

bled, and now accounts for almost half of the irrigated sown area. Irrigated arable land has increased by 60% in the last 40 years. Cotton monoculture is regarded as the main reason for the depletion of soil and water resources in the Central Asian Republics. Cotton cultivation is responsible for the exhaustion of nutrients, soil compression, and a massive application of herbicides, pesticides, mineral fertilizers, and defoliants to ease harvesting. Drainage water from the irrigation fields discharges these toxic substances into the main rivers. Poor water management in the Aral Sea basin is responsible for the decline in agricultural production, and due to salinity, has already taken out of production an area larger than Belgium.

Water for Agriculture

The desiccation of the Aral Sea is one of the major man-made ecological catastrophes in the world. By 1982, the extreme specialization of cotton monoculture and its irrigation practices, had led to an almost total extraction of the runoff originally reaching the Aral Sea, which has already lost 75% of its volume since 1960. The blowing away of toxic salt and dust due to the exposed sea bottom, leads to soil infertility in the once-fertile Amu Darya delta. Furthermore, the falling sea level has caused a microclimate change and a rapid decline in fish productivity [and a shortening of the growing season]. Experts expect that the Aral Sea will evaporate further in the foreseeable future.

Huge dust storms blow salt and toxic sediment far across the Sea's littoral republics—Uzbekistan and southern Kazakhstan—adding to the already chronic health conditions in the region. . . .

The Amu Darya River now feeds into the Kara Kum canal, which carries water along an earthen channel to cotton-growing areas far inside the interior of Turkmenistan. The river is also tapped by Uzbekistan for its cotton fields. Since the Kara Kum canal is really nothing more than a long, open ditch dug out of the earth, much of its water is lost, either through seepage into the earth or through evaporation as the river water traverses hundreds of miles of arid expanse.

At the cotton fields, the water saturates the land through large-scale flooding. Much of the water evaporates in the field, and what is not captured by the soil runs off into small reservoirs or back into the Amu Darya. Beginning in 1982, when water scarcity caused strict limits on the republics' water consumption, improvements in irrigation efficiency and water management in Central Asia were given top priority. The program was given added emphasis by Gorbachov. . . .

By and large, these measures have shown some success in curbing the profligate use of scarce water resources; but no one can say with any degree of certainty whether these measures by themselves can stop the gradual desiccation of the Aral Sea. One of the more controversial proposals to provide the region with more water, would divert northward-flowing rivers feeding the Siberian steppe, back into the Central Asian Republics through an extensive network of canals.

Lothar Komp

The Current Financial System Is Finished

Mr. Komp is an economist with EIR's bureau in Wiesbaden, Germany.

Last weekend, the central bankers and finance ministers of the G-7 countries met in Washington, followed up by the Spring gathering of the International Monetary Fund at the same place the day after. And if we believe the utterings of these so-called leaders of world finance, then everything is still under control—as long as central bankers just keep up printing money to bail out the speculators.



In his address to the German Parliament's Financial Committee in Berlin in early April, IMF Managing Director Horst Köhler stated: "We are not at the brink of collapse," and he urged people not to plunge into "gloomy pessimism" (in German: "*dumpfe Schwarzmalerei*"). If Köhler feels the need to use such words, some real panic must be out there.

And there is a lot of reason for this. If we look around the globe today, we are witnessing a worldwide picture of horror in financial and economic terms.

We will start our *tour d'horizon* with the biggest economy in the world.

The U.S. Economic Collapse

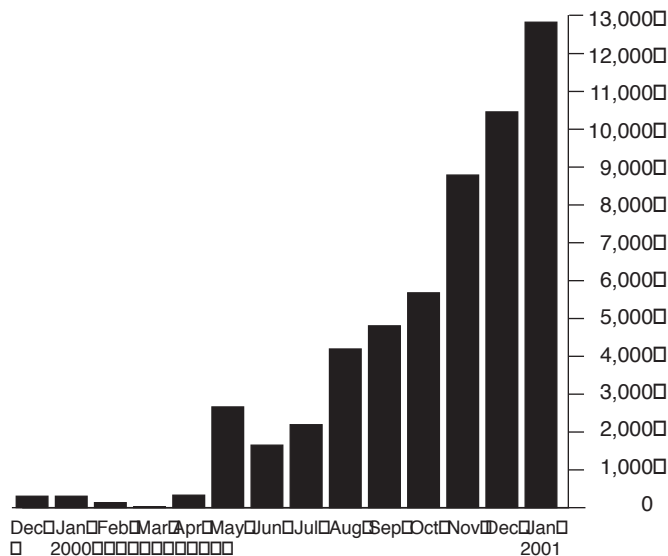
There never was a "U.S. economic boom" during the 1990s, as *EIR* has documented in detail in the past. Instead, there has been the emergence of the biggest speculative bubble in history, built on a "boom of illusions" and cheap credits for consumers and stock market investors, as well as corporate takeovers. At the same time, U.S. strength in key economic sectors, including machine building and aerospace, as well as key infrastructure, from the health system to the energy sector, has been ruined due to insane policies.

Now, since March of last year, the bubbles and the illusions are collapsing. First on the stock market. And immediately after the U.S. Presidential election, also concerning the real economy.

Layoffs. The U.S. Internet sector was the first to face a

FIGURE 10

Internet Sector Layoffs in U.S., December 1999–January 2001



Source: Challenger, Gray & Christmas.

TABLE 1

Announcement of Mass Layoffs in the U.S., January and February, 2001

DaimlerChrysler (automobile)	26,000
Motorola (mobile phones, chips)	6,500
J.C. Penney (retail)	5,600
Lucent Technologies (telecom)	16,000
AOL Time Warner (media)	2,400
WorldCom (telecom)	11,500
Hewlett-Packard (printers)	1,700
Xerox (copy machines)	4,000
General Electric (various products)	50,000
Amazon.com (internet)	1,300
ShopKo Stores (retail)	2,500
Fed. Dep. Stores (retail)	2,600
Goodyear Tire & Rubber (wheels)	7,200
Nortel (telecom)	10,000
Dell (computer)	1,700
Verizon (computer)	10,000
Gateway (computer)	3,000
Sara Lee (various products)	7,000
3Com (telecom)	1,200
SCI Systems (electronics)	3,000
JDS Uniphase (telecom)	3,000

big bankruptcy wave last year, resulting in an unprecedented amount of layoffs in this key area of the “new economy” (Figure 1). The number of layoffs in the U.S. Internet sector in the second half of 2000, rose 600% compared to the first half. In December, layoffs, compared to the previous month, rose 19%. In the year 2000 as a whole, 210 Internet firms, with a total of 15,000 employees, went under.

