

turnover and the real economy, between 1956 to 1990, has produced exactly the same relationship as that of a cancer cell to its host organism. Originally, the cancer cell is part of the organism, existing in a one-to-one symbiosis with the cells surrounding it. But, as the cell turns cancerous, and begins to replicate itself faster than do the surrounding cells, a distinct tumor forms. It no longer exists in symbiosis with surrounding tissue, but overwhelms surrounding tissues, killing them off by arrogating to itself a larger and larger share of the nutrients and oxygen flowing to that area of the organism.

Were the economy a human patient in a cancer ward, you would hear the weeping, as the doctor informed the family that the tumor had progressed to the point that the patient had but a few weeks, perhaps, at most, months, left to live.

Notes

1. See, for example, Paul Einzig, *The History of Foreign Exchange*, MacMillan and Co., 1964; or Raymond F. Mikesell, *Foreign Exchange in the Postwar World*, The Twentieth Century Fund, 1954.
2. *Economic Report of the President*, February 1991, p. 402, Table B-102.
3. See W.M. Clarke, *The City in the World Economy*, The Institute for Economic Affairs (London), 1965, Chapter 3, "Foreign Exchange . . ." [sic].
4. Data for equity market trading are taken from various issues of the annual Department of Commerce/Bureau of the Census *Statistical Abstract of the United States*. In the 1984 edition, for example, see p. 522, Table 871, in Section 17, "Banking, Finance, and Insurance."
5. Irwin Friend, et al., *The Over-The-Counter Securities Markets*, McGraw-Hill, 1958, p. 116, Table 3-2.
6. *Treasury-Federal Reserve Study of the Government Securities Market*, Part II, "Factual Review for 1958," p. 140, Table C-2.
7. See various editions of *Statistical Abstract of the United States*. In the 1984 edition, for example, see p. 524, Table 876, in Section 17, "Banking, Finance, and Insurance."
8. Perry J. Kaufman, *Handbook of Futures Markets: Commodity, Financial, Stock Index, and Options*, John Wiley and Sons, pp. 1-28, Table 1.
9. Those with access to the Internet may wish to visit the Chicago Mercantile Exchange site at <http://www.cme.com>.
10. Securities Industry Association, *1992 Fact Book*, page 28.
11. See note 4.
12. Data are taken from Frank J. Fabozzi and Franco Modigliani, *Mortgage and Mortgage-Backed Securities Markets*, Harvard Business School Press, 1990.
13. U.S. Government Accounting Office, May 1994, *Financial Derivatives: Actions Needed to Protect the Financial System*, p. 187, Table IV.6.

Standing on the edge of the cliff

by John Hoefle

It should be obvious by this point, that the process defined by a financial bubble growing at hyperbolic rates, which depends for its existence upon a physical economy which is shrinking, is a process which must ultimately collapse.

When most people think of collapses, they think in terms of sharp drops in stock markets, runs on banks, devaluations of currencies, hyperinflations, or similar shocks, in which sections of the financial system are strained, but the system itself survives.

What is coming, unless governments intervene by way of virtually 180-degree policy shifts, is a completely different kind of collapse—the disintegration of the global economic and financial systems themselves.

Imagine what might happen, were the holders of all the financial claims in the bubble, to try to cash out at one time. As we shall see, there isn't nearly enough money in circulation to cover the claims. That would leave the financial markets in the unenviable position of either writing off those claims in excess of the money supply, or increasing

the money supply to cover the claims. Either way, they're doomed.

The cash-out problem

As we said, there simply isn't enough money in circulation to cover the claims. *EIR* estimates that annual financial turnover has more than doubled in the last five years, to about \$500 trillion in 1995 (see **Figure 1**). This is a rough estimate to be sure, but the process which it describes is such that an error of 25% or so would make no difference. After all, the claims couldn't have been cashed out in 1990 either.

