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Cannibalism Is Not A Viable Long-Term Economic Strategy

by John Hoefle

In the aftermath of the Sept. 11 events, the breakup of the global financial and economic system has taken center stage, as sector after sector issues dire warnings and gets in line for potential government bailouts. The laissez-faire free-market mantra of recent decades has all but stopped, replaced by calls for government intervention to save the financial markets and corporate America. The blather about how the economy has "hit bottom" and can now only rebound, has largely stopped, as the realization spreads that the bottom is not yet even in sight. What is visible, is panic, a growing, palpable fear that the system is spinning out of control, and that all of Federal Reserve Board Chairman Alan Greenspan's horses and all of his men, won't be able to put it back together again.

None of this should be a surprise. Lyndon LaRouche forecast it all, repeatedly warning that the hyperbolic growth of financial claims, the similar growth of the money supply to service those claims, and the destruction of the productive sector of the economy through a deliberate policy of deindustrialization and the undercutting of research, development, and infrastructure, must inevitably bankrupt the economy and render the giant pile of financial claims worthless.

While the bubble was growing, many of its inherent weaknesses could be papered over, bailed out, or otherwise swept into hidden corners. Today, however, that growth has largely ended, and the economy has entered a self-feeding deflationary spiral in which most categories of financial assets are rapidly losing value, corporations are cutting back operations and laying off employees, and bankruptcies are soaring, triggering further cutbacks, layoffs, bankruptcies, and so on, in a self-feeding process. As the economy contracts, the pressures on the corporations intensify: sales fall, debts which once had the illusion of manageability begin to take on a deadly air, bonds which were once highly rated begin their slide toward junk status, and companies find themselves caught between falling profits and Wall Street's demands for increased stock dividends.

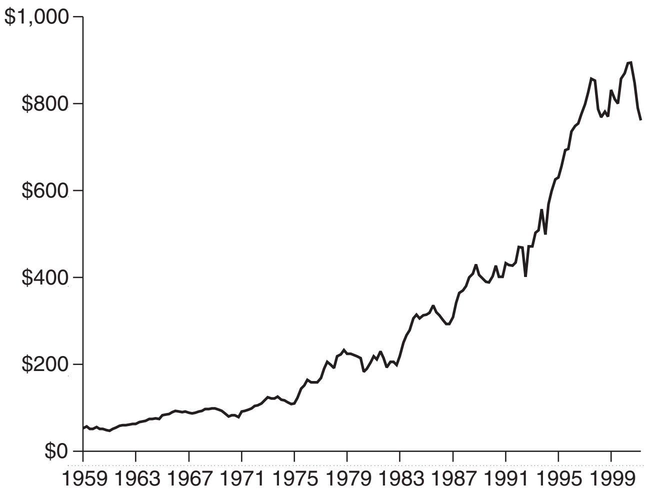
The financial firms have those same problems, and more. As the ability of corporations and individuals to pay their debts declines, so does the creditworthiness of the banks' loan portfolios; bad loans and defaults are on the rise, and once they reach a critical mass, the bank itself goes under. For the biggest banks, where making loans has become something of a sideline, the picture is even worse; they have morphed into investment banks, speculating in the *casino mondiale* of the currency, securities, stock, and derivatives markets. But the collapse of the stock markets has cut heavily into brokerage revenues, the once-lucrative Initial Public Offerings (IPO) market has all but died, and merger and acquisition activity has dropped by half compared to last year. Everywhere they turn, revenues are threatened.

For individuals and households, the picture is equally bleak. Those households which have suffered layoffs are devastated, and those facing potential layoffs live in fear. Families which invested in the stock market have seen the value of their holdings plummet, cutting their investment income and retirement funds. At the same time, many families have incurred painful levels of debt, through credit card and other borrowing, and through mortgages on overpriced homes. As the economy contracts, so inevitably will real estate prices, wiping out equity and leaving many people holding mortgages for more than their homes are worth.