In December 2000, the large automobile and retail sectors were joining the club. The U.S. lost 133,713 jobs, the highest number in any month for eight years.

But in January 2001, the figure rose further to 142,208. The hardest hit was the manufacturing sector, which lost about 65,000 jobs. (See Table 1.)

The international outplacement firm Challenger, Gray & Christmas, reported that U.S. firms had announced 166,000 layoffs in April, the highest number ever since recording started in 1993, and four times higher than one year ago. Total job cuts in the first four months of this year thereby amount to 572,000, about 200% above the level of last year.

In March 2001, payrolls declined by the highest speed (86,000 per month) since November 1991. In April, the number further increased to 223,000.

U.S. weekly jobless claims in the week ending April 28 shot up to 421,000, the highest level in five years.

Earnings. Quarterly reports by top U.S. companies were worse in the first quarter of 2001 than they have been in ten years. Profits were melting down due to falling demand, rising producer prices, and crashing stock markets for both the “new

economy” and the “old economy” enterprises.

Large companies, like the world’s biggest PC chip producer Intel and the biggest automobile producer General Motors, were reporting an 80% to 90% crash of their quarterly profits. Others, even had to present shocking quarterly losses: \$3.7 billion in the case of Lucent Technologies, or \$3.3 billion at DaimlerChrysler.

And those high-tech companies that were already operating at a loss, doubled or tripled their losses this time, compared to one year ago. JDS Uniphase, the largest producer of fiber-optics equipment, even reported a fivefold increase of losses for the first quarter.

While more and more companies are being forced to put out quite ugly profit figures, there is a clear trend towards trying to mask the full extent of the problem, by putting large emphasis on the so-called “EBITDA” (Earnings Before Interest, Taxation, Depreciation, and Amortization). And—believe it or not—once all these costs are subtracted, including all the costs for takeovers and debt service, the companies actually appear to make profits. As an example, AOL Time Warner made a first quarter 2001 EBITDA of \$2.1 billion, causing enthusiastic remarks by chief executive Gerald Levin, “We couldn’t be pleased more,” and frenetic applause by Wall Street analysts. Who cares, that the firm actually lost \$1.4 billion.

But why stop in the middle of the road, and still take into account labor and material costs? I want to propose a more rigorous “earnings concept,” which is called “EBITDA-

LOM” (Earnings Before Interest, Taxation, Depreciation, Amortization, Labor Costs, Other Costs, and Material Costs) and which by definition rejects all costs whatsoever! Once we introduce this earnings concept, every single company in the world will finally prove to be profitable!

Economic indicators. The beginning of 2001 saw most of the leading business and consumer climate indices in the U.S. suddenly falling to their lowest level in a decade or more. The Business Climate Index of the Federal Reserve of Philadelphia fell to the lowest level since December 1990, while the index for American industrial activity of the National Association of Purchasing Managers fell to the lowest level since March 1991. The NAPM index for industrial orders sank to the lowest level since November 1981. For the first time since 1973, the NAPM business index fell for five months in a row.

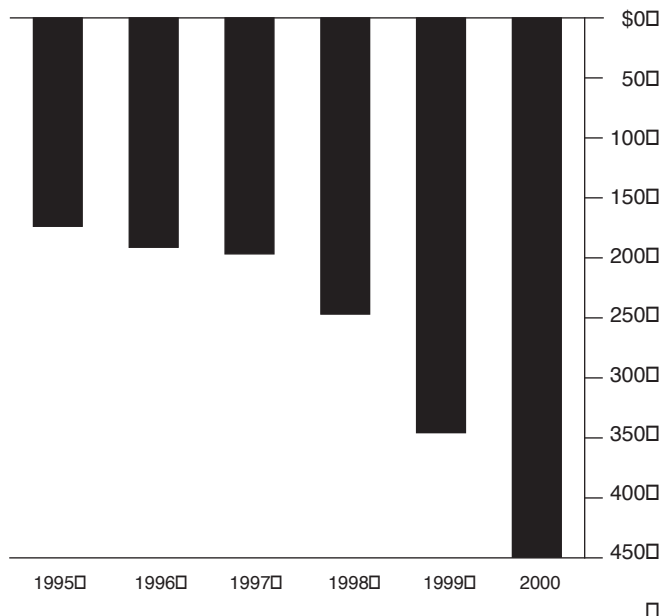
In April, 38% of industrial managers participating in the NAPM survey said they were “worried or pessimistic” about business over the coming year. This is not only a sevenfold increase compared to the previous quarter, but the highest ever since the NAPM records started in 1962. The business climate index for the Chicago area fell to the lowest level since March 1982. The Consumer Confidence Index of the Conference Board fell to the lowest level since December 1996, and suffered its most abrupt fall since October 1990. The Consumer Climate Index of the University of Michigan fell to the lowest level since November 1993.

On Feb. 18, the chairman of the Board of Nortel Networks, John Roth, gave a presentation at the Canadian Club in Toronto, after Nortel, the leading producer of fiber-optics in the world, had shocked the markets with their admission of their fourth-quarter results. Roth, who was accompanied by numerous bodyguards, said: “This is the most abrupt downturn that the U.S. has ever experienced. It’s becoming very clear that all our customers are starting to adjust their budgets to take account of the realities of the very sharp and severe downturn that the U.S. is experiencing.” On Feb. 17, John Chambers, the CEO of the biggest producer of Internet services, Cisco, said, in an interview with the Swedish economic newspaper *Finanstidningen*: “It makes no difference what the Federal Reserve or the latest statistics say. What we see now is absolutely not a soft landing. Ask anyone in the American manufacturing industry and he will say that we are in a recession. . . . If the situation does not change before the half-year point, there is a risk of a domino effect whereby the rest of the world will be imminently affected.” Chambers on April 16 compared the present economic contraction with a “100-year-flood” hitting the tech sector: “Not only did it occur in our lifetimes, but the magnitude was about five times what we thought possible. . . . We never built models to anticipate something of this magnitude. . . . This may be the fastest any industry our size has ever decelerated.”

Texas Instruments Chief Financial Officer Bill Aylesworth, after reporting a 37% decline in first-quarter orders,

FIGURE 2 □
U.S. Foreign Trade Deficit □

Physical Goods Only (in Billions \$)



Source: Commerce Department.

noted April 17: “This is the sharpest deceleration that the semiconductor industry has ever experienced.”

And, at the World Congress for Mobile Phone Techniques in Cannes, France on Feb. 23, the vice president of chip producer Intel, Hans Geyer, spoke about the impending bankruptcy of the telecom sector. With regard to the hundreds of billions of expenditures by telecom firms just to buy new licenses, Geyer said: “We are facing a situation where the industry is headed for bankruptcy, even before the first UMTS [next generation mobile phone] call will have been made.” Already on Feb. 1, the chief of Apple Computer, Steve Jobs, speaking to a group of financial analysts at Apple headquarters in Cupertino, California, said laconically, “I believe the economy is going through a nuclear meltdown.”

