# EIR Economics

# The Regan recovery lies and the election disaster

by David Goldman

Two months before the congressional elections, the New York Stock Exchange threatened the White House with a perceived public-relations disaster on a grand scale. It is typical of Chief of Staff's Don Regan mentality that he assumed that cranking the Dow-Jones Industrial Average back up to the 1900 level would take voters' minds off their economic misery, even more typical that he would try to sell this approach to the President. The election results should finally convince the President that the hoax has worn thin.

Like the threadbare semblance of economic stabilization, the pre-election crank-up of securities values was "made in Japan." The White House, drawing on the Nakasone government's agreement with the President's strategic policy, begged for help, and Japan responded with heavy purchases of dollar-denominated securities. This stabilized the dollar and securities markets in the two weeks prior to the election disaster. Unfortunately, what the denizens of Lower Manhattan may convince each other of, does not necessarily impress ordinary people suffering the effects of economic depression.

What is now occurring in the U.S. economy corresponds to what *EIR*'s Quarterly Economic Report warned of during the fourth quarter of 1985:

"Unless present policies are reversed, the underlying economic collapse of the United States, estimated at a rate of 2.5% per annum, will accelerate during 1986, to perhaps pass over the line into the deflationary part of the depression process. Vulnerabilities that have accumulated under the so-called 'Recovery of 1983-84' create the potential for a further 15-30% ratchet collapse in living standards, from the levels of the late 1960s and early 1970s, and for a further estimated 9% to 15% reduction in the physical economy."

As we will review below, the drastic declines in the output of basic industry that began in June 1986 set the economy on this track as of the second half of the year.

President Reagan's enemies anticipated this result; Monday before the election, the London *Guardian*, an important organ of the European appeasement faction, derided the President's claim of having brought about economic recovery. "Reagan is shading the truth about the economy and no one is yet challenging him," was the headline of Alex Brummer's Nov. 3 article.

The *Guardian* "could not help but be struck by the clanging dissonance between the optimism inside the arena and the dismal scenes of economic dislocation outside, such as the long food queues at a mission in Spokane. . . . To hear the President tell it from inside, the U.S. economy is as healthy as it has ever been: 'We cut government growth, slashed regulations, and cut income taxes almost 25% . . . and we're enjoying one of our longest expansions in our history.' And, 'As for our budget deficit, we have a deficit because Congress spends too much'. . . No one nationally is challenging the notion as Reagan put it, 'We pulled the handle and it came up jobs, jobs, jobs.' The economy did appear to perk up in the 3rd Quarter. . . . However the 2.4% growth rate falls well short of expectations and is seen by analysts as stealing growth from the final quarter because of large final sales of motor cars—at generous discounts."

## Fraud

In the spring of 1983, representatives of this news service conducted a thorough audit of the Federal Reserve's Industrial Production Index, among other statistical series, matching the same raw data provided by private industry to the index-numbers generated by the four Federal Reserve staff members who assemble the index each month. The Fed Index is the only supposed measure of physical output published by the U.S. government on a regular basis. The audit uncovered a pattern of outright fakery in most of the 20 individual series studied.

As the *Guardian* indicated, the level of statistical manip-



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ulation has now worsened to the point that it stinks in the nostrils of usually gullible commentators. The 2.4% rate of increase reported for fourth-quarter Gross National Product was the worst of the lot.

More than the entire $20 billion rise in so-called real GNP was accounted for by a $30 billion rise in consumer spending. The size of the consumer-spending increase depends, of course, on the accuracy of the Gross National Product "deflator," which shows exactly what federal statisticians want it to show. *EIR* studies in the past have shown that inflation measurements are generally off by more than the reported margin of economic growth.

Most of the consumer-spending increase was attributed to auto sales; and the auto sales occurred at a loss to auto makers, who financed them with incentives programs that produced a $338 million loss at General Motors, forcing GM to schedule the shutdown of major plants in several locations, and to halve the $2.4 billion budget of its showpiece "Saturn" integrated small-car facility. Immediately after the announcement of the GNP results, GM announced several thousand additional layoffs.

