

## 2001: The U.S. Economy's Bad Year Points to Worse Ahead

by Richard Freeman and John Hoefle

On Nov. 26, 2001, the National Bureau of Economic Research declared that the U.S. economy had gone into recession in March 2001, thereby ending what it described as a ten-year expansion which began in March 1991. According to the NBER, which is considered the official arbiter of such things, the 120-month 1991-2001 expansion was the longest on record, topping the 92-month 1982-90 expansion and even the 106-month 1961-69 expansion. In its statement announcing that the "Great Expansion" of the 1990s had ended, the NBER suggested that the newly discovered recession might well be nearly over, noting that "most recessions are brief and they have been rare in recent decades." In fact, the NBER stated, the average length of the nine recessions since 1945 was just 11 months; since the announcement came eight months into the recession, a recovery was, on average, "just three months away." So much for forecasting by statistical "trends."

During the 2000 election campaigns, the cornerstone issue for both the Republican and Democratic parties was the economy, with both sides attempting to claim credit for the supposed boom. In doing so, both parties took any serious discussion of economic matters out of the debate. In the Presidential race, Bush and Gore outdid each other in promising to keep the expansion going, were they to be elected.

The only significant economic reality injected into the race came from Lyndon LaRouche, who had challenged Gore for the Democratic nomination. LaRouche warned that all of the economic happy-talk was nonsense; that the U.S. economy—measured in terms of its ability to sustain and reproduce the human race, rather than loot the human race of cheap imports and wealth—had been declining for three decades and was in the process of collapsing. LaRouche also warned that the attempt to keep economic reality out of the discussion would backfire, with the situation deteriorating rapidly once the election was over.

LaRouche's warning was quickly borne out. 2001 will be

remembered as the year they had to admit, "LaRouche was right"—about Enron, about Argentina, and about the U.S. debt bubble. From an economic perspective, 2001 turned out to be a very long year, a year in which reality began to settle in like a noxious fog, and a year in which the economic indicators which were designed to only go up, began—often inexplicably to the disciples of Economics 101—to go down. The "expansion" turned into a "recession," which is actually a depression.

### Phase Shift Downward in 2001

During 2001, the underlying U.S. physical economy deepened its ongoing decline into depression. For the past three decades, the physical economy had been contracting at the rate of 1% to 2% per annum, but during the past 12 months, especially from the period of July-August 2001 onwards, it experienced a dramatic *phase-shift* downward.

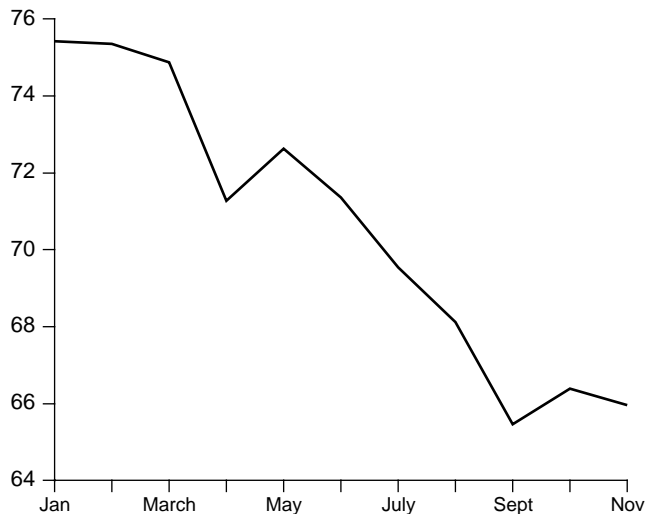
The root cause, in recent history, was the City of London-Wall Street financier oligarchy's imposition of a "post-industrial society" policy upon the United States in 1963-65. The policy instituted several ruinous changes. On Aug. 15, 1971, President Richard Nixon took the U.S. dollar off the gold reserve standard. This divorced financial flows from physical production, and built up speculative dollar markets. In October 1979, Federal Reserve Board Chairman Paul Volcker sent interest rates shooting up to a bank prime lending rate of 21.5% in November 1980. This permanently wiped out whole subsections of industry. The destructive effect was accelerated through the deregulation of the U.S. banking system in 1982.

