
West German Economic Survey

Behind the 'stagnant recovery,' a deep economic recession threatens

by William Engdahl

For almost two years, the West German Bundesbank, major economic institutes, and the Bonn coalition government of Christian Democrat Helmut Kohl, each for their own reasons, have proclaimed an "economic recovery." Continued adherence to this illusion could have devastating results for West European economic growth prospects over the coming decade. We take a detailed review of the actual production sector of the Federal Republic of Germany, which represents, with the possible exception of Japan, the most important industrial-technological base in the world today.

First, as in the United States and most Western OECD economies, national accounting is based on a built-in fallacy: "GNP accounting." By this method, the monetary index of all economic activity—productive as well as non-productive, it does not differentiate—is totaled. So long as the aggregate number is growing, one should assume all is well. By GNP standards, the West German economy grew in 1985, the year of the rapid dollar rise and, beginning in September, fell just as dramatically. Gross National Product totaled 1.847 trillion D-marks. In 1984, it was DM 1.763 trillion. By conventional economic wisdom this is a husky 4.8% annual increase in GNP. This year, though the size of the number has been slipping each quarter, predictions still call for a respectable 3% growth range in German GNP. In a recent series of articles in the largest German paper, *Bild Zeitung*, former Economics Minister Otto Lambsdorff exulted, "The turnaround celebrates its fourth birthday." Calling it Germany's "Second Economic Miracle" of the postwar period, Lambsdorff cited such signals of "strength" as the fact the D-mark has "not been so strong in 10 years."

Few are as euphoric as Count Lambsdorff, but every leading economic institute and major party in the parliament agrees that the Kohl government is benefiting from good economic news in the lead-in to the Jan. 25 federal elections. The real indicators of what will develop in the finely tuned

German economy in the next 6-18 months are buried slightly below the surface of the GNP numbers, and they are far more troubling.

Trouble on the horizon

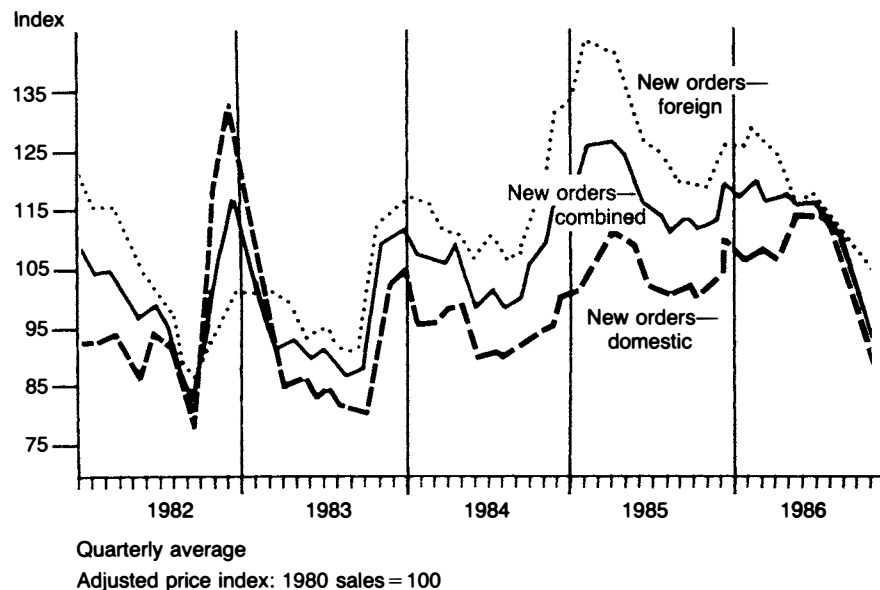
The 12-nation group known as the European Community (EC), has a population of 322 million and Gross Domestic Product of \$2.4 trillion in 1985, which make it second only to the United States as an economic power, and in some areas, more important. In terms of total world trade, the EC, with France and West Germany as its weightiest members, is even more significant than the United States, with a 15% share of the market, versus the United States' 11% last year.