An economy which lives off leverage and debt, as the United States has for the last three decades, dies by leverage and debt when the bloom comes off the rose.

That boom has ended, with many "financial experts" conceding that the nation has entered a recession. But the truth is much worse. As Lyndon LaRouche observed in a U.S. radio interview on Oct. 9, "*We are in a depression*."

FIGURE 1
U.S. Corporate Profits, Quarterly, At Seasonally Adjusted Annual Rate
($ Billions)



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

This is no cyclical downturn, but a systemic failure—the system itself is breaking apart, its economic foundation buckling under the weight of hundreds of trillions of dollars of unpayable financial claims.

Falling Corporate Profits

Take, as one indicator of economic collapse, the level of U.S. corporate profits, as reported by the Department of Commerce's Bureau of Economic Analysis (BEA) (**Figure 1**). The reported level of corporate profits increased dramatically through the 1970s and 1980s, then skyrocketted in the 1990s, rising sharply until 1997. In rough terms, the level of annual profits doubled in the 1970s, doubled again in the 1980s, and doubled yet again in the 1990s.

The BEA reports corporate profits by quarter, with each quarter's profits being annualized to reflect what the annual profits would be at that level. The numbers are also adjusted to reflect the value of corporate inventories and the level of corporate capital expenditures.

The BEA's figures show a sharp rise in corporate profits during the 1990s, but those profits are an illusion (and a delusion), representing a savage looting of the U.S. industrial base and of Less Developed Sector nations through globalization, combined with the mad rush into the largest financial bubble the world has ever seen. That is, the reported profits represent not an expansion of the productivity of the global economy, but the cannibalism of that economy. Cannibalism, however, is not a long-term economic strategy, and all economies which get their "profits" from destroying their economic underpinnings ultimately collapse.

For corporate America, the illusion began to collapse in the fourth quarter of 1997; profits dropped sharply from a then-record $858 billion in the third quarter down to $770 billion in the second quarter of 1998. That represents an annualized drop of about $90 billion, and a drop of roughly $170 billion from what they would have been had profits continued to grow at the previous rate.

This decline occurred at the same time that the Anglo-American financial interests, fronted by hedge-fund speculator George Soros, launched their currency warfare attack on Asian nations, an event popularly but inaccurately known as the "Asian crisis."

Interestingly, earlier in 1997 a British money manager named Tony Dye caused quite a stir with predictions of disaster in the global derivatives market. Dye's warnings were reported by the London *Sunday Telegraph* on March 9, 1997, in a piece entitled the "$55 Trillion Horror." Just a couple of weeks before that, on Feb. 21, 1997, Federal Reserve Chairman Greenspan admitted to a Coral Gables, Florida meeting sponsored by the Atlanta Fed, that "there have been occasions when we have been on the edge of a significant breakout." Thus far, he concluded, the Fed's response has "turned out to be adequate to stem the atomic erosion."

The events of 1997 suggest that the Soros-led attack on the Asian Tigers was in fact a response to some sort of major derivatives disaster, in which money was stolen from Asia through market manipulations, in order to plug a hole in the bubble. The attacks threw world trade into a tailspin, and put a significant dent in U.S. corporate profits.

Profits didn't really begin to recover until the first quarter of 1999, and that was mainly because of the series of interest-rate hikes and other measures implemented by the Fed and the other major central banks in the wake of the Autumn 1998 Russian default crisis and the resulting near-meltdown of the global derivatives markets, of which the bankruptcy of Long Term Capital Management was just the tip of the iceberg.