Following the Russian government's move in August 1998 to declare a moratorium on its Treasury debt (GKO's), and the Sept. 23, 1998 melt-down of the Long Term Capital Management hedge-fund, which had over \$1 trillion in bad derivatives instruments outstanding, Federal Reserve Board

FIGURE 1

### Shipments Of U.S. Capital Goods Plunge Throughout 2001

(Monthly, Billions Of Dollars)



Source: U.S. Department of Commerce.

Chairman Alan Greenspan launched a “wall of money” policy. Greenspan turned on the printing press in an attempt to prop up the bankrupt world financial system. This began to launch a Weimar-style hyperinflationary explosion.

### Perverse Effects of Money-Printing

Throughout 2001, Fed chairman Greenspan cut the Federal Funds rate a record 11 times, increasing even the broadest money-supply measure at 13% annually in a frantic but futile attempt to flood markets, overpower an ongoing deflation of financial assets, and slow the rate of collapse of America’s agro-manufacturing base. But the policy produced the reverse effect, as LaRouche, at the outset of the year, had said it would. It encouraged *more rapid looting* of the underlying physical productive base in favor of “shareholder value,” sending the economy into a free-fall, as the following examples indicate.

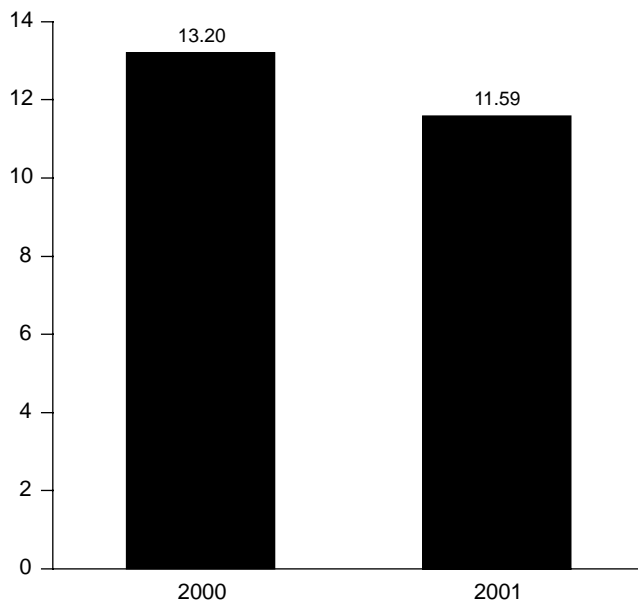
**Figure 1** shows monthly U.S. capital goods shipments. Capital goods are critical to an economy: for capital formation, industry purchases capital goods either to replace or upgrade its aging equipment. This should involve technological advance. The range of capital goods includes machine tools, tractors, cranes (also computers). Between January and November 2001, the monthly level of capital goods shipments fell from \$75.42 billion to \$65.96 billion, a fall of 12.5% in one year.

**Figure 2** shows North American auto production by the “Big Three” auto manufacturers—GM, Ford, and Daimler-Chrysler. From mid-September until the end of 2001, the Big

FIGURE 2

### U.S. ‘Big Three’ Motor Vehicle Production Collapses 12.2%

(Millions Of Motor Vehicles Produced)



Source: U.S. Department of Commerce.

Three offered zero-percent financing and other incentives to sell cars. Sales increased, but the incentives cut sharply into profits, costing the firms approximately \$2,000 per car. Despite higher sales levels than in 2000, Big Three auto production fell 12.2% in 2001. As the incentives become ineffective and are eliminated, production will be slashed deeply.

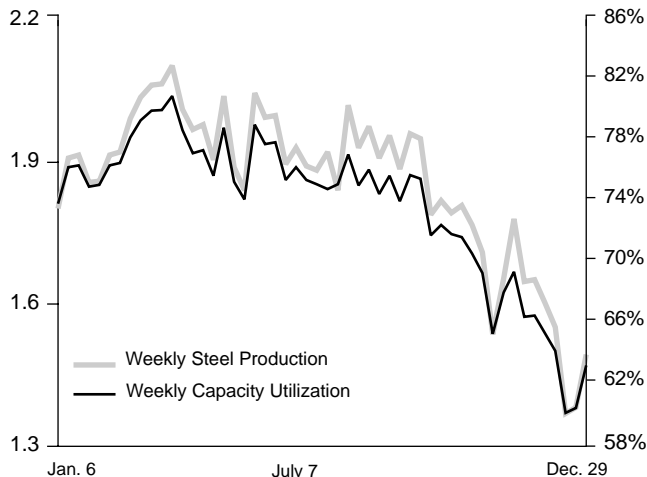
Major American steelmakers’ weekly raw steel production level, and their weekly capacity utilization rate, have both plummeted (**Figure 3**). For the week of March 24, U.S. steelmakers’ capacity utilization rate was an already relatively weak 82.7%, but by Dec. 29, it had plunged to 63.7%. **Figure 4** documents that annual raw steel production tumbled 11.5% from 2000 to 2001.

