'Not an act of war, but of suicide'

The U.S. bankers who brought down the dollar now demand recession

"We will certainly get a recession by 1980 — it's baked in the cake," Citibank Chairman Walter Wriston told a press briefing at the Business Council meeting in Hot Springs, Va., on Oct. 13.

"It's impossible to stop inflation without a recession," Barry Bosworth, director of the Council on Wage and Price Stability told the same briefing.

One after another, leading business figures stood up at the annual meeting of the most prestigious business organization in the U.S. and invited a new recession and mass unemployment.

Such recessionary sentiments, the passage of the energy bill, high U.S. interest rates, and goverment belt-tightening have been cited time and again as the panacea for the beleaguered U.S. dollar.

Now Congress has passed a version of the energy bill, we have an 8.5 percent discount rate for the first time in U.S. history, and leading business and government spokesmen are calling for the "inflation-dampening" effects of a new recession — and this past week has witnessed the continuing steep fall of the U.S. dollar on international markets.

On Wednesday afternoon the dollar closed at an all-time low of 1.83 deutschemarks, after it had opened the week at a miserable 1.87 marks — a loss of more than 2 percent over three days. The Dow Jones industrial index lost 37 points in the first three days of the week. And the gold price soared to an all-time high of $229.25 an ounce in Wednesday afternoon trading, precisely the high bid submitted at the U.S. Treasury's Tuesday gold auction by Julius Baer, one of the private Swiss banks.

Collective hara-kiri

The problem is that American bankers' hostility to the European Monetary Fund, viewed by them as "anti-dollar" with considerable prompting from the London financial publications, has for the moment closed off the one avenue for bolstering the dollar and U.S. economy and has set the dollar up for the kill.

As French financial analyst Jean-Gabriel Thomas pointedly observed in *Le Figaro* Oct. 14, the depreciation of the dollar is hardly an act of warlike competition: "It is rather really a suicidal act: the sad thing is not that the Americans are selfish, but that they think they are. Which is much much worse."

The Business Council meeting last week gave every indication that the U.S. corporate elite is indeed prepared to commit collective hara-kiri — but on one condition. The U.S. government must exhibit leadership in imposing austerity and slashing federal budget expenditures. Only then will the business community abide by the government's forthcoming "anti-inflation" program, threatened DuPont chairman Irving Shapiro at the press briefing.

James T. McIntyre, Bert Lance's replacement as the director of the Office of Management and Budget, was on hand to assure business of the Administration's new gusto. "I can predict there's going to be blood on the carpet in the next few weeks," he promised at the press briefing. In that time President Carter will release his "anti-inflation" program which features a Cabinet-level "productivity" committee centered in OMB under the purview of zero-based budgetor MacIntyre.

19th century weapons

The slaughter of the dollar was given a huge boost when U.S. Federal Reserve Chairman G. William Miller hiked the key "base rate" for credit, the Fed's discount rate, to a record 8.5 percent on Oct. 13. Obsessively promoted as a means of drawing investment into the dollar sector and simultaneously "dampening" inflation, this strategy for fighting inflation also came under fire from *Figaro* analyst Thomas.

Mr. Thomas pointed out that "the interest rate weapon" recently adopted by the U.S. Federal Reserve was "perfected by the Bank of England during the nineteenth century." It might have been efficient under a system of immutable fixed parities, Thomas added, but under floating rates this antidote only aggravates the disease. The interest rate hikes merely "become institutionalized and become incorporated into costs. They feed what they are supposed to reduce: inflation. Provoking what it was to compensate for, it destroys itself."

Gazing at Bank of England "weapons" dredged up from the 19th century, Thomas added, "Even the most obtuse generals were never more than one war behind, not three or four. . . ."

There is a second phase to rising interest rates: at the point when interest rates, and hence business's financing costs, become prohibitively high, they prick

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the bubble and we have a recession. In private conversations businessmen are revealing that they are at this moment rescheduling purchase and production plans to carry subnormally low inventories — in view of high financing costs, the accumulation of excess stocks, and as a hedge against a coming deflationary trend.

Involuntary inventory accumulation

Such corporate decisions have not fully shown up in the statistics yet. But in his autumn 1978 "Quarterly Business Conditions Analysis," Manufacturers Hanover economist Irvin Kellner gives some convincing and worrisome evidence. Kellner cites significant involuntary inventory accumulation, especially when trends in industrial output and retail sales — the two ends of the inventory picture — are adjusted for inflation. He notes that inflation-adjusted retail sales have been declining since last May, while the output of consumer goods has continued unabated.

The irony here is that the buildup of now unwanted inventories was itself fueled by rising interest rates. Over last summer, manufacturers continued to build up inventories before financing costs got even higher and as a hedge against inflation. But now rates have reached the point where everything is unraveling.

— Lydia Dittler

America's pundits of collapse hawk hara-kiri

On Aug. 28, when Milton Friedman wrote the following letter to the editor of the **Wall Street Journal** ***attacking America's allies for supporting the dollar, the U.S. currency had just slipped below 2 deutschemarks. On Oct. 18, thanks to the influence of Friedman's views in Washington, the dollar closed at 1.83 DM — a loss of 8 percent in less than two months.***

. . .The U.S. policy of flooding the country with dollars is wrong — it is wrong internally, because of the inflation it generates; it is wrong externally, because it removes the dollar as a stable anchor of the international financial system.

