Hi wages:

Stimulate certain kinds of inv. - labor. savg, including offshore exports of K.

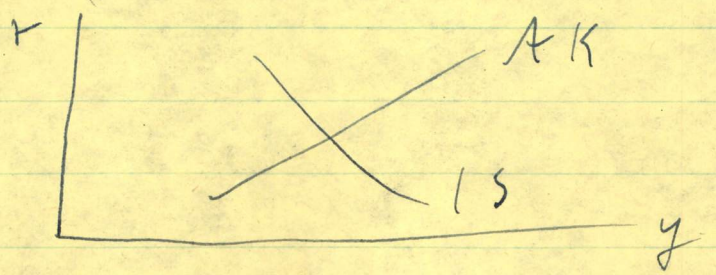
~~Raises~~ Thus in s.r., for a while hi wages downstream & I upstream. And hi wages upstream & one round of I, to build more durable.

Thus, both Work + Earth may be o'priced, + K ~~priced~~ is diverted to o'come - for a while. But then re inv. falls short.

What shd. students learn?

Findings + conclusions of Macro

1. Incomes depend on flow of real inv.
   to focus on what det. that.
   Flow incl. in s.r.
   Avenues annuelles, etc.
2. Can labor make jobs by ~~to~~ cutting wage?
   - underconsn. argument
   - s.r. inelast. of inv.
   - l.r. adaptability of progress.
3. What brings on recessions
   Schedule of maturities approach — tells you when sources of inv. ~~is~~ are drying up — + these sources come from sales, are ∴ balanced by them.
4. Slow payout, or long lead-time, means hi K/y.
5. Hi r speeds payouts, softens IC.
6. Hi r required ∴ to let y.i. expand.



(If LM is rt. of AK, LM is inoperative; + v.v.)

If IS crosses AK, + more folks want work, lower w.r. shifts IS to rt, and AK to rt.

7. Ec. is self-reg.g. Show what regs. it.

8. Cf. 3. History of boom + bust.
Signal of hi r, before bust.
Refuted undercons: confirms shortage of disposable cap.
China + Russia now aborting heavy-hand tmts to lt. indy.

9. How big. panic stimulates undercons. leads to wrong explns.

10. The mult. bus. is another way of describing a (mild) flight from the $.
LM curve shows flight into $.

develop this

11. The real counterpart of mult. is, attempt to s inv.? It works if K will turn faster, or not slow down.

12. How infln. is institutionalized.
Obstacles to stopping infln.
Valuation: reg. cash flow

13. False balance for infln. Buzz raps, § constantly drinned into us.
Greed of profiteers.
History of dumping on specs, now redirected to food distn. system, e.g.
Wage rates.

14. Perils of banking. Barron Mort, Lend Corp.
Curve, decline Acts 45: 698-709, 8/31
Simpson, Fisher
Mintzing - Validating infln.

Monetizing r.e.
Causing infln. by Prop. 13.
Size of mortgage debt + fed. debt, held by comm. banks.
History of wild banks of issue.

15. Tax on fed debt, $806/yr.

16. Light indy. using soft $ is what makes jobs.

17. Short loans encourage saving bcs. they must be paid off fast.

18. Text builds model after model.
Tchg. needs to build one model, then use it.

19. Cause of inflm. is ΔM
" ∴ ΔM is political

Banks
Govt debt

L.V. L.V. are political. Try to establish this as a principle.

20 ~~21~~. Anti-labour bias
TIPS
COWPS

But cf. min. wage.
Idea is, reduce wage diffs. Reduce incentives.

21. ~~Wages~~ Wages & incentives.
It is not wage level but wage structure that makes incentives. Most writing misses the mark.

Hence the folly of our approach to levelling. We use min. wage: then apply prog. pers. inc. tax to wages.

Proper approach to levelling: tax property.

22. To create K:

ΔS

Stop subsidizing cons., e.g. by 30 yr. mtd. mortgage.

Lower l.v.

Raise m.e.c.

23. "Productivity" - causes of decline.

If you ↓L + fixed land + cap, diminishing returns reduces ↓P productivity. But rents are larger; int. higher. Y+ is less per worker, but they weren't getting it anyway.

If ~~wives go to work~~ you add to L force large nos. of new workers of below ave. "skill" (trng, motivation, strength, endurance, risk-willingness, stability, etc.) -- say "grade" -- this reduces marg. productivity.

If use less energy, environment, etc. -- lowers it.

If shift cap. o'seas, lowers it.

Big ↓ Women (?) cap. export; wage structure reduces incentives.

24. Int'l. problem

Cap. drain o'seas. "Runaway"

Mil. spending o'seas.

Resource dependency

Govt giveaways.

Fgn. govts. influence on feds.

Exports stimulated to pay for cap. export + world police, causes inflation at home.

24½. Can we make work for labor by forcing use of K?

25. Instl. supply brakes, barriers
Farm acreage
~~Sa~~ Zoning
Cap. diversion from higher uses
all subsidies.

✓ 26. ~~Ref~~ Role of Positive Mental Attitude.
We identify brakes & constraints, like diminishing rets. & crowding-out, but not to shoot down hope & optimism. Rather, only to shoot down false optimism, & find way to true optimism.
E.g., LM curve as constraint leads to ΔM as solution. But ΔM → ΔP, new constraint. Also, K/y const.
~~ΔΔ~~ ΔP as constraint leads to -ΔK/y, & $-\frac{Geo}{y}$
(Geo = earth)

27. Acceptability. Low K/y needed.

28. Instl. bias favors hi K/y & hi G/y
List. instl. bias

"Tax-based incomes policy"

29. Carter slogans · "incomes policy"
TIP, disrupt., COWPS, COET,
Monetarism (Carter appted Volcker) + msteady i.r.,
Food as a weapon, recession as a weapon (new classical sci., nds)

✓ 30. Beware politicians demanding sacrifices!
" " says "no simple answers". Means they have no answers at all. Likewise, "no panacea".

31. Eff. ≡ output / input

32. Oil + ⅔ food price Δ are not "special factors"; but dim. ret., a basic factor.
Check food + fiber relatives. Maybe a shift there as big as OPEC.

37. p. 71, 1/81 Rpt CEA

Quite instructive, but sketchy + maybe confusing ✓

(K-stock, non-resid., % change, "ave. annual rate".)

1949-59	4.0 %	9.1	Real bus. fixed inv. ÷ GNP
1959-69	4.6	9.8	
1969-74	4.2	10.5	
1974-79	3.0	10.3	

(More)

33 (cont.)

Why is ΔK slowing in 1974-79 while Inv./GNP stays same? Bec. of faster depr'n. The "Inv." used is "Gross".

Depn. is faster bec. they've been investing more in equipment, less in plant than before.

