

Debt Overtaking Not Just U.S. Households, But National GDP

by Richard Freeman

The first part of this analysis was published in last week's EIR, Feb. 6, 2004.

The debt load on the U.S. economy has spiralled wildly out of control in recent years: Americans are now taking extraordinary and unsustainable measures to pay that debt, undermining their personal and national existence. The first part of this study documented that the debt's dimensions reached a level perversely unique in world history. Between Dec. 31, 2000 and Dec. 31 of 2003, *EIR* has estimated that total U.S. indebtedness rose from \$28.80 trillion to \$36.85 trillion, an increase of more than \$8 trillion, or 28%, in only three years.

While the Bush-Cheney Administration has attempted to focus attention on its tax cuts—which are insanely destructive, lowering tax revenue and economic activity—it has actually been the debt expansion which is the “characteristic” of the administration's actions (the 9-10% annual rate of expansion of indebtedness dates from only weeks before this administration took office on Jan. 21, 2001). For purposes of comparison, in the period 2000-03, the dollar amount of the “Bush-Cheney” tax cuts did not equal one-tenth of the total amount of debt expansion (household, business, and government) that was pumped into the economy. The administration has been totally addicted to the debt expansion to prevent an economic-financial collapse that would have been far more severe than what is occurring right now.

This debt explosion has been engineered in conjunction with the wild money-printing policies of Federal Reserve Board Chairman Alan Greenspan. No longer capable of producing its own physical existence, the United States, following a “Roman” imperial policy, is importing huge quantities of physical goods from around the world to sustain itself. This total package, a massive wreck, is what passes for a U.S. economy.

However, there are physical limits to this debt-pyramid-

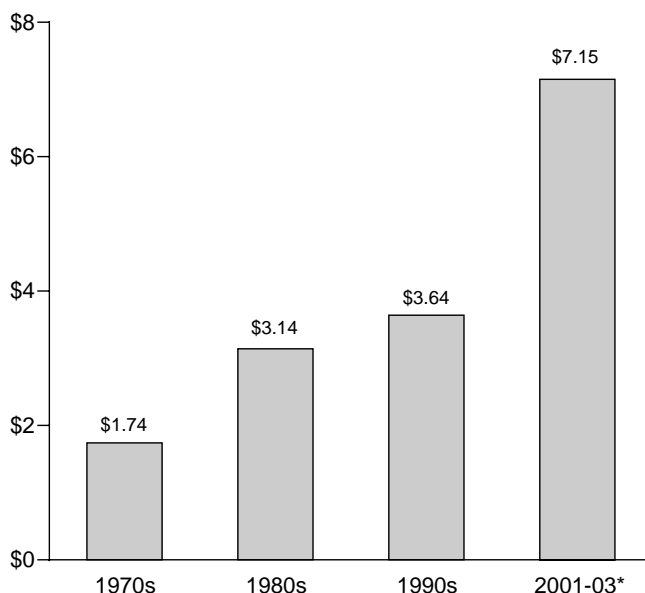
ing. In order to offset falling living standards, millions of households have built up debt to pay for housing, clothing, medical bills, furniture, and even food; and to counteract a contracting economy, many manufacturing firms and farms have had to borrow money to keep from going under, not only for new equipment, raw material supplies, and so forth, but even to pay payroll. Presidential candidate Lyndon LaRouche has shown, through his conception of the “Triple Curve” collapse function (see p. 42), that the larger the financial aggregates—which include the debt—the more they ravage the physical economy, making the nation and its households less able to support human existence, or the debt itself.

LaRouche has advanced a decisive solution: 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.

The debt crisis is highlighted by the relationship of debt to Gross Domestic Product (GDP): How much indebtedness is there in the American economy, per unit of GDP? This process can be conceptualized in two ways. First, since the debt has to be paid out of the economy's output: How much GDP exists, from which the debt can be serviced? (The GDP is not an accurate measure of the economy's performance, but it is something against which debt can be compared, which gives a consistent series for comparison over time.) The second way to conceive of the relationship of debt to GDP, is how much debt is required to move a unit of GDP. In a well-ordered society, there will be some debt, whose purpose is to facilitate the building of the economy, such as great infrastructure projects of one to two generations. In such an economy, the debt to GDP ratio will be reasonable, and should be relatively stable over decades. However, in a speculative economy, the debt to GDP ratio will be continuously rising. That is, it becomes more difficult, and in one sense, more

FIGURE 1

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

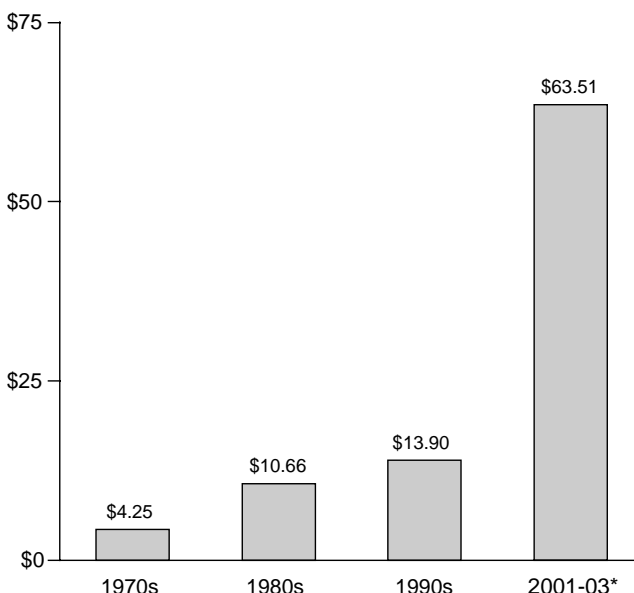


*2003 projected, based on first nine months

Sources: Federal Reserve Board of Governors, "Flow of Funds"; U.S. Treasury Department; U.S. Department of Commerce; *EIR*.

