John Hoefle

Virtual reality, real psychosis

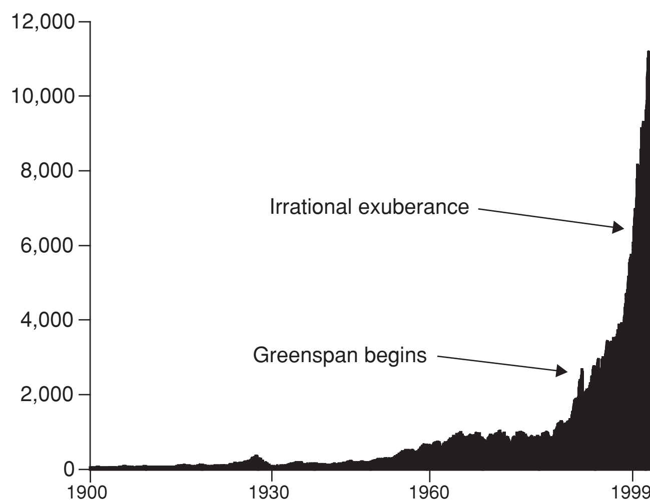
Alan Greenspan walks into a bar, and orders an expensive glass of champagne and some pretzels. The next morning, the *New York Times* carries the banner headline, "Greenspan Expects Economy to Expand, With Some Twists and Turns."

Greenspan is, after all, the financial genius of our times.

His every utterance is studied for hidden meanings, secret codes. (My favorite method is to take the *Washington Post* coverage of his speeches, cut it up into tiny strips, and read it like tea leaves.)

Look at Greenspan's amazing record. When he was sworn in as chairman of the Federal Reserve in 1987, the Dow Jones Industrial Average was at 2,700 points. Today, its over 11,000 points (**Figure 1**).

FIGURE 1
The Greenspan bubble
Dow Jones 'Industrial' Average



Source: Dow Jones.

The Dow has nearly doubled since he warned of "irrational exuberance" in late 1996. God only knows where it would be today, were he not so successful in keeping it under control.

Under Greenspan, the U.S. economy has become the envy of financial parasites all over the world. We have a derivatives market second to none, a stock market well beyond reason, debt levels that make the bankers drool, and enough jobs so that everyone can have two or three. Greenspan may not be able to walk on water, but he has certainly shown he can run right over the edge of the cliff without falling.

The Fed chairman hasn't done this all by himself, however. He's had plenty of help from some of the brightest minds in the business, including the rocket scientists on Wall Street who figured out that you could sell enormous amounts of derivatives, issued by bankrupt banks, and backed by worthless paper.

Take Robert Merton and Myron Scholes, who won the Nobel Prize in Economics for nearly blowing up the global financial system. The pair won the prize in 1997 for developing "a new method to determine the value of derivatives."

Here's an example of their work (**Figure 2**).

What gobbledygook!

At the time they won the prize, Merton and Scholes were partners in Long-Term Capital Management, the big hedge fund that, using their formula, managed to turn millions of dollars of capital into billions of dollars in losses, on trillions of dollars in derivatives bets. It lost so much money that the Fed and the banks had to step in and bail it out, lest it default on its derivatives and set off a chain reaction of derivatives defaults which could have wiped out nearly every major bank in the world. This prize-winning nonsense is, arguably, the worst betting system ever devised.

That's not so surprising, given the track record of the Royal Swedish Academy of Sciences, which awards the Nobel Prize. In the past, they've awarded the prize to defenders of slavery and feudalism.

If they were honest, they'd revoke all the economics prizes they've awarded in the past—except for the one given to Maurice Allais—and give one to Lyndon LaRouche. But the oligarchs of the Royal Academy are not trying to spread the truth, but to hide it.

Insanity of the markets

We live in a world gone nuts, where fiction is pretty strange, and truth is stranger still.