The West German economy is the most productive core of the European Community. It is sustained by three major industrial areas—automobile production (Europe's largest), chemicals (Europe's largest), and engineering goods (Europe's largest). The strategic center and traditional strength of the West German economy is its engineering sector, which produces machines, plant and equipment, and generates the technologies which give other branches of German industry, such as automobiles and chemicals, their competitive edge.

The German recession of 1981-82 was largely induced by the combined impact of the 1979 U.S. interest rate policy and the Iranian "oil price shock," as well as the collapse of developing-sector export markets such as Brazil, Mexico, and Argentina. Unlike most of American industry, German engineering industries responded to the collapse of export-market share by an intensive effort at technological modernization. The result has been a rapid and impressive improvement in the quality and sophistication of West German numerically controlled machine tools, industrial robots, and other products which have made the German auto producers such as Daimler-Benz, VW, and BMW the world standard.

The West German machine tool sector is especially stra-

FIGURE 1
Engineering new orders



tegic, because of its world export importance and its relation to producing other industrial machines. Without machine tools, a modern industrial economy soon vanishes. Although Japanese output of specific types of machine tools has greatly increased in the last decade, following its reworking process from 1983 to 1985, today the German industry remains unexcelled in quality and diversity by any other national sector in the world. Beginning in the recession year of 1982-83, this position began to be reflected in the steady increase in new orders. New orders for machine tools can be taken as one of the most sensitive indicators of real industrial growth prospects, indicating what the economy will do 12 to 18 months from now.

In monetary terms, the value of new orders for the machine tool industry rose from just over DM 8 billion in 1983 to DM 14.4 billion by 1985. The dollar rise against the D-mark from 1984 through most of 1985 meant that the high-quality German tools were able to make a serious impact on the U.S. market. By 1984, the United States had become the largest importer of German machine tools. West Germany is today the world's single largest exporter of machine tools, exporting 26% of the machine tools exported by Western industrial countries. Fully 62% of the industry output in 1985 went to export markets: principally to France, Italy, U.K., and other European Community trading partners, as well as to the United States.

According to the head of one of Germany's leading machine tool makers, L.G. Lundkvist of Friedrich Deckel AG, Munich, the industry is at a relative stasis point. The problem is a relative lack of skilled labor, combined with trade union

work-week limits on existing personnel. "The 38.5-hour week and the lack of qualified labor power," Lundkvist stresses, "have caused us to lose orders to foreign producers." He estimates this to be as high as 15% per year. The result has been a deluge of Japanese and, to a lesser extent, Swiss and Italian machine tools into West Germany, as the German industry is already running at 94% capacity. Hardly proof of an impending recession. But let's look closer.

According to the German Machine Tool Association, VDW, new orders continued to drop for the first nine months of 1986. The largest drop is in the vital export sector, where new orders collapsed in nominal terms by 18% through August.

The current economic wisdom is that the German "recovery" is being carried by expansion in *domestic* industry, rather than *export*. This is being pushed among other things to resist the wild and erratic pressures from Washington, especially from the Treasury and Federal Reserve, for the Federal Republic to "stimulate" its domestic economy by further lowering interest rates. While one can sympathize with resisting wrong economic policies, whatever the argument, this "domestic-led recovery" is a dangerous fraud.

It is true that domestic machine tool orders have risen 12% for the nine months through September. But given the fact that it is an export-directed industry, despite the domestic increase, there has been an overall order *drop* of 5% in the first three quarters this year, compared to 1985.

A look at the engineering sector as a whole reveals a more worrisome crisis brewing. Superficially, the sector appears healthy: Gross sales for the January-September period were

DM 103 billion, a gain of 2% from 1985. Overall industry capacity utilization, is 88.4%—a veritable “boom” by current U.S. engineering industry standards. Employment in the branch is running 5% higher than last year, at 1,080,000. Even exports in nominal terms are running up by 6% over 1985, at DM 63 billion through September. This sector includes, besides machine tools, agricultural equipment, turbines, motors, construction machines, printing equipment, and textile machines—in short, every significant tool of an industrial economy.