Note that the turnover is grouped into two categories, *on-balance-sheet* and *off-balance-sheet*. The on-balance-sheet category is for more traditional items such as assets and liabilities, whereas the off-balance-sheet figures are where you hide the derivatives and other forms of gambling. As you can see from **Figure 1**, the off-balance-sheet component of financial turnover has been growing much faster than the on-balance-sheet component, reflecting the explosion of speculation over the last few years.

FIGURE 1
Annual financial turnover in the United States

trillions \$

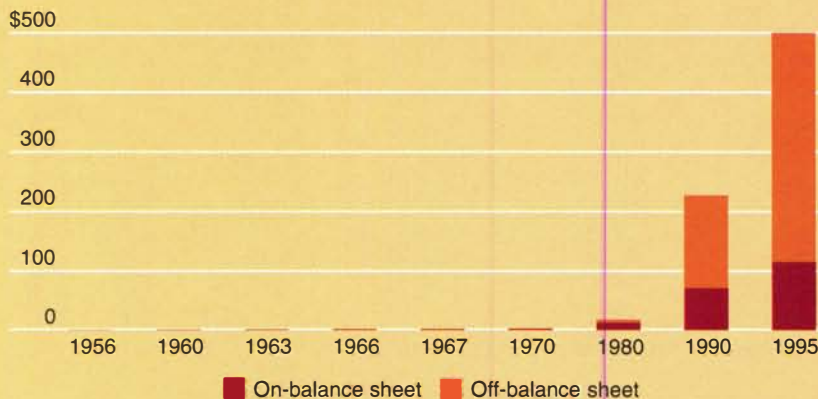


FIGURE 2

Growth of financial turnover, compared to the physical economy

index 1967=1

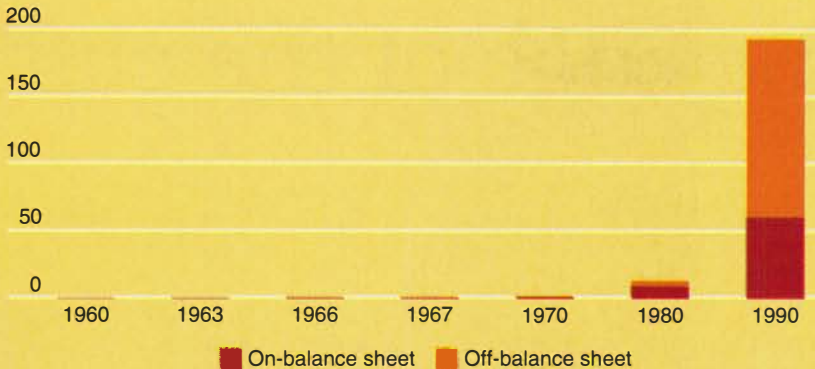


FIGURE 3

Dollars of turnover per dollar of Gross Domestic Product

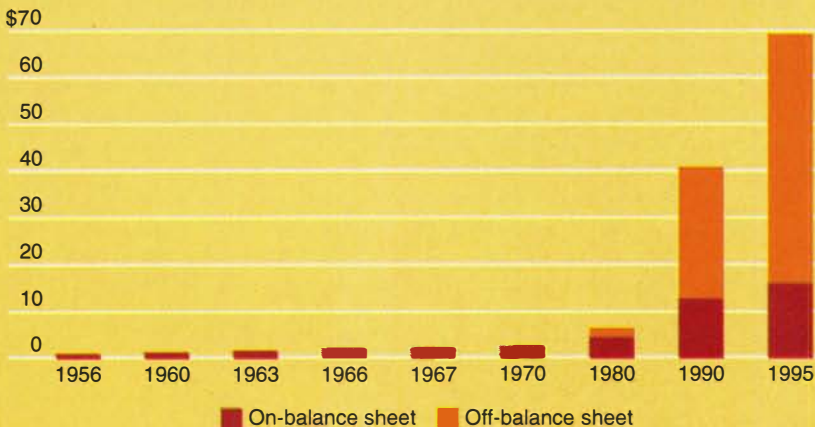
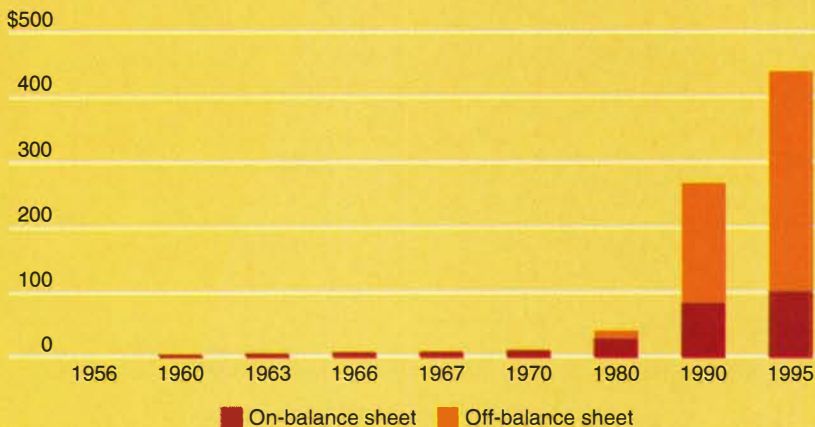