FIGURE 2
Black-Scholes' derivatives formula

$$C = SN(d) - Le^{-rt}N(d - \sigma\sqrt{t})$$

where the variable d is defined by

$$d = \frac{\text{tn}\frac{S}{L} + \left(r + \frac{\sigma^2}{2}\right)t}{\sigma\sqrt{t}}$$

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Take the following truism, which you can find on the business pages of virtually any major newspaper at least once a year: "In a free market, the true value of assets is accurately established by the actions of investors. If an asset is overvalued, investors will stay away, causing the price to drop; if an asset is undervalued, investors will buy, causing the price to rise."

The only problem with that statement is that none of it is true—none of it.

Free market? What free market? It doesn't exist. The markets are largely the creation of the international financial oligarchy, which uses them as a battering ram against the nation-state, and a way to pick people's pockets. The oligarchs routinely organize raids on nations as a way of bailing out their banks—the European currency crisis of 1992 pumped billions of dollars of revenue into the bankrupt U.S. banks, and made George Soros's reputation as "the man who broke the pound sterling." But then, as now, Soros is just a front man—a nasty one to be sure, but merely a front for something much larger and even more evil. The so-called Asian crisis of 1997 was another bankers' manipulation, as was the central bank intervention of 1998, and the intervention under way today. It's insider trading on a scale that would make Ivan Boesky turn green with envy. Free? Only in the sense that the oligarchs are free to steal.

Investors? What investors? Virtually all of what is called investing today is really speculation, bets on the movements of stocks, bonds and currencies. Investors are people who put money into an enterprise in order to increase its usefulness to society. But the markets today are a giant casino, where gamblers place bets that some things will rise, and others will fall. And since this casino is rigged, the advantage goes to the insiders. So you can call them thieves and suckers, but not investors.

True value of assets? You've got to be kidding. The real economy of the U.S., the physical economy as measured in terms of physical inputs and outputs per capita, per household and per square kilometer, has fallen by some 50% since the late 1960s. The Dow back then was hovering just under 1,000 points, which means it should be—according to the economic fundamentals—at about 500 points today. Of course, that doesn't count inflation, the looting of foreign countries and the cannibalization of what was once the most powerful industrial economy in history. But still, anyone who claims that today's bubble reflects the "true value of assets" is a damn fool.

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The Internet

The *Wall Street Journal* recently ran an op-ed which claimed that the Internet was more important to the economy than the Federal Reserve. In a sense, that's true, since at least some aspects of the Internet are useful. But the idea that the Information Age is the natural successor to the Industrial Age, is dangerously wrong.

This is especially clear in that yuppie fantasy of the day, on-line investing. It is widely claimed that, due to the proliferation of electronic and printed financial information, the individual investor now knows as much about what is going on in the markets as the professionals on Wall Street. Thanks to the Internet, cell phones and pagers, the average individual can follow the market as closely as the traders at a Wall Street investment bank. Everyone is now an insider. And if you believe that, I have a bridge for sale.

Much has been said recently about the dangers of day-trading. Now day-trading is insane, certifiably insane. You have guys—mostly men, but some women—sitting at computer terminals in freelance trading rooms, buying and selling stock like mad. Some of these geniuses make as many as 500 trades a day, buying shares of a company and selling them minutes, even seconds, later. Most of them neither know, nor care, anything about the companies upon which they bet—all they care about is making money.

In a typical day-trade, the "investor" will buy a few thousand shares of a company, wait for the stock to go up one-sixteenth or one-eighth of a point and then sell. "Long-term" to a day-trader means holding on to a stock over lunch, assuming they even take a lunch break. The day-trading firms, the companies which rent out trading terminals to individuals, often deliver lunch, so the suckers can keep trading. This is a trick they learned from the casinos, which long ago figured out that you do whatever it takes to keep the bettors at the table.

Still, when the Wall Street investment banks and the Securities and Exchange Commission attack day-trading as gambling, you'd better have plenty of salt on hand.

"Some argue day-trading is really nothing more than speculation," Securities and Exchange Commission Chairman Arthur Levitt noted in a speech to the National Press Club in Washington, D.C., on May 4, 1999. "Personally, I don't think day-traders are speculating because traditional speculation requires some market knowledge. They are instead gambling, which doesn't."