Consequences for the rest of the world. In the past years, the U.S. economy has managed to absorb the products of the rest of the world’s economies, thanks, on the one hand, to the credit-financed consumer boom of American households, but also, on the other hand, because the American economy was becoming ever less capable of itself producing the relevant industrial products. In the process, the U.S. economy became the “importer of last resort” for the entire world economy. Last year’s trade deficit in goods and services had reached a record high of \$369.9 billion. If you look at only goods, without services, then the deficit in 2000 was \$449.5 billion, almost a doubling in just two years (Figure 2). In order to pay for this extreme imbalance of imports over exports, the U.S.

economy had to simultaneously become a vacuum cleaner for all the investment capital available in the world, so that after the financial and economic disruptions in Asia and Ibero-America in 1997-99, about 80% of the entire current account surplus generated by all surplus countries worldwide was transmitted into the United States. Meanwhile, the U.S. was sourcing out and shutting down entire branches of industry and became ever more dependent on imports from abroad. The U.S. trade deficit exploded, along with the U.S. current account deficit and the foreign debt. As a mirror of this, in the last few years, above all in Asia and Ibero-America, large numbers of "national economies" have been transformed to become almost completely dependent on exports of goods to the United States.

'Emerging Markets'

About 57% of all exports by Ibero-American countries go to the United States. In the case of Mexico, the dependence on the U.S. export market is even above 80%. And as the U.S. economy shrinks, all these exports are threatened. Since the beginning of the year, more than 300,000 industrial jobs have been cancelled in Mexico alone. In Japan, Taiwan, the Philippines, Malaysia, and Thailand, it has been true for some time already, that 25-40% of their exports are going to the United States. In the case of China, 41.9% of its total export volume is to the United States.

The collapse of the world electronics and computer chip markets is hitting many Southeast Asian nations, as sometimes more than 50% of their entire exports are in these sectors.

In South Korea, semiconductor sales are expected to crash by 45% this year.

In the Philippines: Computer chips, disk drives, and other electronic parts make up two-thirds of the entire export volume, while exports account for 40% of the economy. Imports of electronics and components have fallen by 45% compared to the level one year ago, as foreign orders and production are rapidly contracting. Imports of industrial machinery and equipment are down 22%.

Malaysia is facing mass layoffs in its computer and electronics export industries. More than 50% of Malaysia's exports are electronics, which it sells mostly to the United States.

In Taiwan, capacity utilization in the computer/electronics sector is down around 50%.

In Singapore, 60% of all exports are electronics, and most of them are going to the United States.

Japan

Even though, since the speculative bubble burst in 1990, the government of Japan has invested the equivalent of about \$500 billion in bailing out the large private banks, not to mention billions more on special programs for reviving the real economy; and even though, on top of that, the Central Bank initiated a zero-interest-rate policy, the situation in the second-largest world economic power is more explosive

than before:

- Industrial production in Japan is contracting again since the beginning of the year, 3.7% during the first quarter 2001. The monthly economic report of Japan's Cabinet Office in April, for the first time since September 1995, formally stated: "The economy is weakening."

- The business confidence index in Japan fell from -1 in the last quarter 2000 to -31 in the first quarter this year. In the manufacturing sector, from +3 to -33, in the steel industry from +5 to -40, in the electric machinery sector from +7 to -35, and in the precision instruments sector from 0 to -41.

- Japan's exports are falling fast. The trade surplus fell 20.6% year-on-year for fiscal 2000, which ended in March 2001.

Western Europe

There is no question, that the global economic contraction is already hitting Western Europe.

Business confidence in the leading Western European economies is going down sharply: In Germany, the IFO index has fallen in nine of the last ten months, to the lowest level since about two years (**Figure 3**). The situation is similar in Britain and in France.

In the automobile sector, car registrations throughout Western Europe were sharply down in the first quarter of 2001. In March, car registrations in Europe were down 5.3%, in Germany even by 9.4%.

And an avalanche of mass layoffs is now emerging also in the European corporate sector. Some examples:

- Siemens, the biggest electronics and engineering company in Germany, announced on April 26 that it will cut 3,500 jobs, or 15% of the workforce, in its division producing phone networks for companies. An additional 2,000 workers will be laid off in Siemens's mobile phone production.

- Netherlands electronics producer Philips, Europe's largest producer of consumer electronics and number three in semiconductors, will cancel 7,000 jobs. Sales are sharply down, and Philips sees "no sign that the slowdown in economic activity in certain parts of the world, particularly in the U.S., is near its end."

- Swedish telecom giant Ericsson, the world's biggest producer of mobile phone infrastructure equipment and third-largest producer of mobile phones, on April 20 announced that it will cut another 12,000 jobs, on top of the 10,000 job cuts announced earlier this year. Sales at Ericsson's mobile phone division were down 52% in the first quarter, compared to one year ago.

- French appliance producer Moulinex will eliminate 4,000 jobs and close down five factories.

- Swedish heavy truck producer Scania, the third largest in the world, will cut 1,200 jobs due to a rapid downturn of sales throughout Western Europe.

- The Dutch-British food producer Unilever, the biggest in the world, will eliminate 8,000 jobs and close more than 30 factories worldwide after its first-quarter profits fell 53%.

FIGURE 3D

IFO Business Climate Index, Western Germany



Source: IFO Institute.

Britain: From December to February, 105,000 industrial jobs were cancelled. Since the Labour Party took power, a total of 440,000 industrial jobs were lost.

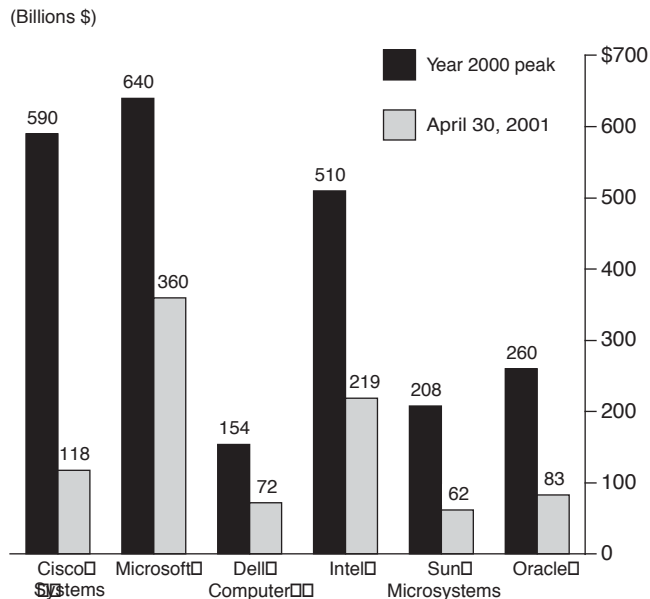
The Engineering Employers' Federation warns in its latest quarterly survey, that much more is beginning to hit Britain, due to the economic slowdown in the U.S. and worldwide. Until recently, traditional industries like steel and the automobile sector had been in the center of mass layoffs. But, following similar events in the U.S., the "new economy" sector is now coming up with ugly surprises as well.