## Industrial collapse

The collapse of the steel industry to levels not seen since the worst of the 1982 decline makes clear that American industry in general is unraveling. October steel output was barely above 5 million tons, i.e., an annual rate of slightly over 60 million tons, less than half of what the steel industry reports its own capacity to be. The decline since October 1985, when the industry poured 7.4 million tons of raw steel, is 30%. Other basic metals show declines in the 20-30% range over the same period.

The collapse of steel output has been falsely attributed to the ongoing lock-out at USX (the former U.S. Steel Corporation). The reverse is true: The lock-out at USX, which will lead to the permanent closure of about half of the capacity at the largest American steelmaker, anticipated a collapse of steel demand, and sought to eliminate labor and capital costs in advance. Steel imports are also collapsing. They fell 13.9% to 14.3 million net tons in the first eight months of 1986, compared with the 16.6 million tons imported last year. Steel imports in August alone declined 25% to 1.5 million net tons from the 2.0 million net tons imported in July, the Institute said. August imports from the European Economic Community and Japan were off 26.9% and 20.8%, respectively.

The economy's capacity to absorb steel apparently crashed during June, when *EIR* warned that a 15-25% per annum rate of falloff in physical output was in progress—corresponding to the forecast offered by *EIR*'s Quarterly Economic Report in January 1986.

## Trade deficit improvement: bad news

Roughly one-fifth of all U.S. physical product, and one-quarter of all capital goods, consumed in the U.S. economy, are now imported net from foreign producers. That is the largest foreign dependency any industrial economy has sustained in history, exceeding the net imports of European nations under the postwar Marshall Plan. Correspondingly, U.S. consumption would fall by close to 20%—since the domestic resources which might substitute for imports is now limited—were the United States compelled to suddenly eliminate its trade deficit, e.g., as a result of a run by foreign investors who have financed the deficit.

As noted, the next big ratchet-step of industrial decline began in June; it appears that the economy's capacity to absorb imports declined between July and August. The U.S. monthly foreign trade deficit fell in August to $13.32 billion, the lowest in four months, after a record shortfall in July of $16.05 billion. The September deficit was slightly lower. Since the dollar size of these deficits reflects the drastically reduced purchasing power of the U.S. currency abroad, the import volume in real terms has probably declined by about 30% from the $15.5 billion monthly deficit registered in November 1985.

If imports represent 20% of total U.S. consumption, and they have declined by 30% in volume terms, total U.S. consumption has declined on account of imports alone by 6% since the fourth quarter of 1985. However, it appears that the decline in consumption was concentrated in the third quarter, given the simultaneous sharp decline of import levels and basic-industry production.

Of course, running off excess inventories, as the auto companies did during the third quarter through their money-losing incentive programs, provides something of a buffer against immediate consumption declines. It appears that the continued expansion of consumer credit during the third quarter, at the immediate cost of future production (as the case of General Motors' profit declines shows), masked the sharp, underlying deterioration of production.

## The decline of employment

Nonetheless, what the population perceived up to and through the third quarter, was a marked deterioration of its economic prospects. Not merely did industrial employment continue to deteriorate, but lower-paying service jobs ceased to become available.

During the first seven months of 1986, services hired about 200,000 new workers each month. However, goods-producers laid off an average of 8,000 employees per month over the same period. During August and September, the rate of availability of new service jobs shrunk by nearly 50% to an average 106,000, while the decline in goods employment accelerated.

Reported unemployment rose sharply to 7% in September, a jump of two-tenths of a percentage point after three months of declines. The actual unemployment number, as most analysts now admit, lies somewhere in the 15 to 20% range, including individuals forced out of the reported work-

force. Nonetheless, the Labor Department's report reflected what voters pulled the lever against on Nov. 4. Another 40,000 factory jobs were lost, bringing the total number of manufacturing jobs eliminated this year to 200,000. The Labor Department reported that 300,000 more Americans lost their jobs in September. In addition, 135,000 jobs in the oil and gas sector have vanished, about 25% of the industry's entire work force.

