eral Electric or Westinghouse, would produce these items. Relative to 1967 levels, the 1990 per household production of refrigerators and washing machines are each down 7%. In the case of radios, America's 1990 per household production, relative to 1967, is down 90%.

In the area of personal transportation, relative to 1967 levels, 1990 per household American passenger car production has fallen 49%.

As shown in another section of this report, America cannot produce the material and cultural basis even for its own household biological existence and reproduction. One can now see why. Even with massive level of imports thrown in, America is still incapable of reproducing itself.

One must ask, what would it be like if America maintained in 1990 the same per household production levels as in 1967, or even, as in the case of some goods, such as compressors, chlorine, and printing, exceeded those levels? Would that be sufficient? The answer is no. Any country's goal is not just to produce and consume at the per household levels it had a quarter of a century ago. The goal is to exceed those levels. The physical economy is constantly depleting "natural resources," as defined by the existing mode of technology and production. Mankind must offset those depletions by "inventing" and utilizing new natural resources, that is, conceptualizing the use of existing or even undiscovered products as the source for a new "natural resource." This means going to a new technological mode of production which will be more capital-intensive, more power-intensive, with a higher energy flux density per square kilometer cross-section of throughput. This requires raising the standard of living. The *per household, per capita,* and *per square kilometer* values of the commodities that make up the consumers' and producers' market baskets, and thus those market baskets themselves, so expressed, must rise.

This is not new to America. This country had rising per household market basket values, reflected in rising values for commodities in those market baskets, during those periods of the 19th century when the policies of the American System of dirigistic national economy were in effect, and in the 20th century, when those policies were in effect during exceptional circumstances, such as during wartime. These values did not just rise for a few years, but rose for decades at a time.

Of course, America today is far from maintaining the per household production levels of 1967. Across the board, in every sector of the economy, from infrastructure to mining and metals processing, from manufacturing and agriculture to the goods of the consumers' market basket, America's per household production is down 20%, 30%, and, in the case of more than 20 crucial commodities in the market baskets, down by more than 50% relative to 1967 levels. This is a catastrophe of the first order.

Anyone who says there is yet another "recovery" under way in America is more than just clinically insane. His or her insanity is pushing the nation into oblivion.

Derivatives: the cancer that killed the economy

by John Hoefle

The Federal Deposit Insurance Corporation released its third-quarter results Dec. 15, amid much fanfare about how the record $11.45 billion profit for the quarter had pushed the banks' nine-months' earnings to $32.6 billion, surpassing the record $32.1 billion for all of 1992. At the current pace, the banks will easily post in excess of $40 billion for 1993.

Buried in the fine print of the FDIC's statistical tables, however, was a shocking new item called off-balance-sheet derivatives. According to the FDIC, U.S. commercial banks had $11.99 trillion in these derivatives, compared to total assets of just $3.63 trillion. The banks' derivatives holdings had risen more than $1 trillion in the quarter, from $10.95 trillion at June 30, and more than $2.27 trillion from the $9.72 trillion for the third quarter of 1992.

The sudden appearance of an "off-balance-sheet" item more than three times larger than the reported assets of the entire banking system, more than confirms *EIR*'s long-standing analysis that the FDIC's banking statistics are fraudulent. More importantly, however, it reflects a growing fear in the international financial community that the derivatives bubble is about to explode. The derivatives bubble is the final phase of the speculative asset-stripping operation known as the Reagan/Bush economic recovery. This so-called recovery was based upon the creation of debt, debt which simply cannot be repaid given the collapse of the real economy, which is documented in this issue.

