

Rollover of U.S. Debt Will Yield Weimar Hyperinflation

by Richard Freeman and John Hoefle

The spiralling growth in U.S. debt, and thus the requirement to service or roll over the debt, is creating the conditions, in the United States and globally, for the eruption of a hyperinflation of the type that ravaged Weimar Germany from March through November 1923. By the end of 2001, total U.S. debt had reached \$31.12 trillion. On average, over the last four years, U.S. debt has surged at the rate of \$2.2 trillion per year, or almost \$200 billion per month.

The debt pyramid has grown so large, that it is unsustainable, and all attempts to service it will not work. Moreover, every such attempt further destroys both the underlying U.S. physical economy, and its bankrupt financial system. *EIR*'s economics staff has determined, preliminarily, that by the end of 2001, on this outstanding debt, America's annual debt service—the interest payment, plus re-payment of a portion of the principal—had reached an unprecedented \$7.36 trillion. This is equivalent to a staggering 72.1% of Gross Domestic Product.

The United States had gotten itself into such a situation, by being guided by a “post-industrial society” policy for the past 30 years.

On June 13, Presidential pre-candidate Lyndon LaRouche addressed the São Paulo Commercial Association in Brazil (see last week's issue). He focussed on the three major crises of Argentina, Brazil, and the United States, “each of which has the same problem, but with different specific characteristics.” While “Argentina is in the most advanced stage of explosion,” the U.S. problem could ultimately have the biggest harmful impact. All three countries are taking extraordinary measures to pay the debt, by undermining their national existence, a process that cannot be continued.

LaRouche presents the decisive solution, with his pro-

posal to put the world financial system through bankruptcy reorganization—in order to write off tens of trillions of dollars of this debt and other obligations—and replace the bankrupt system with a growth-vectored New Bretton Woods monetary-financial system.

Post-Industrial Society Policy

The U.S. debt bubble stems from the City of London-Wall Street financiers' imposition of a post-industrial society policy upon the United States in 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 severed 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 movement 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-indus-

trial process fostered the leap in debt, in a two-fold way. To understand this two-fold nature, it is necessary to make a distinction between productive and non-productive activity. Productive activity is man's activity engaging in manufacturing, agriculture, construction, transportation, mining, and infrastructure-building, which alters nature and manufactured goods for the purpose of man's advancement. This activity is raised to a higher level by man's discovery and transmission of scientific discoveries of fundamental physical principle. Non-productive activity consists of both necessary social services, and those activities which are a deduction from, and destructive to the economy, such as the growth of speculation; of non-productive, non-useful services; etc.

The post-industrial society policy built up debt in a two-fold way, for the non-productive side, and the productive side of the economy.

First, the non-productive side of the economy built a significant amount of debt. For example, many of the highly speculative leveraged buy-outs/acquisitions of companies, cited above, were financed with debt. In the 1990s, the foolish expansion of the dot-com and telecommunications sectors, and the "New Economy" as a whole, involved a mountain of debt. Many households in the upper 20% of households by income class, acquired loads of mortgage debt to purchase \$400,000 to \$1 million "McMansions," etc.

Second, the post-industrial society policy meant that many institutions and households had to compensate for the collapse of the productive side of the economy. In order to offset falling living standards, millions of households have built up debt to pay for housing, clothing, medical bills, furniture, and even food. To offset a contracting economy, many manufacturing firms and farms have had to borrow money to keep from going under, and to pay for new equipment, raw material supplies, and even to pay payroll.

Hence, the post-industrial society policy fostered both types of debt, for different but complementary reasons; the two types of debt merged, sending total debt spiralling upward.

The Surge in Household Debt

The total U.S. debt consists of three parts: 1) consumer debt, which includes mortgage debt for purchasing homes; consumer installment debt (furniture and car purchases); and credit card debt; 2) business debt; and 3) total government debt, Federal, state, and local.

