

Why cutting interest rates won't stop the second Great Depression

by Steve Parsons

When the Federal Reserve cut its discount rate on Friday, Sept. 13, by a half-percent to 5%, both the White House and Wall Street waxed euphoric that the real recovery was just over the horizon. The stock market surged to a new record high, and legions of economists burst forth with renewed predictions that future indicators would point onward and upward. But within days—even hours—of the Fed's move, the financial media and many of these same economists began clamoring for further interest rate cuts. News reports were soon filled with "expectations," if not exhortations, that the Fed would simply have to drop the discount rate to 4% by the end of the year. This has now become a dull roar, as reams of statistics pour out showing a so-called "double dip" in the recession. Everything from home building and auto sales, to bank and industrial balance sheets, is nosediving. Add to this panicky retailers, who are scrambling to mark down merchandise in the face of a looming Christmas sales disaster. For, despite all the verbiage about the consumer's psychological pessimism, the fact is that the average American is simply too broke and too debt-ridden to throw around what money he does have this Christmas.

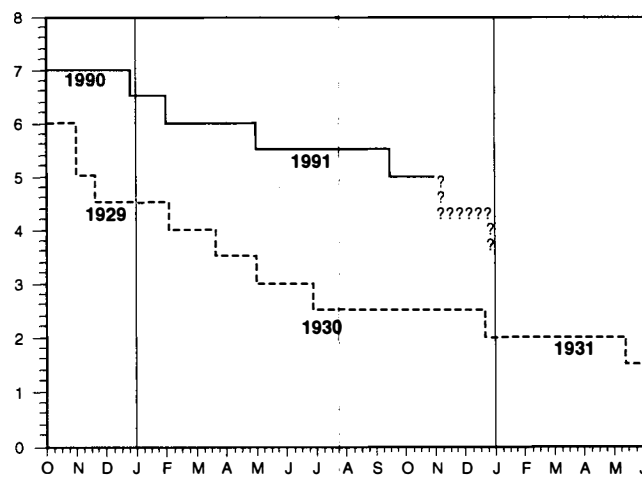
But just as the euphoria of the Fed's discount rate reduction last September vanished almost overnight, an even bigger cut to 4% won't stem the depression collapse. As one European banker told this news service in September: "The discount rate drop is a sign of Fed panic. It doesn't know what to do other than to keep lowering. It's becoming ominously similar to what occurred in the early 1930s."

Interest rate cuts in the '30s

After the October 1929 stock market crash, the Federal Reserve began to ratchet down interest rates, which had been boosted over the previous year in order to curb the raging speculation in the American economy. Barely a week after the crash, on Nov. 1, the New York Fed lowered the discount rate a full percent, from 6% to 5%, and then two days later cut it to 4.5%. During 1930, the Fed cut the rate further, all the way to 2.0% by December, and then finally to 1.5% by May 1931 (Figure 1).

At the same time, a popular and confident President Herbert Hoover was assuring people that prosperity was just around the corner, just as an imperious President Bush today

FIGURE 1
Discount rate, Federal Reserve Bank of New York 1929-31 and 1990-91



Source: Federal Reserve Banking and Monetary Statistics

is assuring us that the "recession" is over and the recovery has begun—even though some people aren't yet feeling its beneficence. Hoover responded to falling federal revenues by insisting that the budget be balanced, and implemented widespread budget cuts. Today, Bush tells us that although a tax cut would be nice, the federal budget deficit is too large to afford a cut for average Americans. Together with states and localities throughout the nation, governments at all levels are "saving money" by attriting and laying off employees in droves. These "savings" ironically are catalyzing even sharper revenue drops and accelerating the downward spiral.

George Bush's hero might be that great genius of American prosperity, Calvin Coolidge, who, like Bush, presided over an unparalleled speculative financial frenzy. But Bush is now following in the footsteps of Hoover. No amount of interest rate reductions can stem the tide of collapse, either for the financial sector or for industrial production.

Lower rates are crippling banks

From a financial standpoint, the moves by both Bush and the Federal Reserve are actually hastening a banking and

general financial collapse. For months now, the lower interest rates have driven more and more money into the speculative markets, as funds cascade out of longer-term investments like bank certificates of deposit and pour into purely paper operations like the stock market, mutual funds, futures, options and the plethora of "innovative" financial instruments born of the computer age. This is actually expanding the overblown bubble even more astronomically, making the inevitable crash even worse, while sucking funds not only out of the productive sectors of the economy, but also out of the banking system.

