Step Two: Use Glass-Steagall Standard To Restore Credit

by Dennis Small

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On Aug. 24, 2011, Lyndon LaRouche outlined a seven-point program as the only possible solution for the present threat of a global breakdown crisis. Having presented the overview of the program in our Sept. 2 issue, and in-depth attention last issue to Step One—the removal of President Barack Obama from the U.S. Presidency, and the reenactment of Roosevelt's original Glass-Steagall Act of 1933—we turn now to Step Two: the separation of fictitious from real liabilities, according to the Glass-Steagall standard.

In that Aug. 24 urgent message, delivered on LPAC-TV, LaRouche stated:

"The next thing we must do, after having established Glass-Steagall, is that the powers ascribed to the original version of Glass-Steagall—that is, by Franklin Roosevelt's Administration—must be applied, and there must be a division of the assets in question, between two categories: On the one hand, you will have the category which belongs to the merchant banking sector and similar kinds of finances. The entirety of the claims against the United States, due to that sector, will be assigned to that sector, and removed as liabilities from the list of liabilities of the government section and the regular banking section. That division of assets and liabilities will define the situation which confronts us at that point.

"Now, the key part of this thing, is that the amount of credit which will survive the purge of this system of debts, is unfortunately rather small. Therefore, it is not possible to simply use Glass-Steagall in the simple way, by continuing the present national currency system. You have to go to a credit system, as implicitly defined by Alexander Hamilton when he was Treasury Secretary, and in forming that aspect of the Federal Constitution. So therefore, that division will define a section of the debts that will go to the merchant banking sector and similar sectors—the gambling sector—they are on their own; they get not a penny of bailout! All the debt is entirely assigned to them, that part of the debt.

"The debt, however, of the part that will be rescued from this embrace, will be a very small part, because we've waited much too long on this thing, and therefore, the ratio of bad money to good money has gone that way as such. So that has to be done; so we have the division of liabilities."

The Glass-Steagall *Standard*

The second point of LaRouche's seven-point program is perhaps the most polemical and contentious point of all. What at first blush seems fairly obvious—the need to separate the speculative financial instruments of the merchant banks or investment houses, from the productive credit issued for normal commercial banking purposes—quickly leads to a string of nervous objections:

"How do you decide what gets paid and what doesn't?"

"Who is going to make those decisions?"

"But they are all debts, and my mother told me that you always have to honor your debts, right?"

"And if we don't pay Wall Street and London's demands, won't the whole system crash?"

The reason that LaRouche's Step Two is so contentious, is that it raises the most fundamental question of economics: If *money* is accepted as the basic measure of value in an economy, then there is in fact no way to rigorously distinguish between a million dollars owed on a steel plant, or a million dollars owed for buying and selling derivatives, or a million dollars owed on prostitution and drugs. Money simply becomes the unit of account of an underlying philosophical worldview known as *hedonism*, or the *pleasure-pain principle* of British Liberalism.

The contrary view in economics, that of the American System of political economy enshrined in the Constitution of the United States, is that value is measured not by money, but by the advance of the *General Welfare*, by the advance of the *public interest* in physical-economic terms. Under this worldview, financial in-

Franklin Roosevelt's 1933 Glass-Steagall Act

The following excerpts are taken from the 37-page H.R. 5661, "Public—No. 66-73d Congress," the Glass-Steagall Banking Act of 1933."

An Act

To provide for the safer and more effective use of the assets of banks, to regulate interbank control, to prevent the undue diversion of funds into speculative operations, and for other purposes. . . .

[Sec. 3 (a)] Each Federal reserve bank shall keep itself informed of the general character and amount of the loans and investments of its member banks with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions; and, in determining whether to grant or refuse advances, rediscounts or other credit accomodations, the Federal reserve bank shall give consideration to such information. The chairman of the Federal reserve bank shall report to the Federal Reserve Board any such undue use of bank credit by any member bank, together with his recommendation.

[Sec. 7] The Federal Reserve Board shall have power to fix from time to time for each Federal reserve district the percentage of individual bank capital and surplus which may be represented by loans secured by stock or bond collateral made by member banks within such district. . . It shall be the duty of the Board to establish such percentages with a view to preventing the undue use of bank loans for the speculative carrying of securities. . . .