Swedish mobile phone producer Ericsson will cut 1,200 jobs at its Scunthorpe and Carlton factories. Compaq Computer announced that it will cut 700 jobs at its plant in Erskine, Scotland. This week, Marconi, the largest British telecom equipment producer, announced that it will cut 3,000 jobs worldwide, half of them in Britain. The Liverpool-based Cammell Laird shipyard, founded in 1824, filed for bankruptcy protection, after orders collapsed and banks refused to extend credit lines. Up to 1,300 shipworkers' jobs will disappear.

U.S. chip and mobile phone producer Motorola will close down its mobile phone factory in Scotland, affecting 3,200 jobs, marking the biggest industrial closure in Scotland in more than 20 years.

FIGURE 4D

Market Capitalization of U.S. Technology Giants



Source: nasdaq.com.

The Market Crash

There is hardly a technology stock in New York, Frankfurt, or Tokyo, which today is still worth as much as one-third of what it was 12 months ago.

For the U.S. technology stock exchange, the Nasdaq, February 2001, with a loss of 22.4%, was the third-worst month in its 30-year history, only exceeded by October 1987 and November 2000. It went down further in March. And even if there had been some gains in April due to Alan Greenspan's monetary shock policy, the Nasdaq is still 55% below its peak value from last year.

Between March 10, 2000, and the end of the first quarter 2001, the market value of the Nasdaq firms dropped from \$6.7 trillion to \$3.3 trillion (Figure 4).

The market value of the six largest Nasdaq titles have melted down, from their maximum last year of \$2.362 trillion, to \$914 billion. Microsoft was at its highest in January 2000; Cisco and Dell in March; and Intel, Sun, and Oracle not until August 2000. Since that time, these six firms alone have had \$1.448 trillion in paper values annihilated.

Between March 24, 2000, and April 3, 2001, the market capitalization of the 5,000 American companies which make up the Wilshire-5000 index, plunged from \$16.96 trillion to \$11.62 trillion, that is, \$5.34 trillion has been wiped out in the meantime.

During the first quarter of 2001, stock mutual funds faced their biggest losses since the third quarter of 1998, when Russia declared a moratorium and the LTCM [hedge fund] melt-

down brought down the world financial system. Average quarterly losses of U.S. stock mutual funds were 13%, but those specialized in Internet stocks even facing losses of 60% to 70%.

In March 2001, the crash on stock markets had reached such a degree, that unnerved investors were pulling out money from U.S. stock mutual funds at the highest speed ever. That is, \$20.6 billion were taken out, more than in October 1987 or in any other month in U.S. history.

Unpayable Debt All Around the Globe

As of March 2000, the technology stock crash is on. On top of that, since the fourth quarter of 2000, the crash of the U.S. economy has forced itself into public awareness. What has only received scant attention from most people until now, is the shock that is still to come: the complete collapse of the worldwide house of cards of debts and other financial obligations.

In one of his first statements on being named Bush's Treasury Secretary, Paul O'Neill declared that it had been a grave mistake in the past for the International Monetary Fund and various governments to rush in with billions, to stabilize Asian and other economies, which "refused to put their own financial houses in order" first. Now, only 100 days in office, O'Neill is reportedly about to eat his words, as the reality of a disintegrating international financial system hits. Already on April 19, the Bush White House opted for the IMF to pour billions more into stabilizing the financial and banking crisis in Turkey.

Only a few months after last December's \$11.4 billion IMF rescue package, **Turkey** will now receive another \$10 billion of IMF and World Bank loans, because the situation now is worse than before, and the banking system is threatened with collapse. Since the Turkish government decided to let the lira float in February, the currency lost 78% of its value to the dollar in just two months. Hundreds of thousands of small and middle-sized entrepreneurs have lost their jobs, as the government was pushing through IMF austerity demands. At least \$115 billion in foreign credits to both the public and the private sectors are at risk, most of this owed to European banks.

And **Argentina**, about to default on \$128 billion in dollar-denominated debt, will also receive a further bailout, on top of the \$40 billion IMF rescue package last December. It's being reported that the Bush Administration is terribly afraid that a default by Argentina could trigger a systemic contagion. Were Argentina to default, or even to abandon its ten-year-old Currency Board, the crisis would spread within 48 hours into the largest Ibero-American economy, Brazil, with its \$120 billion of foreign debt. And the Argentina and Brazil crises together could bring down the entire U.S. banking system.

The government must repay some \$24 billion in dollar bonds this year, \$6 billion of it in the coming four months. But in order to do so, it has to sell new debt, government

bonds. And the "risk premium" which investors demand, has reached such an incredible level, that the government, on April 21, decided to cancel the bond auction for the week after. As an immediate reaction to these renewed fears for an Argentinian default, the Brazilian currency, the real, fell to its lowest level ever against the U.S. dollar.

Argentina will be bailed out due the "systemic risk" it poses to the U.S. banking system. Turkey will be bailed out because it is a key U.S. military base for any confrontation in the Middle East or Central Asia. But it seems that **Indonesia** is being thrown to the wolves, even if it is immediately on the brink of default on its foreign debt of \$141 billion. Even worse, the world's fourth-biggest country by population (210 million) is facing social and political disintegration.

The Indonesian currency, the rupiah, is already down to the lowest level since the "Asia crisis" of 1998. The government reports that some 36 million of its 95 million workforce are unemployed or underemployed. Indonesia is already paying some 45% of its national budget for debt.

The negotiations with the IMF on the next \$400 million loan of the \$5 billion package broke down as the government is just not able to push through IMF demands, such as the cancellation of fuel subsidies, which for sure would lead to further social explosion.

Japan. Several of the biggest banks in the world are already bankrupt by any reasonable standard. It's just the case, that their bankruptcy has not been announced formally, for well-known reasons. In mid-April, an unnamed source of Japan's Financial Services Agency presented some shocking news to the public. In an interview with Japanese media, he said that the FSA has now revised its definition of "bad loans." And due to this new definition, a more realistic account of the total bad debt in the Japanese banking sector is not the 33 trillion yen (\$300 billion) that the Mori government had admitted, and also not 81 trillion yen, as the FSA so far had estimated, but rather 150 trillion yen, or \$1.2 trillion, about one-quarter of the entire outstanding loans in the Japanese banking sector.