34. Another approach to ave. payback pds. is "ave *age of K stock." p. 11 They evidently use carcass age, unweighted. The key qn. of course is how to weight this ave.

A correct method wd. wt. by remaining value, so old carcasses had low wts.

"Age" wd. be defined by viewing ea. item as an aggreg. of units. (The unit is ~~R.K.U.~~ Real Capital Unit, R(U.) Age is the no. of yrs. the RCU has been in storage, waiting to be "picked off".
As it is ripening, Δ RCU are added all the time.
Working out math, one gets a younger ave. age than by their evident method.

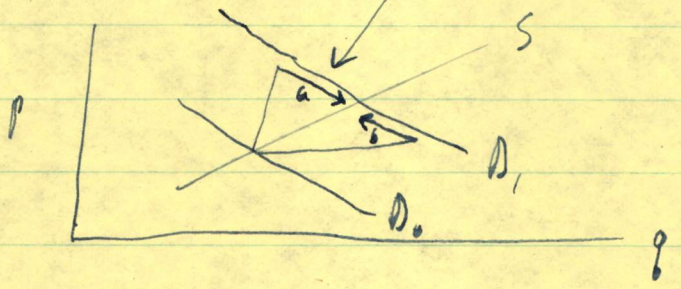
35. U.S. devaluations. Dates; effects on exports. Effects on p of imports ("supply shocks" caused by us, merely reflect our inflns.)

These alleged $ shocks weren't that at all, but

part of gen. infln., esp. as hit by devaln.

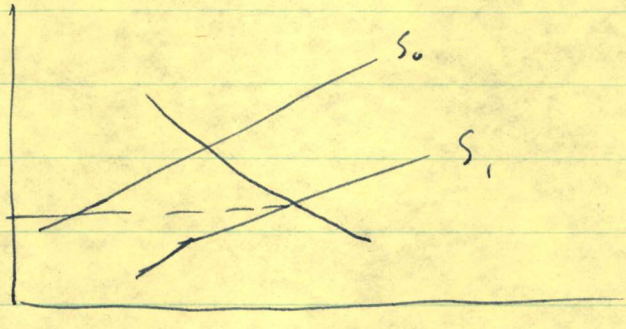
Devaln. raises import price.
" " export demand, hence domestic price.

36. "Compensating reflex"



Fod concludes,

a. Higher demand reduced price, or
b. " " " supply
" price reduced "



Fod says, lower price raised supply?

Ec. 100 B
Fri., Feb. 6, 1981.

A. Loose ends from N.I. accts

1. Cap. gains.

Formally, if we added in gains accts. wd. still balance. On inc. side, Δ inc., (to be divided into C + s). On product side, Δ value is a product.

or "tautologically"

There is unfinished business here, tho, after formally balancing the accts. A new tension is created. On inc. loop, there is a pressure for ΔC, = 85% or so of Δ$. This is reinforced over time, as wealth grows -- a 2nd effect.

On product loop, there is tendency to spend more on C, but there is no more to consume. (there are wishes, wants to consume) This will first, cause disinv., high. of real i%; 2nd, drive up prices; 3d, if ΔV is continuous, a continuous ~~drop in~~ lower level of real inv.

The ΔP is aided by 2 factors:

a. Unrealized accruals do not use any money themselves. They are part of "barter ec.", so to speak,

where the "buyer" is internal to the owner.
But they affect cons. spending just as tho they were money income. In terms of money, the owner stops, or reduces saving, spends his whole money income (or even more). Substitutes $ value for other saving.

So, M is spent faster.

b. There is more M, as banks expand. (Think of them as printing M, bank notes, like old "banks of issue.")

2. Cap. gains as prop. inc.

By omitting, overstates share of labor. Encourages dumping on labor, blaming labor for infln., as tho labor were only cost.

3. Current proposed change in CPI
– omit cost of buying home.

Valid? No. Just bec. seller is better off, doesn't make home cheaper to buyer.
Proper approach is to Δ inc. side.

~~4. Govt. durables ~~ counted as~~

4. "Saving" is a residual.

Msrd. inc. vs. Msrd. spending.

Both measures flakey.

Enormous leverage. Msrd. ~~spend~~ saving bobs up & down. We don't really know.

Beware those who draw big conclusions from alleged changes.

5. 3d part of rule: must not be resold currently.

This excludes intermediate goods, avoids double counting.

But if value is added, the v.a. is counted. This is normal

Most of gross inst. is in things that are resold in current pd. This just disappears from NIPA accts. E.g. the broilers. The last sale is usually C. (over)

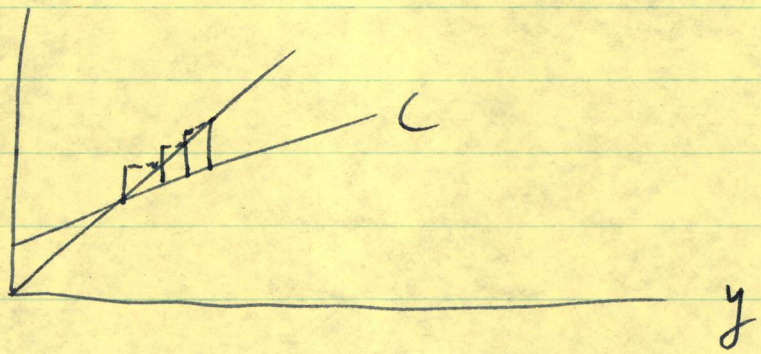
When NIPA goes from NNP to GNP they add in CCA. But this is only depreciation on long-lived K. They do not add in CCA for inv. depletion.

The inv. + disinv. cancel out. Result is to overstate C as a driving force in causation of n.i. ~~Gross-gross~~ True gross inv. > C. This is partly compensated by giv's net inv. big leverage over C; but effect is to focus on durable invts., overlook short inv. Leads to policies favoring long invts.

Thus the mass of replmt. inst. is obscured.

This leads to, or is part of, an exaggeration of the role of autonomous consumer decisions. Model says, $C \rightarrow Y$. But really, gross inst. $\rightarrow Y$, and there is reason to believe the inst. decisions are more autonomous, & are what make spending rise & fall.