Think about that: "traditional speculation." George Orwell would love that one.

After all, day-trading and on-line investing are merely the

FIGURE 3
Microsoft vs. the banks
($ billions)

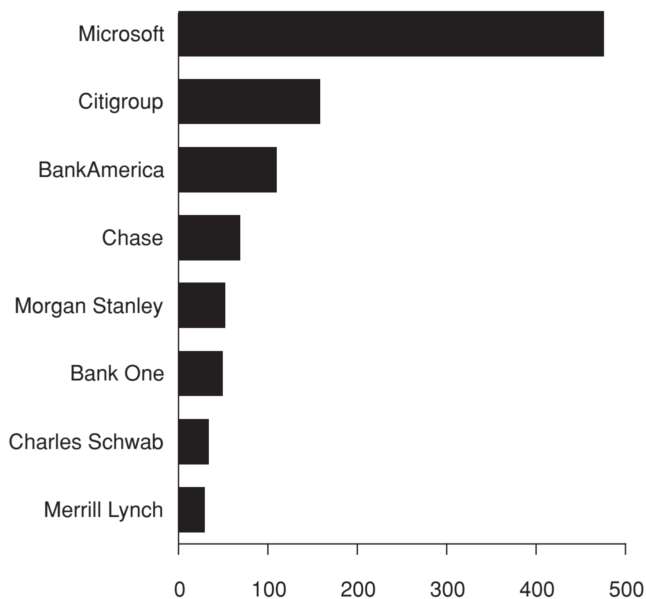
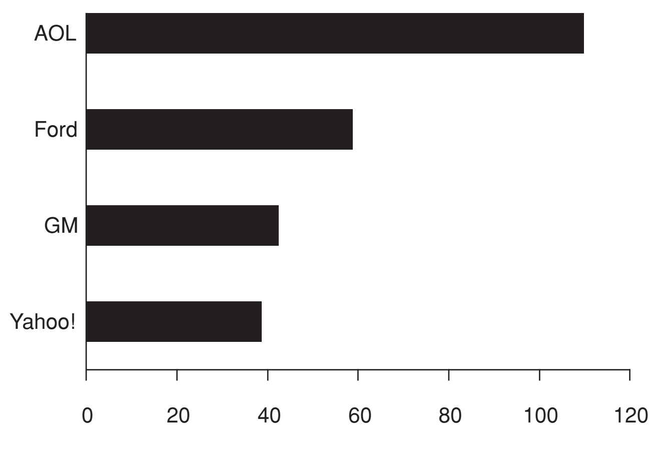


FIGURE 4
Internet vs. industrial market capitalization
($ billions)



extension to the individual, of the practices of Wall Street. Today, everybody's getting into the act, from Grandma to the kids. There are now even summer camps, where kids are taught how to play the markets. Suckers may not be born every minute, but they're certainly being trained.

The markets are nothing but a giant casino. The gambling psychosis is so pronounced in the West that the recent World Congress of Psychiatry held a session on the matter. One professor said his clinic was filled with patients who had developed "perfect" gambling strategies—the only reason they were in the clinic instead of the penthouse, these patients believed, is that they hadn't yet fully mastered their perfect system. Other patients blamed their problems on "bad luck." Former German Chancellor Helmut Schmidt put it more bluntly in a recent editorial, saying that the Wall Street boom was "based on actions by psycopaths."

In a properly functioning economy, the most valuable industries would be those which make things, which transform less valuable inputs into more valuable outputs, thereby creating wealth and increasing the productivity of society as a whole. That's not exactly the way it works today.

The most valuable corporation in the world today, in terms of market capitalization, is Microsoft—the first company in history to top $500 billion (**Figure 3**). (The bugs in Windows alone must be worth at least $100 billion.) Microsoft is worth more than the top five U.S. banks combined, which gives you a clue as to why it is under attack by the Justice Department. The banks are terrified that, should their dream of on-line banking ever take off, Microsoft would take over. Bill Gates is personally worth more than Chase Manhattan and J.P. Morgan combined—but then, many of you are, too, were honest accounting practiced.