[Sec. 11 (a)] No member bank shall act as the medium or agent of any non-banking corporation, partnership, association, business trust, or individual in making loans on the security of stocks, bonds, and other investment securities to brokers or dealers in stocks, bonds, and other investment securities. . . .

[Sec. 20] After one year from the date of the enactment of this Act, no member bank shall be affiliated in any manner described in section 2 (b) hereof with any corporation, association, business trust, or other similar organization engaged principally in the issue, flotation, underwriting, public sale, or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities. . . .

[Sec. 21 (a)] After the expiration of one year after the date of enactment of this Act it shall be unlawful—

(1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor. . . .

[Sec. 32] From and after January 1, 1934, no officer or director of any member bank shall be an officer, director, or manager of any corporation, partnership, or unincorporated association engaged primarily in the business of purchasing, selling, or negotiating securities, and no member bank shall perform the functions of a correspondent bank on behalf of any such individual, partnership, corporation, or unincorporated association and no such individual, partnership, corporation, or unincorporated association shall perform the functions of a correspondent for any member bank or hold on deposit any funds on behalf of any member bank, unless in any such case there is a permit therefor issued by the Federal Reserve Board; and the Board is authorized to issue such permit if in its judgment it is not incompatible with the public interest, and to revoke any such permit whenever it finds after reasonable notice and opportunity to be heard, that the public interest requires such revocation. . . .

struments and liabilities have merit and standing under our Constitution only to the degree that they contribute to the general welfare.

This is also, emphatically, the worldview of Roosevelt's 1933 Glass-Steagall Act, as even a cursory reading of the law shows (see box, "Franklin Roosevelt's 1933 Glass-Steagall Act"). In fact, its opening statement of purpose is unambiguous: "To provide for the safer and more effective use of the assets of banks, to regulate interbank control, to prevent the undue diversion of funds into speculative operations, and for other purposes." Throughout its 37 pages, the Act repeatedly attacks "speculation," and states that the banking sector must promote the "public interest." Its specific provisions, including the establishment of the FDIC, and the strict separation of commercial banking from merchant banking and brokerage activities, were guided by this outlook, and were intended to protect individual depositors from predatory speculative practices in order to keep the entire system functioning productively.

This is what LaRouche is referring to when he says that the Glass-Steagal *standard* must be applied today, to separate fictitious from legitimate obligations. That *standard*—as stated in what we might refer to as the "Preamble" of the Glass-Steagall Act cited above—is a direct echo of the Preamble of the Federal Constitution, which proclaims:

"We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defence, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America."

Therefore, to accept that financial liabilities can be sorted out at all, and that some are to be considered as legitimate while others are not, in fact, implies an axiomatic break with the very premises of British hedonism. And *that* is what many people recoil from in panic today, when they consider the implications of LaRouche's Step Two.

A Cultural Paradigm-Shift

Why is this such a generalized response among Americans today?

Because the United States has gone through an underlying cultural paradigm-shift since the 1963 assassination of President John F. Kennedy, as expressed in today's Baby-Boomer generation. What used to be obvious and second-nature—that we should promote the general welfare, that the public interest comes first, that speculation is to be abhorred, and that economics and morality are one—is now rejected in favor of *my pleasure*, *my money*, *my investments*. "And please don't talk to me about morality. What does that have to do with economics?"

In the domain of economic policy, 1971 was a milestone in the dismantling of the Glass-Steagall *standard*—if not yet the Act itself. In that year, the link of the dollar to any physical-economic idea of value was severed internationally, as the British Empire induced President Nixon to take the dollar off gold, and usher in the era of floating exchange rates among currencies. That destroyed Roosevelt's design of the post-war Bretton Woods system, and allowed for endless quantities of dollars to be printed *outside the sovereign control of the United States government*, and to begin the creation of an uncontrolled speculative bubble of financial instruments.

Throughout the 1980s and 1990s, the reins on speculation were progressively loosened, both financially and—more importantly—philosophically, culturally, and morally. For example, the British Empire was allowed to foist illegitimate foreign debt on Third World nations, such as in Africa, and use it to impose their policy of genocide and depopulation.

