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The bottomless recession

EIR's prediction of a 15 percent drop in output is coming true, but how far down things could go from here blows wires in our computer.

Last week's economic news produced a striking set of all-time records, including a 4.8 percent drop during April in the index of leading indicators, the steepest since the index was first formulated in 1948. The news also carried reports of a 32 percent drop in the current month of auto production, the worst year since 1962; and a total $5.6 billion runoff in commercial and industrial loans since Fed credit controls came on line March 16, also the steepest absolute drop on the record.

On balance, *EIR*'s prediction last October of a 15 percent drop in industrial output by the end of third-quarter 1980 appears within the range of events. What is more fundamental, as *EIR* emphasized in its May survey, "Will the United States Economy Survive?" is the basic underlying change at work reshaping the American economy for the worse.

Even with 7 percent unemployment as of April (and higher as of May), there remain basic shortages of skilled labor throughout the economy, even in those states worst hit by industrial closings, according to state unemployment data. *EIR* has emphasized that the current collapse is not merely cyclical but structural, i.e., provoked by falling real productivity rates due to chronic underinvestment in both plant and equipment and in the development of skilled labor.

This is borne out by the unusually high incidence of permanent plant closings, or permanent plant closings represented as temporary. At least 30 blast furnaces are already down, many never to reopen. Four auto plants are also shut down permanently along with dozens of smaller foundries and other production facilities essential to their industries.

It is important to emphasize that this is not a conventional recession, but a phase-change of the sort that occurs when a shock is introduced into a supercooled gas under pressure. Most gases can remain in gaseous state below their condensation temperature for some time, but will liquefy as soon as a shock is introduced—a physical analogy to economics made by Dr. Steven Bardwell in a May contribution to *EIR*.

There is an identical phenomenon in economics. An economy such as the United States which has failed to meet the replacement costs of maintaining productive capacity can continue for an extended period at stable or even rising levels of output, albeit with lower productivity and greater susceptibility to inflation. However, the minimum level of capacity utilization, required to meet fixed costs which have increased due to additional downtime and higher energy prices, increases. For example, a modern specialty steel facility can be operated profitably at 40 percent capacity, while a 50-year-old steel mill takes a loss at 80 percent of capacity.

When Volcker introduced the March 16 credit controls, forcing even large corporations to mind their liquidity, the economy fell through a hole on the chart to a lower level of capacity utilization. To what extent capacity reductions have already taken place is not clear. However, it is apparent that a "phase change" of the type *EIR* predicted in its April and May surveys of the American economy is in full swing.

The type of measures available to conventional econometrics are not sufficiently precise to grasp an economic situation of this type, and most estimates of the economy's chances for recovery are entirely conjectural for this reason. Temporarily, the rush is on to eliminate costs and preserve liquidity, as it was in the late fall of 1974; however, the method this time is less reducing inventories, which are not high by historic standards, than reducing capacity. This builds a mass of bottlenecks into an economy already suffering from substantial bottlenecks both on the labor and capital side; the result is a much higher threshhold-level of profit expectations and inflation before recovery can begin. The conclusion of the LaRouche-Riemann model analysis *EIR* published last month is that the economy is moving rapidly towards a point where a conventional recovery is physically impossible. If that point is passed, the U.S. economy and American political and business leaders will find themselves in the ironic, and tragic predicament that this nation's chances of retrieving its former economic power will depend upon foreign aid.

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