

We are heading toward the biggest financial collapse in history

by John Hoefle

The following speech was delivered by Mr. Hoefle at a meeting of the Permanent Forum of Rural Producers in Ciudad Obregón, Mexico on Nov. 11.

For the past four years, I have been the banking columnist for *EIR* magazine, and prior to that I covered the Texas banks for *EIR*'s Houston bureau. From this vantage point, I have witnessed the virtual disappearance of the Texas banks, where seven of the eight biggest banks in the state failed, to New England, where the region's second-largest bank failed and the State of Rhode Island declared a banking emergency.

But these regional crises, as devastating as they were, are merely reflections of a much larger crisis which is now unfolding, leading inevitably to the worst financial collapse in centuries. This is what is behind the North American Free Trade Agreement (NAFTA) and the Federal Reserve's plan for the dollarization of Ibero-America, and is the reason why these powerful U.S., Canadian, and British banks are so determined to throw you off your land and take it for themselves.

Citicorp

The prime example of the bankruptcy of the international banking system is Citicorp, the biggest bank in the United States. Citicorp is insolvent—so insolvent that three years ago, it was secretly taken over by the Federal Reserve Bank of New York. Just before Thanksgiving Day 1990, Gerald Corrigan, then the president of the New York Fed, summoned Citicorp chairman John Reed to his office to inform him that the Fed was taking control of the bank, to prevent it from collapsing. That control continues to this day.

The Fed's de facto nationalization of Citicorp, and the multibillion-dollar bailout which followed, stands in stark contrast to the demands of these same Wall Street financiers, that Mexico privatize its banks.

This apparent contradiction is not a contradiction at all. Instead, it proves the true nature of the enemy: They wield ideologies as weapons, advancing whatever arguments they need to help them survive, no matter what the cost, in human lives and misery, of their success.

Citicorp has a long history of attempting to destroy Mexico, dating back some 150 years, even before the bank was founded. In the late 1830s and early 1840s, a freemasonic

intelligence network operating along the Rio Grande tried to break off a portion of Mexico and create the Republic of the Rio Grande. In 1851, these networks tried again, with La República de la Sierra Madre.

The leaders of this network included Charles Stillman and Capt. Richard King. Stillman made a fortune running riverboats along the Rio Grande, and King was one of his captains. Stillman eventually returned to New York, where his son James Stillman used this money to found the National City Bank, which today is known as Citicorp. The Stillman family later married into the infamous Rockefeller family, which controlled Chase Manhattan Bank.

Prior to the outbreak of the U.S. Civil War, Captain King used his share of the loot to create the giant King Ranch in south Texas, which played a crucial role for the Confederacy. As that war progressed and other Confederate ports were blockaded, the port of Matamoros, Mexico, became a crucial port—after the fall of New Orleans, Matamoros became the only Confederate port for foreign waterborne commerce; and the road to Matamoros led right through the King Ranch.

The King Ranch became a major transshipment point for cotton moving south, and for supplies and munitions moving north, as well as the base for Confederate intelligence operations in the area. The steamboats used by Stillman, King, and their friends were crucial for moving the Confederate goods. When Abraham Lincoln ordered the blockading of all Confederate goods on the Rio Grande, the boats were "sold" to Mexican members of the operation. The cotton also became Mexican, so that Rebel cotton continued to flow through the Rio Grande as Mexican cotton on Mexican boats. The rebels knew that Lincoln would not blockade Mexican shipping even if it hurt the war effort due to his support of the administration of Benito Juárez, despite the fact that the Juaristas did not control the port of Matamoros.

During the intervening years, and especially since the early part of this century when Citicorp became the only U.S. bank with deposit-taking branches in Mexico, Citicorp and its allies have worked to subvert Mexico from within, to saddle the Mexican people with monstrous debts, and then to destroy them in the name of debt collection.

Whenever Citicorp pretends to be the friend of Mexico, one should recall this 150 years of treachery.

Beginnings of the bubble

On Sept. 1, 1982, President José López Portillo, in a historic defiance of the international banks and their International Monetary Fund, implemented many of the policies outlined by *EIR* founder Lyndon LaRouche in his "Operation Juárez" debt moratorium and global development plan. López Portillo asserted Mexico's sovereignty by nationalizing the Bank of Mexico and the country's private banks, and setting up exchange controls to stop the flight of capital.