But in spite of all the government bailouts for the banking sector, by which some of the old bad debt could be written off, the volume of bad debt is still very much rising.

The liabilities of Japanese companies that went bankrupt during the last fiscal year, which ended in March, exploded to a new historic record of \$210 billion, 130% more than in the year before.

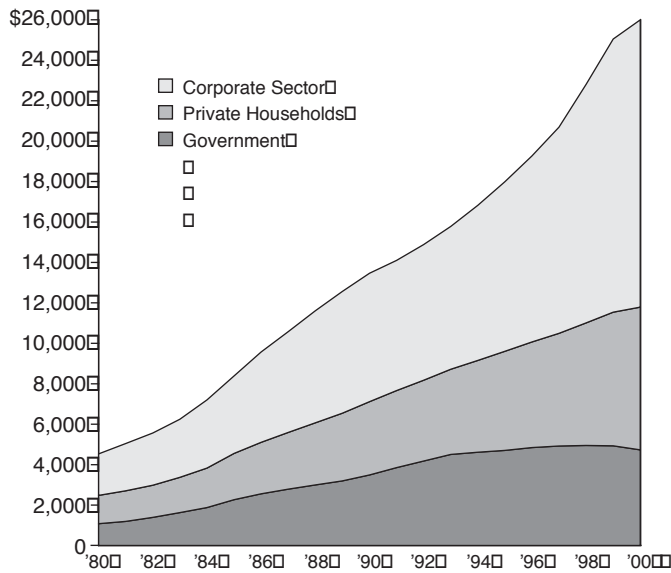
As a consequence of a decade of government "stimulus" programs and bank bailouts, the public finances of Japan are now out of control, and will this year rise to more than \$5 trillion, or 150% of the GDP.

The Japanese financial situation has been characterized very openly by top politicians in recent weeks:

Finance Minister Kiichi Miyazawa, of the former Mori government, summarized the public debt problem on April 8 by saying that the nation's finances are now "close to collapse."

FIGURE 5
U.S. Total Debt

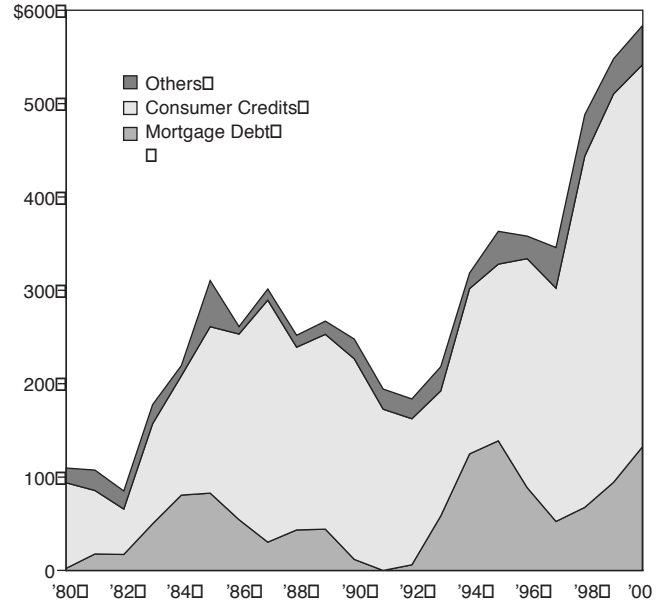
(Billions \$)



Source: "Flow of Funds Accounts," Federal Reserve.

FIGURE 6
New Debt of U.S. Private Households

(Billions \$)



Source: "Flow of Funds Accounts," Federal Reserve.

Former Japanese Deputy Prime Minister Eisuke Sakakibara, known worldwide as "Mr. Yen," on April 10, described the Japanese government bond market as a "bubble waiting to burst."

Toshihiko Fukui, former Bank of Japan deputy governor and likely successor of Masuru Hayami as the new governor of the Japanese central bank, stated on May 1, that the effects of the zero-interest-rate policy reintroduced one month ago "would erase any safeguards protecting the country from the destructive spiral of rising long-term interest rates, fiscal bankruptcy, and runaway inflation."

Other G-7 indebtedness. Another aspect of this house of cards of indebtedness is, again, the American economy, which in the 1990s experienced the worst credit excesses of its history. The combined debt of the government, the corporate sector, and private households at the end of last year reached \$26 trillion (Figure 5).

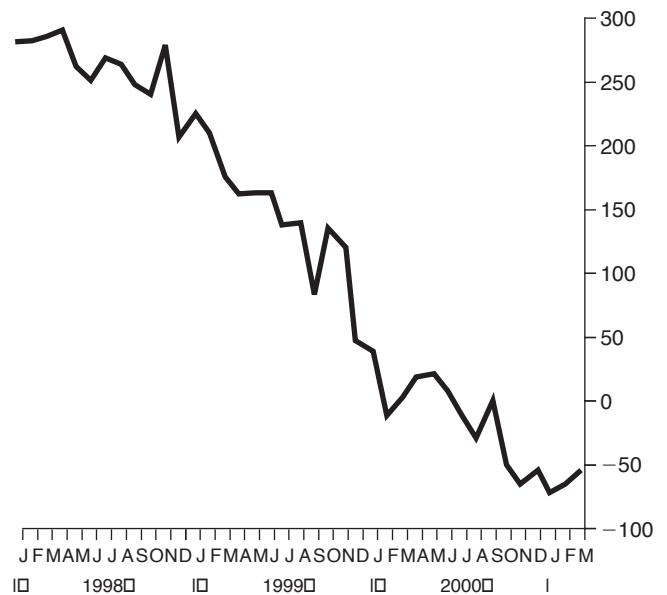
But even more worrying than the total amount, is the rate at which new debt is being piled up by private households and enterprises. The new debt added by U.S. consumers now amounts to \$600 billion per year, three times as much as in the early 1990s (Figure 6).

This process is being accompanied by the worst collapse of U.S. savings since the Great Depression, with the savings rate plunging below zero starting in Summer 2000 (Figure 7).

Meanwhile, U.S. companies are adding an average of \$1.5 trillion of new debt per year in recent years, eight times as much as in the early 1990s. The great majority of new debt is

FIGURE 7
Savings Collapse, U.S.

