

After Deindustrialization and Financial Collapse:

Why the U.S. economy must be made production-centered

By Jon Rynn and Seymour Melman

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Wall Street rewarded the destroyers of wealth during the 1990s instead of the creators of our wealth, the working people of this country. Instead of building a solid industrial base and infrastructure, upper managements of many corporations tricked and cheated their way to riches and power, while the Federal government looked the other way and carefully tended the garden of military overkill.

CAPITAL APPROPRIATION

Enron was the tip of the iceberg. From mid January to June 2002 the *New York Times* filled more than 20,000 column inches with news and analysis about the misfortunes of the Enron Corporation. The financial markets and institutions of the United States have taken on qualities of a casino where large fortunes are made and unmade. However, the top managers of many large corporations have been "fixing the wheel" of the casino, walking away with \$ millions suffering no more than a slap on the wrist, while millions of workers see their jobs and pensions reduced or eliminated.

At this writing there are only very partial data on the "take" by corporate chiefs. For example: WorldCom paid "more than five top executives an average of \$425,000 each to prevent

them from leaving the company" (*New York Times* June 28, 2002); also at WorldCom Scott Sullivan was able to gain \$30 million by selling shares from 1997 to 2000; John Sidgmore made more than \$77 million during the last six years; Mr. Roberts made about \$13 million selling 340,000 shares in 1999 and held about a million shares in April; Ronald R. Beaumont received a \$2 million bonus in 2001.

ABC aired a program (*Primetime Live*, 7/25/2002) showing viewers the huge mansions, palaces and boats being built or operated by the very titans of industry whose firms have imploded.

In parallel with these sampled disclosures, look at the roster of corporations currently under criminal and civil investigation for "burnishing the numbers" (concealing the true state of affairs:)

Adelphia Communications Under criminal and civil investigation on suspicion of hiding \$3 billion in loans to its chief executives and overstating the number of customers it had. Filed for bankruptcy on Tuesday.

Computer Associates Under criminal and civil investigation on suspicion of inflating sales and profits by booking revenue on contracts many years before it was paid.

Dynegy Under civil investigation on suspicion of inflating its cash flow and avoiding taxes with a sham trade of natural gas; has acknowledged making sham electricity trades.

Enron Under criminal and civil investigation; has admitted hiding losses and loans with partnerships that were supposedly independent but were actually guaranteed by the company. Filed for bankruptcy in December 2001.

Global Crossing Under criminal and civil investigation on suspicion of inflating sales and profits by making sham transactions with other telecom companies.

Qwest Under civil investigation on suspicion of overstating sales and profits by making sham transactions with other telecom companies.

Rite Aid Four former top executives have been indicted on criminal charges in what regulators called a securities and accounting fraud that led to a \$1.6 billion restatement of earnings.

Tyco International Under criminal and civil investigation on suspicion of hiding payments and loans to its top executives, including former its [sic] chief executive, L. Dennis Kozlowski; shares have plunged 75 percent this year as investors question whether it inflated its earnings and cash flow.

WorldCom Under criminal and civil investigation; has admitted hiding expenses by wrongly classifying short-term costs as long-term investments.

Xerox Paid \$10 million fine to S.E.C. in April, the largest in an enforcement case, and has reclassified \$6.4 billion in revenue in restated financial results for the last five years. The case is still under investigation. ¹

Meanwhile blue and white-collar workers have been suffering massive job, savings and pension fund losses. At WorldCom around 17,000 workers, about one in five, are slated for job loss. Worker savings have also taken a heavy hit. Many workers at Tyco's electronic components factory in South Carolina had 401(k) savings plans that looked good when Tyco stock was at \$71, but now suffer large losses with Tyco stock under \$14. Said one veteran worker: "We don't even get a bonus at Christmas, and then he [the CEO] winds up with a million dollar bonus." (*New York Times* 7/6/02).

