EIR model: U.S. recovery flunks on three counts

by Vin Berg

More than the entire gain in the American economy's physical output during 1983 and the first half of 1984 represents a subsidy to the American economy by the rest of the world, of which about half derived from the developing sector, *EIR*'s June 1984 *Quarterly Economic Report* demonstrates. The apparent output gain of about 4% in terms of physical product during 1983 reduces to a mere 1% gain when the effect of the subsidy is removed, and becomes an actual decline during 1984, the study shows.

Furthermore, if the cost of repairing the nation's deteriorating infrastructure is treated as an unpaid capital cost, the 1% gain during 1983 becomes a 9.4% decline.

Three measures

In this summary, we present, as opposed to the fraudulent portrait of the economy offered by the Federal Reserve and the Department of Commerce, three national-income accounting measures which describe the status and trajectory of the American economy with successively greater accuracy.

The American economic recovery is a fraud on three counts:

1) First, the Federal Reserve industrial production index reported double the actual gains in physical output, which *EIR* derived from a comprehensive survey of private-sector industrial associations.

2) Even the lower, real level of output improvement was not due to the "operating account" of the American economy itself, but was the result of a windfall: a nearly 40% overvaluation of the U.S. dollar and a drastic reduction of commodity-export prices of the developing sector.

3) The *future potential* of the American economy to produce, measured by including the depreciation cost of basic economic infrastructure, continued to decline rapidly despite the windfall gain due to the trade subsidy. On "capital account," the American economy is declining at nearly a 10% annual rate.

The accompanying graphics generated by LaRouche-Riemann computer simulation reflect the first two corrective points only. Figures for industrial output corrected to account for simple statistical fraud at the Federal Reserve and other reporting agencies, are compared to output figures as further corrected by subtraction of the production inputs representing a pure subsidy from America's trading partners. When one deducts the subsidy to the United States stemming from extremely distorted favorable terms of trade—the discrepancy in the two trajectories—the U.S. economy, officially described as increasing physical goods output, is shown to be declining in physical output.

Even the apparent upward motion of the physical output of the U.S. economy will be reversed during the course of 1984. While the overall results of this downward trend will still show a slight gain at the end of 1984, approximately 1%, the downward trend will continue and intensify in 1985, giving a fall of between 3% and 4% over 1984 and 1985.

Even this projected decline, however, is seen to be conservative in the extreme when viewed from the more comprehensive standpoint which takes account of the third adjustment factor. Net of unmet depreciation costs of basic economic infrastructure, the economy would show a steep fall indeed.

These unmet depreciation costs currently total over 9% of total output. This must be kept in mind to properly evaluate any apparent growth within an overall, "bouncing ball" pattern of economic decline.

What also must be kept in mind in 1984-85 projections is that the American parasite is about to lose its foreign host. The actual level of U.S. economic decline over 1984-85 will be determined by the end of the current level of subsidy which the country is receiving from the rest of the world. This subsidy maintained the slim appearance of recovery in 1983, while the productive capability of the United States slipped further and further into decay. It will be the removal of the subsidy, a foregone conclusion of the ongoing financial crisis, which will reveal the underlying physical-breakdown condition of the U.S. economy, most severe in the obsolete and battered condition of basic domestic infrastructure.

Infrastructure

EIR is currently engaged in effecting improvements in the LaRouche-Riemann model that will permit the more comprehensive picture, encompassing all three adjustment factors cited above, to be computer simulated for graphic representation.

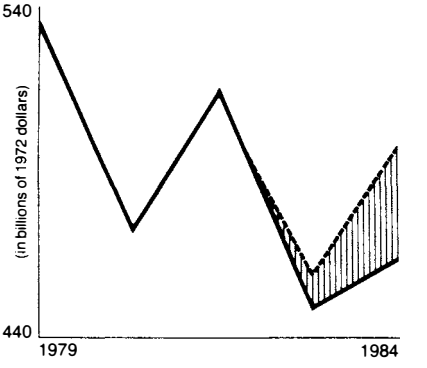
Infrastructure is the framework of the economy which manufacturing and agriculture are "lowered into." No manufacturing plant can be opened without water and electricity supply. Infrastructure is the limiting function, or better, the potential function of industrial-agricultural and population growth. Extensive dams, water systems, piping, electricity generating plants, transmission wires, and so forth are often necessary before a single manufacturing or agricultural enterprise can start operations. Conversely, the erosion of such infrastructural systems will begin to sabotage industrial and agricultural activity, restrict operations, lower productivity. If not ameliorated, industry and agriculture will experience outright shut-down. Thus, if the growth in infrastructure opens up the potential for exponential growth levels in manufacturing and agriculture, at the point that infrastructure erodes significantly, as in the United States today, even a significant investment in manufacturing and agriculture will cause no significant economic growth.

