Debt Explosion Will Kill, Not Save, the U.S. Economy

by Richard Freeman

During the past three years, the U.S. economy has apparently been prevented from sinking into unfathomable collapse, by incurring immense volumes of new debt. The Bush-Cheney Administration is wholly dependent on the debt-generation process, like an addict upon his cocaine; the debt bubble is the principal force holding up the American economy from far greater destruction.

Yet, the immense volume of this debt, swelled by compounding debt service payments, is unsustainable. Its imminent rupture would trigger the breakdown of the world financial system.

By the end of the third quarter of 2003, total U.S. debt had soared to $36.1 trillion, according to data recently released by the Federal Reserve Board of Governors (the "Flow of Funds Accounts") and other U.S. government agencies. **Table 1** documents that between the third quarter of 2002 and the third quarter of 2003, total U.S. debt outstanding grew by $3.09 trillion. That is, it grew in just one year, by an increment that exceeds the total value of all the foreign debt owed by all developing-sector nations.

TABLE 1
Total U.S. Debt Outstanding
($ Trillions)

	3rd Q, 2002	3rd Q, 2003	Rate of Change
Household debt	8.260	9.185	+11.2%
of which mortgage debt	5.847	6.646	+13.7%
Total government debt*	7.653	8.445	+10.3%
Business debt**	17.045	18.421	+8.1%
Total U.S. Debt	32.958	36.050	+9.4%

*Federal, state, and local government debt
**U.S. business debt of both non-financial and financial companies
Sources: U.S. Federal Reserve Board of Governors, "Flow of Funds"; U.S. Treasury Department; *EIR*.

Debt of Households Is the Driver

Table 1 further shows that, between the third quarter of 2002 and the third quarter of 2003, the driving force of this process, was the growth of household debt by 11.2% per year. Within this household debt, the category of "household mortgage debt" grew at the staggering rate of 13.7% per year. This represents households borrowing mainly against *their existing homes;* that is, home refinancings, to extract cash to make some "conspicuous consumption" purchases, but mostly to buy the bare necessities, pay medical bills, and pay off existing debt.

It is evident that the debt bubble contains the seeds of its own destruction, as it hits up against its physical limits. The three principal sectors of the economy—households, businesses, and government—have taken on gigantic levels of new debt. This debt is a cancer which, by shrinking the U.S. physical economy, especially household living standards, renders the economy less and less able to repay the debt, and thus to hold up the growing bubble.

Consider the common instance of a family that borrows to offset the decline in living standards: When the next cycle

FIGURE 1

U.S. Household Debt Surges to $9.44 Trillion

($ Trillions)

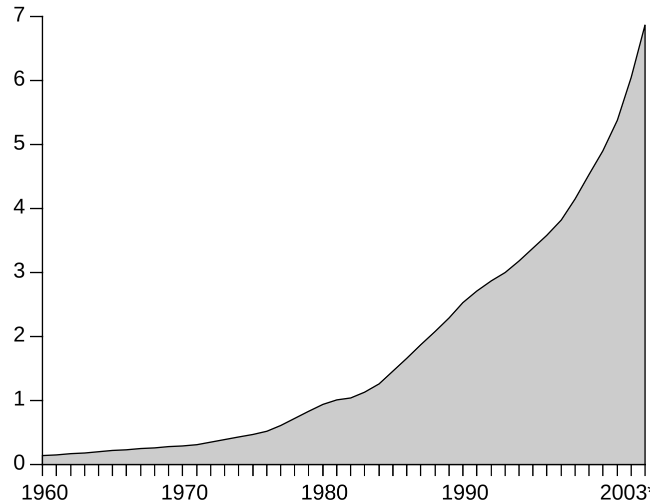
*Projection, based on first nine months

Source: Federal Reserve Board of Governors "Flow of Funds Accounts"; *EIR.*

FIGURE 2

U.S. Home Mortgage Debt Rises to Nearly $7 Trillion

($ Trillions)



*Projection, based on first nine months

Source: Federal Reserve Board of Governors "Flow of Funds Accounts"; *EIR.*

of debt payments comes due, they will be augmented by the expanded interest. To make those payments, the family will have to reduce its living standard to below where it was before it took on the new borrowings. The loss of a job, and the whole process blows out. The same principle applies to manufacturing firms, which to avoid going under, borrowed to pay for new equipment, raw materials supplies, and even to pay payroll. This process has been going on for three and one half decades, but intensified during the past three years, as financial and monetary aggregates have overwhelmed the productive base of the economy.