Mult



Closed system
Hot pot effect
Deck of cards

Study aid, 1st midterm, Ecs. 100B, S87

Learning by vocabulary expansion. If you can define these words and concepts, and/or discuss them intelligently, you will have no problems.

fund, flow
flow/fund ratio
turnover
payback period
period of investment
consumption
KF (fixed capital)
KI (inventory capital)
durable, nondurable capital
long, short capital
depreciation (use, time)
obsolescence
using, using-up
preempting space, time-slots
implicit, imputed
capitalization
devaluation
revaluation
expense
investment
factor, compounding (CF)
factor, discounting (DF)
factor, present value (PVF)
factor, future value (FVF)
*factor, instalment plan (IPF)
*factor, sinking fund (SFF)
capitalized interest
CWIP
com/simp ratio
valuation
level flow
annuity
coupon
productivity of consumer capital
investment (I)
disinvestment (-I)
appreciation (capital gain)
value-added (v.a.)
final product
collateral

flow-through
throughput
input
output
factor (of production)
household
capital recovery
replacement
"financed" (debt-financed)
inventory
infrastructure
Roman Road Syndrome (edifice complex)
goldplating
income
national income
gross product
GNP
using, using-up
expendable
corpus, substance
carcass
increase
equity
liquidity (of real K)
capital (K)
"Price Club Principle"
investment (net vs. gross)
exports (net vs. gross)
*levelling (up vs. down)
net/gross ratio
driving the system (or model)
loanable funds
investable funds
loan recover
capital recovery
cash cow
corporate saving
undistributed profits
solvent

amortization
direct investment (vs. indirect)
system analysis
tapped out
import balance
repatriation
crowding-out
land-saving
land-enhancing
upstream (vs. downstream)
time-slot
bonds vs. stocks
term
growth rate
inflation
base year
deflated $
value-added
fallacy of composition
superior goods
artificial scarcity
structural chokes
velocity
debt service
zero-sum game
drawdown
saving
trade deficit
closed economy
transfer payments
land-linking
pipeline (as allegory)
consumptive use (preemptive use)
exclusionary
redeemable bond
possessory interest
rule of 72 (doubling time)
CPI (consumer price index)
current $
constant $
choke (bottleneck, venturi)
macroeconomics
Malthusian theory
valence
underconsumptionism
12 determinants of velocity
turnover: of money; of loans; of ownership; of KI; of KF
wages-fund theory
subsistence
factor proportions
continuous variation (vs. discrete)
circulating capital
advances
differences of kind (vs. of degree)
either/or vs. shades of gray

H & T, ch. 12, Aggreg. Supply & Eq. Growth

I've never seen an ideologically neutral macro book. They reflect their times.

1. Wage flexib. assures full empl. 325
   In l.r. this really happens.

2. Output depends solely on supplies of labor & K. 325

3. Tax policy shd.
   a. Encourage K formation.
   b. " labor to work more. 325

4. Price flex. ass. is "classical".
   "Neoclassical growth model" refers to revival of classical assms. in 1950s to study long term growth. 326
   (Thus this use of neoclassical is diff. from micro usage, e.g. Leigh, 1947. Neoclassical ~~evidently~~ referred to shift of emphasis from distribn. to allocation.)

(1)

(2)

5. True Classical was clear you cd. Δ demand for labor by using land-saving new mchs. (Mill). + opening new land.
   Ricardo also showed some uses of K were more labor-using than others. So did Austrians + Wicksell.

   These wd. Δ demand for labor.

6. Δ demand for labor wd. help labor.
   a. If supply fixed, raise w.r.

b. If supply elast., Δ empl.

(3) 7. There are homeless & hungry people. Δ demand & they will work more.

Others may choose to work less.

But the composition of work force will change. Then Δ welfare. All have more choice.

Aggregation obscures this.

8. "Rigid wages" is a cheap way of arguing that supply of labor is elastic. So ∴ Δ demand for labor ✓ denying distrib. effects will Δ empl. & output.

9. Diminishing rets. to labor, w. fixed K stock. 327
Max. profit where MRP w.r. = MP

10. Aggreg. labor supply is inelastic. 327-31.
Substn. effect makes elastic
Inc. " " ~~is~~ perversely elast. (backward)
Combo makes fixed.

11. Errors

(4) a. Distrib. effects offset, ~~or more than offset~~, inc. effect. Higher wage inc. from lower prop. inc., no net inc. effect.

~~b. Wealth effect~~

Analysts avoid this bec. they like to identify with

"win-win" situations, thus win support from all sides.
So they downplay distribn., or cutting the pie.

b. Distrib. effects more than offset inc. effect, bcs. of wealth effect. L.V. & comp. shares fall
i. The fall itself is neg. inc.
ii. The lower level is permanent.

c. Kind of work changes.
When mkt. demand for work is low, work on home, car, or boat, if have one. If not, work at crime.

d. Amt of work done is variable, historically.
E.g. ~~##~~ from 30% ~~####~~ unemployed to 0%.
1938-42.

Roman mobs.

e. People move for higher wages; change jobs; accept hardships; train selves;
So, consistently, they also do more work.

12. Output depends on fixed labor supply. 331

13. Unempl. is natural. 332 ff.
a. Frictional, -- job search. B.S.
b. Declining indies, unreconstructed people.
c. Mgmt. people

b + c basically say people are the problem. ~~The system~~

(5) People shd. be reshaped to fit the system, rather than the system accommodating people as they are.

cf. U.S., 19th Cent.

Japan, today.

14. How measure natural rate? ~~It~~ Whatever it is is right!
If unempl. rises, it ben. nat. rate is rising! 334.
But it will take 10 more years to know! 334

(6) 15. Shd. Δ K stock (shd. say flow).

16. ITC worked for a while; then not. 338
Doubtful.

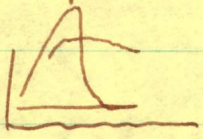
17. Goal: to make people work more - was object of '81 tax cuts.
Is heart of supply-side ecs. 339
No.

a) Max welfare is to let people choose how much they work - make it more voluntary.

(There are today illegals working for $1.75/hr in garment sweatshops, 12 hrs/day, 7 days/wk. Wage - slavery. Not desirable.)

(7) b) Supply-side shd. make land & K work harder. They are inert, don't mind.

c) ∈ of produ. can't be aggregated the way they do.



Low $\frac{MP}{AP}$ of labor on land of hi effic. + low capac.

But switch land to higher use, big Δ in labor need + output.

Mc continuity assms. of Cobb. Douglas obscure this.

~~This is a Cross hall point.~~

MM

H+T Ch. 12.

A. Major major points, direct & indirect.
(Most ec. thy. is "tendentious")
(Weasel words mean the worst.)
1. Labor can ~~act~~ accept lower wage & get full empl.
2. " supply curve is vertical, l.r.
3. S.r. problems, if any, are due to overpricing.
4. This can happen anywhere. There is only L + K, no land,
5. Output depends solely on Q of labor & K.
6. Tax policy shd
a) Encourage K form.
b) " more work
7. Neo classical = classical
8. Dim. rets to labor 327
9. Max. profit where MP = MC
10. Substn. + inc. effects on labor supply. 327-31
11. Unempl. is natural 332 ff.
a. Job search
b. Declining middle, more constructed people.
c. Mgmt. people.
12. Natural rate is found by observing what we is. 334
13. ITC effect only temporary 338
14. Make tax system less progressive.
This will ∆ work - shift vertical curve to the right! 339
Good idea, but careless & vague about "deductions". p. 340

15. If wages are rigid, s curve is elastic.

Errors

MONEY & BANKING

TEXAS BANKS: WHO WANTS 'EM?

