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U.S. Household Credit Bubble Set to Explode

by Richard Freeman

More than half of America's 290 million people, living in every city and hamlet, in every state of the nation, survive day-to-day by virtue of the greatest consumer credit bubble ever created. It is projected that at the end of 2002, American households will have accumulated $8.38 trillion in household debt—roughly $80,000 for every American household—of which $6.04 trillion is mortgage debt, and $2.34 trillion is consumer credit and other debt.

The means are created to make America borrow: Banks mail out 25 billion credit card offers to Americans every year—an average of 250 offers per household—so they will borrow sizable sums on anywhere from one to ten credit cards; department store chains and supermarkets offer their own credit cards, as well as accepting the bank cards; financial institutions' mortgage lending divisions allow and encourage borrowing against homes, whose sums they know will not be spent on home improvement. Lending conditions are so relaxed that often, the borrower has to provide only the most bare-bones credit information.

The United States dependence on credit is the consequence of a major degradation: Beginning in the mid-1960s, the City of London-Wall Street financier oligarchy imposed upon the United States a post-industrial society policy, which sacrificed America's production in manufacturing, agriculture and infrastructure to a gigantic speculative bubble.

Speaking on Dec. 12 in Budapest, U.S. 2004 Presidential pre-candidate Lyndon LaRouche said, "Prior to 1964-71, the standard of civilization was *production*—the production of the means and conditions for the perpetuation and improvement of human life. We prided ourselves on the idea that the individual should be respected for the useful contribution they made to the needs of humanity—each in their own way. The individual, so seeing himself or herself, had self-respect." LaRouche likened America's shift to a consumer society, to that of ancient Rome: "Toward the end of Rome's Second Punic War, Rome's character shifted . . . from a nation of productive peasants, largely—farmers—to becoming, not a producer society, but a consumer society, without benefit of credit cards! Rome lived, by looting the world it subjugated. . . . And then, Rome itself was destroyed, when Rome turned into an empire."

As a consumer society, the U.S. economy has taken on crucial characteristics of the Roman Empire, employing several of its critical methods to survive. No longer capable of producing the goods needed for the population's continued survival, the United States resorted to using a rigged, artificially strong dollar, by which the U.S. financial bubble sucked in the needed physical goods in huge volumes from around the world—not only from North Asia and Europe, but from the Mexicos, Bangladeshes, Dominican Republics, the Third World countries where workers are paid very little per day. In 2002, the United States will have imported a record $470-500 billion more physical goods than it exported.

American households buy large volumes of these goods on credit. *They could not afford to buy them produced by American or other workers paid enough for a good standard of living and health.* This has become painfully obvious this Winter "shopping season," as the celebrated American consumers "spending boom"—all that remains of the U.S. economy—faltered.

$33 Trillion in Debt To Blow Up

American households also use a tremendous amount of credit in the purchase of homes and cars. In a collapsing U.S. physical economy (steel production is considerably down; machine-tool production is half its level of five years ago), housing and motor vehicles production are two of the economy's only viable sectors. The housing and auto sectors place orders of significant size, through the bill of materials, for other sectors' goods: in the case of auto, for steel (steel production would be much lower were it not for orders from the auto sector), rubber, tin, glass, etc; in the case of housing, for lumber, pre-fabricated products, cement; etc.

In the purchase of imported goods, and the record purchases of housing and cars, much of these purchases on credit represent conspicuous consumption by the upper 20% of the American population, by income; $1-10 million homes, Cadillac and Lexus cars, etc. For a good part of the other 80% of the U.S. population, by income class, many (but not all) of the purchases on credit, represent something much more fundamental. Since the mid-1960s, the living standards of that lower 80% of income earners have fallen; during the past two decades the rate of fall has been 1-2% per year when measured by actual market baskets of consumer and producer goods, as *EIR* has documented (see for example, "America's Growing Income Gap: There Is No 'Economic Boom,' " *EIR,* Feb. 11, 2000). Many of these households are using credit to offset the loss in their living standards, and to purchase basic necessities like clothing, food, and homes.

Most households in all but the upper 20% income brackets have their home, their car, part of their medical bills, some of their clothes, and so forth, on credit. They juggle with one credit line to pay off another. This process has a limit: the ultimate ability to pay. Household debt has been growing, for the whole economy, by hundreds of billions of dollars per year, and on a household basis, by thousands of dollars per year. Households cannot continue to pay the debt service if their living standard is stagnant or falling 1-2% per year; or

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worse, if one of the household's members loses a job. Already, approximately 1.5 million households each year are unable to juggle their books and fall over the edge into personal bankruptcy, defaulting on their consumer debt—and in a small, but increasing number of cases, on their mortgage debt as well. Should the growing unemployment crisis trigger a large number of bankruptcies simultaneously, it will detonate the highly leveraged and unsustainable $8.38 trillion market in household debt (including its mortgage portion); this will, in turn, implode the total U.S. domestic debt bubble of $33.2 trillion, of which household debt is a leading component. At that point, the U.S. financial system is shattered beyond repair.