¹ "Burnishing the Numbers" (New York Times 6/29/02)

By indirection, via heavy losses in employee pension funds, workers, including many far removed from the latest centers of corporate fraud are slated to suffer major losses. Here are some of the major U.S. pension funds' losses owing to the Worldcom collapse.

STATE OR CITY <i>INVESTOR</i>	ASSETS	WORLDCOM LOSS
California <i>California Public Employees' Retirement System (Calpers)</i>	\$149 billion	\$565 million
New York State <i>New York State Common Retirement Fund</i>	112 billion	300 million
Michigan <i>Municipal Employees' Retirement System</i>	48 billion	116 million
Florida <i>Florida State Board of Administration</i>	95 billion	116 million
New York City <i>Funds for municipal workers like teachers, firefighters and police</i>	95 billion	100 million
Wisconsin <i>State of Wisconsin Investment Board</i>	58.5 billion	36.3 million
Iowa <i>Iowa Public Employee's Retirement System</i>	15 billion	33 million ²

² "Taking a Hit" (*New York Times* 6/28/02 / *Bloomberg News*)

DEINDUSTRIALIZATION: THE CENTRALITY OF PRODUCTION

While the media have featured the gyrations and collapses in the financial side of US economy, the process of economic decay has been proceeding full tilt. This is a problem that cannot be solved by a quick fix like changing accounting rules. Many Americans, including economists, operate with the assumption that money equals wealth. In reality, money is a socially accepted representation of relative value. Thereby money facilitates exchange of goods and services, while wealth consists, centrally, of the material things that are useful for consumption or as means of production.

Many educated people have been caught up by the myth of the "post-industrial" service economy. Accordingly, money-valued services are regarded as though equal to manufacturing production capability when gauging the economic strength of a country. This reflects a misunderstanding of how a modern economy works. Most of the service economy – retail and wholesale, transportation services, housing – relies on the goods that stock the stores, or the machinery that is used to provide the services, such as the aircraft. The goods themselves must be produced – they do not fall from the sky. These goods are produced in factories, and the factories in turn are filled with production machinery. All large, wealthy nations in history have been competent producers of production machinery and their associated capital goods such as steel. A nation that must import both its production machinery and consumer goods is headed for comprehensive decline, and the U.S. is definitely en route.

In particular, the critical machinery on which the rest of the economy depends is composed of metal-making and metal-working industries such as steel and machine tools. These sectors have the capacity to reproduce themselves, and thus serve as the central force for

economic growth and technological progress. A machine tool can be used to make all other forms of machinery (including computers) as well as more machine tools. A technological change in machine tools, because of its importance in the economic system, has an amplifying effect on the rest of the economy.

The same effects can be seen in a number of other industries, such as in electricity-generating machinery or the equipment for making semiconductors. All of these industries reinforce and support each other, in a cycle of technological and economic growth. But the U.S. has been abandoning these critical sectors in search of a mystical “post-industrial” world that will never exist, throwing its money down the financial whirlpool known as Wall Street.

All this reflects a process of deindustrialization which has direct bearing on the elemental task of an economy, any economy - namely to organize people for productive work.

During the second half of the twentieth century an array of US industries were wiped out. American managers made fresh manufacturing investments in other countries, or shut down their industrial facilities in the U.S. See the pattern of the former American auto industry. New factories were set up in Mexico, while production of components and assembly of whole vehicles was left to European and Japanese firms. American firms reinvested in agricultural machinery and construction outside the U.S. Thereby the U.S. retains major farm production but the needed farm machinery is increasingly produced abroad.

The critical machinery required for agriculture, construction, textile, paper-making, engine-making, printing and materials handling, are increasingly imported from abroad. The United States rose to superpower status because of its leadership in these and other manufacturing industries. According to data analyzed by Jon Rynn, by 1994 about one-quarter of the production machinery purchased in the U.S. was imported, rising from virtually none in

the 1960s. If this process continues, then by 2020 the U.S. will be dependent on the German and Japanese manufacturers of production machinery required in the U.S. Additionally, as this occurs, the American industries that use production machinery – for example agriculture, construction and clothing manufacturing – will lose the critical technological edge that comes from a close relationship with producers of their required machinery. Such distancing limits technological advances in production machinery, and will slow the establishment of American, state-of-the-art factories and reduce orders for new production machinery. A vicious cycle then develops in which the American manufacturers of consumer goods fall further and further behind their competitors in other countries, leading to the collapse of the local production machinery industries and eventually American manufactures as a whole.

