End Wall Street's Theft of Pensions: Re-Enact Glass-Steagall

by *EIR* Staff

July 29—The Detroit default against pensions and retiree health benefits—the voices of Wall Street and international finance make clear—is intended to launch an assault on government retirement benefits, as the "Cyprus template" started the seizure of depositors' money to capitalize insolvent banks in Europe.

Note the following pattern:

• The cover story of the July 27-Aug. 2 issue of the City of London banking publication, *The Economist*, forecast a "domino effect" starting with Detroit, moving to Chicago, and then across the United States, devastating municipal pensions.

• Moody's downgraded Chicago's debt rating by three notches in one day, July 26, at the demand of the city's own banking and financial elite, the Chicago Commercial Club, a move which sets up deep cuts in city pensions.

• A July 27 report of the Bank for International Settlements (BIS) in Basel, Switzerland lyingly termed pension and retiree health benefits to be the world's dominant debt problem—as if the $700 trillion in banks' derivatives exposure reported by the same BIS, was not a concern.

Scores of other financial publications are acting as mouthpieces for the same Wall Street campaign of killer austerity against what they call "age-related payments."

The City of London's house organ, "The Economist," warns of a "domino effect," of municipal bankruptcies, beginning with Detroit, and spreading across the U.S.

Wall Street's destructive financial derivatives game should be killed instead, by re-enacting the Glass-Steagall Act.

Why Detroit, and What Happened

By 1995, the Federal Reserve under Alan Greenspan had unilaterally removed most of the Glass-Steagall Act's crucial, 60-year-old prohibitions on major commercial banks putting their huge deposit funds into securities speculation. This led to the repeal of Glass-Steagall in 1999, the merger of the largest banks with insurance companies, investment banks, and securities broker-dealers, and their creation of large numbers of hedge funds.

The financial derivatives bubble exploded in volume, from a reported $17 trillion in nominal value of derivatives issued by the large banks in 1995, to about $170 trillion by 2002. By 1999, the fear of general financial collapse from the failure of a single large hedge fund, LTCM (Long-Term Capital Management), because it had been loaned over $100 billion by commercial banks to speculate in derivatives, showed how dangerous Wall Street's deregulation of banking had become.

Derivatives, dot-com, and commodities speculation bubbles exploded in the middle of the "Clinton prosperity" era. Serious recession hit in 2000,

with auto sales falling, and employment in auto/auto parts/machine tools began to shrink substantially, falling from 1,275,000 million in 1998 to 1,145,000 in 2003.

In 2002, Detroit's all-source revenues ($1.95 billion), its state revenue-sharing from Michigan ($334 million), and its residents' household property value ($11.1 billion) all reached their peaks and began to fall. The city maintained balanced budgets through 2005, but then began to cut municipal employment, resulting in fewer employed workers to pay into the pension and retiree health funds. Auto/machine-tool employment across the industrial belt fell further by the start of 2005, to 1,100,000.

By that time, the biggest auto and auto-parts producers in the United States had marked nearly 100 plants for shutdown, totalling more than 100 million square feet of the most versatile machine-tool capacity in the U.S. economy.

Killing the Jobs, and Revenue

At that turning point, in February 2005, Lyndon LaRouche's *EIR*—which has now been broadly promoting the restoration of Glass-Steagall since 2009—warned that the U.S.-based auto-production industry was facing collapse, and that the "Big Three" producers were becoming financial debt-securitizing institutions first, and carmakers second. LaRouche and *EIR* warned in May 2005 that 75-100,000 auto production jobs and 300,000 auto-parts production jobs could be lost nationally in a very few years. This proved to be accurate.

The proposed solution was to employ the unused auto/machine-tool capacity to produce for major new national economic infrastructure platforms—a "retooling" which could only be done with national credit by government, as in the retooling of the Arsenal of Democracy for World War II.

That proposal would have stopped the speculation in auto capacity by the biggest hedge funds, private equity funds, and banks, which was accelerating the shutdown of that capacity.

The proposal was broadly supported by local union organizers and elected officials, but it was blocked in Congress and the Bush White House.

Michigan state officials failed to support this solution, and instead embarked on misguided corporate tax cuts to attempt to "hold" production which was closing or fleeing abroad. Despite promises to the contrary, the state corporate tax cuts (in 2004, 2007, and 2011) were followed by cuts in revenue-sharing with cities; Detroit's state revenue was eventually cut in half, from $334 million in 2002 to $167 million in 2013.

Auto- and auto parts-production fell drastically by another 435,000 jobs between 2005 and 2010, through the "managed bankruptcy-bailout" of GM and Chrysler, to 665,000 nationally. It fell by more than 50,000 jobs in the Detroit area alone. Entry-level wages for the industry wound up, post-bailout, cut in half, and average wages were down by 20%.

Detroit's all-sources revenue dropped by over one-third in a decade, from $1.95 billion in 2003 to an estimated $1.395 billion in 2013, despite adding new taxes, casino revenue, etc. Poverty took over its working population. Household property wealth dropped from $11.1 billion in 2002 to $9.1 billion in 2007 and to just $4.9 billion in 2012. Detroit's average *household* income is now $36,000/year, the lowest of all Michigan cities of 50,000 population or more; its median taxable household property is a vanishingly small $12,750.

It should be kept in mind that not only Detroit, but nearly a dozen cities in southern Michigan's once-pivotal auto/machine-tools belt are now under "emergency managers."

