

bubble goes. A New York City bankruptcy could trigger it in the next week. The standard argument that the absence of foreign central bank intervention to support the dollar — which financed \$31 billion of the deficit during 1977 — will automatically force interest rates up is fallacious. Foreign funds will not be available to finance the deficit if the stock market bubble and the currency fluctuations that favor the dollar reverse themselves, which is precisely what Miller is driving at. In this case the U.S. economy will end up with high inflation, reduced output, and skyrocketing interest rates simultaneously! The ultimate beneficiary could be Fed Chairman Miller's colleague — Sen. Ted Kennedy.

—David Goldman

How Long Will It Last?

Money Markets, the newsletter of the First Pennsylvania Corporation, May 25:

We estimate that we are currently in the third phase, or expansion phase, of the business cycle. Sales and inventories are both growing at a robust pace, consumer debt burdens are mounting, and interest rates are rising making it increasingly expensive to fund inventories. Even though the economy seems to be expanding briskly, economists recognize we are living on borrowed time. . . .

Should the economy and inflationary expectations continue to advance at the current feverish pace, however, it makes it increasingly likely that robust business expectations will not be fulfilled, both consumer and business debt burdens will become unmanageable, and the tax cut could very well be shelved (in the interest

of cooling off inflationary pressures) putting us into the fourth, or downturn, stage of the business cycle by year-end.

No Cause for Optimism

Financial Digest, the newsletter of Manufacturers Hanover Trust, May 29:

. . . a lot of sales that were made in April and May might have been made during the first quarter, had the winter been less severe or the coal strike non-existent. Since these sales are bunched with sales that would ordinarily occur at this time, they give the illusion to many businessmen that business is booming. Accordingly, there is an effort to build inventories, in the belief that the current rate of sales (which includes some make-up sales from the first quarter) is the true ongoing rate. This could lead to some disappointments later on, once these makeup sales are finished; it could result in an involuntary accumulation of inventories in some sectors, and a need to cut back.

If this were not enough, there is growing evidence that a large proportion of sales being made today is because of fears of higher prices. As was observed at the beginning of this month (*Financial Digest* — May 1, 1978), consumers appear to have developed a "buy-in-advance" attitude toward big-ticket items. Reinforcing an earlier finding, the University of Michigan Research Center said last week that the nearly half of the people who now believe that it is a good time to buy durables represents "the highest recorded proportion of respondents to indicate a buy-in-advance price rationale since the surveys were started" in the early 1950s. . . .

Miller, Rohatyn Steer New York City Toward Bankruptcy

The New York City fiscal crisis this week entered its "countdown month," with the city "closer to a bankruptcy than ever before," according to informed sources in the financial community.

"I have absolutely no doubt that Rohatyn, Miller and Blumenthal would take a bankruptcy at this point," said a banking source. "Their problem is to deflect the blame off them..."

BANKING

Viewed From the Outside

A city default would trigger a chain-reaction collapse of the more than \$14 billion in outstanding city, New York State, and MAC paper; it would panic the security markets and send the U.S. economy plunging toward the worst depression in its history.

Fed Chairman Miller last week effectively lobbied for a bankruptcy, telling the Senate Banking Committee that a New York default could be handled "smoothly and efficiently" by the Fed and would definitely "not cause a national crisis." Blumenthal, meanwhile, has told a major newspaper's editorial board that he would welcome a bankruptcy.

What makes a New York City bankruptcy likely is that the triumvirate effectively controlling its future — Lazard Freres general partner and Municipal Assistance Corp. chairman Felix Rohatyn, Federal Reserve Chairman William Miller, and Treasury Secretary Werner Blumenthal — have apparently decided that it is a "prime option."

The New York commercial banks, some of whom have over 30 percent of their total equity tied up in worthless New York paper, are apparently falling for this faulty reasoning. "The city can go under," said one deluded banker late this week. "We'll still have MAC. . . it won't be so bad, because the Fed will help out. . ."

The banks are being set up. Aides to Senator William Proxmire (D-Wisc.), the Fabian chairman of the Senate

Banking Committee and an opponent of any Federal aid to the city, are reportedly "grinding their axes"; they are prepared to force a major overhaul of the banking system should New York go under. "You are crazy if you think that we will let the banks off the hook," said an aide. "The people will be demanding the heads of the banks and we are going to give it to them . . . let a bankruptcy clean out the banking system." Miller reportedly shares their views — at least in private.

