

Meltdown of the Telecoms Continues, And Threatens World Financial System

by Richard Freeman

The global telecom sector, especially that of the United States, has been melting down at an accelerating rate. On Jan. 28, Global Crossing filed for Chapter 11 bankruptcy protection, becoming the largest telecom bankruptcy filing—and the fourth largest of any kind—in American history. In taking that action, Global Crossing fired 3,200 workers, adding to the tidal wave of layoffs of telecom workers that is inundating the U.S. economy.

This sector is the largest part of the “New Economy,” significantly bigger than the dot-com sector at its largest; it represents much more physical plant and equipment. Its collapse, following the bankruptcy of hundreds of dot-coms, adds to the implosion of the New Economy; launched approximately 1995, the New Economy built a gigantic speculative bubble, now being punctured.

In real physical-reproductive terms, it was never sustainable. Yet, various so-called authorities, led by Federal Reserve Board Chairman Alan “Dracula” Greenspan and members of the Bush Administration, say the New Economy will lead a 2002 “economic recovery.”

Debt and Overbuilding

The telecom sector collapse is driven by two intertwined forces. First, it is over-leveraged: Its companies borrowed enormous sums of money during the 1990s, to finance a wave of mergers and some expansion. Telecoms’ total outstanding debt—still estimated at \$650 billion or more—requires debt service far larger than that portion of the sector’s revenue stream available to service it; it is sucking the telecom sector dry.

Second, the equipment of the telecom sector does have some useful, if limited purpose, but it was pressed into the service of the New Economy, which is in violent conflict with the real laws of economic development. Thus, there was an overbuilding of telecom capacity based on the fantasized vision of the objectives of the New Economy, which will never be realized. For example, there was an overbuilding of fiber-optic cable systems by a factor of at least 10. Many New Economy companies were built based on the idea that the telecom sector would expand perpetually by 15 to 30% per annum, though the New Economy is a house of cards, which after an initial start-up, could never sustain those rates of growth.

The overbuilding and other factors have caused revenues

in some sections of the telecom sector to stagnate, in other sections to fall. This is not a temporary condition, but a constraint of the telecom sector situated within the larger New Economy. Combine physically constrained or falling revenues, with skyrocketing debt service, and one has a sector trapped in a self-feeding downward spiral.

At this point, the debt service has become so large with respect to the revenue, that an increasing number of companies are filing for bankruptcy. Within days of Global Crossing, McLeodUSA Communications filed the fourth-largest telecom bankruptcy in American history. Companies are now at bankruptcy’s edge, which a few years ago seemed invulnerable, because they were not fly-by-night dot-coms, but large and well-established producers such as Lucent Technologies, the equipment maker; Worldcom, the second-largest long-distance phone company in America; or Nortel, the telephone hand-set maker.

A similar process in Europe is shown by British-based Marconi’s default on March 22 on financial obligations; it could formally file for bankruptcy any day.

Lyndon LaRouche, now a 2004 Presidential pre-candidate, was from 1998 a lone voice of sanity, forecasting that the New Economy, based on its insane premises, would crash. The telecom sector in particular, and the larger New Economy, of which it is a driving part, is not an isolated part of the world economy: It has been made a dominating feature of it. The accelerating physical and financial implosion of the telecom sector is so situated, as to melt down the already bankrupt world financial system.

The New Economy Hoax

For purposes of this report, the following functions and companies are designated in this sector: telecom equipment makers, such as Cisco Systems; satellite equipment makers; producers or operators of cellular and fiber-optic systems; producers or operators of messaging, alarm, and data communications systems (excluding networking). Internet companies, such as Internet service providers and dot-coms, are included. Excluded from the sector are computer makers, such as Dell and IBM; software producers such as Microsoft, and so forth.

There are of course legitimate purposes for computers, within limits, and legitimate purposes for systems such as fiber-optic cables, or digital subscriber lines (DSL). However,

two points are decisive. Most of the computer and telecom systems are used for administrative or overhead purposes; thus, they are non-productive in their use. Second, the New Economy pushed an extreme form of paradigm-shift toward belief in a speculative information age, and away from emphasis on production, manufacturing, agriculture, and infrastructure.