Even with the recent, orchestrated declines, the Internet stocks are astonishingly high (**Figure 4**). America Online is now one of the 25 largest companies in the country, in terms of market value, bigger than Ford and General Motors combined. Why? In part because of the foolish belief in the Information Society, and in part because our manufacturing base is collapsing, and many people can't afford new cars. Fortunately, those who can't afford a car to get to the store can always get their groceries over the Internet.

Yahoo!, the Internet portal and search engine, is comfortably in the top 100 in terms of market capitalization, nearly as big as General Motors, and nearly double the size of Caterpillar.

If you think that's nuts—and you're right if you do—take a look at eBay, the on-line flea market, where people can auction off Beanie Babies, Pokemon paraphernalia and all sorts of odds and ends (**Figure 5**). Even though its computers have been crashing regularly—a major problem for an Internet company—eBay is still valued at some $16 billion, making it almost twice as large in terms of market capitalization as the top five U.S. steelmakers combined! Pretty soon, you'll be able to buy the steel companies on eBay—assuming its computers are up.

There's been a lot of talk lately about this "Internet bubble," but calling the Internet stocks the problem is a lot like pointing at a rock on top of Mt. Everest and calling it

FIGURE 5

Flea market vs. steel market capitalization

($ billions)

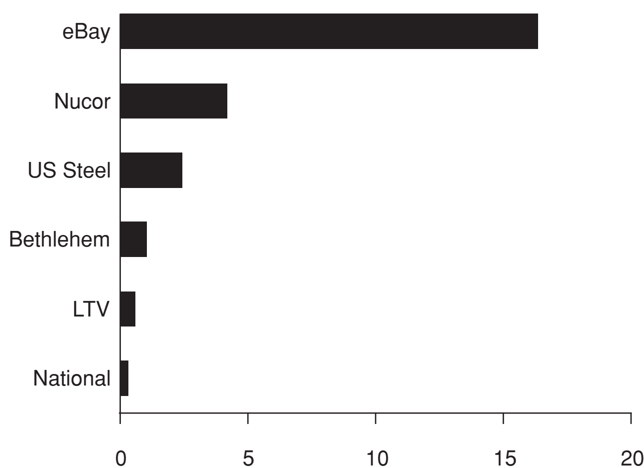
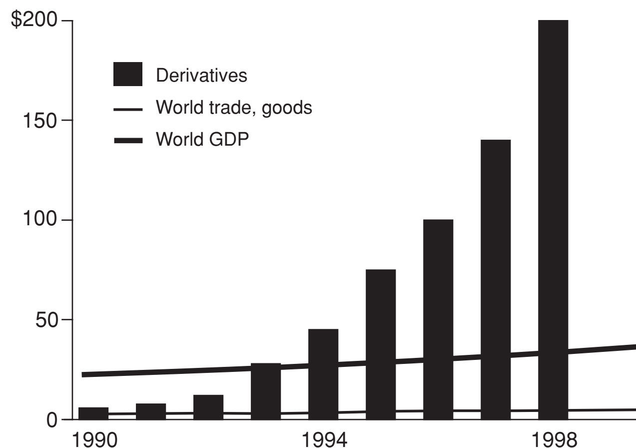


FIGURE 6

Growth of the bubble: derivatives vs. world trade and output

($ trillions)



Sources: IMF, *EIR.*

a hazard to aviation. Its the mountain, not the rock, that's the problem.

Derivatives

In this case, the mountain is made up of derivatives and related financial instruments.

The growth of the derivatives market is astonishing (**Figure 6**). According to the International Monetary Fund (IMF), world trade in goods totalled $6 trillion in 1998, and gross world product was $41 trillion, compared to what we estimate was some $200 trillion in derivatives bets. Overall there are some $300 trillion in financial claims outstanding, with more than $4 trillion in financial bets placed every business day. That puts annual financial turnover—the sum of all these bets—at over $1 quadrillion ($1,000 trillion)—some $150-200 in turnover for every dollar of trade in goods.

