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The economy is facing a swift collapse

The unraveling of the U.S. economy, following the imposition of stringent credit tightening measures by Federal Reserve Chairman Paul Volcker on Oct. 6, is proceeding faster than even this publication warned.

The Riemannian economic model developed by contributing editor and Democratic presidential candidate Lyndon H. LaRouche, Jr. projected a percent collapse of the auto industry.

Reports have come in of a 22 percent cut back in U.S. auto production in November from November

DOMESTIC CREDIT

1978 levels; corresponding "adjustments" in the production schedules of steel, rubber, glass, and other of auto's feeder industries; a virtual halt of all new mortgage lending in the nation's capital and other areas of the country with obvious implications for the construction industry; and other signs of an economic depression like that of the 1930s.

But dramatic as these individual developments are, they are merely the surface phenomena in a sweeping restructuring that is taking place in the world's largest economy. As a result of the Volcker measures and coordinated developments—most notably the death knoll sounded for the U.S. nuclear industry by the Kemeny Commission report on the Three Mile Island nuclear "accident"—the United States economy is entering an era of exhorbitant energy costs, a scaled-down and cartelized industrial sector, no savings banks, no long-term capital markets, "employee stock ownership" financial frauds, and a deep plunge in American living standards—in short, all of the elements that characterized the fascist Italian and German regimes during the Great Depression.

Resistance to this "restructuring" is coming from those sectors of U.S. economic life which are first on the chopping block—the savings banks, the construction industry, and small- and medium-sized businesses generally. However, the "Fortune 500" corporations—with the exception of Chrysler and other black-listed companies—have continued to issue public praises for Volcker's "anti-inflation" measures. We can only surmise that this is because these elite corporations expect to come out on top of the heap when the full force of Volcker's "Saturday night special" package hits.

The most recent monetary statistics available, in fact, show that the Federal Reserve has continued to pump out banking reserves to selected commercial banks via its relatively low-cost discount window, despite the talks about cracking down on credit availability. Borrowed reserves soared during October, lifting the growth of total banking reserves to a 24.1 percent annual rate. And sources at the "Fortune 500" corporations report that they can still get bank loans

Financial Times columnist Samuel Brittan is predicting that the next international phase of the U.S. credit crunch will be the advent of tight, cental bank control over the Eurodollar market, in which U.S. multinational banks can look forward to increased margins and a bigger share of the lending market—at the expense of Japanese, West German, and other international banks.

The contradiction between what the major U.S. banks and corporations perceive as their immediate short-term interest and the health of the U.S. and world economy, has never been greater.

Here is what the latest economic developments look like in energy, auto, on the markets and in the nation's financial institutions:

Energy

The availability of expanding sources of cheap energy, upon which capital formation depends, has now been ruled out by the highly publicized warnings against nuclear power issued by the Kemeny Commission during the first week of November. That the Commission did not vote for a complete moratorium on nuclear plant construction is an academic point. As the *Journal of Commerce* noted editorially on Nov. 6, "Talk of a moratorium on nuclear plant construction, mandated by Congress for the NRC, may be irrelevant. The capital market, by denying the industry the capital it needs at a price it can afford to pay, may decide the matter independently."

The de facto moratorium on nuclear plant construction in the U. S. coincided with a new take off in spot

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oil prices from last spring's highs, following the Iranian government's threatened renewed cutoff of oil exports. Our energy analysts foresee a $60 a barrel spot price on the Rotterdam market and a $30 a barrel OPEC benchmark price by Christmas.

Both developments will hit the energy- and capital-intensive sectors of the U.S. economy the hardest as happened after the 1973 oil hoax.

Auto and Steel

Current Federal Reserve policy, meanwhile, is hastening the trend toward a highly "rationalized" and cartelized U.S. industrial sector.

The U.S. auto industry has responded to what one auto executive termed the Fed's "erratic and contradictory economic actions" and the resulting 21 percent slide in domestic auto sales in October by slashing its November production schedules by 22 percent from year-ago levels. With the announcement of another 10,300 layoffs by Ford Motor effective Nov. 5, there are currently about 90,000 auto workers out of work.

A secret memo circulating among top-eschelon auto exectives, which was obtained by this publication (see our last issue for coverage), predicted a 20 percent cut in the auto workforce by the end of the year—300,000 layoffs—and advised the auto executives to gird for conditions worse than the 1957 recession.

The plight of the consumer credit-dependent auto industry was dramatically illustrated by the recent announcement by General Motors, the best-off of the companies, that it ran at a loss during the quarter ending Sept. 30—that is, before the worst hit. GM's actual operating loss for the quarter was $200 million. A set of tax write-offs managed to give the corporation a book profit of $21 million.

The contraction of the auto industry has immediate ramifications for steel, which ships over 20 percent of its finished product to the auto industry. The planned 22 percent cutback in auto production this month means a 4-5 percent drop in overall steel consumption, according to industry analysts.

Steel is simultaneously being hit by a collapse in orders from the construction industry—also hard hit by the credit crunch—and capital good producers.

During the last week of October, steel producers in the Pittsburg district, the nation's second largest steel-producing region, poured only 407,000 tons of raw steel, less than half of the regions 831,000-ton capacity. Peter Anker of First Boston, the most quoted steel industry analyst on Wall Street, said in an interview that it would be wrong to interpret the below-50 percent-capacity rates in the Pittsburg region as a precursor of what is to come nationally, however. "The steel producers are putting very little capital into that area," according to Anker. In other words, the steel industry has already written off many of its antiquated facilities in Pittsburg, Youngstown, and neighboring steel towns.