This is even more significant than the absurd levels of speculation. Because these investors have liquidated so much in bank deposits, banks are short of funds to lend! This has contributed to a liquidity crunch for the economy, with banks increasingly unable to lend to businesses and consumers. And this is causing a drop in both business and bank profits, thus further depressing the economy and shrinking available funds even further. A vicious spiral downward has taken hold, which cannot be halted no matter how much further interest rates are cut.

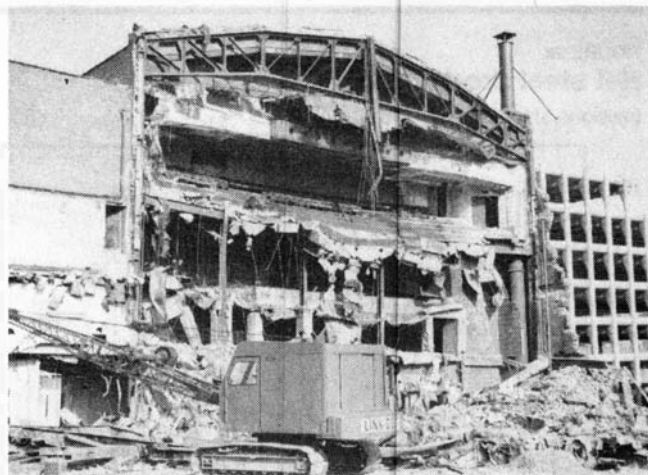
And the recent rate cut won't appreciably help consumers. The extra \$34 a month from lower mortgages, for example, that each household will now have available to spend, translates to just over \$1 billion monthly—a negligible increment in the \$2 trillion worth of annual consumer expenditures.

Furthermore, the escalating federal deficit means that the Treasury has to borrow more and more money in the markets. But the lower interest rates go, the harder it will be to market this debt, despite the relative "security" of Treasury issues. The word from abroad is that international investors, who have been the mainstay of the government debt market, are poised to jump ship for more profitable earnings outside the United States.

Of immediate concern is the upcoming \$38 billion or so needed for the quarterly federal debt refinancing. "The U.S. will need significant foreign investment, if it is to avoid having to raise interest rates in order to sell the \$38 billion or so of Treasury debt," one senior European bond market analyst told *EIR*. "The problem is, there is extremely low foreign interest," he said. "I know directly there will be very little Japanese interest. U.K. interest in U.S. Treasuries has dropped significantly in the past two years, especially since Britain linked sterling with the German mark. And the Germans are preoccupied at home with reunification. It could well lead to higher interest rates and strains in the financial system."

Physical economy worse than 1930s

Underlying this downward spiral in the financial markets is the utter collapse of the nation's real, physical economy. In the last year since the so-called recession was acknowledged to have begun, the downturn in key industries has paralleled that of the 1929-30 period, and portends a plummet like that of 1931. As in 1929-31, no amount of interest rate



Building being torn down in the former steel town of McKeesport, Penna. Lowering interest rates won't save the banks or rebuild collapsed industry.

reductions can overcome the domino-like bankruptcies and enormous debt crippling these industries.

Lest someone point out that the industrial drops over the past year are not so severe as in the Depression, it should be emphasized, that unlike the beginning of the Depression in the 1930s, U.S. physical plant and equipment and capital goods production facilities have been subjected to a far longer period of disinvestment and deterioration. While the policies pushing the economy toward a post-industrial society and rampant speculation actually began in the late 1950s, this tendency did not become dominant policy until the 1973 oil hoax and the vicious recession that followed. As **Figures 2 through 6** exemplify, many industries peaked or were near their peak output at the beginning of the 1970s, and therefore the current decline should be seen from that standpoint.

Nor can one argue that the recessions of 1973-74 and 1981-83 were just as bad, but did not turn into full-fledged financial and economic collapse as in the 1930s. Unlike those periods, there is now no external source of loot sufficiently large enough to prop up the overbloated paper holdings of the financial sector. In the 1970s oil-driven recession, banks and large corporations were able to make a killing by depressing the standard of living in the advanced sector while raking in piles of loot from abroad due to higher oil prices and accelerated debt and interest tribute. The Third World in particular has borne the brunt of this looting, which intensified in the 1980s with the disintegration of Third World development prospects and its leadership.