Post-Industrial Society Policy

The U.S. debt bubble stems from the City of London and Wall Street financiers' imposition of a post-industrial society policy upon the United States beginning the mid-1960s. This policy collapsed production in manufacturing, agriculture, and infrastructure, and fostered speculation, which built up a gigantic speculative bubble. This bubble sucked the physical economy dry, contracting it and real living standards, by 1-2% per annum.

Three nodal policy changes of the post-industrial society policy are noteworthy.

First, President Richard Nixon severed the dollar from the gold-reserve standard on Aug. 15, 1971, which separated financial flows from physical goods flows.

Second, Federal Reserve Board Chairman Paul Volcker moved in October 1979 to apply the New York Council on Foreign Relations' explicit policy of "controlled disintegration" of the economy. Volcker sent interest rates into the stratosphere, so that the prime lending rate charged by commercial banks reached 21.5% by December 1980, which razed basic manufacturing and agriculture to the ground.

Third, Wall Street steered the leveraged-buy-out mania, starting in the 1970s, with heavy doses of laundered drug money, to take over and then asset-strip companies.

Taken as a sweep, the more than three-decade post-industrial process fostered the leap in debt.

The debt grew for two opposite purposes: first, for non-productive/speculative purposes—borrowings by companies to make leveraged buy-outs of one another, and for individuals to buy expensive cars and other luxury items; and second, for productive purposes, such as factories and farms buying equipment and materials to keep themselves open, or families buying the goods necessary for their survival.

The two types of debts, contracted for different purposes, merged, sending total debt spiralling upwards.

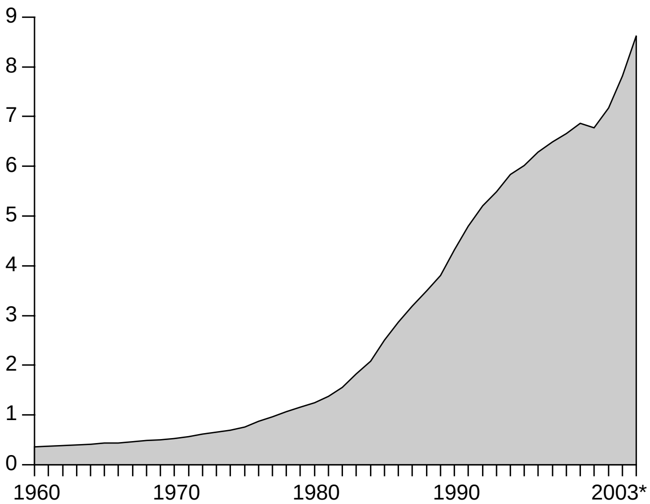
Economy's 'Savior,' Households' Destroyer

The total U.S. debt consists of three parts: 1) household debt, which includes home mortgage debt, credit card debt, and installment debt (to purchase cars, refrigerators, etc. on installment plans); 2) business debt; and 3) total government debt, embracing Federal, state, and local government debt.

(To make comparisons of debt over varying years, we

FIGURE 3
Total U.S. Government Debt (Federal, State, and Local Gov't Debt)

($ Trillions)

