Domestic Credit by Lydia Schulman

Bringing on a deflation

A hue and cry is being raised that Volcker didn't do enough and that more controls and more austerity must be imposed.

In its Feb. 25 newsletter, the Bankers Trust Company proposes a total deflationary collapse. Citing the fact that "the political pressures to keep the economy moving forward at any cost and to reward constituencies are immense," Bankers Trust states that credit controls will be needed to halt spending and economic activity. "The willingness of the political leadership of the country to pluck the nettle of inflation raises the likelihood that some form of controls will be placed on the economy before too long as panic over inflation rises," added Bankers Trust.

Backing up demands for controls that will tighten all credit was the fact that the cost of credit kept rising daily at an astronomical rate. Speaking at the Conference Board's annual finance conference, a leading bank economist predicted that short-term interest rates, already at 16½ percent, would soon shoot up to as high as 18½ percent. As this leading economist spoke, one year Treasury bills sold at auction Feb. 27 yielded 15.28 percent, the highest rate ever in U.S. history for government coupon-bearing securities.

The bond markets meanwhile were taking it on the nose. The undersubscription to a large IBM issue early in the week totally unsettled the markets. Overall, the long-term bond market has plunged 20 percent since the beginning of the year. But on Feb. 28, the bond market temporarily halted its slide and actually advanced by 1 point, on the expectation that credit controls and a blow-out of the economy might be imposed.

The movement to bring on controls has little to do with ending inflation. Rather, as the *New York Times* identified it in three consecutive editorials, it is a plan for massively cutting living standards and forcing the American population to live with less. The U.S., the *Times* has stated, must learn to live with "less oil" and constricted energy supplies, which will of course cripple both long-term and short-term growth. In its editorial Feb. 28, the normally ultra-liberal *Times* suddenly changes field calling for a balanced federal budget. Entitled "The Case for a New, and Balanced, Budget," the *Times* editorial states that "obviously the burden will have to be widely shared. ... The polls show that the people are ready to make some personal sacrifices in a fair fight against inflation. They are waiting to be led."

On the same day Lazard Freres investment banker Felix Rohatyn called, at a public press conference, for "Wage-price controls, credit controls, gasoline rationing" and general increased austerity measures. Rohatyn is known as the director of the Municipal Assistance Corporation (Big MAC), which has slashed New York city municipal jobs—*and services*—by 15 to 20 percent since 1975.

The recent history of credit tightening began in November 1978, when as part of a package to rescue the dollar imposed on the U.S. by the West German government, the Federal Reserve, under G. W. Miller maneuvered in a measure of credit tightening. The next big move came Oct. 6, 1979, when Fed Chairman Volcker tightened credit again. Then on Feb. 15, Volcker moved the credit terms still higher by posting up the Fed's discount rate from 12 to 13 percent.

Yet, the criticism now leveled at Volcker is that he hasn't really tightened, just jacked up the rates without completely shutting off the credit. According to the Feb. 25 Manufacturer's Hanover Trust newsletter, the Fed's new measure for liquidity in the economy, called the "L" ratio, was still growing at a 12½ percent annual rate in late 1979, the same rate at which it grew throughout 1978. The Feb. 19 Bankers Trust newsletter also complained that "the financial system now contains so many bypasses which tend to keep funds flowing that classical monetary restraint may no longer be effective."

Thus, it is argued, not only monetary aggregates must be tightened, but fiscal targets and personal income as well. To impose such a policy means cutting certain sections of the population out of the economy—a decision that Carter appears ready to make just as soon as he thinks he is well enough ahead in the primary polls and doesn't have to face the anti-austerity wrath of the population.

© 1980 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.