Greenspan Turns on Printing Press

The total U.S. household debt has grown most rapidly since 1995, systematically steered toward that growth by Federal Reserve Board Chairman Alan Greenspan. Greenspan has been desperate during the last five years, in his attempts to prevent the implosion of the world's bankrupt, post-Bretton Woods financial system, which is overhung by $400 trillion in speculative obligations, led by $300 trillion in dangerous derivatives bets. To do this, Greenspan has turned on the dollar printing presses full blast, emitting a wall of money, and putting the United States on the path toward the kind of hyperinflationary explosion experienced by the Weimar Republic in Germany in 1923.

Within this geometry, Greenspan has concentrated on attempting to build up mortgage debt and consumer credit. His 12 Federal funds rate cuts in 2001-02 brought that interest rate down to 1.25%, its lowest level in four decades. He has built up the phenomenon of "cash-out refinancing," wherein a homeowner takes out a new mortgage against the artificial increase in his home's market value, and extracts cash from the new mortgage, using a significant portion of it for consumer purchases. Greenspan's actions represent dangerous folly. To prevent the household debt bubble from collapsing, he enlarges it, injecting new debt into it, making the bubble even more unsustainable.

The actual volume of funds pumped into the economy for consumer spending far exceeds the official figures, as we will show.

The precarious nature of the household debt bubble has produced alarm. Stephen Roach, director of global economics for Morgan Stanley investment bank, warned in an article in the Aug. 2, 2002 *Financial Times* that there is "good reason to believe the [real estate] property cycle is about to turn [down]," which would pull the rug out from under the cash-out refinancing gimmick. Furthermore, "U.S. households are still steeped in denial and the imbalances of the 1990s have yet to be fully corrected."

Roach's limited criticism ignores three principal points: 1) that the current crisis goes far beyond a cyclical crisis; it is a breakdown of a greater magnitude than anything that has occurred in the past 500 years; 2) that the household credit expansion has reached a real physical limit at which the debt-service cannot be paid; and 3) that a solution to this crisis involves, as Lyndon LaRouche has advanced, first putting the bankrupt financial system through Chapter 11 bankruptcy—including much of the debt, which has been inflated by usurious practices.

An effective solution must take into account the emergency nature of the breakdown crisis, and not approach it with mere counter-cyclical measures—such as inflating monetary aggregates—which make the crisis worse. This urgently requires the commencement of LaRouche's proposal to create a New Bretton Woods monetary system, generating large volumes of low-interest, directed credit to replace the collapsed bubble of debt; credit to build development corridors of a Eurasian Land-Bridge, and to direct a Super-TVA, infrastructure-led recovery in the United States.

Post-Industrial Society Creates Debt Bubble

The financier oligarchy's imposition of a "post-industrial society" policy upon the United States in the mid-1960s, generated the hyperbolic growth of U.S. indebtedness over the past 35 years, boosting huge cycles of borrowing by both the productive, and the non-productive sides of the U.S. economy. This policy was not implemented all at once, but rather in phases. President Richard Nixon's Aug. 15, 1971 decision to take the dollar off the gold-reserve standard put an end to the Franklin D. Roosevelt-instituted, relatively successful growth era of the fixed-exchange-rate Bretton Woods system of 1945-68. After 1971, the world was under a floating-rate system, which severed financial flows from production flows. The sending of interest rates into the stratosphere in 1979-80 by Jimmy Carter's Fed Chairman Paul Volcker—reaching a 21.5% prime rate in December 1980—elevated post-industrialism to what Volcker called "controlled disintegration." This permanently wasted America's Midwest and New England industrial belts. The 1981 Kemp-Roth Tax Act and the 1982 Garn-St Germain Act, which deregulated the American banking system, promoted speculative banking flows and real estate speculation.

Speculative practices surged, and borrowing for those practices thrived. During the late 1970s through the 1990s, many of the highly speculative corporate buy-outs/acquisitions were financed with record leverage—i.e., debt. The 1990s expansion of the dot-com and telecommunications sectors involved another mountain of debt. On the household side, many households in the upper 20% of incomes used all sorts of debt to buy expensive cars, homes, and luxury goods. Fannie Mae and Freddie Mac floated trillions of dollars of debt to facilitate the sale of homes. Many households used the "cash-out refinancing" of homes gimmick.