The world derivatives figure is our own estimate. It's not entirely clear that anyone knows the actual number, and if they do, they're trying to keep it a secret. All the official figures are designed to hide, rather than reveal, the truth. The bankers call this "transparency."

What are they doing with these derivatives? Hiding losses, rolling over unpayable debt. Look at Crédit Suisse, which was caught red-handed in Japan selling Japanese companies derivatives expressly designed to hide losses. One former Morgan Stanley derivatives salesman metaphorically described the process this way:

> You combine $90 worth of gold and $10 worth of lead into a bar. You then sell half of the bar—the half which contains all the gold—for $90. Since you paid $100 for the whole bar, and $50 for each half of the bar, you book a $40 profit. After all, you paid $50 for that half-pound and sold it for $90, so you made $40, right? Of course, you're left with a half pound of nearly worthless lead, which you're carrying on your books as being worth $50, but that can be hidden. What counts is that you made a big profit, up front. At least, you claim you did.

That type of fraud, applied to paper assets, is what the derivatives market is all about.

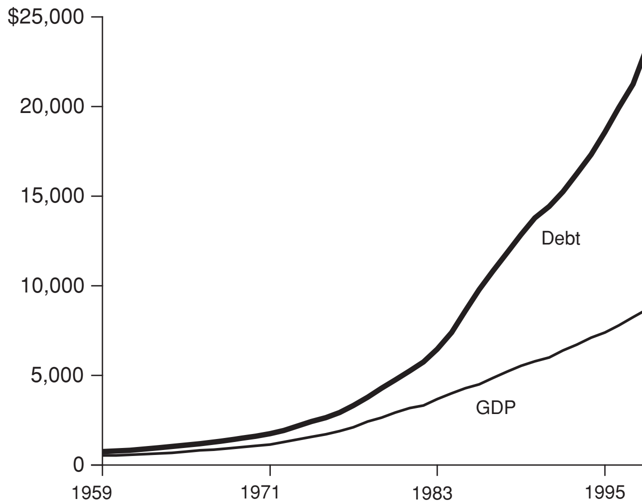
This is the "traditional speculation" which SEC Chairman Levitt defends.

Deeper in debt

In the United States, the great economic boom of the 1980s and 1990s, has been accomplished by going $3 in debt for every $1 increase in GDP (**Figure 7**). But only one-third of GDP represents productivity and two-thirds represents overhead, and virtually all of the growth over the last decade has been in the overhead sector. We've actually been increasing the debt while shrinking the productive sector. This process of going ever deeper in debt, while destroying our ability to pay that debt, is what economists call sound economic fundamentals.

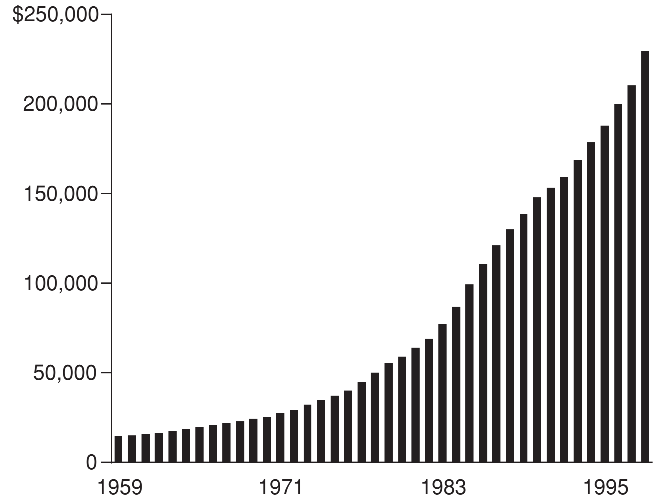
The decline in the productive sector has triggered a decline in real wages for most Americans, who have been forced to go deeper and deeper into debt to make up for shortfalls in income (**Figure 8**). Total credit market debt in the United States now stands at over $23 trillion, or some $230,000 for

FIGURE 7
Growth of debt vs. growth of GDP
($ billions)



Source: Federal Reserve.