Were the other countries in Ibero-America to have found the courage to stand with Mexico, the control over your economy by these international bankers would have been broken, and you would today be prosperous, instead of facing destruction.

Responding to López Portillo's actions, then-Citicorp chairman Walter Wriston displayed the stupidity for which he will soon become quite famous, by claiming that "countries do not go bankrupt. Any country, however bad off, will own more than it owes."

In other words, to the bankers, in even the poorest countries, there is always something left to loot.

Lyndon LaRouche responded with an open letter to Wriston, appealing for Wriston and the banking community to come to their senses, and support Operation Juárez. Only such action, LaRouche warned, could prevent a "chain reaction collapse of that trillion dollars of imminently worthless debt about to crush Western civilization."

But sanity did not prevail. Instead, the bankers, foolishly believing in their ability to defy the laws of God and nature, embarked upon the creation of the largest financial bubble in history, a bubble the very existence of which depends upon the escalating looting of the physical economy.

On Oct. 15, 1982, some 45 days after López Portillo's actions, President Reagan signed the Garn-St Germain Depository Institutions Act into law, escalating a pattern of deregulation of the banking system which continues to this day.

As I stated in my testimony before the House Banking Committee on Sept. 8 of this year:

"Since 1978, the financial community has repeatedly insisted upon the deregulation of banks and other financial institutions, while demanding austerity and cutbacks everywhere else. Every time we have done this, it has led to disaster, as the destruction of the airlines and the S&Ls, and of the U.S. work force attest.

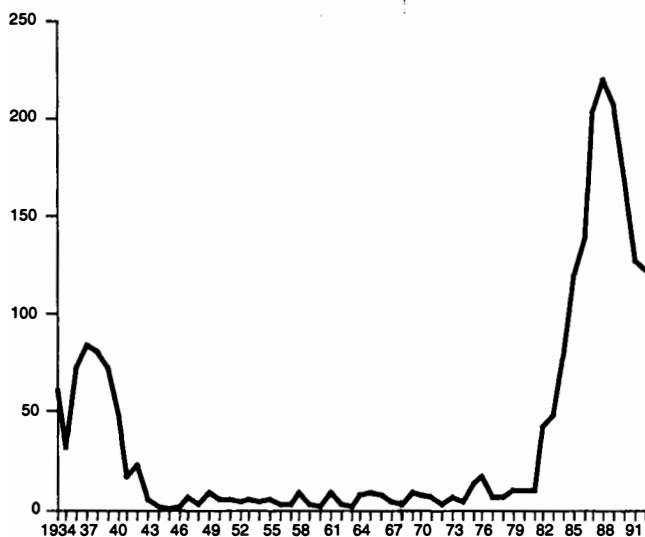
"In response to these disasters, the bankers demand further deregulation and deeper cuts.

"Now, with NAFTA, the bankers are demanding that the United States deregulate its international political and financial relations the same way we've deregulated internally. The purpose of NAFTA is to open up Mexico and eventually all of Latin America for unbridled speculation and looting, of the sort that has already devastated the American economy and bankrupted our banking system.

"When are we ever going to learn that the answer lies not in more deregulation, but rather in the abandonment of the

FIGURE 1

Number of bank failures in the United States, 1934-91



Source: FDIC.

policy of deregulation, and the return to rational rules and regulation?"

Collapse of the banks

Let us take a look at what has happened to the U.S. banks since 1982, as a result of this deregulation frenzy.

Figure 1 shows the number of bank failures from 1934, when the Federal Deposit Insurance Corp. (FDIC) was founded in the wake of the massive bank failures of the Great Depression, through the end of 1992. As you can see, after a flurry of failures between 1934 and 1942, bank failures virtually disappeared. In the 38 years from 1943 to 1981, only 232 U.S. banks failed. But from 1982 through 1992, a staggering 1,475 U.S. banks failed, representing two-thirds of all the bank failures in the last 49 years. In one year alone, 1988, bank failures numbered 220.

The regulators, of course, claim that the drop in failures since 1988 proves that the banking crisis is over. After all, they say, a mere 122 banks failed in 1992. Of course, that's still the seventh worst bank failure total in FDIC history, but who's counting?