Proxmire, who expects to have the votes to get the \$2 billion austerity-based Federal loan program defeated on the floor of the Senate, has another surprise in store for the banks. He will demand that they agree to cough up an additional \$1.5 billion to purchase MAC and other city paper beyond the \$1 billion they have committed to purchase over the next four years. "Miller knows what we are doing," said an aide to the Wisconsin Senator. "And he agrees with it, and so does Blumenthal . . ."

How A Default Could Occur

Miller, Blumenthal, and Rohatyn have a number of options open to them for pricking the New York debt bubble.

In the short term, the city needs approximately \$500 million to meet payrolls between now and the end of June. It plans to finance this through a sale of MAC short-term notes to union pension funds. If that doesn't occur, the city could go bust as early as next week. Most observers, however, feel that if the unions fail to cough up, the banks might be induced to pick up the tab.

The real crunch occurs after June 30, when the city will require several hundred million in financing to meet expenses. On that date the Federal loan program lapses, and a new \$2 billion loan guarantee plan is to be put in place. But the plan must pass Congress, and to have a chance at doing that, the city's remaining labor contracts must be settled on a low-cost, high-productivity basis, a \$4.5 billion dollar, four year financial package must be agreed upon by all parties — including a balanced city budget. But even if the loan passes, Blumenthal can revoke the loans any time he sees fit — and the city heads for default.

Miller, Blumenthal, and Rohatyn have induced everyone into playing by their rules. They have gotten all parties, including the unions, to agree that the solution to the city's financial woes is drastic austerity in combination with a federal loan guarantee program. Sitting back, they are now allowing the various unions and the city government to argue about how much to cut, and from whose hide. The chaos surrounding the city union contract negotiations, reported in the national press, results from this fundamental manipulation.

Rohatyn has already scored a major coup. By using the "threat of bankruptcy," and with prodding from both Miller and Blumenthal, he was able to maneuver legislation expanding the powers of his MAC and the city's austerity monitor, the Emergency Financial Control Board, through a reluctant New York state legislature. These institutions are the embryo of an International Monetary Fund-like post-bankruptcy austerity dictatorship.

He has also set up his scapegoats. The unions have been split into a controlled crew under the agent leadership of municipal union leader Victor Gotbaum on the one side, and another section led by the police and fire unions. One scenario brewing, is to force the police and-or firemen out on strike, and then financially crush them in a bankruptcy. Another scenario would see the banks provoking a confrontation with the unions by claiming that austerity-based contracts are not austere enough. And there is always the "anti-New York" crowd in the Senate who could torpedo the loan package.

At this late date, responsible political leaders have failed to place a single alternative development-based proposal for dealing with the city's problems on the table. Until someone does, Miller and company are calling the shots.

—L. Wolfe

London Bankers Circle Over New York Default

A Washington-based British source close to certain City of London merchant banks gave his views on the New York City crisis:

It looks like we're headed for a default. It's doubtful that all the problems can be sorted out in time and its even more doubtful that Congress will act. Many people here and in London have already accepted this — sooner or later New York goes down, so why not right now?

Miller and Blumenthal have to say they don't want to see New York go down; after all, they are public officials. But they know that bankruptcy is a real option. New York City has to be made a lesson of for all those (municipal and national governments — ed) who live beyond their means — it has to suffer pain. A bankruptcy would get the point across . . .

It (a bankruptcy — ed) could be financially handled. Miller's a business man, and he explained that the Fed could handle it, and quite easily. A few banks might go under and several would have to be reorganized — but what's so bad about that?

But politically, a city bankruptcy creates the biggest crisis since the Revolution, much worse than Watergate. In Watergate, you didn't have to change American institutions, just leadership. A city bankruptcy would require major changes. The Carter government would collapse; the New York State government would collapse; the Koch administration in the city would collapse. But that wouldn't matter too much.

What I mean is that they would have to be reorganized. There would have to be bankruptcy governments to enforce austerity. That's how you would reorganize things. Austerity would be the watchword.

Many people in this country refuse to face up to necessities if they are unpleasant. We British are much better at it. You and I might not like a New York City bankruptcy, but it may be a necessity, and that's something that must be faced . . .