The City of London-Wall Street financiers who have steered the New Economy, have deceitfully called it “high-tech.” But real high-technology is considerably different: It is based on scientific discoveries of universal physical principle, which, when transmitted to the economy, cause high rates of increase of scientific productivity, and of the productive powers of labor. Such high-technology industries include: development of the machine-tool-design sector; fighting disease by increasing knowledge of the principles of the electromagnetic spectrum; development of magnetically levitated transport systems; development of advanced forms of nuclear energy; space travel, etc. These sectors have all been shrunk.

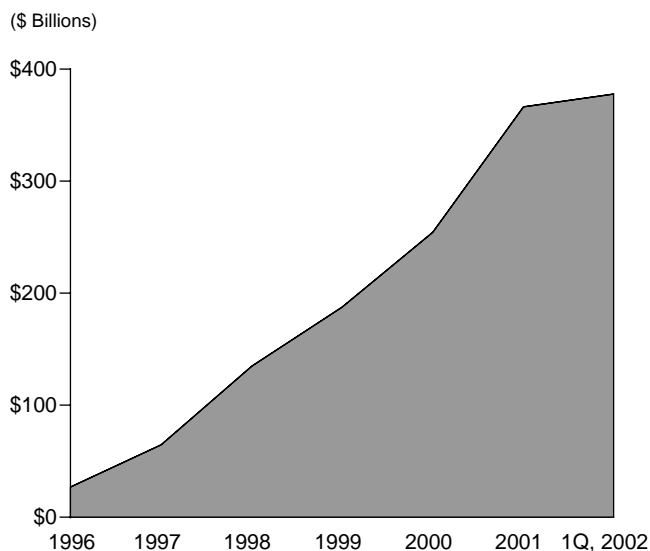
In promoting the New Economy instead, the financial oligarchy’s intention is threefold: first, to destroy a nation’s productive culture, decimating the “Old Economy” based on production; second, to extend the financial bubble to gargantuan proportions, in order to rake in huge sums of money; third, to create the artificial impression of economic growth.

A key gimmick is that increased purchases of computers and other New Economy goods have been counted as increased “capital spending.” Further, the U.S. Commerce Department applies a bogus accounting mechanism called the “hedonic method”: Since new computers cost less to purchase, but can do the same or more computational work, the Commerce Department makes an adjustment, counting each new computer purchased as having the value of a multiple of an old computer, and thus, fallaciously increases the “capital spending” for computers even further. The fraudulent measure known as Gross Domestic Product is inflated; “expansion” and “recovery” are produced from a clear blue sky.

The crazed premises for the New Economy had been drawn up by radical positivist Norbert Wiener in his 1948 book *Cybernetics*. The distinctly creative cognition of human beings to discover new scientific ideas was denied by Wiener; instead, “thoughts” would be simulated by linear equations in computers, which was dubbed “Artificial Intelligence.” “Systems analysis” would replace productive relations. Productive work to increase mankind’s mastery over the laws of the universe, through manufacturing, agriculture, and infrastructure, would be replaced by the Information Age.

The policy was prepared throughout the “post-industrial society” shifts forced by 1970s-1980s deregulation, and by then-Federal Reserve Chairman Paul Volcker’s super-high interest rates in the first half of the 1980s. Manufacturing and agricultural production gave way to bigger and bigger speculative financial bubbles until, by 1995, the deregulated U.S. financial system was white hot with speculation. Then the Information Age virus was introduced at full strength.

FIGURE 1
U.S. Telecom Sector’s Cumulative Bond Issuances, 1996-1Q, 2002



Source: Thomson Financial Services.

Extensions of Wall Street

It is remarkable to consider that many of the big-named telecom companies, with exceptions such as the Baby Bells, did not exist in 1990, and were relatively small in 1995. How did they become so large by 2000? While the heads of these companies were described in every business and financial publication as visionaries and titans of industry, this is pure invention.