The household debt has functioned to prevent living standards, and the U.S. economy, from plunging at a faster rate than they already are. **Figure 1** depicts total U.S. household debt growth from 1945 through the end of 2001. Notice that in the period from 1945-70, it was relatively small, and it did not exceed the level of \$1 trillion until 1978. Then, under the force of Volcker's high-interest-rate regime to enforce "controlled disintegration," it shot upward. By 1990, it was \$3.63 trillion, and today, it stands at \$7.72 trillion.

FIGURE 1
U.S. Household Debt
(\$ Trillions)



Sources: U.S. Federal Reserve Board of Governors, "Flow of Funds Accounts"; Office of Management and Budget, "Budget of the United States"; *EIR*.

The increase in total U.S. household debt of \$4.09 trillion during the last 11 years, financed the purchase of many consumer goods, as well as over-priced homes. It also left the population more burdened with debt than at any time in its history.

Figure 2 shows that the debt of all levels of government—more than 80% of which is the debt of the Federal government—has continued to grow, and at the end of 2001, had reached \$7.16 trillion. However, the rate of growth of combined government debt had decreased, and it has now been overtaken, in size, by the level of household debt. Still, the Federal budget deficit is sharply growing again.

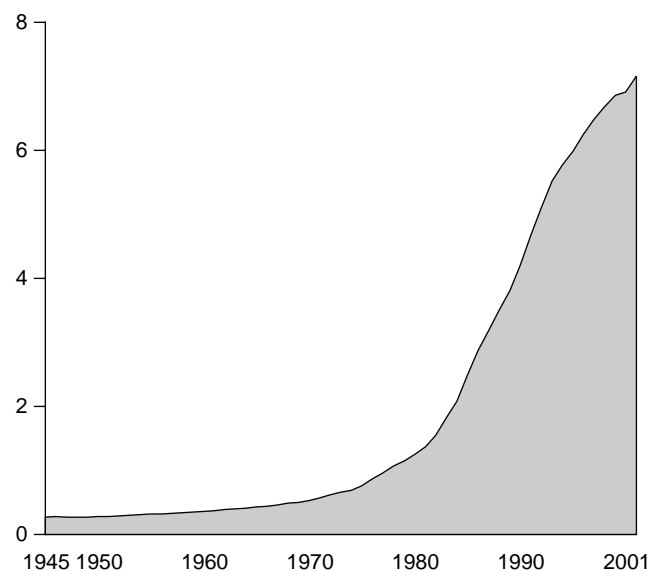
Figure 3 shows the growth of business debt, which is the fastest-growing debt of all. This consists of the debt of two types of business entities: *non-financial companies*, including corporations such as GM, GE, energy, and telecom companies, non-incorporated entities, and farms; and *financial companies*, such as banks, insurance companies, and the Federal National Mortgage Association (Fannie Mae). Financial company debt has shot upward. Between 1995 and 2001, total business debt rose from \$8.37 trillion, to \$16.30 trillion, doubling in only six years.

Figure 4 demonstrates that by the end of 2001, U.S. total domestic debt reached \$31.12 trillion. When one adds in America's foreign debt—which is approximately \$2 trillion, and which has been used to finance America's gaping current

FIGURE 2

All Government Debt (Federal, State and Local Gov't)

(\$ Trillions)

