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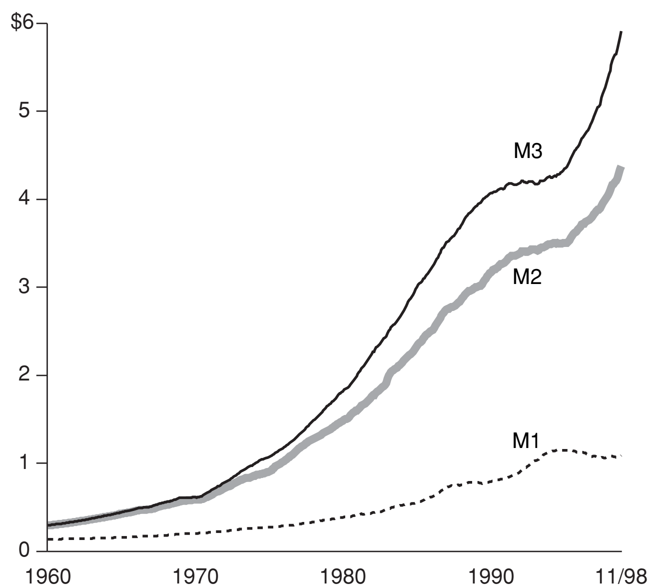
FIGURE 2
**Money supply skyrockets, 1960-98**
(trillions $)




Sources: Federal Reserve Board of Governors.

are, are not as determining in the situation as the subjective problem: Greenspan's disordered state of mind. He has worked for 11 years as Federal Reserve Board chairman propping up this speculative bubble. His recklessness in implementing a policy of hyperinflation to "save the system," if it is not stopped, will, as in Weimar Germany, cause the system's explosion, and through associated looting, finish off the physical economy.

## Testimony to Congress

# Don't regulate derivatives market, but eliminate it!

*The following testimony by John Hoefle,* EIR *banking columnist, was prepared for a Senate Agriculture Committee hearing on over-the-counter (OTC) financial derivatives on Dec. 16. It was entitled, "Don't Just Regulate the Derivatives Market, Eliminate It! Assert National Sovereignty Over the Financial Markets."*

Since the spring of 1993, *EIR* and its founder Lyndon LaRouche have been warning of the dangers posed to humanity by the explosion of financial derivatives. On Sept. 8 of that year, I testified before the House Banking Committee hearing on the financial aspects of NAFTA [the North American Free Trade Agreement], warning of the consequences of allowing the derivatives bubble to continue. On Oct. 28, under the leadership of Chairman Henry B. Gonzalez, the House Banking Committee held its first-ever hearing on derivatives, to which *EIR* submitted written testimony advising Congress to implement LaRouche's proposal for a 0.1% transaction tax on all derivatives transactions in the United States, as a way of drying out the derivatives market, while raising badly needed tax revenue. At the derivatives hearing, the Comptroller of the Currency revealed that the U.S. commercial banks alone had nearly $12 trillion in off-balance-sheet derivatives, some $3.20 in derivatives for every dollar of assets, and $40 in derivatives for every dollar of equity capital.

These figures, which seemed huge at the time, now look conservative. As of June 30 of this year, according to the Federal Deposit Insurance Corp., U.S. commercial banks had $28.8 trillion in derivatives, or $5.56 in derivatives for every dollar of assets, and $64.66 in derivatives for every dollar of equity. Today just two banks, Chase Manhattan and J.P. Morgan, have more in combined derivatives than the entire U.S. banking system did in 1993 (Chase's derivatives holdings are larger than the GDP of the United States, while Morgan has $26.71 in derivatives for every dollar of assets, and $640 in derivatives for every dollar of equity!), and U.S. financial institutions as a whole, have some $45 trillion in derivatives. Worldwide, we estimate the total of derivatives and related financial claims to be in the range of $150 trillion—figures from the Bank for International Settlements put the derivatives holdings of just 78 financial institutions at more than $103 trillion at the end of 1997.

Earlier this year, the Commodity Futures Trading Commission suggested in rather mild language, that it might take up the question of whether some form of new regulation of the over-the-counter derivatives market were advisable. Given the staggering growth in the OTC market over the past few years, such a review was long overdue, but the CFTC's concept release triggered a firestorm of protest from not only the derivatives dealers, but from the regulators as well. The Federal Reserve, the Treasury, and the Securities and Exchange Commission going so far as to demand that legislation be enacted prohibiting the CFTC from touching the OTC market, agreeing with the derivatives banks that just raising the issue of increased derivatives regulation, could blow up the market.

The derivatives market should be left to regulate itself, they claimed, saying that any attempt by the government to impose controls, would constitute "regulatory burden."