Despite signs of a turnaround, most buyers are still gun-shy

With oil prices rising and farmland values stable after a long plunge, the Texas economy may have finally touched bottom—but not the state's default-plagued banks. As First Interstate Bancorp chairman Joseph J. Pinola prepares to purchase one of the Lone Star State's largest—and healthiest—banks for less than book value, it is anything but the start of a wave of bargain-basement acquisitions.



MOMENTUM PLACE: MCORP'S NEW DALLAS HEADQUARTERS WAS BEGUN IN BETTER TIMES

FICARA/WOODFIN CAMP

The Los Angeles banking mogul, on the rebound from an unsuccessful effort to acquire BankAmerica Corp., is buying Houston's Allied Bancshares Inc., which has $9.15 billion in assets. The price is right—securities worth $415 million to $450 million for a bank with a book value of $488 million. Still, Pinola's Texas foray is likely to be a lonely one. Ever since Texas opened up to interstate banking in 1986, only one major out-of-state bank has made an acquisition: New York's Chemical Bank, which bought Texas Commerce Bancshares Inc. in April. Pinola will be No. 2, but there isn't much of a clamor to be No. 3. "Everybody's still going to be gun-shy," says banking consultant Alex Sheshunoff.

The list of Texas banks that could attract out-of-state attention is not long. Heading it are Texas American Bancshares Inc. of Fort Worth, San Antonio's Cullen/Frost Bankers, and MCorp, which is still building Momentum Place, a spanking new Dallas headquarters that was started in happier times. But whatever these banks' strengths, out-of-state bankers have good reason to remain nervous about Texas institutions.

'AN ABSCESS.' Even with the uplift in the oil patch, bad news still abounds. Bankruptcies in Dallas are up 55% over a year ago. In March, Manufacturers Hanover Trust Co. foreclosed on the prize of the city's skyline: the 60-story Allied Bank Tower, whose defaulted loans totaled $214 million. In April alone, lenders foreclosed on more than 3,000 properties in Houston, where a 34-story office building built for about $90 million in 1984 sold recently for $30 million. "You've got to be awfully damn careful that you've assessed the market correctly," says Thomas F. Donovan, vice-chairman of New York's Marine Midland Bank. "Otherwise, what you have is an abscess that continues to bleed."

Indeed, the bleeding has yet to be stanched for many Texas banks, which have suffered from defaults on real estate loans. Allied expects a loss of $100 million in the second quarter as it writes off $96 million in bad loans. Republicbank Corp.'s repossessed properties shot up to $218 million in the first quarter from $99.1 million a year earlier. Texas American's property roster ballooned from $35.2 million to $94.2 million in the same period. And the travails of these banks are minor compared with those of Houston's First City Bancorporation of Texas Inc., whose $918 million in shareholders' equity and reserves for bad loans fail to offset $956 million in nonperforming assets.

Ironically, troubled banks have potential cachet in the hunt for a suitor: possible federal financial assistance. Healthier banks have only their unimpressive balance sheets. "Even after you turn the economy around, the banks continue to hit the wall because of all the junk on their books," notes James L. Sexton, a former state banking commissioner.

Chase Manhattan Corp., for one, is trying to keep an open mind. "We see the first signs of a turnaround," says Vice-Chairman Robert R. Douglass. But Citicorp, which itself faces a $2.5 billion second-quarter loss, is not interested in Texas banks, though it may buy a thrift to enter consumer banking. And in Los Angeles, Security Pacific National Bank Chairman Richard J. Flamson III flatly states: "We've put the checkbook away." Banks in the Southeast are not likely suitors because of legal strictures.

Texas banks may well be able to overcome a troubled past. But with loan write-offs hurting banks nationwide, outlanders have enough problems of their own without taking on a whole new set in Texas.

By Todd Vogel in Houston, with Todd Mason in Dallas

BRIEFS

JUNK BOND FEVER COOLS OFF—FOR NOW

After last year's 52% spurt, the junk-bond market will grow by only 15% to 20% in 1987, estimates Drexel Burnham Lambert Inc. With stocks up strongly and interest rates lower than a year ago, many issuers are replacing their high-yield junk bonds with less costly financing. When this phase passes, a Drexel study finds room for more junk: Only 1,100 of the 23,000 U. S. companies with sales of at least $25 million qualify for an investment-grade rating. And of the rest, only 1,200 or so have issued junk bonds over the past 10 years.

THE FRONT-RUNNER IN THE MUTUAL-FUND PAPER CHASE

With more money going into mutual funds, processing accounts has become big business. Of the 50 million shareholder accounts, 18 million are with giant funds that handle their own paperwork, such as Fidelity Investments. But most mutual funds hire other companies to handle the complex data entry and processing tasks.

By far the dominant firm in that behind-the-scenes business is DST Systems Inc., of Kansas City, Mo., which provides shareholder services to such mutual funds as T. Rowe Price and Kemper. DST handles 15 million accounts, which last year produced revenues of $101 million. Earnings per share jumped to $1.36 last year from 86¢ in 1985, and one big investor looks for $1.80 a share in 1987. He thinks the over-the-counter stock, at 33 lately, could nearly double.

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low for pockets of inefficiency, and there are active money managers and mutual fund managers who seem to have a knack for finding profits in those pockets. That's why many big investors place some 50% to 70% of their equity dollars in passive management and look for heavy-hitting active money managers for the balance. An individual could do the same by placing a core holding in one of the few index mutual funds and picking stocks or turning to a few choice mutual funds in hopes of home runs.

That's exactly the strategy that the giant College Retirement Equities Fund, with $30 billion in assets, has followed since 1981. "It's worked beautifully," says James Martin, CREF's president. "We've earned the market's return with an index approach, and our actively managed funds have outpaced the S&P by two percentage points."

To be sure, if the market were to trail off, index funds would be losers. But the dip in interest rates and a stronger dollar portend a bull market that is still in full run. And that means index funds could be the savvyest way to invest.

By Jeffrey M. Laderman in New York, with Jonathan B. Levine in San Francisco

MARKETS & INVESTMENTS

CHASE CHASES THE STOCK RUNUP—AND BIG INVESTORS

But critics fear its new CDs could unsettle the market

The stock market rally on May 26 couldn't have been better timed if it had been orchestrated by Chase Manhattan Bank. As the Standard & Poor's 500-stock index jumped 6.95 points, to 289.11, Chase unveiled a new certificate of deposit for institutional investors. The appeal: It's money in the bank, but it's also a bet that stocks will keep climbing.

