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Domestic Credit by Richard Freeman

'Recovery' without capital spending

Volcker's tight credit makes capital spending—the only basis of real recovery—impossible in the United States.

The U.S. economic "recovery" will start before or on July 1. On that date, $48 billion, on an annual rate, will be pumped into incomes through both the second round of the three-year personal tax cut and Social Security increases. This will provide the economy with extra buying power—or so the story goes.

The May 10 issue of *Business Week* ran a cover story titled "Here Comes The Recovery." That is now the conventional wisdom. After all, didn't consumers increase their borrowing in March by $990 million, the largest monthly increase since last October? Didn't retail sales increase by 1.4 percent in April? Weren't business inventories run off at the hefty rate of $40 billion per annum in the first quarter of 1982?

Hundreds of economists across the U.S. are now citing these signs. *Business Week* states in its "recovery" feature, "The U.S. economy is entering the early stages of a recovery. The signs of economic upturn are undeniable."

But, as the Business Council, the organization representing 200 chief executive officers of America's largest corporations, noted at their conference this month in Hot Springs, Virginia, most of the executives there predict a recovery, but not an increase in capital spending. As the chief economist for U.S. Trust in New York, James O'Leary, explained May 11, "what this means is that unused capacity will be brought into play." For example, the auto industry, which is operating at 46 percent of capacity, may increase capacity usage. Nothing new will be built. O'Leary and other economists say openly that there may not be increases in capital spending for years. U.S. capital-equipment production fell by 10 percent between July 1981 and March of this year and hasn't stopped falling yet.

A recovery without capital spending is a fake recovery, because even were production in some industries to reach the levels of capacity utilization in August 1979, before Paul Volcker became Fed Chairman, they would not be producing the same output, because capacity has contracted.

The only sector that is showing improvement is the defense sector. In the first quarter, incoming defense orders were 50 percent higher than they were a year earlier. The full weight of new orders has not been translated into production; thus defense output can be expected to increase. But as *EIR* has shown, a defense-spending-led recovery may look good in the short term, but in the longer term it grinds up the industrial base without producing real wealth, unless capital is put into modernizing and maintaining that base.

This brings us to the second point. $48 billion in tax cuts and Social Security payments may seem like a large amount. Yet under the Volcker regime, a good part of this $48 billion will be gobbled up by increasing interest payments. Consumers will spend some of the money, but much of it will go toward paying off bills, and corporations in turn will allocate much of their intake toward debt repayment.

Corporate earnings, without adjustment for inflation, fell by 22 percent in the first quarter to $165 billion, according to Manufacturers Hanover—the sharpest quarter to quarter earnings decline in the post-war period. Corporations with declining profits are not going to increase their capital spending.

Further, as Gary Winglowski, chief economist for Goldman, Sachs investment bank, reported May 3, "In 1947 corporate profits were 10 percent of national income, while total interest payments were only 1 percent. By the fourth quarter of 1981, corporate profits were 7.5 percent of national income, and interest payments were 9.5 percent." The trend got worse in the first quarter of 1982.

Robert Sinche, economist for Bear, Stearns investment bank, stated May 14, "I foresee that as part of the recovery in the 1980s, there will be a liquidation of industrial capacity. This is what the Braniff bankruptcy represents."

Volcker and other Fed governors told Congress May 11 that they intend no basic shift from their tight-money policy. Volcker is not guided by inflation rates, nor by sizes of budget deficits; he is guided by his often-expressed desire to shrink the U.s. economy. Under Volcker, at best, the U.S. economy will recover some industrial capacity usage before it plunges into full depression.

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