The year 1999 was a watershed. On Nov. 12, Roosevelt's Glass-Steagall Act was formally overthrown and replaced by Gramm-Leach-Bliley. Earlier that same year, in mid-June, the IMF had forced the government of Colombia to officially count *drugs* as part of their gross national product. In late June, the head of the New York Stock exchange, Richard Grasso, met in the jungles of Colombia with Raúl Reyes, the head of finances of the FARC cocaine cartel, to discuss a "mutual exchange of capitals," as Grasso put it (see box, "Gross Narco Product").

As the drug case so clearly shows, Roosevelt's Glass-Steagall standard had been dethroned, and British Liberalism and hedonism reigned supreme.

Applying the Standard: Manure vs. Credit

Step Two of LaRouche's seven-step action program calls for reviving the Glass-Steagall *standard* to separate the wheat from the chaff—productive from speculative liabilities—in the U.S. (and international) financial system. LaRouche has promoted this policy for decades. Just a few examples.

In his first major response to Nixon's Aug. 15, 1971 decision to bury FDR's Bretton Woods, LaRouche wrote that the physical economy was being "crushed under a mass of stocks, bonds, mortgages, and other capitalist paper. Destroy that paper, and prosperity

Gross Narco Product

On June 9, 1999, the Colombian government's National Administrative Department of Statistics (DANE) announced that its GNP statistics would henceforth reflect the "inclusion of illicit crops in agricultural production"—i.e., narcotics—using "sophisticated techniques," as demanded by the International Monetary Fund. On June 25, 1999, Richard Grasso, the head of the New York Stock Exchange, met with the head of finances of the narco-terrorst FARC, Comandante Raúl Reyes. In its July 16, 1999 edition, EIR *published "The IMF and Wall Street are gunning for drug legalization," by Dennis Small, which included the following:*

In fact, if monetary value is accepted as an economy's sole metric, then one has implicitly adopted London's bestial view of man that banishes all morality from economics: After all, we are told, a dollar is a dollar is a dollar; you may not *like* the fact that it comes from drug production, prostitution, or gambling, but you can't let your "personal tastes" dictate "objective economic measures," such as GNP.

That outlook is called monetarism. And it is the way economics is taught today in every major university in every single country around the world—whether it be called neo-liberalism, Keynesianism, or Marxism.

If that is *your* outlook, or the outlook you tolerate, then please answer a few simple questions: If drugs and prostitution are to be counted as part of GNP, shall we then consider a successful drug bust as a reduction in GNP or "value added"? Shall we also count pornography as "value added"? What about child pornography (it's a multibillion-dollar business)? How about "snuff films," where people (especially children) are sexually exploited and then murdered, on film?

Perhaps murder, rape, and torture should also be counted as part of GNP—with "sophisticated techniques," no doubt? Was the poison gas used in Hitler's death chambers also part of GNP?

Do these questions make you uncomfortable? Then where do you draw the line? More importantly, *how* do you draw the line between real economic value, and evil with a price tag? Is there not some fundamental difference between "bankers' arithmetic" and "human arithmetic"?

The stark reality is that there is no scientific, systematic, and valid way to repudiate drugs in an economy, until you are prepared to jettison the entirety of standard classroom economics, including its definition of GNP, and replace it with the science of physical economy as developed by Gottfried Leibniz, Lyndon LaRouche, and others. In this approach, economics and morality are united in the concept of economic value being defined as that which contributes to the successful social reproduction of humanity, as measured in rising potential relative population density. Science, Classical culture, and creativity in all its expressions—i.e., that which is moral about man—becomes the bedrock of economic advance.

ANCOL/Fernando Ruiz

The "Grasso Abrazo": Richard Grasso embraces Comandante Reyes in the FARC's jungle hideout.

could emerge." The guts of the problem was clinging to fictitious "money" values, rather than the physical wealth associated with increasing the productive power of labor.

In 1982, at the height of the "debt bomb" crisis, LaRouche stressed, in his book-length *Operation Juárez*, that the world financial system had to be reorganized by freezing the hundreds of billions of dollars of illegitimate Third World debt with a debt moratorium, and issuing new productive credit for great infrastructure projects.

At both these points, such a procedure could still have salvaged a reformed international monetary system. But the situation today is too far gone, and more drastic measures are now required.

