Click here for Full Issue of EIR Volume 7, Number 9, March 4, 1980

What Carter and Volcker have done

by Kathy Stevens

Two announcements on Feb. 22—18 percent annual growth in consumer prices and a record-shattering 16.5 percent prime rate at big commercial banks—show that Federal Reserve Chairman Paul Volcker has "broken the back of the American economy," as a senior congressional staffer put it.

The big jump in the prime rate, which will rise to 17 percent within the next two weeks, is an immediate response to Carter appointee Volcker's increase in the discount rate of the Federal Reserve just a short week before. Other interest rates, including the rate the federal government pays to borrow money, have risen out of control. The value of the federal government's paper has fallen by one-quarter since Jan. 1. A federal long-term bond worth $1,000 last year is now worth $750.

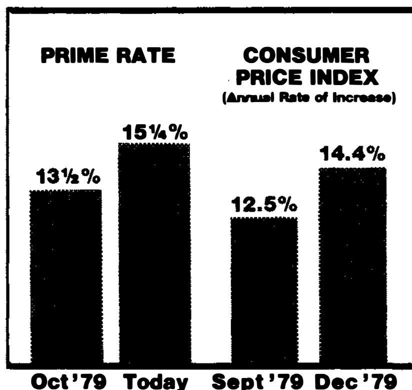
Two features of Volcker's depression policy must be emphasized before we show what that policy has done to the U.S. economy. First, high interest rates are not merely a reaction to inflation but the principle cause of inflation, including both short-term and structural inflation. Debt service on the economy's $5 trillion of outstanding debt—$750 billion of it at 15 percent interest—is the single biggest cost to the economy. Except for defense spending, federal debt service, at $80 billion, is the largest item on the federal budget.

Second, high interest rates undermine productive investment and promote speculative swindles. It costs $60,000 in capital goods to employ a skilled industrial worker and only $4,000 to employ a clerical worker. High rates shut off longer-term industrial investment in favor of quick turnaround "service industry" employment. This process erodes the nation's basic productivity, producing structural inflation.

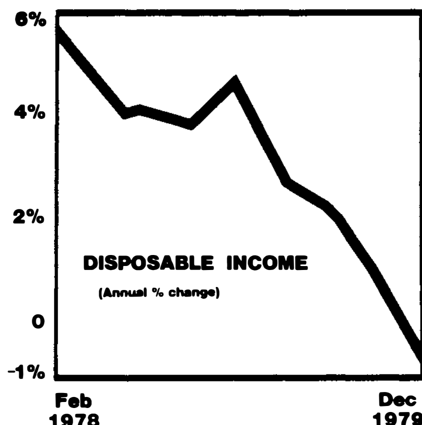
Throughout 1979, both households and corporations ran "deficits"—a gap between income and necessary levels of expenditure—of close to 10 percent. Households first made up the gap by borrowing and, when Volcker shut off consumer borrowing last October, lived off their savings. Normal U.S. household savings rate in 5.5 to 6.0 percent and this rate was maintained in the first half of 1979. But it crashed to 3.3 percent in the final quarter of 1979 and to 2.6 percent in December.

Corporations also tried to fill the gap by borrowing every penny they could get. Now the lid has slammed down on that too.

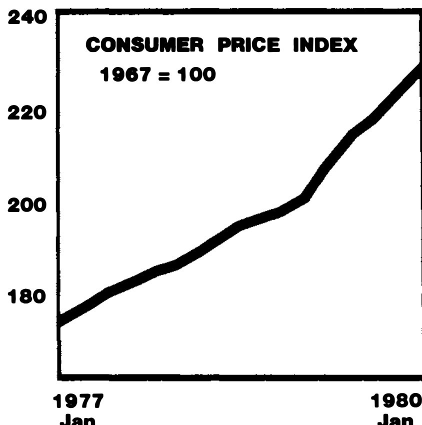
1



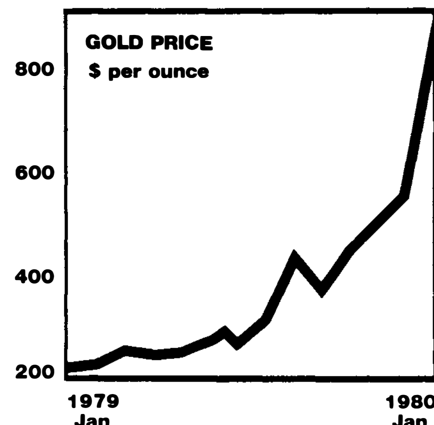
2



3



4



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

By deliberate design of the Carter administration, the American economy has entered a Second Great Depression.

