

LaRouche-Riemann U.S. forecast: great possibilities and dangers ahead

by David Goldman

President Reagan's March 23 address to the nation on defense policy inspires immense confidence in the intermediate-term economic prospects of this nation, but leaves great uncertainty concerning the near future.

Despite much talk of an economic recovery, available data for the first quarter of 1983 fall within the range of the modest decline in economic output projected under the "attempted reflation" scenario issued in *EIR*'s January Quarterly Report (see *EIR*, Jan. 25). As the February and March data trickle in, it is clear that the economy remained dead in the water during the first quarter. The Commerce Department reported April 21 that durable goods orders rose only 0.3 percent in March, which, following a 4 percent drop during February, confirms the problem. Since the big February drop had been attributed to a 33 percent drop in military orders, a supposed "blip," the fall was not taken as seriously as it otherwise might have been. The 1.1 percent industrial production index rise during March, as Chase Econometrics comments, simply meant more inventory accumulation and more downturn later.

Intersecting the still-worsening economic situation, the "bouncing-ball" pattern of rising interest rates since January continues to reflect the fundamental pressures associated with a Treasury borrowing requirement 50 percent in excess of conventional sources of funds to purchase Treasury securities. Additional factors raising interest rates are the massive rollover requirement of developing nations' short-term debt, and the emergence of an OPEC deficit.

Assuming that the present trend brings the level of short-term interest rates to an average 10 percent for three-month Treasury bills during 1983 as a whole, about 2 percent higher than at the beginning of January, the LaRouche-Riemann economic model forecasts a 3.5 percent decline in tangible profit of American industry, a measure which corresponds roughly to the movement of the Federal Reserve's industrial production index. Also assumed in this projection are a \$29-per-barrel oil price, unchanged tax policy, and implementation of the President's defense budget.

As in our January Quarterly Economic Forecast, the decline foreseen is uneven. Certain industries show a small rebound, including steel, auto, and rubber, while the capital

goods industries continue to decline drastically.

The current Quarterly Report also reached the startling conclusion that even a major drop in oil prices would fail to produce a significant U.S. recovery (see *EIR*, April 19).

The trajectory of decline projected by the LaRouche-Riemann model will not continue undisturbed. The LaRouche-Riemann model is not a "forecasting device" as such, but a means to accurately simulate the impact of a pre-specified set of economic policy conditions. Circumstances are emerging under which an international financial crisis will break during the second or third quarter of this year, possibly through the formation of a developing nations' "debtors cartel." Neither fundamentals nor the present political configuration provide grounds for confidence that the crisis may yet again be postponed through refinancing mechanisms.

On the other side, a "phase-change" has occurred as of the March 23 address of the President, committing the United States to a new defense doctrine based on technologies which, in their civilian application, promise an industrial revolution more dramatic than that associated with electricity.

In this conjuncture of great dangers and great possibilities, no "forecast" can be made. Although *EIR* concludes that a combination of steadily, but not dramatically, declining output and unsteadily rising interest rates is an accurate characterization of the economy's present trajectory, we expect this trajectory to be interrupted by major political developments.

If it is interrupted through a breakdown in the present financial order, we expect:

- 1) **The outbreak of a major international monetary crisis**, causing a 15 to 25 percent contraction of world trade during 1983;
- 2) **Decline of U.S. tangible economic output by 10 percent** during the course of 1983;
- 3) **Decline of U.S. exports by 20 percent** during 1983 and of U.S. imports by 5 percent during 1983;
- 4) **Wildly fluctuating American interest rates**, with **real interest rates** (nominal interest rates minus the Gross National Product deflator) remaining at **about 6 percent**;
- 5) **An official unemployment rate of 12 to 14 percent** during 1983, and **real unemployment** including categories

of unemployed excluded from the BLS index) in excess of 25 percent;

6) Decline of tangible output in the industrial nations' group as a whole by 5 to 10 percent.

However, should the administration rapidly act upon the implications of the President's strategic doctrine, and take measures to reorganize the financial system, the prospects for rapid recovery would be excellent.

