How Carter has produced hyperinflationary recession

by David Goldman

Widely-circulated commentaries that the current week's events on the credit markets mark a turning point in interest rates are premised on a fundamental misunderstanding of what the American economy currently is. The bond market gained 5 percent on the long-term side April 16 after Salomon Brothers' seer Henry Kaufman made this evaluation. Chase Manhattan Bank lowered its prime rate the same day from 20 percent to 19¾, and Eurodollar short-term rates have come down by more than 3 percent from their highs of two weeks ago.

The argument that this represents an interest rate peak depends on a model of the American economy during the 1974-1975 collapse, when the recession hit more sharply than during 1929-1931, and interest rates fell speedily. Instead, the model to look toward is Germany in 1935, following three years of Nazi "economic recovery" methods. As *EIR* has emphasized in analyses of Carter budgetary and energy programs, and in the published results of *EIR's* Riemann-LaRouche computer econometric model, the Administration has enforced the same policies that Hitler's finance Minister Hjalmar Schacht used during the first five years of the Nazi regime. The same consequences should be expected.

To preview the comprehensive survey of the problem *EIR* will release next week, the following telling comparison of the last with the present "recession" makes the story quite plain. The rates of decline of total manufacturing and of major individual sectors are given in the table.

From the standpoint of conventional models this makes no sense whatsoever, since the input-output grid of the economy is assumed to move in roughly the same proportions during short-run periods. Last time, the decline in total industrial production was comparable to the developments in housing and auto, the first two sectors both times to take it on the nose. The fact that the total index did not move down—because chemicals, machine tools, aerospace, coal, and manufacturing equipment *rose*—indicates that we now have a fundamentally different economy. Different laws apply.

The anomaly of a steady rate of output of construction materials coincident with the worst drop in housing starts in 20 years—a 50 percent decline in six months—is less of an anomaly considering that the legislation prepared by Rep. Moorehead of Pennsylvania is now in a House-Senate Conference, and, if passed, will permit the construction of hundreds of billions of dollars worth of

Rates of decline

	9/74-3/75	9/79-3/80
Industrial index	−15%	− 0.4%
Housing Starts	−19%	−50 %
Building materials	−21%	− 0.2%
Auto	−25%	−16 %

synthetic fuel plants. According to sources at the Federal Emergency Management Agency (see Special Report), the FEMA itself would then have authority under the 1947 National Security Act to allocate supplies to the construction of these monstrosities, because the Moorehead Act places them under defense priority status.

Even though the actual rate of defense spending is probably falling in comparison to the final quarter of 1979, the level of anticipatory spending, particularly in aerospace, electronics, and machinery, nonetheless assumes a coming military buildup.

Most important of all is the deadly combination of pollution abatement and energy-saving investments, which now make up roughly 10 percent of all capital investments, according to the Commerce Department and McGraw-Hill numbers. However, this is a gigantic understatement. As we have noted, virtually all of the $60 billion in capital spending plans of the big three automakers during the next five years is oriented towards producing smaller, more efficient cars, as a matter of Environmental Protection Agency dictate. The same is true in the aerospace sector, which, combined with auto, makes up the only sector whose capital investment is growing in real terms. The real effects on the aggregate economy are considerable. For example, instead of the usual 12 percent coefficient on the input-output grid relating machine tool output to transportation industry consumption, Commerce Department economists estimate the machine builders are shipping 25 percent of their units to the transportation sector. Prof. Seymour Melman of Columbia University points out that the dollar value of the units consumed by aerospace is much higher, because the aerospace sector uses the largest and most complex machine tools.

We are, in short, six months into a full-fledged Schachtian economy, and rapidly approaching the crisis point that the Nazi economy underwent in 1936-1938, when the productive resources of Germany were no longer sufficient to meet the demands of Hitler's war machine. We do not have free resources and free labor in the most important categories of capital goods—and this is before projected demands of military production, synthetic fuel plants and so on.

Merely maintaining the military potential of the economy at a credible, much less an efficient level, requires enormous effort. FEMA had to directly intervene to prevent bankrupt railroads from scrapping lines that lead to military bases, or carry military supplies.

As we published last week—and will elaborate in detail in next week's Special Report—the result is that the net available tangible product of the U.S. economy (the Riemannian model's "S'") fell below zero during 1980, as a result of overhead and waste demands on the economy's tangible output. This defines in scientific terms precise enough for our purpose here a crisis identical to the 1936-1938 economic crisis.

What does this mean for credit demand? To start with, despite the behavior of the monetary aggregates, total credit demand is still extremely strong, *despite* the 50 percent reduction in mortgage issuance and much lower rate of consumer credit extensions. The most recent week's bank lending figures show a strong rate of growth. The Federal Reserve's policy following the March 16 "shock" was, according to First Pennco economist Joseph Bench, "exactly what they did after the announcement last October." During the past two weeks, the Fed has monetized about $3 billion in Treasury securities, an extremely accomodative gesture.

The simple fact is that if the Carter Administration wants a Schachtian economy, the Fed must either pay the bills for this—both in the form of increased credit expansion and increased inflation—or force the economy through the sort of crisis that Prof. von Hayek and the *Wall Street Journal* have demanded, wiping out inflation-related capitalization through mass bankruptcy.

To comprehend the current state of the economy, the analyst must mentally divide it into two economies, one moving into a Schachtian inflationary bubble, the other forced down to record-breaking depths (e.g., auto and housing). Thus far, the breaking of the second economy has not been sufficient (and never will be sufficient) to feed the demands of the first. Therefore the result will be either a crisis of inflation, in the form of a renewed rise in interest rates, combined with major shortages in the capital goods sector, or a chain-reaction of bankruptcies.

As the Special Report documents, FEMA is already prepared to bypass all existing state and Federal legislation (under the 1947 national security statutes) and, if need be, to accomplish a vast banking consolidation which would turn the American system of 14,000 private commercial banks into a replica of the British or Canadian banking systems, with their national chains of a few major banks, within a matter of days. Nothing in the financial structure domestically will, by itself, prevent the Carter Administration from continuing to follow in the footsteps of Hjalmar Schacht.

However, the economy—as a thermodynamic system—can only be depleted so far, and no further. Once net free energy, or "S'", falls below the zero point, the economy must cannabalize its productive resources at an accelerating rate to meet the demands of "national autarky" investment, while the size of the productive sector shrinks at an accelerating rate. The result is a formula for a national breakdown of a type which the United States has not seen before. Under these conditions the type of emergency management the Carter Administration is now employing to govern will only propel the country faster into a dark age.