The Chase move widens the potential market for a controversial product, available in a consumer version since Mar. 18. The new CDs allow depositors to play the market with a money-back guarantee. Chase expects to eliminate any market risk of its own by artful trading in stock-index futures—an activity that may spur program trading and thus increase the volatility of the stock market.

If the Chase CD looks like a stock market investment, the point has not been lost on Wall Street. The Investment Company Institute, a mutual fund trade group, is trying to halt the CDs in a federal suit, charging violation of the Glass-Steagall Act, which bans banks from the securities business. Chase, which obtained Federal Deposit Insurance Corp. clearance, denies any violation.

The new CDs do indeed look like stock market investments. The retail CD, for deposits of $1,000 to $1 million, is available in four maturities ranging from three months to a year. The amount of the market's rise during that period is multiplied by a factor, set periodically by the bank, that now ranges from only 30% for the three-month CD to 70% for the one-year CD. If the investor settles for a reduced multiplier, he can have a guaranteed annual interest rate of 4%. When the choice is a 30% multiplier, a 25% rise in the S&P 500 would bring a gain of 7.5%—and the original money back after three months.

The new institutional CD is available in terms up to 36 months, with a $1 million minimum. Institutions willing to commit their funds for that term get 115% of the S&P 500's rise in that span. Or, in return for a lesser stake in the market, they can opt for a floor return of 1% to 15% over the life of the CD.

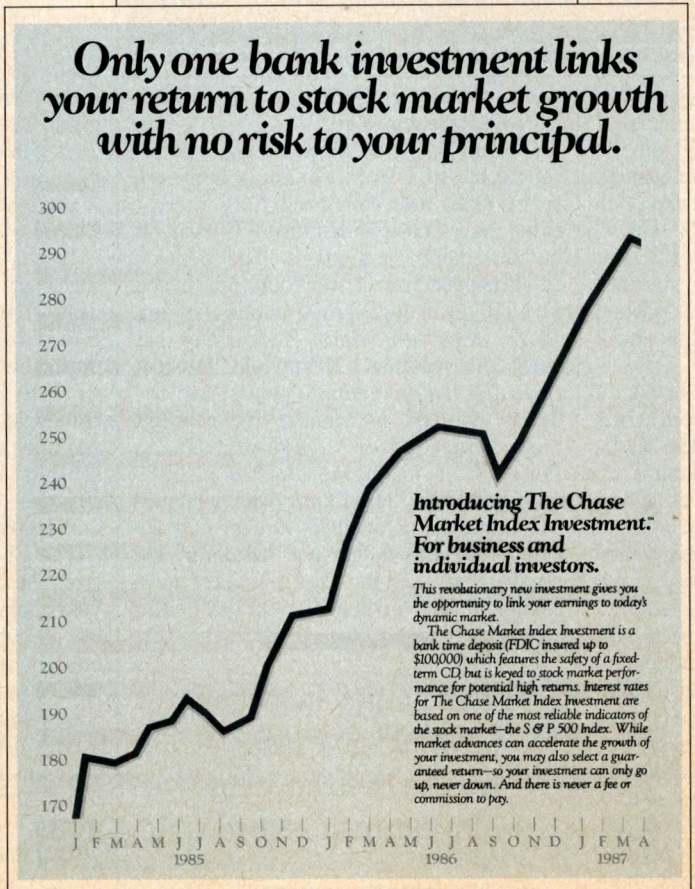
NO RISK. Neither retail nor institutional customers lose any of their original investment if the market falls—and there is $100,000 in insurance in the unlikely event that Chase itself does. "In effect, the FDIC is kind of an ultimate options clearinghouse, guaranteeing the investment if Chase fails," says Robert N. Gordon, president of Twenty-First Securities Corp.

Chase claims to have a "proprietary" formula for trading index futures, leaving the bank with minimal market risk. "By and large, we're indifferent to the movement of the market," explains Nigel E. Gardner, the Chase vice-president who runs the program. A form of "dynamic hedging," the technique involves gradually buying S&P 500-index contracts, which increase in value as the market rises. Chase buys no stocks, and if the market stays steady or falls, Chase needs to do no hedging. The only worry, says Gardner, is if the market rises and then falls. The cost of meeting its obligations to investors would then be high. "Volatility is the main variable in terms of the cost of hedging," Gardner notes.

Chase's hedging may produce an unwanted side effect. If others adopt the approach, higher-volume trading in stock-index futures "may accentuate some of the market's extreme moves," concedes Marc Chaikin, a first vice-president at Drexel Burnham Lambert Inc. "It's almost preordained," declares David D. Holt, director of technical research at Morgan, Olmstead, Kennedy & Gardner Inc.

Chase's Gardner discounts that possibility. But he readily concedes that the bank's sales of the new CDs, which Chase won't disclose, may someday reach into the billions of dollars—even if competitors don't join the fray. And some rivals have already expressed interest in offering similar CDs, notes one brokerage-house executive. Competition would mean new choices for bank customers—and, perhaps, new headaches for the stock market.

By Gary Weiss in New York



MARKETS & INVESTMENTS

WHY CHRYSLER'S CASH HANDLES LIKE A DREAM

Treasurer Zuckerman's cagey strategies have made $2 billion



ZUCKERMAN CALLS CHRYSLER'S REVIVAL ONE OF THE "THREE GREAT EVENTS" OF THE CENTURY

JOHN S. ABBOTT

In August, 1983, Lee A. Iacocca called a news conference to announce that Chrysler Corp. was paying off its $1.2 billion government-guaranteed loan seven years early. Behind Iacocca's podium was a wall-size cashier's check, placed strategically for the cameras. But before the TV lights went on, Iacocca pointed to the front row of the packed room and yelled, "Zuckerman, this check better not bounce!"

Frederick W. Zuckerman, Chrysler's treasurer, is Iacocca's pal from their days at Ford Motor Co. in the early 1960s. While Iacocca was dreaming up the Mustang, Zuckerman was crunching numbers to see if the car would make a profit. He left Ford in 1967 to join International Business Machines Corp. as a financial executive. They were reunited at Chrysler in 1979, with Iacocca still selling cars and Zuckerman still handling the cash. But lately, Zuckerman has been doing a lot more for the company than making sure the checks are good. Since mid-1984, while Iacocca has been racking up well-publicized profits moving automobiles, Zuckerman, 53, has made Chrysler a couple of billion managing its funds. Indeed, most money managers would give their eyeteeth to have his investment record.

On July 19, 1984, Zuckerman, who received his MBA from Columbia University in 1958, was convinced that interest rates had peaked. He fired Chrysler's outside money managers. The pension fund disposed of all stock and purchased $1.1 billion in high-grade bonds yielding 14.2%. For two years, Zuckerman sat back and watched. Meanwhile, interest rates fell five percentage points, and the bonds doubled in value. "He couldn't have done better," says Martin L. Leibowitz, a managing director at Salomon Brothers. "His timing was perfect."