No source of loot can now mitigate the hemorrhaging of U.S. industry. The two drivers of the U.S. physical economy—automobile manufacturing and home building—are collapsing at a pace unseen since the 1930s. The Big Three

FIGURE 2a
Net steel production
 (millions of tons)

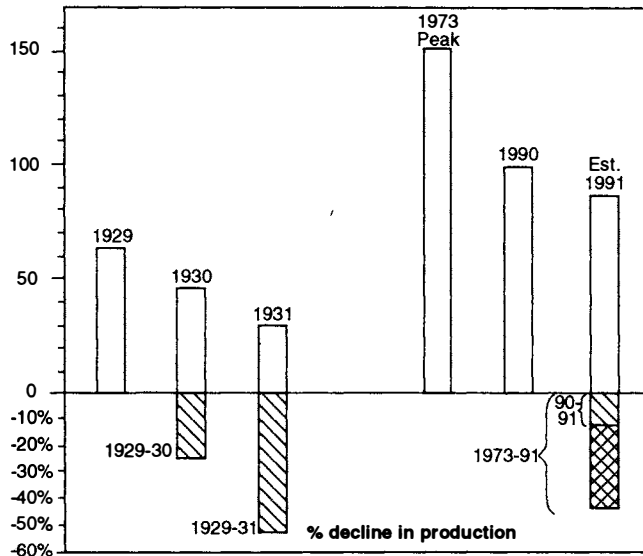


FIGURE 2b
Steel production per capita
 (Pounds per capita)

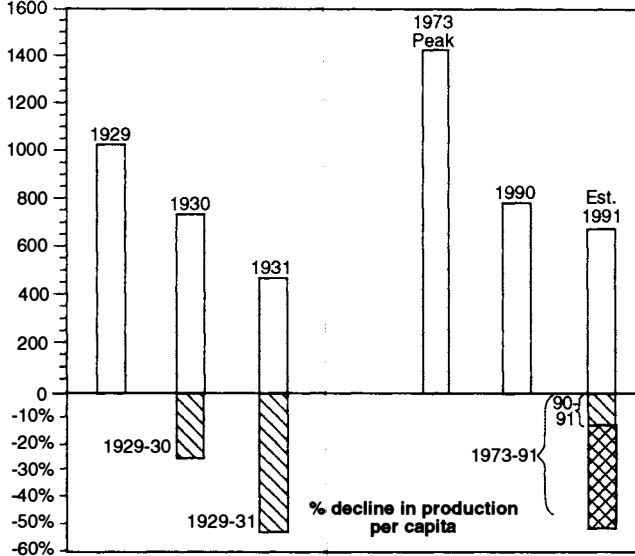


FIGURE 3a
U. S. auto production
 (# of vehicles)

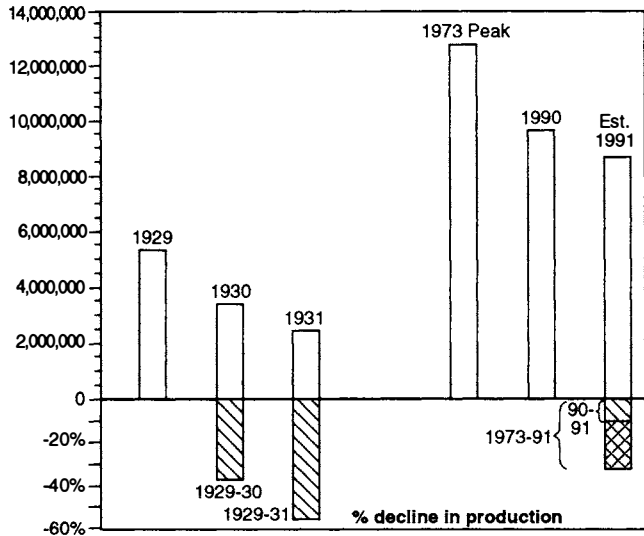
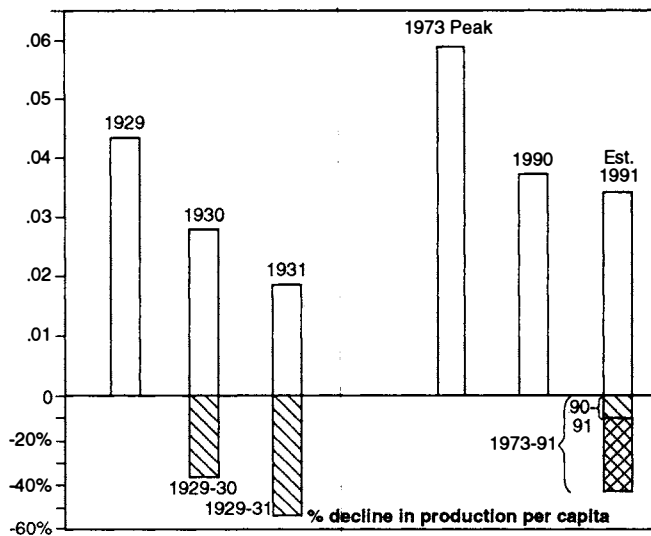


