

Fundamentals of the U.S. collapse

by Peter Rush

The following summary examines some key sectors of the U.S. economy, as well as the state of the workforce.

Auto

The auto industry is now prepared to cut North American production by approximately half—and keep it at that depressed level. This reflects the effects on consumer demand of Volcker's policy, and the fact that at the top of the industry are key collaborators with the "planned shrinkage" program for U.S. industry.

General Motors, the company most volubly threatening to move overseas, and whose threats, if carried out, would wreck domestic production, claims that it will decide in the next six months. It is clear to us that the decision has already been made: eight major new plants or major renovations of old plants have been cancelled in the last four months, at a loss of \$8 billion worth of construction activity and machine-tool orders.

If GM moves abroad—\$12 billion of its \$40 billion capital investment plan has already been invested overseas—the auto industry will be fixed at approximately half its 17-million unit 1978 North American capacity. Ford and Chrysler have already cut production capacity by half. According to a Chrysler report to federal loan officials, the company has cut production capacity from 2.5 million units in 1978 to 1.2 million this October. Industry intentions are confirmed by the 85 percent drop this year in machine-tool orders by the industry. This near-total cancellation of orders currently means that production in the 1984-85 model year and beyond will be produced by existing tools. This indicates a capacity level of about half of 1978.

GM has not made its runaway decision public, apparently in hope of using the carrot of staying stateside to obtain major wage and working-condition concessions from its remaining workforce.

Since auto is the largest of our heavy industries,

consuming 20-25 percent of American steel, 13 and 17 percent of copper and aluminum respectively, and 60 percent of synthetic rubber, the effect of a permanent shutdown of half the auto industry on other industries is obvious. And there will be permanent unemployment of approximately half a million auto workers and 600,000 to 700,000 auto-parts workers, a process well under way.

Housing

Construction unemployment nationwide is above 1 million workers, or 20 percent. The new home-mortgage rate was above 15 percent for the entire year. And new home starts in 1981 were down 45 percent from 1977-78 levels—the years before Volcker took office.

In 1977 and 1978, the number of new home starts averaged 2 million per year. Once Volcker took office, the level began falling. By 1980, the level was down to 1,292,000. This year the housing industry will be lucky to average 1,100,000 new home starts for the year; for the month of November, the total was 877,000. Never before in post-World War II history has the rate of new home construction been so low for so long. This has slashed steel and lumber production.

Not only is the new home market contracting, but the quality of wood, plaster, and so forth that goes into construction—as a result of Volcker-induced cost-cutting—is falling. Even the size of housing is falling: in 1978, the average dimension of a new home was 1,527 square feet. By 1980, it was down to 1,464 square feet. And according to one of the leading home "experts" in the country, Anthony Downs of the Brookings Institution, "one end of the home-apartment market is going to become much more frugal. At that extreme the average size of living quarters will be 450 square feet, one quarter the current size."

In 1970, 85 percent of all homes sold for less than \$35,000. Today, only 5 percent of all homes sell for less than \$35,000. On the traditional premise that home costs should not consume over 25 percent of a family's household income, more than 60 percent of American families cannot afford homes. The American housing dream is destroyed. Fifteen percent of all new homes bought in 1981 were trailers.

And, as noted above, construction suppliers in the lumber, glass, and other areas are being wiped out, along with hundreds of savings and loan banks that used to supply credit for homebuilding. If recovery were suddenly financially possible in the 1980s, it would be physically constrained.

Steel

The U.S. steel industry will end 1981 with a nominally better sales record than 1980—but only because in 1980, cash-strapped steel consumers dipped into their inventories of the metal early in the year rather than

buy more steel on 20 percent credit.

Tons of steel shipped in 1980 plummeted from 100 million tons to 83.5 million tons. With the 7 million tons drawn down from consumers' inventories, total consumption of domestically produced steel was just over 90 million tons.

The major producers blame import competition; but, led by U.S. Steel, they themselves, and the banks that control them, were initiators in the 1970s of the de-industrialization policy, diversifying enthusiastically into real-estate, chemicals, and the energy sector.