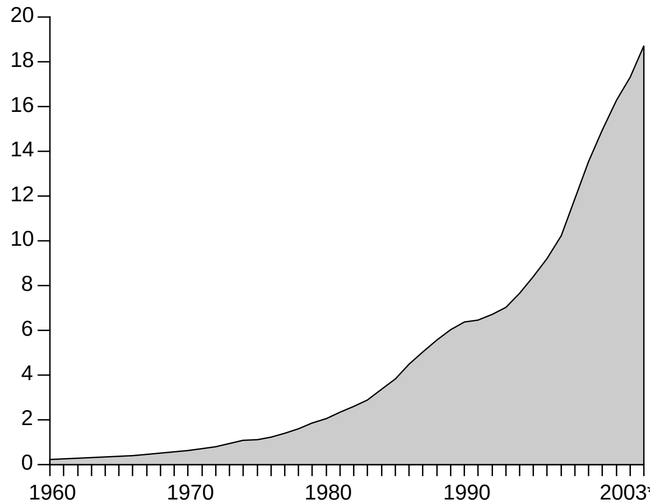


*Projection, based on first nine months of 2003

Source: Federal Reserve Board of Governors"Flow of Funds Accounts"; U.S. Department of Treasury; U.S. Office of Management and Budget; *EIR.*

FIGURE 4
U.S. Business Debt (Non-Financial and Financial Businesses)

($ Trillions)



*Projection, based on first nine months

Source: Federal Reserve Board of Governors "Flow of Funds Accounts"; *EIR.*

took the first nine months data for 2003, and projected it on an annual basis.)

Figure 1 shows that household debt was less than $1 trillion until 1978. Under the impetus of Volcker's high-interest regime, household debt rose steeply. By 1990, it was $3.60 trillion; by the end of 2003, it had risen to $9.44 trillion, a 2.6-fold increase in only 13 years.

Most especially, look at the period since 2000: debt of households rose from $7.08 trillion in 2000 to its current level in 2003, an increase of $2.36 trillion, in only three years. The dates are especially important. The Federal Reserve Board's "Flow of Funds" reports its debt figures for the last day of the year named, so that the debt figure for 2000 is for Dec. 31, 2000. The Bush-Cheney Administration took office on Jan. 21, 2001, a mere 21 days after the start of the year. Accordingly, the debt figures for the period 2000 to 2003, cover the entirety of the Bush-Cheney Administration, minus 21 days.

The Bush-Cheney Administration has falsely trumpeted its package of tax cuts as the "savior" of the economy. Consider that the total tax cuts during the interval 2000-03, did not equal one-tenth of the total amount of debt expansion (household, business, and government) that was pumped into the economy during the same period. As the broad outline will make clearer, the wild debt explosion is the governing characteristic of action of the Bush-Cheney Administration, in conjunction with the wild money printing polices of Fed Chairman Alan Greenspan.

Figure 2 shows that between 2000 and 2003, home mortgage debt grew by $1.98 trillion. During the period 2000-2003, out of the growth in household debt by $2.36 trillion, home mortgage debt's growth accounted for a striking 84%. However, only approximately half of the increment of new home mortgage debt during the period 2000-2003 actually was used to purchase homes. The other half went to refinance homes: In many cases, the homeowner extracted cash for consumer spending.

Figure 3 depicts the rising trajectory of total government spending (inclusive of Federal, state, and local), which has resumed its upward thrust with a vengeance. The Congressional Budget Office has just released its projection that the U.S. budget deficit for Fiscal Year 2004 will be $477 billion (actually, it will be $631 billion). Deficits of that magnitude will ensure that government debt will rise steeply.

Figure 4 shows that non-financial and financial business debt leapt to $18.72 trillion by 2003.

