

new conference with heads of state and government, similar to the Bretton Woods conference of 1944, with a view to creating a new international monetary system and taking the measures necessary to eliminate the mechanisms causing financial instability and adopt programs for the relaunching of the real economy; to submit this proposal to the European Parliament in Strasbourg, to the European Commission and to all EU institutions responsible for European economic policies, as well as to individual European governments through bilateral agreements; to support similar initiatives promoted by other governments and parliaments, starting with those of developing countries.

I thank you very much, again, for your kind invitation and for your attention.

Andrei Kobyakov

World System More Overheated Than in 1929

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It so happens that my presentation will develop some ideas in parallel to what Mr. Tennenbaum had to say, although we certainly did not consult beforehand. Probably we both saw the same logic in the events that are unfolding, and therefore some aspects of my speech and his will resonate together.

First of all, I should like to draw your attention to the greatly increased frequency of financial crises, during the past one-and-a-half to two decades. Moreover, their ripples have been felt planet-wide, which is testimony to globalization— to its flip side, the negative side.

It should be noted, however, that during this period the destabilizing impulses came chiefly from the periphery of the world financial system. For that reason, it seems to me, this system has not yet experienced the kind of really strong crisis that can happen. The next crisis may turn out to be significantly more destructive in its scope than all prior crises, because its epicenter may be at what would seem to be the bulwark of that financial system: the United States of America, and the U.S. markets of what used to be called fictitious capital. Actually, now, perhaps, that term can reacquire its original meaning, freed of ideological dogmas.

This series of crises, and their growing frequency, is no accident. I remind you that the Chairman of the Federal Reserve System, Alan Greenspan, is of the opinion— although he may not have repeated it in quite some time—that the

world is experiencing waves of a single, big crisis of the world financial system. He identified the Mexico crisis of 1994-95 as the first wave, and considered the 1997-98 Asia crisis, which then hit Russia, to be the second wave. He himself forecast that a third crisis was just over the horizon, or rather a third wave of this crisis, which would be more destructive than the preceding ones. And here you have it, with a kind of cruel irony: The mechanism of such a crisis may already have been sprung. There are some indications, that its catalyst was the crash on the American stock market.

In the 1990s, the U.S. economy gave rise to a number of interconnected excesses, each of them fraught with the danger of worldwide tremors. The first excess, which has burst like a soap bubble, or like an abscess, was the stock market. You have already heard figures today, on how the Nasdaq has fallen 55% on the year. At its lowest point so far, in March of this year, it had fallen almost 65% from its high, after which it rose a little bit, but not dramatically. I think there are grounds to say that we shall see this market move downwards again.

Causes of the Stock Market Crash

In order to understand the causes of this crash, one must first sort out the causes for the stock market boom in the first place. Because the U.S. stock market boom, by all conceivable parameters, surpasses in scope the boom that took place in the 1920s, which preceded the famous crash of the New York stock market in 1929 and the subsequent Great Depression. This means such parameters, as the ratios of market capitalization to GDP, to a company's net earnings, to the net value of its assets, and so forth. By all these parameters, there is nothing analogous to today's market, in the world system. It is more overheated than in 1929.

Take one popular parameter, the price-earnings ratio, for the U.S. stock market as a whole. This is the ratio of the price of a share to the net earnings per share. Just before the collapse that began last year, this parameter was at 30-35, a level not reached even in 1929.

Comparing paid-out dividends on shares, to their price, the prices exceeded dividends 93 times over, which means that the dividend yields had fallen to 1%, sometimes even less. This, too, shows a previously unthinkable degree of overheating. It is not clear when the ownership of securities became essentially a speculative activity, but it is clear that to make fairly risky investments, if it were just for the purpose of obtaining a 1% yield as dividends, is nonsensical.

And if we take these parameters, for the companies most typical of the modern U.S. economic system, the companies of the so-called New Economy, which are supposed to be the vanguard of the U.S. economy, here the overvaluation is nothing short of a joke. The figures are astronomical. For example, the P/E ratio for the well-known Internet provider Yahoo! was more than 1,200. Think about this. The significance of this figure can be understood, if we imagine that there's an investor who wants to purchase that entire company. It means that he will pay a price for it, which he can

recoup after 1,200 years. This is a totally absurd proposition. Especially since, with the Internet companies, the “earnings” part of the P/E ratio was not current profits, but the company’s *projected* earnings.

It is clear why these companies have now experienced the steepest crash. . . . Just as rapidly as these share price quotes rose, they are now falling with the same velocity, only really with an even greater velocity, because the fall is always steeper than the rise was.