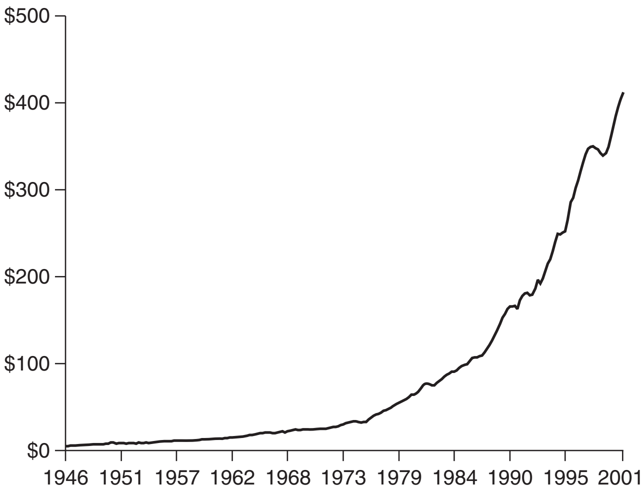
The profit rebound was short-lived. After peaking at an all-time high of $895 billion during the third quarter of 2000—corresponding to the "hear no recession, see no recession, speak no recession" theme of the U.S. Presidential campaign—the bottom began to fall out. Profits fell steadily, to $761 billion in the second quarter of 2001, a level not seen since 1996, and are projected by analysts to drop to some $700 billion in the third quarter and $680 billion in the fourth quarter, a level not seen since 1995.

Had corporate profits continued to grow at their mid-1990s rate, fourth-quarter profits would have been in the range (annualized) of $1.3 trillion, nearly double their projected level. That's a significant hit to the bottom line.

Escalated Looting

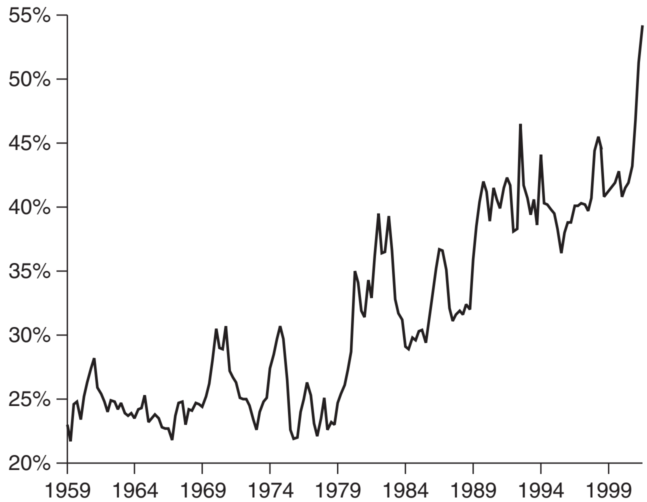
Although corporate profits have been falling, the dividends paid to shareholders have not (**Figure 2**), rising to an annualized $412 billion in the second quarter. That dividends are rising even as corporate profits decline, reflects the pres-

FIGURE 2
Corporate Dividends Paid Quarterly, At Seasonally Adjusted Annual Rate
($ Billions)



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

FIGURE 3
Dividends Paid As A Percentage Of Corporate Profits
(Percent)



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

sure on corporations by Wall Street to keep the dividend money flowing at all costs. This process is even more clear, when one compares the ratio of dividends to profits. The combination of falling profits and rising dividends has reached the point where dividends now amount to more than half of profits, hitting 54% in the second quarter (**Figure 3**). By comparison, dividends averaged roughly 25% of profits in the 1960s and 1970s, 34% in the 1980s, and 41% in the 1990s.

What drives the demand for ever-more dividend income, is pure desperation on Wall Street. The collapse of the information technology bubble has knocked nearly $4 trillion off the market value of stocks traded on the Nasdaq exchange and cut sharply into trading revenues. The tech wreck also put an end to the lucrative IPO market, which generated some $5 billion in fees for the bankers who launched the deals. Another mainstay of the investment bankers has been mergers and acquisitions, but the M&A business was largely fuelled by the stock market boom, as corporations used their overvalued stock as a form of currency to buy other companies. That process has slowed significantly, with the value of deals announced this year running at half of last year's levels.