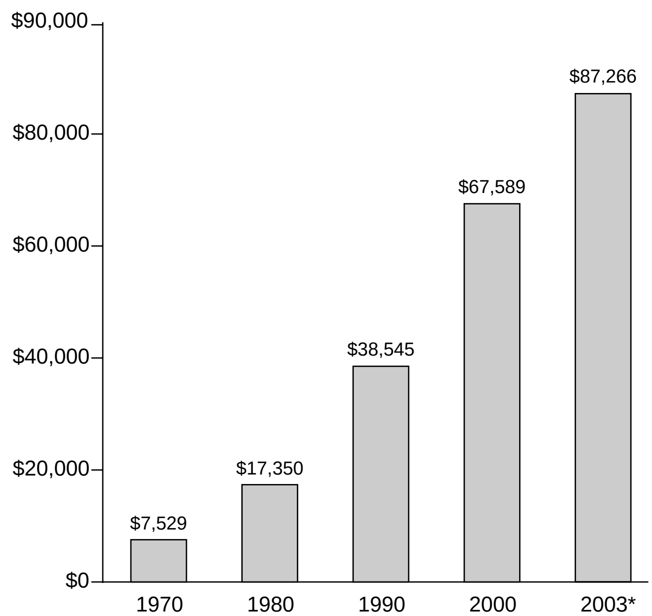
Figure 5 documents that total U.S. debt (household, government, and business combined) has followed a hyperbolic trajectory from $1.63 trillion in 1970, to a projected $36.85 trillion by the end of 2003, a 23-fold increase. In 2000, total debt stood at $28.80 trillion. Between 2000 and 2003, total debt increased by more than $8 trillion, which has facilitated the minimal level of purchases to provide minimal life-signs to the battered economy. Never before in the history of the world has any nation's debt increased by $8 trillion during

FIGURE 5
Total U.S. Debt
($ Trillions)

*Projection, based on first nine months

Source: Federal Reserve Board of Governors "Flow of Funds Accounts"; U.S. Department of Treasury; Office of Management and Budget; *EIR*.

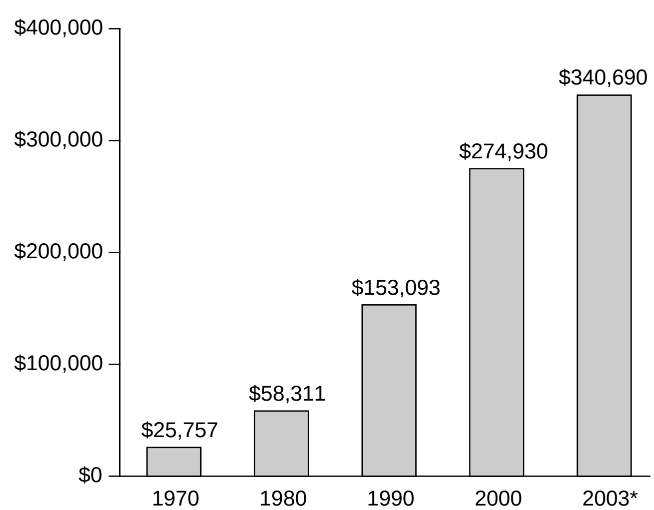
FIGURE 6
U.S. Household Debt, Per Household
($ Trillions)



*Projection, based on first nine months of 2003

Source: Federal Reserve Board of Governors "Flow of Funds Accounts"; U.S. Department of Commerce; *EIR.*

FIGURE 7
U.S. Total Debt, Per Household



*Projection, based on first nine months

Source: Federal Reserve Board of Governors "Flow of Funds Accounts"; U.S. Department of Treasury; U.S. Office of Management and Budget; U.S. Department of Commerce; *EIR.*

three years.

The debt bubble may seem to produce positive short-term effects; and without conceding that such a bubble exists, the Bush-Cheney Administration has duplicitously ridden the crest of this debt wave. But the explosion of debt contains the germs of a destruction two orders of magnitude greater than what happened in the 1929-32 crash and the Great Depression. (The preconditions for the debt bomb's detonation will be discussed in a forthcoming article.)

Figure 6 shows that in 2003, each U.S. household is crushed under the burden of $87,266 of debt (this is the amount of U.S. household debt, divided by the number of households). Two parameters must be kept in mind. First, that the leading element of household debt is home mortgage debt, as referenced above. Second, some wealthy families and some elderly families have little or no debt burden, which means that numerous other families have staggering household debts of $150,000, or $300,000 or more.

It is dramatically revealing that between the end of 2000 and the end of 2003, the volume of household debt per household climbed by $20,000. During the Cheney-Bush collapse process, households piled on the debt, in order barely to persevere.

Figure 7 shows that between 2000 and 2003, total U.S. debt, borne per household, rose from $274,930 to $340,650, a stunning increase of more than $65,000 in three years. It is a pipe dream to believe that households can survive.