Germany Leads Charge To Regulate Hedge-Fund 'Locusts'

by Rainer Apel

To all participants in the April 13, Washington, D.C. meetings of the G-7 finance ministers and central bank governors, it was clear beforehand that no concrete action would result from the talks there, about the problem posed by hedge and private-equity funds. These vast, unregulated speculative funds pose an enormous threat to the global financial-monetary system.

As *EIR* Banking columnist John Hoefle reported last week, there are about 9,000 hedge funds in the world, managing a combined $2.1 trillion. The private-equity business has $1.4 trillion in assets under management. The specialty of such firms is buying up productive companies, stripping their assets, laying off their workers, and leaving the company a ravaged hulk.

The German government, initiator of a move for fund transparency at the G-7 summit in Britain, two years ago, did not even send its Finance Minister to this year's meeting, but rather sent Assistant Finance Minister Thomas Mirow, who has been in charge of most of the talks about the initiative anyway.

Central Bankers, Hedge Fund Operators Meet

The D.C. meetings, which occurred on the sidelines of the Spring summit of the International Monetary Fund and World Bank, also saw a separate session on April 15, of finance ministers and central bank governors with 20 representatives of hedge funds, including funds such as Cerberus, Blackstone, and Fortress. Such a special meeting with hedge funds is unprecedented in IMF/World Bank history, and points to both the clout these funds have, and the worries on the part of bankers over what will happen if the house of cards falls down.

Mirow told the press after the meeting that his government "is not pulling back from demanding a code of conduct for hedge funds. The theme remains important, it remains on the agenda, and will be pushed further by Germany. The big number of dates and events that are dealing with this theme, do indicate one thing, at least: This is not simply an eruption of German spleen."

Remarks by a leading official of the Chinese central bank, April 16, in support of the German initiative, showed that even if the governments of the United States and Britain, the countries of origin of 90% of all hedge funds, oppose fund control and transparency for the time being, other countries have different views.

On May 19, the G-7 finance ministers will convene again, this time with their Russian colleague, in Potsdam, Germany, to hear a report drafted by Mario Draghi, the governor of the Italian central bank—who is known for his extreme pro-British views. As *EIR* documented 15 years ago, Draghi participated in the June 2, 1992, meeting onboard Queen Elizabeth's yacht *Britannia,* off the coast of Italy, which planned privatizations of state-sector industries carried out later, when Draghi was a government official in the 1990s. After an interlude, as head of Goldman Sachs Europe, Draghi was appointed governor of the Bank of Italy in 2006.

German Warnings

After his return to Germany, Mirow told the press that in spite of the known controversies among G-7 members, including "differing interests and cultures of financial-market control," he was nevertheless optimistic that some kind of hedge-fund control would come, sooner or later. There is more awareness globally now, of the importance of the issue, he said. "The theme has gained considerably, in speed and range, and it will not retreat into some corner, again."

Assistant German Finance Minister Thomas Mirow is pressing Germany's demand for "a code of conduct for hedge funds."

Inside Germany, there is considerable demand for fund control—ferment created and enhanced by a weeks-long campaign of interventions by the LaRouche Youth Movement, which in April 2005, was reflected in a spectacular attack by Franz Müntefering, then-chairman of the Social Democratic Party, on the funds as "locusts that come in and graze everything to the ground." Since then, funds are usually referred to in Germany, as "locusts."

Then-Chancellor of Germany, Gerhard Schröder (Social Democrat), took up the theme for his July 2005 initiative at the G-7 Summit in Britain, where it was blocked—as Schröder himself revealed on television several weeks later, by "Wall Street and London." After his defeat in the German elections of September 2005, Schröder was replaced by Angela Merkel, chairwoman of the Christian Democratic Union, a politician with a neo-con profile, who had little interest in maintaining the campaign for hedge-fund control.

Only after the dramatic change of the political situation in the United States after the midterm elections of November 2006, when the new Democrat-controlled Congress voiced a commitment to deal with the fund issue, did the German government re-engage in the initiative for "locust fund" transparency. The surge of Democratic votes was shaped by an intense political campaign by the LaRouche Youth Movement in the United States, which helped to elect many new Democrats to Congress, who are much more interested in regulation of the highly speculative financial markets.

Shortly before the recent Washington, D.C. meetings, Germany's chief financial market regulator, Jochen Sanio, warned that hedge-fund collapses could blow the entire system apart. He said that the Amaranth hedge-fund collapse last September within just a few days, was a "clear warning signal," a "twilight on the horizon. In the next case of such a dimension, the lightning could strike and shake up the financial system." Sanio said he was worried about the U.S. mortgage market situation. "It may only be hoped that we are not now at the beginning of a collapse in the U.S. housing market, which through the U.S. conjuncture would affect the global conjuncture. That would be the last thing we would need."

Sanio endorsed the German initiative for an international discussion about hedge funds, the discussion as such being of value already in itself, because "from now on, no one can play down the issue any longer. "The highly speculative hedge funds pose a great danger to the stability of the financial system."

And one day after Mirow's return, a member of the Green Party's parliamentary group, Gerhard Schick, wrote a letter to the parliamentary financial policy committee, calling for a hearing on the hedge-funds issue.

'Systemic Danger'

Another political breakthrough recently, in the German debate on locust funds, was a March 7 op-ed in the German edition of the *Financial Times,* written by Dierk Hirschel, chief economist of the German Labor Federation (DGB). Under the headline, "Systemic Danger from the Caribbean," he wrote that because of the scope of hedge-fund actions, neither well-meaning appeals for good conduct nor expectations that the banks, which are closely interconnected with the funds, will see to it that funds act reasonably, will work. Since after all, Hirschel wrote, "financial stability is a public good," political action is required, but the German G-7/G-8 agenda for fund transparency would, for the time being, meet "embittered reistance from Wall Street and the City of London. Without international agreements, however, the funds will continue operating undisturbed, as before, from their Caribbean offshore centers. Therefore, if the German and French treasury ministers don't want to wait for the next financial crisis, they should force the euro-zone now to march ahead with regulations. A strict limitation for trading by financial transactors of the euro-zone with offshore centers must be part of such an initiative."

DGB Chairman Michael Sommer followed with similar remarks on April 5, announcing that the labor movement would begin a campaign for the regulation of locust funds. Two proposals have been worked out for the DGB, by Hans-Joachim Voth at the Pompeu Fabra University in Barcelona, Spain, a former consultant for the German Stock Exchange in Frankfurt. Voth wrote that option #1 would imply government moves for "onshoring," which means to impose regulations for funds that are now in offshore havens. This is not very likely to happen, he believes, because of strong objections from the U.S.A. and U.K. Option #2 is more feasible, he thinks, implying that banks will be given stronger credit regulations, including strong restrictions on leveraged credits. Voth writes that this latter option can be realized more easily, because a limited number of big banks are the dominant prime-brokers for funds in any case.

On May 7, Sommer and his fellow labor federation chairmen of the other G-8 states will meet with the German Chancellor, to present labor's recommendations for the G-8 Summit, to be held in Heiligendamm, Germany, four weeks later.