FIGURE 2

\$ Rise in Debt for Each \$1 Increase in Real GDP



*2003 projected, based on first nine months

Sources: Federal Reserve Board of Governors, "Flow of Funds"; U.S. Treasury Department; U.S. Department of Commerce; *EIR*.

expensive in terms of debt, to cause the movement of an unit of GDP.

Figure 1 shows the ratio of the increment in the dollar volume of the U.S. economy's debt, to the increment of the dollar size of Gross Domestic Product. 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 \$3.64 increase in GDP. But for the period of 2001-03, every dollar increase in GDP required an increase in debt of \$7.11. This is double the 1990s' ratio, and four times that of the 1970s. Thus, this period represents a singularity, indicating that past relationships have broken down, and that a new ordering process has become dominant, one governed by hyperinflation and speculative frenzy.

However, a more precise measure would be to compare debt to the productive portion of GDP, which consists of the productive output of the manufacturing, agriculture, construction, mining, public utilities, and transportation sectors. The productive sectors of the economy represent man's alternation of nature, to produce goods that are consumed by man to produce higher cultural and material levels of development. According to U.S. Commerce Department data, the productive portion of GDP is less than 30% of total GDP. The productive portion of the economy produces the actual wealth from which, ultimately, the debt is paid off.

Still, the Commerce Department's category of the "manufacturing portion of GDP" has significant problems. The

Commerce Department reports the "manufacturing sector of GDP" in dollar, not output terms; and it adjusts it by the notorious "Quality Adjustment Factor," which artificially overstates production. Still, the productive sector of GDP brings us closer to what is actually happening.

Figure 2 shows that throughout the 1970s, for every dollar of increase in productive GDP—which we here call real GDP—there was a \$4.25 increase in debt; throughout the 1990s, for every dollar of increase in real GDP, there was a \$13.90 increase in debt. However, in the 2001-03 period, when real GDP, even in its statistically massaged form, stagnated while debt grew hyperbolically, each dollar of increment in real GDP required a \$63.51 increase in debt. The representation goes "off the charts": It defines a singularity, where the system breaks down.

This signifies something else: The U.S. economy's current indebtedness can never be paid off out of the real productive portion of the economy.

There is a second crucial phase of the process.

EIR has determined the annual *debt service* on America's debt, for each year since 1980. The annual debt service consists of that sum of the interest payment, plus a part of the principal amount of the debt, that must be paid each year. Failure, by an individual or an institution, to pay the debt service owed, leaves him in default.

The three principal sectors of the economy—households,

FIGURE 3

U.S. Debt Service Per Year (Principal Repayment plus Interest)

(\$ Trillions)



*Projection, based on first nine months

Sources: Federal Reserve Board of Governors, "Flow of Funds"; U.S. Treasury Department; *EIR*.

FIGURE 4

U.S. Debt Service as a Percent of GDP



*Projection, based on first nine months

Sources: Federal Reserve Board of Governors, "Flow of Funds"; U.S. Treasury Department; U.S. Department of Commerce; *EIR*.

business, and government (including Federal, state, and local government)—owe debt service on their debt. Each sector owes different types of debt, with different maturities, and different interest rates. In determining the debt service, *EIR* consulted and cross-checked with more than a dozen economists and experts from U.S. government agencies and private institutions. The more deeply America fell into debt, the more its annual debt service grew. **Figure 3** demonstrates that in 1980, the annual debt service was \$1.29 trillion; by 2003, it had reached \$8.09 trillion, a six-fold increase. (Of the \$8.09 trillion in debt service in 2001, the interest portion was more than \$2 trillion.)

Figure 4 compares annual debt service to America's annual GDP. (Although, as stated above, GDP is an inaccurate measure of the economy, it can be used for purposes of comparison.) In 1960—not shown on this graph—annual debt service was roughly equivalent to 31% of GDP; in 1980, this had risen to 46.3% of GDP; and by 2003, debt service had leapt to 73.9% of GDP, which is more than double the 1960 level. It will be noted that the ratio of debt service to GDP has been in roughly the same range since 2000 (in fact, it has fallen slightly). This represents Federal Reserve Chairman Greenspan's decision to cut interest rates 11 times in 2001, in order, in part, to make lending and borrowing much easier. However, once interest rates spike upward from their very low rates, the debt service will rise, and the debt-service-to-

GDP ratio will shoot upward even higher.

But this debt service of \$8.09 trillion and rising, cannot be paid. Were it to be paid out of GDP, it would require siphoning off three-quarters of the national product. Moreover, it would require siphoning off the equivalent of 2.5 times the productive portion of GDP (real GDP). The debt service requirements are so large that they could not be met: There would not be enough GDP left over to sustain human existence, by providing the market-basket requirements of enough clothing, housing, food, etc., and a sufficient amount to pay the debt. A system is bankrupt when the debt-servicing requirements exceed its wealth generation, so that an individual or entity cannot pay back the debt service and meet the needs of human existence at the same time. The United States is bankrupt. Some of the debt will be "rolled over" i.e., refinanced with new debt, which swells the debt bubble even further. However, the Wall Street financiers can, and do, take measures to collect a significant portion of 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.

As the world financial disintegration increases instabilities, a spike in U.S. interest rates, a wave of defaults on over-priced homes, will ignite the \$36.85 trillion debt into conflagration. The debt bubble has built into it the causes of its own destruction. The debt bubble's upward flight is nearing an end.