But behind the positive monetary signs, storm clouds are gathering for the German engineering industry. If we take a “stop-action” time photograph of the entire industry as of last April, it appears to conform to the Bundesbank and Bonn Economics Ministry predictions of a domestic “upswing” in the face of export decline. Then, in April-May, domestic new orders begin a reversal and start to track exports in a steep fall (Figure 1). This steep decline in new orders continues through November, according to industry sources. We can date the onset of the *second industrial recession* since 1980 for Germany from this April-May downturn in new orders for engineering goods. The results in the chemicals sector which follow, will further underscore the down-pull under way, even though it has yet to severely hit daily production levels.

The current president of the Association of German Engineering Industry, VDMA, Prof.-Dr. Otto H. Schiele, described the recent increase of domestic investment in new plant and equipment as a long-delayed retooling, which had been postponed by the uncertain markets since the economic shocks of the late 1970s, and was finally set into motion in anticipation of export to the long-awaited international economic “recovery,” especially of the United States.

But, as Dr. Schiele notes with concern, “for an accumulation of reasons, our export business is weakening.” Schiele cites four interconnected reasons why new orders in German machinery and equipment exports collapsed 13% in real terms for the period January-September 1986:

- The collapse of the dollar—35% against the D-mark since October 1985—which set off a staggering reversal in competitiveness for German exports not only to United States but to third markets trading in dollars.
- The drop in oil and gas prices, which has collapsed industrial exports, especially to OPEC states, and severely damaged the large petroleum equipment export possibilities.
- The lack of import growth in the traditional developing markets such as those of Mexico, Brazil, Argentina, Egypt, and Nigeria.
- The lack of any real increase of demand from the Soviet market despite the new Soviet Five Year Plan, due to hard-currency shortages as well the Chernobyl problem.

The traditional export share of West Germany’s engineering sector, is even larger than for machine tools. It is currently fully 65% of total production. Again, it is clear that German industry internally cannot sustain any long rise in

the industry production levels, despite reassuring statements from Herr Bangemann’s Economics Ministry in Bonn or the economic institutes.

The United States export market is extremely important for West Germany in all regards, despite politically motivated denials by Bundesbank chairman Karl-Otto Poehl in New York recently. Schiele points out that this market has almost doubled for the engineering sector since 1983, from DM 6.3 billion to more than DM 10 billion in 1985. “The U.S. has become the most important market for our industry branch,” he stressed at the end of October. Because of the wild fluctuations in relative currency prices over the past months, the West German VDMA head anticipates that export results by 1987 to this crucial market, at present trends, could be *negative*. Already, the rate of decline in this market is being immediately felt in the sharp drop of new orders being placed for machinery and engineering goods. No major West German producer in such uncertain conditions is rushing to make a big new investment in capacity expansion.

But it is not only one sector, albeit a major one, of industry which is being hit by a sharp fall in new orders. According to the November report of the West German Association of Savings and Farm Banks, BVR, the largest regional banking network, overall new orders for the entire manufacturing sector, which is far larger than engineering, are down. This downward trend begins slightly later than for engineering, as might be expected. But it begins by the end of July, only two months after the engineering downturn. Domestic new orders stagnate at 0.0% in August and actually begin a decline of 2% by September over the preceding month. Foreign new orders are currently falling more sharply, at a rate for the nine months to the end of September of almost -4%.