Globally, perhaps as much as $10 trillion of value of financial and related instruments has evaporated, with multiples of that to come, blowing a huge hole in the global financial and economic system. With assets evaporating and income disappearing, the banks are turning more than ever to the form of gambling known as the derivatives markets. As of June 30, U.S. commercial banks had $48 trillion in off-balance-sheet derivatives bets, a 24% increase in 12 months, with nearly all of that exposure held by three banks, J.P. Morgan Chase, Citigroup, and Bank of America. Speculative bets now dominate the financial system, with some $4 trillion a day in foreign exchange and derivatives bets being placed every day, according to the Bank for International Settlements.

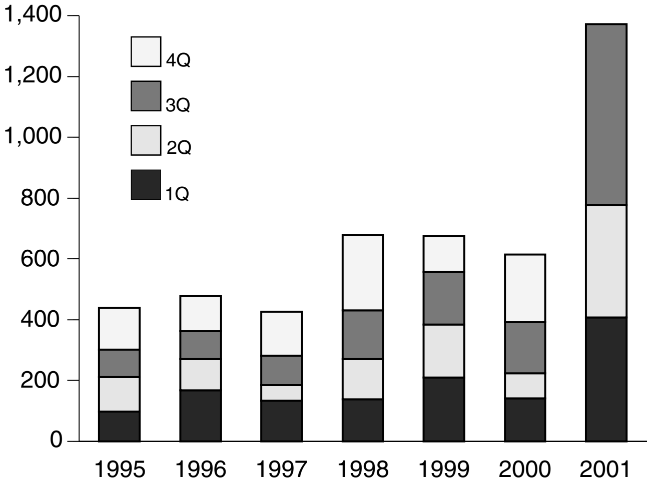
Self-Feeding Spiral Of Collapse

The combination of falling production and increased financial looting has sent the economy into a self-feeding spiral of collapse. The loss of investment income from the stock market, increased layoffs and the fear of layoffs, and choking levels of debt, have cut into the consumer spending which the formerly acclaimed "genius," Greenspan, has declared to be the engine of the economy. As consumers cut back, companies cut back, leading to further layoffs, which causes further cuts in consumer spending, ad infinitum. It is this process, playing out in the financial markets, the office buildings, malls, factories, and households, which has driven the economy into meltdown.

One marker for this domino-style collapse is the sharp rise in corporate layoffs, as corporations cut back in the face of depressed sales (**Figure 4**). Through the first eight months of this year, corporations announced 1.4 million layoffs, according to Challenger, Gray & Christmas. That is more than the total for all of 1999 and 2000 *combined,* with three months still to go, and the pace of layoffs is quickening. During the third quarter there were 594,000 layoffs—not too far shy of the 614,000 layoffs in all of 2000—compared to 407,000 in the first quarter and 371,000 in the second quarter.

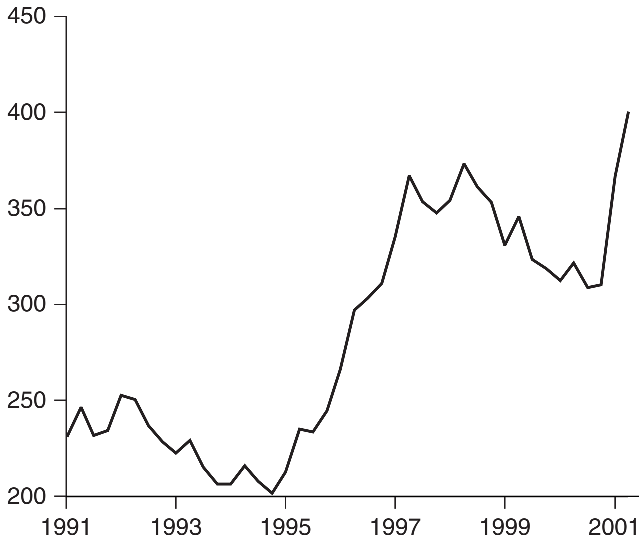
The more people who lose their jobs, the more people file

FIGURE 4
Major Layoff Announcements, By Quarter
(Thousands)



Source: Challenger Gray & Christmas.

