

## Blackmail against the new administration

by David Goldman

Federal Reserve Chairman Volcker's decision last week to raise short-term interest rates again, after a momentary break in the upward spiral, is a political signal directed at the Reagan administration. Volcker has set a trap for the President, with the intent of compelling the White House to accept a Margaret-Thatcher-style policy of "economic pain" despite its intentions to the contrary.

Thatcher's semi-official representatives in Washington, the British-led Heritage Foundation, have succeeded in placing a few key people inside the economic decision-making bodies of the new administration. Their objective, as probable Treasury Undersecretary Norman Ture put it, is to let matters deteriorate until Volcker and the Treasury Department will have the clout to tell Reagan to let interest rates go through the roof and reduce money supply growth to zero.

Among Heritage economists and their Wall Street collaborators, who include former Rite-Aid chairman Lewis Lehrman and Bear, Stearns economist Larry Kudlow, the word is that the 21 percent prime will be a *floor*, not a *ceiling*, for domestic interest rates. In interviews with *EIR*, Kudlow, Salomon Brothers partner Benjamin Rowland, and other Heritage supporters predicted that Fed Chairman Volcker would bring rates up to the 24 to 25 percent level before any peak was evident. Lehrman is a member of the Heritage Board of Trustees, and Kudlow has testified on behalf of Heritage before Congress.

Why would an avowedly conservative think tank like the Heritage Foundation wish to destabilize the Reagan administration? The answer has a great deal to do with the fact that Heritage is intertwined with the socialist

British Fabian Society (see National section). Heritage spokesmen in fact are threatening Reagan with leftist "social chaos and revolution" in the words of Lewis Lehrman, who is close to the Socialist International in Europe. Lehrman predicted this week that Reagan will follow Volcker's policy and be "Thatcherized," adopting the austerity policy of Britain's Margaret Thatcher, and that the left would rise up against him.

This group apparently has the inside track on the Fed's plans for the next two weeks, judging from Paul Volcker's actions on the market. By the Fed's own criteria—which this publication considers dubious—the sharp drop in the money aggregates and commercial bank lending during the month of December should have permitted some easing of the money crunch. When the Fed released money supply data to this effect on Jan. 9, most Wall Street "Fed watchers" predicted a near-term easing of interest rates.

Of course, reading the entrails of the monetary system turned out to be a waste of time. Paul Volcker and his *political* faction are committed to wresting control of economic policy from Ronald Reagan, who sincerely wants to carry out the mandate he received from American voters in November. The Fed's actions stem from political considerations, and all ideological pronouncements concerning monetary aggregates and interest rates are so much Delphic pap.

As matters stand, despite the likely appointment of Dr. Ture to the new Treasury undersecretary post for tax policy and the selection of Friedman student Beryl Sprinkel of Harris Trust as undersecretary for monetary af-

fairs, Reagan does not like the monetarists' counsel. "We can't be certain if Reagan will tell Volcker the right thing. It remains to be seen," said David Meiselman, editor of Heritage's journal, *Policy Review*.

Jack Kemp, who insists that "austerity is the problem, not the solution," more closely reflects the President's personal outlook. In an interview with *EIR* published Jan. 20, Kemp outlined an ambitious program, including both personal income and investment-related tax cuts, and an agreement with the European Monetary System to restore the dollar to gold convertibility. However, Kemp indicated that the latter monetary proposals were not for immediate action. And Kemp has not persuaded the new administration that his tax proposals will necessarily produce an economic upswing.

According to the Heritage scenario, the Federal Reserve will tighten interest rates until the economy hurts and the White House demands a change—and the moment of truth for Reagan will have arrived. Volcker, according to Salomon Brothers seer Rowland, will probably threaten to resign and destroy the "credibility" of the new administration in the monetary sphere.

What makes the Reagan administration susceptible to this form of blackmail is the narrow-gauge approach of Reagan's most powerful subordinates. Treasury Secretary Donald Regan, a top-flight administrator at Merrill Lynch, shows no sign of having the scope of understanding of monetary affairs to avoid the trap ahead. "You can only bring interest rates down by one of two methods: either by having a recession, or by altering expectations about inflation," says Merrill Lynch money-market economist Donald Maude. "And you can't bring down inflationary expectations in a short period of time." Maude describes Regan as a "level-headed executive" who will take orders only from the President.

But the Merrill Lynch economist worries about the Fed's "credibility." He told *EIR*, "There is always the possibility of a real shake-out on the markets. But it won't happen if the Fed can maintain its credibility. If that were damaged, then short-term interest rates would really shoot up."

Apparently, both the Reagan administration and Bonn, the allied government that is likely to have the closest relations with the Reagan White House, are working under the dangerous illusion that they can take their time in addressing the crisis that the Volcker Federal Reserve has set in motion. What will most probably emerge out of the economic policy meeting with President-elect Reagan in progress at *EIR*'s deadline is an ambiguous false consensus. It is likely to include a decision to continue the congressional bailout of the Chrysler Corporation; a mandate to reduce the federal budget that does not address what degree of economic "pain" the administration will tolerate; an agreement to institute Kemp-Roth tax cuts during the coming summer (rather

than immediately, as Jack Kemp would prefer); and some promising initiatives on the energy and environmental regulation front.

