U.S. Business Counters Declining Profits With Cost-Cutting, Fast-Buck Speculation

A sharp fall-off in third quarter corporate profits has prompted U.S. industry to adopt what it believes will be only a short-term austerity tack.

This shift surfaced last week when *The Wall Street Journal* ran a front-page article, extolling plans to create several hundred thousand new jobs through the Work Incentives Program (WIN). WIN pays welfare recipients a bare minimum wage to perform unskilled, labor-intensive work.

BUSINESS OUTLOOK

All indications are that a deal was struck last week between the Carter Adminstration and the business community. The proposed trade-off involves Administration support for a strong dollar in exchange for industrial backing for the Administration's "full-employment" schemes and aspects of the Schlesinger energy program. "Business confidence" has suddenly picket up: the stock market shot up 42 points, closing at 843 Tuesday, Nov. 15.

But far more than patchwork measures will be required to improve the underlying crisis reflected in the deteriorating profits picture.

The Flow of Red Ink

Total U.S. corporate profits, after taxes, stood at $97-98 billion at the end of the third quarter, down three percent from the second-quarter figure of $101 billion. Bethlehem Steel's announcement of a $750-million profit loss contributed heavily to the decline, but steel reflects what is in store for the rest of the economy. For the first nine months of 1977, profits declined three percent in chemicals, three percent in retail (food), and 5 percent in beverages. Metals and mining slipped 12 percent, led by the shut-down of the U.S. copper industry, and textiles and apparel plummeted 27 percent. The steel industry reported actual *negative* profits.

These official reports on profit returns do not reveal the real economic picture. All of these official reports are padded with fictitious "assets," including: a) profits on idle inventory; b) profits fudged by undervaluing the true costs of replacement of plant and equipment; and c) the markup in profits due to the yearly increase in inflation. For 1977 alone, six percent of so-called profits is attributable to inflation.

Once these types of fictitious profits are erased from corporate ledgers, the profit picture goes from bleak to catastrophic.

According to figures compiled by the Federal Reserve, real domestic after-tax profits for nonfinancial corporations (manufacturers) will reach only $49 billion this year — *$30 billion less* than the officially reported profit figure of $79 billion! Rates of return on stockholder investment, a key measure of profits, tumbled to 3 percent this year, as compared to 8 percent a decade ago.

Once the inflationary fluff in profits is discounted, it can be seen that real economic profits have exceeded levels reached in 1965-67 only once in the past 10 years. Press reports of "prosperity" in the early 1970s and "recovery" after the 1973-74 recession can be quickly written off as pure and simple fabrication.

No Cash for the Future

This profit crunch sharply curtailed industry's capital spending, the one area of investment critical to turning around the economic slump.

In 1977, more than 90 percent of capital spending has gone for simple maintenance of existing plant and equipment, and as much as three quarters of this has been for car and truck fleets or computers, purchased to do paper work. This means that only 10 percent of capital spending will go for expansion in new plant and equipment, and half of that will be for worthless pollution-control devices! Industry is currently planning a miniscule 3 percent increase in total capital spending for 1978.

The general stagnation of the U.S. economy reflected in the profit and capital-spending pictures has played a primary role in crippling social productivity. Low rates of productivity in turn only aggravate the overall downwards economic spiral by making American production using outdated technologies more expensive. From 1967 to 1977, productivity rose on average an abysmal 1.7 percent per year.

The Export Market

The link between the falloff in profits and collapsing world trade was drawn out in an Oct. 14 speech by West German Bundesbank President, Otmar Emminger. Emminger warned that the process by which nations have chosen to close balance-of-payment deficits — drastic import cuts — has ripped apart world trade. This process is particularly clear for Third World Countries canceling imports of advanced sector capital goods. In 1977, world trade expanded half as rapidly as last year. Next year it is not expected to grow at all.

For the U.S., this has meant that the U.S. trade surplus for manufacturing goods, which was $12.5 billion for the first nine months of 1976, has fallen 65 percent to $4.5 billion in 1977.