In the spring of 1985, Zuckerman decided that the dollar was peaking. He recalls: "In London, taxi drivers were taking dollars in lieu of pounds. I realized the top had come right then." He set up a hedge in which he bought forward contracts on foreign currencies to lock in the favorable exchange rates. "We have avoided losses of well over $100 million over the past two years on the company's corporate working capital," says Zuckerman. During the same period he made an additional $100 million trading government bonds for Chrysler's cash account.

> Most money managers would give their eyeteeth to have his investment record

In late November, 1986, Zuckerman says, he was leaning toward getting out of bonds and buying stocks for the pension fund. But he didn't actually do anything until Mar. 10 of this year. He concedes that he missed one of the sharpest stock market rallies in history and that the delay cost him a couple of hundred million dollars in stock profits. But Zuckerman did take $1.3 billion, or half of the pension portfolio, out of the bond market a few weeks before the bottom fell out. True, the money went into the Standard & Poor's 500-stock index, and since late March the index is down about 5%. But bonds have dropped 15%. The net result: He saved the pension fund $100 million in losses.

NO FALSE MODESTY. Zuckerman likes to make daring decisions. Take late 1979, when he left a secure job at IBM to join Iacocca at what looked like a dying company. "I told my two teenage daughters that if it didn't work out, they could still go to college, but all the frills would be gone," he recalls. "But it was an opportunity to be a player in what could be a great event. There are maybe three great events in the 20th century," says Zuckerman, with a touch of hyperbole. "Landing in Normandy in 1944. Putting a man on the moon in 1969. And the Chrysler revival."

Like other executives who joined Iacocca at Chrysler, Zuckerman at first drew a modest salary. But he also received options giving him the right to purchase stock at $1.33 a share. Things worked out. Chrysler stock recently traded at 36. Zuckerman lives in a Park Avenue apartment decorated with 18th century British furniture and art and shuttles between offices in New York and Detroit.

The Chrysler pension fund has grown from $1.2 billion to $3.4 billion in three years, placing its returns in the top 11% of all plans. Chrysler's fund now is equally invested in bonds and the S&P 500. What is Zuckerman forecasting for the financial markets over the near term? "The stock market, in a very erratic fashion, will go above 2500 in the next three to six months. And it wouldn't shock me to see yields on 30-year Treasuries drop to 7.5%."

By Stuart Weiss in New York

H & T ch. 8

(Sum. Times, dismal sci. from Feldstein)

2. Rental Cost of cap. is a

$$a = P \frac{i}{1 - \frac{1}{1+i}^{n}} = P \times (1.7.F)$$

3. Subst. approach: rent K to save labor (sales being held fixed.)

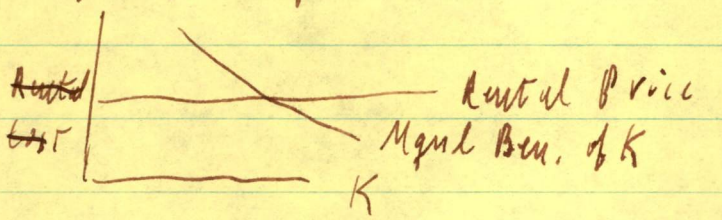
(Land-savg K ignored?)

also, to save energy, + mtrls.

(Ignores that K uses energy).

1. Goal: det. desired stock of K. Leaves this hanging.

4. Units not given. Why?



5. Components of rental price?

$R_p = i$

d = depr., derived from P^K

R^K = rental price.

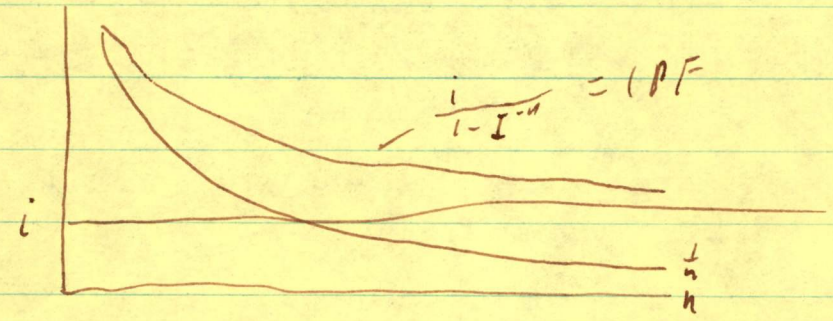
(note absence of maint, rent)

6. H & T give e.g. where $n = 1$; so $R^{15} = P(1+R)$

Value a when $n = 1$

$$a = P\frac{i}{1-\frac{1}{1+i}} = Pi\frac{1+i}{1+i-1} = P(1+i)$$

But my eqn. also gives rental cost for any n.

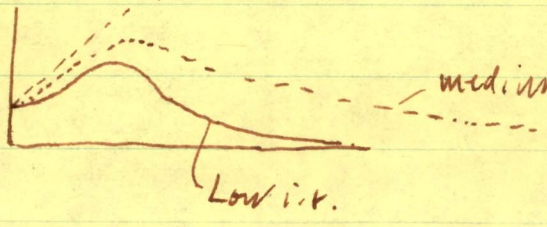


7. Dim. imp of K in their model is strictly dim. impl. rate of substn. based on ~~E~~ ass. of fixed output.

Thus they avoid facing real issues of a) Factor propns; b) Scale; c) Cause of aggreg. dim. rets.

They duck the hard & basic issues posed by classical ecsts.

8. Cash flow analysis ..... pessimistic i.r.



9. If K is expected to fall in value during rental pd, renter adds that to the depree. cost.

So they add an extra term, $-\Delta P^K$, for fall in price. This is awkward. Depreen. already covers that. In my eqn, just lower $\underline{u}$.

10. Conversely, if K will rise, they lower rental price. – say $It + \bar{I}$.

Not so: they raise P.

Need new eqn. for this, allowing for rising value.

$$P = \frac{a I^{-1}}{1-(I+g)^a}$$

$$= \frac{a}{1+i} \frac{1}{1-\frac{1+g}{1+i}} = \frac{a}{1+i-1-g} = \frac{a}{i-g}$$

$a = Pi - Pg$ .. because P is higher, not bcs. a is lower.

$$\left(i - g = \frac{a}{P} \right.$$

$$\left. i = \frac{a}{P} + g \right)$$

This accounts for much of macro land problem of misassessment.

$cc = \rho i = a + \rho g$

ρg must come from some other source.

This accts. for instability of land prices.

$$\rho = \frac{a}{i - g}$$

a small fall of g, or rise of i, collapses l.v. and stock values.

This accts for "interest-obsolescence".

11. p. 215

They have Inv. as Δ_I fn. of w.r.
We will see it is generally the reverse.