At the same time, the so-called high-tech sector was devastated. One example: according to consultant Gartner Dataquest, computer sales/shipments in the United States fell 11.2% in 2001, relative to 2000. In turn, U.S. computer production, by such giants as Compaq and Hewlett-Packard, fell by a similar magnitude.

The collapse of production lowered the United States’ ability to continue functioning; it also lowered profits. The U.S. Commerce Department’s report on corporate profits suffers from serious problems. The data include fictitious profits of many financial institutions, and even much of so-called industrial corporations’ profits come from real-estate and financial speculation, and from a variety of accounting tricks

FIGURE 3  
**U.S. Steel Production And Capacity Utilization Plummet Throughout 2001**

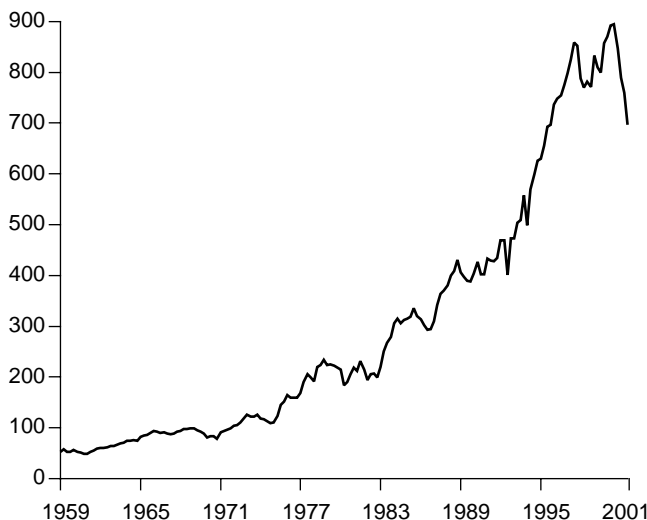
(Weekly, Millions Of Net Tons)



Source: American Iron and Steel Institute.

FIGURE 5  
**U.S. Corporate Profits**

(\$ Billions)

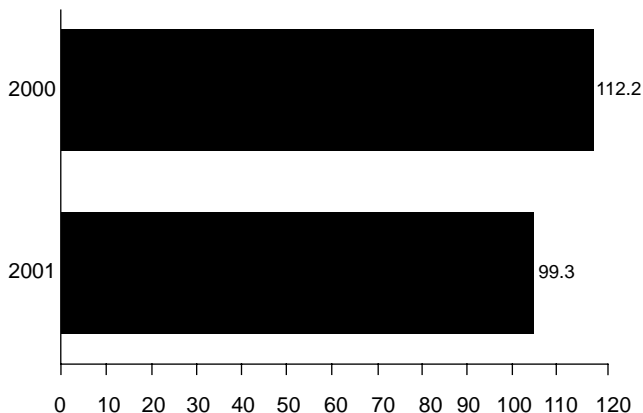


Source: Federal Reserve.

which are more of a reflection of the state of the bubble than of corporate health. Nonetheless, as **Figure 5** shows, the fiction of corporate profitability has broken down. And, as **Figure 6** shows for the year, the manufacturing companies—in this case, the manufacturers of durable goods—are falling faster than the financial companies, reflecting the manner in

FIGURE 4  
**U.S. Raw Steel Production Falls By 11.5% 2001 Compared To 2000**

(Millions Of Net Tons)



Source: American Iron and Steel Institute.

which financial looting is killing the productive economy, and ultimately the speculators themselves.

### Out of Work

How sharp a rise in unemployment flowed from the shut-down of U.S. production, in depicted in **Figure 7**. In December 2000, the Bureau of Labor Statistics reported that “official” U.S. unemployment was 5.653 million workers. The BLS official unemployment level leaves out major categories of unemployed. Nonetheless, by December 2001, even official unemployment had shot up to 8.259 million people, a stunning increase of 46% in one year. Note, that the greatest increase occurred after July, confirming *EIR*’s assessment of a dramatic *phase-shift* downward from July-August onward.