Recognizing both the importance of the paradigm-shift of the “New Economy” project, and the substantial fees, commissions, and interest that would eventually be earned on the deals, financiers put the primary impetus into the growth of the telecom companies. From Jan. 1, 1996 until the end of the first quarter of this year, Wall Street and the City of London financial institutions lavished \$1.09 trillion in credit extensions—nearly \$200 billion annually—on the telecom sector, to build its highly speculative growth. Leading the way were J.P. Morgan (now J.P. Morgan Chase), and Citigroup/Salomon Smith Barney. For the most part, the telecom companies are extensions of Wall Street.

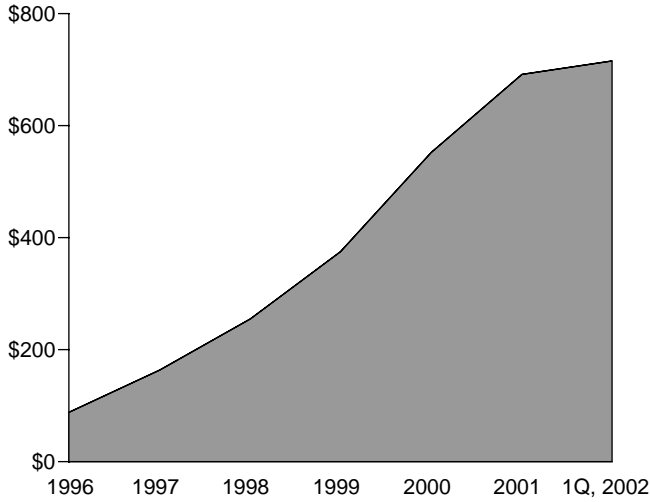
These financial institutions either underwrote the telecom sector’s bonds issuances—and then bought a good portion themselves—or, made commerce and industry (C&I) loans to the U.S. telecom companies. But the process cut two ways: the frenzied rate of credit extension meant that the telecom sector, if it didn’t generate huge revenues, could become indebted at a break-neck pace.

Figure 1 shows that between Jan. 1, 1996 and the end of the first quarter of 2002, U.S. telecoms issued a total of \$378 billion in new bonds. Firms such as J.P. Morgan underwrote,

FIGURE 2

U.S. Telecom Sector's Cumulative Bank Borrowings, 1996-1Q, 2002

(\$ Billions)

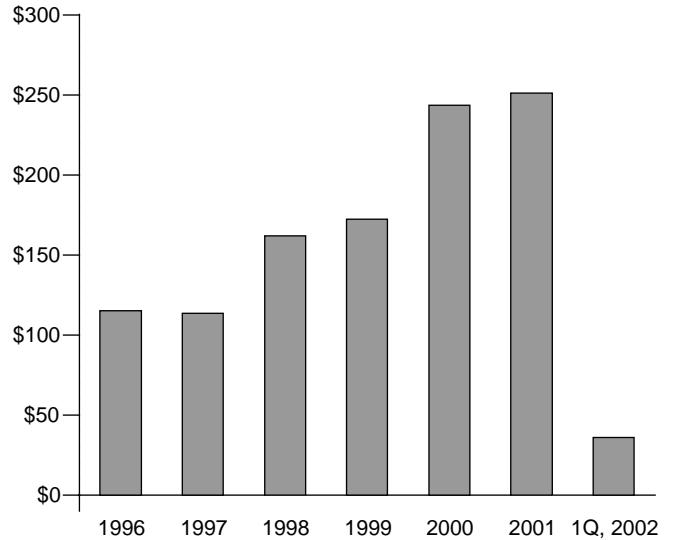


Source: Thomson Financial Services.

FIGURE 3

U.S. Telecom Sector's Annual Increase in Total Debt, 1996-1Q, 2002

(\$ Billions)



Source: Thomson Financial Services.

bought, and sold the bonds to investors.

Figure 2 shows that between Jan. 1, 1996 and the end of the first quarter of 2002, Wall Street and other banks made \$716 billion in commerce and industry loans to U.S. telecoms.

We look next at the amount of funds that the U.S. telecoms raised from their combined issuance of bonds, and from borrowing from banks—adding up to the telecoms' total debt—first, year-by-year, and then, on a cumulative basis. **Figure 3** depicts the annual increase in the U.S. telecoms' total debt. In 1996 and 1997, the sector borrowed (through bond issuance and bank borrowing) \$115 billion per year. In 2000 and 2001, that figure was up to approximately \$250 billion per year.