In his "Profits Without Production" (Knopf, 1983), Seymour Melman showed in detail how such a process of failure in research activity, and focus on short term profits, led to decline, and finally collapse, of much of the U.S. steel industry. By 2002 those forecasts were fulfilled. So now the U.S. steel industry is "on the ropes," the product of finance-oriented managers who pressed relentlessly for short-term gain to the exclusion of technical research and long-term production.

By 2002 the Honda Corporation announced that it was prepared to fly in 200 tons of steel from Japan that it needed for the operation of its U.S. auto factories. The steel was unavailable from the U.S. steel industry.

Among American corporations, deindustrialization in the United States, accompanied by investments abroad, has accounted for the loss of over three million jobs owing to the closing of U.S. factories in many industries. Seymour Melman's report on "What Else is There to Do?" spelled out the scale of deindustrialization in a great array of U.S. industries. For several

industries it was possible to show the scale of closings, plant by plant, as well as the relocation of facilities to Mexico - a large-scale union-avoiding and union-busting process.

FROM DEINDUSTRIALIZATION TO A LOWER LEVEL OF LIVING

Deindustrialization has led directly to massive trade deficits for the United States which, in turn, will lead to a collapse of the dollar compared with the currencies of other leading industrial economies. A weak dollar will make manufactured imports more expensive, which will lead to inflation in the United States, in other words, to a lower level of living for most working people.

Let us trace this sequence: Deindustrialization → Trade deficits → Collapsing dollar → Inflation → Lower level of living.

Deindustrialization leads to trade deficits because the U.S. must import all of those goods, such as cars and computers and consumer durables such as VCRs and toys, for which it is losing competence. For example, the U.S. exported \$17 billion in passenger cars in 2000, but imported \$109 billion. The trade deficit for computers was \$34 billion, and for consumer durables (except cars) \$88 billion (Survey of Current Business, April 2001, p.53-54). Until the late 1970's the U.S. fulfilled most of the needs of its own consumers and businesses.

Now the growing trade deficit threatens a collapse of the dollar. A 2001 trade deficit in goods and services of \$393 billion means that \$393 billion dollars have been accepted by people outside of the United States without receiving anything in return. Those people are simply

holding dollars. The reason these people have not become angry is that most of the money, \$382 billion to be exact (data from Survey of Current Business, July 2002, p. 34) has flowed back into the United States in the form of finance capital – most of it into the stock markets. In other words, instead of exchanging goods and services with other countries for their goods and services, we have been exchanging our companies' assets for their goods and services. If the Europeans and other money managers decide that the U.S. is not the best place to invest, than the trade deficit will have to close, because nobody wants to have dollars that they can't buy anything with.

There are two ways to close a trade deficit. One way is to sell more exports, but since the U.S. has been deindustrializing, this option is being eliminated as other countries such as Germany and Japan make equal or better manufactured goods. The other way to close a trade deficit is to reduce imports. The main way to cut importing is for the dollar to decrease or even collapse in value, because then Americans can afford less of the imported goods. For example, a VCR costing \$300 dollars before the fall in the dollar's value, could then cost \$400. Because of the increase in price, fewer imported VCRs will be purchased. However, a collapse of the dollar is not cost-free. It would bring on domestic U.S. price inflation – paying \$400 dollars for the VCR that previously cost \$300 – and thus, a lower level of living for most Americans.

Most economic journalists seem to think that if the dollar goes down, and therefore if the price of imported goods goes up, then American manufacturers will rev up their production lines and fill the vacuum. There are two problems with this assumption.