Financial Institutions and Markets

An equally sweeping restructuring of the nation's financial institutions and markets has been unfolding, especially since Oct. 6. Volcker's astronomical interest rates have done as yet untold damage to the saving bank industry. Caught in the squeeze between the escalating cost of money and fixed-rate mortgage assets, even industry veterans like the New York Bank for Savings operated at a loss for the first time in their history during the second quarter of this year. The Federal Deposit Insurance Corporation, which, incidentally, is probably the most under capitalized financial entity in the country, is drawing up contingency plans for merging the weaker savings banks and savings and loan institutions into the commercial banks.

This eventuality is part of what bank analysts call the "homogenizing" of the banking system—a "blurring" of distinctions between savings banks, commercial banks, credit unions, and so forth, in which the housing market-oriented savings banks disappear.

The "homogenizing" that is left undone by the "market place" will be taken care of by pending banking legislation. The Federal Depository Institutions Deregulation Act, which passed the Senate by a margin of 67 to 17 on Nov. 1, would permit the issuing of "NOW" accounts (interest-baring checking accounts) nationwide by all types of banks, compel savings banks to hold reserves with the Federal Reserve for the first time in history, and phase out Regulation Q.

Regulation Q places federal interest rate ceilngs on savings deposits, giving savings banks a quarter point rate advantage over commercial banks. Both the institution of Reg Q and the outlawing of interest-bearing checking accounts date from the 1930s, and both measures were specifically introduced to stabilize the banking system and protect a housing-oriented savings bank sector. In tandem with eliminating Reg Q, the pending dereg bill would override state usury laws on business loans of more than $25,000 until mid-1981.

The bitter irony is that this banking "deregulation" bill, which was sponsored by Sen. William Proxmire (D.-Wisc.), is one facet of a broad package of banking measures in the works which would lead to a much more highly regulated and controlled national and international banking system.

As a result of the cut-throat competition unleashed by the pending bill, only a dozen or so banks willremain standing; they will be tightly controlled by the Federal Reseve, which in turn will be tightly bound to the International Monetary Fund (see Congressional Calendar).

The future of the long-term capital markets as we

know them is also completely up in the air at present. Last week the Dow Jones wire carried rumors that the life insurance companies and other major institutional investors are about to pull out of the equity market for higher yielding money market instruments.

In keeping with Fed Chairman Volcker's predictions of a coming decline in American living standards, the new source of investment—read, bail out—funds in the economy is to be wage earners' saving. A feature article in the Nov. 5 *Financial Times* of London cited the proposed "final solution" for bankrupt Chrysler—federal loan guarantees, real wage cuts, and a pension fund bail out—as the precedent for dealing with all of the weaker American industries (see Transport column).

Meanwhile, an Oct. 25 press release from the Office of Management and Budget indirectly revealed that the federal budget deficit is now being financed by a iombined cut in living standards and consumer installment borrowing. According to the OMB, the U.S. budget deficit is down by $9.7 billion from projected levels to $27.7 billion. This is due totally to an unanticipated rise in revenues of $10 billion. That rise in turn was totally the result of inflation pushing households into higher tax brackets.

—Lydia Schulman

Looking to employees for the bailout

Prototype employee stock ownership plans (ESOPs) are now in the works as integral parts of bailout packages for two corporations on the brink of liquidation—Chrysler Corporation and the bankrupt Milwaukee Railroad.

TRANSPORTATION

Under this corporatist plan, employees would be given representation on corporate boards in return for equity purchases, to be paid for variously by payroll deductions and direct worker investments.

In the case of the Milwaukee Road, the railroad has already proposed to abandon two-thirds of its track and shrink its operations to a 3400-mile core system. To forestall this, Congress passed a bill temporarily subsidizing the full Milwaukee system, providing that the interested parties devised alternative financial and system plans by December 1. By then it is expected that a consortium of employees, shippers, and outside investors centered around a group called New Milwaukee Lines, Inc. will submit a de facto takover plan. This ESOP-type formation would inject capital in the Milwaukee Road, while simultaneously paring its least profitable branch lines. With the gathering recession reducing commerce, however, the scale of cutbacks will necessarily approach the original abandonments proposal—and employees and shippers will be stuck with a bankrupt railroad.

Corporatism at Chrysler

In a first for a top U.S. corporation, United Autoworkers President Doug Fraser was recently elected to the Chrysler Board, in exchange for a contract where Chrysler workers will receive $203 million less than other auto industry workers over the next two years. Not only did Fraser agree to a 3 percent annual pay increase but the awarding of the increase itself will be delayed six months in the first year and for several months in following years.

At the same time, cost-of-living increase earned by Chrysler workers under their old contract will be delayed until December 1980, and thus will not be counted in the base pay of Chrysler employees.

The contract also allows Chrysler to defer $200 million in payments into the union pension fund, eliminating part of already slated pension increased for Chrysler pensioners. At congressional hearings several days before the announced agreement, Fraser also offered to loan almost all of the Chrysler workers' $850 million pension fund to the company provided government guarantees were given for the investment.

The UAW's magnanimity is in sharp contrast to the banking community's refusal to extend further loans. Further unsecured loans are not "feasible to the banking community," Manufacturers Hanover Trust's Chairman John McGillicuddy said in his congressional testimony.

Following the announcement of the Carter package, the banks agreed once again to waive default clauses on $800 million in loans to the auto maker, despite the fact that Chrysler's working capital has fallen to a new low of just over $300 million.

The loan guarantee plan requires Chrysler to raise an additional $1.5 billion in unguaranteed funds through more borrowing and sales of assets.

Furthermore, it is widely expected that an amendment mandating a full-fledged ESOP will be attached to the administration's proposal. The UAW's reaction? "We are not opposed in principle to ESOPs," said one Washington-based UAW spokesman in an interview, "and will go along with the expected amendment to the Administration's bill."

—Steve Parsons