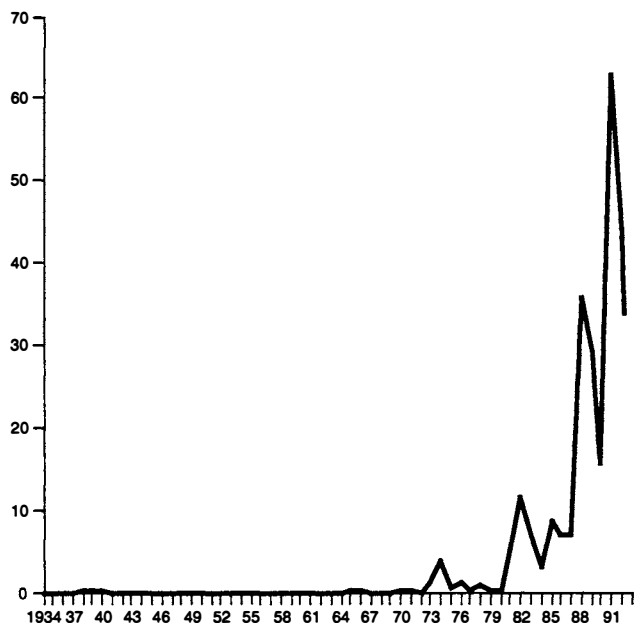
What the failure counts do not show, however, is the size of the banks which failed. Part of the reason is that the failure count includes hundreds of small Texas banks. Texas law prohibited branch banking, so each bank office in that state was a separately chartered bank. When a big bank holding company like First RepublicBank of Dallas failed, the 120 or so individually chartered banks owned by First RepublicBank also failed. Except for a handful of big-city banks, most of these failed banks were relatively small.

In states which allow branch banking, such as the New

FIGURE 2

Assets of failed banks, 1934-91

(billions \$)



Source: FDIC.

England states, the failure of a bank holding company would count as one failure. That is what happened when the Bank of New England, which at its peak was roughly the same size as First Republic Bank, failed.

Figure 2 shows the total assets of these failed banks. Again, the regulators argue that the drop in failed assets shows the banking system is healthy, but one glance at this chart disproves that contention.

Furthermore, these statistics are phony. According to the FDIC, 169 banks with assets of \$15.7 billion failed in 1990. Had the FDIC included the secret nationalization of Citicorp, the picture would have been much different, pushing the failed assets closer to \$230 billion. That certainly would have changed the picture dramatically.

But the real impact of the admission of Citicorp's failure would likely have been to set off a full-fledged banking panic in the United States, with depositors around the country pulling money out of the banking system as fast as they could.

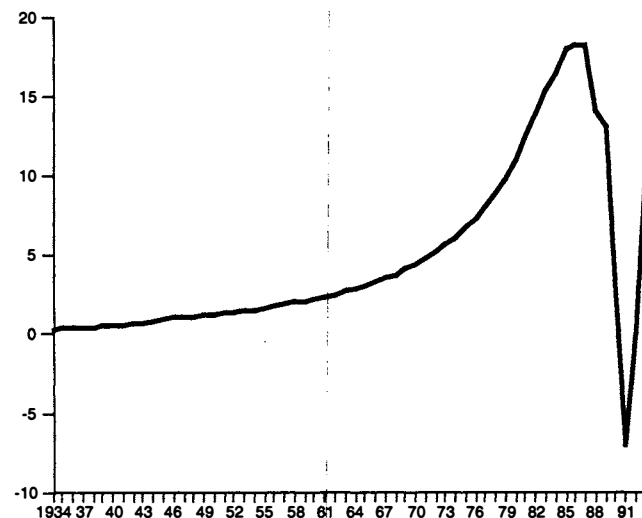
New England was, in fact, hit with runs against some of its banks at the beginning of 1991. In Rhode Island, the failure of a private deposit insurer which protected some 50 banks and credit unions, led to runs against those institutions, prompting the governor of the state to declare a bank emergency on New Year's Day 1991, closing all the suddenly uninsured institutions. Some of these depositors only recently got back their money.

The big crisis in New England, however, was the Bank

FIGURE 3

Balance of FDIC's Bank Insurance Fund

(billions \$)



Source: FDIC.

of New England, one of the region's largest banks. The Bank of New England was closed by federal regulators on Jan. 6, 1991, to head off runs after the bank revealed that it was insolvent. Actually, the bank had been dead for more than a year before it closed, kept alive by huge cash infusions from the Boston Fed.