The productive side of the U.S. economy ran up much debt as well, often with perilous implications. The progressive depression in the physical economy caused many firms to borrow just to stay alive, and meet such expenses as payrolls. Many small businesses exist by the owner-proprietor borrowing on his credit card and/or against his home to keep the

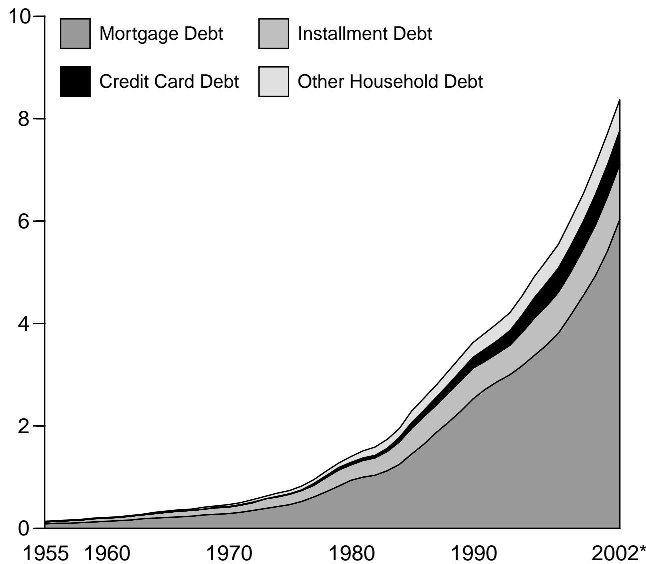


FIGURE 1
U.S. Household Debt Surges to $8.4 Trillion
($Trillions)

*Projection, based on first three quarters

Sources: Federal Reserve Board of Governors *Flow of Funds*; *EIR.*

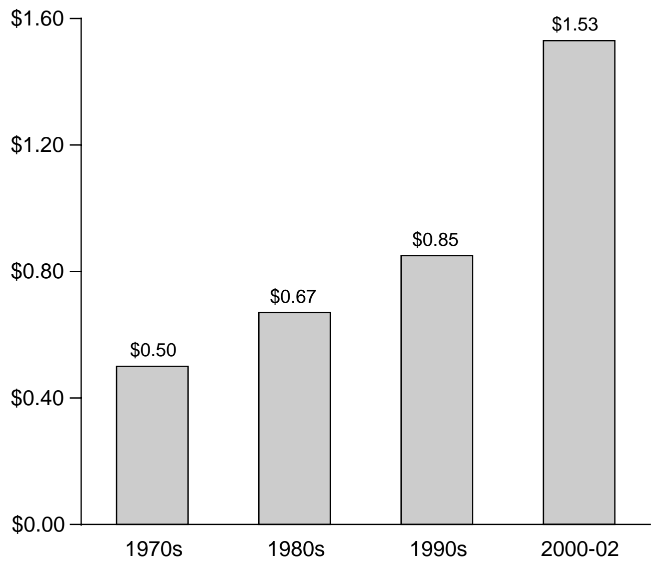


FIGURE 2
$ Rise in Household Debt for Each $1 Increase in GDP

Sources: Federal Reserve Board of Governors, *Flow of Funds Accounts*; U.S. Office of Management and Budget; U.S. Department of Commerce; *EIR.*

business open. Farmers borrow heavily to keep from losing the farm. On the household side, with real living standards falling 1-2% annually over decades, households made up for the lost purchasing power by borrowing on credit cards or against their homes for zooming medical care expenses, clothing, furniture, transportation, and food.

Unprecedented U.S. Household Debt Growth

Figure 1 shows the hyperbolic growth trajectory of debt incurred by America's households, as a consequence of the post-industrial society policy. The graph shows the leading components of household debt; mortgage debt accounts for approximately three-quarters of all household debt. The total household debt started to grow rapidly during the 1970s and 1980s, and reached $4.914 trillion in 1995; but by the end of 2002, it was projected to reach $8.383 trillion, which represents a 70.5% increase since 1995, or nearly 10% growth rate per year.[1] American household debt alone is larger than the combined household, business, and government debt of all but a few countries in the world. During 2002 alone, it surged by a record $659 billion.

