# Stockman and Regan plan 'Black Thursday'

by David Goldman

No sensible person acquainted with the facts of what is now happening in Washington doubts that Office of Management and Budget Director David Stockman and Fed Chairman Paul Volcker are preparing a hard landing for the American economy. Doubt evaporated last weekend when the *New York Times* revealed that it was David Stockman who told reporters "on background" to expect a crisis "that will make the 1930s banking crisis look like small potatoes" in the thrift institutions and life-insurance sector. Stockman's intervention prompted second-level officials to volunteer their own scenarios.

What is less generally known is the extent to which the OMB has planned for a period of major bankruptcies and high unemployment. According to sources close to Stockman's old sponsor and housemate at Harvard University, Sen. Daniel Moynihan (D-N.Y.), Stockman is covertly supporting the institution of a Reconstruction Finance Corporation (RFC), which the New York senator will introduce this week. Although Stockman is sympathetic to the proposal, he will not yet publicly support it. The OMB director will wait until major sections of industry are on the ropes, and then support the RFC plan under the terms Moynihan is putting it forward: that its task is *not* to reconstruct older industries, as under the New Deal, but to phase them out—a sort of industrial hospice.

Reversion to an ugly and inappropriate form of government economic intervention is, in fact, widely mooted on the fringes of the administration. Dr. Robert Kilmarx of Georgetown University's Center for Strategic and International Studies, which sent a dozen staffers into the administration, envisions a return to directed industrial investment, motivated by urgent defense requirements. The National Industrial Defense College's Assistant Dean John Ellison reports that the Pentagon is considering using Presidential Review Memorandum 57—which permits the President to take over direction of the economy through the Federal Emergency Management Agency under conditions of national security emergency. "This is one of the more upbeat aspects of our program," Ellison told *EIR*.

What Stockman and his collaborators envision is a retread of events in Britain under the guidance of Margaret Thatcher, which will ultimately reduce inflation at immense cost in the form of high unemployment, widespread bankruptcies, and lost production. For all Stockman's pre-inauguration disclaimers against "root-canal economics," that is the present course of OMB and Federal Reserve policy. The Treasury Department is on board with a triage program for the thrift institutions.

## 'Weaken credit dependence'

"Margaret Thatcher finally reduced credit demand after there were a lot of bankruptcies," said an economist at U.S. Trust, a Wall Street firm with close ties both to Britain and the Federal Reserve through the elite Ditchley Foundation. "The same thing is going to have to happen here." By warning that the "equity [of the thrift institutions] has been wiped out," and that the life-insurance companies would face a 1930s-style bank run, Stockman began the first phase of this scenario.

The problem, said Crocker National Bank economist Frederick Berger, is that "the markets haven't adjusted" to the Fed's new monetary policy. "Corporations didn't believe that it was going to be so rough, that the prime rate would rise so high—but Volcker did. And at the beginning corporations were borrowing at the same rate that they did before. The problem is that corporations, and the general public, don't understand the new monetary policy. The new policy intends to weaken dependence on credit." But eliminating dependence on credit means that the second tier of the corporate sector will not make it through.

Apart from the dire situation in the thrift industry, the illiquidity crisis *EIR* projected on Nov. 11 ("First-Quarter Downturn for the U.S. Economy") is showing up in the industrial sector, e.g. in International Harvestor's scramble to refinance a debt burden that increased 60 percent over 1980. More poignant is Ford Motor Company's effort to increase cash flow by selling steel on the commercial market it used to produce to make autos. Ford now sells 60 percent of the steel it makes, about what proportion it used to devote to auto production.

What the Reagan administration is now being told was summarized bluntly by Carnegie-Mellon University monetarist Allan Meltzer in a recent interview. Meltzer said, "The decisive issue for the success or failure of the Reagan administration will be that they come out of the recession with their policy still intact. That is, they must get through the recession without having another very large runup in government expenditures. And the reason is that this is not the first time that a government has promised to end inflation. The problem is that when they start to end inflation, they cause a recession. During the recession they forget about their policy to end inflation, and they begin to take their economy out of the recession, and that produces even higher rates of inflation. People have learned that this is the experience of the U.S. government and other governments, but they don't want to believe the policy has changed until they see that it actually has changed."

Turning back to the British example, this is the inspiration for Sir Geoffrey Howe's new budget, which adds new spending cuts and taxes to an already deflationary fiscal stance. Despite unemployment of 2.5 million going on 3 million, and the first instances of widespread starvation since the 1930s, Howe is committed to an even more intense monetarist crunch. What is significant in the present British position is not merely the evidence of where monetarist policies lead—gasoline is $3.00 per gallon and cigarettes are $2.20 a pack—but the way the economic debate parallels what Stockman and Moynihan are working out for the postrecession cleanup.

Labour Party economic adviser and Oxford economist Walter Eltis put the question more clearly than any American commentator in the March 8 London *Sunday Times*. His article bore the title "What Sir Geoffrey Howe should learn from Hitler." Eltis notes that under the present regimen, unemployment will rise by 50,000 per month. Where Britain's future is concerned, manufacturing investment will fall by 15 percent this year, after falling 15 percent during 1980. Howe "should try to do for industry what Hitler did for the German army in the 1930s. . . . He used the opportunity that the German slump provided, of massive spare resources which were not needed for consumption. We could do the same, only it is future battles in export markets we shall wish to win."

Eltis contends that what Thatcher has done was necessary to lower inflation and, more importantly, to lower consumption. Once that freed up resources, then these may be directed into investment forcibly.* Eltis is speaking here of peaceable uses. But should the United States government invoke PRM-57, as Pentagon industrial planner John Ellison suggests, the result might be much closer to the letter of Hjalmar Schacht's policies than anyone is presently willing to suggest.

## The historical record

I argued in this space last week that the monetarist program Stockman, Donald Regan, and above all Paul Volcker imposed on President Reagan was designed to fail in its stated objectives, that is, that the "supply-side" growth policy was a setup for a financial crash. Historically, no monetarist policy has lasted long in power because, as William Buckley commented 10 years ago, "It is possible that Milton Friedman's policies suffer from the overriding disqualification that they simply cannot get a sufficient exercise in democratic situations." Hoover was followed by Roosevelt, Brüning by Hitler, and Poincaré by the Popular Front—three different solutions to the monetarist problem.

In Britain, "Social Democrat" Roy Jenkins, former Labour Chancellor of the Exchequer and high European Community official, is already propagating the Eltis program as the possible basis for a "center" government to replace Thatcher, including the Liberals and the Edward Heath Tories. Should this combination succeed, it would have important bearing on American politics.

Which way out will Reagan take? He can adopt the set of proposals Europe has offered him (see International for French President Giscard's blunt condemnation of monetarism). Or his own fine intentions will dissolve into the type of chaos Herbert Hoover went through. But unlike the 1930s, the consequences of the wrong choices may not be reversible.

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*The argument that this is the hidden agenda of monetarism is made in *The Ugly Truth About Milton Friedman*, by Lyndon H. LaRouche, Jr. and David Goldman, released in January by New Benjamin Franklin House.