Runs also hit Citicorp, mainly in Asia, when Rep. John Dingell (D-Mich.) announced in July 1991 that Citicorp was "technically insolvent" and "struggling to survive." Once again, massive cash infusions, this time from the New York Fed, allowed the bank to ride out the panic.

To soothe worried depositors, the banks and regulators pointed to the deposit insurance provided by the FDIC. This is an illusion, however, as Figure 3 shows. From a peak of \$18.3 billion in 1987, the bottom fell out of the bank insurance fund with the wave of failures. By the end of 1991, the so-called fund to protect depositors was itself completely bankrupt, \$7 billion in the hole.

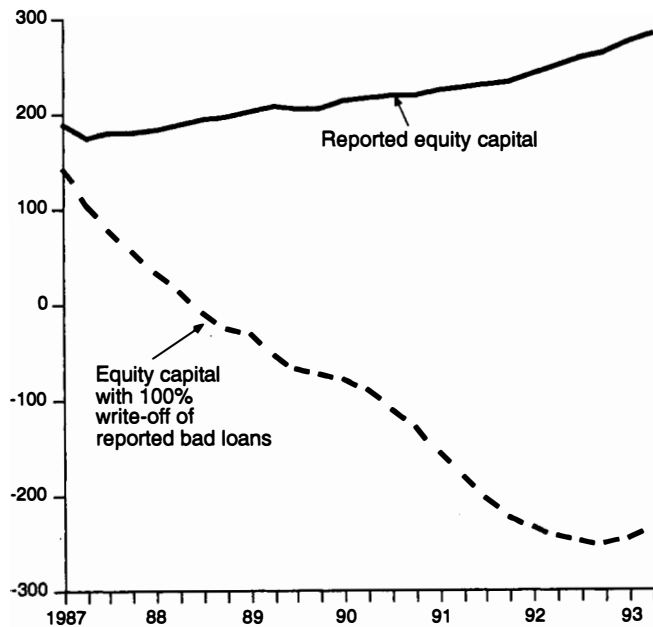
Since then, of course, the bank insurance fund has made a remarkable recovery. At the end of September, the fund had a claimed balance of \$10.5 billion, having risen \$10.6 billion in just nine months. The fund is doing so well, acting FDIC chairman Andrew Hove recently told the American Bankers Association, that it will soon be able to cut the premiums banks pay for deposit insurance.

Judging from the official numbers, the U.S. banking system, which was in such trouble in the late 1980s, has completely recovered. The banks claimed record profits of \$32.2 billion in 1992, and reported \$21 billion in profits for the first six months of this year alone. As Hove told the bankers,

FIGURE 4

U.S. banks are overstating their equity capital

(billions \$)



Sources: FDIC, EIR.

“Banking is having its best year ever.”

But the year is not over yet, and banking’s best year may well turn out to be its worst nightmare.

Phony profits

That the banks are reporting record profits while they are dying, says volumes about the collusion between bankers and their regulators, and about the ability of accountants to cook the books. They deserve some credit: It takes a lot of very creative work to make these zombies look solvent. These guys could teach the morticians a trick or two about making their clients look good.

The trick in making a dead bank look solvent, is to count every possible dollar as profit, while ignoring all the losses. It’s a variation of the three monkeys approach: hear no bad loans, see no bad loans, report no bad loans. The banks love this approach, and so do the federal regulators, who have adopted a virtual “no such thing as a bad loan” policy and made sure their bank examiners toed the line.

The name for this policy, in banker-speak, is “reducing the regulatory burden.” The bankers also like to speak in sports metaphors, using terms like “level playing field.” Of course, to these bankers, a level playing field is one where your money rolls downhill into their pockets.

Figure 4 shows the cosmetic effect of hiding bad loans. The top line is the equity capital—or net worth—claimed by the U.S. banking system. It shows that the U.S. banking

system as a whole has nearly \$300 billion in equity capital, and is getting stronger with every passing day. The bottom line, however, tells a different story, showing what banks’ capital would look like had they fully reserved for just their admitted non-performing loans. The bankers don’t like this graph, which shows them some \$225 billion in the hole. But they shouldn’t complain, since the truth is orders of magnitude worse.

