Five million layoffs in the U.S. by spring?

by David Goldman, Economics Editor

The prospects for the next six months can be expressed, roughly speaking, in terms of another million industrial layoffs and three to four million white-collar layoffs, the first mass unemployment in the latter category since the present depression began. That implies an "official" unemployment rate of 14 percent by April 1983; but the rate of exclusion of working-age Americans from employment, already at about 23 percent by *EIR*'s calculation, will rise to the order of 27 percent, comparable to the worst of the First Great Depression.

Although the August unemployment numbers show no change in service employment to speak of, the drop in U.S. retail sales in August and presumably also in September, marked by the closing of 336 Woolco stores, will begin to bite into retail employment. Then there is the 17 percent p.a. drop in production of office equipment, the great "information society" boom gone sour, and the collapse of office building. The orgy of corporate overhead expansion apparently came to a dead stop during the spring, and corporations will be seeking to pare overhead costs by eliminating white-collar personnel.

If corporations have stopped building office buildings and buying office equipment, they will presently stop employing white-collar workers. At this point, the same GNP multipliers that have puffed that measure of the economy up to levels which disguise the rapid deterioration of the underlying economy will work in reverse, and the economy will see the depression spread from the production-workers' ghetto to much broader layers of the population.

All available evidence indicates that the Volcker bubble in the U.S. credit system, the $100-billion-per-year capitalization of corporate interest payments, began to let out air during the third quarter, with devastating consequences for the American economy. The credit system data suggest that the 4 percent drop in August durable-goods orders was no fluke, nor was the 50 percent decline in steel output and the 40 percent decline in aluminum output in the course of this year. Finally, the highest bankruptcy rate since the 1930s has persuaded major institutions to liquidate their holdings of both financial and non-financial company commercial paper; money-market funds to shun the certificates of deposit of major commercial banks, and bankers to tell their leading borrowers to stabilize their drawings at roughly the present levels.

With consumer-goods industries still flat at their depression lows, only two expense items on corporate balance sheets can absorb the shock of a credit environment which, if not yet a shutoff, is still a dramatic slowdown in the rate of lending.

These are, first, *capital investment,* the one category of industrial companies' expenditures which rose uninterruptedly in nominal terms between 1977 and the second quarter of 1982, when it ran at a $263 billion p.a. rate. Over the succeeding four quarters, i.e., through mid-1983, corporations will be lucky to sustain a $180 billion annual rate. The second is the economy's *white-collar workforce*. The United States has lost about 2 million production workers so far this year, bringing the total to 21 million, against a constant level of 64 million service workers. Once the economic contraction reaches a certain threshhold, the economy will not generate the surplus required to employ so many people in overhead functions.

What is Ronald Reagan talking about?

The above summary was the subject of considerable analysis in *EIR* earlier this year, and has since been echoed by Salomon Brothers and other Wall Street bond houses. President Reagan's Sept. 28 press conference, therefore, prompted a remark by one investment house chairman that "Reagan and [Treasury Secretary Donald] Regan may be naive, but the rest of them *must* be lying through their teeth." The behavior of personal income, on which the administration's official recovery forecast depends, no longer has any significant relationship to economic activity. As the August import numbers show, any small increases in demand will be met through import increase more than through production increases. Panic savings among people who fear losing their jobs and other factors are cited to explain the 0.9 percent drop in retail sales in August; but this is not to the point. *The reduction in goods-producing employment has put a ceiling on consumer purchases.*

The potential for change now lies in corporate, not consumer, balance sheets, and, under the present monetary regime, is only negative. No one has told the President about this.

Since corporations increased their liabilities at a $100 billion annual rate during the first half of the year, they paid no net debt service, but merely capitalized the old interest into their new debt. Conventional econometric models ignore debt service, on the presumption that it will always be refinanced; for this reason they have been consistently wrong since Volcker came into office. However, lenders will ultimately determine how fast corporations may raise their indebtedness in order to cover existing interest costs. The metastability of the past year in an otherwise crisis-prone credit system is based on an unstated agreement between lenders and corporations that the latter will borrow a sum equal to their debt-service costs, less the savings created by a 7 percent annual rate of decline. However, they sought to keep capital expenditures stable (at a low, and entirely insufficient, level), in order to maintain the margin of capacity required for recovery, at least in a few industries, e.g., office equipment, oil equipment, office buildings, and other economic fluff.

As of July, when the rate of expansion of commercial and industrial loans at commercial banks dropped briefly to nothing (it picked up somewhat in September), and the commercial-paper market folded for the duration, it became clear that this modus vivendi between creditors and debtors had fallen through, because the debtors were "borrowing too much." Against a rate of expansion of total credit-market borrowings of about $100 billion during the first half, the third-quarter rate will probably turn out to be between $20 and $30 billion per year, judging from fragmentary available data.

Barring a change in other factors, corporations will, by simple arithmetic, have to find some way to cut costs by that amount. What is the status of these other factors?

1) **Interest rates,** adjusted for corporations' ability to pass on debt-service costs through higher prices, are actually higher than at any time since Volcker took office. A 13½ percent prime rate translates into 15 percent or higher effective borrowing costs; against a 6 percent inflation rate for the year, *the "real interest rate" is 9 percent, or the worst ever.*

2) **Corporate profits,** already down to 1966 levels adjusted for inflation and inventory values, will fall slightly during the third quarter, and probably fall steeply during the fourth quarter.

3) **Final sales,** falling for the last two quarters, will not improve.

Data through the week of Sept. 15 show a declining rate of reserve growth relative to previous levels; earlier, a significant rise in August reserve growth lent an appearance of a Federal Reserve shift, but that trend collapsed in September.

The above summary makes sense out of the 50 percent decline in steel output so far this year. Steel cannot remain at such low levels if the rest of the economy picks up. However, a survey of steel users indicates that the collapse of steel shipments may provide a useful guide to future production plans of steel users. Like the machine-tool industry, whose order backlog fell from $3.3 billion at the beginning of the year to only $1 billion in August—which implies virtual drying-up of machine-tool output within months—other capital-goods industries are working off existing order books, but cannot sustain their present low level of output for long.

As a whole, capital-goods industries' consumption of steel has fallen by 31 percent this year. In construction, whose production index is down 6 percent so far this year, steel purchases are down 30 percent. Some of this extraordinary discrepancy may be due to extremely cautious inventory policies on the part of steel users, but that could only account for a marginal effect. What squares with the financial data is the assumption that new commercial construction, following the post-May bust in the real-estate markets, is about to fall to zero, while homebuilding, staggering along at last year's miserable levels, has no hope of improvement.

In conclusion, all the data point to *a 25 percent or larger decline in capital-goods production,* and *a much faster rate of physical-output decline* than the 7 percent p.a. registered so far this year.

Popping the GNP bubble

Of course, reports of a second- and third-quarter rise in GNP, even though the latter are likely to be revised downward to show a substantial decline, only demonstrate how useless the Gross National Product measure is in the first place. Reductions in inventory and marginal increases in sales of services made up the rise. However, the question is inevitable: how long can the economy go on sustaining 64 million service workers while the rest of the economy remains paralyzed?

By March of 1983, there will be hell to pay.