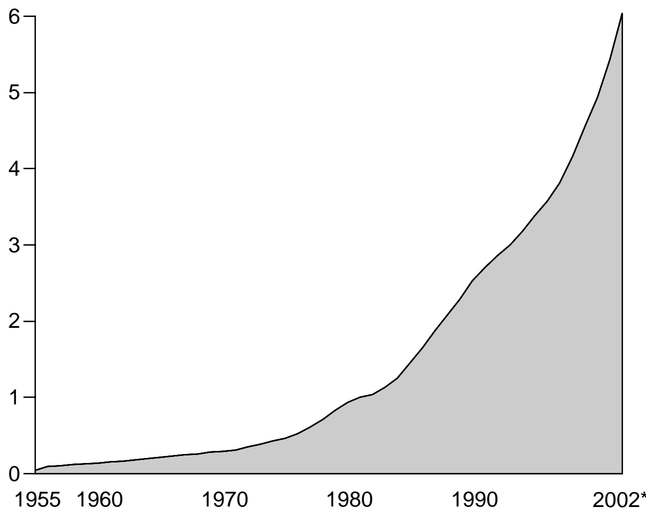
Figure 2 documents the insane situation in the United States: Household debt is growing faster than U.S. Gross Domestic Product (GDP). During the decade of the 1970s, household debt grew by 50¢ for every $1 of increase in GDP; but during the period 2000-02, household debt grew by $1.53 for every $1 of increase in GDP. This can be thought of another way: Whereas during the 1970s, it required only $0.50 in household debt to effectuate a $1 increase in GDP; today, it requires the pumping in of $1.53 in household debt to effectuate a $1 increase in GDP.

Home mortgage and credit card debt are the two major forces driving the increase in U.S. household debt. Home prices are exorbitant, having no connection to reality, because of the explosion of mortgage debt, backed up by the financing activities of Fannie Mae and Freddie Mac, and the money pumping of Fed Chairman Greenspan. Greenspan's cuts have brought the interest rate on a 30-year home mortgage to 5.93%, its lowest level in four decades. This encouraged the mortgage borrowing explosion, and the record purchase of new and used homes. **Figure 3** shows that, until 1981, home mortgage debt outstanding was still under $1 trillion. Then it started taking off; it has been torrid since 1995, a near-doubling in seven years. Between 2001 and 2002, home mortgage debt increased by $610 billion, an 11.2% annual growth rate, and comprising 90% of the $659 billion increase in total U.S. household debt in 2002.

The growth in home mortgage debt is, in turn, financing the increase in the fictitious value of homes. Take, for example, a $600,000 McMansion. The home may really be worth $250,000 when measured in what it costs to produce the home in labor and materials, and a fair profit. The other $350,000

1. *EIR* has taken data for total U.S. household debt, and other categories of debt, which represent the first nine months of 2002, and projected full year totals.

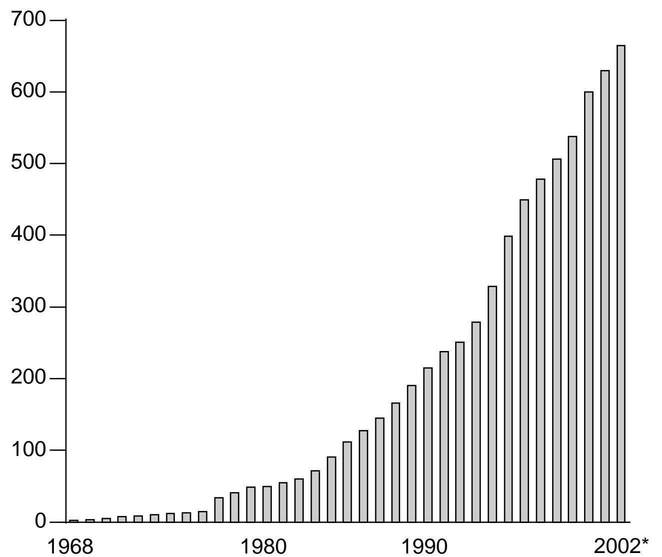
FIGURE 3
U.S. Home Mortgage Debt Tops $6 Trillion
($ Trillions)



*Projection, based on first three quarters

Source: U.S. Federal Reserve Board of Governors, *Flow of Funds Accounts.*

FIGURE 4
U.S. Credit Card Debt Tripled Since 1990
($ Billions)



*Projection, based on first three quarters

Sources: Federal Reserve Board of Governors, *Flow of Funds Accounts*; Consumer Federation of America; *EIR*.

in the home price is the artificial mark-up in a manipulated super-hot housing market. Instances of this abound: Between March 2000, and November 2002, the median price of a home in Arlington County, Virginia, adjacent to Washington, grew from $259,000 to $415,00, an incredible increase of 60% in two and one-half years. In San Diego, median home prices are increasing by greater than 15% per year to reach a level of above $350,000 per home.