Which brings us to derivatives, and the looming international financial collapse.

Pop go the derivatives

The dominant characteristic of a financial bubble, is that it must keep growing, or it will collapse. Like a pyramid scheme, the amount of money needed to feed the bubble grows geometrically. The days when developing sector loans, commercial real estate, junk bonds, and leveraged buyouts were sufficient to keep the bubble going, have passed. The bubble is now living off something even more insane: derivatives.

Derivatives are somewhat hard to explain, since they bear little connection to the real world. A derivative is a financial instrument designed to profit off price differences between interest rates, commodities, and currencies. Banks and other financial institutions use derivatives to speculate on the future prices of interest rates, commodities, and currencies, and upon indices of these prices, and indices of these indices, and so on, *ad nauseam*.

The banks like these derivatives, since the rates of return on derivatives transactions dwarfs the amount of money the banks can earn from making ordinary loans. Returns of 10-15% are common in the derivatives markets, and they can go to 2,000% or higher. This makes for huge profits, at least on paper.

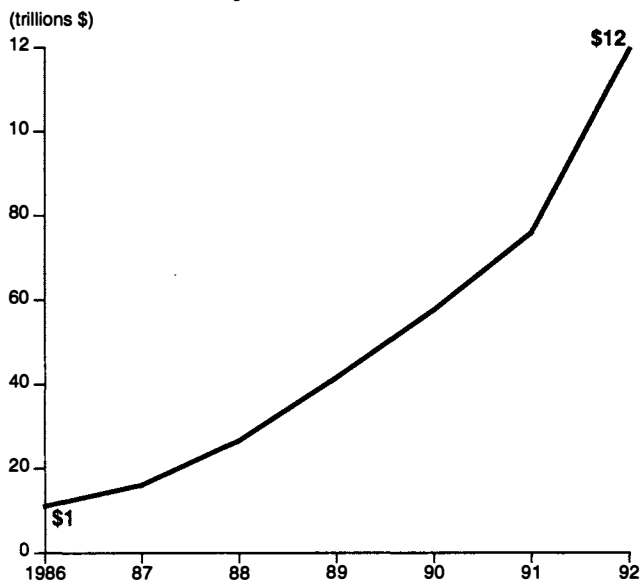
The derivatives market has exploded in recent years, especially since the U.S. stock market crash of October 1987. At the end of 1992, the face value of derivatives instruments outstanding worldwide was an estimated \$12 trillion, or 12 times the \$1 trillion outstanding at the end of 1986, on an annual turnover of \$100-\$125 trillion (see Figure 5). Some \$400-500 billion of derivatives is traded every business day worldwide.

The explosive growth of derivatives trading can also be seen in the rise in trading in financial futures contracts (Figure 6). This shows that financial speculation, or gambling, has become the dominant feature of world financial markets.

Operating in collusion with the Federal Reserve, eight money center commercial banks and four investment banks dominate 95% of all derivatives trading in the United States. The banks are Citicorp, J.P. Morgan, Bankers Trust, Chemical, Chase Manhattan, BankAmerica, First Chicago, and Continental Bank. The investment banks are Merrill Lynch, Morgan Stanley, Goldman Sachs, and Salomon Brothers.

The size of the banks’ exposure to derivatives is staggering, especially when compared to their nominal assets, as shown by Figure 7. The banks’ derivatives holdings are not

FIGURE 5
Face value of worldwide derivatives transactions, at year's end



Sources: International Liquidation Bank, EIR.