Estimates for 1981, held as late as September, forecast a 92-million-ton shipment year. But the fourth quarter turned into a rout, and the steel industry is now estimating that 1981 was a 87-to 88-million-ton shipment year; the Commerce Department says 89 to 90 million tons. In either case, total *consumption* of domestic steel will be lower than 1980. The much-trumpeted 1981 steel recovery never, in fact, happened, because of the phasing out of U.S. heavy industry.

The steel industry's own investment policies, meanwhile, guarantee that even if there were an upturn in demand, the industry will not have the capacity to meet that demand. The American Iron and Steel Institute estimates that the industry must spend about \$7 billion (1978 dollars) a year just to replace and modernize essential operating capacity. Because of the greater efficiency of the modern equipment, this replacement automatically adds about 1 million tons a year to capacity. In 1979, however, the steel industry spent only \$3.3 billion—less than half the replacement level—on new plant and equipment. In 1980, the industry again spent \$3.3 billion, a real decline of 8 to 10 percent. And in 1981, it spent \$3.9 billion, compared with an inflation-corrected \$8.9 billion required *just to replace depreciated capacity*.

The reason is not far to seek: All of the steel industry's major customers are operating at severely depressed levels themselves. Motor vehicles production consumed 21.7 percent of steel output in 1978, but only an estimated 15.3 percent this year. The depressed auto industry alone cut its purchases of steel by 8 million tons. Although housing doesn't consume a lot of steel directly, home appliances do, and their production and sales are down and falling. Commercial construction was one bright spot for steel sales in 1981, especially office buildings. But that market is about to plummet, too.

Capacity utilization had dropped to 64.3 percent by Nov. 7. While these utilization rates may rise again, it will be only because there is less and less total capacity available! In 1977, raw steel capacity (which is about one third higher than finished steel output) was 176 million tons. This year, total capacity was 163 million tons and headed downward.

At 450,000 production workers several years ago,

steel employment now stands at 325,000 to 350,000.

Machine tools

The disappearance of capital expansion is wiping out the machine-tool industry, the most important component in all new growth of industrial capacity.

Machine-tool orders declined 50 percent between the end of 1980, and September 1981.

At the same time, the increased age and obsolescence of the machine tools in use is scandalous. In 1963, 36.0 percent of all machine tools in use in U.S. factories were under 10 years of age. In that year, 43.3 percent of all machine tools were between 10 and 20 years of age, and 20.7 percent were over 20 years of age. But by 1976-78, 30.5 percent were less than 10 years old; 35.2 percent were between 10 and 20 years old, and 34.2 percent were over 20 years old. Thus the number of machine tools over 20 years old increased by almost 75 percent.

The "boom" in machine tool orders that occurred in 1980, where orders reached above \$400 million per month, failed to redress this situation. Instead, as the National Association of Machine Tool Builders confessed, between 40 and 50 percent of their orders went to two industries: providing new tooling for fuel efficiency, and meeting environmental standards in the auto and airline industry. The plague of Naderism was the most important reason for the increase in orders.

Volcker's credit policy plus the deregulation of the airlines slaughtered those two industries, forcing a sharp cutback in their demand for machine tools; and they are unlikely ever to restore these orders. Machine-tool orders fell from \$450 million during the last few months of 1980 to \$188 million in September 1981. Orders are now only half the shipment level; as the backlog is worked off, domestic demand is finished.

This represents the most acute decline in orders since the 1930s. But even worse, the United States did not expand fundamental capacity for machine-tool production during the supposed boom, so that instead of enlarged capacity, the U.S., at the peak in 1980, was importing 27 percent of its machine tools from abroad. Though imports are now declining, the United States does not have the benefit of the added capacity.

For 1982 and 1983, the prospects of new plant and equipment spending are bleak. Over the last 12 months, a significant number of shops have closed, a lost capacity that America is not likely to recover.

Computers and semiconductors

It is ironic that the sunrise industries, long believed to be depression-proof, are finding their growth trimmed for much the same reasons as basic industry is now plunging into depression. First, the purchase of computer hardware, especially large mainframe computers, is being crimped by cost-cutting decisions as managements face high interest rates and cash-flow

problems. Second, the failure of computer manufacturers (most notably the industry giant, IBM) to invest in both hardware and software (programming) R&D has led to a mushrooming of software costs for endless modifications and interfaces of inadequate systems. These software costs and bottlenecks are making corporations think twice about new hardware purchases.

