

EIR tells U.S. Congress: LaRouche is the expert on financial crisis

The following testimony by EIR to the House Committee on Banking and Financial Services, was submitted to a hearing on the Asian financial crisis, on Feb. 3. It was prepared by Marcia Merry Baker and John Hoefle. The summary headlines read, "Asian Financial Crises Express Breakdown of World Financial System"; "LaRouche: 'IMF Is the Disease, Not the Cure'"; and, "U.S. Initiative Required for 'New Bretton Woods' System, To Serve National Economies, Not Speculation."

The Asian and other financial crisis events of 1997, up through the present time, plus the sequence of events and policies over the past three decades leading up to today's situation, document that we are facing a *systemic* financial breakdown, and not some *cyclical* downturn, subject to correction by administrative adjustments.

The EIR News Service (EIRNS), founded 25 years ago, has been the source-of-record in providing in-depth coverage of the nature and scope of this breakdown process, from the point of view of showing what policy directions can lead the world away from catastrophe.

Lyndon H. LaRouche, Jr., the founder and contributing editor of EIRNS, is now internationally acclaimed for his forecasting record, and policy role.

In this testimony, we review certain key features of LaRouche's evaluations, and review the essentials of the crisis.

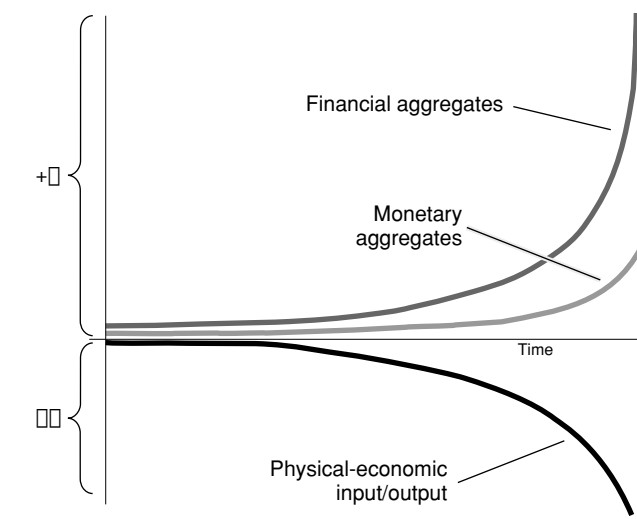
'New Bretton Woods' monetary system required

One year ago this month, LaRouche and international collaborators met at a conference in Washington, D.C. and launched an international drive to scrap the International Monetary Fund, and for the United States to take the lead in initiating a new financial system. By acclamation, the 800 people present backed, an "Appeal to President Clinton to Convoke a New Bretton Woods Conference." Before the year was out, over 2,000 signators, including three former national Presidents (Mexico, Brazil, and Uganda), and scores of elected officials, backed the appeal. (The text is appended below, as part of this testimony today.)

This "New Bretton Woods" drive expresses the desires and hopes of whole nations and peoples the world over. The events of 1997 have come to pass, in exactly the ways LaRouche forewarned of, repeatedly, over the 1994-1996

FIGURE 1

A typical collapse function



period.

- June 24, 1994. LaRouche warned, with precision, of, "The Coming Disintegration of the Financial Markets." He said, "The presently existing global financial and monetary system will disintegrate during the near term. . . . That collapse into disintegration is inevitable, because it could not be stopped now by anything but the politically improbable decision by leading governments to put the relevant financial and monetary institutions into bankruptcy reorganization."

- December 1995. LaRouche first publicized a now-well-known schematic, of a typical economic collapse function (see **Figure 1**). The three curves illustrate the process of collapse, in which financial aggregates climb ahead of monetary aggregates, all the while that the physical economy goes ever downward.

- December 1996. LaRouche spoke at a conference in Germany, on the theme, "Nothing Can Save the Current System." "Now, the *Titanic* is sinking. The unsinkable is sinking, this world economy in its present form. The question is *not* at what minute is it going to sink, or even what hour it's going to sink; but, do the passengers have the intelligence to get off the ship before it does?"

The events of 1997, and breaking events of 1998, have proved these warnings true. What is now called for is backing

in Congress, and throughout the United States, for “New Bretton Woods” arrangements. We here briefly review the state of the current financial breakdown; and then the guidelines for new nation-serving financial arrangements.