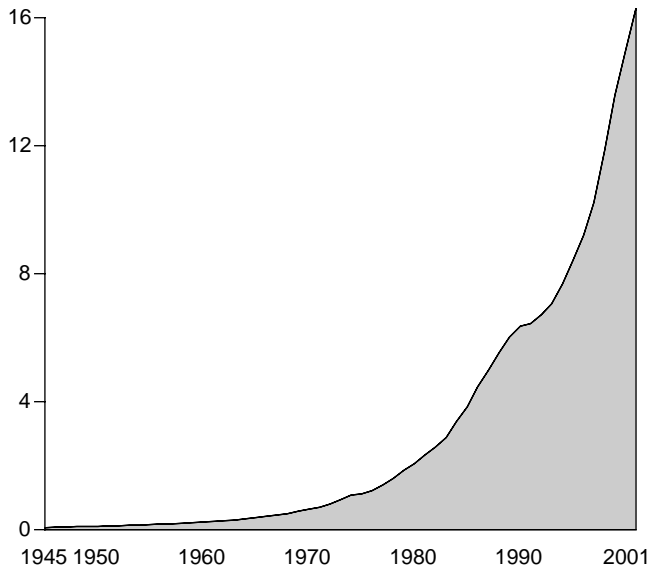


Sources: U.S. Federal Reserve Board of Governors, "Flow of Funds Accounts"; Office of Management and Budget, "Budget of the United States"; *EIR*.

FIGURE 3

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

(\$ Trillions)



Sources: U.S. Federal Reserve Board of Governors, "Flow of Funds Accounts"; Office of Management and Budget, "Budget of the United States"; *EIR*.

account deficit—then total U.S. debt is above \$33 trillion. Brazil has approximately \$550 billion in debt and outstanding dollar obligations, which is, relative to Brazil, a huge sum, and large enough to blow out the world financial system. But America's \$33 trillion is the "grandmother" of all debt.

The Rate of Increase

EIR's economics staff has looked at ways to show the increase in the growth of U.S. debt, and its destructive effect upon the economy and financial system.

Figure 5 shows the ratio of the increment in the dollar volume of U.S. debt, to the increment in the dollar size of Gross Domestic Product, for each year. In the case of a decade like the 1970s, it is the average of all the years in that decade.

Throughout the 1970s, for every dollar of increase in GDP, there was \$1.75 increase in debt; throughout the 1990s, for every dollar of increase in GDP, there was \$3.60 increase in debt. In the 2000-01, this average jumped to \$4.91.

Buttressing this point, *EIR* also determined that the annual debt service on America's debt is approximately \$7.36 trillion. The annual debt service consists of the sum of the interest payment, plus the part of the principal that must be repaid each year. In determining this debt service, *EIR* consulted and cross-checked with more than a dozen economists and experts from U.S. government agencies and private institutions.

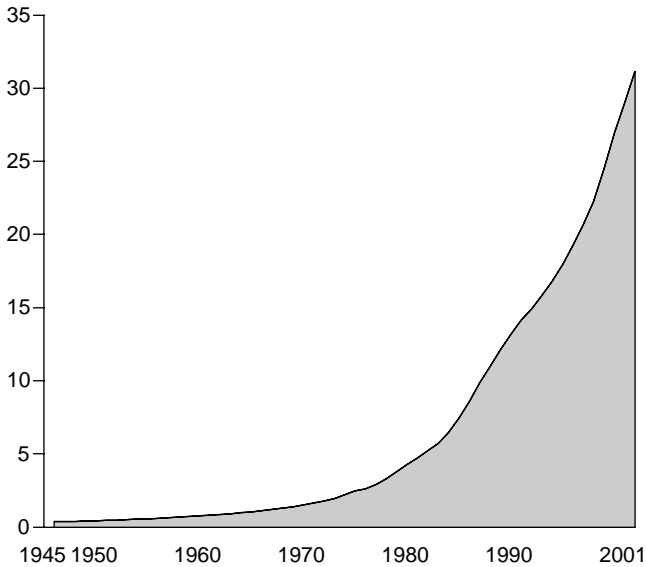
Most of the \$31.12 trillion in U.S. domestic debt, is in the form of either a bond or a bank loan. Bonds have a maturity, and the maturity varies, depending on the kind of bond. For example, a corporate bond has a longer maturity than a U.S. government bond. But what is revelatory, is the change in the maturity of bonds. For instance, in 1980, the average maturity for a corporate bond was 19.4 years. However, since a corporation—or any institution—pays a lower interest rate on a bond that it issues with a shorter maturity, than on a bond with a longer maturity, corporations started reducing the maturity of the bonds that they issued. By 2001, the average maturity for a corporate bond was 6.6 years.

