Why the predictions of a recovery are a fraud

by David Goldman

Because the Reagan administration has tied its entire domestic and international strategy, as well as its political future, to the prediction that the United States is either in process of recovering or on the verge of an economic recovery, it is worth examining the prospective sources of recovery in some detail, and give the recovery myth, once and for all, a decent burial. The four possible sources of a spurt in economic activity are:

1) Consumer spending
2) Capital spending by businesses
3) Government spending
4) Exports

We shall examine them individually.

Figure 1
Rise in personal income since summer 1982 tax cut
(billions of dollars on an annualized basis)

	Personal income	Percentage increase
June 1982	$2,566.3	0.4
July 1982.........	2,592.5	1.0
August 1982......	2,601.0	0.3

Consumer Spending: Recent statements by the administration indicate that its strategy is overwhelmingly premised on the first item, namely a consumer-based recovery. Consumer spending accounts for 65 percent of all purchases in the U.S. economy.

Supposedly, the $20 billion combined impact July 1 of the 10 percent personal income tax cut and the increase in Social Security payments would have produced a rise in personal income. However, the July tax reduction and transfer-payments increase have come and gone, with no perceptible effect whatever on personal income.

The figures for personal income since the tax cut are shown in **Figure 1,** which indicates that the entire effect of the tax changes was absorbed in July. By August, the rate of personal income increase was down to 0.3 percent, or the rate of inflation. More importantly, none of the marginal income increase went toward purchases of big-ticket consumer items such as homes, cars, and appliances.

Housing: Housing starts for June, July, and August have registered, in annualized numbers, 0.91 million, 1.20 million, and 1.0 million units, respectively. The average for the first eight months of the year is 0.9 million. For the same three months, June, July, and August, housing permits, which indicate future home construction levels, averaged 0.96 million, little different from the yearly average. There is no apparent momentum.

Several factors rule out any recovery in the home-building industry, now building only 40 percent of the units it built during the 1970s peak. First among these is the mortgage rate, 15.6 percent in August, or 2.1 percent above the level of the prime rate.

Secondly, the median price of a new single-family home rose from $70,800 in June to $71,800 in July and $74,200 in August. The gap between median family income and the median price of a new home is rising; home-building is increasingly concentrated on the higher-price categories, while low- and middle-income housing disappears. In August, new single-family home sales were only 359,000 on an annualized basis, against 395,000 in May and 470,000 in December 1981. The peak for new home sales was 872,000 at an annual rate. The July level of sales of existing homes was the lowest in twelve years, at 1.9 million.

Auto: Auto sales in September were 5.6 million units per year, the lowest level since 1961, and listed production plans for the fourth quarter show a 5.1 million units per year level, the lowest since 1958. This compares to 9.3 million units per year in 1978, the year before Volcker became Federal Reserve Chairman.

Normal cyclical factors which would point, per force, to

Figure 2
U.S. retail sales, September 1981-August 1982
(billions of U.S. dollars)

	Retail sales	Percent change
September 1981 ...	$87.823	
May 1982	99.827	+2.2
June..............	87.042	−3.1
July	89.086	1.2
August	88.292	−0.9

an auto recovery no longer appear to operate. The average age of an American auto has risen from 5.6 years in 1970 to 6.0 years in 1975, 6.6 years in 1980, 6.9 years in 1981, and over 7 years today.

Retail sales in general: As shown in **Figure 2,** retail sales have remained under the May levels despite the tax cut and Social Security payments; under our forecast, they will fall drastically. First, as noted, the rise in personal income over the summer was negligible, since increased transfer payments and tax cuts barely compensated for rising unemployment, lower interest payments to household investors (this is ironicaly a significant factor in personal income, since interest payments are now 10 percent of Gross National Product), and other depressing factors. Secondly, consumers used the small margin of spare cash either to repay installment credit or to increase their savings, the latter motivated by fear of unemployment. The personal savings rate rose from 6.4 percent of personal income in May to 7.1 percent in July and 7.5 percent in August.