*EIR* warned in our first-quarter 1986 Quarterly Economic Report that a crash of inflated real-estate values would begin this year, especially if "tax reform" eliminating prior tax-benefits for real-estate investment were enacted. The 25% vacancy rate nationwide for prime commercial office space has already produced a 30% decline in commercial construction over the past year, with a virtual shutdown in the stricken oil-producing states. Analysts anticipated a 25% or more decline in office-building prices nationally.

Usually, commentaries on the real-estate industry attempt to forecast demand for commercial office space by projecting office, retail trade, restaurant, and hotel employment. In fact, real-estate speculation creates such jobs in the short-term, not vice versa. Bankers and developers agree to build a shopping mall or an office complex, and, in the process, recruit the tenants of the proposed project. That is to say that much, perhaps most, of the service-sector employment increases of the past three years reflect speculation in rising real-estate values, more than any other economic development.

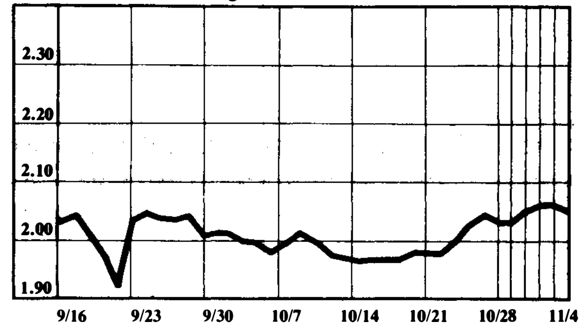
The decline in service jobs during August and September coincided with the break in the real estate market (and Congressional passage of "tax reform"), and may well have been caused by it. The big declines in non-goods-producing employment occurred in hotels, architecture and engineering, recreation, health, and small business, i.e., precisely the sectors which benefited most from the real-estate boom. These sectors hired 100,000 new workers on average between January and July; that fell to 50,000 in September.

In all the discussions of the "shift to services," no one appears to have asked the question: Where do service employees obtain houses, cars, food, and clothing? The answer, in order of volume, is from Japan, the developing nations, and Western Europe. Since conditions no longer exist in which the United States can finance a $200 billion per annum trade deficit, the conditions for continued expansion of services, or even maintenance of the present bloated level, no longer exist.

That suggests that there is still a very long way to fall. During 1982, i.e., during the last major ratchet downward in industrial output, service employment was stagnant. By the end of 1984, the real-estate boom briefly pushed the monthly hiring rate in services to 300,000. The elimination of the foreign-trade subsidy, and the collapse of basic industries, will wipe this out during the ensuing months, creating true mass unemployment—as opposed to the mass *mis-employment* of the last two years.

# Currency Rates

## The dollar in deutschemarks
New York late afternoon fixing

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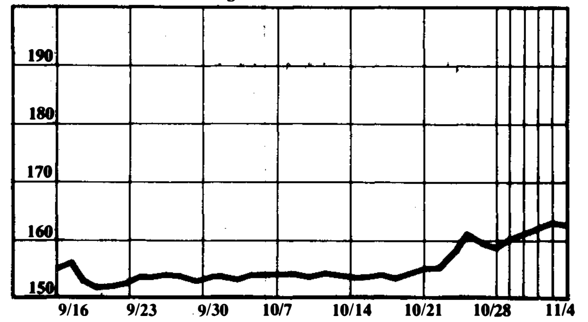
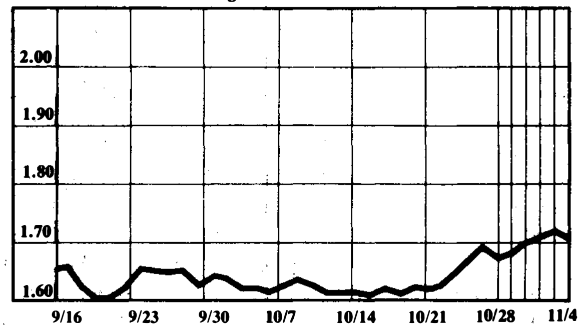
New York late afternoon fixing




## The dollar in Swiss francs
New York late afternoon fixing




## The British pound in dollars
New York late afternoon fixing