But this also increased the principal amount, and thus debt service, that has to be paid back every year. For example, if a \$1,000 bond has a 19.4-year maturity, that means that the bond's \$1,000 principal must be paid back over 19.4 years, or 1/19.4 of the principal amount—\$52—must be paid back each year.¹ However, for the same \$1,000 bond that has a 6.6 year maturity, effectively, 1/6.6 of the principal amount—

1. For most bonds, the principal is paid back, not each year, but at the point when the bond matures, in one lump sum. However, if the average maturity of all corporate bonds were 19.4 years, that means that, on average, roughly 1/19.4 of the total value of the bonds, comes due, and must be paid back each year.

FIGURE 4
Total U.S. Debt

(\$ Trillions)



Sources: U.S. Federal Reserve Board of Governors, "Flow of Funds Accounts"; Office of Management and Budget, "Budget of the United States"; *EIR*.

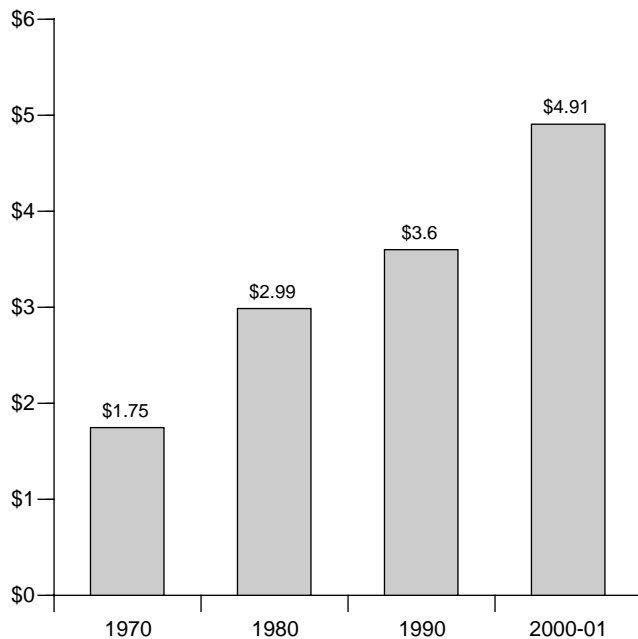
\$152—must be paid back each year. This increases the amount of annual principal repayment required.

Plus, an even more powerful element increasing the amount of principal that has to be repaid each year, and also the debt service, is the growth in the dimension of the bonded debt outstanding. Assume that the maturity of the bond remains the same; on \$3 trillion in bonded debt, three times as much principal must be repaid each year, as on \$1 trillion in bonded debt.

The more deeply America fell into debt, the more its annual debt service grew. **Figure 6** demonstrates that in 1980, the annual debt service was \$1.29 trillion; by 2001, it had reached \$7.36 trillion, a nearly six-fold increase. (Of the \$7.36 trillion in debt service in 2001, the interest portion was \$2.07 trillion.)

The debt service is of crushing proportions. **Figure 7** compares annual debt service to America's annual GDP (although GDP is an inaccurate measure of the economy, it can be used for purposes of comparison). In 1960, not shown on the graph, annual debt service was roughly equivalent to 31% of GDP; in 1980, this rose to 46.3% of GDP; and by 2001, it had leapt to 72.1% of GDP, which is more than double the 1960 level. To pay the annual debt service would require siphoning off three-quarters of GDP: a physical impossibility. Debt-service payment cannot co-exist within the same universe as continuation of the economy and human life.

