Taxpayers to pay for Drexel bankruptcy

by Steve Parsons

Federal officials and the financial media are spreading palaver about how well the "surprisingly resilient" U.S. economy and financial markets have absorbed the Feb. 13 bankruptcy of Drexel Burnham Lambert, the nation's number one junk bond investment bank.

Precisely the opposite is occurring. Drexel is the latest casualty in the intensifying financial crash that was triggered last September by the debt defaults of Robert Campeau's retail empire. The shock wave set in motion by Campeau has spread from the junk bond market to almost everything in sight, hurtling the economy toward the spring blowout forecast by jailed economist Lyndon LaRouche.

Far from the magical workings of the invisible hand, the deepening collapse is being contained only by desperate crisis management by a consortium of top federal financial officials and Wall Street's establishment. According to reports, the group includes New York Federal Reserve head Gerald Corrigan, New York Stock Exchange head John Phelan, Securities and Exchange head Breeden and Treasury Under Secretary Glauber, working with the elite of Wall Street. This team has been responsible for staging a counteroperation to soften the impact of the Drexel failure and to put out the line that "everything is under control."

The central coordinating agency is the Federal Reserve, which, as the "lender of last resort," has put its vast powers and limitless government resources at the disposal of the banks and markets. As in the October 1987 stock market crash, and last October's 190-point plunge, the Fed has made known that it will supply liquidity to preserve "orderly markets."

The Fed has created arrangements that are already pumping liquidity into the markets, and is on the verge of turning the government into one big credit machine to prop up Wall Street. On Feb. 15, rumors flowed through the interest rate futures markets that the Fed was directly supplying cash to Drexel's creditors and propping up the markets, by taking over at least a portion of Drexel's Treasury securities inventory, handing cash over to its panicky creditors, and "discreetly" selling the securities on the market. One of the main creditors is reported to be Citibank, Drexel's lead banker.

This is an unprecedented move by the Fed, which, aside from open market operations, directly markets securities only for other central banks.

The Fed and its consortium cohorts are manipulating not just the bond market, but the stock, futures, and currency markets as well. One Wall Street insider says, "The behavior of the market around the Drexel situation is extremely bizarre and abnormal. The market just didn't respond to the bankruptcy. I've been a student of the market for 20 years, and even though Drexel's failure was not unanticipated, still, the magnitude of it would have resulted in some sudden selling, and at least an initial drop of 50-60 points in the Dow. But nothing happened, like there was a support operation going on. 'Buy' programs were pushing it up, at a time when it should have been going down."

Sheer looting

Coincident with the Drexel debacle, the Fed and Treasury arranged to inject tens of billions in cash into the overwhelmed Resolution Trust Corp., the federal agency which is funneling money into the so-called bailout of the crumbling savings and loans sector. Under the plan, the RTC would borrow some $44 billion—or more—in "working capital" this year through new Treasury debt, which would theoretically be paid back when the RTC disposes of the assets of seized thrifts.

This plan was proposed just after the Fed installed its director of banking supervision, William Taylor, as president of the RTC Oversight Board, thus gaining even greater top-down control over the banking system.

The consortium may be about to play its last card, short of complete hyperinflation: looting the hundreds of billions of dollars in pension funds, one of the largest pools of capital in the world. According to some of the firms that manage General Motors' pension fund assets, GM plans to put a portion of its $35 billion pension fund into junk bonds, on the theory that junk's depressed prices makes it a bargain! There is little doubt such a step could be taken only with the blessing—and probably the urging—of the Fed and Justice Department.

Not that GM or other conglomerates need much urging. The collapse is knocking the bottom out of their stock valuations and balance sheets so fast that only an enormous infusion of capital can help.

Thus, the institutional leverage for a hyperinflationary binge is nearly in place. The stumbling block is high interest rates and the dollar's vulnerability. As long as Western Europe and Japan continue to develop their economies, and keep interest rates commensurate with those in the U.S., there is a limit to the credit pump's bailout of the deflationary bust in progress.

In any event, no matter how much credit is pumped or how much taxpayers are pummeled, saner heads in Europe expect that the next shock—perhaps trouble for the Shearson Lehman brokerage or a large bank like Bankers Trust or Chemical—could spread the panic so far and wide that nothing could contain it.

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