The major depressing influence in personal income is falling employment. Annualized monthly earnings of manufacturing workers, for example, fell from $333.45 billion in July to $331.89 billion in August, both due to rising layoffs and to lower average hours worked. As unemployment continues to rise, particularly in the white-collar sector, personal income will fall sharply.

Government spending: Even before the August-mandated tax increases come into effect—the first time that the United States has raised taxes in the midst of an economic downturn since Herbert Hoover—the government sector, despite the modest increase in defense spending, constitutes a significant drag on the economy.

Non-defense federal-government purchases in the second quarter fell at a 57 percent annual rate, while defense purchases rose at a 17 percent annual rate, the only component of government spending to rise. The non-defense drop more than offset the increase in defense. During 1981 and the first half of 1982, the combined spending of federal, state, and local governments rose after inflation by only 0.3 percent. Under present austerity conditions there is no reason to expect improvement from this side.

Foreign trade: August's record $7.1 billion trade deficit ensures a $40 billion trade deficit for the year, motivated by both rising imports and falling exports. August exports fell from $21 billion in May to $17.5 billion, a decline of 17 percent in nominal terms. Some of this decline may be attributed to the overvaluation of the U.S. dollar, which prices U.S. goods in relative terms about 25 percent higher than comparable West German or Japanese goods. But the largest factor in the drop of exports is the deterioration of the international credit situation.

The largest single drop in American exports occurred with respect to Mexico, which has represented a virtually captive market for American goods, in which foreign-exchange-differential problems have only a secondary importance. Exports to Mexico were at $1.2 billion in both May and June, and fell to $1 billion in July and only $800 million in August, a reduction of 33 percent. It is expected that exports to Mexico will fall by approximately another $250 million, bringing the year-end level to less than half the mid-year level. This is, of course, the result of the fact that Mexico has simply run out of cash, and is unable to pay for goods already ordered. The same problem, in somewhat less dramatic form, is being repeated throughout the developing sector, for reasons detailed in the first section of this report.

On the other hand, U.S. imports rose from $18.2 billion in April to $22.2 billion in June and $24.6 billion in August, or a rise of 35 percent since April. The rise in imports occurred in all categories except metal ores and scrap metals, unwanted by a declining steel industry.

The export decline is most evident in industrial categories. **Figure 3** gives the annual levels for 1980 and 1981 broken down by category, with our estimate for 1982.

Within the capital-goods category, which accounts for most of the drop, the largest component of decline is in the non-electrical machinery category, which falls from $45.213 billion in 1980 to $44.182 billion 1980 dollars the following

Figure 3
U.S. exports
(millions of 1980 dollars)

	1980	1981	1982 (est.)
Total	$220,705	$214,054	$198,524
Foods & fuel	35,310	36,154	36,444
Industrial supplies	70,527	66,240	62,723
Capital goods	72,599	68,653	60,926
Auto	15,857	15,910	13,488
Consumer	16,174	14,975	13,308

Figure 4
Capital goods exports
(millions of 1980 dollars)

	1980	1981	1982 (est.)
Electrical machinery	$11,817	$11,061	$10,344
Computers	7,540	7,566	7,213
Non-electrical machinery	45,233	44,182	39,397
Construction equipment	9,957	9,943	8,705
Power generating equipment	2,825	2,510	2,209
Machine tools	1,704	1,793	1,401
Industrial machines	4,767	4,622	4,074
Agricultural machinery	1,926	1,911	1,678
Transportation equipment	15,550	13,398	10,667

year, and only $39.4 billion 1980 dollars during the current year. The major declines in the capital goods categories are given in **Figure 4.**

The export picture

What is most striking about the export situation is that the biggest declines have occurred in those categories in which, according to the Department of Labor's massive 1980 study on American competitiveness, the United States still retains an historical and competitive edge—heavy capital goods, electrical-generating equipment, heavy machinery, and so forth. It is no surprise that the major decline should have hit the investment-goods category hardest, at a time when America's major trading partners, especially developing nations, are under financial constraints to scale back their development plans. The pattern of decline indicates that a general decline of world trade motivated by lack of credit to finance balance-of-payments deficits is the problem, not simple lack of competitiveness or a strong dollar.

