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Domestic Credit by Richard Freeman

Water, water, everywhere...

Volcker has his own two-tier loan system, which leaves very few drops for productive activity.

Preliminary figures from Dun & Bradstreet, the bond-rating service, show that business failures in the first 25 weeks of this year were 44 percent higher than for the same period in 1980. Yet the volume of commercial bank commerce and industry (C&I) loans is up a sizzling 26 percent over the last three months.

How is that possible? How can credit availability appear to be growing at a rapid clip, while corporate bankruptcies are at a postwar peak of 8,000 thus far in 1981? The answer is that Federal Reserve Board Chairman Paul Volcker and the Wall Street banks have managed to put the United States on a two-tier credit system. Not of the sort recommended in the pages of *EIR*, in which investment borrowing for productive industry and agriculture is made cheap and abundant, while borrowing for speculation, arbitrage, re-insurance swindles, etc. is put at a prohibitive interest rate. Just the opposite: Volcker is starving the productive sector of the economy of credit—and hence the record number of bankruptcies—while the speculative side of the economy can get, and afford, all the credit it wants.

The lending by U.S. commercial banks over the period since April 15 has been sizable. On that date, total commercial bank C&I loans outstanding totaled $170 billion. That number climbed to $181 billion by July 1, including an increase of $2.8 billion during the week ending July 1. And the amount of outstanding commercial paper—that is, corporate IOUs of 30- to 90-day maturities—rose by $6 billion over the last five weeks. Thus, short-term bank loans were not substituting for commercial paper. Rather both rose, by hefty amounts, at the same time.

But these funds were not finding their private way into auto production, public or private housing construction, new nuclear plant production. These sectors could not get credit, because they could not promise a rate of return of 19 to 20 percent equal to the cost of interest.

The first area where a lot of this credit went was to corporate takeovers and mergers. According to W. T. Grimm & Company of Chicago, which compiles data on mergers and acquisitions, in the second quarter of 1981 there were $17 billion in completed corporate takeovers during the first quarter, and at $34.5 billion for the first half of this year, the largest volume of takeover activity ever. This does not even include the DuPont bid for Conoco, the reputed Texaco bid to take over City Service, etc. which are being negotiated. Assuming that at least half of the corporate takeover activity in the second quarter was financed by bank loans, then $8.5 billion of short-term borrowing over the last three months fueled corporate takeovers.

If the Justice Department continues to encourage corporate takeover mania, then we can expect the takeover specialists, including the large oil companies, to crowd out of the credit market the medium-sized productive industries.

A second major area of the borrowing is not for industrial expansion, but for firms to finance involuntary inventories because real sales have collapsed. Inventories jumped by $3.25 billion in May over April levels, and according to Leonard Santos of Henry Schroeder and Company, will rise by at least that amount in June. Sales meanwhile fell $1.5 billion from April to May, although they rose in June, balancing out sales for the two-month stretch. Thus, inventories increased, without compensating sales, by about $6.50 to $7.0 million in May and June alone. Assuming that, again, half of this inventory buildup is financed by bank borrowing (a very reasonable assumption because the companies that build up inventories have the most deteriorated cash flow), involuntary inventory buildup added $3.25 to $3.5 billion in commercial bank borrowing in May and June.

Another area is debt financing. According to Gert von der Linde, an economist at the Donaldson, Lufkin, Jenrette investment firm, "Lower business activity is placing more and more firms in a situation where they have to borrow from their banks just to pay interest on their outstanding debt."

A fourth area is credit to the oil, gas, and mining sector, which borrowed $3.3 billion. Some of this was oil multis' financing their takeovers, which involves double counting, but some was for just plain investment in the superheated energy sector. This investment in itself cannot upgrade U.S. productivity significantly.

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