International Credit by David Goldman

Drug money leverages drug money

What is happening in the equity markets bears an eerie resemblance to events of the 1920s and early 1930s.

The world depression of the 1930s began in Germany in 1928, before the 1929 stock-market crash, and, in fact, as a result of the stock market bubble. Margin loans to stock speculators, with interest rates reaching 12% in 1929, became the single most profitable form of lending in the world. Brokers accepted 10¢ on the dollar for stock purchasers, and lent speculators the remainder. The New York stock bubble sucked cash out of the rest of the world. The small trickle of funds that Germany, Austria, and the Eastern European losers of World War I had obtained from the international banks turned into a leak outwards. The stock market crash only made matters worse, and the global banking collapse began in Austria and Germany in 1931.

That is why some financial observers warn that the reorganization of the London Stock Exchange, the "Big Bang" scheduled for next Oct. 27, might trigger a global financial crash. The post-1929 regulation of U.S. securities markets, starting with the 1934 founding of the Securities and Exchange Commission, gave way in the last three years to the "global marketplace," with a degree of speculative leverage that would have given pause to the most dedicated bulls of 1929.

"What scares me most is what I term, 'creative lending,'" one European equities specialist said July 9. "Merrill Lynch does it, Amex International, Salomon, Crédit Suisse First Boston. We are all in it. Say, for example, South America flight capital. There's so much drug money there. We try to screen, but I'm sure there's dirty money coming in.

"This money is then leveraged to the hilt. Say someone comes into one of our offices in South America with $100,000. We then do what we call 'gearing'—his $100,000 buys equities or securities worth $600,000 face value. We lend him the other $500,000. We then sell notes [on the Euromarket] to cover that and collect the profit on the higher interest rates. This is today the biggest source of new business in the world. As long as we know when to get out, we are holding all the cards. The fees we charge our clients for this business, I tell you, are incredible. We gouge our clients. . . . And some people would kill to get a piece of this business because it's so profitable. I don't want to paint a picture that we deal in dirty money, but I'm sure that there's some dirty money coming in. But this business really scares me. There's a lot of wild things going on out there."

In other words, the dope trafficker of today has stepped into the shoes of the speculator of 1929—no surprise, since the $500 billion annual narcotics traffic is the world's single largest source of ready cash. Through offshore branches of the major brokerage houses, he buys securities for 1/6 of their value—even though U.S. Securities and Exchange Commission rules demand that stock purchasers put down at least 50% of the value of stocks they purchase.

The brokerage houses charge the dope trafficker a high interest rate for these loans, but obtain funds at a lower rate, by issuing securities on the Eurobond market. However, 80% of all Eurobond sales are to numbered Swiss bank accounts and anonymous trust accounts. Eurobonds are "bearer," i.e., unregistered paper, favored by international dirty money. Most of the funds Merrill Lynch raises to fund margin purchases by one drug trafficker come from other drug traffickers.

"The real thing now driving these markets is all this insane 'options' business," added the chief of the equities division at a London merchant bank. "Not just stock options, but index options, futures options, options on options. It's insane. Where the 1929 Black Friday was triggered by margin problems, if we have a crash today, we could say it was triggered by this options insanity."

For those speculators without large amounts of dirty money to invest, the commodities and options market permits them to speculate for a downpayment worth a few percentage points of the value of the shares they purchase. The London banker cited notes that it is now possible to write an option to buy or sell the future value of a contract linked to the price of the *Standard & Poors* stock market index, representing a degree of leverage unknown in 1929.

What is most remarkable is that the largest source of funds for actual purchase of stock shares—after all of the futures and options contracts have cleared—is offshore dirty money. During the last half of 1985, major corporations made net purchases of about $50 billion in equity in the U.S. stock markets, in the process of mergers and acquisitions. During the first quarter of 1986, their purchases fell off to "only" $11 billion. Nonetheless, the market continued to climb, as dirty money washed in.