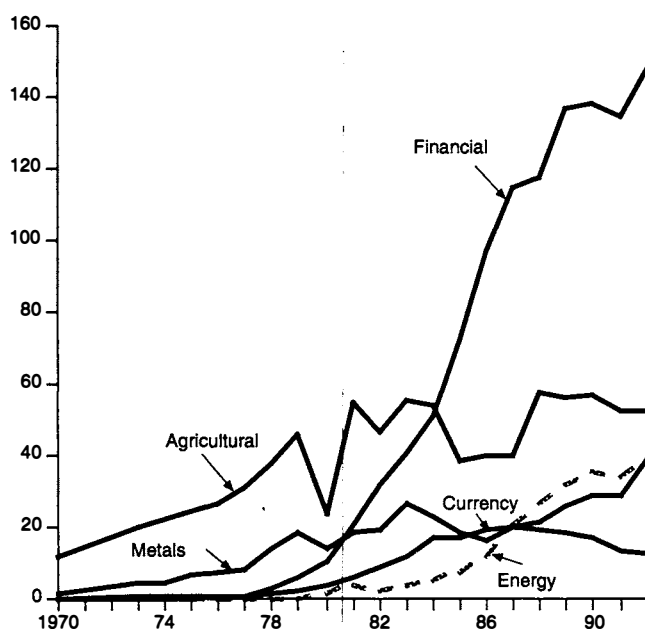
part of their official assets and liabilities, but instead are considered "off-balance-sheet liabilities." As of mid-1992, the eight commercial banks just mentioned had \$6.8 trillion in off-balance-sheet derivatives exposure, compared to total official assets of \$876 billion, or nearly \$8 in derivatives for every dollar of assets. Citicorp alone had \$1.4 trillion in derivatives, compared to assets of \$213 billion. Chemical Banking had \$1.3 trillion in derivatives compared to \$140 billion in assets, and J.P. Morgan—supposedly a conservative bank—had \$1 trillion in derivatives and assets of \$103 billion. Bringing up the rear were Bankers Trust with \$958 billion in derivatives, Chase Manhattan with \$837 billion, BankAmerica with \$795 billion, First Chicago with \$387 billion, and Continental with \$136 billion.

The off-balance-sheet figures, more than anything else, show the fraud of the FDIC's official banking statistics, which look at just one-eighth of the total exposure of the big banks.

When I wrote a column entitled "They're Not Banks Anymore," on these off-balance-sheet figures, U.S. Congressman Henry B. Gonzalez (D-Tex.) entered the column into the *Congressional Record*, later pointing out that his Banking Committee hadn't been able to get those figures.

Figure 8 shows how much the banks have come to depend upon derivatives for their income. It's actually worse than it looks, since the data for 1993 is just for the first nine months, compared to 12 months for the prior years. During the first nine months of 1993, the seven top derivatives banks reported a combined \$6.2 billion in gross trading revenue,

FIGURE 6
Number of futures contracts traded per year
 (millions of contracts)



the bulk of which came from their derivatives operations. At this rate, the big banks will rack up \$7.8 billion in trading revenue this year, a 50% increase over the \$5.2 billion in trading revenues in 1992. Since 1983, Citicorp alone has accounted for 25% of the trading revenue of the big banks, and the New York banks as a whole have accounted for 85%.

The banks don't report net trading revenues, but according to Goldman Sachs, trading accounted for \$900 million in profits at these big banks, or 40% of their \$2.2 billion in profits for the quarter.

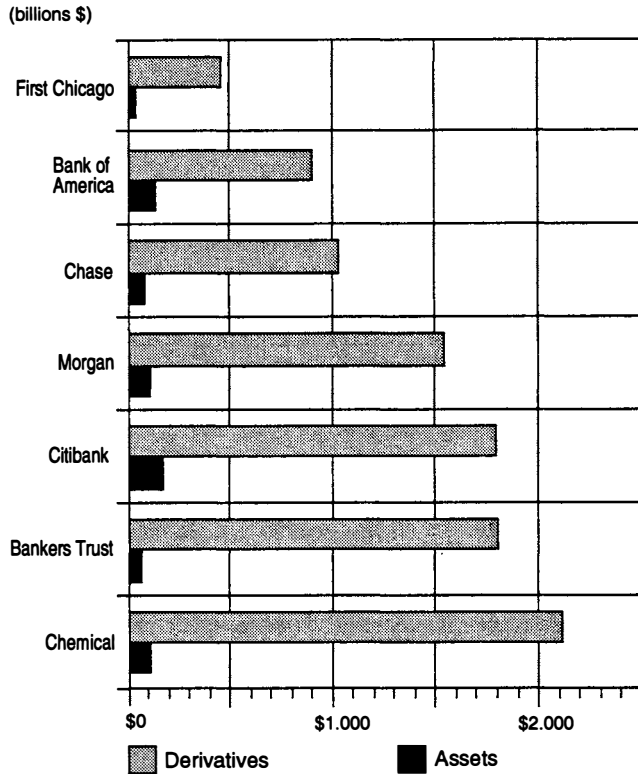
When the derivatives bubble pops, as it inevitably must, these derivatives portfolios will evaporate, taking the banks with them.