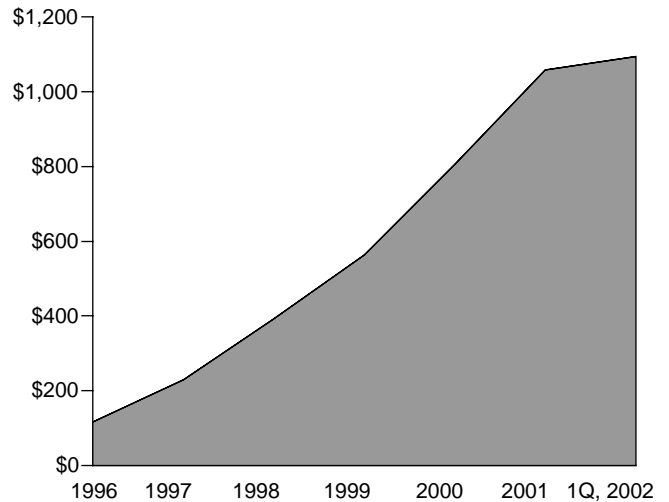
There is an important distinction to make. Between 1996 and 2000, the increase in the U.S. telecom sector's total debt was largely for merger activity, with some expansion. However, in 2001, the sector was borrowing principally to roll over its debts in an attempt to survive. Notice that in the first quarter of 2002, the sector's debt increased by only \$36 billion, which projects to an annualized rate of increase of \$144 billion—significantly below the level of 2001.

Figure 4 shows that between Jan. 1, 1996 and the end of the first quarter of 2002, the U.S. telecom sector's cumulative total debt—both bond issuance and bank borrowing—increased by \$1.09 trillion. *No other sector of the economy received credit even remotely approaching that amount.* Imagine if, instead, during this same period, \$1.09 trillion in credit had been extended to expand and upgrade America's most essential industries, such as the machine-tool sector—what a positive effect on the productivity of the total physical economy would have resulted.

FIGURE 4

U.S. Telecom Sector's Cumulative Total Debt, 1996-1Q, 2002

(\$ Billions)



Source: Thomson Financial Services.

What is the total debt outstanding of the U.S. telecom sector, and what is its effect? Undoubtedly, the companies paid off some of this \$1.09 trillion extended since January 1996. *EIR* estimated that the sector paid back 40% of this

debt, leaving \$650 billion outstanding (this may be a very conservative estimate of the remaining indebtedness). Of that \$650 billion, the annual debt service (repayment of a portion of the principal plus interest) would be approximately \$135 billion per year.

According to the March 13 *Wall Street Journal*, the U.S. telecom sector raises approximately \$300 billion in annual revenues. Thus, some 45% of the telecom sector's annual revenues may be going to the account of servicing the debt. The companies acquired this debt through such means as manic mergers and acquisitions. Under the best of circumstances, the U.S. telecom sector could not service this debt; but now, with great overcapacity and fallen revenues, it is sucking the sector dry, driving its collapse.

It should be noted that of the financial institutions that extended credit to the U.S. telecoms, J.P. Morgan led the way. The world's largest derivatives bank, J.P. Morgan made \$280 billion in bank loans to telecom companies, and underwrote \$48.1 billion in telecom bonds, for a participation of \$328.1 billion in credit extension to the sector. Citigroup/Salomon Smith Barney participated in \$209.1 billion in telecom credit extension. Together, the two firms participated in half of the credit extended to the U.S. telecoms since Jan. 1, 1996. These two banks are very exposed, in this, as in derivatives and other ways, and ripe to fall.

The Problem of Revenues

While their debt escalated, the telecoms had serious problems on their real economic side, and with their revenues.

There was never any basis, from the standpoint of the real physical economy, for the New Economy to realize its fantasy-ridden objectives; it was a hoax. Its advocates proclaimed that it would grow by 15-30% each year, effectively forever. In his 1997 essay, *The Long Boom*, and in other writings, system analyst Peter Schwartz predicted that the emergence of the New Economy had put an end to business cycles, and there would never again be a recession. Many suckers believed him and similar "analysts," as they believed in the price of Enron stock and many other myths.