Exports of capital equipment, the sector in which the United States is most competitive, fell by 20 percent between 1980 and our projected 1982 total in physical terms, while exports of autos, an area in which the United States is least competitive, fell by only 17 percent. Exports of consumer goods, which depend very much on currency differentials in the short run, fell by 21 percent, indicating the effect of the strong dollar in another field. The fact that computer exports have fallen by as much as they have is especially ironic, since the United States computer industry prided itself on a dominant share of the world market.

These export results are the symptoms of an international credit problem which began to show itself in earnest only mid-year. In general, export shipments lag orders by several months. The likelihood, given the international problem described in the first section of this report, is that exports will continue to fall, and at a faster rate.

It also appears that the August rise in imports is not sustainable. Were the July and August rate to continue throughout the year, total imports would rise from $129.2 billion 1980 dollars in 1980 to $131.8 billion 1980 dollars in 1981, and $139 billion 1980 dollars in 1982. The only categories of imports that showed an increase between the first half of 1981 and the first half of 1982 were the manufactures categories; fuels, food, and industrial materials fell off sharply, as **Figure 5** indicates.

Figure 5
U.S. imports
(millions of 1980 dollars)

	First half 1980	First half 1981	First half 1982
Total	$129,190	$119,509	$113,959
Food & fuel	9,871	9,202	8,885
Industrial supplies	70,289	62,180	53,095
Capital goods	15,403	16,348	17,680
Auto	14,347	12,669	13,517
Consumer goods	17,329	16,417	17,104

Although the August bulge showed an increase in oil imports, the principal rise was concentrated in the capital-goods, automotive, and consumer-goods categories, which had already shown an increase during the first half. This suggests that a portion of the rise in personal income, marginal as it was, turned into demand for imported rather than domestically manufactured goods, the result of deteriorating relative American productivity and the temporarily strong dollar, which attractively price foreign goods. The United States appears to have run into the same problem Britain has experienced recently; as the London *Economist* noted Sept. 18, any rise in consumption is now more likely to be translated into a rise in imports than a rise in production.

Import dependence

It is therefore to be expected that imports in the three strong categories, capital goods, auto, and consumer goods, will fall back to 1981 levels by the end of 1982, and continue to decline steeply through the end of 1983. The expected decline in imports marks a phase change in the course of the depression which began, formally, in March 1980.

As *EIR* has emphasized during the past two years, the extraordinarily high level of imports throughout the entire course of the post-1980 downturn violates all precedents in American economic history. During the last *apparently* comparable decline, the 1974-75 recession, imports moved in precise tandem with industrial production; now imports have formed a virtual inverse function with industrial production. In addition, the 1974-75 decline in imports occurred when the dollar was comparably as strong as it is now, under the impact of the 1974 rise in oil prices, which forced a devaluation of other currencies. It is clear that the currency factor is of secondary importance, and that the high degree of import-dependency in the course of this downturn identifies the last two years' events as a fundamental decline of the American economy, not merely a cyclical decline.

In a May 6, 1980 special report, *EIR* asked, "Can the American Economy Recover?" In this report we documented the underlying decline in the industrial capacity of the United States economy, and demonstrated, with the aid of the LaRouche-Riemann Model, the existence of a "point of no return" past which the United States economy would lack the means to reproduce its own capital stock and labor force, and enter a type of "thermodynamic death."

Import dependence masks the underlying process involved. It is clear that under conditions of attempted recovery, the American capital goods industries could not produce the range of capital equipment, from machine tools upward, and that the American labor force could not find the skilled workers to make them.