Speculation and Austerity

U.S. industry has responded to this situation by investing its reduced surplus in "fast-buck" speculative ventures and cutting production costs wherever possible. In the past year and a half, U.S. companies have invested heavily in buying each other up, figuring that it is better to buy up standing capital and equipment than to develop new-technology facilities.

Last year, the total value of corporate mergers exceeded $20 billion, the highest level since 1969, and the totals will be higher this year. At the same time, the *New York Times* and *Washington Post*, proposed Nov. 14 that a more "probusiness" Administration adopt the tax-incentive program proposed by "liberal" economist Arthur Okun and by Henry Wallich, a governor of the Federal Reserve. The plan, called TIP, would penalize companies for raising wages above a standard modeled on the Brazilian cost-of-living wage indexation and speed-up criteria. Companies that push wages below the standard would get "tax breaks."

U.S. Steel Chairman Speer's recent proposals to cartelize the steel industry, rationalizing jobs and lowering wages, follows directly from such corner-cutting insanity. Steel will pave the way for the rest of U.S. industry to become "more competitive."

If industry adopts this and other austerity proposals now —as it has adopted some full-employment proposals already — profits will look like the final stretch of a rollercoaster, from which the economy will not recover.

—Richard Freeman

European Central Banks To Mobilize Gold Reserves?

Earlier reports from West German Finance Ministry sources that European central banks would remonetize gold after new International Monetary Fund rules came into effect Jan. 1, 1978 are corroborated by an array of developments last week. The prestigious West German daily paper *Handelsblatt* published a lead editorial Nov. 17 entitled "The New Gold Standard," which asserted that central banks would use the new rules to purchase gold as backing for their currency reserves. "The role of gold is on the road to remonetization," the newspaper predicted confidently.

GOLD

The IMF rules in question date from the January 1976 meeting of the organization's Interim Committee in Jamaica, which agreed to "demonetize" gold by giving central banks free rein to trade the metal, in a French-American compromise.

According to West German sources, the first major clearing operations in gold will start immediately as the new rules come into effect, involving the Banque de France and the central banks of several developing countries. If the first steps towards gold remonetization take this form it will have significance beyond the initial transaction. Last month, the chairman of the French nationalized bank Credit Lyonnais visited Moscow and proposed joint Franco-Soviet investment in developing countries, with reportedly favorable responses. Senior official French sources say that negotiations with the Soviets towards common monetary gold arrangements are "maturing on the Soviet side."

Closely related to the West German monetary discussion is the change in the world strategic situation after the announcement of the Sadat-Begin visit. One senior Swiss banker with close personal ties to West German leaders said, that West German Chancellor Helmut Schmidt "will move to gold only if the American nuclear umbrella is no longer relevant to West Germany. The Germans are not antigold, but they will do nothing to contradict their strategic relationship to the United States." The new phenomenon of Mideast peace negotiations conducted under the nose of the White House might give the West Germans more maneuvering room in other fields.

NSIPS interviews with senior West German officials and well-placed private bankers indicated that the country is still divided on the gold issue, and that no final decision has been made. One top-ranking private sector banker said that he expected a movement towards gold to be facilitated by the projected role of West German banks in opening a major gold-trading market in Luxembourg, but that the shift to remonetization could take several years. But other sources indicated they expected the French to take an immediate initiative which would settle the question for West Germany.

Indications are that last week's sharp drop in the gold price, from a high of $167 to a low on Thursday of $158.60, included a strong element of political infighting over gold's monetary role. (As EIR went to press, the gold price had recovered by over $2). A large element in the gold decline was the sale of 46 tons of the metal by Portugal, which was forced to market this huge amount by the U.S. Treasury. Portugal had pledged the gold against an earlier $300 million loan from the Treasury, which the Treasury called. In effect, the Portuguese gold affair seems to have been the political equivalent of a Treasury gold sale to depress the gold price. However, the reported timing of the Portuguese sale does not correspond precisely to the drop in the gold price, although it certainly could have been a major influence nonetheless. Opinion among gold traders is divided, but there is general agreement that the sharp price drop represented temporary profit-taking, and that the price will recover