The Asian crises express world financial collapse

The defaults of entire nations in Asia, and pending in Brazil, Russia, and elsewhere, reflect, not the realities of the national economies involved, but the bursting of the world bubble of untenable rates and volumes of speculation. Hundreds of trillions of dollars worth of debts and claims are unpayable.

The extraordinary growth of world financial markets over the recent years is not a sign of economic health, as many would prefer to think, but rather a sign of looming disaster, comparable to the rapid growth of a malignant tumor: The growth is a reflection of the rapid spread of a deadly disease, the success of which will ultimately prove fatal to its host—and itself—unless it were eradicated.

The seeming success of the financial markets is based upon the creation of an enormous speculative bubble, a financial tumor, the existence of which depends upon the cannibalization of the real, physical economy. Exemplary of this process is the Dow Jones Industrial Average, which some people consider America’s premier economic indicator.

As an indicator of industrial progress, the Dow is a lie. There is little “industrial” about it: As American industry has declined, the composition of the Dow has been shifted further and further into the financial and service sectors, hiding that economic decline under the rubric of the “information society.” The 30 Dow companies now include such decidedly non-industrial companies as Walt Disney, Coca-Cola, Wal-Mart, and American Express, along with the second-largest derivatives bank in the world, J.P. Morgan & Co. As such, the Dow Jones Industrial Average has become a measure of the size of the bubble—it measures the tumor, not the healthy tissue. It has become, in effect, the Dow Jones Tumor Index.

The ‘Casino Mondiale’

“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.” That statement, as reported by the *New York Times* in 1993, was made by one Michael G.J. Davis, a deputy risk manager at Chase Manhattan Bank, and says volumes about the character of the bank and of the global financial system. Chase is far from alone, as the “lure ‘em in and f—‘em” culture at Bankers Trust, and the “there’s blood in the water—let’s go kill something” tactics of Morgan Stanley, show. It is the Predators’ Ball, writ large.

The global financial system has become a *Casino Mondiale*, dominated by speculators, who place bets on everything from interest rates and currencies, to the record sales of rock

stars and the ability of debt-ridden Americans to service their credit card accounts. The idea of production has become passé—what counts, is the ability to “earn” high rates of return. What corporate America produces, in the minds of all too many investors and corporate officers, is stock prices. They are oblivious to the concept of production, the idea that the wealth they seek to take, must actually be created through the physical transformation of raw materials, into intermediate and finished goods, wherein the output has a higher value than the costs of inputs plus production. To the modern investor, money, and lots of it, is what counts.

EIR’s physical-economic studies, commissioned and guided by Lyndon LaRouche, show that the productive capacity of the U.S. economy, as measured in per-capita, per-household, and per-square-kilometer terms, has been declining at a rate of about 2% a year over the last three decades, resulting in a drop of some 50% since 1970, during which period the standard of living of the ordinary American has dropped precipitously. Whereas in the 1960s a single wage-earner could support a family on just one salary, in most of today’s families both the husband and wife are forced to work, often more than one job each, and still often get by only by going increasingly deeper into debt. The result is an unsustainable debt burden, record levels of bankruptcies, and sliding of many of our citizens off the cliff into economic oblivion.

Derivatives: blood futures

The most egregious example of the *Casino Mondiale* nature of the global financial system, is the global derivatives market, which the Bank for International Settlements put at \$82.6 trillion at the end of 1996, and which *EIR* estimates to be in the range of \$100 trillion to \$150 trillion, worldwide, compared to a gross world product in the neighborhood of \$40 trillion. (See **Figures 2** through **9**.)

The purpose of derivatives, the claim goes, is to hedge against risk in volatile financial markets: derivatives are used by companies to hedge against changes in interest rates or currency exchange rates which could radically raise their expenditures or lower their income. But with world trade accounting for just 0.5% of daily foreign exchange trading, it is clear that derivatives bear little connection to real-world economic activity.

To understand what derivatives actually represent, picture a dog with a bad case of fleas, fleas engaged in sucking the blood out of the dog and trading it among themselves. The fleas are so successful in building their trading empires, and pumping out so much blood to support their trading, that the dog starts running dry. That presents the fleas with a big problem. But being clever little critters, the fleas come up with a solution: They start trading in blood futures, instead of actual blood. No longer limited by the amount of blood available, the fleas can trade on a vastly larger scale, and become richer and more powerful than ever. Until, of course, the dog dies. That, in a nutshell, is the derivatives market today. Its very success, dooms it.