I shall not repeat the estimates [presented by Tennenbaum] of how much money has been burned up. Some people consider that since it was fictitious, merely paper capital, and wasn’t real, there is nothing to worry about, and nothing will happen in the economy because of this. In reality, this is not exactly the case. As was mentioned, 50% of American families own these shares, and if we take things like certain institutions, which began to invest in these shares and got in up to their ears, then we can say that pension funds and insurance companies are suffering from this collapse. Therefore, it has a real impact on people’s welfare. . . .

Like Mr. Tennenbaum, I am convinced that the reason [for the meteoric rise of share prices] is to be found in the credit-pumping, which became the credo of American national economic policy during the 1990s, which, at first glance, would seem to fundamentally distinguish it from the policy of the 1980s, the notorious Reaganomics, which pulled the economy out of its preceding crisis by increasing budget spending. Now, funds were mobilized by the issue of long-term Treasury bonds with very high yields, as high as 14% annual return, which led to an increase in the national debt at the beginning of the 1990s—to over \$5.5 trillion.

Despite this apparent distinction of the economic boom of the 1990s, the mechanism for creating the boom, involving low interest rates and reliance on private initiative, did not really shift the United States away from a debt economy, because public sector indebtedness was merely replaced by private sector indebtedness. The availability of cheap credit led to an unprecedented growth of debt in the country. At the end of the 1980s, some economists were horrified that the total debt of all sectors of the U.S. economy had exceeded \$11 trillion, saying that it could not go any higher. Today the Federal debt alone, without the [private] financial sector, has surpassed \$15 trillion, while the total indebtedness of all sectors of the U.S. economy is more than \$26 trillion.

Mr. Tennenbaum called this the domestic debt, but—if I might correct him—actually it is the total debt, and a rather substantial portion of that debt is in the hands of foreign citizens. If we take corporate bonds, for example, 25% of all corporate securities are held by foreign investors. If we take the government debt, it’s more than 40%. If we take stock shares, the level fluctuates between 5 and 10%. So, this is the total debt, and a very substantial part of it is held by foreigners, which ought to be a matter of some concern.

In the past few years, the analytical and banking community did become concerned about this, and started to sound

the alarm. I remember when the Bank Paribas said in one of its analytical reports, that investors would only want to “buy America,” if they could be compensated in some way, for the rising risk of investing in that country. This either meant a devaluation of the dollar, or it was a suggestion that the return on those investments ought to be higher—referring to the interest-rate policy. Unfortunately, neither such thing has happened to date, which only tells us that this strain, this disproportion, is intensifying, and that the crisis, which so far is proceeding in a sort of hidden or latent form, may burst to the surface at any moment, and with terrific force.

The boom mechanism, it should be stated, was not limited to credit-pumping. There was also a mechanism for self-intensification of the boom. . . . If a person bought x number of shares, [the price of] which then doubled in two or three years, he began to feel that he was twice as wealthy as before, so he could keep back a smaller portion of his income in reserve. It seemed to him that he needed to save less, freeing up more of his funds for spending on personal consumption, as well as to increase his speculative operations, on the stock market first and foremost.

Thus, the market has lived on constant nourishment with liquidity, and on mass liquidity from that part of the U.S. population that plays the market. This is also an unprecedented figure, more than 50% of the population. Overall, it’s like a spiral: high earnings expectations, a big influx of liquidity, an increased demand for shares, automatically driving them up—which, in turn, automatically increased the profitability of this market through the automatic increase in share prices.

Another Pyramid Scheme

We know this mechanism very well from the infamous case of Mr. Mavrodi’s MMM pyramid. The construction [of the U.S. stock market] is not at all different from that. It was built by exactly the same principles: the influx of cash allowed Mr. Mavrodi to keep making the ever-growing payments on the MMM shares, on which he was setting the price, and only he could see when the influx would dry up and collapse the whole pyramid. Such pyramids cannot last forever. But, they can exist for quite a while, given a sufficiently high level of greed and a high level of confidence among the participants. As to the level of greed, nourishing the U.S. stock market in the 1990s, perhaps [it is difficult for you to see because] we here have not grown accustomed to normal notions of profitability. After all, the average returns on shares there, over long periods of time, are very low, according to the notions that predominated in the Russian economy at its early-1990s turning point, when somebody could make 300 and 400% per annum. So perhaps this will seem modest, but the rates of 15-20% annual growth, which were constantly shown in the American statistics, pulled everybody into this pyramid.