Conclusions and assumptions

The base scenario assumes:

1) That changes in tax policy during 1983 will not affect the flow of funds into productive or non-productive categories. According to our analysis of the flow of funds, an attempt to reduce the budget deficit through increased taxation will merely substitute taxation pressure upon corporate and household incomes for credit pressure arising from the deficit.

2) That the President's military spending plans as adopted by Congress during 1982 will remain in place; the impact of the military spending plans have been programmed into the 30-sector model, using Defense Department estimates of the sectoral impact of defense procurement of tangible goods.

The base scenario with added interest costs of 2 percent above the January 1983 level assumes:

1) That the combined continued pressure of Treasury borrowings \$100 billion in excess of normal sources of financing, as well as the continued rollover pressure of developing-sector nations on the international markets, will bring the average interest rate for short-term credit to 10 percent for 1983.

2) That credit is widely available for users of short-term credit, but that long-term credit for capital investment or consolidation of debt remains in short supply due to the extraordinary demands of Treasury financing.

3) That the result of this unusual credit situation will follow a pattern already discernible during the fourth quarter of 1982:

loans and mortgages for single-family homes, will be encouraged, capital investment will continue to decline, and goods-producing corporations will be unable or unwilling to amass large amounts of short-term credits in order to rebuild depleted inventories.

4) That the overhead costs of the economy, defined by both the military budget and the additional cost of unemployment compensation and other social welfare programs, will remain high as a result of the depression. In real terms, this implies continued diversion of tangible output away from re-employment of labor, in favor of maintenance of a population made unproductive by the depression. In financial terms, it takes the form of a federal deficit borrowing requirement perhaps 50 percent in excess of total domestic savings, which will absorb that credit fund that might otherwise be available to finance a recovery. The implication is that nothing short

of a thoroughgoing reorganization of the financial system would break the vicious cycle, and that such a reorganization would have to be directed toward restoring the depleted productivity of the goods-producing sector.

In terms of the LaRouche-Riemann model, this means that the labor productivity ratio S/V must be higher than the overhead ratio of d (non-productive expenditures) over V ; if the latter is larger than the former, economic growth cannot take place. No demand-management program is capable of restoring the imbalance between the productivity and the overhead ratios. On the contrary, the austerity demand-management program exercised by the Federal Reserve during the past three years merely damaged the productive sector, while permitting non-productive employment to grow (until May 1982, when non-productive employment also began to fall).

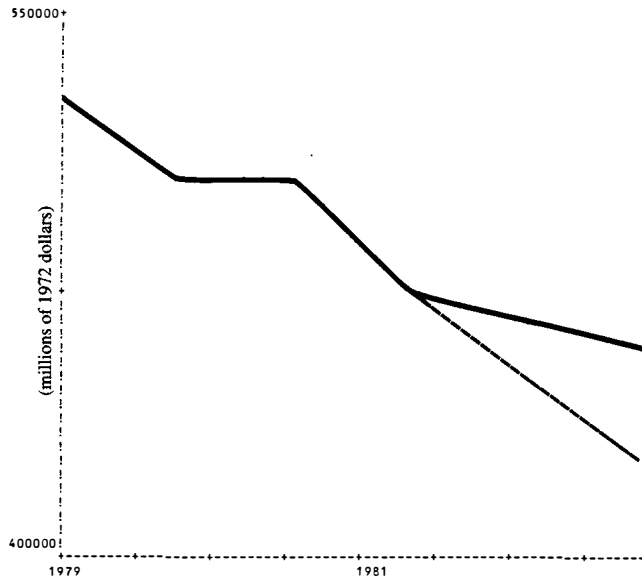
Under normal conditions, an economy's growth rate is limited on one side by the percentage of its tangible profit that must be diverted from reinvestment in the stream of goods-production, into services and other overhead. Under the special conditions of disturbances in the credit system, the economy, in the short term, responds not only to the pressure of overhead costs, or d , but also to the cost of debt service and other financial constraints in excess of previous levels. This excess is included in the projection inputs for the LaRouche-Riemann model as d' . From the standpoint of the individual productive firm, the majority of overhead costs of society as a whole are drawn from its balance sheet in the form of taxation or debt service. Since the banking system, the credit markets, and the federal budget are the means by which a capitalist economy arranges for the reinvestment of profit, financial costs at the level of the goods-producing firm transmit these decisions.

