

## Domestic Credit by Lydia Schulman

### Volcker lifts credit controls

*Protest in the United States had something to do with it.  
It was Europe that did the rest.*

**F**ederal Reserve Board chairman Paul Volcker's announcement July 3 that he will disband his credit controls program in the United States over the next several weeks occurred sometime after their failure was clear.

Volcker's measures, which invoked the 1969 Credit Control Act, limited new bank lending to 9 percent while giving himself top-down control over virtually every transaction in the economy. Inflation responded to Volcker's clamps on credit by shooting up to the annual equivalent of 20 percent, and is still rattling around above 10 percent.

It is clear to most analysts that Volcker never did get inflation under control. But his July 3 disbanding of credit controls came because of factors beyond his power of manipulation.

A Franco-German offensive to slash interest rates and channel credits into Third World industrialization has forced the retreat. Working in tandem, German and French banks over the last two months invaded the U.S. markets with dollars from abroad to capture customers who were usually the clients of American banks, offering lower borrowing terms, and in effect, creating a two-tier credit market.

In past weeks, the French and Belgians lowered key lending rates. Not wanting to lose their own business, the British followed suit and

dropped the Minimum Lending Rate last week to 16 percent.

Taking a cue from the British policy circles that influence him, Chairman Volcker did the only sensible thing and junked the credit controls.

Volcker simply saw that French banks are now offering an impressive array of loans at attractive prices. For example, the French banking giant *Crédit Lyonnais* managed a \$75 million loan to *Electricité de France* at 0.36 percent over LIBOR on dollar markets. This has set a precedent that will allow other prime borrowers to get lower rates.

Since four out of the world's 10 largest banks are French—the United States only has two—they have the resources to provide the loan volume needed to enforce a low-interest rate policy.

But it is not just the size or terms of the loans that is worrying *Lombard Street* and Lower Manhattan. The French and Germans combined are taking over both the East-West and the Arab petrodollar recycling concessions and have left the U.S. in the dust.

The U.S. banks which must do battle with the continental Europeans are in no shape to do so. As a result of Volcker's "anti-inflation" moves the economy is collapsing around their ears.

In June, for example, the number of unemployed rose by 500,000

and only a statistical quirk in the BLS unemployment statistics—the labor force simultaneously shrank but at a faster rate—led to the national unemployment rate holding to the 7.7 to 7.8 percent range. The sole success Volcker can claim is that the steel industry, which is operating at only 58 percent of capacity, was forced to announce last week a 4.5 percent slash in prices. But then, that is the only way the industry can find buyers for its product.

Moreover, this has led to growing domestic opposition to credit controls. The U.S. Savings and Loan League is suing Paul Volcker for trying to put them out of business. It would be naïve to think that Volcker's backdown is intended to boost Jimmy Carter's political fortunes, but it is true that Volcker belongs to the *Ditchley Foundation*, one of the Anglo-American strategy centers bent on "stabilizing" the administration.

The full extent of the impact of the European initiative to break Volcker's credit-rationing policies is apparent in the editorial of the July 14 issue of *Business Week* magazine. *Business Week* had supported Volcker's measures, but its editorial reports that "At the recent Summit meeting in Venice, West German Chancellor Helmut Schmidt and other world leaders voiced their fear that the United States would drag down the rest of the world by failing to recover soon enough. . . . If the United States is going to check the economy's downward swing, it must relax monetary policy. . . ."

For Volcker a domestic consensus for lower rates and the continental European offensive formed a difficult combination to resist.