Mountains of debt

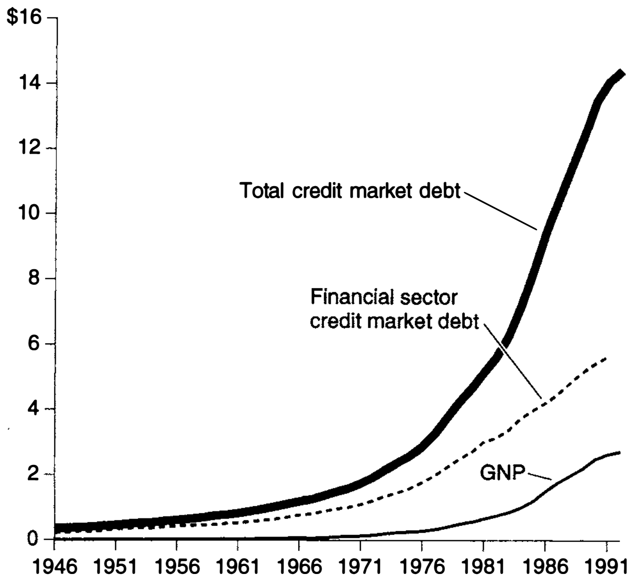
Between 1980 and 1992, the total credit market debt in the United States grew $10.2 trillion, from $4.3 trillion at the end of 1979 to $14.5 trillion at the end of 1992, according to data from the Federal Reserve **Figure 1.** During this same period, the nation's Gross National Product grew by $3.5 billion, from $2.5 billion to nearly $6 billion. That's roughly $3 in new debt for every $1 added to GNP during the period.

The Federal Reserve's policy of low interest rates has disguised the debt-repayment crisis somewhat, by allowing borrowers to refinance their debt at lower interest rates. This rolling over of debts has allowed the debt crisis to look better on paper, at the expense of making it worse in the long run, since the roll-over process actually increases indebtedness.

The most egregious case of debt creation is that of the federal government, whose debt has been turned into what one might call the "house bank" of the worldwide casino

© 1994 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

FIGURE 1
Total credit market debt, financial sector credit market debt, and GNP
(trillions $)



Source: Federal Reserve.

known as the international financial system. Because of the unconstitutional way in which the Federal Reserve acts as an agent for the U.S. government, a piece of every dollar of debt issued by the government is paid as tribute to Wall Street. With the federal government running up staggering deficits every year **Figure 2,** that tribute is enormous **Figure 3.** Through this scam, the federal government is transferring revenues of more than $200 billion a year from the pockets of taxpayers, to the participants in this global casino.

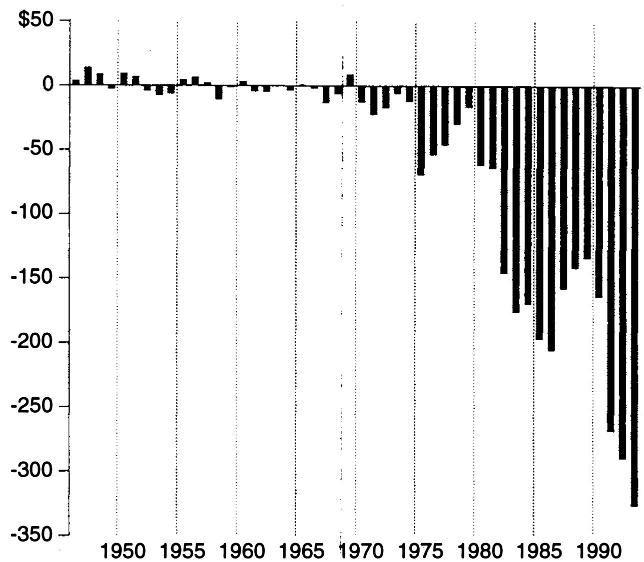
The nature of speculative pyramid schemes like the current financial bubble, is that they must expand constantly, geometrically, in order to survive. This ever-increasing need for new ways to loot the populations of the world, is the driving force behind the derivatives bubble.

Addicted to derivatives

Faced with trillions of dollars of unpayable loans and other forms of debt, the international financiers have rushed headlong into the derivatives market **(Figure 4),** in which pieces of the bubble are traded back and forth as if they were real, and the resulting fees and income streams are counted as "profits."

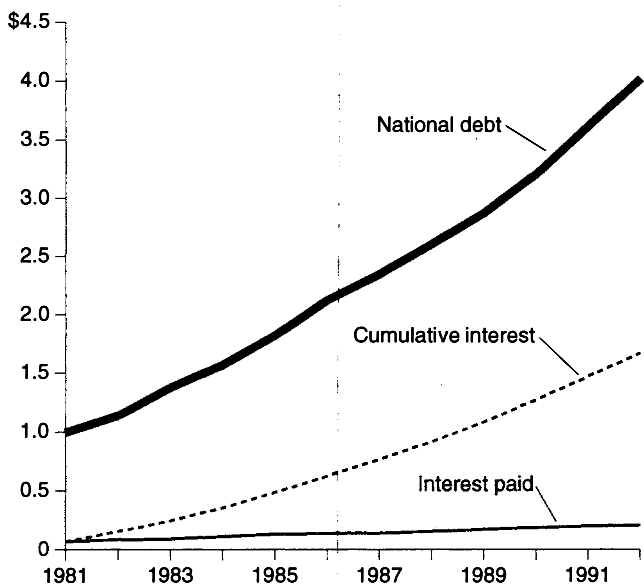
In testimony before the House Banking Committee on Oct. 28, Comptroller of the Currency Eugene Ludwig reported that U.S. commercial banks had $10.95 trillion of derivatives contracts on their books as of June 30, 1993. $9.6 trillion—88%—of those contracts were held by just seven banks (Citicorp, Chemical Banking, J.P. Morgan, Bankers Trust, Chase Manhattan, BankAmerica and First Chicago). As **Table 1** shows, the big banks' off-balance-sheet derivatives portfolios dwarf their nominal on-balance-sheet assets.