Second Davignon Plan ahead for steel

West Germany today, as traditionally, concentrates Western Europe’s most important steel-producing industry. Current “wisdom” in Europe, though less advanced in this direction than in the United States, is that steel is a declining industry. For five years, West European national sectors have savagely destroyed capacities, adjusting to financial community demands to permanently shrink output. The steel crisis is in reality no steel production crisis. Rather, it is an induced crisis in response to the 1974 and subsequent 1979 oil-price-rise shocks together with the post-1979 interest rate policy of the OECD central banks. To destroy capacity for future production is to ensure a shrinkage of future industrial base and walk away from an active export-oriented solution to economic growth stagnation. The Davignon Plan was and is a bank “rationalization” scheme designed to protect certain book-values of present debt at the expense of future national capacity to produce. To its credit, the West German steel industry has been one of the more cautious about destroying such capacities. British steel is at the other extreme, where blast furnaces were blown up under the infamous “Lazard’s Plan” of investment bankers. The best index of utilization of

steel is ton-per-capita consumption. By this index, since the initial 1980 Davignon five-year European steel reduction (euphemistically termed "rationalization"), German consumption has declined by some 5% per capita.

This said, the West German steel industry today is a reflection of the overall problems of collapsing international trade. In 1974, termed by the industry the "beginning of the crisis of the steel industry," some 250,000 workers were employed in producing steel in the Federal Republic of Germany. When the Davignon Plan started in 1980, the number had already dropped to 190,000. By 1986, following the five-year term of Davignon reductions, it stands at 150,000. Today, according to the West German steel producers association, Wirtschaftsvereinigung Eisen-und-Stahlindustrie, this is still not sufficient to control falling prices. They propose to cut some 20,000 more jobs from German steel beginning sometime shortly after the January federal elections.

Recent industry assessments have underscored that, despite two years of trend reversal by the highly modern and efficient West German industry, by all accounts the world's quality standard in steel production, the industry is still in great difficulties. Domestic production for 1986 will run less than 38 million tons. This is a big drop from the rising output for 1984-85. By 1985, German steel produced 40.5 million tons of raw steel. According to industry sources, the main problem immediately is an indirect effect of the drastic dollar fall against the D-mark. Import steel is able to be shipped in from halfway across the world at competitive prices to the domestic German market.

In the five years of restructuring, the West German steel industry has put itself through a major forced change. Raw steel capacity has been cut by 20 million tons, and rolled capacity by another 10 million tons. To retain competitiveness with especially new Japanese mills, the German steel industry has invested in the most efficient advanced technologies to the point that today, more than 80% of production is continuously cast steel. Specialized high-quality mills have been developed. Computerization has been extensive. Some DM 10 billion have been invested in the process since 1980.

This is the situation as the EC is contemplating removal of Davignon-term protective barriers which have guarded German and other European steel producers from a flood of cheap imports. As early as March 1987, the EC in Brussels could remove the Davignon protective restraints. In such a regime, German industry sources predict a bloody and unpredictable trade war which could devastate the remaining industry. The biggest demand market for the German steel industry is the metal-working, engineering, and motor-car industries. A major drop in production there, of course, will aggravate the pressures already mentioned. Already 40% of German steel consumption is imported. Only 25% of this is from other EC nations. Exports are under major constraint. The EC-U.S. steel trade agreement became fully operational this year and puts a ceiling on Germany's most important export market for the next four years. By the formula, Ger-

TABLE 1
The EC and world fleet 1975-85

1st July	EC		World		EC as % of world (dwt)
	No.	mn dwt*	No.	mn dwt	
1975	9,636	154.9	34,934	544.2	28.5
1976	9,621	165.5	35,666	598.4	27.7
1977	9,443	168.5	36,208	637.2	26.4
1978	9,684	177.6	36,880	658.7	27.0
1979	9,539	177.2	37,668	669.0	26.5
1980	9,467	178.2	38,401	677.3	26.3
1981	8,975	179.6	37,959	683.2	26.3
1982	8,508	169.7	38,416	687.2	24.7
1983	7,971	155.5	38,419	678.6	22.9
1984	7,502	141.1	38,103	666.8	21.2
1985	7,265	138.9	38,048	665.8	20.9

Note: refers to trading ships only and does not include ships registered in overseas dependencies of some member states.
*million dead-weight tons

