roads, are being based on the assumption of private funding.

California urgently needs to re-regulate electric power, bring the plants under state control, and build new power and transmission infrastructure. It can't do this without Federal credit directed to the purpose, and shielded from being diverted back to up the state's large bonded debt: LaRouche's "Super-TVA" policy.

Leadership and LaRouche's Policy

It is no accident that 10 of the 24 state governors who were eligible to seek re-election on Nov. 5, decided not to; and that of those who did seek it, seven were defeated. Suicidally, the National Governors Association held an immediate post-election, closed-door seminar in Austin, Texas, Nov. 15-17, to *teach budget-cutting* to the "baby governors" just elected. One of them, Democrat Jennifer Granholm of Michigan, faces a typical deficit for the just-started fiscal year—about $1.5 billion in the hole, out of a state general fund of only $9 billion. She immediately dashed the hopes of Michiganders who—in a deep fiscal collapse with public hospitals closing and schools going to four-day weeks—had elected her to replace a conservative Republican. "We are going to cut," Granholm told National Public Radio, "and it may be painful for the first couple of years, but we will get this budget in balance."

Rather than leadership in the crisis, this is the organized brainwashing of potential leadership, to cause disaster. The "fiscal fascist" think-tank, the American Legislative Exchange Council (ALEC), is being deployed to train governors to think only of downsizing and privatizing government. As California, Virginia, and many other states have already proven, this austerity brings pain and destroys lives, but can never restore "budget balance" when the economic source of revenue is being killed.

Another terrible path being seized upon, by the newly elected Governors Robert Ehrlich of Maryland and Mitt Romney of Massachusetts, among others, is the eager solicitation of casino-gambling centers, slot machines at race tracks, and other forms of mass gambling mania such as New Jersey, Connecticut, and others have already tried. These literally ill-gotten revenues have tapered off after a few years, even in the most-addicted states such as Mississippi, and studies show clearly their terrible social consequence in mass bankruptcies and psychological disorders among the citizens.

The state governors have only one way out: They must, and will be forced immediately to demand action from the President and Congress to "create revenue." Democrats gained governorships, including in key formerly industrial states such as Pennsylvania, Ohio, and Michigan; and the party's constituencies now demand that they give up the Joe Lieberman-style imitation of conservative Republicans, and act for economic recovery, so this pressure must hit the White House in the post-election period. Presidential candidate LaRouche's Super-TVA idea is the only national policy on the table, that will work.

Latest Greenspan-Fed Rate Cut Will Backfire

by Richard Freeman

On Nov. 6, Federal Reserve Board chairman Alan Greenspan led the Fed's Federal Open Market Committee (FOMC) in cutting two pivotal interest rates. It was a desperation move that Greenspan knows will largely fail—but will have far-reaching impact on the U.S. and world economy.

The FOMC unanimously decided to cut the Federal funds rate from 1.75% to 1.25%, a half-percent cut where a quarter-percent had been expected. The Federal funds rate is the rate at which banks trade overnight surplus funds; it is now at its lowest level since July 1961. The Fed also cut the discount rate (at which banks borrow directly from the Fed) to 0.75%, also a half-percent cut, to what appears to be its lowest level in 75 years.

Implication of a 'Negative Rate'

The Federal Reserve is desperate, because the bankrupt financial system and the physical economy are not responding to traditional monetary policy, and things are getting worse. It may also be that a catastrophe has already occurred in the credit markets, such as a derivatives blowout requiring an emergency credit infusion, which the Fed and the media are blacking out.

The FOMC had already talked of the consequences of such a very-low-interest-rate policy, which it called the " 'zero bound' policy constraint," at its meeting of Jan. 29-30, 2002. The minutes of that meeting, and a discussion that an unnamed senior Fed official held with the March 25 *Financial Times* of London, indicated that the Fed realizes a "zero bound" policy probably wouldn't work, and could end up creating paralysis—but on Nov. 6, it took the action anyway.