Banking on chaos

The banks are so hooked on derivatives, that mere speculation is no longer enough. They have become predators, targeting whole sections of the world for looting. Former Federal Reserve chairman Paul Volcker used to call this process "controlled disintegration." Current Fed chairman Alan Greenspan prefers the term "creative destruction." But Michael G.J. Davis, the deputy head of risk management for Chase Manhattan, said it even more clearly: "The bank's biggest fear would be a long period of calm and stability in the markets, which would lull companies and investors into slowing their trading activities. The worst thing for us is a marketplace where nothing happens."

Reflect upon that statement for a moment. Here we have

FIGURE 7
Derivatives portfolios versus reported assets
at big U.S. banks



Source: Comptroller of the Currency.

one of the top risk managers, at one of the biggest banks in the United States, saying that his bank's biggest fear is stability in the financial markets.

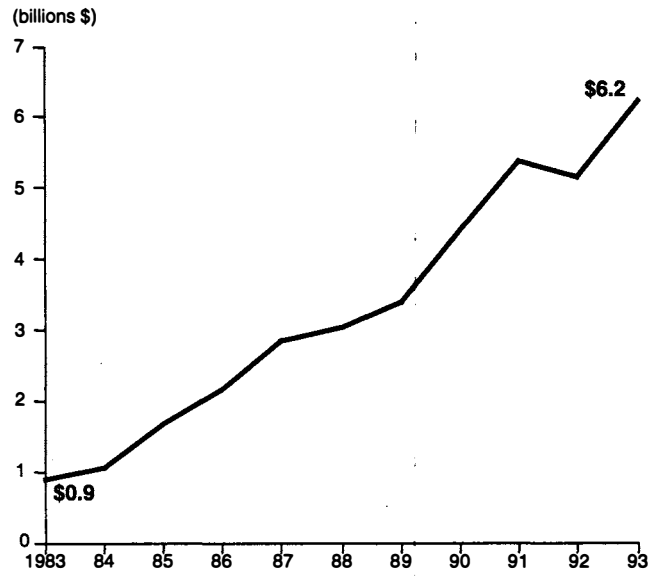
If stability is the enemy of the banks, then volatility and chaos must be allies.

But the banks like a special kind of chaos—the chaos they organize and control. They use chaos as a form of financial warfare against nations and peoples, to create the conditions under which they can loot.

For proof of this, one need look no further than our friend Citicorp. During the European currency crisis of September 1992, Citicorp gained some \$1 billion in revenue from currency trading.

The nominal cause of the European currency crisis was American speculator George Soros, who supposedly launched an attack against the British pound. When the dust settled, the European Exchange Rate Mechanism, a device to calm fluctuations among European currencies, had been dealt a severe blow. The pound and the Italian lira dropped out of the ERM, and most of the other currencies were devalued. Soros walked off with more than \$1 billion in profits, and the title "the man who broke the pound."

FIGURE 8
Trading revenue of the top seven U.S.
commercial banks



Source: Keefe, Bruyette & Woods.

The idea that Soros "broke the pound" is ludicrous. He did no such thing. George Soros is an agent of Anglo-American finance, deployed by the British Rothschilds and the U.S. Federal Reserve, to manipulate the markets. When you know which way the markets will go, you can make a lot of money.

In the case of Soros, the proof is clear. Soros was not only joined, but also funded by Citicorp in his attack upon the ERM. They were partners in the crime. And when this occurred, Citicorp was being run directly by the Federal Reserve Bank of New York.

Not only that, but the Fed was, according to reports we have received, providing Soros with inside information on the financial reserves and strategies of the European central banks, allowing him to more precisely target his attack.

This is the policy of chaos at work. It is evil at work.

Never capitulate

The policy of the bankers is to destroy everything in the world which is capable of standing in their way. They will sacrifice nations and peoples, spread misery far and wide, subvert, corrupt, and murder those who oppose them. That they would steal the lands of farmers, when much of the world is starving, tells you all you need to know about their morality.

We must join together and organize our fellow man; we must use the power of reason given to us by God. By that power, through science and culture and economics, we can defeat this evil and get to work building a better world for ourselves and our children. No one will do it for us, we must do it ourselves. But do it we can.