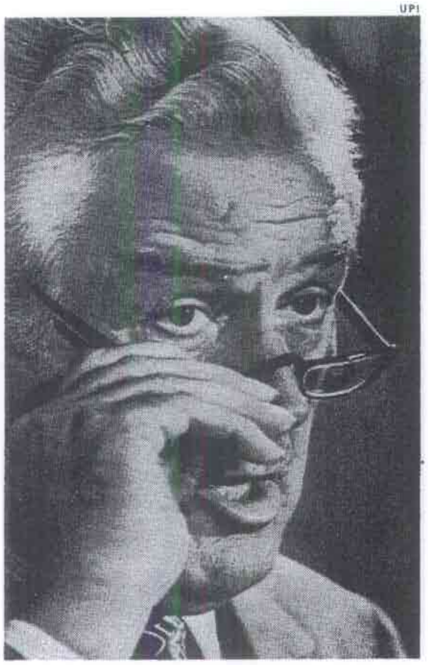
POLICY

Connally's New Toughness

Despite withering fire from critics outside the Administration, Treasury Secretary George Shultz, President Nixon's economic coordinator, has remained imperturbably committed to the flaccid wage-price controls of Phase III, which he largely formulated. Lately, though, Shultz and his chief supporter, Herbert Stein, chairman of the Council of Economic Advisers, have been under increasing pressure from within the Administration itself to take a more vigorous—and visible—stand against soaring prices. Leading the push is former Treasury Secretary John Connally, now a White House consultant. His position has the strong backing of Federal Reserve Chairman Arthur Burns, who has been pressing the same point for months.

UPI



CONSULTANT JOHN CONNALLY

TREASURY SECRETARY SHULTZ

To the enforcer of Phase I, Phase III is pallid.

Last week the scales seemed to be tipping in Connally's favor. Despite President Nixon's solemn campaign pledge to the contrary, the White House let it be known that it is considering seeking some sort of tax increase to slow the runaway pace of the economy. At the same time there were strong indications that the Administration will shift back to much sterner price controls, possibly within the next two weeks.

Shultz himself announced last week that the Administration might ask Congress to increase the federal tax on gasoline, though he stressed that no firm decision has been made. Most estimates put the proposed hike at about 5¢ a gallon, which would more than double the present 4¢ levy. That big a boost would siphon about $5 billion in additional tax revenues out of the economy and produce a budget surplus in the 1974 fiscal year, starting July 1. Such a measure would meet formidable opposition in Congress. But a gas-tax hike is only one of the Administration's fiscal alternatives. Another option is a temporary income tax surcharge, which could be easily and quickly removed next year when the economy might well be sluggish and in need of stimulus.

Administration sources also revealed last week that plans to readopt some of the mandatory controls of Phase II within the next few weeks are now all but completed. Just how far the Administration might go, even if Connally wins the policy fight, is not yet clear. At an extreme, the Government could once again require big corporations to get advance approval for price boosts. It also could reimpose some of the penalties that were slapped on price gougers during Phase II—for example, forcing them to make refunds to customers. At present, corporations are supposed to follow price guidelines, but enforcement is mostly voluntary; only the 650 largest corporations are required to notify the Cost of Living Council in advance of large price boosts that they plan, and they can go ahead if the COLC does nothing, subject to no penalty greater than an eventual rollback. Even these loose controls have been less than vigorously enforced. Some Internal Revenue Service officers, who are charged with enforcing price policy, complain that many reports of violations that they have made to the COLC have gone unheeded.

Connally, an ambitious politician more attuned to public-opinion nuance than economic nicety, believes that the present anti-inflation policies are simply too pallid to satisfy consumers riled about rising prices. As Treasury Secretary in 1971, Connally won Nixon's admiration by urging the relatively successful wage-price freeze. Since his appointment to the White House last month, Connally, a new convert to Republicanism, has again been prodding the President to make a greater show of leadership by stiffening controls and fiscal policy. Burns is taking the same line out of fear that otherwise the Federal Reserve will have to carry the entire burden of fighting inflation by keeping a dangerously tight rein on the money supply. Last week even generally loyal Senate Republican Leader Hugh Scott declared that if the Administration fails to act, he might support congressional action to tighten controls.

The final decision rests with Nixon. But as in all aspects of government today, the Watergate revelations are complicating the discussions. If the President follows the advice of Connally and Burns, in effect repudiating present policy, he risks the resignations of Shultz and Stein. Neither man cares much for Connally, and his re-emergence as a major economic policymaker would be professionally and personally galling to both. And as the President well knows, at a time when scandals emanating from the White House have hampered recruitment for top Government posts, finding replacements for officials of the caliber of Shultz and Stein could pose a serious problem.

SCANDALS

Mr. San Diego in Dutch

In many ways, C. Arnholt Smith seemed to personify the American Dream. A high school dropout and former grocery clerk, he rose to the ownership of a major league baseball team (the San Diego Padres) and became head of a financial empire that included one of California's largest banks and a multimillion-dollar conglomerate with interests that ranged from hotels, real estate and insurance to tuna-fishing fleets, canneries and a commuter airline. He became the chum of a President, so close to Richard Nixon that the two watched the 1968 election returns together on television. He was so respected in his hometown that a local newspaper once dubbed him "Mr. San Diego of the Century."

Last week this classic success story seemed headed for an unhappy ending. Smith, 74, and some of his closest associates found themselves at the receiving end of a double-barreled federal investigation.