Infrastructure capital-stock investment is larger by a factor of three or four than capital-stock investment in plant and equipment. Thus, from the standpoint of a proper overall economic policy oriented to maximizing agro-industrial development, in terms of the sheer size of investment, infrastructure should consume greater amounts of capital goods

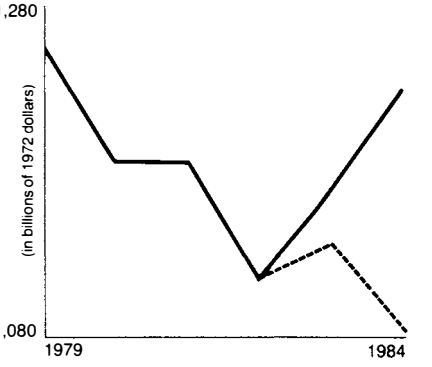
LaRouche-Riemann U.S. Economic Survey 1979-84

KEY
—apparent vs. ----underlying

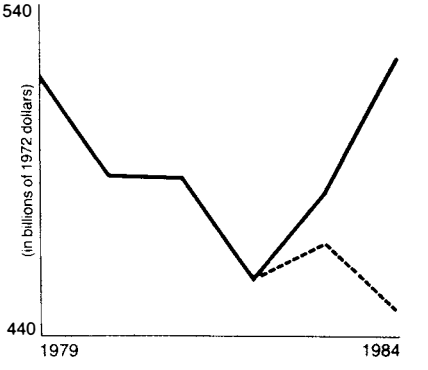
GRAPH 1
Overhead less net imports



GRAPH 2
Total tangible output



GRAPH 3
Tangible profit (S)



than the plant-and-equipment annual bill for industry and agriculture.

Measuring the infrastructure deficit presents an interesting problem. Since infrastructure is a potential function—measuring the potential for various levels of economic growth in the future—it must be measured from a measure of future economic value. The problem may be broken into two parts. Between 1984 and 2004, we have assumed that deterioration in infrastructure, *dating from 1960*, requires major repair and replacement projects. Calculating the necessary expenditures on such projects gives an infrastructure *deficit*. Second, we have assumed certain transformations in the economy to avert disaster and achieve the next level of technological progress. Both parts make up the cost of amortization of basic economic infrastructure over the next 20 years.

In the measurement of infrastructure, we have made a departure and included the cost of repairing and expanding manufacturing plant and equipment. Plant is often included in infrastructure studies, but equipment is usually not. However, since the two are so closely related, we have included the cost of replacing equipment. In the truest sense, this is a cost that must be accounted before any new levels of output can be achieved.

One final note: America's military needs are inexorably tied up with the functioning of infrastructure. Exemplary is the highway system. America's roads were built with national defense in mind. In fact, in 1956, Congress officially designated the Interstate Highway network "the National System of Interstate and Defense Highways."

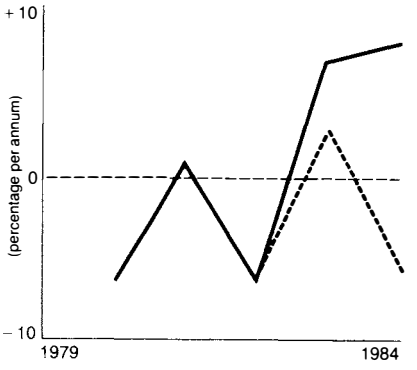
In congressional testimony in June 1950, commissioner of the Bureau of Public Roads, Thomas MacDonald, attested to the defense needs of all infrastructure: "The minimum requirements of structural and capacity design of the major routes to serve national interests must be equated to the foreseen needs of the national defense. Thus, the question of whether the highways would be built at less cost if there were no heavy trucks [allowed] becomes largely academic since the design of major routes must be held to defense standards."

So, the question might be asked: If the United States had to go to war, would each element of infrastructure be capable of sustaining the mobilization? The current answer is a resounding no.

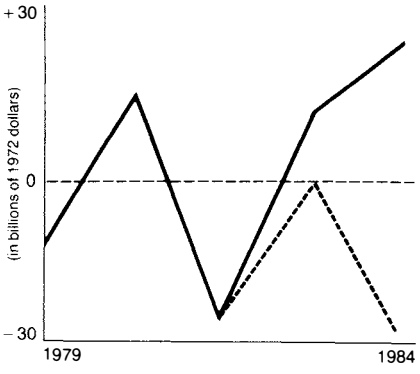
Analysis of the trade subsidy

By estimate of the LaRouche-Riemann model, the present trade deficit is the equivalent of 7% of total tangible ouput, i.e., an amount greater than any swing in reported output during the last eight years. The deficit functions as a source of *production inputs which are not being paid for* due to dollar overvaluation and import underpricing (the latter resulting from the fact that, under IMF conditionalities, for example, developing-sector debtors must export everything not nailed down, even at a net loss, to earn foreign exchange

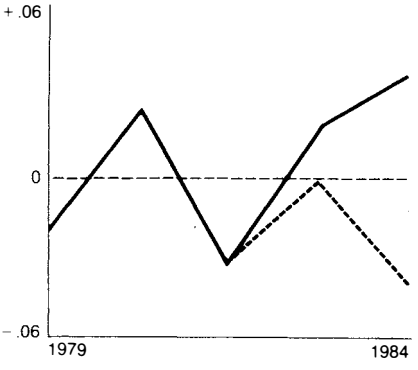
GRAPH 3A
Percent growth of tangible profit



