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Open Letter On The Crash of 1987-1988

by Lyndon H. LaRouche, Jr.

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Dear Fellow-Democrat:

My credibility and responsibility have soared as a result of the international financial crash of "Black Monday."

So far, the administration and leaders of the Congress are repeating almost word-for-word the same mistakes of Herbert Hoover and the Congress back during 1929-32. Let those proposing budget-balancing measures face the fact that about \$100 billions of federal tax revenues were suddenly wiped out by the time of close of business on "Black Monday," and as much as \$400 billions in federal tax revenues will be wiped out by time the smoke clears on the really big crash that is still coming.

The failure of both the administration and congressional leaders to face the reality of the situation is inviting chaos in financial markets and the economy as a whole. Once the collapse of the international financial bubble hits into the highly-leveraged layer of real-estate holdings, banks around the nation will be swept away in a tidal wave—unless federal regulatory action intervenes to prevent this.

Contrary to the President's wishful assertions, the economy is not sound. Agriculture, manufacturing, and basic economic infrastructure have been collapsing at an accelerating rate since February 1980; a growing portion of the work-force has been shifted out of productive employment into much lower-paid administrative, sales, and services occupations. Over the past ten years, households have shifted from being depositors of savings, to victims of a rising mass of credit-card and other high-priced debt.

As a result of these trends, the (inflation-adjusted) tax-revenue base has been collapsing at the federal, state, and local levels. Cuts in government budgets for every category excepting debt-service have not been able to keep up with the rate of collapse of the tax-revenue base. The solution is to put the United States back to work, through increasing the number of workplaces available in manufacturing and capital improvements in basic economic infrastructure: to raise the real incomes of households and businesses, and thus increase the tax-revenue base.

It will be impossible to bail out those sections of the financial markets which have reached price-earnings ratios in the vicinity of 1,000-to-1. To attempt to bail out these parts of the market

would bankrupt the federal government and Federal Reserve System. All that government could, and must do, in these markets, is to use the regulatory powers of government to ensure that the collapse in prices is an orderly one, and not the chaotic collapse which could sweep away the banking system.

The following actions must be taken, even long before the January 1989 inauguration of the next President.

1. The President must declare a national economic emergency.

This enables the President to employ his constitutional and statutory authorities for dealing with this crisis. It also assures citizens and foreign governments that the United States has faced the reality of the crisis and is prepared to deal with that reality.

2. The President must use the regulatory powers of government, to defend the value of the U.S. dollar, defend the value of U.S. government bonds, and ensure that even seriously troubled local banks continue to conduct ordinary day-to-day business under such measures of medium-term reorganization as may be required.

3. The President must employ his emergency powers to "federalize" the Federal Reserve System.

The Federal Reserve banks must be transformed, for the duration of the emergency, into a de facto national bank, like President George Washington's Bank of the United States.

The issuance of additional volumes of Federal Reserve notes must be suspended for the duration, to be replaced by issues of U.S. Treasury currency-notes, issued by act of Congress under Article I of the federal Constitution.

Over the coming five years, beginning immediately, several trillions of dollars of Treasury currency-notes must be issued. This must be loaned, at federal rates of between 1% and 2%, through the Federal Reserve as a national bank, and through participation of local private banking institutions.

These loans should be limited in application to job-creating production loans for capital improvements and operating capital of agriculture, manufacturing, physical-goods-producing industry generally, and to federal, state, local agencies, and public utilities, for capital improvements in basic economic infrastructure.

Although one more big round of deficit-spending in government operating budgets is unavoidable, during the period of the bottoming-out of the depression in the tax-revenue base, the philosophy of government must be to stimulate the economy through loans on capital accounts, rather than deficit spending on account of the operating budget.

The immediate objective of such capital lending of U.S. treasury-note issues, is to stimulate a rapid rise in the tax-revenue base through expansion of the incomes of businesses and households.

Over the medium-term, the philosophy of government must be to ensure that, on the average, for every dollar issued as loans in this way, more than one dollar's worth of capital improvements or tangible output is added to the economy as security for the loans issued.

4. Investment Tax-Credits

An emergency tax-reform must be included as part of the emergency actions.