TABLE 2
Composition of EC and world fleet at 1st January 1985

	Total EC		World		EC as % of world (dwt)
	No.	mn dwt	No.	mn dwt	
General cargo	3,942	19.8	21,123	108.9	18.2
Cellular container	245	6.0	956	18.1	33.2
Ore/bulk carrier	1,048	39.5	5,052	188.2	21.0
Combination carrier	81	10.2	437	46.6	21.9
Passenger and ferry	386	0.8	1,301	2.4	33.3
Other dry cargo	76	0.5	756	5.6	8.9
Total dry cargo	5,778	76.8	29,625	369.8	20.8
Oil tanker	1,143	58.8	6,620	279.2	21.1
Chemical tanker	145	0.9	880	6.1	14.8
Liquidified gas carrier	163	2.2	776	10.3	21.4
Other tanker	36	0.2	147	0.4	50.0
Total tanker	1,487	62.1	8,423	296.0	21.0
Total all ships	7,265	138.9	38,048	665.8	20.9

man steel exports to the United States fall proportionately as domestic U.S. demand further weakens, as the present recession collapse portends there.

But the secondary effect of the universal U.S. import ceiling on steel means that other steel exporters must compete for a shrinking market. Price wars and dumping are expected to escalate in coming weeks, while the high D-mark is already hurting German export capabilities. Rupert Vondran, managing director of Wirtschaftsvereinigung Eisen-und-Stahlindustrie in Düsseldorf states, "It is important not to confuse a healthy appearance with well-being." Moreover, "environmental" levies on German steel of DM 100/ton must soon be imposed, further cutting profit margins. This is on average four times the rest of EC levies.

The end of Europe's last major shipbuilder

For some years, West Germany has concentrated the largest and most advanced shipbuilding capacity in the European Community, with the largest annual tonnage of ships built in the European Community. In terms of tons of steel consumed, however, the precipitous decline of this sector is shocking. Although by no means as drastic as the case of Sweden—which 10 years ago was the world's second largest shipbuilder behind Japan, and today is virtually out of the business—German shipyards are today in the worst crisis in history and getting worse.

The EC is the world's single largest trading area. Some 95% of its trade with non-EC countries is seaborne as is 30% of the trade among the EC countries. Fully 45% of world seaborne trade is carried by the EC as a group. A cardinal rule for national and regional economic self-defense for a

trading nation, historically, has been to exercise control over transportation costs. This dictates a serious alarm over the EC shipyards, especially the West German yards (See **Tables 1-6**).

Despite the clear national and EC interest in maintaining such strategic resources, since the first oil shock hit world trade in 1975, EC shipyards have cut employment 46%. This will fall 25% more by summer 1987. The backdrop for this collapse is not mysterious. Total world trade tonnage has fallen since the second oil shock and interest rate shock of 1979, from 19 billion ton-miles down 26% to 14 billion ton-miles (see **Figure 2**). But select Far East shipyards have increased output at cut prices, especially Japan and South Korea, and the Soviet fleet has increased by more than 42%, according to industry estimates since 1975.

For the case of the German shipbuilding industry, annual steel supplied to shipyards plummeted from a high of 772,000 tons in 1975 to 238,000 in 1984. Deliveries (Brut Registered Tons) went from 2.3 million BRT in 1975 to less than 0.44 by 1985. But this year the dam broke, as backlogs of old orders have been worked up and the soaring D-mark has made export orders disappear. In July Harmstorf Yards, Germany's fourth largest yards, declared bankruptcy. According to a report in the Oct. 1, 1986 *Financial Times* of London, the worst drop in new orders for shipbuilding has hit the German yards. For the first six months of 1986, German yards had 68 new ship orders, in contrast to the same period in 1985, when the figure was 395. The labor-force has plunged 25% from 1980, from 57,000 to under 45,000 at the beginning of 1985.