First, even if the American consumer goods manufacturers could increase production, they would still need to buy new production machinery to make more goods in the factories. The state of the U.S. industries that produce production machinery is such that most new

machinery for expanded U.S. production would have to be imported. Since the dollar would have dropped in value, this imported machinery would cost more in dollars, and thus the manufactured goods would be more expensive as well. In addition, the trade deficit would worsen because we would be increasing our imports of production machinery. This is exactly the dilemma faced by developing countries that want to industrialize. They try to exchange their exportable goods such as textiles for the required production machinery until the time when they build their own machinery industries. South Korea has been developing for decades and has made vast advances towards self-sufficiency in production machinery. The U.S. is going in exactly the opposite direction.

The second reason that U.S. business can not supply goods equivalent to more expensive imports, is that most American consumer goods manufacturers either could not increase production rapidly or simply do not produce required goods, as in the case of VCRs and TVs. The reason that a collapse, not simply a fall, of the dollar is possible is because we simply might not have anything to trade for most imported goods, yet we would still need to do some importation. With large amounts of dollars going abroad, more and more assets of the U.S. would have to be sold – for these would be the only tradable goods – until we became a virtual colony of foreign multinationals.

This process of deindustrialization leading to a lower standard of living has been masked thus far by the stock market bubble that has burst. For the bubble, after all, consisted of money values alone, not real goods and services. By the end of the 1980s, many Americans were genuinely concerned about the lack of U.S. competitiveness. But the financial “exuberance” of the 1990s led to the false claim that we had regained our competitiveness. The stock market bubble was a result of the selling off of much of what remained of our manufacturing base (for

example, DaimlerBenz buying Chrysler), combined with a vision of a nonproducing universe in which the Internet was supposed to replace much of the producing economy. The bubble was sustained by the ideology that manufacturing doesn't matter. Supposedly, if manufacturing doesn't matter, then nonmanufacturing, such as finance and the Internet, do matter.

Instead of investing finance capital into the most important parts of the economy, that is, manufacturing, the bubble of the 1990s diverted precious resources into the scheming hands of financial manipulators including top officers of famous firms. The 1990s represented a wasted opportunity to rebuild the industrial base and infrastructure of this country. Now the Bush administration and its corporate entourage want the working people of this country to pay for their incompetence.

MILITARY SPENDING AND INDUSTRIAL DECAY

The enormous outlays by the U.S. government for military purposes at home and abroad (half of federal spending) have spurred the process of industrial decay. The military outlays use up material goods and work time that yield no product that is useful for future production or as ordinary consumption. Hence, the entire U.S. labor force engaged, directly and indirectly, in military production requires a subsidy from the rest of society.

The U.S. government has played a vital role in all the processes that we have outlined here. During the half-century of Cold War, the federal government was by far, the single largest controller of research funds in the U.S. During the 1990's 55 percent of federal R&D allocations were for military projects while the Japanese government allotted 6 percent, and the German government assigned 8 percent of their R&D spending on their armed forces. These major differences in military priorities go far to explain the continuing superior competence of German and Japanese industry as producers of basic industrial machinery.

In all these processes of financial and production deterioration, the federal government now plays a central role. The federal government plays a major role in the financial mechanisms defined here, and in the deindustrialization process throughout the economy. See the role that the White House played in relation to Enron. The chief of Enron was given an honored place in the year 2000 inauguration of the new president. And Enron top executives were prominently placed in the opening moves of the Bush administration – the Secretary of the Army still is a former top Enron executive. All this proceeded while the administration has been hiding behind a war on terrorism and its military expansionism.

The combined corporate plus government managerial hierarchies result in spectacular growth in the managerial, administrative and enforcing occupations of every sort as compared to occupations primarily producing consumer goods. We expect that the data for the year 2000 census - when released - will show a major growth in the administrative, managerial and enforcing occupations. This was the mechanism of collapse of the economy of the Soviet Union – the economy became top heavy with management, and the production foundations were allowed to deteriorate. The U.S. is now on the same track.