As the global breakdown crisis was playing out in 2008 and 2009, LaRouche presented his policy to solve the crisis with total clarity, such as in these remarks to a private meeting of diplomats and others in Washington, D.C., on Nov. 11, 2008:

"There's no way to save this monetary system in its present form. It's so full of junk, with the financial derivatives far in excess of a quadrillion dollars in claims, against the nominal size of the actual production of nations, it is impossible to reform this monetary system in its present form. You have to put the monetary system itself *through bankruptcy*. You will have to wipe out the greatest portion of nominal monetary assets in the world today! Cancel them! Because the system as a whole is hopelessly bankrupt.

"Now, what do you do in that case? Well, what you do for a monetary reform to a credit system, is, you use the U.S. Constitution. Because of our Constitution, we can create, as Roosevelt did that formally, we can create a credit system. To replace a monetary system.

"Now, what you do under this case, and with agreement with the United States and its Constitution, with Russia, China, and India, it can be done. What you do, is you say, we put all the claims which are equivalent of monetary or credit claims in two piles. One pile we call 'monetary.' That's the manure pile. The other we call the 'credit' pile.

"Now under the U.S. Constitution, money, when the Constitution is followed, is created only by the will of the government. It is done by the Executive branch of government, with the consent of the House of Representatives, and things flow from that. This credit being issued, is also authorized for monetization: So, the credit can be issued as loans for projects, or international loans, and part of it can actually be monetized, under the condition under which it was uttered.

"Particularly, if we had a national banking system, which we don't have presently, we could convert the Federal Reserve system, which is bankrupt, into a national banking system, as Hamilton proposed. Then it would do that automatically. We *do* need a national banking system in each country. That doesn't mean they're the only banks, but it does mean you use a national banking system to control the relationship between government and the banking system as a whole, in general....

"What do you do? You have to protect those things which are productive, and are necessary for the government and necessary for the population. Therefore, you create a pile called the 'credit pile.' What you do, is you take every obligation, and every asset, which is valuable to society, currently, or necessary and meritorious—you take the monetary value of that, and you assign that to the creation of credit, government credit, a credit system. *And you leave the remainder to rot.*"

In an international webcast on Jan. 22, 2009, two days after the inauguration of Barack Obama, LaRouche returned to the issue:

"Put the present system, economic system of the United States, in particular, into a general reform, general reorganization, reorganization in bankruptcy. This means putting the Federal Reserve system into bankruptcy, under bankruptcy protection; taking the assets, or claimed assets, of the banking system and sorting them into two piles. One pile fits the chartered bank standard, conventional ordinary banks, as under Glass-Steagall, that kind of contingent. Those banks must be restored to full functioning now, and they must be used as receptacles of Federal credit to get some things moving that have to be gotten moving.

"On the other side, the garbage side, the bailout side: Not a penny! You put them into bankruptcy receivership, freeze them. That's the garbage department: You freeze the garbage so it doesn't stink too much. Don't put more garbage in there, don't generate more garbage."

How Much Garbage Is There?

An awful lot.

First, let's consider some of the categories of the interlocking global financial garbage that will simply be written off, or returned to the City of London and Wall Street for them to handle on their own. It will *not* be bailed out by governments—i.e., by you, the taxpayer. This is by no means a comprehensive list, but it includes:

• Derivatives instruments, such as MBS (mortgage-backed securities), CDO (collaterized debt obligations), CDS (credit default swaps), foreign exchange swaps, and commodity futures markets. Derivatives in general are the lion's share of the total speculative bubble; nobody really knows the amount involved, but it clearly surpasses $1 quadrillion, and infects the entire Trans-Atlantic financial system.

It is pointless for our purposes here to either try to define, or quantify, each of these forms of financial cancer. Instead, we refer the reader to the succinct definition of derivatives provided by *EIR*'s John Hoefle (see box, "What in the World Are Derivatives, Anyway?").

• Third World debt, which officially totals a mere $2.5 trillion, is almost entirely illegitimate debt which has been paid many times over by these countries.

• Stock markets worldwide.

• The trillion-dollar international drug trade.

On the other side of the ledger, we have obligations that will be defended and guaranteed under the Glass-Steagall standard, including:

• Social Security, Medicare, Medicaid, and similar government programs serving the general welfare.