A deeper problem has been the failure to apply microprocessor technology to industrial production, limiting its application to office and service sector automation, in a way that would revolutionize production processes and productivity throughout the economy. The hard statistics for the U.S. industry show a decided downturn in its rate of growth: Between 1978 and 1980, the value of hardware shipments increased dramatically from \$16.4 million to \$26.0 million, a 30 percent annual growth rate. In 1981, the yearly increase was 12.7 percent. (As the price of computer hardware is still coming down, the volume increases are greater than the dollar-value increases.) With the reduced rate of growth of computer hardware sales, the market for semiconductors is naturally also slowing. Employment shows a similar trend, with annual increases in employment of 14 percent in 1977 through 1980, slowing to 8 percent this year and only a 1 percent growth for production employees.

Microcomputers and all consumer electronics continued to do well in 1981. This market is now expected to stagnate as discretionary income peters out, and with it, all nonessential spending.

A major factor in the sector's emerging problems has been federal budget austerity. The federal government, led by the Department of Defense, is the largest consumer of new computers in the economy, and is now trimming its hardware purchases. More important, without Japanese-style government support for major R&D programs, such as the large-scale application of computers to outmoded production processes, the sunrise industries will follow basic industry into the sunset.

Agriculture

That the nation's farm sector is in its worst crisis since 1934 is shown by current data for the industry and the testimony of farm producers themselves. Production costs have soared by an average of 15 percent this year, while farm prices headed downward. Returns to farm operators have collapsed by about 50 percent. And now budget cuts in the federal farm programs threaten to remove the one thing that has offset the steady erosion of farm income since the 1950s.

Producers emphasize that unless there is a sharp change in the administration farm policy by the beginning of the year, many farmers—and not just marginal ones—will not be able to finance another spring planting.

The U.S. Department of Agriculture has continually revised its projections of net farm income for 1981, down from \$30 billion at the beginning of the year to an \$18 to \$20 billion range presently. That would make 1981 the second disastrous year in a row. And 1980 net income was already off 39 percent from 1979. In terms of deflated spendable income per farm (or cash receipts minus production expenses) this has been the worst year since 1934.

The price and income collapse threatens to explode a financial time bomb of soaring indebtedness that was built into the farm economy over the past 30 years, as producers were forced to operate at below the cost of production. According to the USDA, since 1950 outstanding farm debt has increased more than thirteenfold, from \$12 billion to \$180 billion in 1981, with most of the increase in the past 10 years. The debt bubble rests precariously on inflated land values which, as long as they continued to pace inflation, provided producers with collateral for new loans.

This year farmers had to rely on borrowed money for 23 percent of their *operating* capital—compared to 5 percent just 10 years ago! As a result, today interest has become the largest single fixed cost for producers and will eat up more than \$20 billion in 1981—their entire projected net income. Cattlemen now get \$70 per hundredweight for a calf, and \$37.50 comes off the top to cover interest charges.

The only thing which has prevented a blowout until now is the patchwork of federal farm programs, including the Farmers Home Administration (FmHA) loan programs which, in the past five years, have provided 20 percent of non-real estate credit to farmers. Now the budget axe has chopped away this protection, and FmHA foreclosures are multiplying.

Last year, farm equipment sales plunged 15 percent, and they won't do better this year. The result: International Harvester, one of the largest equipment manufacturers, is on the verge of bankruptcy, and the other manufacturers have slashed production.

Over the longer term, capital investment has been seriously throttled in agriculture. Even with the highest official depreciation rates in the economy, agriculture can only afford about one third of the annual investment level in new equipment and machinery it requires. Especially in the last 10 years, producers have been unable to afford investment in enhancement and maintenance of soil fertility, including water management, contouring, and crop rotation. The lack of real profitability in agriculture has forced producers to cost-cut these crucial investments. The results are documented problems of soil erosion and soil deterioration in our agricultural heartland.