Municipal Ruin by Derivatives

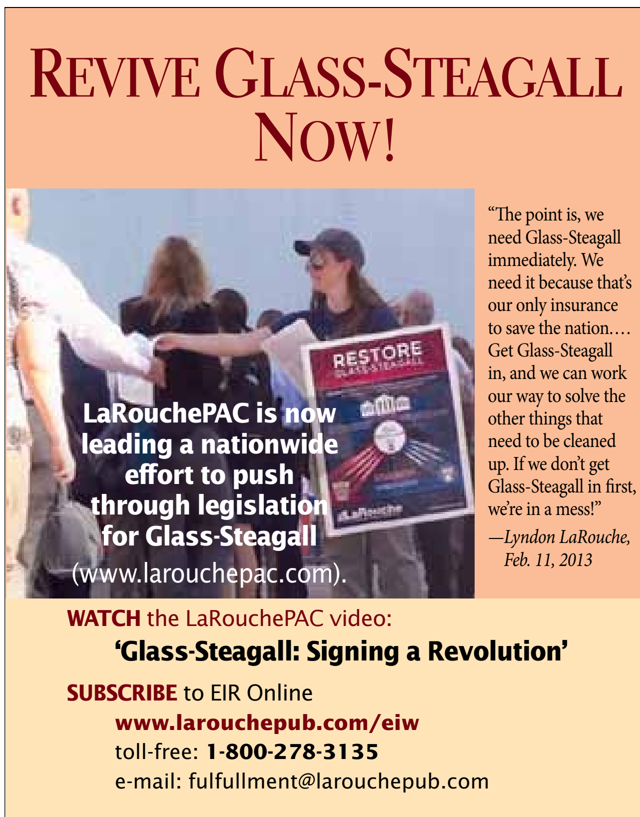
From 2005 on, the city, and then its Water and Sewerage Department, began large, billion-plus borrowings and refinancing of borrowings, primarily from the Swiss giant UBS Bank and Bank of America. Those banks immediately convinced Detroit to issue variable-interest-rate bonds for the loans, and to buy derivatives on those loans—so-called "interest-rate swaps," or bets on whether interest rates would rise or fall in coming years. These supposed "interest-rate protection products" proved ruinously expensive to the city, as they have to Chicago, to hundreds of other U.S. cities and states, and to thousands of cities, states, and provinces across Europe and the Americas since 2000.

The Glass-Steagall Act, while enforced, prohibited banks from manufacturing these financial derivatives "products." Had Glass-Steagall remained in force after the later 1990s, hedge funds and investment banks could certainly have offered these "financial weapons

of mass destruction" to municipalities. But the overwhelming evidence from around the world is that very few—if any—cities and states would have been trapped into such "swaps" products, had they not been sold them, at the same time, by the same big banks that were buying and/or syndicating the municipalities' bond offerings.

Without Glass-Steagall, UBS, Bank of America, and SBS could and did sell "swaps" bets to Detroit and its Water and Sewerage Department. As has subsequently been exposed, those bets were "Libor-rigged"; the banks which had "bet" the municipalities on the direction of interest rates, were also manipulating the direction of the Libor base rates.

Since 2006, Detroit has paid an annual average of $107 million in "negative value" payments to the banks on the derivatives products, including a single $536 million payment by Detroit Water and Sewerage. (Similarly, Chicago's annual payments on banks' interest-rate derivatives have averaged $101 million/year since 2006, according to records compiled by the Service Employees International Union there.)



When combined with the city's loan- and loan-refinancing "fees," totalling over $200 million since 2005, it is clear that *non-principal, non-interest, securities payments* to banks have robbed Detroit of approximately one full year's revenue out of its last eight years, through 2012.

Interest-rate swaps on $3.8 billion in Detroit debt are still outstanding.

Derivatives vs. Pensions

Now in July 2013, it appears that the most immediate choice in Detroit could be pitting derivatives versus pensions directly.

The city emergency manager, bankruptcy lawyer Kevyn Orr, has made an agreement to pay three banks—UBS, Bank of America, and SBS—approximately $225 million *by Nov. 1* to terminate these interest-rate swaps. This amount equals more than 15% of Detroit's total annual all-source revenues, estimated at $1.395 billion this year, and Orr agreed to do it while defaulting on pension bonds.

This $225 million is not a debt; rather it represents 75% of the "current negative value" (to Detroit) of swaps agreements with those banks on $1.4 billion in 2005 city borrowing. That is, it is a payoff on a Libor-rigged derivatives bet that Detroit was conned into making in 2005 by those banks, after borrowing from them. And if the payment is delayed beyond Nov. 1, to a second payment deadline of March 31, 2014, under Orr's agreement it will reportedly be 80% of the "current negative value" of the bet, or likely $250 million.

Orr's office announced that he had agreed with the banks on this derivatives payoff on July 16, two days before declaring bankruptcy against pensions, retiree health funds, and other general creditors, giving the derivatives payoff first priority in bankruptcy.

Will Congress and the White House allow this to happen, directly sacrificing pensions and health benefits for derivatives bets? The previous derivatives payments have had a severely injurious effect on Detroit. But it appears this new bet payoff will directly start the drastic reduction of retiree health and pension benefits in 2014.

What's necessary and urgent is to go after Wall Street's derivatives bubbles instead: Re-enact Glass-Steagall, issue national credit to reindustrialize the nation's "Rust Belt" in the service of urgent new national economic infrastructure platforms.