FIGURE 8
U.S. debt per household
($)



Source: Federal Reserve, *EIR*.

every household in the country, compared to $10 trillion in debt and $115,000 per household when Alan Greenspan took over at the Fed.

When debt rises and real income falls, bankruptcy can't be far behind, and it hasn't been. More than 1.4 million bankruptcy petitions were filed in 1998, of which 96% were personal bankruptcies (**Figure 9**). Over the last seven years, some 7.7 million personal bankruptcies have been filed, or about 1 bankruptcy for every 13 households. Since Alan Greenspan took office, more than 11 million Americans have filed for personal bankruptcy, and nearly 700,000 businesses have filed.

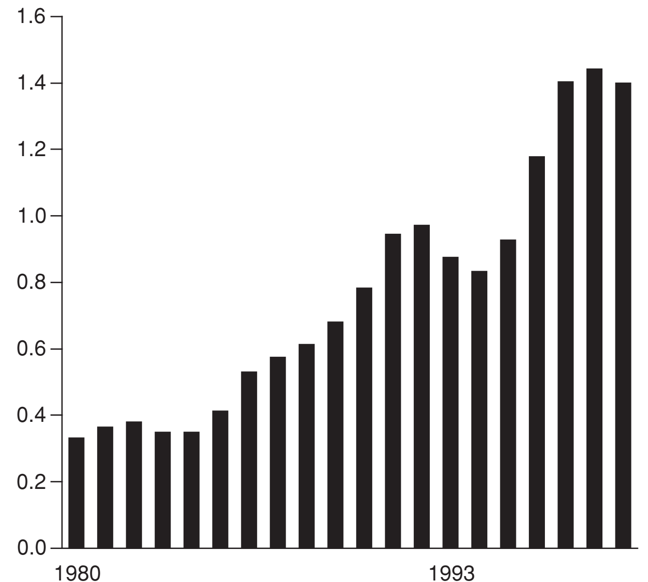
One of the linchpins of the assertion that the U.S. economy is "fundamentally sound," is the presumption that rises in asset values create wealth. That is, if the value of all stocks listed on the stock exchanges was $15 trillion yesterday, and rises to $15.1 trillion today, then $100 billion of wealth has been created. By this standard, the U.S. stock markets are amazing wealth-creation machines. When Alan Greenspan took over at the Fed, the capitalization of all stocks on U.S. markets was $3 trillion. Today, the stocks are worth $16 trillion, a five-fold increase (**Figure 10**).

There's a small problem with this rosy picture, however. Stocks do not create wealth.

In a speech late last month at a Federal Reserve conference in Jackson Hole, Wyoming, Chairman of the Bubble Greenspan stated, "At, root, all asset values rest on perceptions of the future. A motor vehicle assembly plant is a pile of junk if no participants in a market economy perceive it capable of turning out cars and trucks of use to consumers and profit to producers."

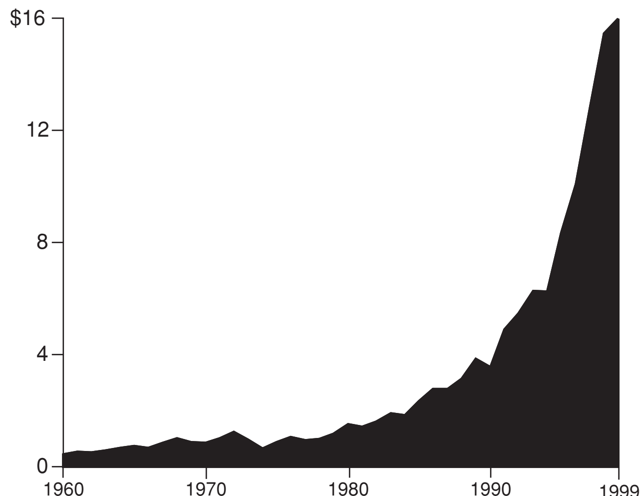
Now we're getting to the heart of the matter: a bubble has formed in Greenspan's brain.