It might be difficult to ask the participants in the pyramid, why they didn’t ask themselves the following: How can this be, if during the entire century, the growth rate for corporate

earnings was essentially the same as the growth of GDP as a whole? For the century, profitability averaged 5 or 6%, which was not far off the growth rates for the economy.

It is often said that Russian economists are too far away from American reality to have an accurate impression of the U.S. economy, and that therefore our approach to evaluating what is happening there must be somehow “marginal.” But, I would simply like to quote Lawrence Lindsey, President Bush’s economic adviser, who recently said in a speech to the American Society of Editors and Journalists, “Last year, the private sector spent \$700 billion more than its post-tax earnings.” Here he paused, and repeated, “That is 7% of GDP. There has been nothing like this in the history of the U.S. economy. It is around 3% of the budget surplus, and the other 4% came from foreign investment. The United States has never been so dependent on foreign investment.” “We are in uncharted territory,” Lindsey said, “and we don’t know what will come of this. We cannot borrow 4% of GDP from the rest of the world for the indefinite future. Imagine going to your banker and saying, ‘Thanks a lot for the \$280 billion you loaned us in 1999 and \$435 billion in 2000. It looks as if we’ll need another \$520 billion this year, \$650 billion in 2002, and probably \$800 billion in 2003.’ This is called ‘evergreen’ financing, and it cannot exist. Sooner or later, it comes to an end.”

Indeed, this problem can hit all the existing financial markets very hard. But in spite of this, the same Lawrence Lindsey continues to support the strong dollar policy, on which the influx of capital to the United States has been based, thus drawing the rope more tightly around the debt trap, and, in a sense, impeding any long-range resolution of this powerful contradiction on the market. Thank you very much.

Dmitri Mityayev

Russia Must, and Can, Act To Protect Itself

Dmitri Mityayev is president of the Center for Systemic Forecasting. His speech was translated from Russian.

We have had plenty of macroeconomics today, so I shall try not to deal with that side of things. I believe we are living in a system of false notions. There is no world financial market, in the sense we use that term. There is a system of interconnected cartels, which derive superprofits. There is the stock market cartel, there are the commodity cartels, including OPEC, there is the gold market cartel, there is the currency

cartel, and there is a cartel that is absolutely not understood or studied, but which is powerful nonetheless — the cartel for shaping expectations on the derivatives market. These things are all interconnected.

In this sense, globalization is the global power of these few dozen players, among whom the central banks and ministries of finance are sometimes not the biggest or the most powerful. And history shows that, as a rule, unless the three main central banks — the Federal Reserve System, Europe, and Japan — unite, the combined power of the so-called financial speculators can breach any defense.

There is no economic competition among America, Europe, and Japan. There is, rather, an ongoing economic war, in which all means are utilized — from hoof and mouth disease, to Macedonia, and so forth. There is no monetarism for themselves, in the standard sense; it is only for export to backward countries, in order to forge techniques there for pumping out financial and other resources, while for themselves, fairly tough market programming is employed. This is the Keynesian model, if not Marxist.

Therefore, what I now see as the main danger for Russia, since we’re discussing Russian threats and Russian responses, in the short term is the “paving” of Europe [by foreign capital], which is taking place before our very eyes. We can say a lot about the fact that the games of financial speculators are one thing, and the real economy another; in reality, everything is very directly and closely interlinked.

Since the beginning of the year, the euro has been devalued by 13% and continues to be pushed down, with the direct consequence being increased capital flight out of Europe. In April, it was 21 billion euro, which is 3% of GDP, or four times more than one year before. The capital flight, naturally, is to America. For the umpteenth time, the Europeans are paying for the stock boom that occurred, and in which the Europeans have already lost more than half of what they invested. It is a war for survival. Actually, all the players understand quite well the real rules of this game.

Three Choices

In this sense, the United States has essentially three choices. Either turn Europe into a poverty zone, i.e., the same mechanism that was tested on Japan at a certain point, and then on several Asian and Latin American countries, and on Russia. Or, the ordinary American citizen will have to pay, an option which the current U.S. leadership is afraid of. Because the two-thirds of demand, and the domestic economy in general, is something sacred. This is why the strong dollar policy is being maintained, so that the ordinary American will not (God forbid!) get hit, and flee the stock market. . . .

And the third choice, the least probable, which they don’t really consider as an option, is for the initiators and main players themselves to pay, i.e., the global financial — actually, not even so much financial, as informational-financial — groups. Statistics have come out on these derivatives. Strange