FIGURE 2
Federal budget surplus/deficit
(billions $)



Source: Federal Reserve.

FIGURE 3
Tribute to the Federal Reserve: national debt and interest payments
(trillions $)



Source: Federal Reserve.

TABLE 1

Derivatives exposure of U.S. commercial banks and trust companies on June 30, 1993

(millions $)

Rank	Bank name	State	Total assets	Total derivatives	Assets as % of derivatives	Derivatives/ assets ratio
1	Chemical Bank	NY	$ 110,375	$ 2,114,028	5%	19.2
2	Bankers Trust	NY	63,853	1,802,308	4%	28.2
3	Citibank	NY	168,567	1,789,276	9%	10.6
4	Morgan Guaranty Trust	NY	103,490	1,537,466	7%	14.9
5	Chase Manhattan Bank	NY	79,947	1,026,141	8%	12.8
6	Bank of America	CA	133,970	893,546	15%	6.7
7	First National Chicago	IL	34,081	457,444	7%	13.4
8	Continental Bank	IL	22,038	169,852	13%	7.7
9	Republic Bank N.Y.	NY	28,381	167,653	17%	5.9
10	Bank of New York	NY	35,776	92,189	39%	2.6
11	First National Boston	MA	25,723	70,673	36%	2.7
12	Mitsui Trust U.S.A.	NY	755	51,560	1%	68.3
13	First Union	NC	20,745	45,956	45%	2.2
14	NationsBank of N.C.	NC	24,549	34,908	70%	1.4
15	Harris Trust	IL	10,225	32,109	32%	3.1
16	J P Morgan Delaware	DE	6,827	31,724	22%	4.6
17	Mellon Bank	PA	28,553	31,189	92%	1.1
18	National Westminster	NY	16,457	30,580	54%	1.9
19	Citibank Nevada	NV	4,524	27,523	16%	6.1
20	Bankers Trust Delaware	DE	2,184	26,804	8%	12.3
21	State Street Bank	MA	18,268	23,785	77%	1.3
22	Seattle-First	WA	15,099	20,312	74%	1.3
23	PNC Bank	PA	36,823	19,530	189%	0.5
24	Bank One Columbus	OH	6,158	18,078	34%	2.9
25	Marine Midland Bank	NY	16,123	15,773	102%	1.0
	Top 25 Banks		**1,013,491**	**10,530,409**	**10%**	**10.4**
	Top 10 Banks		**780,478**	**10,049,903**	**7.8%**	**12.9**
	Top 7 Banks		**694,283**	**9,620,209**	**7.2%**	**13.9**
	Other 591 commercial bank companies		**418,661**			
	Total derivatives portfolio		**$10,949,070**			

Sources: Office of the Comptroller of the Currency, *EIR*.

Bankers Trust, for example, has a derivatives portfolio some 28 times bigger than its nominal assets.

These off-balance-sheet derivatives are growing like crazy: Federal Reserve Board Vice-Chairman David Mullins put the banks' holdings of derivatives at $7 trillion at the end of the first quarter of 1993; the Comptroller of the Currency put the figure at $10.95 trillion at the end of the second quarter; and the FDIC put it at $11.99 trillion at the end of the third quarter. That's a $5 trillion—71%—increase in just six months.

