EIR Economics

Carter's economic plan: no good, or worse

by Richard Freeman

President Carter has two options on the U.S. economy: no good and worse. Presently, Carter is sitting on top of an economic time-bomb, which he has no way to control, and which is already making him the laughing-stock of continental Europe. Each time Carter does intervene into the economic life of this country, such as his recent approval of Fed chairman Paul Volcker's hike in the discount rate twice in the last 45 days, it has tended to intensify inflation and heighten the potential for Penn Central 1970-style bankruptcy in the corporate sector.

For their part, the Republican opposition in the Senate smells that Carter is ripe for the taking. After drafting a resolution calling for broad budget-cutting, signed by all 42 Republican senators, a Republican reported March 13, "This is beautiful. Carter's budget can't work. He can't balance a damn thing and now we've got him."

But the issue is broader than opposition politics in the U.S. This past two weeks, while Carter was fumbling on the Israeli settlements question at the U.N., President Giscard of France was locking up large technology transfer deals with Saudi Arabia, Kuwait and all the major Gulf countries, cutting the French in on the big potato—the $120 billion OPEC current account surplus. This will give the French and Germans control over the marginal amount of new liquidity coming into the banking system, foretelling a big shift away from Anglo-American control over the world's monetary system.

At the same time, Carter is coming in for merciless criticism from his allies in Europe. Chancellor Helmut Schmidt, after meeting Carter's economic advisers on his visit last week to Washington, could only shake his head in dismay and wonder, according to *Der Spiegel*, how come the U.S. can't stop its own inflation which is spreading across the world.

Even Carter's erstwhile friends in the British financial press are now treating him with open scorn. In an article cataloging the breakdown of all of the principal U.S. markets, the March 8 *London Economist* editorially suggests that Carter can cut losses and "confine the panic to Wall Street" by firing his top policy advisers. After criticizing Fed chairman Volcker for mishandling the economy, the *Economist* coyly proposed, "President Carter should also bring in a new treasury secretary. Mr. William Miller, who came from Textron, might (like his predecessor, Mr. Michael Blumenthal, who came from Bendix) have made a good secretary of commerce, but both men have lacked an understanding and a feel for the treasury's financial constituency."

The budget fraud

The Carter 1981 fiscal budget deficit, while purporting to be in the range of $21 to $25 billion, is actually, as the *EIR* documents in this issue, closer to $115 billion. This includes off-budget items, inflation adjustment indexes, and almost $25 billion added on as increases in refinancing the Treasury's short-term debt at higher interest rates.

In the face of this projected deficit, Carter proposes to cut socially useful programs in the budget, while continuing and abetting capital flows into the very speculative ventures that have, with Volcker's assistance, shot the January-February Wholesale Price Index to an 18 percent annual inflation rate. In the latest version of cuts,

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leaked from the White House March 11, Carter plans to go for an $11 billion slash in programs in the budget, including a $1.7 billion cut in the state portion of local revenue sharing, $400 million from a health program for the young, $400 million from highway construction and $.5 billion from federal subsidies to the private Postal Service by proposing eliminating mail service on Saturdays. For the time being, it appears Carter has abandoned his earlier announcement that he would seek to eliminate the inflation-adjustment index for Social Security and veterans program beneficiaries.

In order to increase revenues, Carter seems to be throwing his weight behind an energy rationing plan that would impose a 10 cent excise tax on each barrel of imported oil, which would raise $6 billion, as well as another tax on dividend and interest payments.

The implicit rationale behind all this proposed budget-slashing is the Milton Friedmanite assumption that a balanced budget per se will put an end to inflation. In fact, budget-cutting in the manner it is occurring—targeting productive or socially useful programs rather than those tied into non-productive speculation—is more wildly inflationary than what the most wild-eyed Keynsian turned lose in the Treasury could do.

A Penn Central bankruptcy

While Carter fiddles away the federal budget, his interest rate policy which sent money-center commercial banks hiking the prime interest rate to 17.75 percent March 7, is now fueling the chances for a 1970 Penn Central-style bankruptcy.

Ford Motor company is now being talked about in Wall Street circles as the most likely candidate. According to sources close to the company, Ford will report out a $1.2 billion loss on North American car sales for the first half of this year alone. This threatens hundreds of Ford supplier industries as well scattered throughout the U.S. midwest. At the same time, the problems at Ford have spread to its dealerships in Maryland reportedly preparing to file bankruptcy papers next month.

Even the largest U.S. auto company is not immune, as GM showed a 7 percent drop in sales in the first twenty days of February, despite heavy rebates, and announced last week plans to shut down 4 auto and truck plants and give 6,400 workers indefinite layoffs. The sole response the auto sector has mustered to its liquidation at the hands of Carter and Volcker is for Chrysler head Lee Iaococa to call this week for limiting foreign car imports, currently at 25 percent of the U.S. market, to its 1978 level of 17 percent of the market.

The latest newsletter for the National Association of Homebuilders predicts that housing starts this year will drop to an annual 1.1 million level. This says the NAHB will be 900,000 units below 1977 and 1978 levels, and will cost the country of 1.4 million jobs, almost $25 billion in wages and $6.7 billion in tax revenues—which must be figured as revenue shortfall into the Carter 1980 and 1981 federal budgets.

The problem that Carter's and Volcker's policy poses is broader than either the badly hit auto and housing sector. A potential Ford Motor Company blow-out would intersect a worsening U.S. corporate liquidity picture and the danger of an international credit market blow-out. Unlike last year, when large U.S. companies were fairly flush, this year, the financing needs of large U.S. companies will be strained to the limit. With the bond and stock market shut off to corporations as a source of new liquidity, only short-term commercial paper and 6 month bank loans remain open to corporate treasurers. In January, the volume of this type of financing was together nearly $5 billion—as great as the entire figure for the fourth quarter of 1979. This of course feeds the growth of the monetary aggregates—which Volcker allegedly wanted to stop. Salomon Brothers general partner Henry Kaufman in a widely quoted speech delivered last month in Los Angeles, predicted that, this year, "corporations credit needs will be so large as to prevent funding of liabilities."

Carter, through his interest rate policy, has simultaneously touched off an international interest rate war, whose only consequence will be to make it impossible for Third World countries to get import suppliers credits except at 25 percent interest. If U.S. corporations and the U.S. Treasury are also competing for international funds at soaring rates, no one will be able to get funding. It has been the goodwill of Europe and Saudi Arabia that has held the Eurodollar market above collapse up to this point, and that good will is eroding with each new Carter foreign policy blunder.

Finally, as a way out for Carter, in addition to the unworkable budget cuts, some have proposed credit controls. Indeed, there is a fight in the administration over this issue, with Carter favoring controls on industry, while Volcker favors controls on consumers. Ultimately, both sides are refuted by the simple fact that controls are the fastest way to insure a blow-out of both the domestic economy and international lending. The only sober view of this debate of controls, aside from this magazine, has come, not unexpectedly, from Europe.

Appraising the entire Carter strategy and the proposed controls in particular, the West German *Wirtschaftwoche* ("Economic Week") commented that "American industry is fully opposed to the Carter administration's economic policy. With 18 percent inflation, Carter's house is in disarray. The American population—without being informed of what is really going on—might support credit controls, but would soon see how useless they would be. It is hard to see how Carter could win the presidency under any circumstances."

Indeed.