(Billions \$ Per Year)

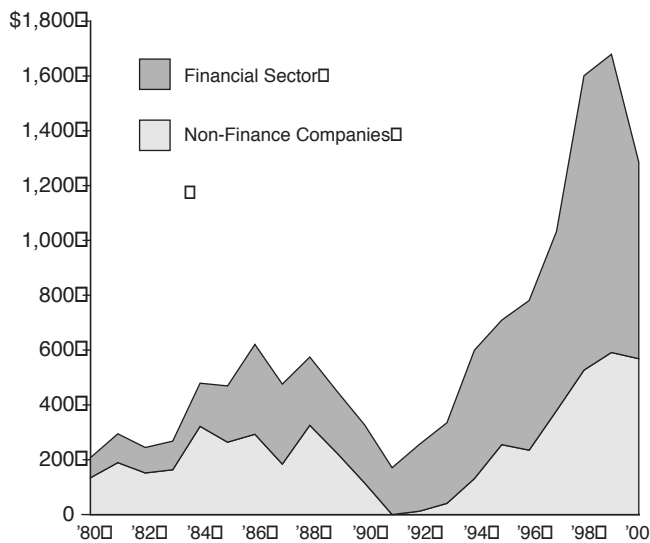


Source: Department of Commerce.

FIGURE 8

New Debt of U.S. Corporate Sector

(Billions \$)



Source: "Flow of Funds Accounts," Federal Reserve.

now being piled up by the financial sector itself (Figure 8). Overall debt in the U.S. economy is now rising four times as fast as the GDP.

Just in case you thought that such things don't exist in Germany, note that the total public and private debt in Germany last year crossed the mark of 25 trillion deutschemarks, whereby the German financial sector alone has DM 13 trillion in debt, more than five times the much-debated public debt (Figure 9).

The Debt Time-Bomb in the Telecom Sector

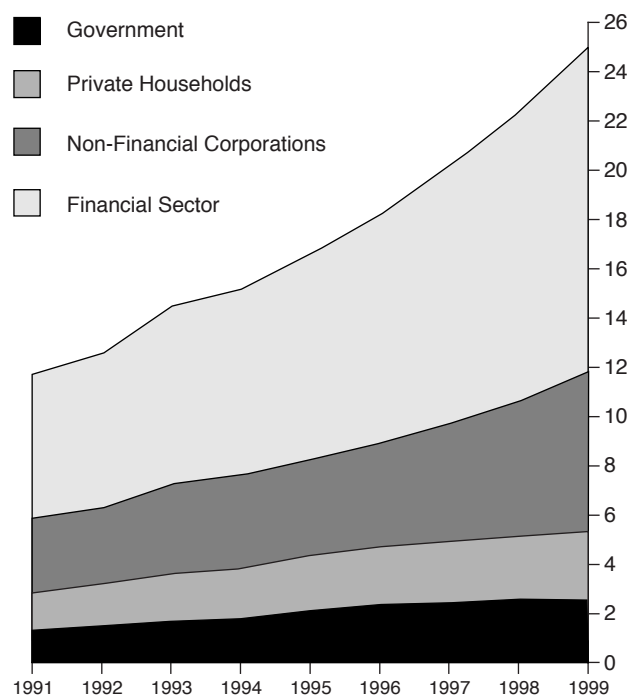
After the countless takeovers and mergers in the telecommunications sector and the gigantic expenditures for future mobile phone systems—DM 200 billion last year alone for mobile phone licenses—the great telecom firms are stuck in a desperate financial situation.

By the end of the year, the seven large European telecoms alone have to meet debt service of more than \$80 billion. This is in the same dimension as this year's combined debt services of Turkey, Argentina, and Indonesia. For the telecom sector as a whole, worldwide, it is estimated that debts due in 2001 amount to \$200 billion. In the year 2000, bank debts of the European telecom sector went from \$41 billion to \$150 billion, a near fourfold increase. But the European banks are now so massively exposed to telecom loans, that bank supervisors have rung the alarm bell and have urged them not to expand their commitment to this sector any further. Another way to refinance the telecom debts, would be to go to the international lending market. But telecom firms have already flooded the

FIGURE 9

Total Debt, Germany

(Trillions DM)



Source: Bundesbank.

bond markets in recent times, and now have to promise ever higher yields to attract buyers. This is the direct way into bankruptcy.

Until last year's stock market crash, telecoms could easily get billions of dollars, just by issuing new stocks. But as millions of investors have burned their fingers with telecom stocks, almost all of the scheduled stock emissions in the telecom sector this year have been cancelled, because nobody would buy these things any more. Of course, the telecom debt is not just a European problem: Between 1995 and September 2000, the debt of U.S. telecoms quadrupled from \$75 billion to \$309 billion. In recent years, their debts were rising much faster than their sales.

De-Globalization Process Starting

The telecoms and other top global players in the corporate sector have piled up so much debt, and are indeed so bankrupt, that they are no longer able to open up the financial resources required to continue the global takeover race.

As Thomson Financial Securities Data notes, the global merger and acquisition (M&A) business is now in a state of "meltdown." While mergers and acquisitions in the first quarter of the year 2000 amounted to \$1.172 trillion worldwide, M&A activity in the first quarter 2001 shrank to a vol-

ume of just \$455 billion, a fall by 62%.

In telecommunications and technology, global M&A activity in the December 2000 to February 2001 period, almost came to a standstill.

In the United States, overall M&A activity in the first quarter dropped by 63% compared to the year before.

The biggest decline was reported for Germany. Here the M&A volume in the first quarter crashed by 90%.

Contributing to the sudden M&A meltdown is the crash of worldwide technology stocks, but also the fact that the large companies, which have dominated the global takeover business in recent years, are now sinking in debt and are no longer able to open up new credit resources.

But it's even worse: In order to prevent bankruptcy, some of the global players now are being forced to sell off what they just bought up a few months or years ago. Something like a de-globalization process is now in the making.

As an example, the Netherlands telecom firm KPN is preparing a huge selloff of shares in foreign telecom companies, including in the Czech Republic (Cesky Telecom), in Ireland (Eircom), Hungary (Pannon), Ukraine (Mobile Communications), Indonesia (PT-Telkomsel), Germany (E-Plus), and in the international data network operator Infonet.

Mega-Bankruptcies Coming

Bad loans are now massively piling up in the American banking sector: Write-offs of bad loans were one of the reasons for much lower profits of large U.S. banks in the first quarter. The U.S. Office of the Comptroller of the Currency has warned that the problems are also spreading to the medium-sized and small banks, in particular in the industrial Midwest. As an example, at the Detroit-based bank Comerica, non-performing assets jumped 40% just during the first quarter of this year.

The financial group Finova on March 7 filed for bankruptcy protection with \$11.3 billion of debt in bank credits and bonds, one of the biggest bankruptcies ever. It didn't make very big headlines, only because the company was quietly taken over by Warren Buffett's Berkshire Hathaway investment fund.