By comparing the Comptroller's June 30, 1993, statistics with those from Salomon Brothers for June 30, 1992, we get a picture of the rate of growth of derivatives at the top eight derivatives banks **Table 2** and **Figure 5.** Bankers Trust leads the pack with an 88% growth in its derivatives portfolio over one year, followed by Chemical Banking with a 63% increase and J.P. Morgan with a 52% increase. Citicorp, whose derivatives portfolio rose 25%, is now number three in derivatives holdings, showing the incredible volatility in what the Ger-

TABLE 2

Growth of banks' derivatives trading

(millions $)

Bank holding company	6/30/92	6/30/93	Growth	% growth
Citicorp	$1,426	$1,789	$ 363	25.5%
Chemical Banking	1,296	2,114	818	63.1%
J.P. Morgan	1,014	1,538	524	51.6%
Bankers Trust	958	1,802	844	88.1%
Chase Manhattan	837	1,026	189	22.6%
BankAmerica	795	894	99	12.4%
First Chicago	387	457	70	18.2%
Continental Banking	136	170	34	24.9%
Total	**$6,849**	**$9,790**	**$2,941**	**42.9%**

FIGURE 4
Hierarchy of financial transactions

Currencies	Bonds	Stocks	Commodities
CASH			
Interest rate; Exchange rate	Interest; Principal	Dividends; Price appreciation or depreciation	Price appreciation or depreciation
FUTURES			
OPTIONS			
OPTIONS INDEXES			
FUTURES OPTIONS			
FUTURES OPTIONS INDEXES			
SWAPS			

Distance from real physical economy increases →

As one proceeds downward in the chart, transactions have increasingly less bearing on processes in the real physical economy.

man Bundesbank has characterized as the "violent global growth" of derivatives.

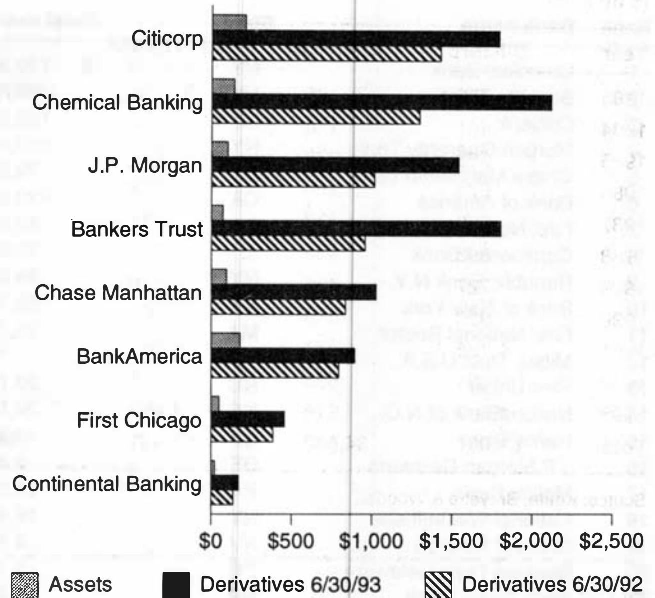
Banking on chaos

The explosive growth in derivatives trading has allowed the banks to post huge trading revenues **Table 3** and **Figure 6.** For the second quarter of 1993, trading accounted for $900 million in net profits at the big banks, or 40% of their $2.2 billion in reported profits. Trading revenues at the top seven derivatives banks topped $5 billion in 1991 and 1992, and hit $6.2 billion for the first nine months of 1993.

Such trading profits come not only from volatile markets, but from organized raids on the markets, as the activities of the Federal Reserve, Citicorp, George Soros, the Bank of England and others made clear in their September 1992 and July 1993 currency warfare against the European currency markets.

Chase Manhattan's deputy head of risk management, Michael G.J. Davis, expressed the banks' philosophy clearly in August, bluntly telling the *New York Times:* "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."

FIGURE 5
Big banks are addicted to derivatives
(billions $)



If chaos and instability are the banks' friends, they should be very happy these days. They are, perhaps, on the verge of a fatal attack of self-induced joy.

Sounding the warning

While intelligence and an understanding of history are not often found in abundance within the financial community, there are relatively saner elements warning that the days of the speculative bubble are coming to an end, and that something must be done to manage its collapse in a way that salvages as much of the financial system as possible.

Within the financial community, derivatives have become a hot topic.

U.S. bank regulators have established a task force on derivatives, led by the Comptroller of the Currency's senior policy adviser Douglas Harris, who moved over from running J.P. Morgan's derivatives activities to handle the job. This is a classic case of the fox guarding the chicken coop, as Morgan and its political sister Bankers Trust, together hold more than 30% of U.S. banks' derivatives.

