tional lending policies of the *Grossbanken*, I would have to go along with that. But he will not succeed."

This casual attitude does not so much reflect lack of concern in the German banking community over the possible consequences of Volcker's actions, as it does ignorance of what Volcker will do next. There are European contingency plans in the hopper. These include the issuance of gold-pegged credit instruments at low interest rates, in combination with central bank action to stabilize the gold market. The plans are not much talked about.

The real danger is the situation of the Third World. According to one New York bank economist, the current $1 billion syndication for the Brazilian government is a test case that might lead to great difficulties for the Third World's biggest debtors in obtaining additional funds. Brazil paid out $5.4 billion in debt service during the first half of 1979, or 84 percent of its export revenues during the same period—an astonishing sum. The additional interest charges on LDC debts this year might boost their current account deficits considerably, translating into brutal standard of living cuts in many cases. Commercial bank economists are busy devising their estimates of the 1980 current account deficit from $50 billion to between $60 and $70 billion. These interest charges will have to be paid out at the end of the first quarter of 1980, when, according to Banque Bruxelles-Lambert economist Gérard Vila, great difficulties might be encountered in papering over the deficits.

If Volcker holds off, the continued growth in short-term credit will wreck the Fed's bogus credibility as the last functioning institution and throw the U.S. political game open. If Volcker grits his teeth and plunges forward, he will have entered a political universe in which the meticulous monetary approach of the Bundesbank and the cautious lending operations of the Western European banks will no longer apply—and gold-activation contingency plans will have to be put into effect.

—*David Goldman*

Will the Fed's Volcker

As the stock and bond markets quietly racheted downward this week, *EIR* did some arithmetic on Federal Reserve Chairman Paul Volcker's intent, as reported by his close associates to go for a 5 percent ceiling on credit expansion for the remainder of the year.

For the past two quarters, the rate of short-term credit expansion was 12 percent, the inflation rate was 12 percent, and net growth in output was zero. In the short-term category, commercial and industrial loans

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rose at a 37 percent annual rate while consumer and mortgage rates tapered off considerably. Credit expansion went chiefly for inventory building, takeover finance, and activation of preexisting credit lines usually for relending on the commercial paper market in the form of suppliers' credits.

The difference between the credit expansion rate and the inflation rate can be called the economy's operating deficit with respect to itself. Now, Salomon Brothers' Henry Kaufman has convincingly shown that the rate of short-term credit growth tends to parallel the growth rate of nominal GNP (itself now equal to the official 12 percent inflation rate). This implies that any reduction in short-term credit growth must come directly out of output. A 15 percent cut from the 20 percent expansion rate to reach Volcker's reported target would mean a 15 percent drop in output, and more, since inflation has accelerated even before the latest round of oil price increases. These results parallel the computer-based estimates cited in Lyndon LaRouche's statement below.

Economists differ fiercely as to whether Volcker will go through with this slash. An Oct. 15 survey in the *Wall Street Journal* cites Data Resources analysts as predicting that he will. "A total interruption of the flow of funds to the private sector" will result, they said. Note Volcker's emphasis in comments to the Senate Banking Committee the same day on reducing living standards, and his insistence that the Fed cannot discriminate between speculative and nonspeculative credit. As noted in *International Credit*, "rationer" Volcker does know how to discriminate against small business, homebuilding, and so forth—but not against speculation.

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pull the trigger?

"No objective criteria"

From the question and answer period of Senate Banking Committee hearings Oct. 15 with Federal Reserve Chairman Paul Volcker:

Adlai Stevenson: *It has been suggested that your recent actions were necessitated by development in West Germany, pressure from West Germany. There are hundreds of billions of dollars of Eurocurrencies sloshing about the world. Isn't there a danger that other nations will seek to support their own currencies by raising interest rates? Then the end result will be the same in terms of the relative valuation of currencies, but the result will be less long-term productive investment in the world, thus exacerbating the more long-term structural problems of inflation. Is there a danger of an interest war internationally?*
Volcker: The U.S. actions cannot be traced to West Germany. We do not think there is a danger of an interest rate war. To the extent the West Germans have raised interest rates in the past, it has been in response to justifiable domestic factors.

Stevenson: *The real question though is how are we going to deal with high producer costs, the collapse in productivity without long-term investment. How are we going to have longterm investment with interest rates where they are?*
Volcker: As a practical matter, we don't have that choice.

Robert Morgan: *I am not sure where we are going. Although I agree that you probably had no choice, what are you going to do about the fact that some sectors are going to be hurt more than others and I am particularly thinking about housing here.*
Volcker: We have to keep a longer-term perspective here. ... While there will be pain in the short run, it will be good for the country in the long run.

Morgan: *But there has been a boom and bust cycle in the housing industry for years now. The industry is drying up. There is no money available. There has been a decline in S&L deposits in my state of $32 million. What about the housing industry?*
Volcker: The housing industry has survived this past recession better than any previous one.

Morgan: *How significant are cost-of-living increases in contributing to inflation? Doesn't it have a ratchet effect?*
Volcker: I am inclined to agree. When productivity drops, as it has, there is an overall drop in the standard of living. When some are protected through cost-of-living clauses, it pushes more of the burden off onto others and others are hurt more. When the economy as a whole has to accept a decline in the standard of living, and a certain category has a clause which says "I refuse to accept a decline in the standard of living," then it is going to hurt others.

Paul Sarbanes: *Are you seriously proposing eliminating cost-of-living increases for social security recipients?*
Volcker: I am not talking about complete elimination. But if productivity does not increase, then the question will have to be faced of a partial elimination.

Sarbanes: *I am getting calls from small businessmen in my state who are telling me that they now simply cannot get credit. In your recent speech in New Orleans you told a bankers convention to avoid lending for speculation and to support their customers requirements and draw the line at excesses. How do we know that small businessmen, who are engaged in productive activity, will not be squeezed out by currency or commodity speculators who are willing to pay a higher price for money?*
Volcker: We can only remind the bankers to use their best efforts. The Fed has no regulations by which to make those kind of distinctions in an official regulatory kind of way.

Sarbanes: *Would the Fed be prepared to at least survey the lending practices of banks and highlight speculative lending, hold it up to the public scrutiny, so as to give some assurances to productively engaged businesses that these abuses will be curtailed?*
Volcker: We really have no objective criteria by which to judge the situations and that limits our ability to engage in that kind of practice.

Sarbanes: *But the response welling up from the productive sector may be a growing agitation for credit allocation. I don't advocate that, but that is what may happen.*
Volcker: Credit allocation would cause more distortions in the market than good.

Donald Stewart: *There is legislation introduced in the Senate to provide a tax cut for capital improvement, for the kind of productive long-term investment which has been discussed here.*
Do you support that legislation?
Volcker: I support it in principle, but it is wrong at this time.