Lucent Technologies, a leading telecom equipment producer, on April 3 had to put out a statement, calling rumors "absolutely false," that it is about to file for bankruptcy. Nevertheless, prices of Lucent stocks on that day were falling below its 1996 initial public offering (IPO) price, and 93% below its peak in late 1999. The bankruptcy rumors were triggered by a report in the London *Financial Times*, quoting sources familiar with the company's finances and stating that Lucent has used up all the \$3.8 billion cash reserve, which existed at the end of last year, and on top of this has now started to draw on a \$6.5 billion credit line it received from a group of banks during February. The *Financial Times* also quoted an unnamed banker involved in financing Lucent, who said that Lucent could soon be downgraded to "junk bond status" by leading rating agencies.

Motorola, the world's second-largest mobile phone producer and sixth-largest chip producer, on April 6 put out a statement denying market rumors that it is about to default on \$6.3 billion of outstanding short-term debt. The Motorola stock price nevertheless fell to its lowest level in eight years on the same day. In the week after, Motorola reported its first quarterly loss in 16 years. Its mobile phone orders were down 29%, and new orders for Motorola chips even by 47%.

On April 18, telecom services provider Winstar Communications filed for bankruptcy protection, marking one of the biggest bankruptcies in U.S. corporate history. Winstar had defaulted on a loan by telecom equipment giant Lucent Technologies, which itself had to issue a statement recently denying that it is bankrupt. Winstar has about \$6.3 billion in debt. Even before the announcement, corporate bonds of Winstar were trading at 2% of face value, while its stock price had collapsed from \$65 a year ago to 35¢ now. The Winstar bankruptcy was a key factor for Alan Greenspan's surprise 50 base-point rate cut the same day.

PSINet: The telecom provider announced on April 17 that it might have to file for bankruptcy and that it had already defaulted on several loans from equipment producers. PSINet revealed losses of \$3.2 billion in the first quarter; its net debt at the end of the year 2000 totalled \$5 billion. PSINet stock prices have fallen to 20¢—from \$34 a year ago.

California energy provider Pacific Gas & Electric filed for bankruptcy protection on April 6. With about \$9 billion in debt, it marks the third-largest bankruptcy in U.S. history.

The Corporate Bond Bubble

The amount of outstanding U.S. corporate bonds has now reached \$4.2 trillion, that is, almost 40% of the U.S. GDP. About \$685 billion of these bonds are rated as junk bonds. And this whole structure is now falling apart.

We are witnessing an unprecedented rise in the number and volume of corporate bond defaults. On April 23, Standard & Poor's published a report on the first-quarter 2001 global corporate bond market, noting that 48 large companies defaulted during the quarter, on a total bond volume of \$37 billion. While already the year 2000 marked a new historic record—when companies defaulted on a total of \$42.3 billion—the new figures reveal that in 2001, the same level was almost reached again after the first three months alone. Out of the 48 companies listed, 41 are from the United States, including the two California utilities PG&E and Southern California Edison, and an array of telecom, food, and retail companies.

The S&P report also notes that due to the very unpleasant condition on global stock markets, and the already very high credit exposure of the banking sector, large corporations worldwide are right now flooding the bond markets with their corporate bonds, in spite of the fact that they have to offer ever higher bond yields. First-quarter bond emissions by U.S. corporations jumped up to a record-high volume of \$150 billion, an increase of 270% compared to one year before.

So, what we are seeing here is somehow comparable to the collapse of the Russian GKO bond market in August 1998, only we are now dealing with a bond volume that is about 50 times bigger.

Derivatives

Three commercial U.S. bank holding companies held 91% of all the derivatives held by U.S. banks at the end of 2000, according to data released last week by the Office of the Comptroller of the Currency—an unprecedented and dangerous concentration of derivatives risk in the largest U.S. financial institutions. The notional amount of derivatives held in all U.S. banks rose in the fourth quarter to \$40.5 trillion.

J.P. Morgan-Chase alone had \$24.5 trillion in such off-balance-sheet liabilities, followed by Citigroup, with \$7.9 trillion, and Bank of America, with \$7.7 trillion.

In order to look at the usual ratios between those bank liabilities, that show in the balance-sheet, and those which are “off-balance,” consider the example of Deutsche Bank. According to its own figures, Deutsche Bank, at the end of September 2000, held assets (and liabilities) worth 996 billion euros, secured by 27 billion euros of its own capital. Against that however, there were 10 trillion euros in off-balance-sheet financial derivatives, more than 530% of the German GNP. But remember, this is just one of the German banks.

Printing Money To Postpone the Collapse

Since the beginning of the year, Fed Chairman Greenspan has cut interest rates already four times, always going for a double portion of 50 base-point cuts. Twice, he didn’t wait for the scheduled Federal Open Market Committee meetings to announce the rate cuts, but preferred to come up with a surprise shock, in order to maximize the effect on otherwise crashing stock markets.

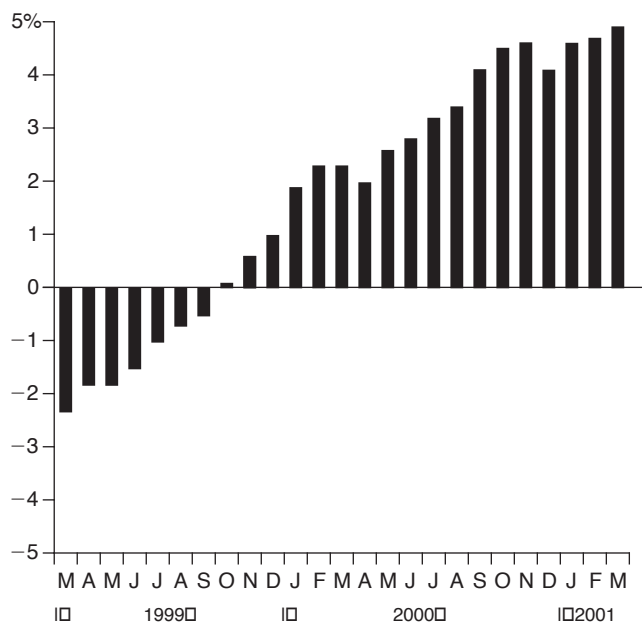
Greenspan became so ruthless in his money-printing policy, that even Germany’s leading conservative daily *Frankfurter Allgemeine Zeitung* noted that the head of the Federal Reserve is no longer serving the aim of monetary stability, but has turned into just a “servant of private speculative interests.”

