Ban, Don't 'Regulate,' Derivatives

by John Hoefle

June 19—Every time someone proposes taking action against the derivatives markets, the bankers come scurrying like roaches, to proclaim that taking any action against derivatives will end civilization as we know it. You'd think, listening to them squawk, that derivatives fill some vital societal need. What a crock. Not only do we not need derivatives, we should ban them entirely. Outlaw them. Period.

Derivatives have never served any purpose other than as a mechanism by which a bankrupt financial system could pretend to be solvent. Derivatives are, in truth, the biggest pyramid scheme the world has ever seen—and one that has now collapsed.

Here we are, three years into the greatest financial crisis in modern history, one which is widely understood to have been caused by derivatives, and nothing substantive has been done to fix the problem. Even relatively mild suggestions, like moving all derivatives trading to exchanges, or moving derivatives trading out of the banks which hold the public's deposits, have been met with rabid counterattacks by the derivatives lobby and its smarmy mouthpieces, such as House Financial Services Committee chairman Barney Frank.

We understand their objections. Wall Street makes its money by theft, and the derivatives racket is one of its prime thieving tools. It is really a variation on the old mafia protection game, where you throw a brick through a shopkeeper's window at night, and then sell him "insurance" against vandalism the next day. With derivatives, the name of the game is manipulating the financial markets, and then selling "insurance" against the market fluctuations. The techniques differ, but the predatory nature of the racket remains.

Doomed from the Start

The derivatives market was created in the late 1980s, as a foolish response to the financial crisis typified by the stock market crash of 1987, the demise of the S&L industry, and the bankruptcy of the U.S. banking system. Rather than face up to that bankruptcy, the bankers did what they always do whenever they can get away with it: They lied, they covered up, and went double-or-nothing. Leading the charge was then-Federal Reserve chairman Alan Greenspan and the usual Wall Street crowd.

The easiest way to grasp the nature of the derivatives markets is to think of a dog with a bad case of the fleas. The fleas, whose existence depends upon eating the dog, set up little empires buying and selling the dog's blood. They are so successful, in fact, that the dog begins to die. This presents the fleas with a real dilemma, but being clever little critters, they come up with a solution. Instead of trading the dog's blood, they switch to trading blood futures. Suddenly, their trading is no longer limited to the amount of blood they can suck out of the dog—they are now trading virtual blood, which by its nature is unlimited. Their trading empires expand as never before, making them rich beyond their wildest dreams—and who cares if the dog has died in the meantime?

Derivatives are a form of gambling, a way of speculating not on the economic values of investments, but upon the direction of their price movements. You can bet, say, on whether the price of a particular corporate stock will go up or down, without even having to own the stock. You can bet that a company will default on its bonds, or that a nation's currency will rise and fall, without owning the bonds or the currency. Some three-quarters of the quadrillion-dollar-plus global derivatives market is interest rate swaps, which are, essentially, bets on the movements of individual interests rates, and the relative movements among sets of interest rates. They are not investments, in any productive sense of the word. They do not create wealth, but extract it, skimming off the wealth created elsewhere. Derivatives are thus parasitic in nature, a hidden tax on humanity.

They are also virtual, in the sense that the volume of derivatives is far, far greater than the volume of the financial assets which—only theoretically—underlie them. And the value of those underlying financial assets is itself overstated. The whole market is a house of cards, hopelessly bankrupt and already crumbling. This state of affairs is what the banks are so desperately trying to hide, and why they so vehemently attack any