By buying these homes, Americans are financing and capitalizing the fictitious portion of the home's value into a mortgage. The total cost of the mortgage may consume 35-40% of their household income. The households can't pay the mortgage and still have enough left over for other essential living expenses. This situation is untenable; the emerging wave of home mortgage defaults will puncture this $6 trillion debt bubble; this, in turn, by itself, could shatter the world financial system.

Credit Card Debt

The growth in mortgage debt performed a double function: It both financed the housing boom, and provided cash for consumer spending from the cash-out refinancing gimmick.

Families build up installment debt when they buy a car, furniture, or household appliances on credit. Car purchases are growing briskly, because the finance divisions of car companies—such as Ford Motor's Ford Credit Division, and General Motors' GMAC—are making car (installment) loans for as little as zero percent, and zero down. But the fastest growing component of household debt, and indeed of every category of debt in the U.S. financial system, is the debt carried on credit cards. **Figure 4** documents that prior to 1968, credit card debt did not exist; even in 1980, it was small. But that changed dramatically between 1990 and 2002 when credit card debt tripled, from $215 billion to $665 billion, as families reached for their plastic.

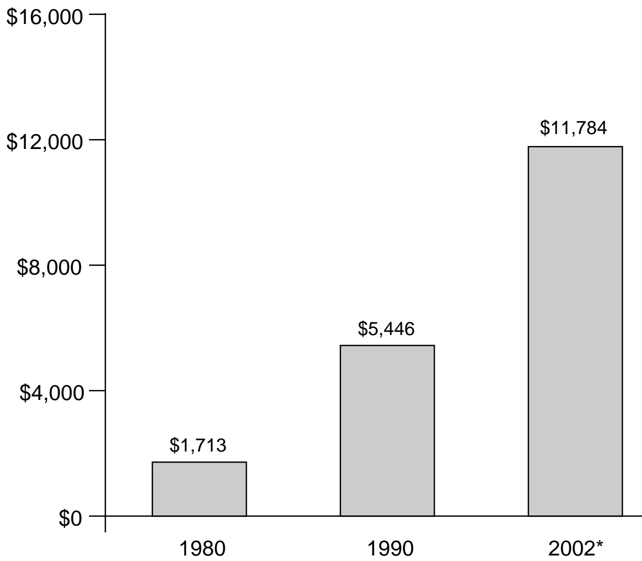
A credit card may offer the realization of a fantasy: One can buy Gucci shoes, a home video theater, even a two-week vacation on the Riviera, and forget about it, putting it on a credit card. Many families in the upper 20% income brackets, and some families in the lower 80%, regularly make such fantasy purchases. But for most households in the lower 80% of the population, the Visa or Mastercard is not a fantasy instrument: For them, the credit card purchases have become a necessity. During the past two decades, as the majority of these households' standard of living had fallen in real terms, they substituted for lost income by borrowing more, on more and more plentiful credit cards.

Increasingly, households use credit cards to pay medical expenses not covered by the pro-genocide HMOs. In 2000, the Consumer Bankruptcy Project, co-headed by Elizabeth Warren of Harvard Law School, released a study, "Medical Problems and Bankruptcy Filings." Based on its survey, in 1999, there were 1,281,581 households that filed for bankruptcy; nearly 40% of these cases were wholly, or in part, due to medical crises. Several desperate households charged $15-25,000 in medical expenses on their credit cards, before filing for bankruptcy.

How large is credit card debt per household? Today, ap-

FIGURE 5

Credit Card Balances Outstanding, Per Household With a Credit Card Balance



*Projection, based on first three quarters

Sources: Federal Reserve Board of Governors, *Flow of Funds Accounts;* U.S. Department of Commerce; Consumer Federation of America; *EIR.*

proximately 86 million out of America's 107 million households (about 80%) own a credit card, and approximately 56 million of these households carry a credit card balance from month-to-month. **Figure 5** shows that the average credit card balance of the cardholder carrying a balance has, since 1980, grown seven-fold, to a current level of $11,794. At the current interest rate, the annual interest on this average balance costs that family $1,800 per year.