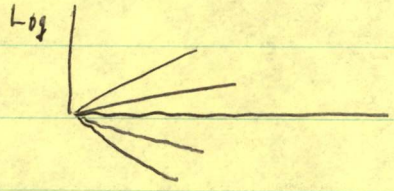
12. 216 1983

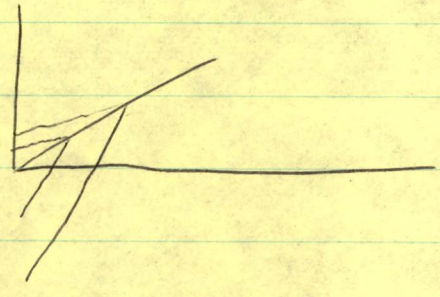
Gross inv. = 478
Depn. 377
Net Inv. = 101

13. Banking, p. 286, 284

Blind Alleys in H & T, ch. 8

1. Accelerator, p. 216.
   Makes det. of I purely circular: depends on output.
   Also on p. 220, 224
2. Tobin's "q", p. 218.
3. Taxes, p. 220 –
   Use class model instead.
4. Housing: o's state its relative durability.
   But correctly state that longer invts. are more sensitive to i.r. Recap:





$$P = \frac{u}{i - g}$$

5. Invies. bulge when demand falls, p. 225.
   p. 226 shows reverse, in general

6. "Pipeline fn. of invies".
   Rather, of <u>all</u> cap.

Chap. 11.

1. Focus on pp. 296-98.

2. Review intro. on V

3. T-accts

Fed

A	L
Bonds	Notes
	Dep's ← Reserves

Pvt. banks

A	L
Loans Invs.	Dep's.

Wed., 27 May 87

Soltani

M^s ≡ Money Supply

1. $\Delta M^s \longleftrightarrow$ ~~Xmas~~ GNP

"Xmas Mechanism"

2. Causes of innovation.

a. Old banks find loopholes in existing laws.

Interstate banking develops as outstate banks come in to bail out failed banks.

Citibank offers many services

NOWs (negot. order of withdrawal) began in Mass. pd. int. on checking accts.

Banks buy up brokers, e.g. Chas. Schwab.

b. Simple deregulation

allow ~~int~~ higher interest.

(banks & S+Ls acting merely as originators move in direction of "inv. banking".)

c. New products

0-coupon bonds

Neg. CDs

Repos

Euro $

Cash mgmt. accts

Old rule of banking: 6 - 3 - 6
Borrow at 3%, lend at 6%, golf by 6 PM

d. Industry changes — non-bank banks

e. Fn. banks

3. Why are banks regulated?
No good answers came from class.

4. Compn. is good for consumers.
E.g. Chas Schwab issues credit cards.

Fails to bring out need for ~~good~~ synthesis of regulation & compn.

Changes are happening "whether we like it or not". ("Determinism, fatalism).

O'stated ecs. of scale. Cf. Bk. of Berkeley, Oakland Bk. of Commerce.

Safety net makes banks careless. (but curable by taking losses from shareholders — and double liability)

5. Effects on monetary policy.

   a. V has doubled, 20 yrs.
   b. Defn. of M blurred.
      Near-money serving as M.

6. As Fed. squeezes, unreg. sector grows.

Labor not irksome, but labor of which cannot see good.
What get from Macro?

Basic accty. concepts
∴ fnce ∴
Some bases of macro forecasting
(Every bus. decision is an invt.
∴ inv. reqs forecast
∴ forecast includes macro element
Understanding of what forces drives ec.
Banking
Nat. Debt: asst; current def. it
Ec. interdependence
Circ: of K: of M
Capl. budgeting - inv. analysis

Kennedy	1/61	to	?/63
Johnson 1	?/63	to	1/65
Johnson 2	1/65	to	1/69
Nixon 1	1/69	to	1/73
Nixon 2	1/73	to	7/73
Ford	7/73	to	1/77
Carter	1/77	to	1/81
Reagan 1	1/81	to	1/85
Reagan 2	1/85	to	—

} Vietnam, 1963–73

Recessions: 1970-71 Nixon
74-75 Ford
-80 Carter

10/79 M growth target adopted as Fed. policy.
But misses targets by a good deal. 1/81 Rpt CEA. p. 53.

'76	6%
'77	8
'78	7
'79	5.5
'80	7%

Growth of M_1

37. U.S. exports, 1980, $= \frac{\$40.56}{.193} = \$210$ b

Farm exports are 19.3% of all.
Exports have grown fast. But cf. 40

38. Inv/sales ratio, non-farm, p. 143.
2.9 mos, up & down.
This is much higher than L.A. Times article.

39. p. 151, figuring wages as share of n.i.
They include employer share of payroll tax as part of wage! Adds 5.5%. Probly then they also include labor's share, same amt. Thus adds 11% to labor's share!

40. Nos. from Supp. of 2/81 Rpt CEA
T-bucks = Trillion or Tera. B-bucks = Billion or Giga-
GNP, 1980 III = $2.6 T (~~Tera~~ T-bucks) 10^{12}
C 1.7 T
gross pvt. dom. inv. .38 T or 379 B (~~Giga~~ B-bucks) 10^9
X, exports 342 B
M, imports 298 B
fed spending for goods & services 195
S&L " 339

40 (cont.)

Savings, 1980 III = $402 G$

Gross pvt s	446	
Psnl.		111
Gross bus. ①		335
Less govt. deficit	- 46	
Fed def.		-74
S & L surplus		29

Note: Bus. saves 3/4 of all savings; psnl. savings is 1/4. Some bus. s may really be cca – not clear. But the message is that property inc. is what savings come from. This used to be disputed.

Cap. gains not included!

p. 260. Net fin. inv. = $28 G or 10^9. But this excludes unrepatriated plowbacks, & is again unclearly defined.

① Def. unclear. "Undistr. profits .. with cap. cons. adjustments ...", but what "adjustments"?

40 (cont).

Money supply.

	Yr.	M1-A	% growth from prior yr	% growth from 1960	
	~~1960~~				
	1959	141			
Eisenhower	1960	$142.6	0.6		election yr.
Kennedy	61	146	2.8		
	62	149	2.1		
Johnson	3	154	3.4		
	4	161	4.5		
	5	169	5.0		
	6	173	2.4		
	7	184	6.4		
Johnson	8	198	7.6		election yr.
Nixon	9	205	3.5		
	1970	215	4.9		
	1	229	6.5		
Nixon	2	251	9.6		election yr.
" - Ford	3	264	5.2		
	4	275	4.2		
	5	288	4.7		
	6	305	5.9		
Carter	7	328	7.5		
	8	352	7.3		
Volcker	9	370	5.1		
	1980	385	4.1		

40 (cont.)

12/80 Currency $116 €B

DDs 269 B

p. 304 Funds raised in credit mkts., a by "nonfncl sectors" 1979.

