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Domestic Credit by Richard Freeman

Bankruptcy and illusion

The significance of four recent Chapter 11 bankruptcies has been underplayed by the press and the Fed.

While certain analysts on Wall Street are frantically searching for the proverbial needle in the haystack, i.e., the evidence that the economy is emerging from recession, they are missing two essential points.

First, between April 13 and April 26, four major U.S. firms with half a billion dollars or more in annual sales have gone bankrupt. Second, Federal Reserve Board Chairman Paul Volcker is in the process of tightening, not loosening, the supply of credit.

The bankruptcy picture marks a qualitative change in the U.S. situation. Previously, most of the bankruptcies were in the range of corporations with less than $1 million, with an occasional firm of $10 to $100 million in assets. But the bankruptcies that struck during late April were all in the top 5000 companies.

Many bankers have said that there is no danger of chain-reaction corporate bankruptcies as long as a given bankruptcy, no matter how large, "was known and expected in advance." However, of the four bankruptcies that have recently occurred, only that of AM International, the former Addressograph-Multigraph Company, could be said to have been anticipated.

A quick review of those four bankruptcies shows the potential problems they pose.

AM International: AM, which produces electronic addressing machines, copiers, and phototypesetting equipment, filed in Federal District Court in Chicago on April 13 for a Chapter 11 bankruptcy in which it would be allowed to cancel $254 million out of the more than $400 million in debt it owes to creditors. Under Chapter 11, a company is permitted to continue operating under existing management with court protection from creditors while it tries to work out a plan to pay its debt. But AM, which lost $245 million in 1981 on sales of more than $600 million, is fairly certain it can't meet any of its debts to banks, which total $254 million.

Saxon Industries: The producer of paper products and photocopier machines filed for Chapter 11 bankruptcy on April 14, in New York Federal District Court. The company, which listed assets of $500 million, stated that it has liabilities totalling $461 million. Saxon's Vice-president for Law, Jay Jacobson, reported April 14 that Saxon's largest expense has been interest payments, forcing it into bankruptcy.

Wickes Companies: One of the largest lumber and furniture retailers in the country, Wickes has been particularly hard hit by the depression. It filed for bankruptcy in Los Angeles Federal District Court on April 26. Wickes is one of the 100 largest companies in the United States, with $4 billion in annual sales. It owes $2 billion to a gigantic list of creditors. According to its new chairman, Sanford Sigoloff, it will "conservatively" take Wickes at least three years to recover and come out of bankruptcy.

RedBall Inc.: The nation's sixth largest trucker, this trucking company, with $460 million in revenue in 1981, filed for Chapter 11 bankruptcy in Houston Federal District Court on April 26. RedBall cited the downturn in the economy, and the effects of trucking deregulation, as the reasons for its collapse. RedBall, according to its parent company, Telecom, will be stripped down to one special commodities operating division.

The U.S. financial press has attempted to downplay the significance of these four bankruptcies. But in the event that the companies do not substantially repay their debt, as is certainly the stated case of AM International, then banks and other creditors will be stuck with nearly $3 billion in bad paper. This cannot be easily written off.

Nor have the small-scale bankruptcies stopped. For the latest reporting week ended April 22, bankrupt firms totalled 511.

And Volcker is showing no sign of really easing interest rates. The increase of the official money supply to nearly $454 billion for the week ending April 21 has given the Fed the excuse to keep federal funds in the range of 14.5 to 15.0 percent. After an eight-week constant level of business borrowing from banks, in the first three weeks of April it rose $4 billion, putting pressure on banks for funds. A Chase Manhattan Bank official said on April 26, "We have had three different people talking with the Fed, including a Senior Vice-President of the Fed, and the Fed has told us that Volcker will remain tight."

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