EIR Economics

U.S. 'Recovery' Was Debt Dressed Up for Hallowe'en

by EIR Staff

Once again this year at Hallowe'en time—the beginning of another election season—an Alan Greenspan midnight recovery was conjured up in the U.S. economy, to distract its 20 million actually unemployed citizens (see *EIR*, Nov. 7, 2003). The Federal Reserve Chairman on Nov. 7 pronounced that a "real recovery" was now under way, after figures claiming an annualized rate of GDP growth of 7% or so in the third quarter of 2003, were announced on Oct. 31 by the Commerce Department. On Nov. 5, Treasury Secretary John Snow had given an enthusiastic address to the Economic Club in Washington. "We've seen a real turnaround this year. . . . It seems clear that we have entered a new phase of economic expansion. This is not a fleeting glimmer, there is real muscle behind the growth trend." And by the time Greenspan spoke Nov. 6, the Labor Department had reported the net creation of about 130,000 jobs in October.

But reality is quite different—as indicated by the fact that in the same month, October, *announced layoffs* by American corporations leaped to 172,000, according to the tracking firm Challenger and Gray—two and a half times the previous month and equal to the worst months of workforce shrinkage in 2002. (Of the human resources executives polled by the job agency, 78% did not see any significant upturn in hiring within the next three quarters.) Like the "New Economy" bubble of the late 1990s, the new hype about the American economic "recovery," is again based on two pillars: fraud and debt. Preliminary figures indicate that in the third quarter, it required \$6-8 of new indebtedness, public and private, in the U.S. economy, to generate each new dollar of GDP.

Overwhelmed by Debt Growth

The bulk of the increased GDP was achieved by the generation of a tremendous amount of new debt. During recent years, the combination of American private households' borrowing on mortgages and credit cards, etc; corporations' issuing bonds and taking credit lines; and the borrowing of Federal, state, and local governments, have produced about \$2 trillion of additional debt annually. But during the second quarter of 2003 alone, this growth of new indebtedness soared to about \$850 billion, an all-time record by far. This huge increase produced, in that quarter, a reported increase in GDP of \$108 billion; for a ratio of \$8 in new debt for each dollar of GDP "increase."

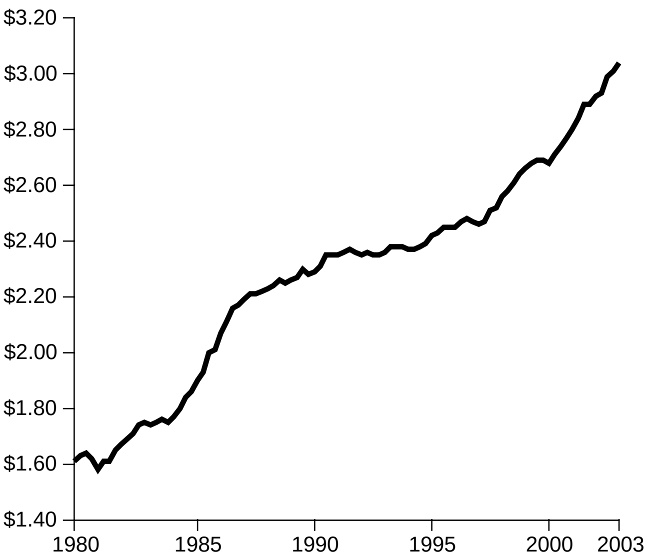
Public budget deficits in that second quarter accounted for 20% of the new debt. Government spending increases produced 38% of the new GDP. For Fiscal 2003 as a whole, Federal government spending rose by an astonishing 12.3% year-over-year, a rate of increase seen only twice before since World War II. Government tax cuts produced 85% of the increase in disposable income of households.

Figure 1 shows that over the last quarter-century, the ratio of cumulative debt in the U.S. economy, to the total GDP, has grown in speculative spurts, up to more than three-to-one.

But when one looks at the amount of new debt being added year by year, and compares that to the officially-claimed increases in GDP, it is clear from that the 1990s "New Economy" bubble onward, far more indebtedness has been required to pull up GDP at all (**Figure 2**). And when the process is broken down quarter by quarter up through the second quarter of 2003 (**Figure 3**), the period since early 2000, when the collapse of employment and industry hit, is shown to be still worse. More than \$6 in new indebtedness has become necessary, to produce a \$1 increase in officially-reported GDP.