FIGURE 9
U.S. bankruptcy filings
(millions)



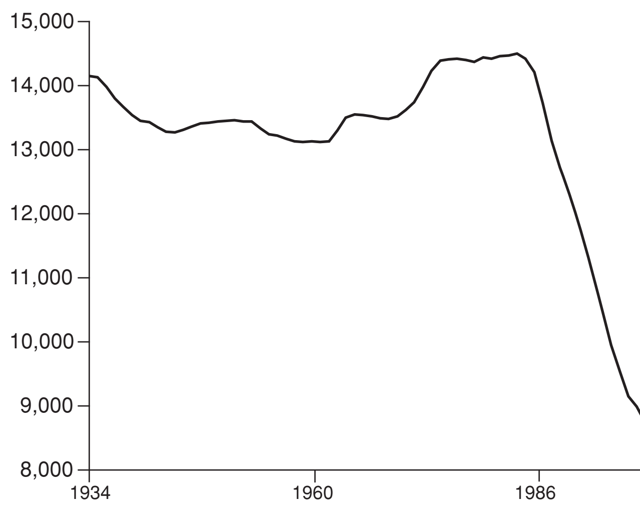
Source: Administrative Office of the U.S. Courts.

FIGURE 10
Capitalization value of stock traded on U.S. market
($ trillions)



Source: Federal Reserve.

FIGURE 11
Number of U.S. banks



Source: FDIC.

The idea that reality is determined by perceptions is one of the more pervasive idiocies of our time.

The truth is that a plant which produces motor vehicles has value no matter what Wall Street thinks, and regardless of whether or not it makes a profit, because the production of motor vehicles is inherently useful. The plant can lose money and still be productive, in real economic terms. It's the effect on the economy, not the investors, which counts.

A steel plant, even the most outmoded, inefficient plant in the world, has more value than eBay, because it produces steel, which is necessary for human survival. We can live without eBay—at least most of us—but we can't live without steel.

Wall Street lives by a simple philosophy: If it makes money for us, it's good; if it doesn't, it's bad.

In such a warped world view, full employment is bad, because it increases the chances that companies will have to pay higher wages to attract and keep employees; for Wall Street, having a big pool of unemployed workers is good, since anyone who dares to demand a decent wage or decent working conditions can be easily replaced. Therefore, when employment goes up, the market goes down, and when employment goes down, the market goes up.

The same thing occurs when the production indices—which should never be confused with actual production—go up. Rising production increases the chances that the economy will "overheat" from growing so fast, thereby increasing the likelihood that the Fed will raise interest rates to cool things off.

This is truly virtual reality: Those things which are actually good for society—such as a rising standard of living and rising productivity—are considered bad, and those things which are bad for society—like a declining standard of living and falling productivity—are considered good. All that counts to the fleas, is their money. To hell with the dog.

It is, in a word, psychotic.

Post-crash positioning

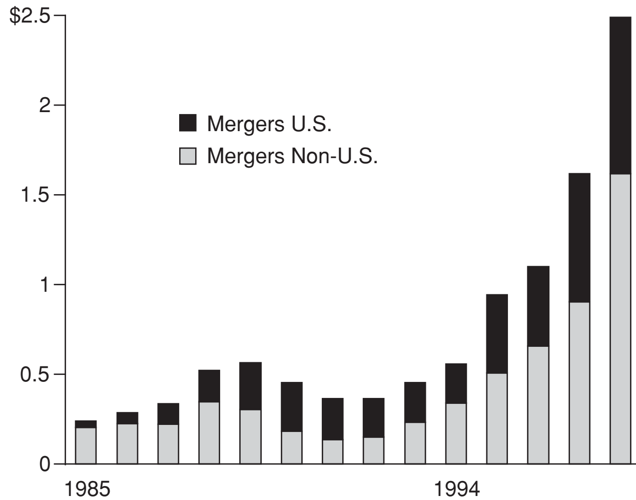
Sooner or later, such a system must inevitably collapse, and we have now reached that point—we have entered the zone of instability which marks the end of the present system. The party is over.

