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Derivatives crisis sparks calls for emergency action

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Just how close the world came to financial and monetary disintegration following the collapse of British investment bank Barings PLC on Feb. 24, was intimated in a March 16 speech by U.S. Commodity Futures Trading Commission chairman Mary L. Schapiro, before the annual meeting of the National Futures Industry Conference in Boca Raton, Florida. "It is important to understand," Schapiro told the conclave of derivatives practitioners, "the truly international character of the problems that Barings' demise created, despite Barings' fairly minimal direct contact with the U.S. markets. . . . The delays encountered in transferring positions and funds had potentially significant systemic risk implications."

Schapiro told of how she and her staff worked, "for five days, virtually 18 hours a day," to get the futures exchanges and regulators of other nations to adopt tested U.S. practices in order to avoid a system-wide freeze of liquidity. "We talked, cajoled, and pressured foreign exchanges and regulators to transfer positions from various Barings accounts," Schapiro said. "Extraordinary efforts were made to design and implement systems ad hoc, to permit the transfer of positions at exchanges that had no rules for such transfers."

But while Schapiro boasted how U.S. regulators and policymakers had successfully crisis-managed the sudden obliteration of Barings, prominent voices in Europe and elsewhere were beginning to hint that the international financial and economic crises required emergency action. At the United Nations Social Development Summit, in Copenhagen during March 6-12, the idea of a 0.05% tax on short-term foreign exchange transactions was proposed and widely discussed, as a means of redressing the budgetary difficulties of the U.N. Though this, by itself, may not appear to be a response to the turmoil in the financial markets, the fact that International Monetary Fund Managing Director Michel Camdessus declared himself open to such a proposal, suggests that a significant shift in thinking at the highest levels of international banking and finance has occurred, since U.S. physical economist Lyndon LaRouche proposed a 0.1% tax on all financial derivatives transactions in Spring 1993.

Feeble proposals

In fact, for the paranoid derivatives dealers, it may have sounded, by the second week of March, as though almost everyone were demanding a take of their casino's profits. President François Mitterrand and French Socialist presidential candidate Lionel Jospin expressed support for controlling derivatives speculation through a similar international tax, during the U.N. conference.

In a front-page article in the March 10 issue of the weekly *Die Zeit,* entitled "Wild Bet at Any Price," former German Chancellor Helmut Schmidt charged that derivatives "have spread more rapidly over the world in the last years than any epidemic," and outlined three "necessary steps." First, said Schmidt, national legislatures, including the Bundestag (parliament), must hold special open public hearings on derivatives. Second, "Banking control authorities must intervene in every individual case, in which it seems to them that the internal control system of a bank [with respect to derivatives] is inadequate." Third, "To all non-banks, the participation in abstract financial derivatives deals is to be legally forbidden."

The Germans appear to be the most serious in addressing the issue at the moment. On March 20, the Social Democrats

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presented a "Grand Motion" in the Bundestag, signed by Rudolf Scharping, the national party chairman and opposition leader, declaring that, in light of the billions of deutschemarks in derivatives losses suffered by the Metallgesellschaft group and the Balsam group last year, the assurances of German Finance Minister Theodore Waigel that derivatives pose no fundamental threat to the economy, must be called into question. The motion included 20 questions concerning government plans for monitoring derivatives, and for forcing banks, companies, and municipalities to report how much "money at risk" they have in derivatives activities. A parliamentary debate on the Grand Motion is expected to occur within the next three or four weeks.

Even the stoical German Bundesbank (central bank) could not escape the issue. In an interview with the German weekly *Wirtschaftswoche* on March 19, Edgar Meister, a Bundesbank director, was asked for his opinion about imposing a "punishing tax" against financial speculation. While Meister hastened to reassure everyone that there was no threat of a systemic collapse, he did say that "any proposal to restrict purely speculative transactions should be studied seriously."

On March 14, Canadian Foreign Minister André Ouellet revealed that officials assigned the task of preparing the agenda for the Group of Seven meeting in June in Halifax, Nova Scotia, had been informally discussing the idea of imposing a tax on currency transactions as a means of discouraging speculation. "The information I have received is that there is genuine interest on the part of many to discuss this," Ouellet told the External Affairs Committee of Canada's Parliament. "The very fact that it would be on the agenda and that it would be discussed in Halifax [is] an immense step forward." The next day, no doubt reflecting the concern by the international banks that the issue is even being discussed, a spokesman for the Canadian Foreign Ministry insisted that the issue be discussed in the context of an upcoming review of the 50th anniversary of the Bretton Woods system, mandated at the Group of Seven (G-7) meeting in 1994 in Naples, whether or not the financial markets are in turmoil.

On March 16, Hans Georg Fabritius, vice president of the central bank of the German state of Hesse, told the Hesse Banking Association that current German regulations on "high-risk instruments," such as derivatives, were insufficient. Fabritius attacked the dangerous tendency of many to dismiss the Barings collapse by asserting that it was "only an isolated case" that "cannot happen here," or that the demise of Barings was "not caused by derivatives per se." The "real emergency" lies in the near future, Fabritius declared, and warned that an even worse derivatives failure is inevitable, and will be much more devastating than what hit Barings.

Panic in Italy

Fabritius's warning was amply proven within days, in Italy. On March 16, the Italian Parliament approved a major austerity package, aimed at reassuring financial markets about the stability and soundness of Italy's economy and currency. But on March 18, in "30 minutes of panic," as one source at the Banca d'Italia called it, the lira collapsed 5% against all other currencies, reaching a historic low of 1,280 to the deutschemark, while the Milan stock market plunged by 3.41%. The panic defies monetarists' arguments for "stabilizing measures," since it occurred within days of the legislative enactment of exactly such "stabilizing measures." "Whence do the massive sale orders come?" the Italian newspaper *La Repubblica* asked on March 18. "It is primarily the result of derivatives, those strange financial products that have brought Barings Bank to its knees."

It was no surprise, therefore, that the instability of the world's financial markets was the major topic of discussion during the meeting of European Commission foreign ministers in Carcassonne, France over the March 19-20 weekend. Commission President Jacques Santer, former prime minister of Luxembourg, called on the G-7 to take action to restore stability to the world's currency markets, by reviving the international cooperation typified by the Plaza and Louvre accords of the mid-1980s. The London *Financial Times* fretted that Santer "told Commission colleagues at their regular weekly meeting that he would dearly like to teach speculators a once-and-for-all lesson."

French Foreign Minister Alain Juppé, who presided over the March 19-20 meeting, declared that a reform of the world's currency system is indispensable. Otherwise, he warned, every country in the world will be exposed to foreign exchange turbulence, with all its dangerous consequences for economy and society.

Underlying causes ignored

But such instability is an effect, not a cause. The underlying problem that has yet to be addressed is that the world's physical economy has been decimated by the past three decades' policies of post-industrialism, financial deregulation, environmentalism, and population reduction. Until it is admitted that the past three decades' experiment in "free markets," allowing money to seek the highest return, has been an utter failure, there is nothing in store for the world but more financial turmoil, and the new Dark Ages of the worst economic collapse in history. Simply moving customers' accounts from one bankrupt derivatives player to another—the desperate gambit used by U.S. CFTC chairman Schapiro to contain the collateral damage from the implosion of Barings—merely postpones the inevitable day of reckoning.

What is needed is a return to real economic activity: building the water, transportation, education, and other systems human beings need. That means that governments need to stop worrying about balancing budgets, and reassert sovereign control over money, seizing control of credit flows from the stupid financiers and bankers, who, as the smoking crater that once was Barings PLC attests, are only killing themselves—and everyone else—anyway.