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Fourth-quarter dangers for the world economy

by David Goldman

An overview of developments in the economies of the United States, Western Europe, and the developing sector indicates that the world economy will have moved into severe depression as of the end of the third quarter of 1980, barring extraordinary changes in national and international monetary policies. In summary, the world picture is composed of the following mutually reinforcing trends:

1. Federal Reserve Chairman Paul Volcker has precipitated a new phase of credit austerity that will not only wipe out the weak signs of upturn that appeared during the third quarter of 1980, but push the most-affected sectors of the American economy into liquidation.

2. The developing countries face a pre-programmed series of debt crises over the next two quarters, which will culminate in a major reduction in their import capacity and hence in the exports of the major industrial nations.

3. The Western European and Japanese economies have shown themselves incapable of absorbing either a new energy price increase or a reduction of their export markets, and the West German economy, which has heretofore held up the rest of Europe, is being drawn into world depression.

The international motivating force behind these developments is twofold, the global rise in interest rates promoted by Fed Chairman Volcker, and the expected $4, or roughly 10 percent, increase in the price of oil. The current crisis of the developing sector is due to the operation of both related developments. The nearly $90 billion debt service requirement of these countries—which figure contains the generous assumption that interest rates will not rise sharply—combines with an $80 billion import bill following the 140 percent rise in the oil price during 1979 to threaten the dissolution of these economies. The new threatened rise in the oil price should not be seen as a simple increment, but rather as the step toward a marginal breaking point.

Actively promoted by the British government, the proposed "indexation" plan for oil prices to link the price of oil to Western inflation would make the status of the developing sector insupportable. If the "indexation" plan is linked to the absorption of available international funds through the International Monetary Fund, the circle will be closed. The IMF appears to be the intended receiver of the developing sector, absorbing the $110 billion or so surplus of the oil-producing countries either directly or through borrowings on the open market, and lending it to developing countries under onerous austerity terms. This sequence of events, which will be the principal subject of discussion at the Fund's annual meeting Sept. 30, would ensure a drastic reduction of international trade.

As *EIR* emphasized last week, the economic situation in the United States is directly linked to the developing-sector crisis. The immediate impact of Volcker's most recent restrictive actions will be to drain credit resources from the American sector on behalf of the debt stabilization of the Third World.

After the Federal Reserve invoked the Credit Controls Act of 1969 and placed a ceiling on bank credit

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extension in the United States, American commercial banks transferred an unprecedented $16 billion abroad, mainly to provide short-term bridge credits to developing-sector nations. Volcker has now effectively shut the bond market window for American industrial corporations. This time, American banks may not increase their exposure to developing sector nations as quickly as before. However, the credit resources disposable on the international markets will again rise at the expense of the American economy.

America's depression is the locomotive of the world crisis. Despite some increases in retail sales from the May trough over the summer, the clear evidence is that the slump will continue unabated. The qualitatively new development is a wave of bankruptcies (see article p. 15).

As *EIR* has emphasized since Volcker put a credit crunch in place almost a year ago, the liquidity position of the American manufacturing sector means that the traditional heavy-industry sectors of the economy and consumer durables sectors cannot operate under the present environment. This consideration informed *EIR*'s precise forecast of first-half 1980 economic performance, the only accurate computer econometric forecast available. The result is that auto, steel, trucking, farm equipment, other consumer durables, airlines, and the farm sector are undergoing a brutal, permanent reduction of size in orders of magnitude ranging from 20 to 50 percent.

In addition to the status of the manufacturing sector, the trucking and airline sectors are facing mass bankruptcy due to the combined effects of deregulation, the credit squeeze, and the recession. Farm income will fall this year more than 20 percent from the previous year's level. Most economic forecasts fail to take into account how critical transportation and agriculture, the tangible economy's two largest sectors, are to the nation's basic economic health. These sectors are the worst affected.

Western Europe and Japan are at a critical turning point. The Japanese economy has survived through effective marketing of consumer durables in the United States and Western Europe, increasing its market share in autos and consumer electronics, although the overall size of the consumer market in both sectors has declined sharply. Either through trade restrictions, voluntary agreements to restrict trade, or the continued deterioration of the American and European consumer markets, the Japanese export pattern will not be sustainable through the rest of this year. West Germany's economic health has until now been shaky, but sustained by the strength of domestic capital investment. However, a sharp drop in foreign capital goods orders from June to July indicates that the all-important export component of Germany's capital goods production is blocked by the world depression.

As Karl-Otto Poehl, the chairman of West Germany's Bundesbank, told a meeting of central bank governors in Switzerland earlier this week, the tight-credit regime enforced internationally by Paul Volcker's high-interest rate policy in the dollar sector is intolerable for the Western European economies. With a DM 30 billion ($17 billion) current account deficit projected for 1980—entirely due to the doubling of oil prices during 1979—West Germany is in no position to lower rates, and permit an outflow of funds seeking higher return. Therefore Germany has been in a credit bind to which the housing and auto sectors of the economy have fallen victim. A further rise in oil prices would force the Bundesbank to adopt even more aversive credit policies, and break the back of the West German economy.

The chairman of West Germany's leading industry confederation, steelmaker Otto Wolf von Amerongen, in a speech Sept. 9, warned that without both higher rates of capital formation and faster write-offs of technologically obsolescent capital goods, West Germany would not be able to "ride out the rough seas of the 1980s." This assessment is correct. West Germany's capital goods sector has not made sufficient commitment to new technologies to withstand an escalator of oil price increases.

As Western Europe's contribution to world trade declines, the situation of the developing sector nations will immediately worsen, because the previously buoyant performance of the West German economy was a major factor sustaining Third World exports.

It is not a matter of recession in any single part of the world, but the end of the postwar economy in the form we have known it, and a regime of global austerity whose consequences are barely imagined by most economic participants. There is nothing inevitable in this set of developments. The Western Europeans could reverse this process by activating the so-called "Phase II" of the European Monetary System, the creation of a fund capable of centralizing global credit resources for the expansion of international trade. The creation of such a monetary arrangement, as *EIR* has shown in three years of reporting, would open up rather than constrict the markets for industrial goods in the developing sector and reverse the depression course.

On the energy side of the equation, much of the discussion this week at the World Energy Conference in Munich, West Germany, identified solutions to a problem which would otherwise be fatal to the world economy. In one striking example, a Soviet spokesman proposed joint East-West development of transport and other infrastructure to export 500 million tons of Siberian coal per annum to the West. That is a staggering volume of coal, quintuple the most optimistic expectations of potential United States exports by the year 1990.

The solutions exist, but the political will to act on them is entirely questionable.