

## IMF's De Larosière demands: Slash budgets, raise taxes

by Richard Freeman

Speaking on Aug. 27 in Innsbruck, International Monetary Fund czar Jacques De Larosière called for an immediate "consensus" to halt the growth of domestic public debt of Western countries. De Larosière put his finger on the major weakness in the industrial nations, the explosive growth of public as well as other industrial sector debt, which could fissure the world monetary system. By presenting a generalized debt crisis in the industrial sector, De Larosière emphasized that this crisis is every bit as severe, and perhaps more so, than the Third World debt crisis, a point that *EIR* founding editor Lyndon LaRouche has stated in these pages more than once this year.

Holding out the threat of a blow-out of all Western nations' government debt, De Larosière warned that if they don't behave, the leading industrial nations in the Group of Seven—Canada, United Kingdom, France, Germany, Italy, Japan, and especially the United States—will be hit with adverse "psychological reactions" which will bring on a short-selling of Treasury securities—a breakdown of the Treasury market which these governments will be hit with anyway.

### "Nothing untouchable"

The IMF chieftain said that growth in federal government debt is unsustainable in the long run. Warning that later it would be "politically difficult" for governments to implement the necessary steps, he urged in substance that all expenditures be cut drastically now; "nothing can be considered untouchable, including social and welfare payments," he

added. "No group should be insulated" from such a policy. Either the growth of public debt is stopped now through drastic austerity or "it will be stopped, as in the past, by a new burst of inflation with all the social, political, economic disarray that accompanies it. What is at stake here is monetary stability and the soundness of institutions."

Like some predatory animal closing in on its prey, De Larosière senses that the advanced sector has worked itself into a debt corner that nothing short of a fundamental transformation of monetary relations can get it out of. Therefore, he is ready to grasp the advanced sector in his "conditionality" claw.

Few who heard De Larosière's speech at the International Institute of Public Finance in Innsbruck, could fail to miss the timeliness of his utterances, especially with regard to the United States. At the end of August, the largest savings and loan association in America, the Financial Corporation of America, blew apart, despite its hasty reorganization by the government over the previous weekend. It had to be stitched together with a \$2 billion infusion of cash from the Federal Home Loan Bank Board and Freddie Mac.

The fourth largest commercial bank, Manufacturers Hanover, started doing a credible imitation of the beleaguered Continental Illinois, and sucked up to \$3 or \$4 billion from the Federal Reserve's emergency discount window (see *Banking*). The \$5.3 trillion public, corporate, and consumer debt structure of the United States began rocking to and fro like an old dried out tree ready to snap in the wind.

De Larosière sketched the dilemma the Western governments find themselves in: The mercurial growth of debt service, fed by Federal Reserve Board chairman Paul Volcker's five-year diet of double-digit interest rates, causes budget deficits to spiral out of control. Even were revenues and expenditures to remain the same and be in balance, budgets would still be in deficit because of swelling interest costs.

Of course, De Larosière makes scant mention of the Federal Reserve. Instead, like the dark-souled monetarist that he is, De Larosière puts the blame on too much government spending and "fiscal laxity."

"Over the past two decades, several factors brought about an attitude of fiscal laxity on the part of policymakers of many countries.

". . . The prevailing mood of the time created high expectations of the role that governments should play with respect to income maintenance, job creation, and income distribution. . . . Increasing subsidization of public services made them cheap to the users, thus raising the demand for them. Governments were led to spend progressively more to prevent a deterioration of their quality."

De Larosière has plans to reduce everything to chaos. "So-called entitlements must be scrutinized"; "[inflation]-indexation or other mechanisms cannot continue" for social security or the elderly; taxes and the cost of services must go up.

This, of course, is the same blast Walter Mondale is delivering against President Reagan, in conjunction with Swiss financial interests. One would think that "De Larosière for Mondale" bumper stickers will soon appear.

De Larosière, who would have been happy serving as a cost-accountant at Auschwitz, archly opines: "People came to feel that they had almost a natural right to cheap or free health care, transportation, communications, and so forth."

What is otherwise most obvious is that the "medicine" De Larosière prescribes is in fact the cause of the disease in the first place: Exorbitant interest rates and the implementation in the Western nations of precisely the austerity that De Larosière has recommended—the indiscriminate cutting of infrastructure, and contraction of industry and agriculture—are the twin causes of the budget deficits eviscerating the advanced sector.