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When the Financial Accounting Standards Board decreed that corporations would have to reveal the extent of their derivatives positions, the response was equally vociferous, with bank and non-bank derivatives dealers demanding that the proposed FASB standard be stopped.

Forcing companies to disclose their derivatives activities to the public, the derivatives dealers argued, might cause the companies to reduce their use of these wonderful risk management tools.

Why regulation and disclosure would prove so disruptive to a market which claims to reduce the risk of financial disruption, was never quite explained. To do so would have meant the confession that, far from reducing risk, derivatives are the riskiest financial instrument imaginable.

## Above the law?

The claims that financial companies can be trusted to regulate themselves run counter to reality. In recent years, banks have been caught cheating their customers in derivatives deals and laundering drug money; securities firms have been caught dumping overpriced securities upon, and churning the accounts of, their customers; and insurance companies have been caught selling policies under false, but lucrative, pretenses. The actions of Bankers Trust in 1994, for example, were so egregious that the bank was accused by Procter & Gamble of racketeering, of violating the Federal RICO [Racketeering Influenced and Corrupt Organizations] statutes which were designed to prosecute organized crime. (Lest anyone forget, prior to its barely concealed 1994 takeover by the Federal government, this same Bankers Trust had been repeatedly cited as the leader in the global derivatives market, a bank whose expertise proved beyond a doubt that self-regulation were preferable to government "interference.") The violations of law and public trust by U.S. financial institutions have been so widespread and pervasive, that they must be viewed as a *characteristic of the system,* rather than as an anomaly. It is business as usual.

Having been caught so often and so publicly, the financial sector deployed legions of propagandists to rebuild its image. But behind the scenes, they also launched a full-scale, and successful, campaign to get Congress to change the laws, to reduce regulatory oversight, and to make it more difficult for future victims to obtain justice.

The view by the financial sector that it is above the law, was evident in both the actions of Travelers and Citicorp, in proposing a merger that was illegal under U.S. law, and in the reaction of the regulators, who quickly promised to change the law to suit the financiers. The money won out over national sovereignty, hands down.

## Derivatives disintegration

Deregulation has not only been a failure, it has brought the world to the edge of the abyss. Through the use of derivatives and other forms of speculative paper, the world financial system has been turned into a global casino which feeds off of, rather than helps build, the productive sector upon which all human life—and all financial claims—ultimately depend. The very fabric of our society is being destroyed, to keep this doomed bubble going a bit longer. Measured in terms of a market basket of production and consumption of physical goods, rather than in bubble-inflated dollar terms, the U.S. economy has declined at a rate of about 2% a year since 1967, and that decline is accelerating. We destroyed much of our industrial capacity by moving it offshore, and made up our shortfall in food production by importing food from countries where significant portions of the population are starving. Now many of those nations are collapsing, unable to buy what goods and services we still produce, and unable to provide the goods upon which we have come to depend. This is a self-feeding spiral from which there will be no escape, unless we break free of the grip of the casino.

The characteristic of the last few years, has been that of a series of systemic financial shocks, the density and severity of which are increasing. It is this process of escalating shocks, and not the seeming calm in between the shocks, that must be examined. The "Asian contagion" and the "Russian crisis" were not anomalies, but the lawful consequence of the cancerous growth of the bubble. The anomaly is that the Dow Jones Industrial Index has risen to new heights, while world industrial activity has sunk rapidly into depression. The anomaly is that regulators and politicians defend the derivatives bubble as the essence of economic productivity, even as that bubble strangles the life out of real productivity. They are killing the patient, to save the cancer.

This system, as economist Lyndon LaRouche has repeatedly proven, is doomed. The efforts to pump liquidity into the bubble will not save it, but merely hasten its demise, and make the effects of its collapse even worse. Unless the United States government acts to put this global casino through the equivalent of a bankruptcy proceeding, we face the very real possibility that, within weeks, the entire global financial system will disintegrate, wiping out not only the speculative paper and the financial sector, but also most of what remains of the world's productive capacity.

To try to save this bubble, is to ensure that the world will plunge into a new dark age. Re-regulation is not enough. Nations must exercise their sovereign power to eliminate the derivatives market and related speculation, and launch an emergency mobilization to rebuild the world's infrastructure and industrial capabilities. Some nations have begun to fight, notably Russia, and in Asia, where Malaysia, China, Hong Kong, Taiwan, and Japan have taken sovereign action to curb speculation. But these efforts, as welcome as they are, will not succeed unless the United States comes to its senses. The derivatives market is dead, but humanity need not die with it, if reason prevails over greed.