Production Breakdown Puts Financial System on the Edge

by Richard Freeman

The United States trade deficit on goods and services in April totalled $32.17 billion, the U.S. Commerce Department announced June 21. The Commerce Department was quick to call this an improvement: The April trade deficit fell by 1.2%, from the March level of $33.1 billion. If one considers *only physical goods trade*—excluding services—the trade deficit in April was $37.83 billion, a fall of 2.4% from its March level of $38.78 billion.

However, if one looks at the underlying processes in the U.S. physical economy, the fall in the U.S. trade deficit—whether for goods and services, or for goods alone—represents a sharp deterioration, not an improvement. Concentrate on physical goods trade only: In April, U.S. physical goods exports were $62.12 billion, a fall of 2.7% from their March level of $63.88 billion; also, in April, U.S. physical goods imports were $99.96 billion, a fall of 2.6% from their March level of $102.67 billion. U.S. physical goods exports have now declined by 7% since last September, and physical goods imports have declined by 6.1% over the same period. In fact, U.S. physical goods trade is collapsing.

This has serious implications. For the past decade, but especially during the last five years, the United States has functioned as the world's "importer of last resort." A collapsing U.S. economy, unable to produce the physical goods for its own physical existence, has gotten by, by sucking in physical goods from the rest of the world. At the same time, many countries have become heavily dependent on the U.S. market, to which they ship a huge amount of their physical goods. As the U.S. physical economy collapses, it cannot process physical goods, and shuts off physical goods imports from other countries into the United States. These countries reduce their production, and cut back their own imports. This has set off a self-reinforcing spiral of world trade collapse, followed by production collapse, followed by deeper trade reduction, and so forth.

The "importer of last resort" relationship required foreigners to invest funds into the speculative U.S. financial bubble, which funds the United States used to pay for its imports. As foreigners disinvest from the U.S. financial bubble—taking their funds back home—because the bubble is disintegrating, this intensifies the collapse of the importer of last resort relationship, and accelerates the popping of the bubble. Economist Lyndon LaRouche has forecast that a 40% plunge in the value of the dollar will ensue. This will shatter the dollar-centered banking system.

The U.S. trade figures through April indicate that such a process is building force. The recent trends in the U.S. economy reinforce this picture. U.S. industrial production is falling sharply, and the telecommunications sector's meltdown indicates both the breakdown of the U.S. physical economy and the "New Economy." But it also has the potential to blow out banks and Wall Street investors, which have lent heavily to the telecom sector. This would magnify the financial disintegration associated with the breakdown of the importer of last resort relationship.

The same process of economic-financial decay is occurring in Japan, the world's second-largest economy.

Inflation and the Industrial Crash

A sane way to defeat this crisis would be LaRouche's plan for a reorganization of the bankrupt world financial system, and a New Bretton Woods monetary system based on the Eurasian Land-Bridge, and its development corridors, which will radiate development for the world economy. But instead, the U.S. administration of President George W. Bush is relying upon the lunatic money-pumping policy of the U.S. Federal Reserve Board of Governors and its Chairman, Alan Greenspan. Money is flooded into the system to hold up the mass of bloated financial instruments, including the stock market.

Even in its short-term objective of stabilizing the stock market, the Federal Reserve and "Greenspin" have failed. However, that policy is generating a hyperinflation like that of 1923 Weimar Germany, which will shatter the $400 trillion in financial obligations overhanging the world financial system, and produce the deepest financial-economic depression in history.

On June 16, the Federal Reserve Board of Governors announced that the U.S. industrial production index—which is officially supposed to measure the output of the nation's factories, mines, and utilities—fell to a level of 143.1 in May, a decline of 0.8% from the previous month. The media and Bush Treasury Secretary Paul O'Neill had organized a publicity campaign, claiming that the U.S. economic collapse had "slowed down" in April and would be halted in May. Accordingly, "economic experts" had estimated that the fall in the Fed's industrial production index in May would be between zero and 0.4%. However, the official fall was twice as large as that estimate, indicating that the collapse had not slowed down, but accelerated.