Here's what Carter and Volcker have done to the U.S. economy in the three short months since the October Massacre.

1 Their anti-inflation policy has given the U.S. the worst inflation ever. In the first round of credit tightening, the prime lending rate (the rate banks charge their best commercial customers) stood at 13.5 percent. Consumer price inflation, measured by the consumer price index was at 12.5 percent, almost the worst level in American history. On Feb. 22, the Commerce Department announced that consumer price inflation was the worst in American history, at an annual rate of 17 percent during January. The prime was at an all-time record of 16.5 percent and expected to rise higher. This is the basic index of the effectiveness of the Volcker policy.

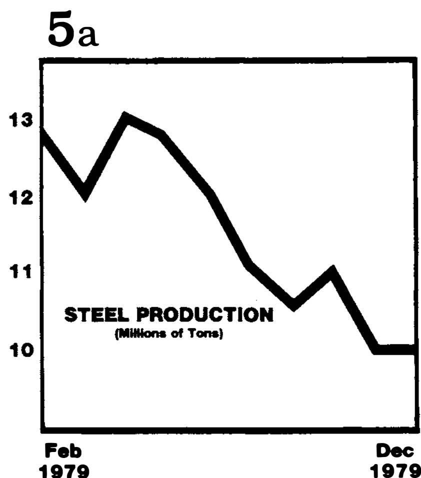
2 They've slashed income. Disposable, after-tax income plunged deeply into the red at the end of 1979 taking living standards with them. The government's "disposable income" category actually understates the decline in real incomes under the Carter presidency. Households have been able to avoid declines in spending on food, clothing, and other short-term essentials only by giving up purchases of homes and automobiles.

3 They've sent prices soaring. Since Jimmy Carter took office, the consumer price index has taken a sharp turn. The curve of consumer prices made a sudden change into double digit inflation around the beginning of 1979—the result of two years of disastrous economic policies. The CPI rose at a 13.3 percent annual rate, the highest since World War II and outstripping the growth of wages by 5.3 percent. Starting with January 1980,the rate of inflation (shown by the slope of the line) will take an even more dramatic turn upward as inflation heads above 20 percent.

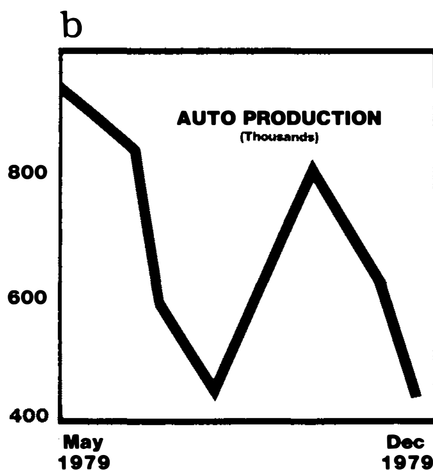
4 What they did to the dollar is shown in gold's rise. Gold, the basic measure of the dollar's value, in terms of the most-trusted central bank reserve asset, is the only category that has stabilized during January 1980 for extremely short-term and extraordinary reasons. Since the Soviet military move into Afghanistan the United States has made it a point of Atlantic Alliance loyalty that the dollar must be propped up. This is ironic, since Carter's former Treasury Secretaries W. Michael Blumenthal and G. William Miller spent the last three years "talking down the dollar," by calling for its abandonment as a reserve currency. However, the current inflation rates ensure a new collapse of the dollar early this year.

5 The decline in industry shows there is worse ahead. During 1979, there was a sharp decline in the nation's three biggest goods-producing industries: steel, auto and housing. In each case, October 1979 marks a sharp downturn, followed by a plateau at low levels of activity during December. As of the last figures available, housing starts had fallen an additional 6 percent, and auto production remained 23 percent below previous year's levels, during the month of January. The shut off of funds to auto dealers, builders, and consumers as a result of the recent extreme rise in interest rates means a much faster rate of collapse. Auto dealers' swollen inventories and weak balance sheets are no better off than before the big production downturn this winter, and the housing market has virtually shut down, as bankers withdrew mortgage credit in response to Volcker's discount rate increase.

5a



b



c