The President and the interest-rate battle

by Richard Cohen

In the weeks leading up to the July 21 Ottawa economic summit, President Reagan and his closest political strategists will face the decisive question of their first year in office. White House observers report that the justification for the recent Social Security debacle and a publicly mooted second round of budget cuts was the acknowledgement a week and a half ago by Reagan advisers, including Chief of Staff James Baker III, that high interest rates will continue to force upward adjustments in the administration's projected budget deficits for fiscal '81 and '82. The question here in Washington is whether the administration will judge these ever-increasing cuts mandated by Volcker to be politically intolerable; or will they, as recent signals indicate, attempt to buy a short-term compromise package in conjunction with the Congress, in an attempt to hold the line until the critical September-October period in the budget process.

Sources close to the House Democratic leadership reported that Speaker of the House Tip O'Neill is convinced that the administration will choose the latter course, and is already preparing his forces to conduct "guerrilla warfare" against a number of the proposed cuts in social programs. O'Neill is said to be pledged to this course even if there is a compromise on the tax side of the Reagan program. These sources further confirm that O'Neill's assaults on the administration will provide the headlines around which the U.S. branch of the Socialist International is planning widescale demonstrations this summer and fall against the budget cuts.

In an important move, House Majority Leader Jim Wright, the behind-the-scenes organizer of the large bloc of moderate House Democrats, publicly broke with the O'Neill strategy May 24 on national TV. Probing whether Reagan had yet concluded that a break with the Volcker interest-rate policy was necessary, Wright offered the administration a bipartisan tax compromise in conjunction with a full-scale effort to force down interest rates.

Wright denounced the current "exorbitant," "usurious" interest rates. "Volcker says you bring down interest rates by lowering the deficit, but you can't lower the deficit under the present plan." Both tax policy and credit policy, Wright indicated, must be determined by the necessity "to have capital formation, and modernize U.S. industry through investment." "The President is a good American. When interest rates are so high, it adds 13 billion to the deficit," Wright added.

A new and crucial element was the announcement last week of large demonstrations to be held in Washington, D.C. this month protesting high interest rates. White House politicos who watched the "Social Security disaster" emerge from an overwhelming negative constituency response will have to take note when organized elements of labor and small business, the very constituency which elected the President, ask the White House to take immediate action to lower interest rates. These demonstrations, organized by the National Coalition to Reduce Interest Rates, may also provide anti-O'Neill Democrats


Stuart Lewis/NSIPS

Helmut Schmidt and Ronald Reagan at their May meeting in Washington.

with the necessary clout to open up a high-profile lobby on interest rates with the White House.

When Democrats helped en masse to pass a Reagan-sponsored House Budget Resolution, the White House was privately and publicly told that their accomplishment was not enough to "calm the fears of the market." Under the auspices of Volcker, interest rates did not begin a steady decline as President Reagan was told they would, but instead held firm before beginning a steady rise. Simultaneously, inside sources began to report that such administration stalwarts as Alan Greenspan and Arthur Burns warned that the market (i.e. Paul Volcker) was not satisfied that the administration could hold to its reduced budget deficit projections. In fact, Greenspan's appraisal was leaked in such a way as to send jitters through the market.

Two days after President Reagan's massive triumph in Congress, Volcker and Greenspan had created panic. Volcker's men inside the administration, OMB director David Stockman, and domestic policy chief Martin Anderson, immediately approached the President along with Health and Human Services Secretary Richard Schweiker and persuaded Reagan to propose serious cuts in the Social Security program, which comprises one-fifth of the federal budget. At the same time, Stockman unleashed his budget raiders to find additional cuts in the fiscal '81 and '82 budgets.

Volcker, Stockman, and Greenspan had by then successfully connived to commit President Reagan to a second round of budget cuts plus a full-scale assault on Social Security. The calamitous result, which saw the President's efforts on Social Security rejected 96-0 on the Senate floor last week, was not lost on Reagan's political advisers. Early this week, White House sources put out reports that the triumvirate of Meese, Baker, and Deaver had not been adequately informed of the Social Security decision and would have vetoed it if they had been. Whether or not that story is true, one thing is clear: the dominant group among Reagan's advisers has publicly distanced itself from the earlier decision. Close observers are still waiting to see whether Reagan's political advisers recognize the more profound point of the Social Security exercise. First of all, will they see that they were manipulated and set up by Volcker, Greenspan, and officials within the administration? More importantly, will they recognize the vulnerability of the principles of their own economic program upon which they were manipulated?

