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EIR Economics

Greenspan raises legality of Fed as Gonzalez attacks

by Anthony K. Wikrent

In a most peculiar reference to the legal mandate of a central bank—or lack thereof—U.S. Federal Reserve Chairman Alan Greenspan told the Bankers Club in London on Feb. 1 that the rapid growth of trading in financial derivatives the past few years reinforces the requirement for central banks to oversee monetary policy and payments systems to protect the integrity of the financial system, "whether written in law or not."

This is the first time Greenspan has voiced concern about the derivatives markets, in which an estimated $1.5 trillion *per day* are traded in various financial instruments such as futures and options. But this is not nearly as significant as his queer reference to the legality of a central bank's operations and objectives.

What is emerging, as Rep. Henry B. Gonzalez (D-Tex.), chairman of the House Committee on Banking, Finance, and Urban Affairs, presses forward in his efforts to force greater accountability on the Fed, is a conflict over two views of law. Gonzalez insists that the U.S. Constitution has meaning, and that its rule of law applies to all areas of policy in national life, including monetary and financial policy. The Federal Reserve cannot, of course, openly argue that it is exempt from the rule of law. But its response to each of Gonzalez's thrusts of the past few months (such as former New York Fed president Gerald Corrigan's defense of entertainment tickets provided to Fed staffers by the banks they supposedly regulate); the actions of the Fed since October 1987 to save the various financial markets (such as propping up the Dow Jones Industrials Average through the use of stock index futures contracts); and now Greenspan's remark that the Fed will preserve and protect the financial derivatives markets, "whether written in law or not," clearly demonstrates that Fed officials believe law subserves monetary and financial policy to the exclusion of everything else.

"The problem," U.S. American System economist Lyndon LaRouche explained on Feb. 2, is that "we've got a bunch of yuppies in Europe and in the United States, who are sitting at their personal computers or similar devices, and making money out of thin air, but at the expense of real business and real people. We're destroying the economy by a kind of cancer of speculation, which acts just like a metastatic, malignant cancer, eating at the whole of our economy: We gobble up assets; we sell off assets; we strip assets; we downsize—all for the purpose of feeding this margin of profit into this game called derivatives, and similar kinds of speculation.

"These people are fanatical.

"What's the issue? The issue is, first of all, like most prosecutors that I've known in this country, the Fed officials lie all the time. Why should anybody be surprised about that? They're looting the American people! Are they going to say that?"

Crisis accelerates

Greenspan's defense of the Fed's extra-legal practices is obviously prompted by the rapidly accelerating derivatives-related crises. On Jan. 28, Aetna Life and Casualty Co., one of the ten largest diversified insurance outfits in the United States, announced that it was laying off an additional 4,000 employees and charging $1.28 billion against earnings this quarter to cover $825 million in losses arising from $15 billion in guaranteed investment products Aetna sold to pension funds in the 1970s and 1980s.

If one firm's financial gamble from 15 years ago is just now resulting in 4,000 Americans losing their livelihoods, one trembles to think what carnage awaits us as the derivatives debacle of the 1990s plays itself out. In just the past few months, at least four derivatives disasters have come to the public's attention: Ferruzzi, *boom*. Metallgesellschaft, *boom*. Banesto, *boom*. Codelco-Chile, *boom*. It's as if some god-forsaken infantry unit has strayed into a minefield.

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On the other hand, one recalls Michael Lewis, in his book *Liar's Poker,* about selling bonds at Salomon Brothers in the 1980s, describing how trainees and new salesmen were "allowed" to "blow up" some of their customers by selling them bonds that more seasoned Salomon veterans knew to be bad investments. It certainly sounds like someone out there is getting blown up. The question is, who planted the mines, and how long before they blow themselves up? Another question is, are these explosions not occurring more frequently? And, are they not becoming more powerful, and thus more dangerous?

Morgan's Banesto shell game

Some of the answers may emerge soon. On Jan. 27, Gonzalez sent letters to Fed chairman Greenspan and J.P. Morgan and Co. chairman Dennis Weatherstone, demanding a full accounting of J.P. Morgan's relationship with Banco Español de Crédito (Banesto) of Spain, one of the more recent explosions that have lit up the horizon. According to unconfirmed reports, Morgan had used Banesto to construct an elaborate financial shell game between New York, Mexico, and Spain that included the use of derivatives contracts (see *EIR,* Jan. 14, "Derivatives Cancer Claims More Victims in Europe").