Cash-Out Refinancing

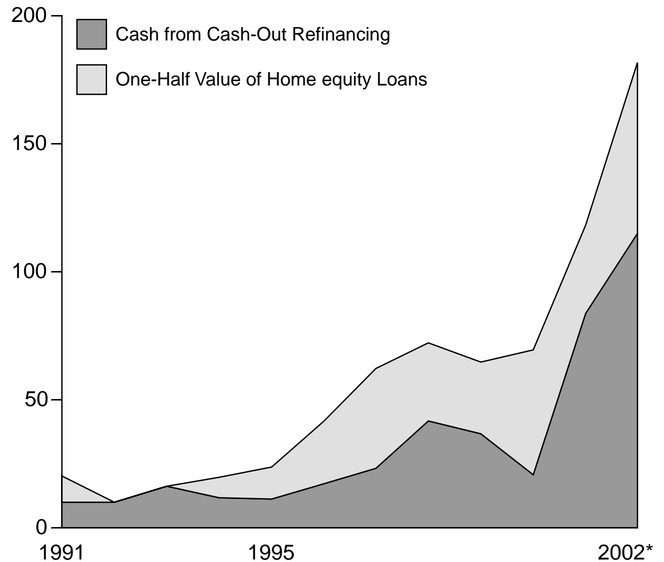
The volume of credit that is extended for consumer purchasing purposes, is officially listed by the Federal Reserve Board of Governors as the combined total of installment debt, credit card debt, and other household debt. But the real volume of credit that is extended for consumer spending is actually much larger.

During the last decade, the practice of cash-out refinancing has grown to monstrous proportions. Families have utilized their home not just as shelter and a place to impart culture and ideas to their children, but as an investment against which they borrow to extract funds for consumer spending. Households borrow against their homes for cash-out refinancing and in the form of home-equity loans. Half of all home-equity loans are spent not on the home, but on consumer spending. *EIR* can show that the combined total of cash-out refinancing, and this one-half of home-equity loans, is greater than the official total of credit that the Federal Reserve claims is extended for consumer purchasing.

FIGURE 6

Growth of Cash from Cash-Out Refinancing, and Consumer Cash From Home-Equity Loans

($ Billions)



*Projected, based on first three quarters

Sources: U.S. Federal Reserve Board *Flow of Funds Accounts;* Federal National Mortgage Association; Federal Home Loan Mortgage Association; *EIR.*

Cash-out refinancing is a risky gimmick. Under this arrangement, a homeowner takes out a new, larger mortgage on his home, whose value has risen because of the still-ongoing home real estate bubble. With the new cash, he pays off his old mortgage and some credit card debt, and then spends the remaining cash for consumer purposes. For example, let us say that a home has risen in value from $225,000 in 1999, to $300,000 in 2002. Further, assume that in 1999, the homeowner had taken out a $225,000 mortgage to buy the home (not the usual practice, but we can make this 100%-financed assumption without any fundamental distortion of the point). In 2002, the homeowner takes out a $300,000 mortgage. With the $300,000, he pays off the original $225,000 mortgage, pays off credit card and other debt, and has $40,000 to spend for cars, home video theaters, etc.

Figure 6 shows, in the lower curve, the growth of the cash extracted from cash-out refinancing, which has grown tenfold from $10 billion in 1991, to a projected $115 billion in 2002.

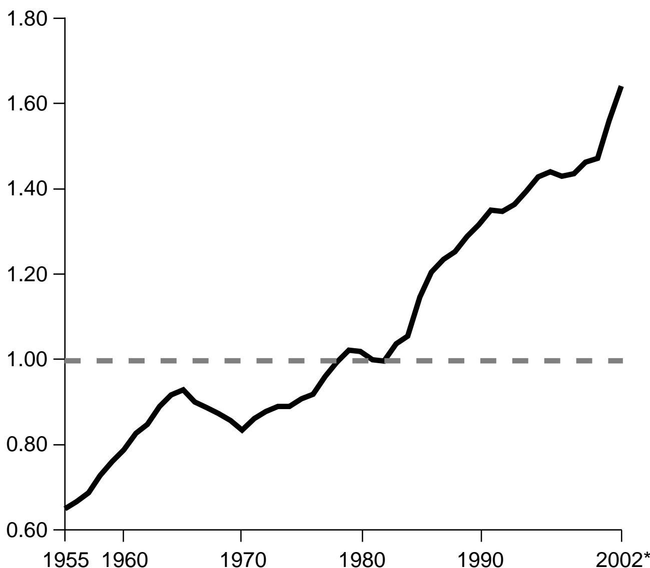
The other major form of borrowing against one's home is the home-equity loan. Unlike cash-out refinancing, the home-equity loan does not refinance mortgage *debt,* but rather is a borrowing against some of the paid-in equity built up in the home. Federal Reserve economists admit that half of the funds that homeowners borrow this way are not used for home expansion or improvement, but for consumer cash. Figure 6 shows, in the upper curve, the growth of this one-half of the

TABLE 1
Credit for Consumer Spending Rises Sharply, 1991-2002
($ Billions)