FIGURE 3b
U.S. auto production per capita



U.S. automakers will lose something in the range of \$6 billion this year, by far their worst financial performance in history. Domestic auto production is down 10% in 1991, while home building has dropped nearly 27% since 1989. The steel industry, similarly, is facing a 13% decline.

Even more telling, however, are current output figures compared with the peak output of these three industries, which all occurred in the 1970s before the oil crisis. This

reveals why the current "recession" is indeed a depression threatening to surpass that of the 1930s. From their peaks in 1973, auto and steel production have plummeted 32% and 43%, respectively. In 1973, the U.S. manufactured nearly 12.7 million cars and 151 million tons of steel. In 1991, these industries are on track to produce only 8.6 million cars and 86 millions tons of steel.

The drop in home building is even more spectacular. In

FIGURE 4a
U.S. auto & truck sales of domestically built vehicles

(# of vehicles)

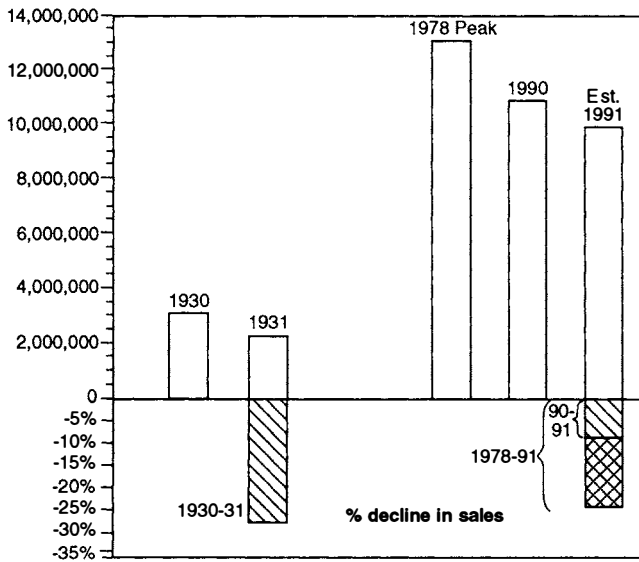


FIGURE 4b