FIGURE 4

Dollars of turnover per dollar of M1



Contrast the growth of financial turnover to the rise and fall of our market basket. The market basket rose until 1967, then began to decline sharply, while the financial bubble began to grow. The result, based upon our 1967 market basket index, is that turnover grew by a factor of 194 compared to the physical economy (see Figure 2). This is the post-industrial society at work, with a vengeance.

Now compare the growth of annual financial turnover to the growth of Gross Domestic Product (see Figure 3). In 1956, there was \$1.22 in financial turnover for every \$1 of GDP, compared to our estimate of some \$69 for every dollar in GDP today. When financial turnover increases at such a rate relative to GDP—which itself significantly overstates real economic activity—it should be clear to all that the financial world has become detached from reality, and that there is no economic basis whatever to support this bubble.

The discrepancy between financial turnover and the money supply is even more alarming (see Figure 4). There are now about \$440 in financial turnover for every \$1 of M1, or \$440 in turnover chasing every dollar in cash, travelers checks, and checking accounts. This occurs even though M1 itself is rising rapidly, as the federal government borrows to generate a money supply which is then leveraged to create money against the turnover. This is the process which generates inflation.

Not all of these claims are due at any given time, however, since financial turnover includes many claims which begin and end in less than a year. We estimate that the average dollar of claims outstanding in U.S. markets turns over about 20 times a year, with the amount outstanding at any given point being about \$25 trillion to \$30 trillion.

What, then, would happen on any given day, if the holders of all \$25 trillion in U.S. financial claims tried to cash them in?

They couldn't. Today the M1 money supply is just over \$1.1 trillion, or 4.5 cents for every dollar of outstanding claims. Even if every dollar of M1 were used, if every dollar in every pocket and checking account could somehow be applied to this payout, it would cover less than 5% of the total.

There's not even enough money in circulation to cover all the claims which expire on the average trading day. With 244 trading days in a year and \$500 trillion in claims, just over \$2 trillion of those claims come due on the average trading day. For every dollar in claims due, there are only 55 cents in M1 available.

So even if all the money in M1 were used—a practical, political, and economic

FIGURE 5

Money in U.S. mergers and acquisitions

value of funds involved for businesses of all types, billions \$



impossibility—there wouldn't be enough to cover even one day's claims, much less all outstanding claims. There is no way to cash out this bubble, which means the claims are effectively worthless.

Double or nothing

Since the claims can't be cashed out, the market has three broad options: 1) It could roll the claims over, putting off dealing with the problem at the expense of making it even worse in the long run; 2) the Federal Reserve could print enough new cash to allow for a cash-out; or 3) the holders of the financial claims could take their losses, at which point the system would effectively cease to exist.

The first option, rolling over the claims, is their preferred method. It is this continuous putting off until tomorrow what can't be paid today, which is at the heart of the bubble. But what happens the day this option is no longer available, and settlement must be made?