But the policy of Germany and other foreign countries of supporting the dollar is also wrong. Contrary to your editorial opinion, the United States was not "able to coerce" foreign financing. There was absolutely nothing to have prevented Germany and other countries from letting the dollar find its own value on the marketplace — and that is the policy that I and almost all other advocates of floating exchange rates have consistently recommended as best for them individually, and for the world as a whole. Support of the dollar was simply a reflection of the political pressure for protection, the same pressure that has produced tariffs and other restraints on imports. Have we "coerced" them to impose those restraints on trade?

In "James, Jimmy and intractable labor" (Oct. 16), Washington Star columnist Charles Bartlett cited the views of Friedrick von Hayek, Milton Friedman's co-thinker, on the beneficial effects of recessions.

James and Jimmy (British Prime Minister Callaghan and President Carter) both came to power as candidates of the working classes, but they are both burdened these days with deep concern over the intractability of labor. . . .

Inflation is the issue for both leaders. Callaghan is trying to prolong a tough incomes policy that has brought British inflation down from alpine heights to below 10 percent. Carter is ready to put teeth in a floppy policy which has allowed American inflation to soar towards 10 percent.

Neither leader has at this moment the support of his trade union allies.

Callaghan's bold hopes of capping wage increases at 5 percent were rejected last week at the Labor party conference. Carter's plan to hold wage gains to 7 percent is assailed by labor leaders as a futile venture that may stir a public impression that labor is the mainspring of inflation.

Callaghan tells friends he would rather resign than preside over another wage explosion. He is being realistic. He and Carter will be left with only slim hopes of re-election if labor demands get out of hand because their only option will be to pull levers that tighten the economy, restrain public spending and expand unemployment.

As the architects of recession, they will not be strong candidates.

The British Labor party has kept its grip on popular support through a long grey period of vicissitudes largely because British voters believe the Laborites are their best hope of making 12 million trade unionists behave rationally. . . .

If Carter and Callaghan articulate the inflationary dilemma clearly and firmly, the workers of their countries might get the message. It was well described for the British by Nobel Laureate F.A. Hayek: "The greater we allow the number of those to grow who are maintained in their present employment while producing what the world market will not buy at prices adequate to maintain them at their present level, the greater will be the ultimate catastrophe when the fools' paradise collapses." . . .

In contrast, Le Figaro on America's 'suicidal act'

Writing in Le Figaro *Oct. 14, Jean-Gabriel Thomas, Administrator of the Society of French Financial Analysts, dubbed the U.S. Federal Reserve's policy of defending the dollar through high interest rates "A Dull Weapon."*

. . .Let us consider the interest rate weapon which the Federal Reserve just resorted to in the summer campaign of the dollar. The tactic was perfected in the 19th Century by the Bank of England. In a system of immutable parities — the pound sterling having kept the same value for two centuries — its efficiency was absolute: a small rate increase sufficed to maintain the allies on the right side. Who would have been crazy enough to refuse to cash in on additional remuneration without taking any risks at all?

The fire power of this weapon significantly decreases in a system of fixed but not immutable parities, such as that established by Bretton Woods. The possibility of a devaluation must be taken into account, with the risk included in the interest rate. One ends up continually upping the dose, as the same Bank of England bitterly experienced up to the drama of 1967.

In a system of floating parities, the risk is daily and the exchange rate fluctuations are very broad. One thus wonders whether the Fed is not getting mixed up as to what century we are in when it increases the discount rate by half of one percent per year. At the time of this spectacular decision the depreciation of the dollar against the stronger currencies reaches 5% during one day, that is three thousand six hundred times the amount of the Royalty bonus offered to the creditor. Does one have to be a poker player to know that, while anyone might agree to risk one chip for a small chance of winning three thousand, one would less readily agree to risk three thousand to win one? ...But, it will be said, what is at stake for the Fed is to show its intention to fight internal inflation and its tactical move must be understood in this context.

Well, it is hard to see how such a small rate increase can be more of a deterrent for national borrowers than an incentive for foreign lenders. And, when it doesn't achieve its goal, the rate increase becomes institutionalized and becomes incorporated into costs. It feeds what it is supposed to reduce: inflation. Provoking what it was to compensate for, it destroys itself.

. . .The strategy which subordinates the value of the dollar to shifts in the trade balance thus cancels out a tactic which is itself ridiculous. Unfortunately, this contradiction doesn't imply at all that the first has a more solid basis than the second.

. . .One doesn't have to be a genius — or an expert — to understand that an advanced industrial country which practices a "competitive" depreciation of its currency increases the price of its necessary imports of raw materials without being able to reduce their volume. It only reduces its apparent overall costs through an artificial under-estimation of the national surplus. It unloads very cheap exports, sophisticated technological products whose sale depends more upon technical quality or commercial aggressivity than upon price.

...Unfortunately the long term vision of the experts is not directed towards the future, but towards the past. And it is a very long term past: It goes back to the time when Ricardo determined the influence of relative costs and prices on international trade by doing dissertations on the exchange of Manchester sheets for Porto wine.

The depreciation of the dollar is not, as Mr. Michel Debré asserts, "an act of bellicose competition." It is rather really a suicidal act: the sad thing is not that the Americans are selfish, but that they think they are. Which is much much worse.

As for the experts, they can be compared to military men — or at least, to some of them — only to the extent that, placed in front of a problem, they seem to ask themselves only one question: what is the section of the rule book which applies to that situation?

Could we suggest to those modern-day chart strategists that they seek their ideal model in Clausewitz's "Art of War," rather than in Corteline's "Follies of the Squadron"?