

Domestic Credit by Richard Freeman

Regan's bad advice to Reagan

Failure to "scapegoat" the Fed means Volcker will be allowed to accelerate the depression.

Treasury Secretary Donald Regan's comment that the Feb. 1 increase in the prime lending rate from 15.75 to 16.5 percent is "a temporary phenomenon," and that this will not prevent, "a roaring recovery" from taking place in the spring of this year, shows confusion, to say the least, at the top levels of the administration. Regan, speaking Feb. 2 before the National Press Club, was still touting the line that tax cuts in July and budget slashes for fiscal 1983 would be sufficient for that recovery.

But Regan's Press Club remarks did not reckon at all with the reason Federal Reserve Board Chairman Paul Volcker forced interest rates upward.

On the surface, Regan's remarks might look like a case of foolish "boosterism" on behalf of the Reagan economic recovery package. Closer inspection shows that Regan may in fact be in on a Volcker support operation that may very well lead President Reagan down the path of Hooverization.

It is after all Regan who on CBS News' "Face the Nation" Jan. 31 said that "Volcker should definitely stay on as Fed Chairman; he's a good professional." Regan also said, "The administration does not intend to scapegoat the Fed" for the current recession. "The administration will take the blame or credit—I think the credit—for what happens to the economy."

Thus, Regan graciously loaded

onto Reagan's shoulders responsibility for what happens to the economy as a result of Volcker's disastrous monetary policy over coming months.

What is most remarkable is the way Regan bypassed the fact that interest rates are rising at all during a period when industrial production has been falling at a 17 percent annualized rate over the last July-December period, and will be shown to have fallen during the January period as well. If the Department of Labor is correct that the Consumer Price Index rose by 8.9 percent for the 12 months of 1981, then a 16.5 percent prime minus a 8.9 percent inflation rate gives a 7.6 percent real interest rate, the highest in 100 years. How is this possible in the middle of a still-worsening recession?

Two things explain this, which Mr. Regan should have thought about before he opened his mouth. First is the fact that Volcker is manipulating the situation on behalf of the New York-based Council on Foreign Relations policy of "controlled disintegration" of the U.S. economy. Volcker is, after all, the one who raised the federal funds rate at which banks trade excess overnight reserves from 12.54 percent Jan. 1 to 15.50 percent Feb. 1. This sets the floor under the prime rate. Volcker also ensured bank reserves were \$2.5 billion lower for the week ending Jan. 20 than for the week before.

Volcker, who told the Joint

Economic Committee Jan. 16, the day of President Reagan's State of the Union address, that there would be "more pain in the inflation fight," meaning further destruction of the economy, was disappointed that the President refused to push for new excise or oil import taxes. Failing that, the Fed created the tightness in the banking system that would force the prime rate up. Some people would call this retribution against President Reagan for refusing to impose new austerity taxes, and they would be right.

Then there is a second consideration: the fact that corporations are still borrowing exceedingly heavily to refinance the Volcker high interest rate-enlarged debt load. According to St. Louis Federal Reserve Board figures, the lending of large weekly reporting banks to business jumped from \$188 billion Nov. 20 to \$195.2 billion the week ending Jan. 20, for a 20.6 percent per annum growth rate—phenomenal in the midst of a recession. The tremendous borrowing of corporations scrambling to refinance their debt, is probably the biggest cause of the \$10.8 billion increase in money supply through the week ending Jan. 13. The fact that only \$600 million of this washed out over the next reporting week means that if there isn't further wash-out through the middle of February, business borrowing is the prime cause of the money-supply increase.

Volcker's tightening decision was taken against the background of a 24 percent drop in sales and 39 percent fall in production for the auto industry in January compared to last January's dismal levels. A tightening now will ensure a deeper depression; recoveries don't occur at 16.5 percent prime rates.