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Orange Co. files bankruptcy in derivatives-led collapse

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Orange County, California, with 2.6 million people the fifth most populous and among the 10 wealthiest counties in the United States, filed for Chapter 9 bankruptcy protection against its creditors on Dec. 6. It is the latest, and the largest, sign yet that the financial swindles of the past 30 years—from the formation of conglomerates in the 1960s, to the recycling of petrodollars into the Third World debt and Eurodollar market in the 1970s, to the junk bond mania, program trading, and insider trading in the 1980s, and finally, derivatives in the 1990s—have reached the outer limits. The speculators and usurers, the traders and risk managers, have made their fortunes by bankrupting the society that stupidly allowed them to ply their evil trades.

Up until the day it declared bankruptcy, Orange County, just south of Los Angeles, was assigned the highest possible credit ratings for a municipality by the two major credit rating agencies, Standard & Poor's and Moody's Investors Service. Probate judges in the county earnestly advised heirs to place their inheritances in the Orange County fund, which boasted of annual returns of over 10% a year for the past decade. Robert Citron, the county treasurer, had compiled this admirable record by using the $7.8 billion entrusted to his care by the county and about 180 other local municipalities and government agencies, as collateral to borrow another $13 billion to buy securities paying higher interest. About one-quarter of the securities were derivatives. As recently as Sept. 26, Citron wrote in his fund's annual report, "We have constructed a well-balanced portfolio that we believe can withstand the impact of current interest rates."

Well-balanced losses

Not three months later, the fund is worth only 80% of what it once was; Citron has resigned in disgrace; the county's creditors are scrambling to sell the collateral they hold; the county is screaming that they can't do that; and teachers, administrators, sanitation workers, policemen, and firemen are wondering if they will see another paycheck soon.

Because California has the most lenient laws in the United States governing investments by local government entities—which were partly written by Citron himself when he headed the Association of California County Treasurers in 1979—much of the operating funds of the county and the 180 other government units is tied up in Citron's fund. Local school districts, in fact, are required by California law to place all their monies with their county's fund.

The rapidly developing legal fight over the disposition of the securities Citron put up as collateral, clearly shows how high the stakes are, as the Orange County bankruptcy moves the world into a new phase of the ongoing financial and monetary collapse which American System economist Lyndon LaRouche has characterized for the past few years as "the great mudslide." The Wall Street investment banks that lent Citron's fund $15 billion are falling over themselves to sell off the county's collateral securities they hold. The county's lawyers are arguing that the bankruptcy laws prohibit them from doing so. Some of the investment banks have proceeded anyway, pointing to a little-known technical loophole Wall Street had inserted in the 1984 rewrite of U.S. bankruptcy laws. This loophole allows investment banks to sell securities held as collateral in repurchase agreements, the type of deal Citron had borrowed his billions to play with.

CS First Boston dumped the entirety of its $2.6 billion of Orange County collateral on Dec. 6, no doubt helping to persuade county officials they had no choice but to seek bankruptcy protection. Paine Webber also sold $300 million

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of the $650 million of the Orange County collateral it held that day. On Dec. 7, the day after the bankruptcy filing, Nomura Securities dumped the entirety of the $900 million it was holding. The Smith Barney unit of Sanford Weill's Travellers, Inc. tried to sell its $800 million, but was unable to. The mortgage derivatives-plagued Kidder Peabody managed to unload all but $100 million of the $1 billion it held. Merrill Lynch still has $2.01 billion; Morgan Stanley, $1.6 billion; and Prudential Securities, $1 billion.

Ending up with nothing

If the courts rule in favor of the investment banks, then the entirety of the losses will fall on Orange County and the 180 other government units: When the county emerges from bankruptcy, and attempts to reclaim, or even use its $10 billion in collateral, it simply won't be there.

And despite their having sold off the collateral, the investment banks will no doubt insist that the county still has to pay back every red cent in principal and interest Citron contracted—when it can, of course.

What this means for the residents of Orange County, is that essential services will be cut back. What does a water district or a sanitation district do if its operating funds must go to the greedy investment banks, rather than operations? Taxes supposedly paid for maintenance of essential services have gone up in the smoke of reckless speculation. Will a resident turn on the tap, only to find that there is no longer any water? The bankruptcy laws were supposed to prevent this sort of nightmare from transpiring, but now we find that Wall Street has for years been busily rewriting the bankruptcy laws to suit itself.

Thus the real issue is not whether derivatives were involved or not, or whether leverage was involved or not, or whether the Federal Reserve raised interest rates too high, too fast. The real issue is whether the battered, wheezing, starved physical economy will now be butchered and made an offering to appease the mighty morlochs of money and finance. We have reached the point Lyndon LaRouche began warning about two years ago, that the financial collapse is creating the conditions for the physical disintegration of the United States as a nation-state.

The struggle for survival

Now, as the losses are tallied, the fingers are pointed, and the court papers are filed, comes the end-phase struggle for survival. Will the society rouse from its stupor, and assert justice, forcing a reorganization upon a socially useless, indeed, a *predatory* financial system? Or shall the society now dismantle the very fabric of its existence, selling itself off piece by piece, to meet the ravenous demands of the usurers that their contracts of debt and speculation be "honored"?

"Orange County," LaRouche said in his weekly radio interview on Dec. 8, "is typical of the situation which has been developing around the United States in publicly controlled private pension funds, in other state and municipal funds, and in this kind of situation you have with the various county and city governments, and school boards that were involved in Orange County. That's found all over the country.

"What I warned, is that, although the speculative bubble can blow out through reverse leverage at almost any time—it could blow out *now*—the thing which would break down all efforts to postpone the explosion, would be a breakout in the political sector.

"That is, as we've seen, when you get into school board funds and public funds of communities, as in the Orange County case, you get something that you *cannot* control in the way you can manipulate a bankruptcy in the private sector; and therefore, these political limits, when Social Security funds or pension funds begin to be wiped out, and you get masses of people screaming about their immediate victimization, even much more so, of course, than in a banking failure, that is the point at which this blowout tends to break out."

Half-measures won't work

"So, the limit is being approached at which the whole system is going to collapse," he continued. "And those who didn't take it seriously, last year or back in 1992, when I warned against this mudslide in my nomination campaign that year, perhaps now wish they had. And those who last year and earlier this year, tried to pretend that the derivatives crisis was not what I represented it to be, are finding out that I was right; and they're going to have to take the kinds of actions which I indicated, going *beyond* what Rep. Henry Gonzalez [D-Tex.] and his [House Banking] Committee was pushing. They're going to have to go all the way, and straighten this mess out.

"So, this is not the final story, *yet*, on the international derivatives bubble. But it's a point of inflection. It warns you of how close the international financial collapse, the blowup, is, and that you cannot sit around and say, 'There is prosperity going on, let's not disturb it,' or you cannot say the kind of things or do the kind of things that Alan Greenspan at the Federal Reserve is doing, believing that he's controlling the situation. He's controlling *absolutely nothing*. He's not even controlling his own mind here. What he's doing, is foolish.

"This is the end of the system; and the question is, as our Founding Fathers knew when they formed the federal Union, that we're going to have to go back to the kind of thinking that shaped the creation of the federal Union in 1787-89 under Washington and Hamilton and Franklin's leadership, and we're going to have to put aside all these kinds of [post-industrial] nonsense: Third Wave, Fourth Wave, and other kinds of 'Hair Wave' nonsense, that Alvin Toffler and [incoming House Speaker Newt] Gingrich are pushing. That kind of stuff is *finished*, even before it starts. We've got to go back to the old hard ways of doing things, and then we can work our way out of this mess."