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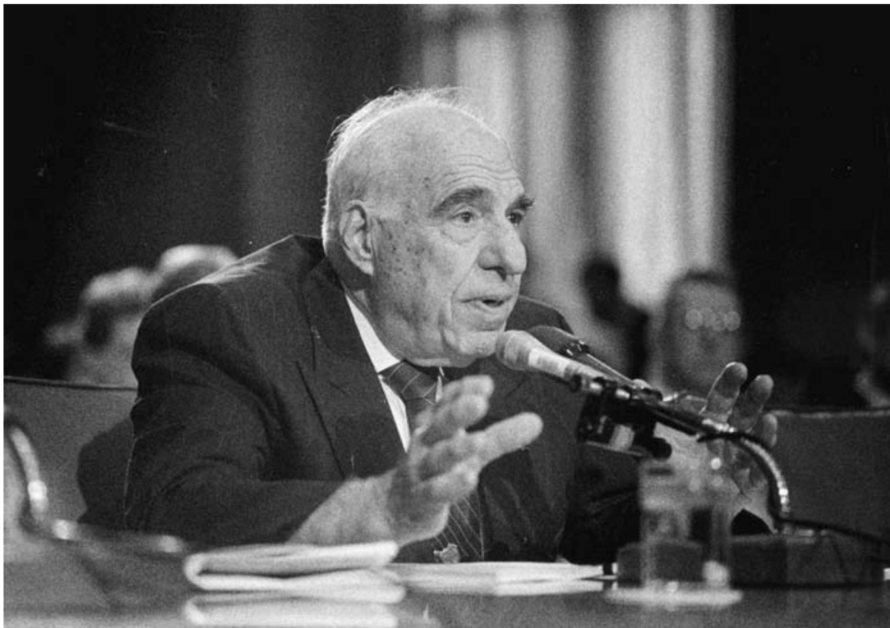

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The late Texas Democrat Henry B. Gonzalez (shown here, in 1992), a patriot of courage and honor who became House Banking Committee chair in 1989, was a rare exception to the traditional sleaze that have held that position.

serious reform efforts. The whole system is smoke and mirrors.

The bankers made a double-or-nothing bet at the end of the 1980s, went with the derivatives casino in an insane effort to hide their bankruptcy, and now we have the predictable result. The worst financial crisis since the 14th Century is upon us—is killing us—and yet the banks are once again refusing to admit reality.

LaRouche Was Right

By the early 1990s, the effects of the financial cancer that Greenspan and his cabal had wrought was becoming glaringly evident. In a 1993 statement calling for a tax on derivatives transactions to dry up the market, Lyndon LaRouche warned that the very existence of a derivatives market reflected "a planet on which scientific and technological progress in production is collapsing."

"The time has come," LaRouche said, "to consider what this insanity is: not merely the insanity of derivatives, but what kind of insanity has seized governments, financial markets and so forth, that they would foster these kinds of conditions."

That was nearly 20 years ago, when the biggest derivatives banks had just over a trillion dollars in derivatives, or seven to nine times their assets. Had we stopped derivatives then, the current disaster could have been avoided. Instead, we've seen a hyperbolic increase in derivatives, with JP Morgan Chase alone reporting over $90 trillion in derivatives before the market busted. Morgan Chase is not a bank, it's a casino—and a hopelessly bankrupt one. The same Anglophile JP Morgan, we should add, led the fight to repeal Glass-Steagall, and spread the derivatives cancer even deeper into the tissues of the nation.

The result, as LaRouche predicted, has been a relentless collapse in the productive sector of the U.S. economy, and the visible blowout of the entire global financial system. Then, in a criminally insane attempt to save the casino, the governments of the world threw even more money down the bailout rathole, so that now the banks, the governments, and the people are all bankrupt, with no prospect of recovery—unless we finally reverse this stupidity and return to sound economic policy.

No More Derivatives!

If we are to survive, we must do now what we failed to do in the 1980s: We must outlaw derivatives. Declare all existing derivatives contracts null and void, and prohibit the creation of any new derivatives. That is the only kind of regulation that will make a difference. One does not "regulate" malignant tumors, one eradicates them.

While we support the impulses of some in Washington to regulate derivatives by moving them out of the commercial banks, and forcing the trading onto exchanges, such lesser measures will fail to solve the problem. We are way too far down the path of destruction to compromise on this matter.

To Wall Street, we say "howl away." We understand that if we shut down the derivatives market your mafia-style protection racket will end, and that is precisely why we intend to shut you down! Let the bankers who still know how to earn an honest living rise to the fore, and return the sector to the form of banking which supports, rather than loots, the economy. As for the rest of

the bankers, consider yourselves lucky if you avoid being punished for your crimes.

We must put an end to the policy of industries dictating to the government what regulations they will and will not accept, and reinforcing that with armies of lobbyists passing out favors and campaign contributions that are often little other than bribes. This corruption has given us a financial disaster, a Gulf full of oil, and a nation ruled by corporatist cartels that routinely do violence to the public trust.