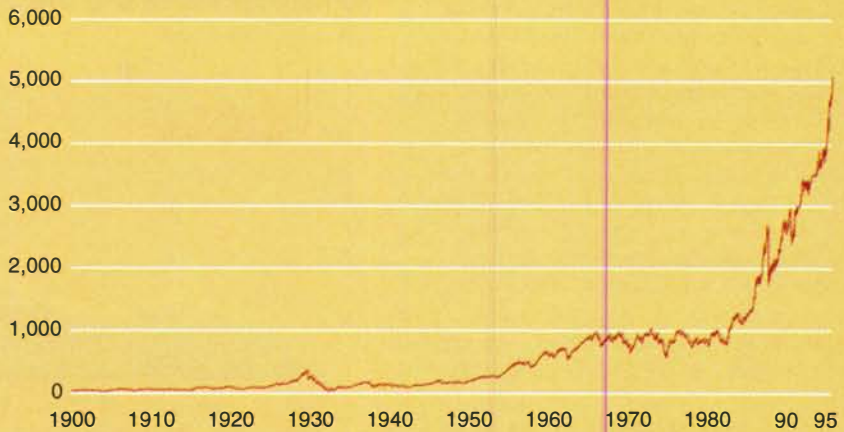
Suppose the Fed were to turn on the printing presses to flood the markets with sufficient cash to cover the claims. To cover all \$25 trillion in outstanding claims, the Fed would have to print nearly \$24 trillion in cash, a 2,100% increase in M1. Even the most well-educated economist could see that such an act might cause inflation.

Just to cover the average daily turnover, would require the printing of \$914 billion in cash, an increase of nearly 90% in M1.

Printing enough cash to cover all \$500 trillion in annual turnover, would require a 44,000% increase in M1. Given the decline of manufacturing in the United States, we

FIGURE 6

Dow Jones Industrial Average weekly closings, 1900-95



probably couldn't make enough wheelbarrows to hold all the cash people would have to carry around in such a hyperinflationary circumstance.

What, then, about the third option, taking the losses?

With just over \$1.1 billion in M1 and \$25 trillion in outstanding claims, some \$23.9 trillion—95%—of all claims would have to be written off. Of the \$500 trillion in annual turnover, some \$499 trillion—99.8%—would disappear. At the end of such a day, no financial institution would be left standing.

Bubbles upon bubbles

This inability to cash out is nothing new.

Even in 1980, when the turnover stood at \$17.8 trillion and the outstanding stood at \$890 billion, there was only 47 cents in M1 per dollar of claims outstanding. For at least the last 15 years then, there has been no way to cash out; the paper claims have been piling up, like a mountain of IOUs, impressive in size but essentially worthless.

Over this 15-year period, there have been a series of mini-bubbles: the loans to the less developed countries (LDC); the junk bond boom; the corporate merger and acquisition boom (see Figure 5); the stock market boom (see Figure 6); and the real estate boom (see Figure 7), to name some of the more significant ones. Each one of these booms has risen, generating huge paper profits, and fallen,

FIGURE 7

U.S. land values

trillions \$

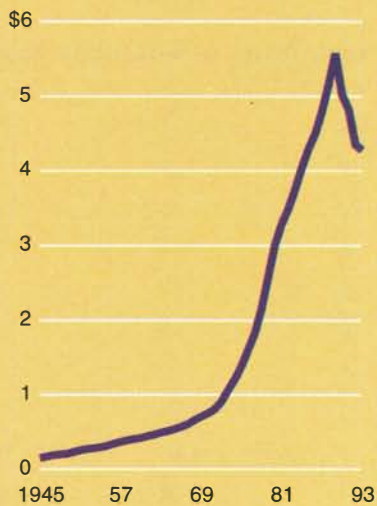
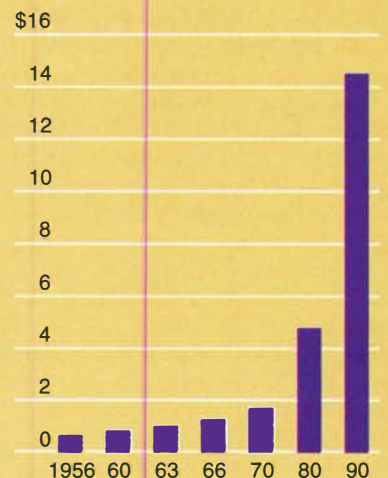


FIGURE 8

Total debt in the U.S. economy

trillions \$



generating huge paper debts.