Year	Credit Card Debt	Combined Installment Debt and Other Household Debt	Cash from Cash-Out Refinancing	One-Half Value of Home-Equity Loans	Real Consumer Spending Credit Level
1991	$22.6	$–34.6	$10.0	$10.2	$8.2
1992	13.2	–8.1	10.0	–0.4	14.7
1993	28.3	28.3	16.1	–3.7	69.0
1994	50.1	71.6	11.7	8.1	141.5
1995	69.8	65.6	11.1	12.5	159.0
1996	50.2	39.0	17.2	24.4	130.8
1997	28.9	29.1	23.1	39.0	120.0
1998	28.3	46.2	41.8	30.3	146.6
1999	31.7	67.1	36.7	28.0	163.5
2000	62.0	82.3	20.6	48.9	213.8
2001	29.9	77.4	83.7	34.4	225.4
2002*	34.9	52.1	115.0	66.8	268.9

*Projection, based on first three quarters of 2002
Sources: Federal Reserve Board "Flow of Funds Accounts"; Federal National Mortgage Association; Federal Home Loan Mortgage Corporation; *EIR.*

FIGURE 7
Ratio of U.S. Household Debt to Total Wages and Salaries



*Projection, based on first three quarters

Sources: U.S. Federal Reserve Board of Governors; U.S. Department of Commerce; *EIR.*

value of home-equity loans, which in fact, is used for consumer spending; it has grown sixfold from $10.2 billion in 1991, to a projected $66.8 billion in 2002.

In 2002, the total of credit extended for consumer spending was strong. Based on Federal Reserve Board data, the *official* credit so extended—the combined total of installment debt, credit card debt, and other household debt—was a hefty $87.0 billion. But in 2002, the combined total of cash solely from cash-out refinancing and half the home-equity loans, was a much larger $181.8 billion. These funds added a real kick to consumer spending.

Table 1 shows the real level of credit, generated from all sources each year for consumer spending. Column 2 shows the annual amount of new credit card debt, and column 3 the combined total for new installment debt and other household debt. The sum of these columns gives the total amount of new credit for consumer spending, as officially reported by the Federal Reserve Board. Column 4 shows the new cash extracted from cash-out refinancing, and column 5 shows one-half the value of home-equity loans. Thus the real level of credit for consumer spending is the sum of all the different sources, and it leapt *thirtyfold* from $8.2 billion in 1991, to $268.9 billion in 2002. This is far bigger than what the Federal Reserve reports.

This explains Greenspan is so determined to keep the housing bubble going, in order to extract credit for consumer spending.

Debt Service

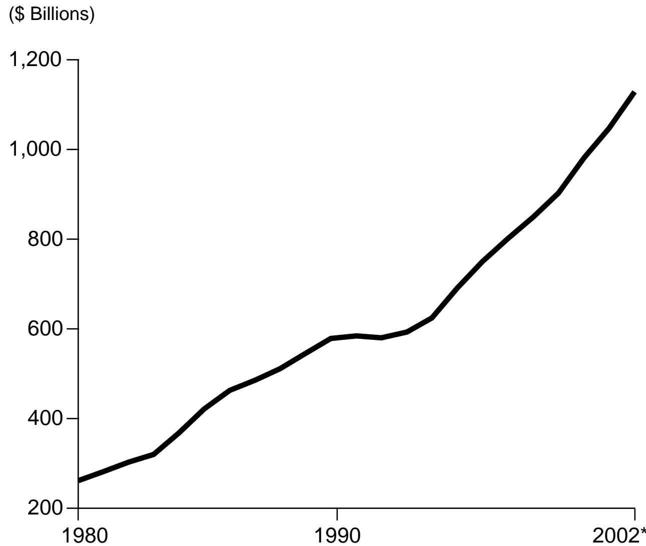
This debt system is unsustainable. American household debt is reaching a point at which it is so large that it cannot be handled out of the wages and salaries of the population. **Figure 7** shows that in 1955, the level of household debt was only 65% of the level of wages and salaries; it took until 1985, for the level of household debt to become larger than the level of wages and salaries. Today, the ratio has climbed to 1.64.

The build-up of all of this debt comes with a price. In 2002, as total household debt outstanding reached $8.38 trillion, the debt service burden—annual payment of interest and a portion of the principal of the debt—surged. **Figure 8** shows that the debt service that households must pay, has quadrupled from $261 billion in 1980, to $1.128 trillion—more than $10,000 per household in annual debt costs—in 2002.