FIGURE 2
World derivatives
 (trillions \$)

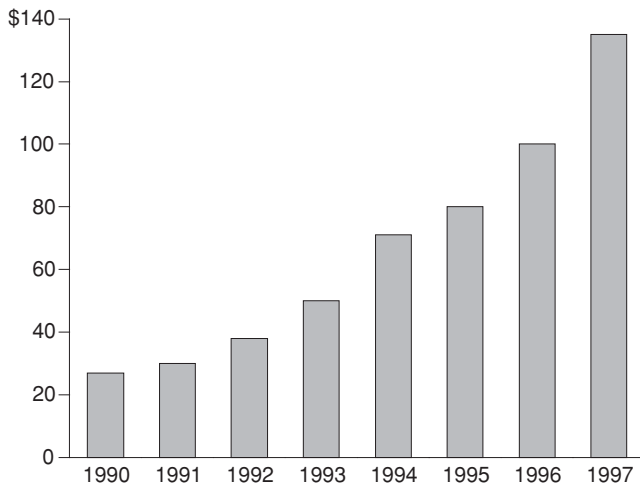


FIGURE 3
Derivatives in selected countries
 (trillions \$)

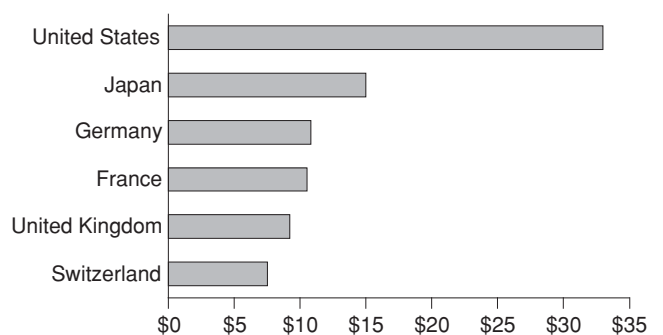


FIGURE 4
Growth of U.S. financial claims
 (trillions \$)

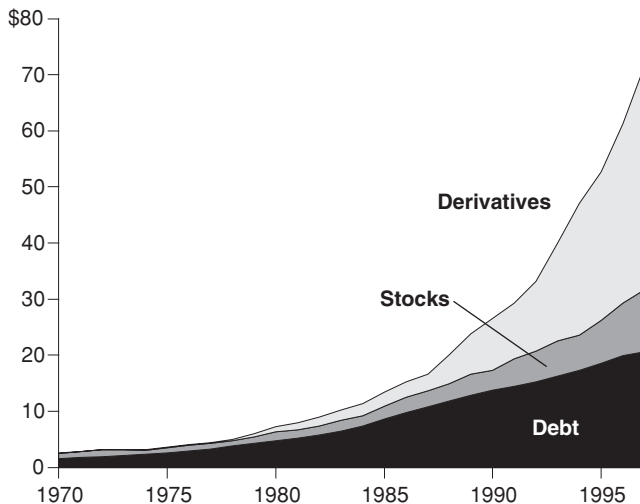
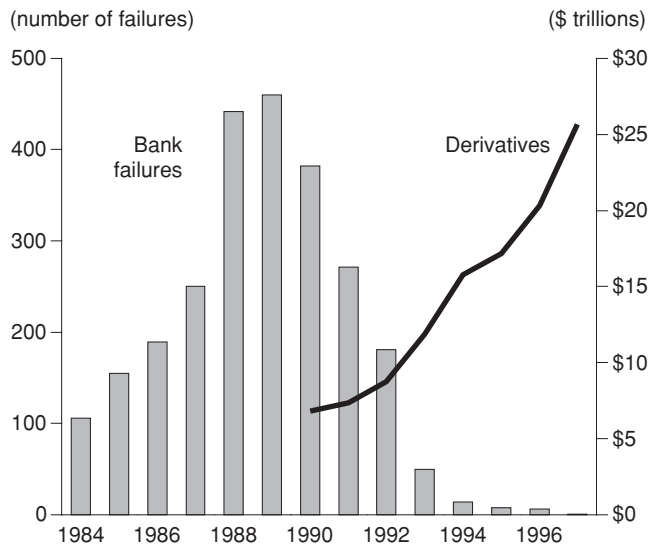


FIGURE 5
Bank and thrift failures versus derivatives



It has been said that the financial crisis is an “Asian contagion,” which can be contained and prevented from spreading to the rest of the world. Nothing could be further from the truth. What is occurring, is the *disintegration of the global financial system*, a system in which the United States, due to its derivatives exposures, is sitting at ground zero.