This presents a paradox from the standpoint of economic forecasting. From the standpoint of the firm, a margin of financial payments exists which, at the level of the economy as a whole, corresponds to no margin of real-goods consumption. This financial overhead was the principal determinant of economic developments during the second half of 1981 and during 1982, when it constituted a "surcharge" of overhead costs of approximately 20 percent during this period.

By the beginning of 1983, after three months of aggressive credit creation on the part of the Federal Reserve, the surcharge had shrunk to 10 percent in excess of the physical volume of diversion of output. However, the physical volume of diversion of output, or true d , had grown correspondingly, as a result of higher unemployment and higher federal transfer payments. The economy, at the outset of 1983, therefore carried approximately the same overhead burden, but in a relatively weakened condition.

In the simulations conducted to produce the "base forecast," it was demonstrated that without the impact of military spending during 1983 (the first year in which Reagan administration military spending has a significant effect on the

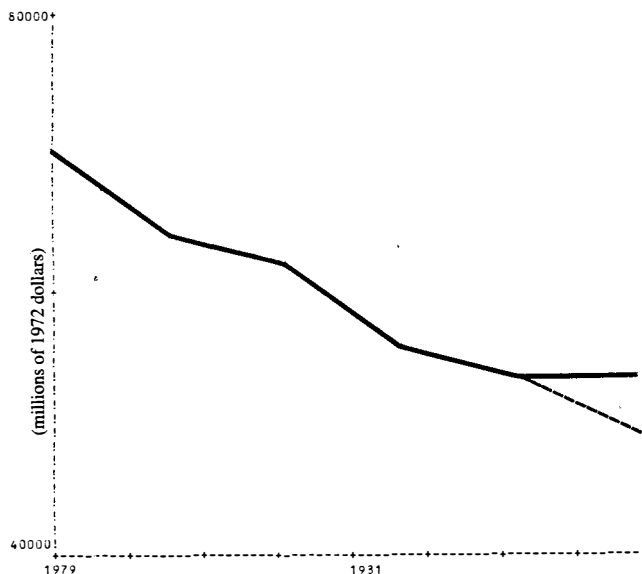
Figure 1



Tangible profit of U.S. economy:
base scenario (—) versus 2 percent rise in interest rates (----)

Figure 1 shows tangible profit for the total economy under the base scenario and the base scenario adjusted for increased interest rates. Under the base scenario, profit falls by 0.2 percent during 1983 and by 2.3 percent during 1984. In the second case, tangible profit falls by 3.6 percent during 1983 and by 6 percent during 1984.

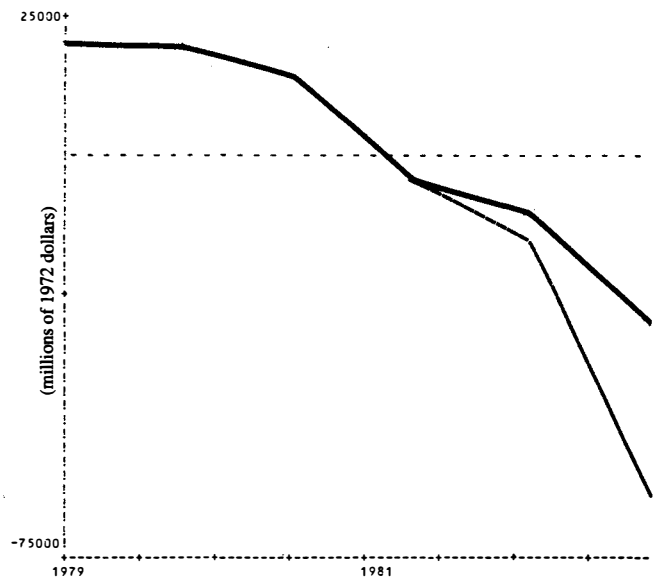
Figure 2



Tangible wage bill of U.S. economy:
base scenario (—) versus 2 percent rise in interest rates (----)