The derivatives "industry" is a case in point. When then-House Banking Committee chairman Henry B. Gonzalez (D-Tex.) tried to bring derivatives under control in 1993, his efforts were overwhelmed by Wall Street and the whores among his fellow members of Congress. A few years later, after a series of derivatives disasters and crimes, the Commodity Futures Trading Commission (CFTC) under Brooksley Born once again raised the issue of regulating derivatives, only to be slapped down by Alan Greenspan and the Plunge Protection Team.

In hearings on the issue, the bankers, led by representatives of JP Morgan, threatened to take their derivatives trading to London if their activities were restricted in the United States. Rather than telling them not to let the door hit them in the behind on their way out of the country, Congress punked out, and attacked the CFTC instead.

The Congress behaved in similar fashion when it came to the repeal of Glass-Steagall. Everyone with a functioning mind knew it was a mistake, but the banking sector poured in the money—and the threats—and once again, the people of the nation were sold down the river by their elected so-called leaders. Often, the sleaziest members of Congress are the ones chosen to head the banking and finance committees, for the obvious reasons. Henry B. Gonzalez was a rare exception, a patriot of courage and honor. The present chairman of the House banking committee, Bailout Barney Frank, is a reversion to the sleazy norm of putting the interests of Wall Street ahead of the interests of the nation.

This craven sellout of the national interest must be stopped. Which means we have to dump our Queen-loving President Obama and his pack of White House goons, and purge Congress of all those who lack the character to put the welfare of the nation above the greed of the parasites.

Derivatives must be banned. Glass-Steagall must be reinstated. The huge debts run up in the casino must be written off, and we must turn our attention to rebuilding and expanding our infrastructure, to restore the productivity of our people. We must break the control of the Brutish Empire over our economy, so that we may lead the world out of the Hell into which it is descending. This is what the American System was created to do, and it remains our mission today. The louder that Wall Street howls, the more shrill the bleating from London, the better for us all. We are here not to negotiate with them and their criminal system, but to whip the bastards back into line and assert the right of the people of the United States to run their government for the benefit of all. To the economic royalists, we say: Sit down and shut up—while we clean up your mess. We will deal with you shortly.

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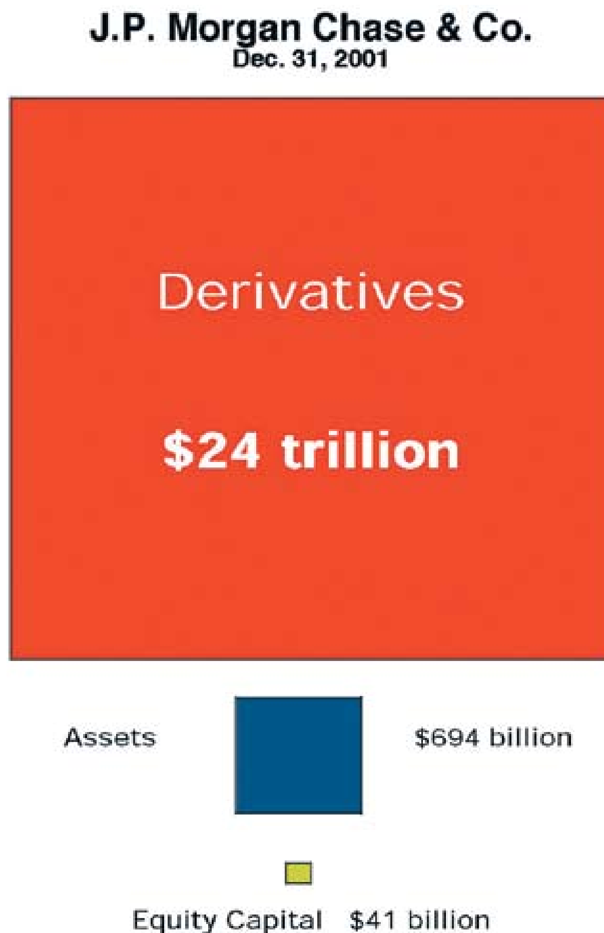
FIGURE 1



At the end of 2001, J.P. Morgan Chase had nearly 35,000 times more in derivatives holdings than in assets, and derivatives holdings about 595,000 times that of its equity capital.