FIGURE 5
Number Of U.S. Bankruptcy Filings, By Quarter
(Thousands)



Source: Administrative Office of the U.S. Courts.

for bankruptcy. U.S. bankruptcy filings hit a record 400,000 in the second quarter (**Figure 5**). Part of the surge can likely be attributed to the attempt by some filers to enter bankruptcy court before the new, tougher bankruptcy laws took effect, but then the law was changed in anticipation of increased levels of bankruptcy filings, so the law change is more of an effect than a cause.

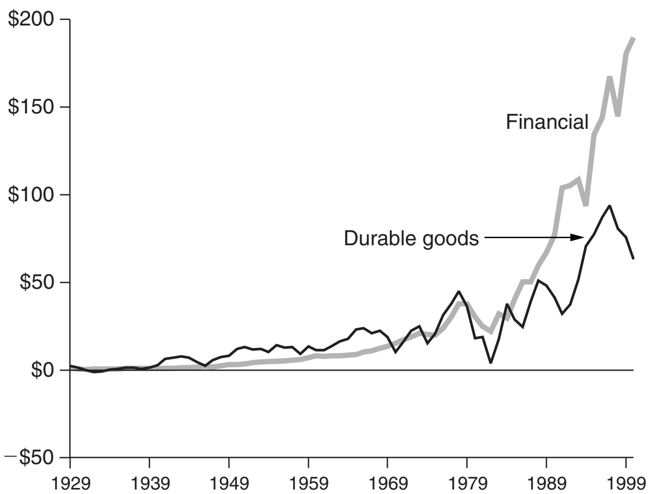
It's Not Coming Back

While the Wall Street propaganda machine continues to assert that the economy will regain its strength next year, no reasons are given, at least not in the higher use of the word. Instead we get vague references to business cycles and projections of past trends, real and perceived. Greenspan's money-pumping will work, we are assured, but the lag time is greater than we thought.

Through it all, the economy continues its accelerating downturn. The attempt by Greenspan and company to halt this process through interest-rate cuts and liquidity pumping hasn't worked, and won't work, because this is a physical-economic crisis, not just a monetary crisis.

Over the past three decades, the once-mighty U.S. industrial economy has given way to the siren call of the Information Age, with its emphasis on finance, services, and information. The effects of this shift can accurately be measured only by a market-basket approach of physical production and consumption of goods, per capita and per household, which eliminates the inflationary distortion of dollar-based measurements. However, one can see a reflection of this process by comparing the profits of financial corporations versus the profits of manufacturers of durable goods (**Figure 6**). Even with all the financial fluff that gets counted in manufacturing

FIGURE 6
Finance Profits At Expense Of Manufacturing: Profits of Financial and Durable-Goods Manufacturing Sectors
($ Billions)



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

FIGURE 7
A Typical Collapse Function

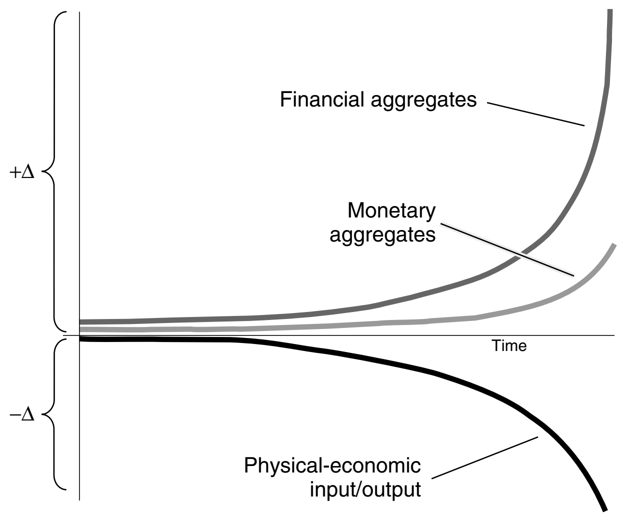
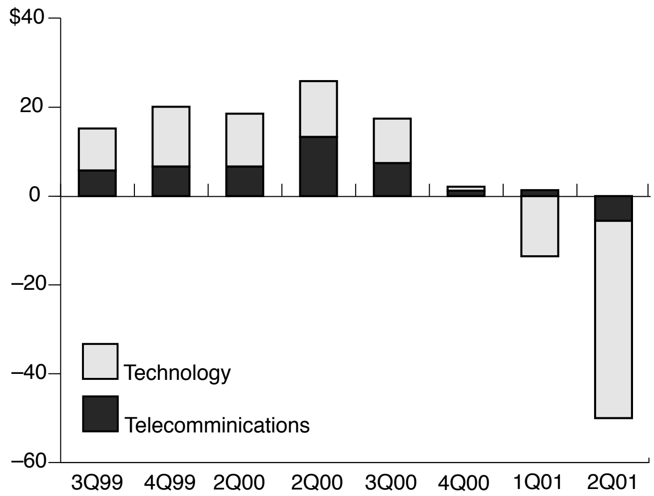