And as “Uncle Alan” is printing money ever faster, price inflation in the U.S. is going out of control. Even the most sophisticated statistical tricks like “hedonic price indexing” are no longer able to cover up this problem. At the beginning of the year 2001, the Producer Price Index reached its highest level in more than a decade, at an annualized inflation rate of 13%.

One of the key factors, but not the only one, is exploding costs for energy. In California, the wholesale prices for electricity in January 2001 were ten times higher than one year before, marking an annualized inflation rate of 1,000%.

In the second half of the 1990s, the M3 money supply increased by about \$500 billion, clearly more rapidly than in the preceding years. In March 2001, the annualized growth

FIGURE 10 □
Producer Price Inflation in Germany □
 (Percent)



Source: Federal Statistical Office.

rate of M2 reached 15.6%! Since 1997, M2 has been growing much faster than the GDP.

Also in Europe, price inflation is accelerating. German producer prices in March (+4.9% higher than a year ago) were rising at the fastest speed in 19 years (July 1982) (Figure 10). European Central Bank chief economist Otmar Issing on April 28 noted that price inflation in the euro-zone has now reached an “intolerable” level.

Statistics as ‘Weapons of Mass Distraction’

On April 26, Lyndon LaRouche noted that, as the Bush Administration and the Federal Reserve “are no longer able to postpone the economic and financial crisis, they are trying everything they can to postpone the perception of the crisis.” All sorts of tricks are being used, from liquidity pumping to, especially, the faking of statistics, just to somehow get through the second quarter of 2001.

Even the April 28 *Financial Times* noted that the Bush Administration is now using economic statistics as “weapons of mass distraction.” This was in reaction to the government’s release on April 27 of the very surprising 2.0% annualized increase of the GDP in the first quarter of 2001, double what all the bank economists had forecasted. In the following days, U.S. stock markets shot up in a way comparable to another 50 base-point rate cut by Alan Greenspan, while leading financial dailies in big headlines on their front pages announced the end of the U.S. recession.

Now, how is this possible, if car sales are going down 10% to 20%, high-tech companies are facing the most rapid decline they ever experienced, and hundreds of thousands of workers are losing their jobs?

First of all, the GDP report by the Commerce Department states very clearly in its introduction that it is just an “advance estimate,” based on incomplete data, and, at the end of May, a revision is supposed to come, which then will be the “preliminary estimate” and the final figures will be put out not before June.

Second, the “advance estimate” already notes that capital investment in the U.S. corporate sector is shrinking. So, business investments in equipment and software were falling by 2.1% in the first quarter. Exports were down by \$6.2 billion, and imports even by \$43 billion, each time on an annualized basis.

The main source of growth in the U.S. economy, as the figures admit, is credit-financed consumer spending by private households, going up by 3.1%. But, how is this possible, when at the same time consumer confidence in the U.S. is crashing to its worst level in a decade? Actually, consumer spending on durable goods, including automobiles, was falling in March. So, the answer to the mystery, is that U.S. consumers in the first quarter had to spend more on items they were not able to avoid, such as skyrocketing energy costs and debt service.

Exploding Defense Orders

But the government is not only using “weapons of mass distraction,” it is actually using physical weapons of all sorts, in order to boost economic growth statistics. And this is already being done in a shocking dimension, as the government’s own figures on the manufacturing orders for March reveal.

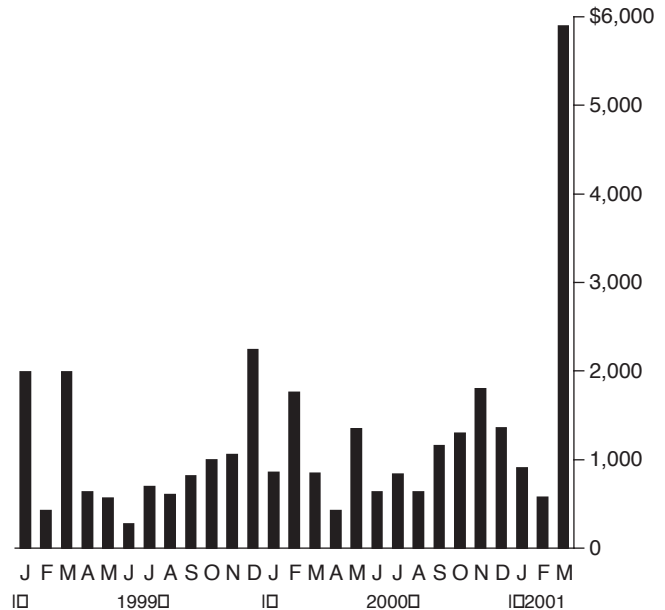
According to the report put out by the Commerce Department on May 2, new orders for manufactured goods in March increased by 1.8% compared to February—but only due a strong rise in orders for transportation equipment. New orders excluding transportation equipment were down by 1.2% in March, falling for the fourth month in a row, marking the longest string of monthly declines since March 1991.

The most spectacular feature in the report by the Department of Commerce is the more than tenfold increase of new orders for—almost exclusively military—shipbuilding plus tanks, going up from \$568 million in February to \$5.886 billion in March, a rise by 936% (Figure 11). The monthly order income for shipbuilding and tanks in February was rather normal, so the dramatic rise from February to March cannot be explained by some extremely low figure in February. It is rather the case, that what the Pentagon would normally spend on ships and tanks in a full year, it is now spending in a single month. New orders for aircraft, missiles, space vehicles, and parts—making up another sub-category of transportation equipment—increased from \$11.356 billion in February to \$14.122 billion in March, a rise of 24.4%. Overall new orders

FIGURE 11

U.S. Defense Expenditures on Ships and Tanks

(Millions \$)



Source: Conference Board.

for transportation equipment thereby were pushed up in March by 24.8%, compared to the month before.

New orders for what the Commerce Department characterizes as “defense capital goods”—ships, tanks, missiles, and some other categories—were rising from \$5.459 billion in January to \$6.832 billion in February (+25%), and to \$11.196 billion in March, marking another monthly rise by 64%.

President Bush has just announced an \$80 billion re-armament program. On top of this, the government is preparing for a \$50 billion “cyberwarfare” program, in order to prevent and retaliate against Internet attacks on key U.S. infrastructure.

All of these are just desperate attempts to somehow keep the economy alive, which in the end will fail, as they avoid the fundamental problem: that the present worldwide economic and financial system is finished, and that every additional day that the final collapse of this rotten system is postponed, more indispensable economic substance in terms of enterprises, physical infrastructure, and health systems are being destroyed. That is why LaRouche has called on governments and central bankers to do exactly the opposite of what Wall Street demands. That is, to come up with the shocking announcement of interest rate *increases*. In the present mood of markets, this would kill the speculative bubble and finish the system in a matter of a few hours or days. And then, we can clean up the mess.