U.S. auto & truck sales per capita of domestically built vehicles

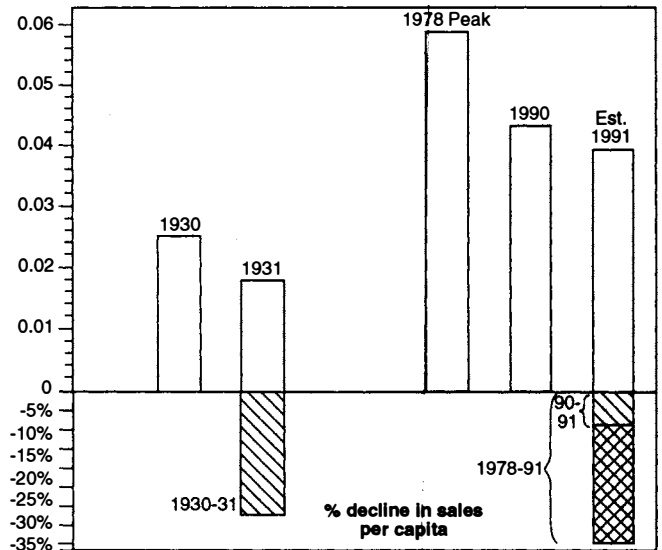


FIGURE 5a
Home building industry: housing starts

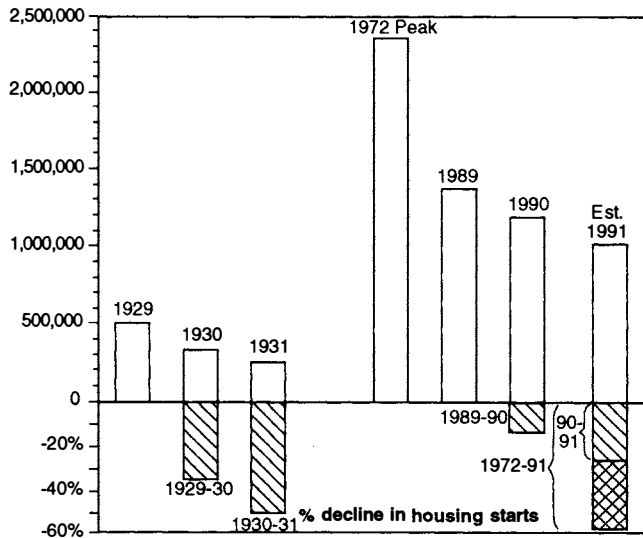
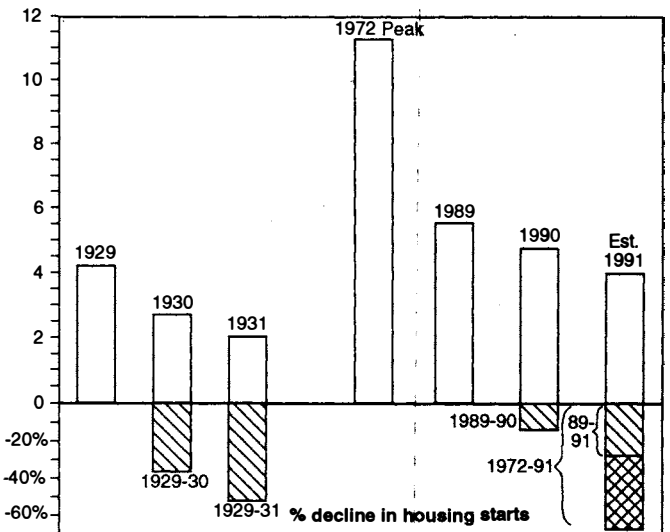


FIGURE 5b
Home building industry: housing starts per capita
 (thousands)



1972, there were 2.4 million housing starts. This year, the housing industry will be lucky to break 1 million—a 57% collapse.

In terms of output per capita, the figures are even worse because the population is greater. Per-capita steel production this year will amount to only about 681 pounds per person—less than even in 1930—as compared to 1,427 pounds per

person in 1973. This is some 52% below the 1973 level—that is, the U.S. will produce less than half the amount of steel per capita than it did 18 years ago. Auto production per capita is estimated to plunge some 43%, and is now below that of 1929. Housing starts per capita are now barely *one-third* those made in 1972, while the amount of lumber per capita being produced is now verging on 1931 levels.

FIGURE 6a
Lumber production
 (millions of board feet)