FIGURE 8
Demise Of The New Economy: Quarterly Net Income Of Telecommunications And Technology Companies
($ Billions)



Source: *Wall Street Journal.*

profits, the sector has been falling since 1997, while financial profits have risen. Such a process is best understood from the perspective of Lyndon LaRouche's triple curve collapse function (**Figure 7**), in which increased financial looting accelerates the collapse of the physical economy.

The axioms of the Information Age are falling as fast as that sector's profits. During the first six months of 2001, the 240 firms in the *Wall Street Journal*'s compilation of technology companies lost a whopping $58 billion, while 21 fixed and wireless telecommunications firms lost $5.5 billion in the second quarter (**Figure 8**). Many families that jumped into the Nasdaq frenzy in late 1999 or early 2000, have seen the value of their stockholdings wiped out, and stock-based pension and retirement funds are evaporating rapidly.

The shrinkage of the service sector would not be bad, were it accompanied by a boom in the productive sector, fed by the rebuilding and expansion of the world's infrastructure and manufacturing capability, but no such boom is occurring. Instead, we have entered this depression with an economy—and a society—much less capable of meeting its needs than we had in 1929, with a smaller percentage of Americans working in manufacturing, agriculture, and related productive fields than ever before. We simply are not prepared for the systemic collapse which is now unfolding before our eyes.

Any attempt to "save" the system, to try to protect the trillions of dollars of fictitious value of inflated financial assets, will fail. To resolve this crisis, we must build our way out, rebuilding our tattered infrastructure and launching a series of Great Projects such as the Eurasian Land-Bridge and the North American Water and Power Alliance.

Compare LaRouche's rebuilding approach to the consumer-spending nonsense promoted by the Plunge Protection Team and Wall Street. The Bush Administration is already talking about another round of tax rebates to spur consumer spending.

But Bush and company are thinking small. In the spirit of a consumer-led recovery, *EIR* offers the following modest proposal: The next time your credit card company calls you to offer you credit, tell them you're willing to do your part for the economy, and ask them for a $1 trillion line of credit. Promise them that if they give it to you, you will spend it. Should they balk, as they might, challenge them to step up to the plate and support the country; you're willing to do your part, so why shouldn't they do theirs? If just a dozen people did this, it would more than double the size of the U.S. economy! And if you're worried about paying all that money back, don't be; once you owe a trillion dollars, you are too big to fail! There's no downside!

Obviously, this is a crackpot idea, but it is no different in principle from the Bush/Fed/Plunge Team idea of bailing out the economy through increased consumer spending. The only difference between their plan and mine is that theirs is spread out over a larger group of borrowers. Basing a recovery on increased borrowing by a population that can't pay its existing debt, is world-historic stupidity. It won't work, and it isn't working.

What will work, is LaRouche's Great Projects development corridor approach, projects which lay the groundwork for real physical-economic development, and real profit. Cannibalism has failed, and to get out of this mess we're going to have to build our way out.