By lowering the discount rate to 0.75%, the Fed has lowered it below the official 12-month inflation rate level of 1.50%, which is the Consumer Price Index, published by the Department of Labor's Bureau of Labor Statistics (BLS). This situation gives rise to a "negative interest rate." The real inflation rate, as determined by *EIR*'s economic staff, is at least twice the official BLS rate. But, even taking the BLS's posted 1.50% inflation rate: This means that, were a commercial bank to borrow money for a year from the discount window of the Federal Reserve, when the time came for the bank to pay back the loan, *after the principal amount of the loan is adjusted for inflation,* it would pay

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A "zero-bound" policy on interest rates? Even "what, me worry?" Alan Greenspan is worried about this desperation move, because his own staff studies in early 2002 told him it would not work. From the same studies, it's clear that Greenspan's becoming "zero-bound," shows that he know's the economy's failing.

less *combined principal and interest* than the principal it originally borrowed.[1] This is a mechanism for the Fed to flood the system with money.

Interest Rates Approach Zero

As mentioned, the minutes from the FOMC's Jan. 29-30 meeting reveal that: "At this meeting, members discussed staff background analyses of the implications for *the conduct of policy if the economy were to deteriorate substantially in a period when nominal short-term interest rates were already at very low levels.* Under such conditions, *while unconventional policy measures might be available,* their efficacy was uncertain, and it might be impossible to ease monetary policy sufficiently through the usual interest rate process to achieve [Federal Reserve] System objectives. The members agreed that the potential for such an economic and policy scenario seemed highly remote, but it could not be dismissed altogether. If in the future such circumstances appeared to be in the process of materializing, a case could be made at that point for taking preemptive easing actions to help guard against the potential development of economic weakness and price declines that could be associated with the so-called *'zero bound' policy constraint"* (emphasis added).

Behind the Fed-speak are two important features: First, the Fed discussed what it should do "if the economy were to deteriorate substantially," when "short-term interest rates were already at very low levels." Following orthodox policy, and lowering interest rates still further, could produce a " 'zero bound' policy constraint." The Fed is referring to Japan, where interest rates were lowered to virtually zero two and one-half years ago, and the economy and financial markets did not respond. Why? although the Fed did not say so, the world is hit by financial disintegration, a condition that does not respond to orthodox policy. By so citing Japan, the Fed was warning of paralysis, in which reduced interest rates do not produce the textbook effects.

Second, the Fed was examining "unconventional measures." In the *Financial Times* interview, the anonymous senior Fed official said a policy of "unconventional measures" could include "buying U.S. equities," and the Fed "could theoretically buy anything to pump money into the system," including "state and local debt, real estate and gold mines—any asset."

Fed "staff background analyses" show that lowering interest rates toward the "zero bound" would not work. The second approach, taking "unconventional measures," does not stand in opposition to lowering interest rates; so, the Fed could be considering this. But a Fed buying spree of equities and/or real estate is at best a short-term policy that would end in hyperinflationary explosion.

So it's clear: Greenspan et al. know that lowering interest rates to a "zero bound" condition won't work, but they're doing it anyway—like closing a door, and then trying to walk through it. This goes beyond desperation.

Has the Fed Lost It?

Why do Greenspan and coterie pursue this policy? Because they adamantly reject Lyndon LaRouche's proposal to put the financial system through Chapter 11 bankruptcy, and set up a New Bretton Woods system in its place.

In the current system, financial assets are tremendously inflated, but the physical economy is contracting. One cannot simply generate money, no matter how cheaply, into the physical economy and expect it to function. During the third quarter of this year, U.S. business had cut back investment in fixed structures, such as factories, at a 16% annualized rate. Moreover, for the year-to-date through September, U.S. machine tool consumption is 62% below its level of five years ago. In the environment of the LaRouche Triple Curve function, as industry contracts, shutting down plant and equipment, industry will not buy new plant and equipment, no matter what level Greenspan pegs interest rates at. The financing of the huge debt service will swallow up most of whatever credit is put into the system.