Gonzalez explicitly demanded to know, "Did J.P. Morgan engage in any derivatives transactions with Banesto? If so, please list the type of instrument and the dollar amount of any transaction. Has any money been lost on those transactions as a result of Banesto's problems?" Gonzalez also asked Greenspan, "Has any other U.S. counterparty lost money on derivatives transactions with Banesto as a result of Banesto's current problems?"

Gonzalez demanded complete details of Morgan's application to the Federal Reserve to establish Corsair Limited Partnership (the "vulture fund" Morgan used as the vehicle for investing in Banesto), including a list of "all general and limited partners," and a full accounting of any and all attempts by employees of Morgan "to sell or attempt to sell" any securities related in any way to Banesto. Gonzalez also questioned "the safety and soundness of bank holding company 'vulture funds,' (i.e., partnerships created to invest in bank or bank holding company stocks) such as the one J.P. Morgan set up to invest in Banesto stock," and demanded that the Fed chairman list all such "bank vulture funds . . . their bank holding company affiliate . . . [their] total assets, liabilities, and capital," as well as explain how the Fed supervises and examines such "vulture funds."

The Fed's 17-year secret

On the same day these letters were sent, the staff of the House Banking Committee released its report entitled "The Federal Reserve's 17-Year Secret," on the Fed's attempt to withhold transcripts of Federal Open Market Committee meetings from the public. The FOMC is the policymaking organ of the Fed, comprised of the seven board governors and five of the 12 regional Fed bank presidents, which sets target ranges for U.S. interest rates and the growth (or collapse) of the U.S. money supply, and issues direct orders to the Open Market desk of the New York Federal Reserve Bank, which carries out the day-to-day tasks of implementing FOMC policy.

Fed officials have for years argued that the deliberations of the FOMC could not be made public, lest the deliberative process would be impeded and the smooth functioning of the financial markets imperiled. When pressed, they have insisted that there is simply no record of FOMC meetings extant. But in a delightful display of investigative tenacity, committee staff obtained 3,000 pages of transcripts of the secret FOMC meetings covering 1976-78 from the Gerald R. Ford Library in Ann Arbor, Michigan. The transcripts were given to the library by the late Arthur Burns, chairman of the Fed from 1970 to 1978.

The Banking Committee staff report painstakingly details how Fed officials repeatedly lied and dissembled as they sought to prevent the dark secrets of central banking from being revealed to public scrutiny. The Burns transcripts show that such stonewalling was endemic in the 1970s as well, and include Fed officials considering possible ways of avoiding the Sunshine In Government and Freedom of Information Act (FOIA) laws of 1976.

"Upon reading the transcripts," the report states, "the Banking Committee discovered that the Federal Reserve not only has a policy of redacting transcripts given out under FOIA requests, but it attempts to skew the information in the directives issued after each FOMC meeting. For example, in 1976, the Federal Reserve made a decision not to release complete minutes of its FOMC meetings, even with a five-year lag, which had been its policy up until that time. The Federal Reserve instead decided to release a 'summary' of its meetings. But in reality, they were 'padding' the summary with boilerplate materials about the economy. Concerned that someone might notice, then Federal Reserve Chairman Arthur Burns ordered his staff to add pages to the summary to look like there were substantial discussions taking place. His instructions . . . were that he did not want anything that remotely resembled 'padded' minutes, but he directed his staff to 'produce several additional pages.'

"A reading of the transcripts revealed that the FOMC members and staff discussed what should or should not be included in the Memorandum of Discussion (detailed minutes in paraphrased form) which had been made available to the public up to 1976. A communication from Joseph Coyne, Assistant to the Board, to Chairman Arthur Burns, describing material that the FOMC should consider withholding is included in this report."

The Banking Committee report results from the most recent effort of the Fed to avoid public disclosure: In a series of hearings before the Banking Committee which began in

January 1992 and concluded in October 1993, Gonzalez eventually forced Fed officials to reveal that, contrary to Greenspan's and the other officials' misrepresentations before the committee, there do exist transcripts of FOMC meetings dating back to 1976. The report "provides evidence that Federal Reserve officials planned to deceive and mislead Congress in their testimony at the Oct. 19, 1993 House Banking Committee hearing in regard to the inventory of transcripts at the Federal Reserve and that the officials carried out their plan at the hearing," the report states.