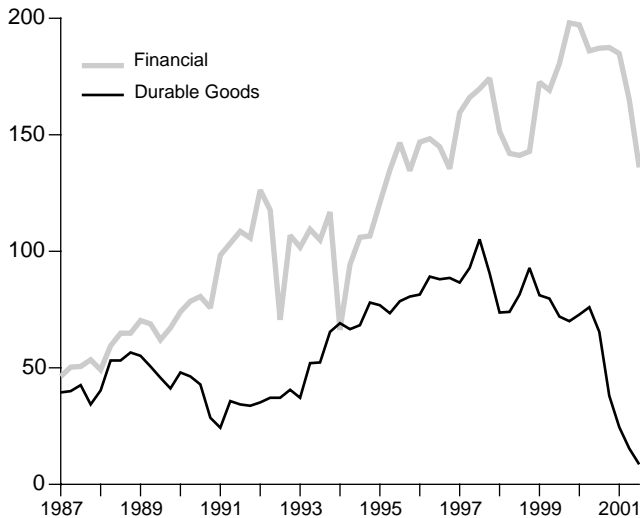
Between July 2000 and December 2001, a cumulative 1.527 million manufacturing jobs were eliminated from the U.S. workforce (**Figure 8**), with 1.322 million of them lost during 2001. Thus, of the 2.696 million workers who became unemployed during 2001 (**Figure 7**), half of those new unemployed were manufacturing workers. The manufacturing sector bore the brunt. This is the economic sector which produces that array of goods—from capital goods, such as machine tools, to consumer goods, such as food and clothing—which help sustain human existence. Thus, when manufacturing workers lose their jobs, the impact on their communities is multiplied by the loss of productive labor force/capacity for the United States economy. Most of that loss may never be restored.

But the greatest impact of the 2001 U.S. slide on the global economy, is shown in **Figure 9**, charting the monthly level of U.S. physical goods imports. Between September 2000 and November 2001, the level of U.S. physical goods imports

FIGURE 6

### Corporate Profits: Financial Companies v. Manufacturers Of Durable Goods

(\$ Billions By Quarter, Annualized Values)



Source: Bureau of Economic Analysis, U.S. Department of Commerce.

tumbled by an extraordinary 15.3%. The reason for this is evident: As the U.S. physical economy contracts and living standards plunge, the United States cannot process and absorb the level of physical goods it used to. In recent years, the United States has functioned as the “world’s importer of last resort,” buying goods produced in other nations to compensate for declining domestic production; as global economic activity declined, these nations became increasingly dependent upon their exports to the United States for their survival. Thus the decline in U.S. goods imports reflects not just a domestic collapse, but a global one.

### Bubble Trouble

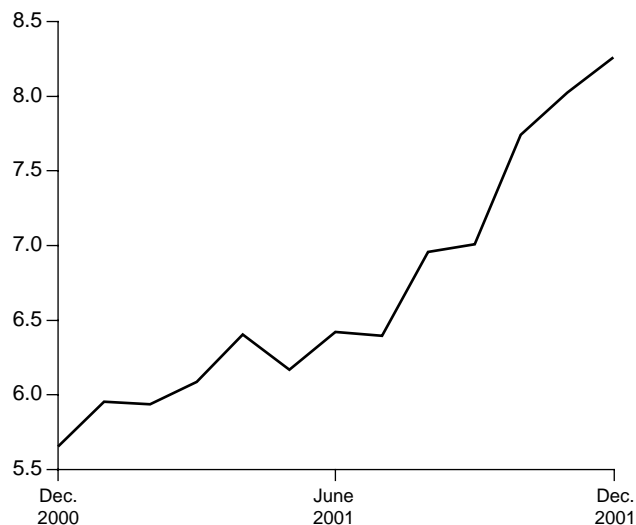
The global downshift during 2001 is also reflected in a number of financial statistics, particularly in the decline of stock markets around the world. **Figure 10** shows declines of 20% to 30% in most major countries, as measured by Dow Jones; the worst performances were elsewhere, but the 21% fall in the U.S. Nasdaq and the 13% decline in the S&P 500 reflect a much greater total “vaporization” of assets. For most of the major markets, 2001 represented a second, accelerated, year of decline.

