

International Credit by William Engdahl

The real U.S. debt problem

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Debt is a much-discussed issue these days in Washington and in the international financial media. But the real debt problem which is causing alarm and driving policy in Washington, New York, London, Tokyo, and Basel is not that of Mexico or Brazil. It is not even that of the embattled U.S. savings and loan banks. The real alarm is over the mushrooming U.S. internal debt.

Now, debt is sometimes an elusive commodity. What is one man's debt can be another's credit. But in this case, the growth of U.S. debt, most of all private debt, is causing alarm bells to ring in more than one central bank headquarters. Here is a little indication of what they are alarmed about.

According to the Federal Reserve, total U.S. debt is growing at a breathtaking rate. Debt per se is not so alarming as the rate of increase of debt in relation to a nation's ability to repay it from production of something real. According to the Fed, in December 1984, total U.S. debt was an eyebrow-raising \$5.9 trillion. That figure included \$1.4 trillion of federal debt.

By August 1988, the latest available data period, the total U.S. debt figure had ballooned to more than \$8.7 trillion. This represents an increase of a whopping 48% in three and a half years. In addition, the rate of increase of this indebtedness continued, unabated, after the warnings of the "Black Monday" October 1987 stock market crash.

The much-publicized increase in the U.S. national debt incurred under the Reagan years, rising to some \$2.5 trillion by the end of 1988, is one com-

ponent of this problem to be sure. But the increase in U.S. private sector indebtedness is the far larger one. Here, in addition to bank debt, and mortgage and private consumer debt, U.S. companies have incurred a staggering amount of corporate debt, most alarmingly through the wave of so-called leveraged buy-outs (LBOs).

Under U.S. financial market deregulation, Reagan-era regulatory permissiveness and tax law, it is enormously profitable for a group of predators, "investors," to borrow up to 90% of the cost of taking over a company through buying all its available stock shares, in hopes the value of the target will rise. That borrowing is typically collateralized by the assets of the victim company, hence the term "leveraged." Because of tax laws which make interest on such debt tax-deductible, the "investors" often turn short-term profits of 100% or more.

Ironically, Black Monday's background was the misconceived attempt by big New York banks like Citibank, then-Fed chief Volcker, and the Reagan administration to "solve" the 1982 Ibero-American debt crisis for the U.S. banks by triggering the "Reagan recovery" consumer boom. This led directly into Oct. 19, 1987. Then, as an attempt to recover trading profits lost after Black Monday, Wall Street investment houses and large banks rushed pell-mell into LBOs at an all-time record pace. One Wall Street estimate is that the volume of all U.S. mergers and acquisitions, LBOs included, hit an all-time record well above the record in 1986 of \$205 billion. LBOs were a major part of this.

Major banks, insurance companies and pension funds have all gone into the LBO boom in recent months, joining Wall Street houses like KKR, Drexel Burnham, and others.

Already in September 1987, a Congressional Research Service report to Congress on LBOs warned that "debt is increasing at an unprecedented pace for the postwar period, and that debt is mounting more rapidly than nominal gross national product—an unusual phenomenon." Additionally, that study warned, "the composition of debt outstanding has shifted markedly towards short-term borrowing—mainly in the form of floating-rate financing—while long-term borrowing by the private sector has diminished significantly in importance." This report was actually written some weeks before the October 1987 market crash. It is even more alarmingly true in January 1989 than when it was submitted.

The problem is that U.S. interest rates for precisely short-term borrowing are rising rapidly. Since last spring, rates have gone up more than 2% to the highest levels since the crash, with no limit in sight. Fed chief Alan Greenspan "is clearly walking a tightrope trying to cool the LBO frenzy before it threatens the entire edifice, while also trying to avoid precipitating full-scale recession from higher rates," a well-placed City of London banker stressed to me. As Anatole Kaletsky of the London *Financial Times* noted recently, "Unfortunately, leverage has an appalling way of making losses spin out of control on the way down just as it sensationally magnifies rewards on the way up." Little wonder that reports of problems for KKR of New York in raising part of the staggering \$25 billion it committed to the LBO takeover of RJR Nabisco already have tremors running through London, New York, and Tokyo.