Will Reagan 'reawaken this industrial giant?'

by David Goldman

The apparent resolution of the fight within the Reagan camp over whether to start tax cuts immediately is far from a guarantee of economic success for the new administration, but it does settle the question of who's in charge. President Reagan and the Western senators have not forgotten who elected them and are ignoring advice not to take risks on behalf of economic growth.

What has emerged for public consumption is a debate between the new budget director, David Stockman, and hoary Republican traditionalists like Arthur F. Burns, the former chairman of the Federal Reserve Board of Governors, over whether to move "slowly" or "quickly." In fact, there is no such simple division of ranks.

Stockman wants to move quickly not only to put through the Kemp-Roth tax cut first installment of 10 percent, but also to butcher the Federal government's backup for high-technology research and development, and support for agriculture, the nation's most productive and most vulnerable economic sector.

But this type of budget-cutting will meet with bitter resistance from Sen. Robert Dole's Finance Committee staff, who say they are committed to preserving, if not expanding, the role of the National Aeronautics and Space Administration, and nuclear research and development.

EIR demonstrates in this issue's Special Report that maximum impetus for the nuclear and space programs are the baseline condition for both the long-term and short-term survival of the American economy. The collapse of American productivity is, more than anything else, due to the straitjacketing of power production and power use in American industry. If Reagan's budget-cutters destroy the economy's sinew along with the fat, the British disease will become terminal on this side of the Atlantic.

The counterpressures

But there are already bitter complaints among the monetarist academic hacks who surround the new administration that the President is listening to his "political advisers"—to the constituencies who elected him—rather than to technocrats like them. Says one senior economist at the American Enterprise Institute, the concentration of everything that has been wrong with Republican economics in the past 10 years:

"There are two groups of people I'm worried about. The real problem is with the conservative populists, like [Reagan confidant and Nevada senator] Paul Laxalt, who have been complaining to Reagan that the Fed is doing horrible things and urging him to do something about high interest rates immediately upon taking office. Then there is another group, the supply-siders."

Supply-side spokesman Jack Kemp—the best of an extremely heterogeneous group who wear that label—

warned in an *EIR* interview Jan. 20 that austerity is not the solution, but the problem.

A more sophisticated argument, circulated in the U.S. by Warburg-Paribas-Becker and other outlets for the old European banking oligarchy, is that American corporate and household liquidity is so weak that a crash is inevitable sooner or later. Efforts to bring down interest rates will crack on the hard reality of the financial problems of industry, the argument goes. *EIR* demonstrated with a simple financial model of U.S. credit flows (Nov. 11, 1980) that a prime rate level above 17 percent triggers debt service obligations of a magnitude sufficient to throw the economy into recession.

There is some truth in the Warburg argument, but only on the surface. Reagan can break the interest-rate spiral by adopting the tested methods of the French, Japanese, and Irish central banks: a two-tier credit system favoring lending for expansion of tangible wealth output above overhead and speculative categories of investment.

This approach, proposed initially by the National Democratic Policy Committee and currently being worked into legislative form by Rep. Bill Alexander (D-Ark.), conflicts with some ideological prejudices that President Reagan shares. But a number of other to-be-expected Reagan initiatives will quickly call the question with respect to the Federal Reserve, and on terms favorable to the right sort of solution.

Priorities for cuts

Rapid action to eliminate environmentalist roadblocks on the energy front could add $30 billion to capital investment in the utilities sector alone during 1981, according to *EIR* staff estimates. Over 350 power plants, including both nuclear and fossil fuel, are in various stages of completion around the United States, delayed by a series of environmentalist demands of the old Environmental Protection Agency. Shutting off the budget of this agency would permit utilities to bring facilities on line in a burst of project completions.

According to nuclear industry managers at one top U.S. construction firm, the White House has already sent assurances to the industry that regulatory relief on this front will be a top Reagan priority. In addition, the new administration promises an educational campaign to counteract the effect of the hysteria around Three Mile Island.

In addition, the likelihood of rollback of some of the most onerous fuel-saving and emission requirements imposed on the auto industry could enable battered auto-makers to shift investment from purely environmental expenditures to more profitable, and more useful, investments in auto capacity. Precisely how quickly the auto industry could shift investment strategy is difficult to tell, but it is likely that a significant amount of U.S. machine tool capacity now diverted toward overhead forms of utilization could be diverted back to expansion of output.

Export potential

Also of potentially great importance is the role of the U.S. Eximbank. Some of the companies now suffering the worst short-term liquidity problems, such as the agricultural equipment industry, also have the best potential for rapid export expansion. More broadly, this is true for agriculture in general, for all heavy equipment industries, and for the power-generating industries in particular. A targeted Exim program, combined with the right sort of treaty agreement with Mexico, could provide a $50 to $100 billion stimulus to American manufacturing and agriculture.

To summarize: by removing the cap on industrial activity imposed by the Carter administration, key sectors of the economy can restore production levels of a year ago and higher, and restore sufficient income to American consumers (as a spinoff of higher production levels) to lift the consumer-goods industries out of the present trough. Particularly if the Kemp-Roth tax cuts coincide with the initiatives cited above, the economy will indeed be jolted forward.

The credit question

This is more than a financial consideration. As my Special Report in this issue documents, the electric utilities have suffered a 20 percent decline in their total productivity in the past 10 years, entirely due to environmentalist meddling. Taking the constraints off could give the economy a literal "surge of power," the precondition for real expansion of tangible wealth creation.

However, the jolt forward Reagan's first 90 days could generate will run directly into the monetary policy of the Federal Reserve. Not merely will the additional loan demand resulting from the program provide the Fed with the rationale for raising interest rates still further; the additional freedom provided by the expected tax breaks could also fuel a new cycle of real-estate and similar inflationary speculation.

At this point, an abortion of the recovery and a major escalation of inflation will become twin dangers, at almost the moment that economic activity begins to pick up—a potentially fatal flaw in the Kemp-Roth approach.

At that point Mr. Reagan will have to make some tough choices, and jettison the arguments against using the public credit for public purposes. If his constituency—the producers he called "heroes" in his inaugural speech—insists that the growth policy take precedence over ideological considerations, the right decisions will be made.