This debt service is crushing the population, especially the lower 80% by incomes. **Figure 9** shows that in 1980, debt service, on average, consumed 18.9% of American wages and salaries, and that in 2002, it consumed 22.1% But, as high as it is, the simple average only tells half the story. An individual who earns $1 million in wages and salary, may pay $30,000 per year for debt service, which is a considerable sum, but only 3% of his salary. This individual's 3% is mixed in with the ratio of other households to reach a national average.

At least 20 million households, out of those in the lower 80% by income, pay between 35% and 70% of their wages and

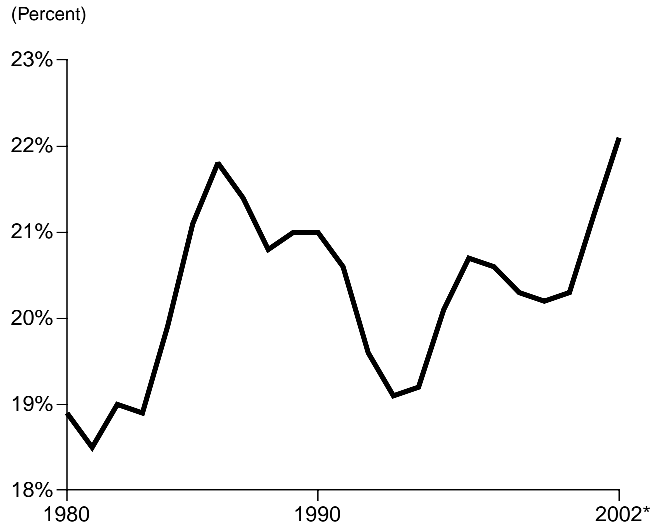
FIGURE 8
Annual Debt-Service Paid by Households Escalates



*Projection, based on first three quarters

Sources: U.S. Federal Reserve Board of Governors; U.S. Department of Commerce; *EIR*.

FIGURE 9
Debt-Service as a Percent of Wages and Salaries



*Projection, based on first three quarters

Sources: U.S. Federal Reserve Board; U.S. Department of Commerce; *EIR*.

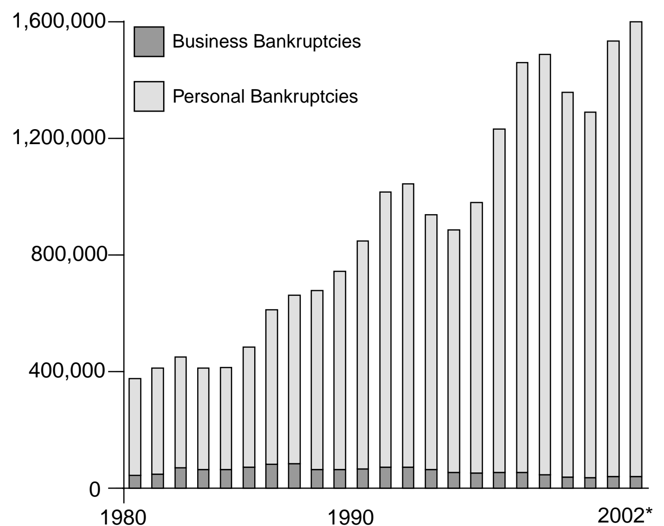
salary income for the debt service payment of home mortgage, car debt, credit card debt, and other debt items. This is draining the life-blood out of the household. Once the debt crosses the threshold to being excessive, it can be serviced only by greater issuance of credit. That represents no ultimate solution.

When a household can no longer meet the debt obligations, it files for personal bankruptcy. **Figure 10** shows the projection that an historic high of 1,572,672 households will have filed for bankruptcy in 2002. During the past dozen years, (avoiding double counting) one in every ten households in America has been forced to file for bankruptcy. The most alarming feature of the wave of bankruptcies is that a growing number of households are filing a home mortgage bankruptcy, not merely defaulting on credit card and installment debt.

On Dec. 5, the director of research of the Mortgage Bankers Association, the trade group for mortgage lenders, told *EIR* that he projects that the level of cash-out refinancings will fall in 2003 to half their level of 2002, which would reduce the cash extracted from cash-out refinancings from roughly $115 billion to roughly $57.5 billion. This will slash the amount of money that households have used to pay down their other debt and to buy goods, many of which are needed for survival, intensifying the already severe liquidity pressures of households.

The household debt bubble will come down, as the system fast approaches its limit at which a large portion of households cannot pay. The collapse of this $8.38 trillion household bubble will bring down the larger $33.2 trillion total U.S. debt bubble, in a chain-reaction fashion. That will shatter the bankrupt world financial system.

FIGURE 10
Bankruptcies Swell Five-Fold Since 1980



*Projection, based on first three quarters

Source: American Bankruptcy Institute.