But the laws of real economics—based on the upward progress or lack of progress of mankind, as measured by an increase in potential relative population density—treated the New Economy harshly.

For example, for all the telecom infrastructure to be utilized, there had to be a vast increase in Internet traffic and data and voice transmission. Ultimately, though such a calculated goal was never published as such, this was premised on every home having one or two cable hook-ups, three or four Internet terminals, etc.; and each business increasing its data and voice transmission by 15-30% per year. It wasn't going to happen.

The fate of the fiber-optic cable system is exemplary. In and of itself, fiber-optic cable could be a useful advance, up to a point. It consists of hair-thin strands of super-clear glass, which carry infrared light, generated by tiny lasers that blink on and off billions of times per second, in a code that transmits

voice or data traffic. Such cable dramatically increases the number of calls that can be handled at one time, making it cheaper to use than the standard copper coaxial lines. But the fiber-optic cable system was premised on being a subordinated adjunct to the Internet, above all.

Since no regulation of the fabrication and laying of fiber-optic cable was permitted, every company that could get its hands on the stuff proclaimed that it was going to build a national, or super-regional fiber-optic network. In some cases, four to six companies built fiber-optic cable networks between or within the same major cities, far beyond prospective levels of voice or data transmission.

The result is overcapacity: 39 million miles of cable were laid underneath railroad beds, natural gas lines, corn fields, and roads—enough to encircle the Earth more than 1,500 times. Today less than 5% of the cable is "lit"; the rest remains dark, and most is not likely to be "lit." The laying of the fiber-optic cable may be the relatively easy part. For every \$1 spent in laying cable, about \$20 needs to be spent for what is called "last mile connection," which means building the switching stations and all the equipment that is necessary to reconfigure the system to connect to the final customer. This is an expense the industry would not undertake, since there is no justification for it in terms of voice or data traffic.

In this wild environment, the case of Global Crossing was typical. Global Crossing was founded by Gary Winnick, who, in the 1980s, worked with Michael Milken at the dirty-money machine known as Drexel Burnham Lambert. Winnick headquartered Global Crossing in Bermuda, both for tax purposes, and to keep it away, as much as possible, from inspection. Winnick's Global Crossing went on to build over 100,000 miles of fiber-optic cable, in the United States and 26 other countries. It became Wall Street's darling: J.P. Morgan and Citigroup/Salomon Smith Barney extended large amounts of credit to it. From a level of zero in 1997, Global Crossing's market capitalization reached \$60 billion in 2000, making it one of the 30 largest companies in America.

But it had little voice or data traffic on the fiber-optic lines it had laid, and thus little revenue from that source. Winnick had to come up with voice or data traffic; so, in part, he invented it. Global Crossing engaged in "swaps": It booked traffic on other fiber-optic telecommunications companies' systems, and they in turn, booked traffic, usually of an equal value, on his. That way, each company could show an increase in recorded revenue, though no actual increase in economic activity had ensued. The swaps were also used to hide costs. The Securities and Exchange Commission and various Congressional committees are now investigating Global Crossing's practices. While the media have focussed on the illicit practice of swaps, it has failed to address the larger point: that this practice was used, above all, to make it appear that the unrealizable fantasy of the New Economy could be achieved.

Global Crossing's accountant is Arthur Andersen.

J.P. Morgan made hundreds of millions of dollars from its dealings with Global Crossing, and fulfilled other Morgan

objectives. Global Crossing pumped up the entire speculative New Economy bubble further, allowing Morgan and other banks to float trillions of dollars of derivatives contracts based upon it. This was critical for Morgan, with its nearly \$25 trillion in notional derivatives instruments outstanding, to keep the overall cancerous derivatives bubble afloat by expanding it.

On Jan. 28, Global Crossing filed for bankruptcy.