But ideology aside, De Larosière does pinpoint the dynamic of the danger *inherent* in the leapfrog of government debt. Two tables of the several De Larosière presents in his speech were most revealing. One of them showed that in most countries, the ratio of central government debt to GNP/GDP is 200 to 400% higher than it was a decade ago. For example, in 1972, West Germany's central government debt to GNP/GDP ratio was 6.6%, Italy's was 44.3%, Japan's was 12.5%, Denmark's was negative 1.6% and America's was 28.0%. By 1983, West Germany's ratio was 20.4%, Italy's 78.9%, Japan's 52.5%, Denmark's 68.7%, and

America's 35.5%. Since both government debt and GNP are increasing, this means that public debt is growing many times as fast.

The United States alone has \$1.4 trillion of the approximately \$3 trillion treasury debt obligations of the advanced sector. (These figures exclude state and local government debt, which is at least another \$1 trillion.) The U.S. Treasury debt outstanding was \$600 billion, or less than half its current amount, only five years ago. Think back and recall what happened then: Paul Volcker was appointed Federal Reserve Board chairman.

A second table presented by the International Monetary Fund chief showed the interest on the public debt as a percent of total federal government debt. In 1972, the interest payments as a percent of federal government expenditures for West Germany, Japan, Italy, and the United States, were 2.5%, 4.2%, 4.8%, and 7.1%, respectively. In 1983, for the same countries, the ratios were 10.8%, 18.0%, 17.3%, and 14.6%.

Interest on federal government debt has taken on a life of its own, enlarging both itself and the budget deficit. As De Larosière put it:

"We are at a juncture where fiscal deficits are feeding upon themselves through the interest component of government expenditure. As the relative size of the debt increases, interest expenditure also grows. Furthermore, that growth can be accelerated by a rise in real interest rates or by a reduction in the rate of growth of the economy."

In the United States, the interest on the public debt for fiscal year 1985 will be roughly \$115 billion. To put this interest payment in perspective: The entire cost of one Space Shuttle mission, which many budget-cutters would eliminate, is \$150 million, which amounts to less than a half-day of U.S. government debt-service costs.

De Larosière acknowledges that he has pinioned the United States and other advanced sector countries under the weight of interest rates, from which position they cannot extricate themselves. He then applies the bone-cruncher in his neat formulation:

"These are sobering results because they indicate that if taxes *remain* at the same share of GNP, and expenditures other than interest payments also *remain* at the same share of GNP, fiscal deficits and the financing requirements of governments would grow [because of rising interest on the public debt—ed.] Only if taxes can be *increased* and/or *noninterest expenditures can be cut* by amounts that *exceed the increase in interest expenditures*, can the debt explosion be contained and the fiscal deficit reduced."

Further, he says:

"The larger the increase in interest payments, the larger must be the cuts in other expenditures, by a magnitude large enough to accommodate the interest payments."

What remain uniquely sacred are interest payments. Cut

anything and everything to pay the interest.

It's called usury, and will make Credit Suisse and other bondholders of U.S. government debt happy. The United States would have to close a \$175 billion budget deficit plus run a \$20 billion budget surplus, through sharp tax increases and budget-cutting, to effect a balanced budget.

To do this would require dictatorship conditions.

De Larosière warns of financial panic. He speaks of "psychological reactions," wherein, "if those who hold public debt came to feel that the monetary authorities might give in to pressures to expand the money supply [bail out government debt and the banks—ed.] . . . the holders of bonds might attempt to unload them." De Larosière is sardonically aware of his power and quotability as head of the International Monetary Fund, that his public warning *may instigate the markets to panic in that direction.*

The moment the U.S. government debt market even appears to be going under, the viability of the U.S. banking and credit system has ceased to function. All the benefit of such a collapse accrues to the Soviets, the Swiss, and the IMF itself. The tip of the iceberg

Yet, the rash of bank failures this year, which has put more than 200 institutions on the government "watch" list, attests to the rotten nature of corporate, consumer, and farm loans. The U.S. economy has built a credit bubble over the past 15 months that resembles the 1929 stock market bubble.

Consider some of the stunning rates of growth of debt taken from the Federal Reserve Board of Governors' Flow of Funds for the first quarter of 1984 (second quarter figures are yet to be released). Short-term corporate borrowing occurred in the first quarter at a \$161.7 billion annual rate. This is more than \$100 billion greater than the level of such credit for all of 1983.

Consumer credit grew at a \$78.5 billion rate in the first quarter, more than two and one half times its average rate for the last five years.

The extent of short-term lending was extraordinary. Many car loans had four-year maturities, and one New York bank began offering five-year car loans. More than half the car owners hold cars for less than three years, so the loan is longer than the time the car is held. The ratio of cash sales of cars is now no more than 15-20% of all such sales, an all-time low. On trade-in sales, many dealerships are giving inflated values for the trade-in car, which is in effect giving a discount on the price of the new car. Plus, car finance companies are paying low double-digit interest rates on the commercial paper market to then lend the credit to customers at sometimes below 10%. The finance companies take the loss to move the cars. This has led the commercial paper market to grow at an explosive 20%-plus rate for the first six months of 1984.