However, as our econometric simulation of the impact of Volcker's interest-rate policy indicates (see *EIR*, Dec. 10, 1980), the economy will turn down sharply before the end of the first quarter. Reagan will have a much worse problem on his hands than his new Treasury secretary, for example, is counting on.

### **Bonn floating**

West German Chancellor Schmidt should be explaining to the new White House that the future of the Western economies depends on the success of the dramatic monetary and development initiative he proposed two years ago with French President Giscard d'Estaing. He should strongly reinforce Rep. Jack Kemp's input on the question of bringing the United States into the European Monetary System, and extending this collaboration into a global development effort that, among other things, would boost American exports by about \$100 billion per year.

But the West Germans have put off completing the second, credit-issuing phase of the European Monetary System until sometime in 1982. Meanwhile they are hoping that a slow fall of American interest rates will take pressure off their own currency and reduce capital outflows. The Bonn chancellery has written off economic growth for the coming year, and is hoping to hang on long enough to institute the European Monetary Fund in about 18 months. Apparently, Chancellor Schmidt views West Germany's economic ties to Saudi Arabia (see International Credit) as a short-term palliative, rather than as an opening to a much broader degree of collaboration on monetary and trade matters, in which the United States also has a major interest.

More encouraging is the announcement by Sen. James Sasser (D-Tenn.) and Rep. Bill Alexander (D-Ark.) of legislation—in the form of resolutions in both houses—to compel the Federal Reserve to give priority to credit for the tangible wealth-producing sectors of the economy. The Sasser and Alexander proposals, in different ways, embody a plan released in December by the National Democratic Policy Committee for reform of the Federal Reserve System. The plan, in brief, would compel the Fed to introduce discount-window participations in loans for tangible goods production instead of the present open market operations, namely, dumping new money supply into the large money markets, where it never reaches American producers.

What the President needs to avoid the Heritage Foundation trap, above all, is the right points of orientation toward those he ranks among his peers: the Congress, the leading American economic constituencies, and the leaders of allied countries.

# Ture and Rowland on 1981 credit squeeze

*The following interview with Treasury Undersecretary for Tax Policy designee Dr. Norman Ture was provided to EIR by a Washington source.*

**Q:** What does the Heritage Foundation Project Report on the U.S. Treasury, which you headed, recommend the Federal Reserve do with monetary policy?

**A:** Our section on monetary policy simply says that control of inflation is not located in fiscal, in budget actions at all, but in money supply, pure and simple. What we must do to reduce inflation lies not in the budget, but in credit: we must very, very severely restrict credit. The Fed has not done enough. The Fed must do more. The Fed's portfolio of U.S. Treasury securities is larger now than when they began the credit squeeze. We should reduce money supply growth to *zero* for a time if necessary.

I think that the Federal Reserve instead has played a substantially passive role, and I think we'll get another monetary explosion if the Fed does not hold interest rates to where they are. I hope that the secretary of the treasury and the President will be able to persuade Mr. Volcker: "Let's forget about interest rates, and bring monetary expansion under control." At this point the problem is an absence of monetary authority, rather than the active participation of the monetary authority. We've had a 20 percent run-up in the money stock since the middle of the year.

**Q:** So now interest rates must continue to rise?

**A:** If you have that kind of expansion of the money stock, they will soar. . . . If the Fed can insist on and arrange for a very slow rate of growth in money, then we might see a decline.

**Q:** And if the figures are not so good, rates will be headed up?

**A:** Sure, if we get any resurgence in the money supply, 21 percent for the prime rate is going to be the floor, not a ceiling. I don't think there is any natural law that limits it.

**Q:** What about the danger of a U.S. dollar crisis?

**A:** Our report said that we could care less about what happens to the dollar. We just get our domestic house in

order, deal with inflation here, and the dollar will have to take care of itself. Suppose the Fed did announce zero growth in the money supply, and collapse credit. The dollar would be perceived as very sound.

*Benjamin Rowland, a partner in Salomon Bros. Corporate Finance Department close to Lewis Lehrman and the Heritage Foundation, told EIR of Volcker's plans.*

**EIR:** Does Norman Ture's appointment mean Ronald Reagan will be swayed toward Volcker's monetarism?

**Rowland:** It's not decided. Reagan himself has divided loyalties, divided between those who believe in the efficacy of Kemp-Roth tax cuts, and those who consider tax cuts wildly inflationary, as I do.

**EIR:** Will Volcker do what Reagan tells him to?

**Rowland:** No. I think Volcker will maintain a tight money policy, and if he comes under pressure for easing, he'll put up a fight and might quit. If challenged, he'd rather leave, from the contacts I've had with him.

