# A declaration of national emergency?

by David Goldman

An economist with close personal ties to Treasury Secretary-designate Donald Regan describes the Washington scene as "up for grabs," following a Dec. 17 statement by a Reagan spokesman that the President-elect is "seriously considering" a declaration of national emergency after inauguration. In some press discussions, the "national emergency" formula has been identified with the Republican group around Rep. Jack Kemp, with reference to a report that Kemp and OMB Director-designate David Stockman (R-Mich.) submitted to the transition team last month. The memo, entitled, "Avoiding a GOP Economic Dunkirk," was made available to *EIR* by Republican sources.

## Ready-made emergency

Although the Kemp-Stockman statement became a point of departure for public airing of the issue, the fact is that Federal Reserve Chairman Volcker has already ensured that the new administration will face emergency conditions upon taking office.

The interest-rate skyrocket will force a severe economic downturn during the first quarter, with the predictable disastrous consequences for the Treasury's tax base. Once the real economic collapse enters the expected second phase, interest rates will fall off, provoking a crisis in the foreign exchange markets as the dollar falls off sharply. The terms of the emergency are already set, however Reagan chooses to qualify it.

At this point, it would be useless to dissect Reagan's cabinet choices in order to obtain hints of what future policy will look like. Merrill Lynch Chairman Donald Regan was chosen by process of elimination, after Reagan and his team refused to accept hard-line followers of Milton Friedman like former Treasury Secretary Bill Simon or Citibank Chairman Walter W. Wriston, rather than for any special policy objective.

Regan has publicly defended the Fed's high interest-rate policy as the price of inflation—although high interest rates are a principal *cause* of inflation—but other Reagan spokesmen have indicated the opposite during the past week. Edwin Meese, the transition team's chief spokesman, said Dec. 17 that interest rates had risen too much and that the new administration would take some (unspecified) action to bring them down, a vague but important nod to the growing lynch climate in the country against Fed Chairman Volcker.

## The Austrian school

Volcker's perspective was summarized by the Austrian economist Friedrich von Hayek in a recent interview, in which he stated: "Sooner or later you must go through this very unpleasant process of stopping inflation, incur all the exceedingly painful consequences—temporary large-scale unemployment, numerous bankruptcies—in a period of something like six months *and get it over with before opposition can organize sufficiently* *to force you to stop the process."*

The Federal Reserve's objective, as *EIR* reported in a Dec. 16 cover story, has nothing to do with containing inflation, which it is in good part responsible for. Rather, the Fed foresees a gigantic fire sale of American assets devalued both by depression and by the relative decline of the dollar. The package that accompanies the 20 percent-plus interest rate, including the so-called International Banking Facilities, banking deregulation, electronic funds transfer through the New York Clearing House, and other plans treated in depth in the cited *EIR* cover story, facilitate this design.

The mooted declaration of national emergency would either be a vehicle to carry off a Hayekian "stabilization crisis," in the academic euphemism, "before opposition can organize sufficiently to force you to stop the process," or to stop the crisis before it gets under way.

This is the context in which to understand the Kemp-Stockman memo. Were the report followed to the letter, the aging Friedrich von Hayek would have a second opportunity to write books praising and defending a world depression. Two parameters show how the Kemp-Stockman proposals would create a blowout if adopted as written. One is monetary policy; the second is energy policy.

First, "President Reagan should meet with [Fed Chairman] Volcker or the entire Federal Reserve Board at an early date and issue them a new informal 'charter'—namely, to eschew all consideration of extraneous economic variables like short-term interest rates, housing market conditions, business cycle fluctuations, etc., and to concentrate instead on one exclusive task: bringing the growth of Federal Reserve credit and bank reserves to a prudent rate and stabilization of the international and domestic purchasing power of the dollar," the memo concludes.

The above contains in a nutshell the proposal circulated by Louis Lehrman, a possible appointee to a high treasury post, who has gotten in with the Kemp group. As *EIR* noted in some detail last week, the Lehrman plan is acknowledged to imply a Hayekian crisis. After the interest-rate cycle has created self-feeding credit demand (see Domestic Credit), slamming the brakes on monetary expansion as proposed above would blow out the economy—especially if, as Lehrman proposed, the Fed makes discount window credit available only at a punitive interest rate.

Although Lehrman, whose family made its fortune through a drugstore chain, sold this plan handily to the Kemp "supply-side" group, close Lehrman associates think it too deflationary to be acceptable. Although Lehrman sold it as a proposal in the tradition of the great French economist Jacques Rueff, its generic name is Austrian School.

Second, Stockman took as a given—a month before the latest OPEC $10-per-barrel price rise—a jump in the oil price of that magnitude. Stockman insists that these price increases must become a tax against consumption: "Demand for these basic commodities is highly inelastic in the very short run; and this generates strong credit demands from both the business and household sectors to finance existing consumption levels without cutting back on other expenditures. If the Federal Reserve chooses to accommodate these credit demand shocks, as it has in the past, then in the context of the massive federal credit demand and financial market disorders . . . only one result is certain: the credibility of monetary policy will be destroyed. The Federal Reserve will subsequently succumb to enormous internal strife and external pressure, and the conditions for full-scale financial panic and unprecedented global monetary turbulence will be present."

## Bottom line

The bottom line of the "new charter" that Reagan should, in Stockman's view, issue to the Fed, is that "insulation of the Fed from extraneous economic and financial preoccupations, political pressures, recalibration of its monetary objective, and restoration of its tattered credibility is the critical linchpin in the whole program." As for energy prices, Stockman not only believes they will rise, but includes the impact of a big oil-price rise in his tentative budget estimates through the additional revenues available through the windfall profits tax.

While Stockman argues that the only cure for the out-of-control federal budget is economic growth, his monetary and energy demands could only deepen the present depression!

"Elimination of deficits and excessive rates of [government] spending growth can only be achieved by sharp improvements in the economic indicators in the next 24 months," to reduce $26 billion of what Stockman calls "soup-line expenditures" and broaden the treasury's tax base. Almost all the report, except for some of the substantive proposals, centers around this argument that only economic growth can work. What Stockman proposed to stimulate growth—a 10 percent tax reduction which will not even compensate for the inflation-linked rate of increase in taxation—is a less than convincing counter to the brutal energy and monetary policies cited earlier.

But it would be foolish to dismiss the *tone* of the report as irrelevant. The sharp insistence on economic growth, however much at variance with the substantive proposals, tells us something fundamental: that this is the basis for any reasoned discussion with President-elect Reagan. That is more important than any particular proposal at this stage of the game.