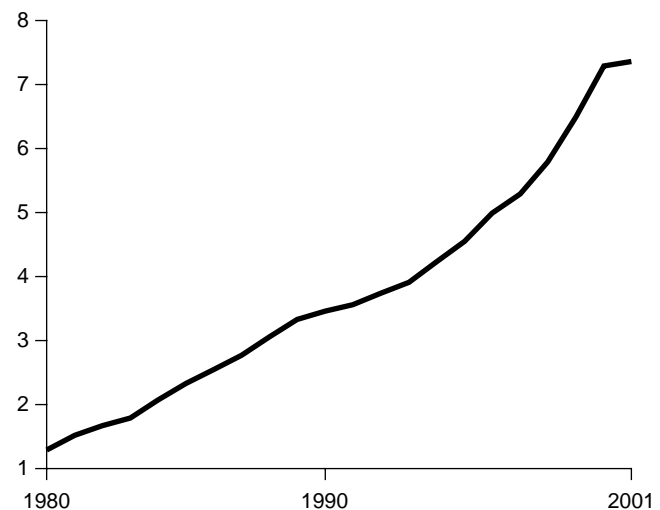
FIGURE 5
\$ Rise in Debt for Each \$1 Increase in GDP



Sources: U.S. Federal Reserve Board of Governors, "Flow of Funds Accounts"; Office of Management and Budget, "Budget of the United States"; U.S. Department of Commerce; *EIR*.

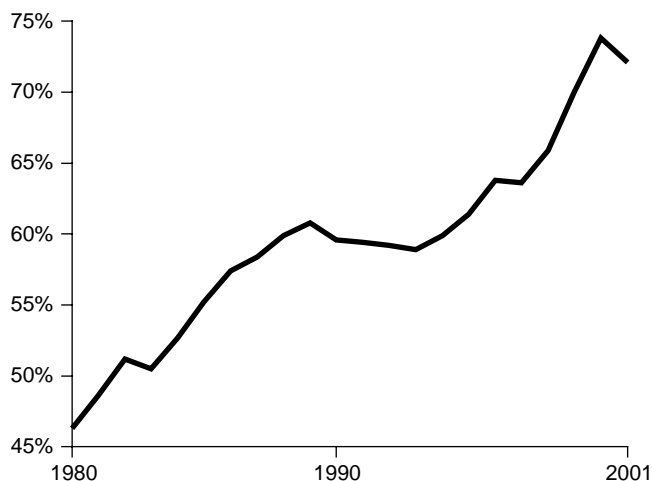
FIGURE 6
**U.S. Debt Service, Per Year
(Principal Repayment, plus Interest)**

(\$ Trillions)



Sources: U.S. Federal Reserve Board of Governors, "Flow of Funds Accounts"; Office of Management and Budget, "Budget of the United States"; Mortgage Bankers Association; Thomson Financial Services; *EIR*.

FIGURE 7

U.S. Debt Service as a Percent of U.S. GDP

Sources: U.S. Federal Reserve Board of Governors, "Flow of Funds Accounts"; Office of Management and Budget, "Budget of the United States"; Mortgage Bankers Association; Thomson Financial Services; *EIR*.

How Can It Be Paid?

This presents a paradox. How does the United States pay \$7.36 trillion in debt service annually? The Wall Street financiers can, and do, take measures to collect the debt service through extraction: They loot the population through fierce austerity; they do not replace run-down plant and equipment, etc. This is destroying the underlying physical economy upon which life depends, and ends up in fascist looting. But it will not produce \$7.36 trillion per year.

In addition, there are measures to roll over a significant portion of the debt service, through re-financing it with new debt and other similar mechanisms. Some of the new U.S. Federal debt will be directly monetized: that is, new monetary emissions will be issued against it; but ultimately, just as in Weimar Germany, there will be a large increase in money supply to facilitate the debt financing.

However, the annual increase in the debt and debt service is so huge, that this process cannot be continued in a fixed mode. LaRouche has forcefully characterized the process in his discussion of the "Typical Collapse Function" ("Triple Curve"), and its transformation during a breakdown crisis (see Lyndon H. LaRouche, Jr., "Regional Organization Under a New Bretton Woods," *EIR*, June 9, 2000). Every attempt to hold up the values of the financial aggregates, which are the mass of debts, derivatives, and other financial paper which constitute the upper curve of the "Triple Curve" function, crosses a boundary condition, and produces a hyperinflationary shock front that gathers force. In turn, it will rip apart the world monetary system, more surely than the Weimar hyperinflation ripped apart the German monetary system in 1923.