Carter, Pain, and Inflation

viewpoint

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Pain—*our* pain, of course—has been a constant theme of Jimmy Carter's since he burst on the national scene. During the 1976 campaign Carter assured us that "Ah feel yo' pain," and such is his enthusiasm for this empathy that he has gone out of his way to inflict pain ever since. After he went to the mountaintop last summer to receive his revelation on energy, he proceeded to remind us of his "pain" motif and then to scourge us for the mortal sin of wishing to buy foreign oil. His fellow born-again Christian, John Anderson, has been earning plaudits from the pain brigade for his high courage of wishing to inflict a 50-cent-a-gallon gasoline tax.

Now the old maestro of pain is back again, with his "comprehensive anti-inflation package" of March 14. Inflation, continuing for over two decades, has accelerated dramatically under Jimmy's ministrations and is now approaching the banana republic mark of 20 percent per annum. So Jimmy has decided to take off the gloves. It's "no more Mr. Nice Guy"; the time has come for stern measures, for "discipline" and especially—you guessed it—"pain."

The theory of the Carter administration, like all other administrations before it, is that inflation is some form of mysterious social disease, an epidemic among the American people. The job of the government is, like a white knight on a fiery charger, to go out and do combat with this dragon, to fight the disease. The theory, too, is that, while the causes of the inflation disease are bewildering and multifaceted (hence the need for a "comprehensive package"), they all boil down to sin—to excessive greed and hedonism on the part of some or all of the American public. Businessmen cause inflation by charging higher prices, unions by asking for higher wages, consumers by presuming to buy goods or borrow with their own money on credit, citizens by urging the poor old government to spend more. Since repeated exhortations from the White House to reduce our greed and enjoyment have failed, the time has come for the pain-master to get his jollies once again.

The Carter crackdown is on us, the consumers—strongly implying, of course, that our hedonism is responsible for inflation. Credit cards—that marvelous convenience of capitalism that enables us to enjoy first and pay later—have, like installment credit since the 1920s, long been the bane of Christian moralists. Now they are to be curbed and made more costly. Foreign oil is to be restricted once again, on the rather odd reasoning that inflation will be combated because the higher price will restrict consumption. On that reasoning, of course, we should hope for ever higher prices, unto the very stratosphere, as a method of "curbing inflation." Money market mutual funds, which, like credit cards, have nothing to do with generating inflation but are marvelous ways for ordinary people to try to catch up with inflation and not get wiped out, are also to be cracked down on and made far more costly. It is almost as if Carter looked around and discovered two dramatic recent innovations by which the lives of ordinary consumers and investors have been made more tolerable—credit cards and money market mutuals—and determined to punish us grievously for these sins.

Other forms of consumer credit will also be harassed, although of course not housing, which remains sacrosanct. And while Carter abstained from imposing wage-price controls, he did triple the staff engaged in monitoring the wage-price "guidelines" that have become a laughing-stock but have probably helped to keep wage rates behind inflation and thereby ensure more pain for the nation's wage earners. Tax cuts were of course spurned as being "inflationary." To the contrary, pain will be imposed by subjecting interest and dividend income to the barbaric system of withholding taxes, originally imposed on wages and salaries as a strictly wartime and emergency measure during World War II.

In addition to consumer credit, other forms of *non*inflationary bank credit have been cracked down on in the new Carter program. They include certificates of deposit, which is a way by which banks can borrow from the public and relend without creating more money. Commodity speculators, especially in precious metals, have annoyed Carter by being able to keep ahead of the inflation, and so their borrowing has been made more difficult. Other proposals in the package were a gasoline tax that would drive up gas prices and a renewed appeal to Congress to hurry through the "windfall profits" tax on crude oil (actually an escalating excise tax on domestic crude), which will penalize domestic crude production and make sure that oil supplies will be smaller and prices higher. *This* is an anti-inflation program?

Of course, the federal government, too, is prepared to "sacrifice." In the cause of combating inflation, it is willing to reduce its budget by all of $17 billion, a whopping 2.8 percent cut. But before we throw our hats in the air, we must realize that this magnanimous cut is not made from the current 1980 budget but from the *projected* larger budget for the fiscal year 1981. This heroic belt-tightening by our masters means that the federal government will "only" *increase* its budget from 1980 to 1981 by 7 percent instead of the originally projected 9.3 percent. Now, *there* is "sacrifice" indeed!

The point in all this is that *there is no dragon* that the federal government must go out and slay, if only it had the will. Inflation is not caused by hedonism or greed out there in the economy; it is not the result of sinful actions by businessmen, unions, speculators, or consumers. It is not mysterious, nor is it especially multifaceted. A *price* is the result of interaction between money and the supply of a good; if a loaf of bread costs 70 cents, this is the result of interaction between the supply of bread and the number of dollars seeking to buy bread. The more money bidding for commodities, the higher their prices will be. Massive, chronic, and accelerating inflation can only come about because the supply of money has been increasing at a rapid rate. And this can only happen when the sole legal creator of new money—the federal government—expands its activities as the only legalized counterfeiter in the society and keeps increasing the money supply.

There is only one institution in America that is legally empowered to create new money—the Federal Reserve System—and it can keep increasing new dollars at will.