According to the Federal Deposit Insurance Corp., the U.S. banking system had \$25.7 trillion in “off-balance-sheet derivatives” as of Sept. 30, 1997, compared to \$4.9 trillion in balance-sheet assets, \$415 billion in equity capital, and \$55

billion in reserves for loan losses. For the banking system as a whole, the off-balance-sheet numbers were more than five times what appeared on the balance sheets.

The picture gets even worse when you look at the big derivatives banks. Chase Manhattan Corp. alone had \$7.9 trillion in derivatives—a figure just shy of the U.S. GDP of \$8.1 trillion—and J.P. Morgan, supposedly a conservative bank, had \$6.2 trillion in derivatives. Chase’s derivatives were 21 times its assets and 364 times its equity, while Morgan had 23 times and 537 times, respectively. A loss equivalent to 0.3% of its derivatives portfolio would be more than enough to wipe out the entire equity capital of either bank. Five more banks—Citicorp, Bankers Trust, NationsBank, BankAmerica, and First Chicago NBD—have derivatives

FIGURE 6

Derivatives for each dollar of assets of seven major U.S. banks

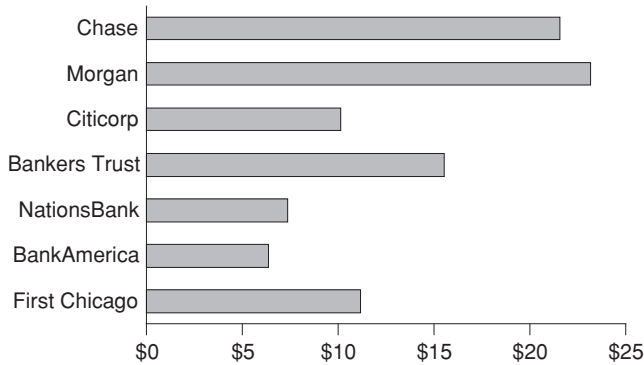


FIGURE 7

Derivatives for each dollar of equity capital of seven major U.S. banks

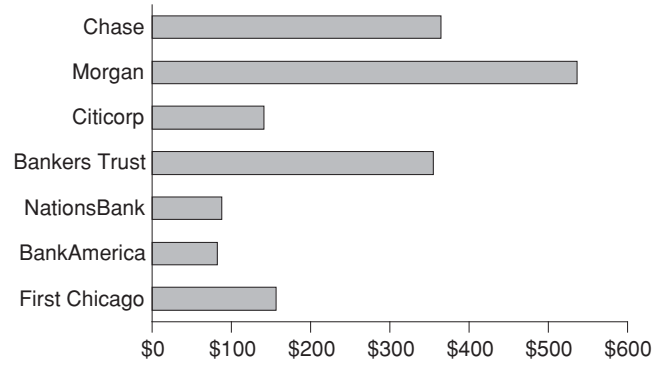


FIGURE 8

Chase Manhattan Corp.'s derivatives, assets, and equity compared

(as of Sept. 30, 1997)

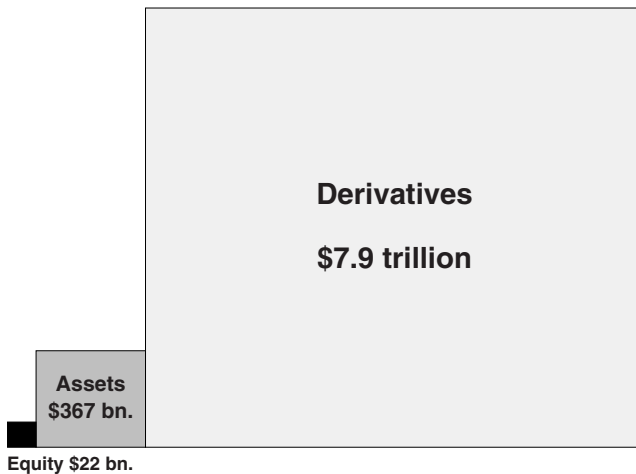
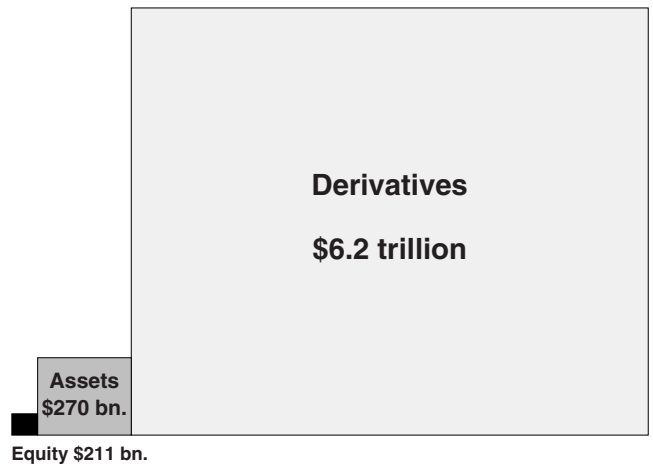