After a ten year interregnum at the close of the Cold War, American state managers had not only enlarged an already swollen military budget to \$400 billion, but also propose production of new nuclear technologies, saying: "Nuclear attack options that vary in scale, scope and purpose will complement other military capabilities..." Nuclear weapons factories are to be reopened and the researchers and designers are to be given fresh funds. New deep-penetration nuclear bombs are to be designed to destroy bunkers or other targets at depths of 100 feet or more, through rock, concrete and steel. Such weapons would not only be useable against Bin Laden and Co. in their Afghan caves. They could also break apart America's planned long-term

storage site for high level radioactive waste at Yucca Mountain, Nevada.

The new generation of American Strangeloves is bound to be followed by their counterparts in other countries. They threaten the whole human race.

But releasing the nuclear weapons genie and multiplying overkill will have immediate effects inside the U.S. even without a worst case nuclear war. The overkill madness will starve every part of public infrastructure. First tens then hundreds of billions of dollars will be devoted to the new weaponry - all in the name of Defense. The American Society of Civil Engineers has reckoned the bill for infrastructure repair for the next five years at \$1,300 billions (see last page of this paper). But the money will not be available. The whole array of neglected public activities will go to rot more speedily than before-- no rescue for the poorly housed, no medical care for the poor, no repair of school buildings, no rescue for America's underclasses, no cleanup of waste sites, and on and on.

If our public funds were invested for building a modern electrified railroad network in the U.S., it would first require building the manufacturing industries that could produce such equipments. The U.S. does not currently support a subway car industry. All subway cars must be imported. In November of 2001, a conference was organized at Columbia University to explore the possibilities of organizing such an industry.*

* See <http://www.columbia.edu/itc/business/melman/> , and also <http://www.aftercapitalism.com> for Seymour Melman's work.

ALTERNATIVES

All told then, the American economy has been damaged by the massive appropriation of capital by upper managements, the deindustrialization of the economy, and the misdirection of capital into the military. The economic result could be a declining standard of living for most Americans. In addition, the American government has been transformed into a partnership (as in Bush - Cheney) of top political and corporate managers.

There are alternatives to our present finance-centered, corporate-power-wielding economic system. The whole array of financial collapses in U.S. corporations from 2000 to 2003 would have been avoided if enterprise decision making were based upon workplace democracy. Notably, workplace democracy mechanisms operated by blue and white collar workers would not agree to the extravagant salary and related payments in the form of stock options to top managers. Neither would a combination of white and blue collar workers agree to the wipeout of their pension funds, or to the deindustrialization of the U.S.

A nation-wide drive for reindustrialization needs to take place in the United States. The Federal government may be presently poorly-suited to such a task. Not only do corporate based politicians have major control, but the Federal government has been focussed mainly on the military, not civilian, part of the economy. Therefore, it may be fruitful to bring together city governments, with the help of states, in combination with local unions and universities, in order to construct plans for the reindustrialization of urban centers. This could attract and make productive use of the huge pool of finance capital that the working people have created in the

form of pension funds. Reindustrialization is imperative if the decline process of the U.S. is to be reversed.

We are also faced with two possible futures for the process of globalization. If continued as now practiced, globalization will lead to further deindustrialization of the U.S., with goods produced offshore; all this leading to enlarge joblessness, now at 10% plus, a widening trade deficit and a decline in the level of living. Globalization can be the faster and thicker interconnection among national economies in the realms of production, trade and finance, made possible, mainly, by improvements in transportation, information, and communication technologies. Such globalization and related trade has been made possible by the technological improvements created by the working people worldwide. Therefore, there is another path for globalization: greater interconnectedness could lead to greater solidarity among the working peoples of all countries, a new center of economic and political power, countering and supplanting the power of multinational corporations and the global reach of the U.S. military.

The American public needs to understand how the economy works in reality, not in ideology. We don't need a new economy, we need a real economy. Finance is not at the center of a modern economy, manufacturing is. Market relations with their buying and selling do not magically produce goods and services. Only the working people of a society can do that.