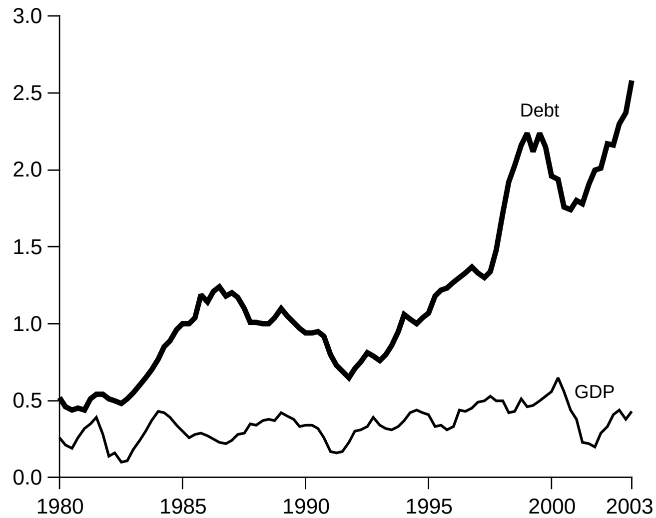
The debt-growth figures for the "spectacular" third quarter are not yet available, but the biggest *components* of rapid debt increase did not let up—record mortgage refinancing, record quarterly Federal budget deficits, large-scale corporate merger and acquisition activity, etc. If the third quarter's debt increase was comparable to the second quarter's, it would be

FIGURE 1
Dollars of Debt Per Dollar of GDP, 1980–June, 2003
(Dollars of Debt)



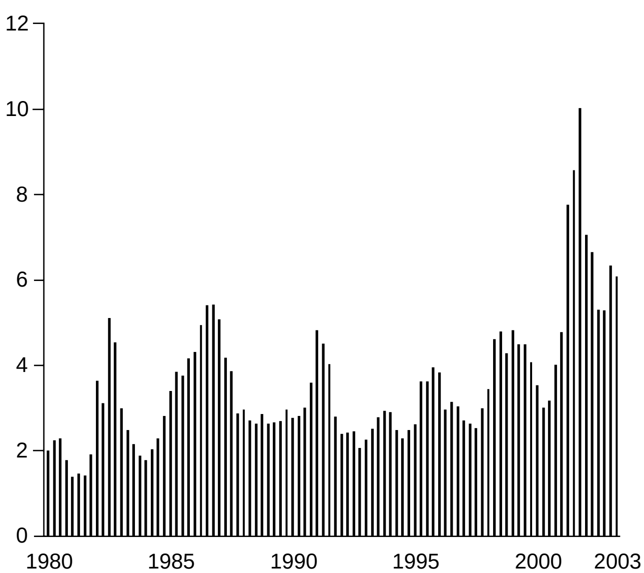
Sources: Federal Reserve, Bureau of Economic Analysis, EIR.

FIGURE 2
Year-Over-Year Increases in Debt and GDP, By Quarter, 1980-June, 2003
(Trillions of Dollars)



Sources: Federal Reserve, Bureau of Economic Analysis, EIR.

FIGURE 3
Increase in Debt for Every $1 Increase in GDP, Year-Over-Year, By Quarter, 1980-June, 2003
(Dollars of Debt)



Sources: Federal Reserve, Bureau of Economic Analysis, EIR.

six times the reported third-quarter increase in GDP, which was claimed to be $168 billion.

Morever, that figure itself has been thoroughly massaged by creative accounting. According to the Commerce Department, GDP rose from $9,629 billion in the second quarter to $9,797 billion in the third quarter, an increase of $168 billion or 1.7%. The 7.2% "growth" rate was fabricated by annualizing—that is, by quadrupling—the quarterly growth rate. Aside from increased debt, the factor which officially contributed the most to the GDP growth during the third quarter was investments in computers, rising from $354.9 billion to $390.3 billion, if measured in "1996 dollars."

But the Commerce Department admitted in the same report that *actual* computer sales increased only from $82.4 billion to $88.3 billion. How is this possible? The reason is the notorious special method of manipulating the original sales data in order to account for changes in the quality of the products, called "hedonic" price indexing, denounced by Lyndon LaRouche and *EIR* for years as having made GDP figures so fraudulent that the measure must be scrapped entirely. To put it simply: The Commerce Department merely *claims* that a present computer with a market price of $1,000 in 2003, would have cost $4,420 in 1996. Therefore, if a company buys a computer for $1,000, the GDP, as calculated by the Commerce Department, immediately rises by $4,420! Thereby, an increase in computer sales of $5.9 billion has been turned into a $35.4 billion rise in the third quarter, a six-fold increase. According to calculations by former Bundesbank chief economist Kurt Richebächer in his newsletter for

Nov. 7, "hedonic" false-pricing of computers accounted for 43% of U.S. GDP growth in the first quarter of 2003, and 44% in the second; it appears to have accounted for more than 20% of the third quarter's "spectacular" growth.

And there are many other "industrial" categories besides computer investment where similarly notorious methods, known as "quality adjustment factors," are being used, as *EIR* has repeatedly exposed.