Figure 2 shows the tangible wage bill (variable capital) of the total economy. Under the base scenario, it falls from \$54.1 billion constant 1972 dollars in 1983 to \$53.3 billion, a fall of 1.6 percent during 1983, and to \$52.1 billion during 1984, a fall of 2.2 percent. In the second case, it falls from \$54.1 billion in 1982 to \$51.7 billion in 1983, a fall of 4.6 percent, and to \$48.8 billion in 1984, a further fall of 5.5 percent.

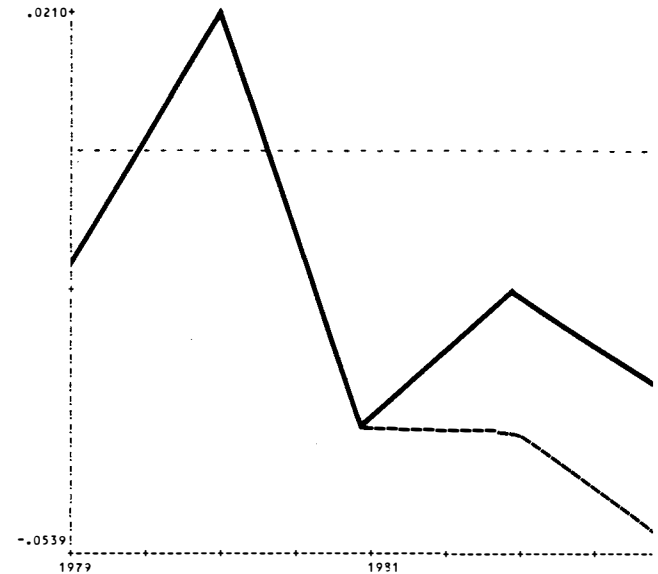
Figure 3



Net capital investment of U.S. economy:
base scenario (—) versus 2 percent rise in interest rates (----)

Figure 3 shows net capital investment for the total economy. Under the base scenario, it falls from negative \$8.9 billion in 1982 to negative \$12.8 billion in 1983. Under the interest-rate scenario, it falls to negative 18.2 billion in 1983.

Figure 4



Rate of reinvested profit (potential growth rate):
base scenario (—) versus 2 percent rise in interest rates (----)

Figure 4 shows the rate of reinvested profit, the economy's potential growth rate (each year's value defines the potential growth during the succeeding year). In the base scenario, the rates applicable to 1983 and 1984 are, respectively, negative 1.9 percent and negative 2.9 percent. In the interest-rate scenario, the applicable rates are negative 3.9 percent and negative 5.4 percent.

economy), the economy would fall sharply. However, since the military budget transfers tangible profit from less productive to more productive sectors of the economy (such as transportation equipment and electrical machinery), the military budget reduced the 1983 rate of decline.

The "base forecast" does not take into account the impact on the financial system of transferring real incomes from productive accounts to federal transfer payments through the overgrown federal budget deficit. The minimum "realistic" condition to account for this effect is included in the second scenario, the base forecast adjusted for a 2 percent rise in interest rates. This scenario includes the less-than-realistic assumption that an economic decline in the context of high real interest rates may continue for some time without undermining the now-tottering financial structure.

The LaRouche-Riemann model analyzes the following categories and ratios of economic output:

- 1) **Variable capital (V)**, or the wage costs of households economically engaged in the production of tangible wealth, measured in terms of their consumption of tangible goods;
- 2) **Raw materials costs of capital inputs (C1)**;
- 3) **Replacement costs of plant and equipment**, in terms of the physical volume of capital goods required to make such replacements (C2), as calculated by the Department of Commerce and the Bureau of Labor Statistics;
- 4) **Net capital investment**, or investment of capital goods

in excess of replacement costs (CN);

5) **Tangible profit (surplus)**, or output of tangible goods in excess of the production costs of tangible goods during a given production cycle (S);