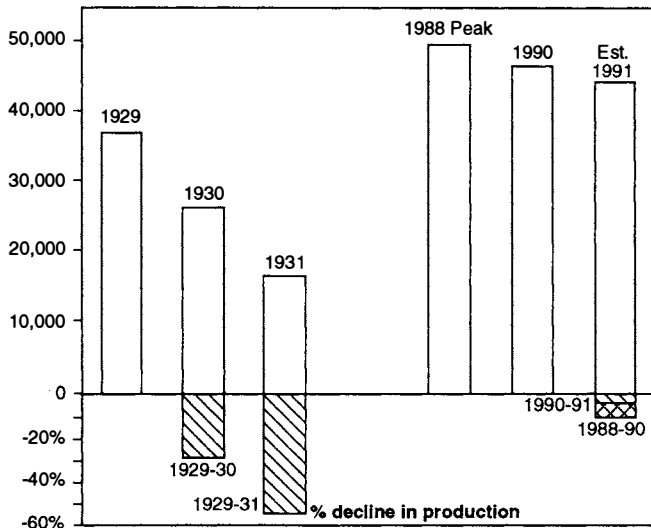
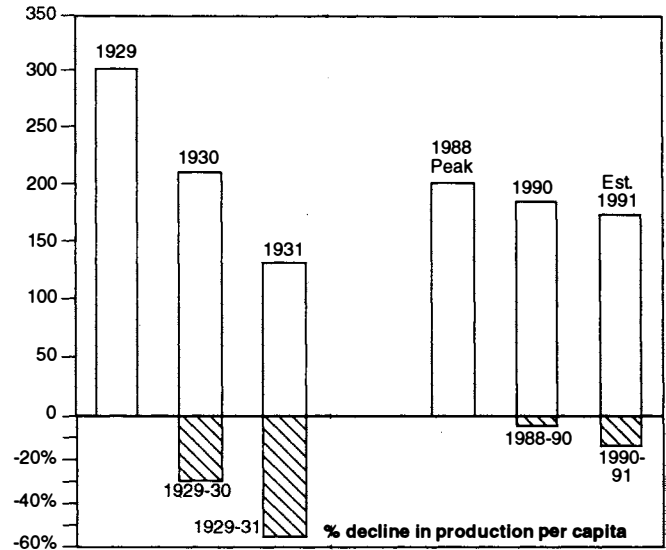


FIGURE 6b
Lumber production per capita
 (bd ft/capita)



No more workers

But more telling than all the numbers involving the collapse of production is that the productive base of the economy—the skilled U.S. manufacturing work force—is not only at its lowest level, relative to the total population, in the postwar period; it is below the level of 1931, and closing in fast on the depths of 1932 (see Figure 7).

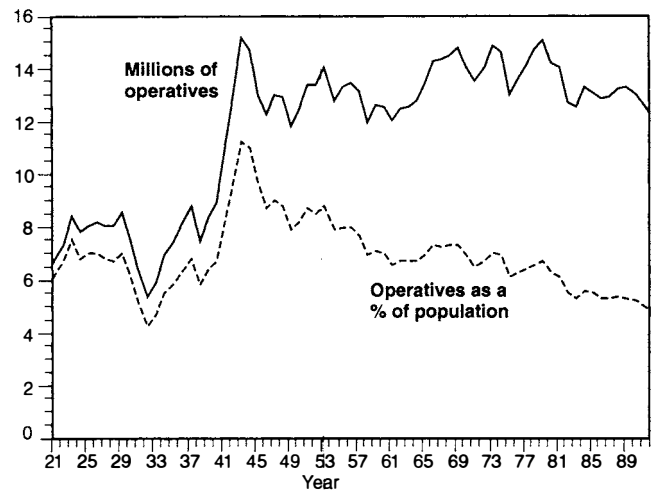
For most of the 1920s, the number of U.S. manufacturing production-line workers hovered around 8 million. This was about 7% of the total population, which meant that between 14 and 15 people in the general population were “supported” by each manufacturing operative. But when the Depression struck, the number of such operatives plunged to just 5.3 million by 1932. Thus, only 4.3% of the population was engaged in manufacturing production—fewer than 1 in 22 people.

With the war mobilization, the number of manufacturing production workers peaked in 1943 at 15.147 million, or 11.2% of the population. That means that more than one in nine Americans were manufacturing operatives.

This ratio has been falling ever since. In the 1950s and 1960s, the number of such workers ranged between 11 and 15, roughly the same level as in the 1920s. But by the 1970s, the manufacturing surge generated by President Kennedy’s space program and investment tax credit policy was aborted by the shift to the post-industrial society and financial speculation.

By 1975, the proportion of production manufacturing workers began to drop even more sharply. In the 1970s, the ratio of these operatives was 1 for every 14-17 Americans; by the 1980s, this had fallen to 1 in every 18-19. Now, in 1991, the ratio is fewer than 1 in 20 Americans, most of whom contribute nothing to the real physical wealth of the nation.

FIGURE 7
Manufacturing production workers
 (in millions of workers)



Source: Employment, Hours, and Earnings, US 1909—present Establishment Survey Data of Bureau of Labor Statistics (Annual average of monthly data; not seasonally adjusted)

This is a level not seen since 1933.

That is the most important measure of this depression, and ultimately the most important reason why no amount of financial manipulation and interest rate shenanigans can forestall a collapse this time around.