The fall in stock values seriously damped the mergers and acquisition (M&A) market, since in recent years, wildly inflated stock prices had become the currency of choice for corporate takeovers, pushing that market to record levels. The dollar “value” of U.S. mergers fell by more than half in 2001: \$796 billion in 7,385 deals, less than half of \$1.8 trillion in 10,754 deals in 2000. Non-U.S. deals also fell sharply, to

FIGURE 7

### Official Number Of U.S. Unemployed Workers

(Millions)

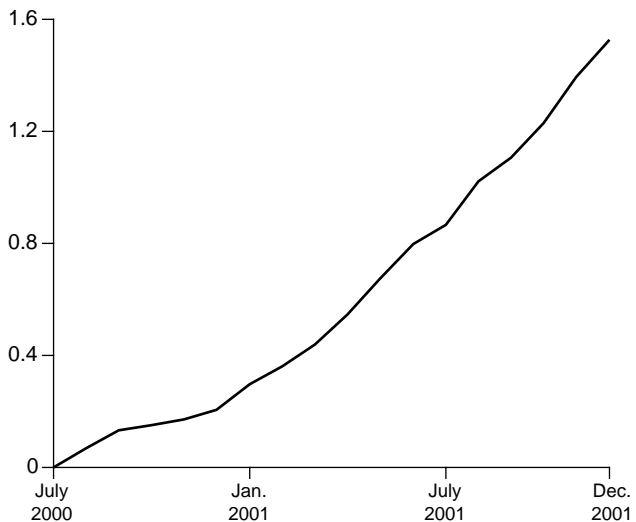


Source: U.S. Department of Commerce.

FIGURE 8

### The Cumulative Elimination Of U.S. Manufacturing Jobs Since July, 2000

(Millions Of Manufacturing Jobs)



Source: U.S. Department of Labor, Bureau of Labor Statistics.

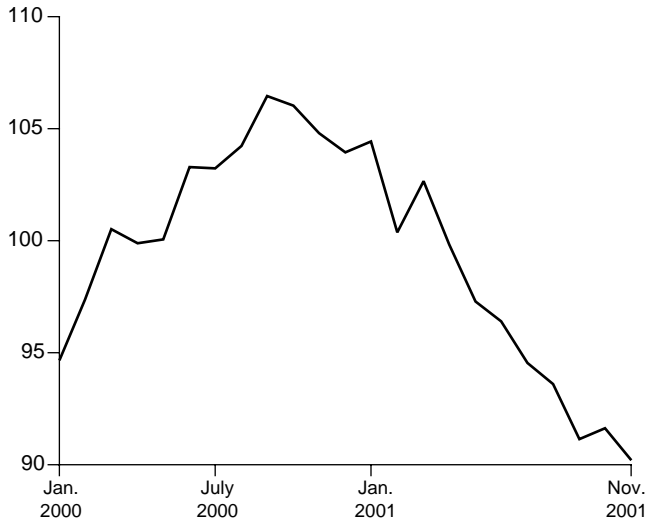
\$905 billion on 21,000 deals, from \$1.7 trillion on 26,000 deals in 2000 (**Figure 11**). Overall, the \$1.7 trillion in mergers announced was a 51% decline from 2000’s \$3.5 trillion.

2001 was also a bad year for Initial Public Offerings

FIGURE 9

### U.S. Is No Longer Able To Take in the World's Goods: Monthly Level Of U.S. Physical Goods Imports

(Billions Of Dollars)

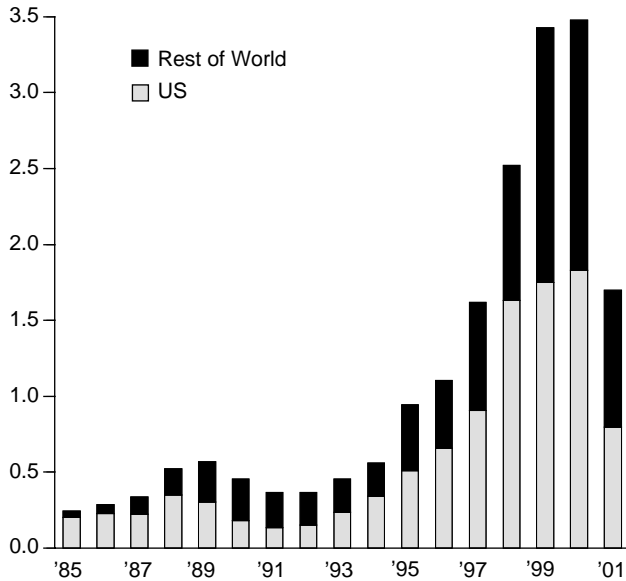


Source: U.S. Department of Commerce.