A small portion of those paper profits get cashed out, but the debts just get rolled over. Each time one of these mini-bubbles popped, the debt was rolled over into new bubbles, each more detached than its predecessor from the real economy. The bad LDC loans got transformed into Brady bonds, which could then be speculated against. The collapse of the junk bond market gave rise to the vulture funds which speculated upon the remains of companies looted by other speculators. The merger and acquisition frenzy produced enormous corporate debts, many of which took the form of bonds, another boon to the speculators.

By the end of the 1980s, the decade of the endless months of economic recovery touted by the Reagan and Bush administrations, the U.S. economy resembled a giant casino, with lots of chips on the table, but no money to back them up. During that go-go decade, total U.S. debt nearly tripled, from \$4.8 trillion in 1980 to \$14.7 trillion in 1990 (see **Figure 8**), while GDP only doubled; for every \$2 in GDP growth, we went \$3 in debt. Meanwhile, the physical economy shrank at 2% a year.

The mudslide

These scams began to break apart in the mid- to late-1980s, leading to what LaRouche has characterized as the great mudslide, in which huge chunks of the economy slide off into oblivion. The Texas banking system disappeared in 1987 and 1988, along with a huge chunk of the savings and loan system, as real estate values began to collapse. That collapse spread into New England, California, and the mother of all U.S. real estate bubbles, New York City, effectively wiping out many businesses, individuals, and the U.S. banking system.

Personal bankruptcies skyrocketed, as a result of massive corporate layoffs and business bankruptcies (see **Figures 9 and 10**), and the replacement of high-wage manufacturing jobs with low-wage service jobs. The size of the companies going bankrupt also increased (see **Figure 11**), blowing more holes in the bubble.

Rather than put the system through bankruptcy, the financier-dominated Bush administration decided to bail it out. The Federal Reserve began dropping interest rates in 1989, and began pumping money into the banking system through the back door. In November 1990, the New York Fed secretly seized the bankrupt Citicorp; a month later, regulators held a secret meet-