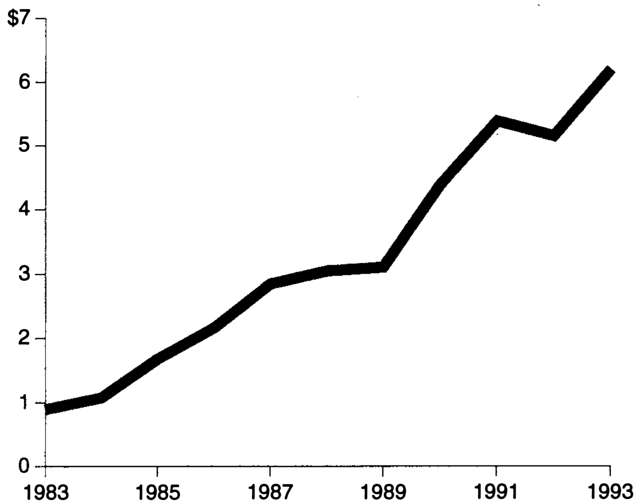
The Securities and Exchange Commission has discussed increasing the capital requirements for the investment banks involved in the derivatives markets (the investment banks, led by the usual suspects—Salomon Brothers, Merrill Lynch, Morgan Stanley, Goldman Sachs, and Smith Barney

TABLE 3
Trading revenues of selected banks
($ millions)

Year	Citicorp	Chemical	J.P. Morgan	Bankers Trust	Chase	First Chicago	BankAmerica	Total
1983	$ 356	$ 96	$ 93	$ 70	$ 141	$ 38	$ 98	**$ 892**
1984	401	118	82	134	148	38	152	**1,072**
1985	568	228	249	122	204	77	225	**1,677**
1986	574	260	328	224	291	131	354	**2,160**
1987	630	389	321	715	306	86	401	**2,847**
1988	893	452	374	375	379	192	383	**3,048**
1989	727	436	418	582	383	139	423	**3,106**
1990	928	519	959	1,026	340	164	450	**4,386**
1991	1,166	671	1,297	1,229	335	186	499	**5,383**
1992	1,331	853	965	896	468	177	460	**5,150**
1993	1,507	818	1,453	1,182	548	224	468	**6,200**
Total	**$9,081**	**$4,840**	**$6,539**	**$6,555**	**$3,543**	**$1,452**	**$3,913**	**$35,921**

Source: Keefe, Bruyette & Woods.

FIGURE 6
Trading revenue of the top seven banks
(trillions $)



Shearson—are heavy players in derivatives, ranking just below the top five or six banks).

The Bank for International Settlements, the Basel, Switzerland-based central bank for central banks, has proposed standards for regulating derivatives, but the BIS's standards will serve mainly to force the smaller players out of the market, consolidating things even further. BIS director Alexandre Lamfalussy did warn in June, however, that "the phenomenal growth of derivatives and associated trading techniques has reduced the transparency of balance sheets."

LaRouche proposes a solution

Before 1993, the discussions of the derivatives market took place mainly in the rarefied air of international banking centers. Lyndon LaRouche changed that, and put the derivatives crisis on the public agenda March 9, when he issued a call for a tax of 0.1% on the notional value of every derivatives transaction in the United States. This proposal, which came while the Clinton administration and Congress were debating ways to raise taxes and cut vital government services. LaRouche movement organizers blitzed Capitol Hill with the derivatives tax proposal, pointing out the benefits of raising some $60 to $80 billion in tax revenue the first year, while beginning the process of shutting down the parasitical derivatives market.

LaRouche's proposals percolated around Washington until mid-June, when House Banking Committee Chairman Henry B. Gonzalez took to the floor of the House to warn of the dangers of letting the speculators run wild. Gonzalez also put into the *Congressional Record,* an article by this author on the size of the banks' off-balance-sheet derivatives.

On Sept. 8, the LaRouche card was played again, as this author testified on the dangers of derivatives before a House Banking Committee hearing on the financial services chapter of the North American Free Trade Agreement.

EIR was asked to submit written testimony for an Oct. 28 House Banking Committee hearing on derivatives. Gonzalez's committee also held a series of four hearings on the accountability of the Federal Reserve in October. Lyndon LaRouche has repeatedly identified the nationalization of the Federal Reserve as a key part of any economic recovery plan.