FIGURE 11

### Global Merger Frenzy Fizzles Annual Mergers & Acquisitions

(\$ Billions)



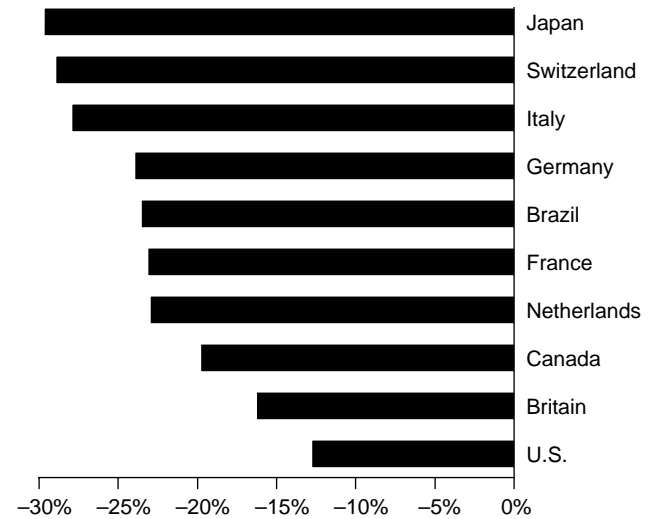
Source: Thomson Financial.

(IPOs), one of the most lucrative types of issuance from the standpoint of Wall Street investment bankers. The combination of the sharp drops in M&As and IPOs caused the dis-

FIGURE 10

### Global Stock Markets Fall In 2001

(Dow Jones Country Indices)



Source: Dow Jones.

closed fees of the Wall Street investment banks to fall to \$17.8 billion for the year, down from \$21.2 billion in 2000.

But the most dangerous of financial elements did rise in 2001. As of the third quarter, the latest for which statistics are available, the notional value of off-balance-sheet derivatives held by U.S. commercial banks, stood at \$51.7 trillion, an increase of \$12.9 trillion—33%—over the third quarter of 2000 (Figure 12). This gives the banks \$88 in derivatives contracts for every dollar of equity capital, a perilous condition in a financial collapse. Some \$24 trillion of those derivatives bets were held by just one bank, J.P. Morgan Chase & Co., with another \$9 trillion each at Citigroup and Bank of America.

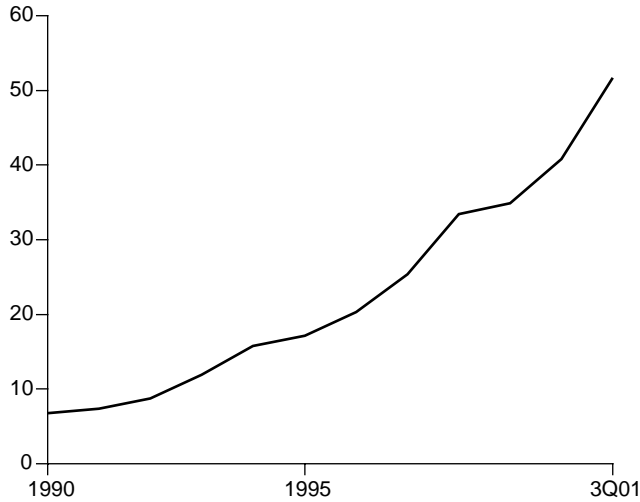
The dangers of such enormous derivatives exposures were suggested in J.P. Morgan Chase's fourth quarter financial report. At year's end, the bank reported \$694 billion in assets, an astonishing \$105 billion less than the \$799 billion reported just three months earlier, on Sept. 30. The bank's explanation was that the "majority of the reduction" in assets "reflects the resolution of the industry-wide clearing and settlement problems experienced in September." Since the existence of such industry-wide derivatives problems was denied after the Sept. 11 events, Morgan Chase's explanation raises far more questions than it answers.