• Pensions, from both the public and the private sectors.

• Business loans for productive activities.

• Family home mortgages—as distinct from the fraudulent Ponzi scheme built up on mortgages by the leading banks.

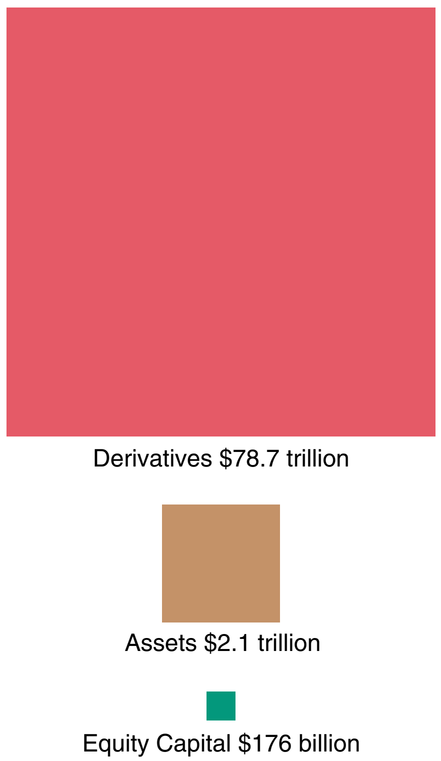
• Infrastructure investment projects.

• Commitments by states and municipalities for productive economic activity.

Globally, speculative financial assets have grown from about $200 trillion in 1997 (before Glass-Steagall was revoked), to well over $1,000 trillion ($1 quadrillion) today—a fivefold increase. During this same period, the physical economy, and its valid obligations, have been savagely shrinking, such that the ratios are now unmanageable.

Look at the situation of America's leading banks. They have been thoroughly taken over by the cancer of derivatives. In 2000, the country's top ten banks had some $2.5 trillion in assets, which tripled to about $7.7 trillion in 2009. But those banks' exposure to derivatives went from $45 trillion in 2000 to $294 trillion in 2009—a 6.5-fold increase! And when you compare the derivatives cancer to the banks' equity captial (see De-

A Dog with a Bad Case of Fleas: JPMorgan Chase & Co.
(Dec. 31, 2010)



What in the World Are Derivatives, Anyway?

The easiest way to grasp the nature of the derivatives markets is to think of a dog with a bad case of 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?

—*John Hoefle*

rivatives box, for the case of JPMorgan Chase), the true magnitude of the insanity is even clearer.

The cancer is also highly concentrated. The top five derivatives banks in the U.S.—JPMorgan Chase, Bank of America, Goldman Sachs, Morgan Stanley, and Citigroup—hold about 90% of total derivatives.

So guess who got bailed out when the derivatives bubble blew in 2008? Of the nearly $17 trillion in bailouts provided, as documented by Sen. Bernie Sanders (I-Vt.), amounts disbursed included:

$1.5 trillion to Morgan Stanley;

$1.2 trillion to Merrill Lynch (now part of Bank of America);

$1 trillion to Citigroup;

$700 billion to Bank of America;

$600 billion to Goldman Sachs.

Another large, and continuing, flow of bailout funds is going to British and other European banks, through unlimited dollars provided through the Federal Reserve's swap window with the European Central Bank and the Bank of England.

And now that the Bush and Obama administrations, consecutively, have handed over $17 trillion in taxpayer funds to help feed the cancer, we are being told that some $4 trillion in cuts have to be made out of the flesh and blood of the *productive* economy: Social Security, Medicare, state and local budgets, and people's living standards in general.

This is the exact inverse of the Glass-Steagall standard. Instead, we should reinstate Glass-Steagall and, for starters, "charge back" the $17 trillion that was added to the government's illegitimate obligations—which is more than four times the amount of cuts in legitimate, vital programs that Obama is proposing to make.

Lunacy has taken over our national policy-making on economics. It's as if a man with cancer went to his oncologist to report a big cancer tumor growing in his belly, only to be told to stop complaining, that he was showing clear signs of "growth," and that all cells have equal rights in any event.

If that were your doctor, you would fire him for being a quack, wouldn't you? Time to do the same with Obama, and get on with the treatment.