Germany's chemical industry: crown jewel tarnished

Since the technological revolution sparked late in the last century by circles around the father of modern industrial chemistry, Justus von Liebig, Germany has been in the forefront of the world chemical industry. Names such as Bayer, Hoechst, BASF are known worldwide. Combining associated mining and products industries, the total West German chemical sector in 1985 was responsible for DM 1,304 billion

TABLE 3

Average age of EC and world fleet 1st July 1984 age distribution

Range (years)	EC Bulk			World Bulk		
	Oil tankers	carriers	Others	Oil tankers	carriers	Others
0- 4	7.12	17.26	19.34	11.27	26.55	17.44
5- 9	39.08	24.94	28.54	41.07	25.71	24.45
10-14	31.39	31.90	23.34	31.71	23.75	26.20
15-19	14.80	19.15	13.22	8.92	17.09	15.06
20-24	4.70	5.57	7.68	3.95	4.67	8.28
25-29	2.25	1.07	4.42	1.88	0.83	4.24
30+	0.66	0.11	3.46	1.20	1.39	4.32
	100	100	100	100	100	100
Average						
Age (yrs)	11.51	11.22	11.92	10.68	10.28	12.62

Average age of total fleets: EC: 11.55 World: 11.19.

Note: Calculation based on girt, includes non-trading ships.

TABLE 4

Tonnage on order by type at 1st January 1985

For registration	Tankers		Bulk carriers		Others		Total	
	No.	mn dwt*	No.	mn dwt	No.	mn dwt	No.	mn dwt
EC	62	2.3	74	3.4	196	1.6	332	7.3
World	311	10.8	531	24.9	735	9.9	1,577	45.6

*million dead-weight tons

of the German industrial product. The direct chemical industry was responsible for DM 149 billion.

Next to the automobile and engineering industries, the German chemical industry is the most heavily export-dependent branch of German industry. According to the report of the German Chemical Industry Association, in 1985, West Germany exported fully 52% of its product. This is the second most important export sector of the export-oriented German industry. Fertilizers, pesticides, pharmaceuticals, plastics, and industrial chemicals—all are major export items for the world industry.

The statistics seem to show that this industry is prospering. Despite setbacks in oil prices and foreign exchange, company profits continue to be positive. On Nov. 7, Dr. Hans Albers, president of the German Chemical Industry Association, noted that the "domestic" results for 1986 were "good." But, he cautioned, the overall results for this year of gross sales for the entire industry will be "some 6% lower." The reason? The "collapse of the U.S. dollar and the fall of the price for crude oil," says Albers.

Does this presage a deeper decline in coming months?

To give a comparison, the "recovery" of the total chemical industry in 1985 was coincident with the extraordinary competitive shift in export terms of trade between the D-mark and the dollar, which lasted until the last quarter of 1985. The industry began its downward slide along with the fall of the dollar at that time. But, if we look historically, even the good year of 1985 only achieved a production level 4% above 1980. And the previous four years before 1985 have all been *below* the production level of 1980. It was in 1980, of course, that the combined impact of the second "oil shock" and Paul Volcker's high interest rate policy began to devastate long-term trade and industry worldwide.

So far in 1986, according to industry sources, production is down in the major sectors of agricultural chemicals (fertilizers, pesticides etc.), industrial chemicals, and pharmaceuticals.

Automobiles: the only thing left?

The only major branch of West German industry to record a rise in actual production levels this year is the automobile