**EIR:** Do you think Ronald Reagan will challenge him?

**Rowland:** Sure. But he is a man of great personal integrity and would rather leave office.

**EIR:** If the President doesn't want a recession, why wouldn't he just go ahead and force Volcker out?

**Rowland:** I don't think he would. It would obviously be very bad to lose such a major, well-respected figure in such a time of economic difficulty. I don't imagine it would be in anybody's interests to force a figure of Volcker's stature out. He won't be pushed into a corner, not without reacting publicly and clearly, and the undesirability of that reaction is great enough, I suspect, that he won't be pushed into a corner. It would have a very bad effect on the markets.

**EIR:** What does that mean for interest rates in 1981?

**Rowland:** They're going to be high, current levels at least. They're going to be volatile, certainly double-digit. I don't think we've seen the peaks in the present circumstances. I wouldn't be surprised if they went up to a prime of 24 or 25 percent.

## Lewis Lehrman: rates cannot come down

*Lewis Lehrman, adviser to the Reagan Transition Team and board member of the Heritage Foundation, made the following comments in an interview made available by Washington sources.*

**Q:** Will the new administration succeed in stabilizing the U.S. economy and lowering rates?

**A:** My view is that there is a comprehensive program needed now, which I outlined in a recent proposal published by Morgan Stanley, for the U.S. My role in the administration has become very controversial, because I don't believe that marginal tax cuts are the answer to our problems, nor are budgetary cuts sufficient. It's my view that we need a comprehensive reform of monetary policy, domestically and internationally, from the top down, to lower monetary growth while cutting fiscal growth, and it has to be done promptly. But there are people resisting this view more highly placed than I.

**Q:** You mean the Nixon-Ford traditionalists?

**A:** Yes.

**Q:** What about Jack Kemp?

**A:** Jack agrees with some things, but he's a supply-side tax cutter. Stockman is a budget-cutter. None of this makes sense in the absence of international reform. The international monetary system is falling apart. But unfortunately, the issue of international monetary policy is not one that will preoccupy this administration.

The U.S. must organize the international system. Step one: we announce the intention to create a convertible currency, to peg the dollar to gold. Step two: we establish a balanced budget. Step three: we renovate our regulatory agencies. Step four: we systematically reform our tax structure. Step five: we rebuild our fighting forces.

We then convoke an international monetary conference, in which we elaborate a fixed-exchange rate regime, based upon the dollar as a convertible currency. We prohibit, by threat of force and by treaty, protectionism. We underwrite a world of order.

**Q:** But the new administration won't do this?

**A:** I'm pessimistic. And then we don't have stabilization.

**Q:** What about these record interest rates?

**A:** They would stay high.

**Q:** How long can we survive with twenty percent interest?

**A:** Eight more years. If things do not change during this regime, the election of 1988 will be truly a revolutionary one, in the good old American revolutionary sense. The coalition building up to a change, which came together behind Ronald Reagan, will have fully materialized by 1988, a coalition of people who are not prepared to accept twenty percent interest rates and seven and a half percent unemployment.

I think the political divisions in this country will become much more radicalized, and we could see real social chaos. There is no such thing now as a left-right division. But the conditions you've observed in England right now are a precursor. You've observed the demolition of the Labour Party, the destruction of its vital center and the commandeering of the Labour Party apparatus by the radical, autarchical national-socialist left, led by Foot and Benn. That could not have happened in the absence of eighteen months of agony, worklessness, and bankruptcy that came from Margaret Thatcher's efforts. *Mutatis mutandis*, in the U.S. you will get similar effects. The Democratic Party will be commandeered by those who are prepared to adventure the most. The economic crisis makes for different kinds of politics. Then the conservative coalition behind Reagan will be pulled in half by the left and the right, forced to choose.

Twenty percent interest rates continuing, worklessness at the level of seven to eight percent, the loss of whole segments of American industry which are unable to adapt, like steel and auto, among others, are going to change the way Americans think about politics. The rich companies will get richer, and the leveraged and declining industries will fail very rapidly.

**Q:** What would this mean for Europe?

**A:** I don't think there's a thing Reagan can do with the European Monetary System, except observe these Lilliputians, like Helmut Schmidt. The Europeans have failed in every respect. The EMS has been a clever bit of financial chicanery, but of no consequence, all rhetorical flourish. . . . The EMS gold standard angle is an inefficacious application of even the most nominal aspects of a gold standard.

The EMS is doomed without the U.S., without the kind of global program I've outlined. . . .

**Q:** How long can Europe hold out with these levels of U.S. interest rates?

**A:** Under these conditions, Western Europe will remove itself from what is left of the Western Alliance, both politically and economically. Increasingly, they'll develop economic policy characterized as protectionist. Quotas, tariffs, more subsidized industry, more export subsidies, and trade arrangements with the Soviet bloc. It's starting already. Europe will be Finlandized. U.S. power in Europe will decline, even more rapidly than over the past ten years.

European monetary arrangements don't mean anything. There is now a DM bloc, but not by choice. It's like Topsy, it has grown, and it will disintegrate with the volatility of the mark.