As Reagan's Social Security program was unveiled, James Baker was supplying the reasons in an interview with the Newhouse chain last week. Baker reported that higher-than-expected interest rates had thrown out of whack the fiscal '81 budget deficit projections supplied by the Carter administration. According to Baker, an additional $5 billion had to be located by Stockman and his "raiders" to balance the deficit. The impression Baker left was that underestimation of the '82 deficit would also require higher future budget cuts.

Late last week, the White House staff and the President himself sent out unmistakable signals that a compromise on the administration's tax proposal was now on the agenda. All the administration asked was that House Ways and Means Committee Chairman Dan Rostenkowski (D-Ill.) make the first move. The administration's new-found eagerness for a compromise on Kemp-Roth was inspired by their quick failure on Social Security cuts. The shape of the emerging compromise bill will probably show a maximum first-year across-the-board tax cut of only 5 percent as compared with the President's original 10 percent request. While skirmishing continues on the rest of the compromise, it is clear that the administration will judge this probable $10-$15 billion saving as a necessary buffer pending final budget activity in September and October. The savings can be used to absorb the additional cost of continued high interest rates. Sources close to the Senate Democratic leadership say that such a compromise could only be short-term, and on the next budget round the administration would have to come face to face with the interest-rate problem.

That problem was brought to President Reagan's doorstep last week not only by the apparent widening budget deficit, but by West German Chancellor Helmut Schmidt. Sources close to the meetings between Reagan and Schmidt reported that the bulk of time was spent on the implications of high U.S. rates on all the Western economies. Chancellor Schmidt, urgently attempting to stabilize the West German economy, is known to have urged Reagan to take steps that would lead to the lowering of interest rates. The chancellor commented at a National Press Club briefing last week after his two meetings with Reagan that the question of interest rates would be a principal topic at Ottawa.

The Schmidt statement indicated that at least he had not been rebuffed by Reagan on his request for relief on the interest-rate question. Observers believe that for the chancellor to go on the record reporting the likelihood of substantive talks on interest rates at Ottawa meant that he had received a clear signal of the President's own deep concern on the matter, noted in the final communiqué, in which Reagan recognized the implications of "U.S. economic policy on the Western economies."

International concern intensified when, as the President was meeting with Schmidt, Treasury Undersecretary Beryl Sprinkel, speaking to the International Monetary Fund meeting in Gabon, and Treasury Secretary Donald Regan, speaking on Capitol Hill, simultaneously reported that the prime rate would remain above 15 percent into next year.

Reagan will once again be reminded that he has an alternative when he meets with Mexican President López Portillo June 8-9. Mexican sources report that López Portillo will confront Reagan with the disastrous effects of high U.S. rates on the Mexican economy.

Interview

Operation Prime Cut targets Paul Volcker

The following is an interview with Walter Kelly, Jr., co-chairman of Chrysler-Plymouth Auto Dealers Council of the United States, who operates a Chrysler-Plymouth dealership in Marietta, Georgia. On May 13, Mr. Kelly and Lee Auge, chairman of the Dodge Dealer Advisory Conference, sent a joint letter to every Chrysler-Plymouth and Dodge dealer in the country, urging them to join "Operation Prime Cut," that is, to urge their congressmen to immediately address the issue of high interest rates. Anita Gallagher interviewed Mr. Kelly for EIR.

EIR: Mr. Kelly, what is Operation Prime Cut?
Kelly: We are about to die because of high interest rates. I am 58 years old, and have been an auto dealer for 30 years. I am what you would call "middle business," and I do $15 million in business a year. The federal government is trying to put me out of business. Who is going to replace my taxes? I support 400 people. Who is going to replace that business?

I know that you are aware that the Federal Reserve answers to no one. If you have a stubbed toe, they are proposing to cut off the leg.

EIR: How did this campaign come about?
Kelly: Mr. Lee Auge, of the Dodge Dealer Council—we represent the Plymouth-Chrysler dealers, and Mr. Auge [represents] the Dodge dealers nationwide—the two of us came up with the idea that we should at least let Congress know what the federal government is doing to the auto industry. You know that the auto industry supports one out of every seven people in the country, even now, as bad as things are. We could get across a consciousness of this problem to the congressmen.

EIR: What about going to President Reagan on this?
Kelly: Well, I am a born and bred Democrat, but Carter was not a good President. One of the better Republican Presidents, Calvin Coolidge, said that "the business of the country is business." We have a situation now where the business of the country is government, and the government is taking 25¢ out of every dollar in interest costs. That's why we are asking every dealer to send 25¢ to their congressmen.

My own personal opinion, and this is not anybody's