The first inkling of Smith's trouble came in mid-May, when the Securities and Exchange Commission suspended trading in shares of Westgate-California Corp., the conglomerate of which Smith is chairman, after its accountants withdrew their certification of the company's 1972 financial statements. Then last week two lengthy federal investigations into Smith's affairs suddenly bore fruit. The SEC filed a suit in San Diego federal court alleging that Smith,

UNION-TRIBUNE PUBLISHING CO.

SMITH & NIXON AT 1960 G.O.P. CONVENTION
$2,068 and all that.

Westgate President Philip A. Toft, Michael J. Coen, a former Westgage director, and several corporate defendants had systematically looted the conglomerate of some $100 million in assets. In a separate action, the U.S. Comptroller of the Currency moved against the U.S. National Bank, California's tenth largest (assets: $1 billion), on charges that the bank had lent more than the legally permissible 10% of its capital to Smith's various enterprises. Only a week before, Smith had resigned as the bank's chairman.

To make matters even hairier for Smith, an Internal Revenue Service task force that has been investigating his books for the past two years turned over the results of the audit to the tax agency's intelligence division for investigation of suspected criminal fraud. And a former member of a federal anticrime strike force accused high Administration officials of calling off a grand jury probe into the "laundering" of illegal contributions to Nixon's 1968 campaign by the Barnes-Champ Advertising Agency, which was controlled by Smith.

The details of the alleged looting of Westgate's holdings are exceedingly complex. Essentially the SEC charges, which Smith dismisses as "unfounded," say that he, Coen and Toft arranged sales of the company's holdings to various co-defendants at bargain prices. The purchases purportedly were made for cash, but the SEC says that they were actually financed by loans from U.S. National. To hide the fact that Smith was on all sides of the transactions, the SEC says, the loans were channeled through a thicket of holding companies that were also under Smith's control.

At the same time, the SEC alleges, Smith's co-defendants were selling Westgate a number of far less valuable properties at inflated prices. To make these investments appear sound, Smith and Toft supposedly manufactured $17.5 million worth of phony profits for the new acquisitions between 1969 and 1972 and fraudulently reported them in annual reports to the SEC. On top of that, Westgate shifted control of the grossly overvalued companies to other cogs in Smith's financial machine, which used their assets as collateral to obtain huge loans from U.S. National. These funds were diverted to Smith's and his co-defendants' use.

One Look. The SEC's civil complaint asks that Westgate be put into the hands of a receiver and that Smith and Toft be barred from running any publicly owned companies—about the harshest penalty the SEC can ask for, since it cannot bring criminal charges. The IRS investigation, which could result in criminal prosecution, reportedly covers much of the same ground as the SEC complaint and also looks into the possibility that Smith-controlled firms made contributions to Nixon's 1972 campaign, in violation of federal laws that prohibit corporate political gifts.

Similar charges surfaced last week about Smith and Nixon's 1968 campaign. According to David Stutz, an ex-IRS agent who now works for San Diego's district attorney, a federal anticrime strike force and grand jury in 1970 heard testimony from Charles Pratt, owner of a San Diego cab company, about illegal contributions. Pratt said that Smith had asked him to buy a ticket to a $1,000-a-plate Nixon campaign dinner in 1968. When Pratt replied that he did not have the money, Smith allegedly told him that it could "come out of the business." Pratt used company funds to buy two tickets to the dinner, and the ad agency billed him $2,068 for a nonexistent "wage and hour survey"—the $68 being thrown in so that the even amount would not look suspicious. That way, says Stutz, "Nixon got the contribution, and Pratt could take it off his income tax."

Armed with the Pratt testimony, Stutz and other members of the strike force began to examine the books of the ad agency controlled by Smith. "It appeared that there were tens of thousands of dollars in contributions that had been handled in the same manner, and most of them were from companies owned by Smith," says Stutz, but "one look was all we got before we were stopped." Stutz claims that the investigation was called off by San Diego's U.S. Attorney Harry Steward, who had publicly stated that he owed his position to Smith's backing. Stutz also says that former Presidential Assistant John Caulfield, a prominent figure in the Watergate cover-up, asked him three times to meet secretly and discuss the status of the investigation of Smith prior to Steward's action.

On top of all that, Smith is the target of a $300 million damage suit filed by some Westgate shareholders. Smith seems to have realized that the roof was caving in on him, and has been trying to dissociate himself from both his bank and his conglomerate. Last week his attempt to sell out his interest to Barclays Bank of London for $50 million fell through. That leaves Smith in the same position as Westgate shareholders, who cannot trade their stock: all have to sit tight.

WALL STREET

Valley of Despair

For seven days in May, a price rally raised hopes that the stock market might finally be pulling out of its five-month slide. But that was two weeks ago, and last week the drop resumed. Sour suspicions about Watergate, the continued weakness of the dollar, the soaring price of gold—up to a record $118.75 an ounce in London—and the continued rise of inflation and interest rates combined to hammer the Dow Jones industrial average down 37 points, to 894. After a brief moment of sunshine, Wall Street again became a valley of despair.

Securities men are worried not only about stock prices but also about their own survival. Trading volume is running nearly 10% behind last year's rate on the New York Stock Exchange, and a chilling 40% below 1972 on the American Exchange. The 549 member firms of the N.Y.S.E. collectively lost $75 million in this year's first quarter. Some 67 sizable brokerages are under surveillance by the N.Y.S.E. or Amex because their capital is running dangerously low;