FIGURE 9
Bankruptcies in the United States

thousands of bankruptcies

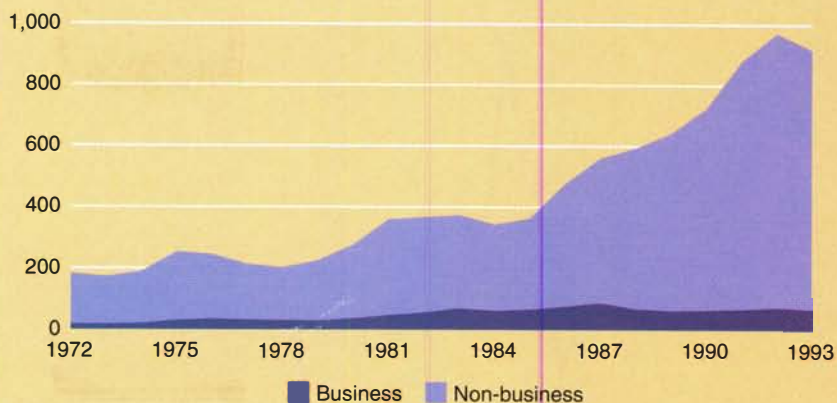


FIGURE 10
Business failures in the United States

thousands of failures

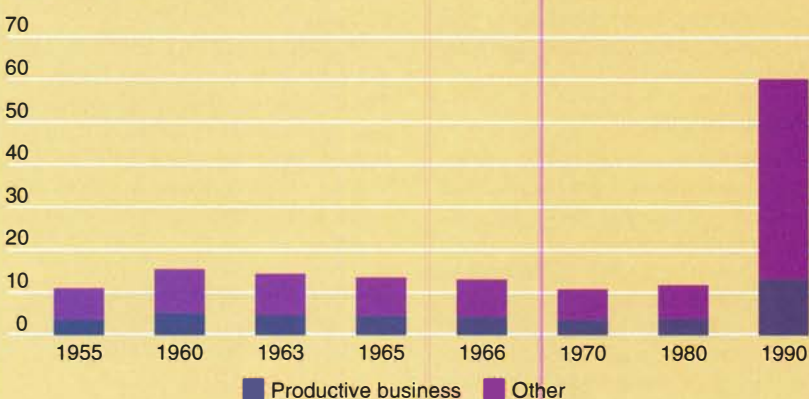


FIGURE 11
Liabilities of business failures

billions \$

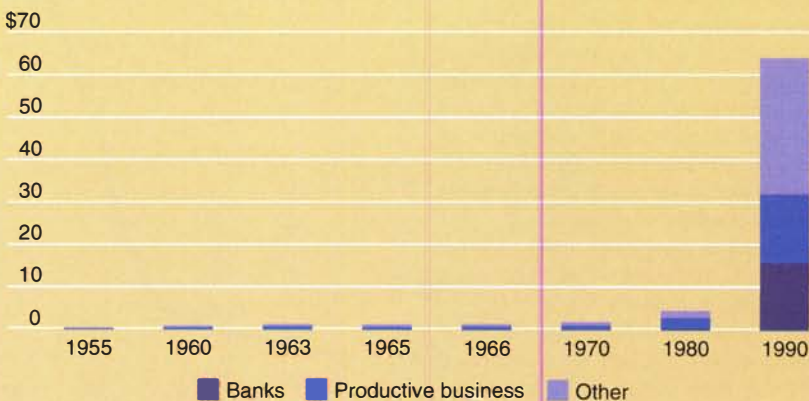


FIGURE 15

U.S. banks are addicted to derivatives

trillions \$

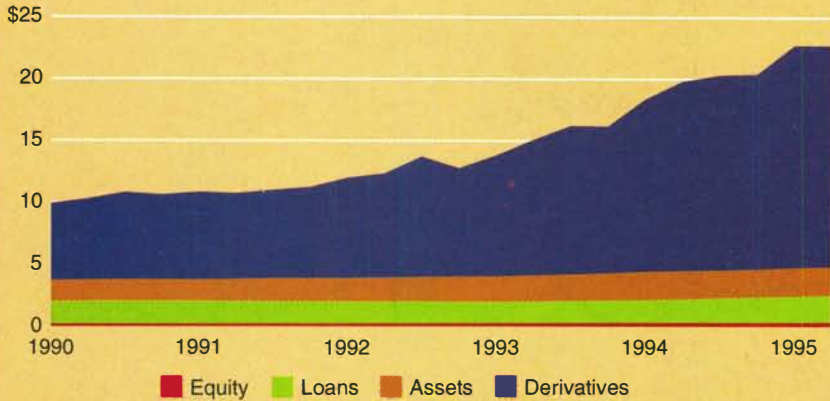


FIGURE 16

Bankers Trust assets

billions \$

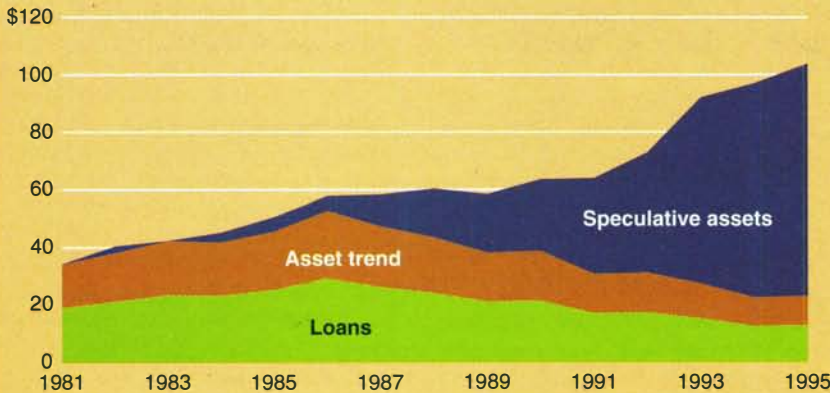


FIGURE 17

Bankers Trust New York Corp., 1994

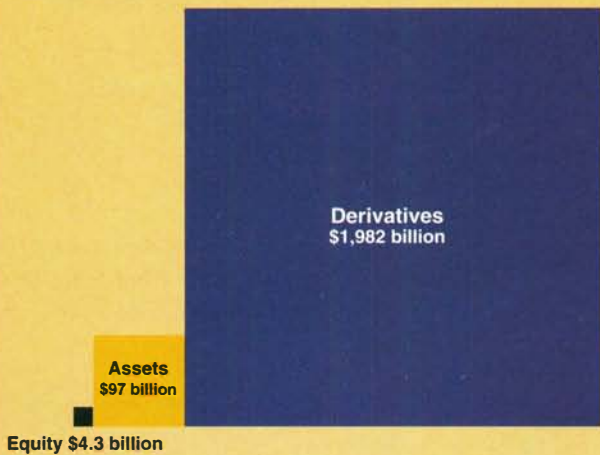
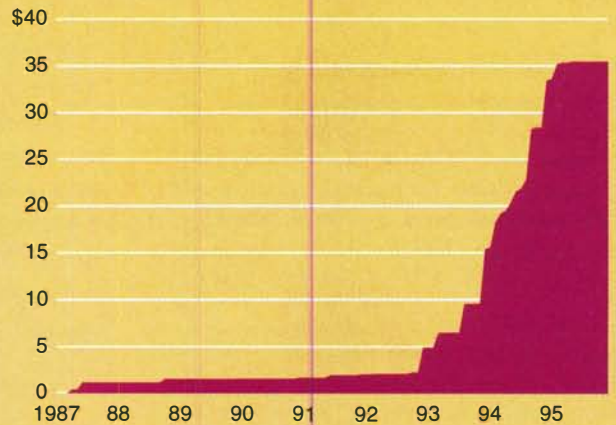


FIGURE 18

Cumulative derivatives losses

billions \$



had \$34 billion in assets, of which \$19 billion were loans, a ratio of 55 cents in loans for every \$1 in assets. Had this ratio continued over the entire period (the section marked "asset trend"), the bank would now have just under \$21 billion in assets, or roughly two-thirds of what it had in 1981. Instead, the bank now has some \$104 billion in assets, of which loans are just 11%. By the end of 1994, it clearly wasn't a bank any more (see Figure 17).

Having chosen to live by derivatives, Bankers Trust also chose to die by them. When the Federal Reserve began to raise interest rates in February 1994, in a desperate attempt to head off losses in the derivatives bubble its own policies had helped create, it triggered a bloodbath (see Figure 18). The move killed the mortgage-backed derivatives market and its market leader, Kidder Peabody. Orange County went bankrupt, Barings failed, and S.G. Warburg narrowly escaped the same fate, as the mudslide claimed more chunks of the financial system.

Edge of the cliff

Thus we have arrived on the edge of the cliff, staring down into the abyss. The crash is coming, be it in the form of a massive deflation of financial claims, or in the form of a massive inflation of the money supply. When the final crash begins, it will move through the markets like wildfire, courtesy of reverse leverage and computer technology. Within days, unless governments act to put the system through a formal bankruptcy, nothing will be left of the financial system but ruins, and a new dark age will be upon us all.