This must include restoration of investment tax-credit incentives echoing the successful model of the Kennedy round of such tax-credit incentives for investment. It was the combination of the Kennedy round of tax-credits with the technological stimulants spilling over from aerospace research and development which caused the Kennedy recovery to be the most vigorous of the postwar period to date.

We should improve the Kennedy model of investment tax-credit incentives by extending the benefits to the banks and depositors who participate in the loans used for the relevant capital improvements. The included object is to foster investment of retained earnings and savings in the areas of technologically progressive job-creating ventures, as opposed to the speculative trends of investment during the past 20 years.

We must maintain and expand the base-line of purchases of household market-basket goods, through increasing the number of skilled and semi-skilled industrial operatives employed, while increasing the percentage of household income flowing into financial savings.

Our tax-policy should emphasize sheltering two sectors of income: per-dependent tax-exemption increases, and income promptly invested as savings in promoting capital investment in technological progress and expansion of production of useful physical goods.

Such tax-reform measures are economically feasible, sound actions under present conditions. The tax-revenue base would rise faster than the amount of tax-relief provided.

5. Economic Objectives

So far, the Reagan administration has been guided by the economic mentality of the reseller and financial speculator, with exhibited ignorance of the standpoint of the management of enterprises of agriculture and industry engaged principally in the production of goods. Thus, if goods can be purchased more cheaply abroad than from U.S. production, domestic production is collapsed, and dependency upon assumedly cheaper imports increased: This is the root of the soaring of the trade deficit.

Even if U.S.-produced goods appear to be more costly than imported ones, the tax and other benefits of producing goods inside the U.S. far outweigh the apparent, marginal advantage of cheap imports. Every U.S. employee is a taxpayer, and his

or her employer, too. Every U.S. producer of goods is a market for domestically produced goods and services.

The elementary fact apparently overlooked by the Reagan administration so far, is that we must pay for everything we import. We are able to pay to the degree U.S.-produced goods are exported. Collapsing levels of U.S. employment in production of goods, for sake of growing floods of cheap imports, is the sure road to national bankruptcy.

Also, the sole ultimate source of real economic growth is the increase of productivity in production of physical goods per-capita and per-square-mile of land-area used for agriculture, industry, infrastructure, and residence. Ultimately, this increase in productivity comes from capital investments in production and infrastructure which raise the level of technology employed.

The objectives must include increasing the number of workplaces in production of physical goods by not less than five millions so employed, over the coming four to five years, and proceeding to raise the percentage of the U.S. labor force so employed to between 40% and 50% by the close of this century.

Let x signify the percentage of the labor-force employed as operatives in production of physical goods, and y relative productivity of the labor-force as a whole. Then, $100 - x$ is the percentage of the labor force either unemployed or employed in overhead-burden occupations of administration, sales, and services. Let r signify the physical productivity per operative, measured in per-capita market-basket of combined capital and household consumption.

Then productivity of the operatives ration of the labor force is rx , and relative productivity of the labor force as a whole is $y = rx/(100-x)$. So, for every increase or decrease of x , relative productivity of the labor force as a whole increases at a rate expressed by the integral of this function, $F(x, dx)$. Over the post-war period, the ration of the workforce employed as such operatives has declined, from above 60% to the vicinity of 20%.

So, increasing the percentage of the operatives component of the labor-force, is presently the cheapest and quickest way to increase national productivity. So far, Reagan administration policy has been aimed to produce directly the opposite effect. That policy must be dramatically reversed.

It is unnecessary, and most undesirable, to repeat the follies of Smoot-Hawley. Instead, we must use a system of tariffs and regulatory measures of import-licensing, which encourage desirable inflows of capital and consumer specialty goods, and set a price-floor on effective domestic costs of other categories of imported goods. At the same time, we must provide U.S. producers ample, low-cost credit for medium-term and long-term financing of exports, especially of basic foodstuffs and capital goods.

In any case, we must resort immediately to export-import licensing as the regulatory means for managing the current problem of trade-deficits. This involves a delicate, but workable set of diplomatic negotiations with trading partners. Most of these, such as Western Europe and Japan, recognize that the stability of the U.S. economy is in their own most vital interest; they will accept any sensible arrangements which all parties recognize as well-designed to accomplish that most-desired result.