Only Reality Has Struck Telecom

But reality has further asserted itself, causing additional problems in the physical economy and revenues of the telecom sector, and ripping apart that sector's two fundamental assumptions. The sector's CEOs thought that increased volumes of data traffic, as opposed to voice calls, would be the savior of the telecom industry. But data users, mostly corporations, instead of paying on the more expensive per-minute basis, are paying for the data in bulk. On this basis, data transmission is not even as profitable as old-fashioned voice calls.

Telecom "entrepreneurs" like Winnick also believed that voice-call traffic would rise. But alarmed industry executives report that people are sending millions of e-mails per day, instead of spending money for telephone calls. Some industry sources now predict that, in the future, the volume of voice calls will fall each year.

"It's never been this bad, not even close," said Scott Cleland, chief executive of Precursor Group, an independent research company in Washington, D.C.

In addition to their debt, the telecom companies are having severe difficulties with their stock price.

Table 1 shows the stock valuation of six telecom data/voice carriers and eight telecom data/voice equipment producers, which are key companies in the telecom sector. It can be seen that on Jan. 1, 1996, only four companies had publicly traded stock, with a combined market capitalization of \$69 billion. By Jan. 1, 2000, the market capitalization of these 14 companies had skyrocketed to \$1.352 trillion: in only four years, \$1.283 trillion of artificial paper value had been created.

By March 18, 2002, the 14 companies' market capitalization had fallen to \$212 billion: \$1.14 trillion of paper value had been wiped out.

The telecom stock wipe-out is part of the overall wipe-out of the New Economy stocks and companies, encompassing two related phases. During the first phase, which extended from March 2000 through roughly Fall 2001, principally the Internet companies—the dot-coms and the Internet service providers—failed. During this period, over 200 dot-coms, with names like Pet.com and Furniture.com, filed for bankruptcy. But this set off a direct chain-reaction: Many telecom companies ultimately depended on the Internet to generate a significant share of their revenues: The collapse of that Internet revenue, and related problems, like the overcapacity of

TABLE 1

Market Capitalization of Telecom Companies (\$ Billions)

	Jan. 1, 1996	Jan. 1, 2000	March 18, 2002
Data/Voice Carriers			
Global Crossing	\$0	\$22	\$0
Level 3 Communications	0	28	1
PSINet	0	5	0
Qwest*	0	38	15
Williams Communications	0	11	0
WorldCom**	14	151	21
Data/Voice Equipment Producers			
Ciena	\$0	8	3
Cisco Systems	42	369	121
Corning	2	32	8
JDS Uniphase	0	52	7
Juniper Networks	0	106	4
Lucent	0	230	16
Nortel Networks	11	278	15
Sycamore	0	22	1
Total Market Capitalization	69	1,352	212

* In 1996, excludes US West

** In 1996, excludes MCI

Source: Scot Cleland, chairman of the Precursor Group, "Global Crossing's Bankruptcy: A Window Into a Broken System of Protecting Investors," testimony March 21, 2002 before the House Committee on Financial Services, Subcommittee on Oversight and Investigations.

the fiber-optic system, threw the telecom companies under the stone of their huge debt.

Then, as a result, since Spring 2001, a second phase of wipe-out erupted, in which the telecom companies sharply curtailed their own functioning, or went belly up. Far more substantial than the dot-coms, these companies comprised the "backbone" of the New Economy.

Together, these two phases wiped out the Nasdaq stock market.

Layoffs and Shutdown

The sector's collapse in revenues and functioning is now in full swing, slashing its large workforce, and producing a dramatic effect throughout the U.S. economy. According to the outplacement firm Challenger, Gray, and Christmas, the telecom sector announced the layoffs of 317,777 American workers during 2001, more than nine times the layoffs of 2000 (reflected in **Table 2**). CEO John Challenger called it "a shaking out of the bubble. In many ways, it is much more severe than what happened to the dot-com sector. Telecommunications is much bigger, and there are many more people employed there."