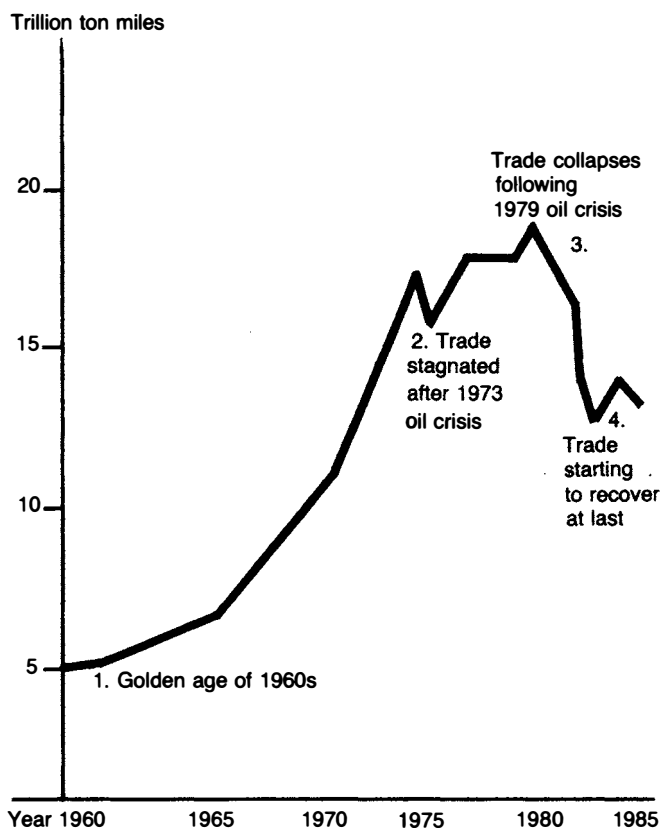
TABLE 5

Tonnage on order for registration in the EC as at 1st January 1985

On order in	No.	mn dwt
EC yards	208	2.9
Non-EC yards	124	4.4
Total	332	7.3

FIGURE 2

Why there is a shipbuilding crisis: seaborne trade 1960-85



Source: Fearnleys and U.N.O.

and vehicle branch. For the 10 months through October, the combined vehicle (cars, truck, special vehicles) production of West Germany reached 3.83 million units, according to

TABLE 6

EC trade by sea

		Total '10' (mn tons)	World (mn tons)	EC as %
Loadings	1980	311	3,650	8.5
	1982	352	3,249	10.9
	1983	396	3,090	12.8
Unloadings	1980	996	3,650	27.3
	1982	879	3,249	27.1
	1983	875	3,090	28.3

the German Automobile Industry Association. This is a respectable 3% above one year earlier, also a strong year. Since the low year of 1981, each year's output has climbed, interrupted only by an extraordinary strike in 1984. European industry sources regard the German auto industry as the premier European, and the technological leader for high-profit margin luxury autos such as Mercedes, BMW, and Audi. "Germans today are one or two steps ahead of the Japanese in introducing new technology," one London industry analyst notes. One reason is the intensive technological upgrading of the productive plant over the past decade. Introduction of assembly robots and computer production technologies in West Germany is the most advanced of any West European industry. The largest West German manufacturer of industrial robots is VW, also Europe's largest car producer. But VW consumes virtually its entire production in-house, according to industry sources.

Beginning in October, even this "bright spot" of the German economy began to show disquieting signs. According to the industry association, the rise in vehicle production stopped flat in October compared with the previous year. Exports also stopped flat. More troubling is the fact that despite the 3% production rise through October, the ten-month export volume in real unit terms of vehicles was down. The result for auto exports "is overshadowed by the low level of heavy-truck exports," a spokesman for the industry emphasized.

Best index of the economy: employment

This dark picture is underscored by the stark fact of enormously high unemployment. Even discounting the political manipulations of statistics on the "officially" jobless, West German unemployment remains extraordinarily high. According to a Nov. 13 report of the West German Labor Ministry, while 1986 is the "first year since 1979-80 when the absolute number of unemployed on average will be lower," it will still show 2.23 million unemployed compared with 2.30 million in 1985. However much the "improvement" represents political gimmickery before the national elections in January, it is clear that there is no actual "recovery."

According to Ulrich Cramer of the German Institute for Labor Market Research, "persons who are for a short period unemployed often do not appear in official unemployment statistics." But another indicator of the depth of the problem is the official statement in November that the government is extending the length of unemployment benefits by six more months. The Labor Minister stated on this occasion, "There is no royal road back to full employment." Indeed, this year, a record number, 100,000, has been forced off unemployment rolls into government public works programs. In 1982, the number was 30,000. This comes suspiciously close to the difference between official unemployment levels for 1985 and 1986, suggesting the means by which the Bonn government has "reduced unemployment for the first time since 1979."

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