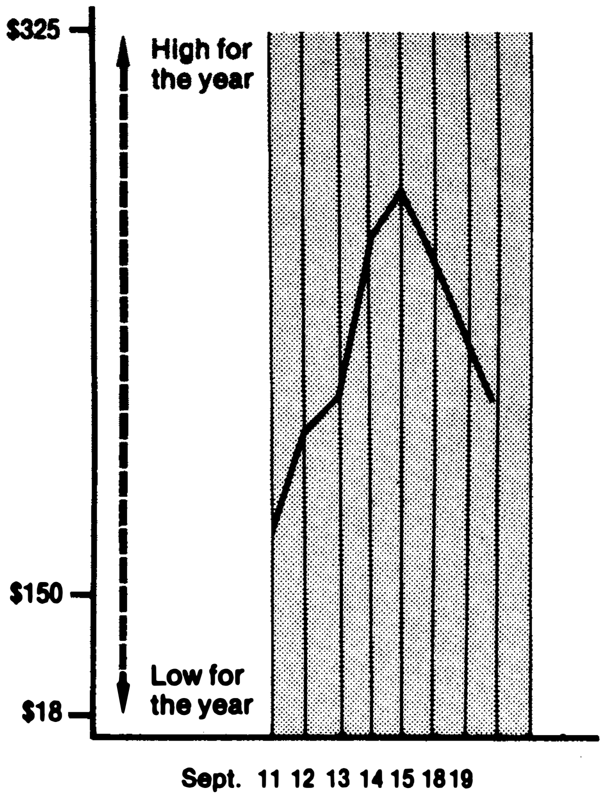
The nonrecovery

The last three years' economic "recovery" has been based almost entirely on the generation of still rising levels of consumer credit, which have allowed consumers to purchase higher priced cars and other goods on longer and longer credit terms. In the first seven months of this year, for example, $150.8 billion of consumer credit was issued, up about 66 percent from the same period in 1975. And now this last illusion of economic growth is threatened by near liquidity-crisis conditions in the banking system, deliberately made worse by Federal Reserve Chairman Miller's high interest rate policy.

The "consumer-led" recovery was financed chiefly by the nation's regional banks, which account for more than half of the assets of the banking system and provide the bulk of the credit issued to consumers, real estate developers, and small and medium sized businesses. While loan demand at the money center banks has remained slack, rising only 3 percent per year over the last two years, domestic loans have

How one gambling stock fared last week

Selling price at days end for Resorts International "B"



soared at an average of 17 percent per year at the regional banks. According to analysts, the regional banks are presently so strapped for funds that they are asking major New York banks to participate in loans with them, and in some cases they are turning customers away and sending them to New York.

Some regional banks are offering home appliances and other gifts to lure in deposits. The competition for funds is also showing up in the steady rise in the interest rates banks are willing to pay on Certificates of Deposit, and at the time of this writing rates on 90-day CDs have reached 8.65 percent.

Since banks must set aside a portion of their deposits as reserves, the effective cost of money is more like 9.25 percent. With the prime rate 9.5 percent, that leaves the banks an extremely narrow spread. Many analysts predict the prime rate will reach 10 percent by the end of the year or early next year, in large part due to the liquidity pinch at the regionals. Rates are expected to rise even if the Federal Reserve relaxes its policy of deliberately raising interest rates through withdrawing reserves from the banking system.

No "reliquification"

The liquidity pressures at the regional banks stem from the fact that the U.S. banking system was never "reliquified" — it never built up its liquid assets — after the last recession. The banks only appeared to be more liquid because there was no loan demand. But as soon as loan demand began to pick up in 1976, liquidity problems reappeared.

The other worrisome area in the economy is the real state of corporate profits. At a glance it would appear that the profits of nonfinancial corporations surged nearly 50 percent between the first and second quarters, to a $54.5 billion annual rate. However, the Flow of Funds statistics just released by the Federal Reserve show that the composition of business profits is steadily deteriorating. Inventory profits, due to the mark-up of inventories held in stock, accounted for nearly 46 percent or $24.9 billion of the increase in earnings. Adjusting depreciation to reflect the actual replacement cost of plant and equipment reduces profits by another $16.2 billion. Thus a much truer measure of profitability puts U.S. business's second quarter profits at a $13.4 billion — not a $54.5 billion — annual rate.

There is only one sector of the economy that can be described as booming right now — the legalized gambling "industry." On any given day on the New York and American Stock Exchanges, the "most actives" list includes Resorts International, Ramada Inn, Holiday Inn, Caesar's World, Bailly Manufacturing, and the other casino-hotels or pin-ball manufacturers.

On a given day the swings in these stocks can be as large as 60 to 90 points, with the enormous block buying providing a convenient laundering vehicle for drug and other dirty money, as well as yielding enormous quick profits to insiders who know what that day's "leaks" will be. For example, Resorts International "B" has traded between $18 and $325 per share over the last year! The movement of the gambling stocks is now determining the ups and downs of the market as a whole, with volatile 1929-like conditions developing in the market as a result.

—Lydia Dittler