Corporate bankruptcies and defaults also soared, led by the failure of Enron, the largest bankruptcy in U.S. history. In total, 231 public companies with \$250 billion in assets filed for bankruptcy during 2001, up from 176 companies and \$95 billion in assets in 2000. In the bond markets globally, a record 211 companies defaulted on \$115.4 billion of debt in 2001, up from 132 companies and \$42.3 billion in debt, the previous

FIGURE 12

### Derivatives Bets Soar At U.S. Commercial Banks

(\$ Trillions)

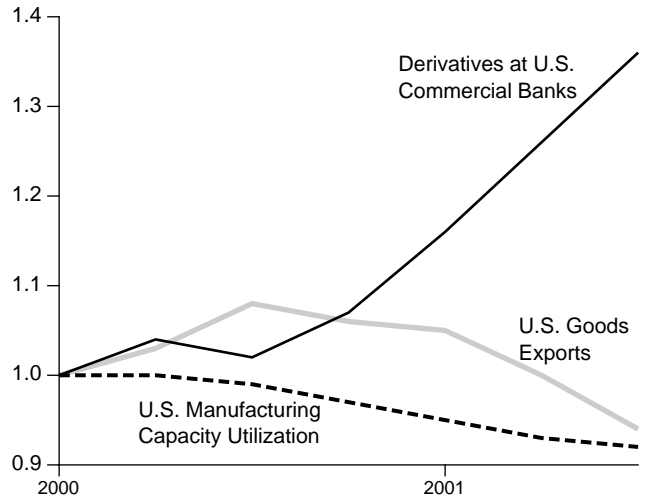


Source: FDIC.

FIGURE 13

### Derivatives Soar, Manufacturing Falls In 2001

(Indexed To 2001/1Q = 1.00)



Sources: FDIC, U.S. Department of Commerce, Federal Reserve.

record, in 2000. The default rate for all bonds hit 4% for the year, the worst year since 1991, while the default rate on junk bonds jumped to 8.6% from 5.7% in 2000. The record for junk bond defaults was 10.9% in 1991, following the collapse of Drexel Burnham Lambert.

### The System Is Bankrupt

The combination of rising financial claims such as debt and derivatives, the deflating value of paper assets such as corporate bonds, and the decline in the manufacture and trade of physical goods, defines a system which is hopelessly bankrupt. Greenspan and his G-7 counterparts have attempted to save the system with their wall of money, but flooding the markets with cash adds monetary hyperinflation to an already highly unstable system.

The utter failure of Greenspan's approach can be seen in **Figure 13**, which compares the rapid growth of the derivatives held by U.S. commercial banks to the declines in the utilization of U.S. manufacturing capacity and the declines of the exports of U.S.-produced goods.

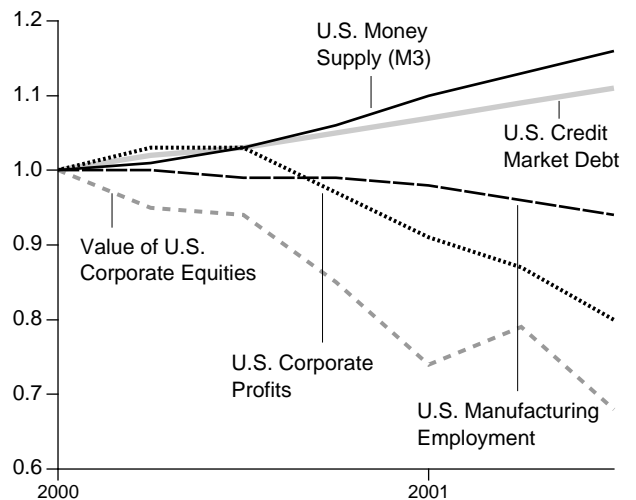
Another view of the collapse in progress is shown in **Figure 14**, which shows the rate of increase in the money supply (M3)—the result of Greenspan's money-pumping—which is outstripping even the rate of growth of U.S. credit market debt. This threatens hyperinflation, while corporate profits and corporate equities—the value of all corporate stock—are falling along with manufacturing employment.

The lesson of 2001 is that Lyndon LaRouche has been correct in his analysis of the nature of the problems facing the U.S. and global economies. Nothing the Greenspans of the

FIGURE 14

### Claims Soar While Ability To Pay Falls In 2001

(Indexed To 2001/1Q = 1.00)



Sources: U.S. Department of Commerce, Federal Reserve.

world are doing will work. 2002, despite all the “recovery right around the corner” nonsense, will be far worse.

The solution is to write down the financial aggregates such as debt and derivatives, while rebuilding the productive sector, including the manufacturing base and infrastructure. It's time to put John von Neumann out to pasture and return to Alexander Hamilton, and LaRouche.