As for the "net jobs" created in the U.S. economy in the third quarter, *all* were in service sectors of the economy; employment in manufacturing reportedly fell by a further 17,000 jobs in October, its 39th consecutive monthly decline. Of the net 130,000 jobs created, some 30,000 were in "employment services"; that is, unemployed workers getting jobs—or starting their own businesses—looking for jobs for their unemployed neighbors! As noted above, *EIR* has recently shown that real unemployment—including discouraged workers, those dumped from the labor force by Labor Department counters, and those forced to work part-time—totals 20 million.

Mortgage Bubble May Soon Pop

The U.S. Congressional Budget Office (CBO) sees nothing but $400-500 billion-per-year Federal deficits for the next ten years, in its latest estimate produced Nov. 6 at the request of the so-called Blue Dog (conservative) Democrats in the House of Representatives, led by Rep. Charles Stenholm (D-Tex.). These Democratis had asked the CBO to revise its baseline estimates based on the assumed implementation of the Bush Administration's entire economic policy, including assuming that all the Administration's proposed discretionary budget levels for 2004-08 are enacted and extrapolated through 2013, and additional spending for the wars in Iraq and Afghanistan go as planned by the White House. The value of the CBO's resulting estimate of deficits is purely indicative—it nearly doubles the Administration's own forecasts using the "same assumptions," and thus points to the fact that there is no reduction in Federal deficits in prospect; rather, the size of these deficits will continue to increase from their record levels. For this Fiscal Year 2004, the reported deficit should exceed $500 billion, and leaving aside the looting of Social Security and Medicare Trust Fund surpluses to pay government bills, that deficit will be $6-700 billion or more.

At the same time, a survey of 21 U.S. Federal states projects another collective budget deficit of at least $32 billion for Fiscal Year 2005—these are the 21 states which have prepared budget estimates that far ahead. The Center on Budget and Policy Priorities in Washington estimates that the total for all states will exceed $40 billion as more states issue estimates over the coming months. These new amounts are on top of the estimated $78 billion shortfall that they faced when they enacted their FY2004 budgets, and the large deficits which forced them to cut budgets in in FY2002 and 2003. The National Conference of State Legislatures estimates that over the last three years, states have had to close a cumulative budget gap approaching $200 billion. On average, real state per-capita spending will be 5% lower in Fiscal Year 2004 than in 2001.

Reacting to the tremendous rate of increase of indebtedness in the American economy, including also its $500 billion per year trade deficit, long-term interest rates rose steadily from July through mid-September, and after a pause, began rising again in early November. The linked rise in mortgage interest rates threatens to puncture the U.S. real-estate debt bubble which has been driving the entire "consumer economy" during the last three years' collapse of the industrial economy as a whole.

An international interest-rate shift is on the horizon. On Nov. 5, the Reserve Bank of Australia surprisingly announced that it had raised its key interest rate, to cool down the home-lending boom, which threatens the stability of the Australian economy. Similar to the situation in the United States and Britain, mortgage lending in Australia has recently hit annual growth rates of more than 20%. On Nov. 6, the Bank of England (BoE) raised its prime rate by a quarter percentage point to 3.75%, after British mortgage borrowing just hit a historic record of £8.8 billion ($15 billion) in the month of September. The BoE move was the first rate rise by one of the four leading central banks in the world since the year 2000.

That same day, U.S. Federal Reserve Governor Jack Gwynn said, at a public event in Louisiana, that a U.S. "recovery" will mean that interest rates obviously "will have to rise."

Reflecting fears that the housing bubble may pop, Gregory Mankiw, chairman of the White House Council of Economic Advisers, on Nov. 6 pointed to the systemic risk posed by the two giant mortgage corporations or Federally-backed "enterprises" known as Fannie Mae and Freddie Mac. While the debt of Fannie Mae and Freddie Mac is not formally guaranteed by the U.S. Treasury, the government's sponsorship is widely believed to include a public bailout in case of a financial emergency. Mankiw warned, "The [government's] subsidy creates a source of systemic risk for our financial system." Even a small error in risk management by the companies, at this point, could cause ripples in U.S. financial markets, he said.

Presidential candidate Lyndon LaRouche estimates that when—not if—this last, real-estate debt bubble falls in the near term, not just the value of homes, but average incomes may fall by 30-50% in some sectors of the American population. LaRouche has announced policy steps that he will take immediately on taking office—and will try to force into action earlier—to put the vastly-indebted banking system into bankruptcy reorganization, and to employ a "Super TVA" public infrastructure-rebuilding policy to produce credit and revenue for states, and skilled productive jobs for the unemployed. Without such a dramatic shift in policies at the Federal level, there is no "recovery" under way or in prospect in the United States economy.