The Fed performs its counterfeiting activities by buying US government securities. By the arcane processes of the modern banking system, for every $1 billion of US government bonds purchased by the Fed, $6 billion of new money—of new checking deposits—gets created by the American banks. *This* is the process that has been generating inflation for decades. Week in and week out, the Fed enters the bond market, buys government bonds, and adds to the money supply by six times that amount.

In short, the federal government itself, through its Federal Reserve banks, is the one and only culprit in generating inflation. Last October Paul Volcker, head of the Fed, pledged to restrict the growth of the money supply through Fed operations. But since then, Fed purchases of assets, and consequently the money supply, have bubbled along merrily at the same inflationary rate. There is nothing in the new Carter package that addresses this key problem.

There is only one thing that the Fed need do to stop inflation: stop buying assets, period. The only institution that need sacrifice, that need suffer pain, is the federal government itself. If the government stops creating new money—that is, stops *inflating*—then inflation will at long last come to an end. But to do that, the federal government will have to stop scapegoating the rest of us and look to its own deeds. The only dragon that the white knight need slay is the white knight himself.

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money

The Silver Trading Caper

By Steve Beckner

WASHINGTON. Although silver trading has been resumed in New York, questions about what motivated its suspension in late January continue. How those questions are answered could have long-term repercussions for all US markets and for the American dollar.

The questions that are being asked in Washington, in New York, and, with fervid interest, in such competitive financial centers as London are: Did the silver-buying activities of big-time speculators like Nelson Bunker Hunt and family force the New York Commodity Exchange (Comex) to issue a "trading-for-liquidation-only" rule on January 21 in order to prevent "manipulation" of the market? Or, did other influential traders and companies with an interest in cheaper silver engage in manipulation of their own to drive the price of the white metal down?

The official justification for the suspension of all new position taking in silver futures contracts was that certain large silver speculators were threatening to create a "squeeze" on the supply of silver available for delivery. Many insiders, however, including sources at the Commodity Futures Trading Commission (CFTC) and Comex, believe the exchange's board of governors may have been motivated more by a financial squeeze on prominent members who had bet against rising silver prices by "shorting" the market—that is, selling silver for future delivery.

The Comex action had the effect of braking silver's rise and in fact causing it to fall from $49.00 to $33.50 an ounce within a few days. This allowed "shorts" to extricate themselves from their sell positions at lower prices, as it also accomplished the stated purpose of relieving the apparent shortage of deliverable silver. Further, it eased financial pressures on metals dealers, who had been getting huge margin calls on short hedge positions, which their banks became increasingly unwilling to finance. Gold traders with similar exposures may have benefited from a spillover effect.

A group of unidentified "longs" (those who had bought futures in anticipation of higher prices) are still considering a suit against the Comex for possible "conflict of interest," according to their counsel, Phillip Bloom. "A large number of people on that Board are known to have been short hedgers or sell hedgers," Bloom commented. "Many of them are such that they had inventories of metals that were not deliverable or in a deliverable state, who had been hedging them in the futures market and financing the cost of that inventory at major banks. And as the price of the metal continued to rise, the banks did not allow them to continue to borrow money for the purpose of paying variation margins [additional earnest money required to maintain a futures position]. . . . So that may have precipitated the 'emergency'—not a squeeze."

Bloom has demanded all communications between the CFTC and Comex, as well as the proceedings of Comex meetings, the names of participants, and their positions in the market. The Chicago attorney, who says the Hunts are not among his clients, has not received a response to his Freedom of Information Request with the CFTC, and Comex has refused to release any information. Bloom vows that if Comex does not cooperate with his investigation he may "institute litigation and seek discovery." If he then determines there was "impropriety," his clients may sue for damages.

While this issue is being resolved, doubts about the integrity of American markets are rife. As a result, according to a number of traders and market analysts, US exchanges are losing business to foreign markets, and not only in silver. By reducing the liquidity of the futures markets, this drain of trading interest into foreign markets makes it more difficult for American producers and users of commodities to hedge their price risks via futures contracts.

Further, as prominent New York trader James Sinclair has noted, "if the interests who held those long positions in silver were bona fide international interests, specifically representing friendly OPEC nations, and we . . . reneged on their ability to take delivery, then we may have inadvertently seized their assets." That, he added, not only "takes interest away from our exchanges" but is "terribly negative for the dollar."

Sinclair says the "delivery squeeze," to the extent there was one, could have been handled through "negotiation" rather than through the drastic steps that were taken. "Longs" would have "acquiesced to taking reduced deliveries over deferred months." Bloom concurs, asserting, "My clients were willing to roll forward [their long positions]. . . . Nobody asked them."

One Comex member, who did not wish to be named, has suggested that firms and traders with exposed "spread" positions had their "problems solved by the break-up of the silver market." (A spread, also called arbitrage, involves the simultaneous buying and selling of commodities in different months.) "You're either borrowing money on the physical and shorting the forward, or you're short the near [month contract] and long the far," he explained. Either way, the short side of the spread was creating painful financial pressures not offset by the long positions.

He said his firm had gotten a $90 million margin call on the short side of one of its spreads. "We're a moderate size arbitrageur," he noted. "If we're getting $90 million margin calls, my colleagues are getting $200 million, $400 million, and $800 million margin calls." Sooner or later, the banks "are going to shut you off," he declared. "And unless something

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