Look at the pace of mergers in the financial world, where the big banks are in a mad dash to become too big to fail. After all, the big banks don't go bankrupt, they merge (in the trade, its called mergers and acquisitions, or M&A for short, but to the households affected, its closer to S&M). We have the formation of the world's first trillion-dollar bank in Japan, and the failed attempt to create a trillion-dollar bank in France. All over the world, the number of banks is shrinking rapidly, as the drunks lean against each other to keep from falling down.

In the United States, the number of banks has dropped by some 40% since the mid 1980s, but even that doesn't tell the whole story: The big banks are swallowing each other at an incredible rate, usually in shotgun marriages arranged by the Fed.

As the bubble grew, a whole group of financial institutions

FIGURE 12
Global cartelization
($ trillions)



Source: Thompson Financial Securities Data.

grew up with it, institutions of seemingly great power (**Figure 11**). Now that the bubble is dying, those same institutions are now threatened with extinction, and are fighting for their lives. They won't make it. These seemingly all-powerful giants are crumbling before our very eyes.

The more clever among the oligarchs have been preparing for the crash by buying up control over the necessities of life, so that after the crash—after all the paper wealth has evaporated and all the suckers have been ruined—they can control what is left of the world. That is the reason for the bloody wars along the Great Rift mineral belt in Africa, and the reason for the surge in mergers among industrial companies in recent years (**Figure 12**).

There are those among the oligarchy who, after all, understand that those who control the raw materials, the strategic minerals, the precious metals, the energy and water supplies, and the means of production of those items, control the destiny of mankind. After the crash, they plan to use their control over these necessities of life to consolidate their control over humanity.

This is what is behind the escalating pace of mergers in oil, food, telecommunications, pharmaceuticals, chemicals, aluminum, copper, and energy and water utilities.

The old system is gone, finished. The question is: What will replace it? A return to the days of the empire? Or a leap into a new Renaissance? To repeat the errors of the past, is to doom the world to feudalism and a new Dark Age. Better that we learn from the best lessons of history, and build that new Renaissance. Let us choose reality over psychosis.

Marcia Merry Baker

U.S. farms, factories, 1960s and 1990s: a real economy documentary

How real is reality to you? We have prepared a mini-documentary on the United States at two points in time—1960s and 1990s, at two representative locations: a farm county and a factory town.

This is meant as a reality check for us all, given our historic challenge to enable others to truly see reality and act on it. But as we go along, I will repeat some of the voices of *unreality* (shown below, indented in italics). See if they sound familiar.

I. A U.S. farm county, 1960s and 1990s

We begin with a farm county in the 1960s, perhaps in the Midwest, central Florida, or elsewhere. We are not using dollar figures yet for income (**Figure 1**). Can someone farming support a family in the 1960s? Yes. In the 1990s, no—unless he or she and others work *off* the farm at something else, and as of right now, 1999, you maybe can't make it even then.

Take just the price of one farm-produced commodity—durum, which is a very important hard wheat, because it is used for pasta! The price for a bushel of durum wheat in the 1960s was $3.10. Today, it is $2.70! Straight, unfiddled-with dollars. In the 1960s, to buy a combine-harvester—nothing fancy, it took 2,000 bushels of durum. Today, a new harvester—not the biggest and fanciest—takes 59,000 bushels. That tells you something.

Here in **Figure 2,** you see that over time, the prices a farmer must pay for farm inputs—tractors, fertilizers, buckets, pumps, seeds, breeding stock, veterinary medicines, and so on—goes up way higher than the prices the farmer receives

FIGURE 1
Farming in America

	1960s	1990s
Support a family?	Yes	No
Prce received—durum wheat, bu	$3.10	$2.70
Price paid—combine harvestor	2,000 bu	59,260 bu