FIGURE 9

J.P. Morgan & Co.'s derivatives, assets, and equity compared

(as of Sept. 30, 1997)



holdings in excess of \$1 trillion; together, these seven bank have \$24 trillion in derivatives, compared to \$1.7 trillion in assets, \$109 billion in equity, and \$19 billion in loan loss reserves.

This is “risk management”? Hardly.

Can you imagine if you went to your doctor, and you said, “Doctor, I’m feeling poorly, I’ve got this huge tumor that I have to wheel in with a truck.” And the doctor gives you an examination, and he probes around on the tumor, and finally, he reports to the *tumor*: “You’re doing very well!” That’s what modern economic statistics are. They’re all reflections of this tumor, reflections of the disease.

Look at some of the entities which have reported deriva-

tives losses. Take the Admiral Peary Vo-Tech, vocational-technical school, in Pennsylvania, or the Palm Beach County Sheriff’s Department in Florida. When vo-techs and sheriff’s departments start playing the derivatives markets, it’s a sure sign the system is out of control.

The financial sharks are attempting to issue derivatives on just about any income stream they can find—credit card receivables, David Bowie record sales, and God knows what else, spinning out layer after layer of unpayable claims. The prestigious French bank, Paribas, one of the top derivatives banks in France, is now selling what amounts to derivatives on the crash: derivatives based on the five European banks with the largest exposures in Asia.

What the system needs, is not more bailouts, or more derivatives or more funny money. What the system needs is a flea dip, and fast, before the entire system disintegrates.

Get the world economy above breakeven

In brief, the hallmarks of a new financial system in the interests of nations, not financial speculation, call for a return to some of the tried-and-true national interest measures such as re-pegging currencies, imposing foreign exchange controls, and exercising controls over capital flows. These all worked at the beginning of the first “Bretton Woods” system, up through the beginning of the 1960s.

At the same time, domestically, nations now require versions of what the U.S. codes call “Chapter 11” bankruptcy — where vital functions are protected and restored, and debts and financial claims are managed in ways to serve that purpose.

These are the kinds of measures required, because in fact, the toll of speculative extractions from the real physical economies of nations, has been so great, that the world economy is, effectively, *below breakeven*. Basic ratios, per household, and per unit land area, of such necessities as safe water, housing, transportation, power, and so forth, are inadequate the world over, and in most places, on the decline. The only general exception is China.

In the United States, by these real measures of conditions of the potential productivity of the economy, the real “economic fundamentals” are in a state of disaster. For example, look at transportation infrastructure. The rail grid, and capacity, have shrunk to the point that the 1997 grain harvest, and other cargo, were unable to be moved in the western states.

Production and consumption levels in the United States have been on the decline since the late 1960s, by about 2% a year, by real “market basket” standards of measurement. Households require several jobs to scrape by, where one principal wage-earner in the 1960s could support the family.

If we approach the present crises of the breakdown of the physical economy, and the financial system, as an *opportunity* for restoring economic development policies, and ending the insanity of “post-industrial” thinking, then we can find the ways to begin reversing the damage, avert catastrophe, and restore hope.

Documentation

New Bretton Woods appeal to President Clinton

The following “Appeal to President Clinton to Convoke a New Bretton Woods Conference,” was submitted with the EIR testimony as an appendix. The text was voted up by parti-

cipants in the Schiller Institute conference in Reston, Virginia, on Feb. 19-21, 1997, and has subsequently been signed by thousands internationally.