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trillions \$

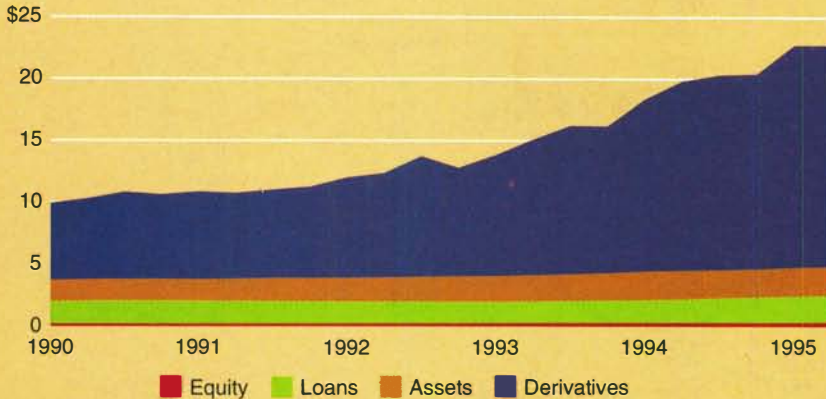


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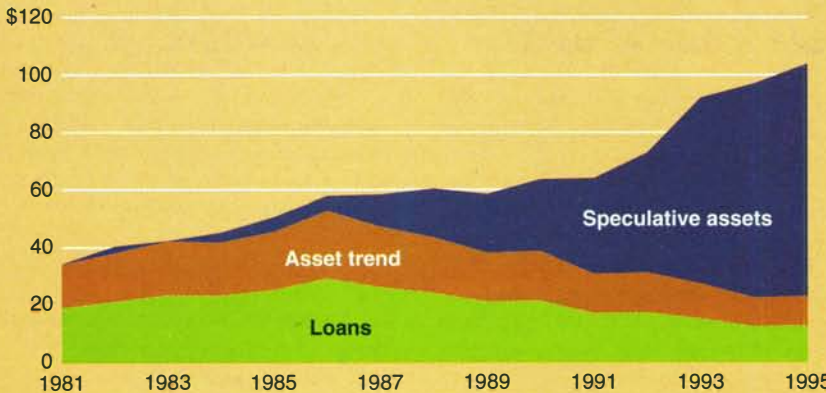


FIGURE 17

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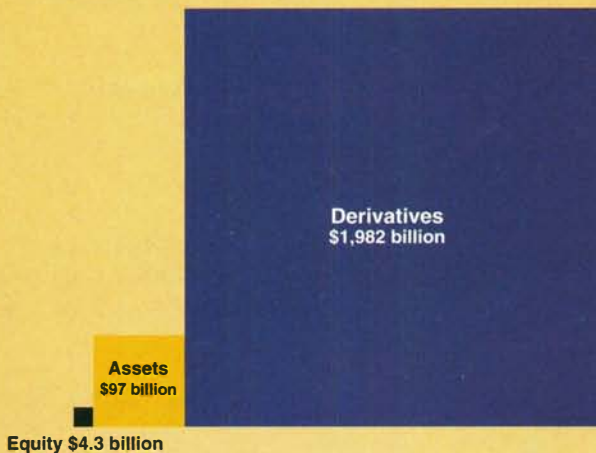
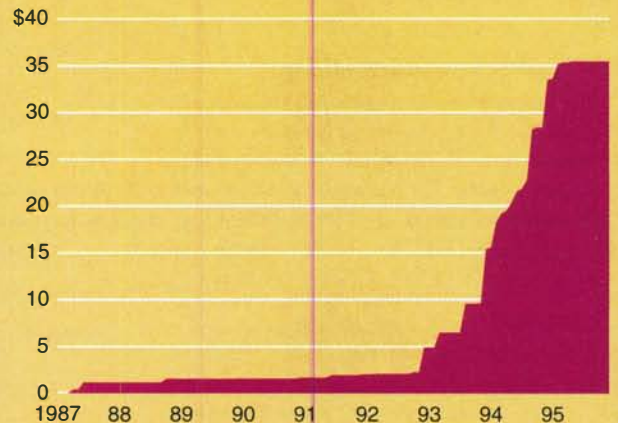


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