Lucent Technologies, the maker of telecom equipment, announced 46,000 layoffs, of which a minimum of 10,000

TABLE 2

Telecom Sector Announced Layoffs of U.S. Workers in 2001

Motorola	48,400	SBC Communica-	
Nortel Networks	48,000	tions	6,500
Lucent Technologies	46,000	Sprint	6,000
Communications	17,000	Agere Systems	6,000
JDS Uniphase	16,000	Avaya Inc.	4,900
WorldCom	11,550	Cable & Wireless	4,000
Qwest Communica-		Bell South	3,000
tions	11,000	Global Crossing	2,000
ADC Telecom	9,600	Level 3 Communi-	
Ericsson	9,000	cations	1,725
Cisco Systems	8,500	McLeodUSA	1,600
Agilent Technologies	8,000	Ciena	1,430
Corning	7,575	Nokia	1,300
Philips Electronics	7,000	Marconi	1,000
3Com	6,500	360 Networks800	

Source: Challenger, Gray & Christmas.

will be in New Jersey. Otherwise, Chicago; Dallas; San Jose, California; Cedar Rapids, Iowa; and Raleigh-Durham, North Carolina are areas with significant exposure to telecom equipment makers.

That the collapse process is still accelerating, is shown by the case of Nortel Networks Corp., one of the world's three largest makers of telephone handsets and other equipment. Though a Canadian company, Nortel makes most of its sales in the United States. In fiscal 2000, Nortel had sales revenue of \$30 billion; in March, it projected sales revenue to fall to \$12.3 billion in fiscal 2002, a drop of 59%. When profits fall 59%, that is significant; but when sales revenues drop by 59%, it is a sign that the company is evaporating.

Fed Chairman Greenspan and Bush Administration officials still point to the New Economy, underpinned by the telecom sector, as the supposed leader to take the U.S. economy into recovery. So do industry "experts": When February semiconductor sales, for example, were announced as 35% below a year ago, the Semiconductor Industry Association pronounced, "Although business investment has yet to pick up, [and] flat to slow growth of sales in the first quarter" was expected, "overall recovery" is on the way.

In fact, the diametric opposite is true.

The U.S. telecom sector debt is valued at \$650 billion, and the debt of America's entire New Economy is estimated at considerably above \$1 trillion. It is estimated that the debt of the New Economy firms worldwide is above \$2 trillion. Because the City of London-Wall Street financiers insisted on thrusting the New Economy into the central place in the world economy, the implosion of the New Economy's debt and its physical-economic structure will disintegrate the world financial system.

The Federal Reserve Vs. the United States

by John Hoefle

Major financial crises are never announced in the newspapers, but are instead treated as a form of national security secret, so that various bailout and market-manipulation activities can be performed behind the scenes. The primary vehicle by and through which these secret activities are performed is the Federal Reserve, which sets U.S. interest rates through its Federal Open Market Committee (FOMC), and intervenes in the banking system through its regional banks, and the markets through the Federal Reserve Bank of New York.

Even though it acts in many respects as a government agency, the Fed is a private corporation owned by the banks, and was created by the financial oligarchy in 1913 for the purpose of seizing control of the money- and credit-creation powers of the Federal government. The Constitution reserves such powers for Congress, as they are essential elements of national sovereignty. Congress has no right to give up those powers, and the Fed has no right to assume them. Thus the Fed is an illegal institution, the activities of which are in violation of the U.S. Constitution.

This is not an academic question, as the Fed is actively involved in looting the American population for the benefit of giant U.S. and global financial institutions, and the global casino. Few Americans have any idea the extent to which the Fed and its system reach into their pockets on a daily basis, and the extent to which their standard of living has been eroded by the financier-led deindustrialization of the United States. The cost of this usurious system is embedded in the price of every purchase, a form of hidden tax. That hidden tax also shows up in the form of shoddy goods, poor customer service and long lines at stores, time-wasting commutes, inadequate wages, and similar mechanisms in which costs are transferred to the citizen. Even more important, is the way in which the scientific and technological development of the country has been vandalized by the financier crowd; not only do we suffer from an inadequate infrastructure, but we have lost the benefits of those breakthroughs which would have occurred, the technologies which would have been developed, had the parasites not taken over the economy. It is the failure to push back the boundaries of science, that is responsible for most of our problems today. The Fed, with its imperial back-to-feudalism world outlook, is one of the deadliest and most corrupt institutions in the world. It does more damage through its policies, than even the most prolific thieves and murderers.