The world economy, with the exception of China, is faced with an accelerating collapse of industrial capacity and the skyrocketing of unemployment, which has led to a political mass-strike process, shaking the foundations of many governments and social institutions around the world.

The unavoidable bursting of the international derivatives bubble, or any relevant political event, could trigger a chain-reaction of stock market crashes and banking crises in many countries, leading toward the vaporization of the international financial system within a matter of days. The political, social, and military consequences of such a systemic crash would be incalculable.

Meanwhile, the tragedy of the so-called IMF reform policies in the former Soviet Union is now playing out, in the form of a monstrous collapse of production, a demographic disaster, and an unprecedented criminalization of society, which has resulted in an even worse and more rapid catastrophe than has already occurred in Ibero-America and Africa. If the present course of these international policies is not changed, entire nations will vanish from the map of the earth, as is already demonstrated in Africa. And, as the conditions in Bulgaria and Albania illustrate, even Europe can plunge into a new dark age in a very short time. Germany, for example, has reached *de facto* the same level of unemployment as when Hitler came to power.

Thus, many governments, parliamentarians, and leaders of social institutions are confronted with the unacceptable dilemma, that if we are to fulfill the conditionalities of the IMF, or such requirements as those of the Maastricht Treaty or the Balanced Budget Amendment in the United States, we would have to act against the most vital interests of the people, whom we represent. But the international financial institutions have no right to require that the debt to them be paid with a pound of flesh of each of our citizens.

The U.S. Declaration of Independence states:

“When in the course of human events, it becomes necessary for one people to dissolve the political bands which have connected them with another, and to assume among the powers of the Earth the separate and equal station to which the Laws of Nature and of Nature’s God entitle them, a decent respect to the opinions of mankind requires that they should declare the causes which impel them to the separation.”

In this spirit we say, that not for “one people,” but for the peoples of the world, it has become necessary not to dissolve the political, but the financial bands with the presently hegemonic financial institutions.

In the Declaration it is further stated: “But when a long train of abuses and usurpations, pursuing invariably the same object, evinces a design to reduce them under absolute Despotism, it is their right, it is their duty, to throw off such Government, and to provide New Guards for their future security.”

Such a condition has emerged, threatening to throw our entire human civilization into chaos and barbarism.

Therefore, we appeal to you, President Clinton, to use the Powers of the Presidency of the United States, to convoke, on an emergency basis, a new international Bretton Woods conference, to replace the present bankrupt monetary system with a new one. A global debt reorganization, the establishment of fixed-parity exchange rates and a new set of trade and tariff agreements are the absolute precondition for stability in world economic and financial relations, which are required for a return to economic growth.

It is also required that sovereign governments have exclusive responsibility for the emission of currency and the creation of credit and that, in the tradition of President Franklin D. Roosevelt's bold anti-depression programs, they make available cheap and long-term credit lines for large-scale investments in infrastructure, industry, and agriculture.

The outline of a new world economic system is already taking shape. Led by the initiative of the Chinese government, several countries of Asia are currently engaged in the construction of the "New Eurasian Land-Bridge." By integrating all of the Eurasian continent economically, a similar "land-bridge" development is planned which will soon also connect the United States, via the Bering Strait, and Africa, via the Near East, bringing economic development and prosperity to all previously landlocked areas of the world.

As a cornerstone of this global reconstruction program, the economist Lyndon LaRouche has emphasized what he terms the "Machine-Tool Principle." This principle is the recognition that the economy must be based on the fact, that it is solely the creative reason of the individual which is the source of wealth in society. It is the continued ability of creative reason to formulate adequate hypotheses about the laws of nature, which leads to scientific and technological progress. These discoveries are applied in the form of new, improved machine tools and in upgrading the skills of the labor force, resulting in increasing productivity of the productive process. The global economic reconstruction must therefore put absolute priority on Classical, universal education and the strengthening of the creative powers of the individual.

The building of the Eurasian Land-Bridge as the cornerstone for similar infrastructure and economic programs for Africa, Australia, and the Americas is the only way that economic development can bring peace and stability to all corners of the world. Such a policy is therefore in the strategic security interest of the United States. It is also in the tradition of the Founding Fathers as a policy for a community of principle among nations.

We appeal to you with the utmost urgency to take the necessary steps, so that your Presidency does not mark the beginning of a new dark age, but that of a new golden era of mankind.

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