We must regulate imports with emphasis upon current payments accounts. The balance of current dollar claims upon the U.S. by foreigners is what must be managed. We must control this for the immediate future, and over the medium-term ahead. Hence, the terms of credit offered by exporters to U.S. markets, should be a marginally decisive factor in import-licensing.

We must use import-licensing and tariffs to provide a fair-price shelter in domestic markets for basic foodstuffs and manufactured goods. Where reasonable tariffs will accomplish this result, we should prefer this to restrictions on import-licensing. Where higher tariffs would be counterproductive, we must place relatively more emphasis on the mechanisms of import-licensing.

In compensation to OECD trading-partners, we must take the lead in reorganizing the foreign debt-balances of developing nations which are the traditional markets of Western Europe, North America, and Japan.

Under present terms, these debt-balances are unpayable in any case; so we lose nothing by classing large portions of these debts as non-accruing and rescheduling principal payments. To enable those debtor-nations to meet new schedules of payments, we must foster their internal economic growth in per-capita output of physical goods, which requires relatively large emphasis on imports of capital goods for building industries, agriculture, and basic economic infrastructure. This represents a market for capital goods in the order of tens of billions of dollars, or higher, annually.

We must share this reopened market for exports equitably with our OECD trading-partners, thus compensating them for the downward adjustment in exports into the U.S.

6. Technology

Despite the severe constrictions on federal expenditure at this time, we should adopt the proposed Moon-Mars space-exploration-and-colonization program as a technology-driver for the U.S. economy's growth of productivity.

This must be organized in such a way as to directly foster a regrowth of the U.S. machine-tool industry on a most advanced technological basis, including production of laser machine-tools. Research-and-development prototypes developed thus become, more or less immediately, available new technologies for our industries.

The political implementation of this approach requires some clarification.

The inevitable, deep collapse of private financial markets means a diminished role of the existing form of the financial sector in industry and commerce. The issuance of loans of U.S. Treasury notes through the banking system undergoing reorganization becomes the dominant credit-mechanism in the economy. This establishes a new informal relationship between the Federal government and industry.

In effect, the President and Cabinet must call in combinations of corporate industrial management and trade-unions for consultation. The establishment of a working consensus in

support of feasible programs of technological upgrading of the automobile and other industries, must be the objective. Once the consensus is reached, government must agree, for its part, to assist the success of the growth-programs through attached priorities to flows of credit into such programs, and through such "bureaucratic red-tape-cutting" emergency legislation as may be required to facilitate the work in other respects.

The correlated activity of this sort by government, is the promotion of capital improvements in basic economic infrastructure. This involves government in reaching a consensus with federal, state, and local agencies, and with relevant public utilities.

This sort of consensus-building among government, production management, and labor, is the proper approach to getting the desired quality and scale of results at the optimal rate.

Under such arrangements, government can coordinate the task-oriented progress of technological research and development with the investment plans of industry. The general objective is to make the U.S. economy once again the most technologically advanced and productive one, through emphasis upon leap-frogging the levels of technology currently in use in other nations.

In Conclusion

The essential economic fact underlying the recent and impending financial crashes, is that twenty years of drift toward a "post-industrial" utopia has shown itself most dramatically a catastrophic failure. We are in an economic condition today somewhat analogous to the state of affairs during the second half of the 1930s, although structurally our condition is relatively worse than then. The same proven methods which pulled us out of that depression will succeed now, with the advantage of hindsight guiding us to avoid some of the mistakes included in President Roosevelt's recovery efforts.

It is urgent that as much of this as politically possible be accomplished during the last fifteen months of the current administration, and the job of restructuring completed under the next President. Our immediate concern must be to minimize the danger of chaos, and to introduce some measures of genuine economic recovery. Otherwise, the next President will be faced at his inauguration with a disaster of incalculable proportions.

The new view of policy perspectives must be adopted by both parties, or, at least, a large part of each. Up to this moment, the proposals from the administration and the leadership of the Congress are equally disastrous, equally echoes of the observations and recommendations of the Hoover administration and Congress during the 1929-32 period. We must break through that log-jam of habituated, but outlived perceptions. Those of us more receptive to the need for the changed outlook must start the political ball rolling, and that quickly.

Sincerely Yours,
Lyndon H. LaRouche, Jr.