The land-price bubble, and now the usurious interest rates on borrowed capital, have also made it increasing-

ly impossible for young farmers to get started. The median age of America's farmers today is over 50.

It was precisely this type of crisis in agriculture during the 1920s that precipitated the 1930s Great Depression. Initially producers will scramble to produce more, to try to make up for falling prices. But as bankruptcy claims more and more operators, the food glut will turn into a shortage. In the process, *one out of every five jobs* in the rest of the economy, now supported by agriculture, will disappear.

Labor force

Were the U.S. to turn to reviving the economy, the required skills would be lacking in many sectors. And most importantly, the next generation of the labor force is not being equipped to take this generation's place—a devolution that has accelerated fearfully during Volcker's term in office.

The deterioration in skill level is the most pronounced. According to Department of Labor (DOL) statistics, the U.S. economy needs machinists to fill 22,000 new jobs each year. But each year only 2,300 machinists complete apprenticeship programs. Again, according to the DOL, the economy has job openings for 8,700 tool and die makers each year through the foreseeable future. Only 2,400 tool and die makers complete registered apprenticeships each year. The average journeyman-level craftsman is now 55 years old. If action is not taken soon, within four to five years, the U.S. will face a far more acute skilled labor shortage than it faced at the end of the 1930s.

At the same time, the standard of living of the labor force is falling, which lowers productivity. Since 1979, according to the DOL, the after-tax, inflation-adjusted weekly income of the average American non-agricultural worker with three dependents has fallen by 11 percent—a far sharper drop than the 1973-74 recession or any years since the Great Depression.

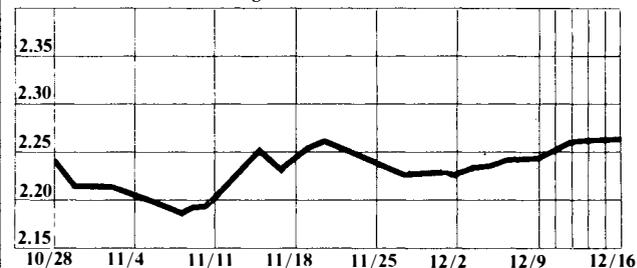
One month after Volcker took office in September 1979, nationwide unemployment was 5.99 million. Two years later it was 7.97 million, an increase of 2 million. Two *months* after that, in November 1981, nationwide unemployment was 9.00 million, an increase of another million workers. Since Volcker took office unemployment has increased by 50 percent. The only previous period of such a rapid increase was the 1930s, when the unemployment figure reached 12 million. By early 1982, official unemployment is likely to hit 10 million and above.

If workers too discouraged to work (1.17 million workers) and workers who have been forced by partial plant closings into part-time work are counted as unemployed (5 million), then the total number of unemployed is now 15.17 million, the highest it has ever been in the United States.

Currency Rates

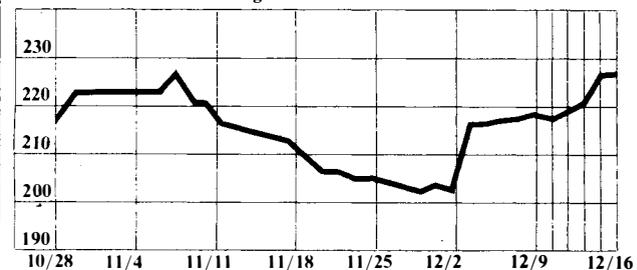
The dollar in deutschemarks

New York late afternoon fixing



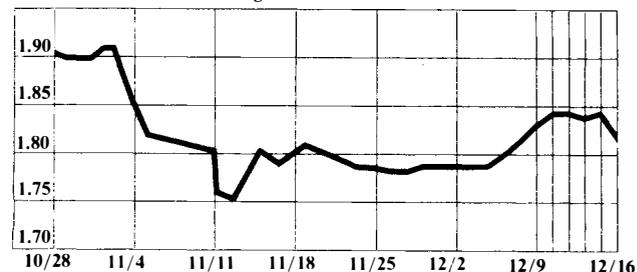
The dollar in yen

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