3.	U S Gov.	37.4	
4.	"Foreign"	21.2	
7.	Corp. equity	3.5	
1.	Mortgages	160.0	
	a. "Home"		109
	d. Multi-fam.		9
	b. Comml.		26
	c. Farm		16
5.	Corp. bonds	21.2	(+ those are mortgages, too)
6.	S+L govt.	19.0	" " " "
2.	Other ≠	133	

So no longer can we say infln. to fed. debt. It comes from monetizing cap. gains.

≠ Commercial bank loans "n.e.c.", open-mkt. paper, other.

40 (cont.)

Mortgage debt outstanding, 1980 II

All	$1,386 ~~G~~	
Farm	101 ~~104~~	
1-4 fam. homes	904 ~~926~~	5/6 is conventional, not govt. insured.
Multi	134 ~~136~~	But fed. relay mkt. agencies hold 246 G
Comm.	247 ~~253~~	

p. 313 Comm. banks held $258 G mortgages.
S+L 492

p. 315 Gross Fed Debt, 1980, Dec. $914 G

Held by govt. agencies ‡	199
" "public"	715
FRS	120
Other	595

‡ i.e. owed to soc. sec. pensioners.

Budget Receipts, 1980 $520 G

Pers. Inc. Tax	244
Soc. Ins. Tax	161
Corp. Tax	65
Excise Tax	24
Earnings of FRS	12
Customs	7.2
Estate + gift	6.4
All other	.9
Deficit	59

Budget Outlays 579

1. "Income Security" (pensions, soc. sec.?)	193
2. Defense	136
3. Interest	65
4. "Health"	58
5. Ed., trng., empl., soc. services	31
6. Xptn.	21
7. Vets	21
8. Nat. Res. + Env.	14
9. "Int'l. Affairs"	11
10. Regional Dev.	10
11. Fiscal Assist.	9
12. "Commerce + Hsg. Credit" (?)	8
13. Energy	6
14. Science	6

So much for old ideas about public works spending. The big outlays are for current cons.

Not until 6, X pts. is there an invt.

Mostly pied away. There is leakage — true leakage.

But besides the budget deficit, there is another $23 G of "off budget" spending, not shown. Much of this is loans.

✓ The true problem of unempl is what it makes us do ~~to avoi~~ out of fear of it.

- massive welfare spndg.
- imperialism

And these things really worsen it.

Fed govt. mainly taxes work, & subsidizes leisure.

Combo. of min. wage & wage tax hits hardest at black youth. Crime in streets

Macro data, cont.

Year	Fed Deficit	p. 318	
40	-1.3		
1941	-5.1		
42	-33		
43	-47		
44	-55		
45	-42		
46	+3.5	Truman	
47	+13.4	Truman	Paying off war debts in earnest.
48	+8.3	"	
49	-2.6	"	
1950-59	mil. exp., no Korean war effect.	Truman & Eisenhower	
1958	-10.3	why?	
1960-69	-2 or so	Kennedy-Johnson.	
1961	-13.2	Johnson	This yr. is only Viet War effect.
1970	-12	Nixon	
71	-22	"	
72	-17	"	
73	-6	Nixon, + a little Ford	
74	-11	Ford	
75	-69 !	Ford.	End of war brings deficits.
76	-53	Ford	
77	-46	Going Wild! Carter	
78	-29	"	
79	-15	"	
80	-62	"	

Fed Recpts p. 314

Year	Total	Psnl / %	Corp. / %	Indirect / %	SS / %
1958	78.1	36.3 / 46	17.9 / 23	11.6 / 15	12.3 / 16
1980	527.3	249.7 / 47	70.6 / 13	35.7 / 7	171.3 / 32

Fed Spending p. 314

	Total	G+S / %	Xfr. Pmts, dom. / %	To Sth / %	Int / %
1958	83	51 / 61	18 / 22	4.7 / 5.7	5.4 / 6.5
1980	~~578~~	190 / 33	~~235~~ / 41	87 / 15	51 / 8.8

In 1958, fed taxed business to provide G+S.

In 1980, fed. taxes labor to provide welfare, and grants to Sth.

Note, these xfrs. do not figure in u.i. eqs calc. Yet, all the demand mgmt. theories seem to say they should.

It's no great mystery then why we're falling behind other countries. The fed budget mandates it.

But these data need reconciling w. earlier data.

Macro Mon., 4 May

$$i = a \frac{1 - I^{-n}}{P - F I^{-n}}$$

1. Sensitivity
   a. Δ fn. of a
   b. n tugs both ways.
   ✓ → Is way of finding opt. n
   Imptnt for macro - determines replmt. timing
   (But decay of a is also imptnt — big subject.)

   c. Diff. in denom. reduces i.
   Low P, hi F ∴ raise i

2. E.g.
   Citrus grove model
   Urban structures. Machines in structures (e.g. Printing Presses, Bldg. is wrapped around the press).

3. Effect of L.V.

$$i = a \frac{1 - I^{-n}}{(K + L_n) - L_n I^{-n}}$$

   a. If $L_n = L_o$, increases diff. in denom.
   Lowers i. Japanese problem.
   If rent hand, reduce "a".

If $L_n > L_0$, offsets in part. But then puts more drag on next investor. Basis for boom & bust.

$$RR = a \frac{1 - I^{-n}}{K + L_0 - L_n I^{-n}}$$

L_n / L_0 raises RR <u>if</u> it lowers drawn, i.e. if

$$L_n I^{-n} > L_0$$

$$\frac{L_n}{L_0} > I^n$$

But then, no need for K

l'Hôpital's rule

$$a = P\frac{i}{1-\frac{1}{I^n}} = P\frac{i\,I^n}{I^n-1} \to P\frac{i\times 1}{ni} \quad \text{as } i \to 0$$

$$(1+i)^2 = 1+2i+i^2$$

$$(1+i)^3 = 1+2i+i^2+i+2i^2+i^2 = 1+3i+3i^2+i^3$$

$$RRAT = \frac{a(1-t)(1-I^{-x}) + \frac{P}{x}t(1-I^{-x})(1-\frac{L_0}{P})}{P - [F(1-s) + L_0 s]\, I^{-u}}$$

$$= \frac{\frac{a}{P}(1-t)(1-I^{-x}) + \frac{t}{x}(1-I^{-x})(1-\frac{L_0}{P})}{1 - [\frac{F}{P}(1-s) + \frac{L_0}{P}s]\, I^{-u}}$$

$$\frac{L_0}{P} \equiv q$$

$$RRAT = \frac{\frac{a}{P}(1-t)(1-I^{-u}) + \frac{t}{x}(1-I^{-x})(1-q)}{1 - [\frac{F}{P}(1-s) + qs]\, I^{-u}}$$