Second, the Federal Reserve's official industrial production index contains considerable fakery. The same Quality Adjustment Movement (QAM) that the Bureau of Labor Statistics uses to lyingly understate inflation, is used by the Federal Reserve Board to *overstate* industrial production. For example, the Federal Reserve industrial production sub-index for auto production claims to show that U.S. auto and truck output in April 2001 was practically the same as that in November 2000, even though, in the real world, U.S. auto and truck production had been slashed. It is likely that in reality, U.S. industrial production fell in May by 1.0-1.5%, an annualized rate of 12-18%. If the rate of infrastructure collapse were factored in, as it should be, the rate of collapse would be much larger.

The Federal Reserve's official industrial production index fall of 0.8% in May followed a drop of 0.6% in April. The official measure of industrial production has thus fallen for eight consecutive months, surpassing the 1990-91 recession; in fact, such a drop hasn't been seen since 1982.

At the same time, capacity utilization of U.S. industries in May fell to 77.4%, the lowest level since August 1983. Meanwhile, capacity utilization of U.S. high-tech industries fell to 70.3%, marking not only the tenth consecutive month of decline, but also the lowest level recorded for the high-tech sector in 25 years.

Telecom Annihilation

A key element driving the plummeting of U.S. industrial production, is the annihilation of the telecommunications sector. The telecom sector has a real component—regular coaxial wires or fiber-optic wires, switching and serving equipment, etc.—but it is based on a close relationship with the Internet and the so-called "New Economy," non-productive investments loaded with collapsing debt.

On June 15, Nortel, the world's largest producer of telecommunication equipment, which is based in Canada, but has one-third of its production facilities in the United States, announced that it will take a $19.2 billion loss for the second quarter, the second biggest quarterly loss by any company in history. Nortel had to write down the greatly shrunken "market value" of other New Economy companies which it had bought—another self-feeding collapse process. Nortel will close plants and fire 10,000 workers, in addition to 20,000 workers already laid off earlier this year. The combined 30,000 layoffs will constitute one-third of Nortel's workforce.

The telecom sector overbuilt and overexpanded massively, based on meeting the fantasy of what it imagined the Internet would become. For example, it has laid about 39 million miles of fiber-optic cable across the United States. Only 2.9% of that cable capacity is lit—actually in use; the rest is dark. Companies wildly built many competitive routes, in an unregulated way, when only a few routes would be needed or can be put to use.

Scores of telecom companies have gone bankrupt; and others, like the giant telecom equipment-maker Lucent, are on the ropes. The decline in the telecom sector has not hit bottom.

But in addition to the effect on the physical economy, this has tremendous adverse consequences for the financial system. Of the world telecom sector's borrowings of $650 billion, it is estimated that the U.S. sector's portion is $300-350 billion, mostly from issuing bonds and taking bank loans. Some of the telecoms that went bankrupt have defaulted on their bonds, and are close to defaulting on their bank borrowings. For example, a consortium of banks led by Citigroup and Bank of New York has lent $1.35 billion to Winstar communications, which went bankrupt; a consortium of banks led by J.P. Morgan Chase lent $1.78 billion to Level 3 Communications, which is crashing; and so forth.

The meltdown of the telecom sector could, by itself, trigger the blowout of the financial system.

This collapse is global. On June 20, the Japanese government announced that its trade surplus in May was 80.1 billion yen, or $652 million, compared to a level of 575 billion yen in May 2000, a fall of 84%. Japan's exports for May 2001 fell 9.9% from the preceding April, marking the fifth straight month that Japan's exports have fallen. Leading the fall in exports, Japan's exports to the United States in May fell 15.9% from the preceding April. Japan's economy is driven by its trade surplus, and the collapse in exports, which caused the fall in the trade surplus, represents a serious threat to the Japanese economy.

The cumulative effect of collapse in the United States and Japan highlights the worldwide contraction, and feeds the rapid unravelling of the U.S. importer of last resort relationship. That is a leading force that will shatter the world physical economy and financial system.