What LaRouche has proposed—wiping out the bankrupt and destructive financial paper, and gearing manufacturing and industry to a scientifically ascertained matrix of national missions—is the precondition for an effective monetary policy.

By insisting it will not accept LaRouche's workable policy, the Fed, Hamlet-like, chooses a policy which it knows will not work, but will bring on self-destruction.

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1. Start with an inflation rate of 1.5%. Were a commercial bank to borrow $100 for one year in 2002, when it came time to pay the loan back in 2003, the bank would effectively be paying $98.50 in 2002 dollars. The interest on the loan is 0.75%, which means the bank must pay $0.75 in interest payment. The total amount the bank pays back, expressed in 2002 dollars, is $98.50 plus $0.75, or $99.25 in combined principal and interest—less than the $100 it originally borrowed.

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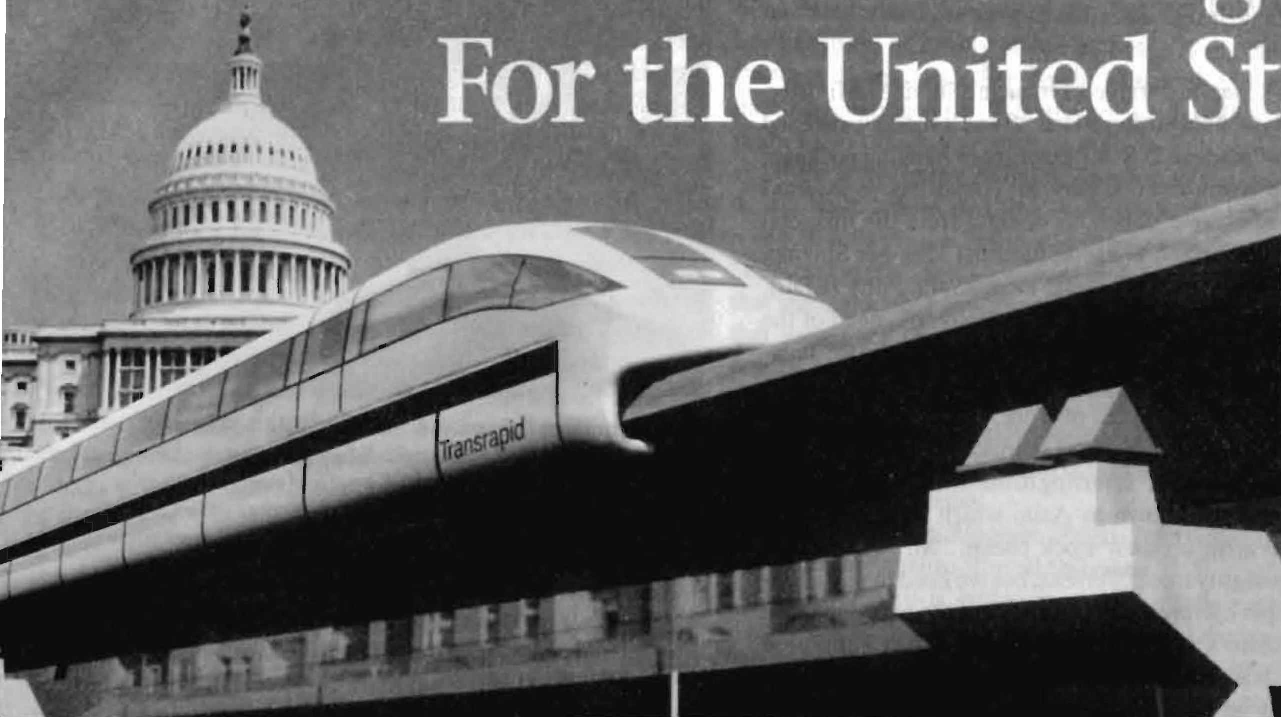

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