Home mortgages were lent at a spectacular per annum rate of \$145.7 billion in the first quarter, versus an \$86.2

billion rate in the first quarter of 1983. But this is just the first level of hypothecation. Home-owners have once again started using their homes as speculative entities. Borrowing against home equity, which totaled less than \$8 billion in 1982, rose at a rate of \$40 billion per year in the second half of 1983 and continued to rise at that rate in the beginning of the year. This practice is what added to the speculative blow-out in housing in late 1980.

## Shelter wars

But the gross figures can only convey half of the true picture of the level of credit expansion, and sheer bubble activities now ongoing in the United States. For example, during the first half of 1984, corporations used \$75 billion in borrowings to simply buy back their own stocks. They then promptly declared higher dividends per share, by virtue of having fewer shares outstanding, and engaged in various games to increase profits through selling divisions, leasing them back, and counting the capital gains from the division's sale as profits.

Thus, the stock-market rise was based on inflated profits, which rose higher as a result of the stock market bubble. The reverse-leverage on this process will be devastating.

On top of this, a good percentage of all real-estate deals concluded this year were tax-shelters, in which the individual investor put up a minimal amount of, say, \$25,000 and realized two to six times that amount in tax benefits. This, of course, spurred the multi-family housing market boom, but cut perhaps \$25 to \$50 billion from corporate and individual tax payments.

So, the U.S. economy and profit structure in 1984 became in reality a "paper tiger"—most of the gains were registered on paper only. But farming, many basic industries, and infrastructure continued their collapse. Corporations, which borrowed so much short-term, never corrected their balance sheets to fund out into long-term debt. This is a most unusual act of neglect during a "recovery." According to the Farm Home Administration, 40% of its mortgages, worth \$150 billion, could default this year.

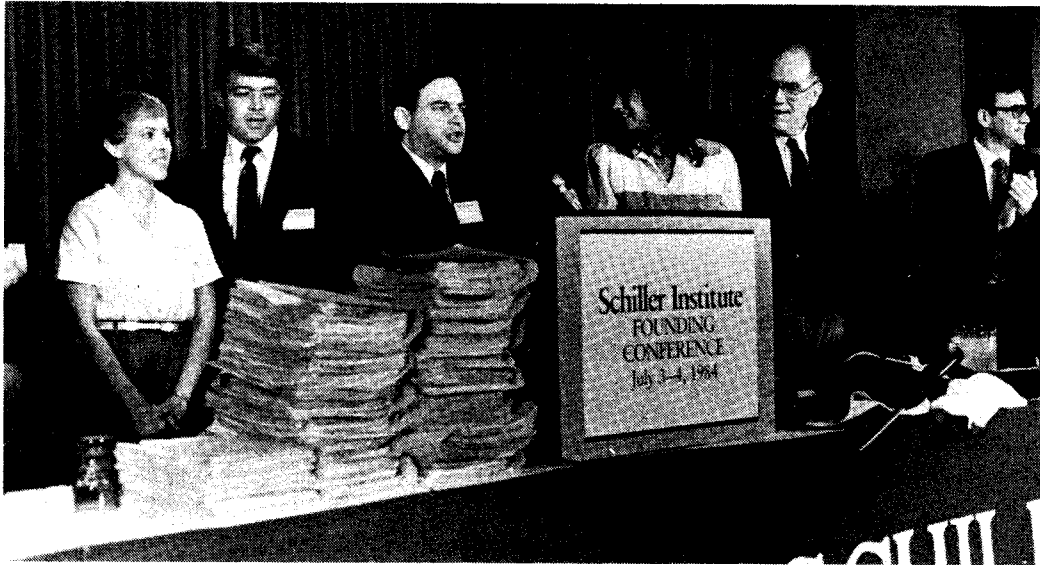
The reams of credit extended during the first half of this year, on top of an already-bloated consumer and corporate debt load in the United States—exceeding \$3 trillion—has put the banking system at the straining point, especially since so little of the money went for sound investments.

The end result can be seen in the current fate of the Financial Corporation of America, the Continental Illinois Bank, Manufacturers Hanover, and many other institutions. The recent two-month downturn in housing, the downturn in retail sales and other critical parameters, indicate not a long-sought cooling off period. Rather, they represent the end of credit-generated speculative "boomlets," which will leave banks with even more worthless and vulnerable paper on their hands.

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