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EIR World News

# Shut Down the Derivatives Markets To Save Civilization

by John Hoefle

Oct. 10—"It is time to break the silence on derivatives," Lyndon LaRouche said yesterday, after observing the carnage in the financial system and the pathetic response from the so-called regulators. "The true, hyperinflationary factor in the situation is the unregulated, insanely leveraged derivatives trade. This is what is killing us. This is the great crime of Alan Greenspan."

LaRouche described the derivatives market as a "hyperinflationary bomb, crushing the international financial system," and warned that "until you just shut down the whole derivatives trade—wipe these gambling obligations off the books of the financial system—you are just kidding yourself."

"Unless and until you deal with this derivatives bubble, which can not be bailed out, you are just kidding yourself," he continued. "It is time for Hank Paulson to swallow the only real medicine: bankruptcy reorganization of the entire, dollar-based financial system. And the first step in any such bankruptcy reorganization would be the cancellation of these quadrillions of dollars in pure gambling obligations. Without such action, this planet is doomed to a horrible dark age, just like the dark age of the Fourteenth Century, that followed the collapse of the Lombard banking system."

## Blood in the Streets

You don't have to be a financial insider to see that the entire global financial system is collapsing, since that collapse is now front-page news every day. The Bush Administration, its co-conspirators in Congress, and the Federal Reserve have passed the largest financial bailout scheme in history, and the Fed and the Treasury are cooking up new bailout facilities and increasing the money available in existing facilities on practically a daily basis. The stock markets are plunging, with the Dow Jones Industrial Index down 40% in a year, and dropping like a rock. The banks, particularly in the United States and Europe, are vaporizing faster than most people would have thought possible a year ago, with governments in most major European countries belatedly taking steps to prop up the banks and stop runs by protecting deposits. Yet despite it all, the crisis deepens by the day.

The carnage is becoming increasingly visible in the daily lives of citizens, as the demise of the securities market "debt machine" wipes out the credit most Amer-

**Top U.S. Derivatives Bank Holding Companies, at June 30, 2008**
($ Billions)

| Rank | Bank Holding Company | Equity | Assets | Derivative |
|---|---|---|---|---|
| 1 | J.P. Morgan Chase | $133 | $1,776 | $98,827 |
| 2 | Bank of America | $163 | $1,723 | $40,624 |
| 3 | Citigroup | $136 | $2,100 | $39,935 |
| 4 | Wachovia | $75 | $812 | $4,433 |
| 5 | HSBC North America | $27 | $461 | $4,081 |

Sources: Office of the Comptroller of the Currency, Federal Reserve.



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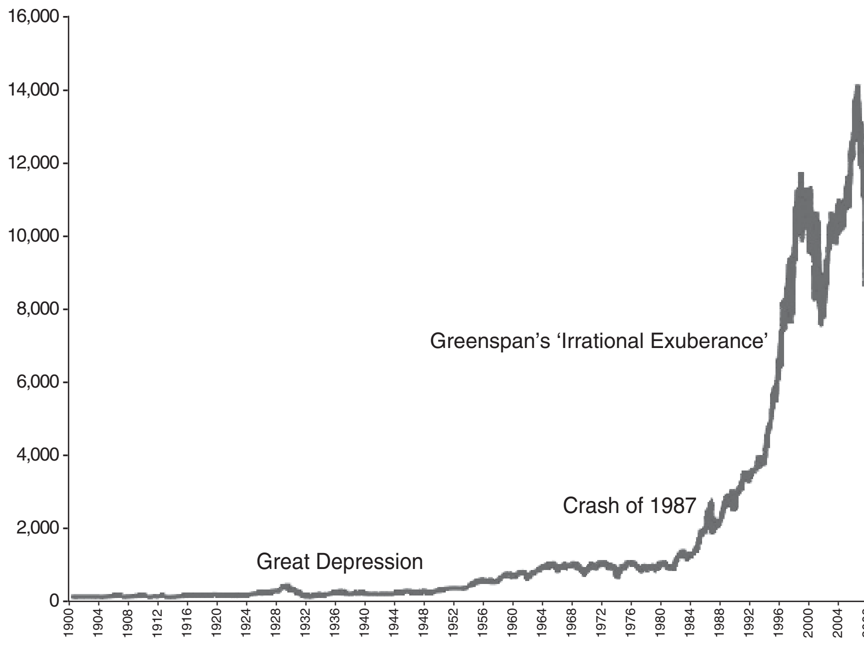
FIGURE 1
**Dow Jones Industrial Average, Weekly, 1900 to Oct. 2008**
(Weekly Closing Value)




Source: Dow Jones.

icans had come to depend upon, in their households and workplaces. Banks are cutting back on credit-card limits and other consumer loans; mortgages are harder to come by; cash-out refinancings and home equity lines of credit are drying up as home prices fall; and businesses are finding it harder and harder to sell new debt in the bond, commercial paper, and other corporate debt markets. For an economy which is dependent upon debt, and already in hock up to its eyeballs, these are ominous developments. The fabric of society is breaking down, and the blood in the streets is spreading.