6) **Reinvested tangible profit (S')**, or the component of surplus which is returned to production of tangible goods; the components of the reinvested profit are net capital investment and the margin of expansion of the tangible wage bill and of raw materials inputs;

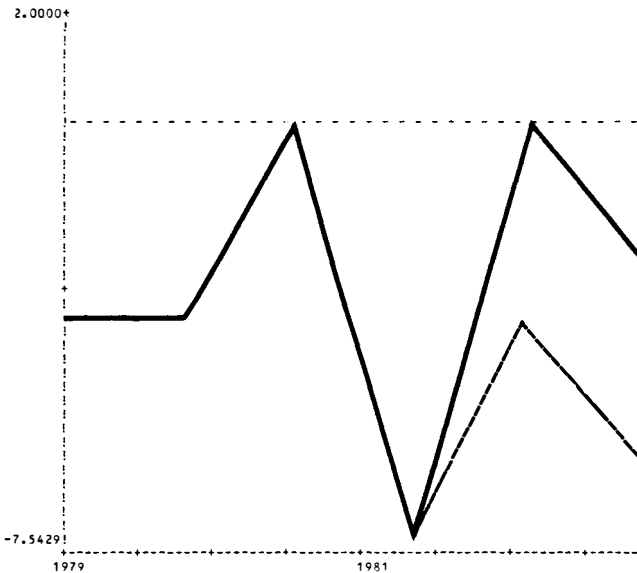
7) **Overhead costs (S - S' = d)**, or the component of surplus which is diverted from production of tangible goods to meet the requirements of private and government services;

8) **Labor productivity (S/V)**, or production of surplus per unit of tangible wage input;

9) **Total economic, or thermodynamic productivity, $S/(C1 + C2 + V)$** , or production of surplus per unit of labor plus capital inputs. It should be noted that this is both a productivity and a productivity-growth measure. This form of analysis weighs current output from the standpoint of its contribution to future growth. Its measure of productivity, therefore, is the extent to which current inputs of tangible wealth into the production process contribute to the economy's capacity for growth; and

10) **The net surplus, or the reinvestment of surplus relative to the production costs of the total tangible output of the economy.**

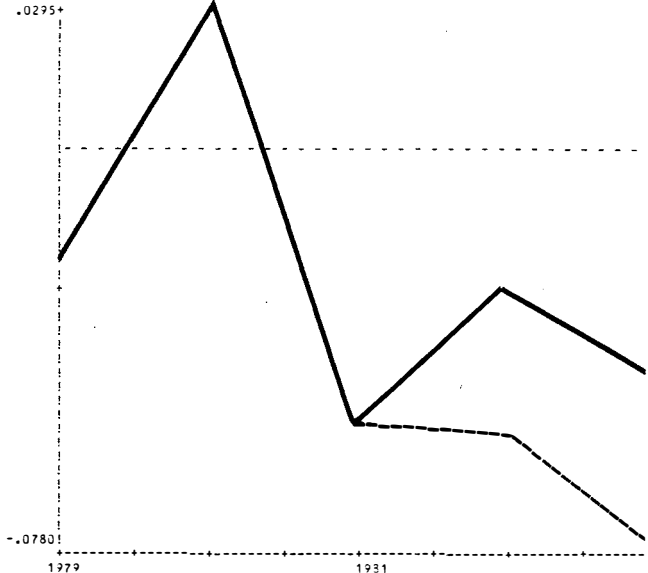
Figure 5



Growth rate of tangible profit for U.S. economy: base scenario (—) versus 2 percent rise in interest rates (---)

Figure 5 shows the growth rate for tangible profit for the total economy. Under the base scenario, profit falls by 0.2 percent during 1983 and by 2.3 percent during 1984. In the second case, tangible profit falls by 3.6 percent during 1983 and by 6 percent during 1984.

Figure 6



Reinvested profit as a percentage of total: base scenario (—) versus 2 percent rise in interest rates (---)

Figure 6 illustrates the decline of reinvested profit relative to total profit, showing the former as a portion of the latter for both scenarios.