No grounds for secrecy

In a news release accompanying the report, Gonzalez wrote, "Once the public has the opportunity to read some of the . . . transcripts obtained by the Banking Committee, they will see that the Federal Reserve has no grounds for keeping this information secret. The reality is that by keeping its meetings secret, the Fed fancies itself as appearing all-powerful and all-knowing. Like the Wizard of Oz, the Fed tries to keep the curtains closed—to do otherwise would be to reveal that the person pulling the levers is a mere mortal after all. . . . The transcripts . . . reveal that in the 1970s, then Federal Reserve Chairman Arthur Burns decided to secretly make complete transcripts of each FOMC meeting even as he told the public and the Congress that the FOMC would no longer be taking minutes."

Gonzalez's release went out on the Dow Jones newswire, and was sent to the major newspapers in the many cities where the Fed has its branches. But, except for a small item buried in the back of the *Wall Street Journal* on Jan. 28, there has been no coverage in the U.S. press. Rather, *Fortune* ran a four-page article on Feb. 7 lauding Greenspan and the Fed for being "determined not to repeat the mistakes of the 1970s." More specifically, "just as generals are judged by whether or not their armies control the field when the smoke clears, Fed chairmen are judged by what happens to prices," *Fortune* decreed. This mantra of "price stability" has been used by virtually all press commentators to dismiss the issues raised by Gonzalez, conveniently defining the criteria for judging the Fed as holding inflation in check—obviating any consideration of the accelerating derivatives debacle and the physical economic depression. The complete lack of interest by the press in the scandalous attempt by the Fed to avoid public disclosure stands in sharp contrast to the feeding frenzy the media have engaged in over Zoe Baird, Adm. Bobby Inman, and the allegations over Whitewater.

The republic is ill-served by these whorish press pundits, but then, they are only aping the institution they so slavishly defend. "The function of the Federal Reserve chairman is *to lie*," LaRouche explained on Feb. 2. "That has always been the function of the Federal Reserve chairman—to tell lies. That goes with the job. This is not something he does only on Tuesday. It's something he does seven days a week—that is, if you ask him any question which seeks a truthful answer."

Chernomyrdin declares shock therapy is over

by William Engdahl

A preliminary outline of an economic policy for the controversial new government of Viktor Chernomyrdin in Russia was outlined at a recent international economics conference in Switzerland. In response to a question from *EIR* Jan. 29 at a press conference during the World Economic Forum in Davos, Prime Minister Chernomyrdin declared, "Russia will not backtrack to the old system. We must consolidate a market economy. But we say, 'No shock therapy.' Rather, we in Russia need, simply, therapy. We have seen the end in Russia of the period of what I call 'market romanticism.' "

Chernomyrdin's remarks were doubly significant, because they were delivered only days after the resignation of the last remaining "reform" advocate from the earlier Yeltsin government. Boris Fyodorov, the finance minister, left denouncing the Chernomyrdin cabinet, accusing it of irresponsible hyperinflationary policies which threatened even more chaos in Russia.

Behind the sometimes heated rhetoric of exchanges between members of the Chernomyrdin government present at Davos and western critics, including Harvard "shock therapy" guru Jeffrey Sachs and his Swedish monetarist business associate Anders Aslund, the first outlines of a Russian economic strategy began to emerge. From what was said, the following three broad areas of emphasis appear likely under Chernomyrdin.

The role of military industry

First, as indicated, the experiments since Jan. 2, 1992 with International Monetary Fund (IMF)-imposed "shock therapy" monetary policies are over. These policies, as numerous Russian delegates emphasized to *EIR* in private discussions, dictated freeing 70 years of state-controlled prices to "world market" levels in an economy in which a functioning market did not yet exist, as all production was still effectively under the state budget.

What Sachs prefers to ignore is that it was precisely his "shock therapy" recipe for immediate chaos which forced a desperate government and central bank over the past two years to print more and more rubles in order to provide the population with means to buy basic essentials such as food and fuel. When the IMF demanded that the Russian govern-