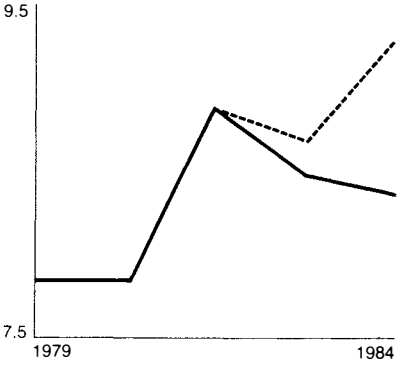
GRAPH 4
Net reinvestment (S′)



GRAPH 5
Instantaneous reinvestment rate, S′/(C + V)



GRAPH 6
Overhead per unit of tangible wage bill



for debt service). These imports are substituted for essential manufacturing and semi-manufacturing output the economy no longer invests in producing—permitting a level of output unmerited by the underlying physical conditions of the U.S. economy.

The graphs compare the apparent course of the U.S. economy through the first half of 1984 with the trajectory which the economy would have followed in the absence of the import subsidy. All measurements were made in constant 1972 dollars. The 1984 values are annualized from conditions existing at the end of the second quarter of 1984.

Graph 1 shows the magnitude of the subsidy which has been supporting the U.S. economy since 1982. The difference here is calculated by taking the *change* in the balance of trade between, for example, 1982 and 1983, and adding that change to the overhead. In this way, a comparison can be made between the observed course of the economy and the internal capabilities which it possessed at each point.

Graph 2 shows the course of total tangible output with and without the subsidy. The pattern of deep falls followed by temporary respites seen in 1979-81, is repeated in 1981-84 when the result of the subsidy is removed. While the rate of decline of the underlying economy appears to have slowed, the net course is still negative.

Graph 3 shows the divergence of tangible profit between the apparent and underlying trajectories. Note that the subsidy received in 1982 produces an increased tangible profit in 1983.

Graph 3A indicates the rate of change for tangible profit. Rates of decline of 6% to 7% between 1979-80 and 1981-82 would have been almost matched by the 5% drop between 1983-84 in the absence of the subsidy.

Graph 4 shows that the apparent net reinvestment in 1983 and the first part of 1984 was purely a result of the trade imbalance. In 1982, the U.S. economy itself produced barely enough tangible profit to meet the overhead requirements, and in 1983, it produced significantly too litle. The difference, experienced as net investments in the following period, was made up by the trade surplus.

Graph 5 demonstrates that the *rate* of net reinvestment would have been more negative in 1984 (-0.04) than even in 1982 (-0.02) if the trade surplus had not increased. With the rapid growth of the subsidy, the economy showed a relatively high growth potential of 0.03.

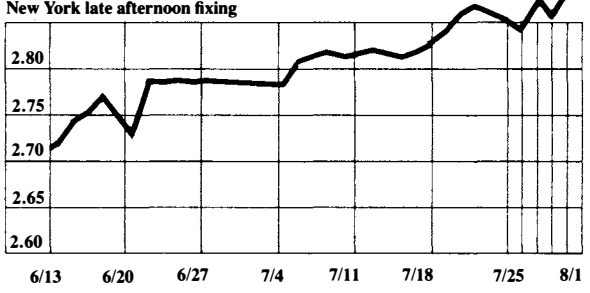
Graph 6 provides the empirical proof that the apparent growth of the economy must have come from a source such as we describe. The ratio of overhead costs to the wage bill of the productive workforce is shown to fall over a period of massive increase in service, government, and all other types of overhead costs.

The EIR Quarterly Economic Report, *entitled "The United States on the Edge of a General Breakdown Crisis," is available at $1,000, $500 to subscribers.*

Currency Rates

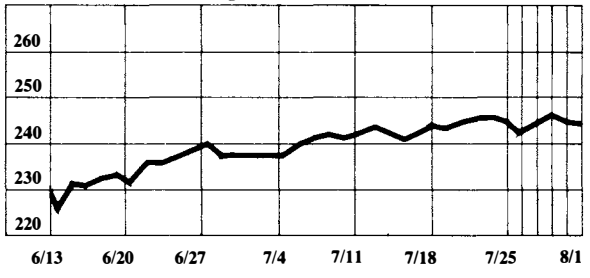
The dollar in deutschemarks

New York late afternoon fixing



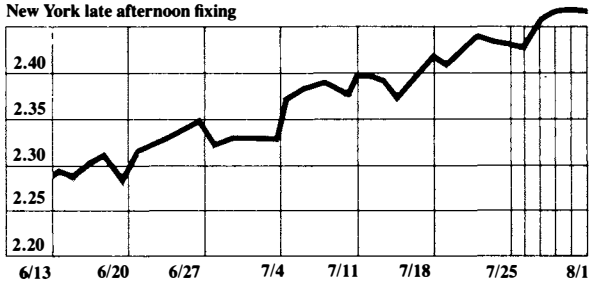
The dollar in yen

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