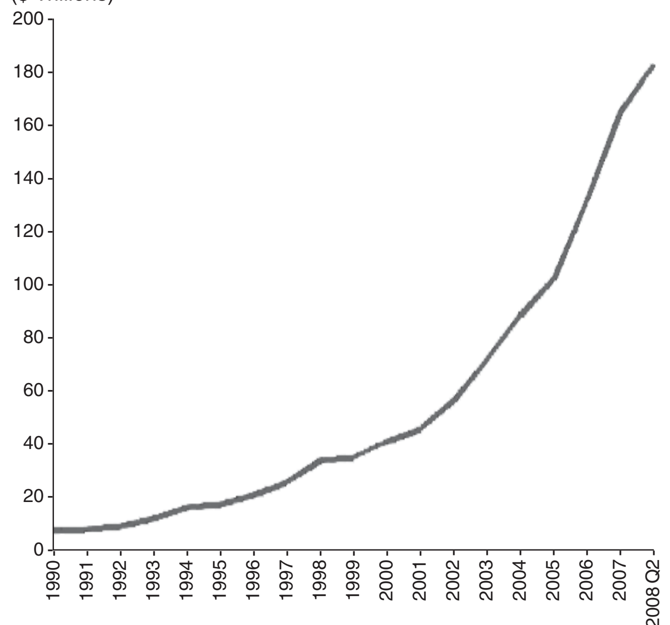
## Deadly Derivatives

The chief financial factor in this carnage is the world's largest casino, the derivatives market. The derivatives market is far larger than the world's stock and bond markets combined, with bets in the quadrillions of dollars compared to the trillions of stocks and bonds. While it is impossible to put an exact number to the *size* of the overall derivatives market, given its unregulated operations and the way most derivatives deals are privately negotiated, it is possible to put a number to the *value* of the derivatives bets outstanding, and that number is *zero.*

Derivatives were the great financial innovation of the Greenspan era, a form of sleight of hand designed to hide the bankruptcy of the financial system after the stock market crash of 1987, the collapse of the savings and loan sector, the bankruptcy of the banking system as a whole, and the collapse of the junk-bond bubble. The derivatives market was a fraud from its inception, a virtual market where the big banks and other speculators could bet on the movements of currencies, bonds, stocks, and the indices associated with them. Because the derivatives did not require the ownership of the instruments upon which they were nominally based, the level of bets soon outstripped the levels of the underlying instruments, with, for example, far more derivatives bets on bonds than there were actual bonds.

The derivatives market also employed high degrees of leverage, placing bets with borrowed money. Using leverage, the speculators could place far larger bets than they could,

FIGURE 2
**Derivatives at U.S. Commercial Banks**
($ Trillions)




Source: FDIC.

were they limited to their own money. This leverage was highly profitable—at least virtually—as long as the game was expanding, but turned deadly when the music stopped. Then, reverse leverage set in, and the players began losing not only their bets, but the money they borrowed to place those bets. This reverse leverage made it possible for the gamblers to lose multiples of the money they put in, before the loans.

Another innovation that was highly "profitable" before it blew up, was the market for credit derivatives (a.k.a., credit default swaps, or CDS), a form of insurance policy for bonds and derivatives bets. While the derivatives market was in full swing, banks, insurance companies, and other financial firms sold trillions of dollars of credit derivatives to guarantee the value of a wide range of securities. The credit derivatives were a fig leaf, a necessary part of the derivatives scam.

The obvious point is that, in any widespread securities crisis, the credit derivatives sellers would never be able to cover the insurance they wrote. AIG, for example, wrote hundreds of billions of dollars of credit derivatives, including a substantial amount based upon securities issued by Lehman Brothers. When Lehman failed, so did AIG, which has now received some $120 billion in emergency loans from the Fed.

The settlement date for credit derivatives written on Lehman securities was Oct. 10, at which point the Lehman securities were valued, optimistically, at just 8.6¢ per dollar of face value. This will be the largest payout ever for the credit derivatives market, assuming the sellers (protection-writers) can afford the payments.

### Shut It Down

The attempt to save the fictitious "values" and "profits" of the derivatives market is one of the prime drivers of the largest bailout *attempt* in history.

It is therefore essential that the bailout of the derivatives bubble be stopped, immediately. All derivatives trades should be declared null and void, and wiped off the books of the speculators. Any financial instrument containing a derivative should also be declared null and void, and wiped off the books. This unregulated, insanely leveraged casino should be shut down, and all claims arising from derivatives bets nullified, as if the bets had never occurred.

There can be no compromise on this. Shut it down, and shut it down now. Your life, and that of the nation, depend upon it.

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# International Bankers' Scramble Shows Money Can Solve Nothing

by Nancy Spannaus and Claudio Celani

Oct. 11—The week that began with the ramming through of the U.S. Congress's bailout bill on Oct. 3, was supposed to demonstrate that the U.S. political-financial establishment, and its European colleagues, had brought the global financial meltdown under control. In fact, all it showed was that the current financial authorities have no credibility, and that the issuance of *money*, trillions of dollars of it, will do absolutely nothing to save the financial system.

Rather, as Lyndon LaRouche has emphasized consistently, the current financial system *cannot* be saved. It must be put through bankruptcy reorganization, and replaced.

The unprecedented collapse (800 points) of the U.S. stock market on the day immediately after the bailout was signed, launched a process of escalating panic, which unfolded day by day over the week. Leaving aside most of the European measures, which we will relate later below, the following shows the increasing amounts of money which were thrown down the bottomless sinkhole:

**Oct. 6:** The Fed increased to $900 billion the lending limit in its Term Auction Facility, and announced that it would begin paying banks interest on their reserves, thus, de facto, reducing interest rates by 0.75%.

**Oct. 7:** The Fed invoked emergency powers to establish a new unit, funded by a deposit by the Treasury at the New York Fed, which will buy up an undisclosed amount of *unsecured* commercial paper, which businesses are no longer able to sell to banks to fund their daily operations.

**Oct. 8:** As the stock market opened in the U.S., the central banks of the Group of 7 announced a coordinated cut in interest rates, in the alleged pursuit of providing liquidity to the banks. The cut brings the U.S. rate down to a nominal 1.5%. The Fed announced that it was issuing an additional $38 billion to AIG, because it has already burned through most of the first $85 bil-