

Brand X proposals for financial reform: What is to be done?

by Marcia Merry Baker

The following is an adaptation of a review by Marcia Merry Baker of recent proposals for dealing with the disintegration of the international financial system, presented at a March 29 Washington, D.C. conference, "Economic Development in a Period of the Collapse of the Financial System," sponsored by the Schiller Institute.

Who says they know what to do about the financial and economic crisis? If you go by what you hear and read in Washington, D.C., you would think, almost no one. With some rare exceptions, no one is saying anything. But that isn't true.

Look at Europe, look at Japan. Just in the past month, many voices have been raised. For example, the finance minister of Japan, Masayoshi Takemura, addressed the Diet (parliament) on April 10, and said that the post-1971 floating exchange rate monetary system should be rethought. Besides making some of his own recommendations, he reported that "economists in several nations" are now studying ways to reform the monetary system.

There are many proposals coming forward from France, in particular, in the context of the Presidential election campaign. French President François Mitterrand, speaking at the U.N. Social Summit in Denmark in March, said, "Are we really going to let the world become a global market without any laws except those of the jungle? . . . Should we leave the world's destiny in the hands of those speculators who in a few hours can bring to nothing the work of millions of men and women?"

French Prime Minister Edouard Balladur also said in March that action is needed. "Every time there's trouble, people say, 'It's very serious, we have to do something about it.' And then life goes on. They say it wasn't so serious, 'We survived,' and they wait for the next shock. For me, my fear and my obsession is that one day the shock will be so severe that the prosperity of the world would suffer badly. So I would prefer that we prepare for the worst."

There are similar voices elsewhere in Europe, and from our own hemisphere, from Asia and Africa.

Most of the alarms have come about the time that the international speculative bubble started popping over the past year, and the losses and destruction are obvious, even to the

U.S. media—Orange County, Barings Bank, Mexico, Crédit Lyonnais, and others.

But even before these recent blowouts, there were a few warnings. On June 22, 1994, Roland Leuschel, of Bank Bruxelles-Lambert, said in the Paris daily *Le Monde*, "The countdown to the crash has begun. . . . We are today paying the price for the creation, during the last two years, notably in the United States, of the most significant financial bubble in human history."

LaRouche was right

This warning, and a few others, were cited by Lyndon LaRouche in a June 1994 policy statement [see *EIR*, June 24, 1994] entitled "The Coming Disintegration of Financial Markets," known otherwise as his "Ninth Forecast." Since its release, 900,000 copies of this document have circulated in the original English-language version, and thousands of copies in many translations.

In this document, LaRouche reviewed the nature of the financial bubble, in contrast to how an economy should function properly. Since then, he has stressed that a "Chapter 11"-style bankruptcy reorganization of the world monetary system, by the United States in concert with other nations, is necessary for reversing the process of disintegration and reviving the economy.

You now hear frequently from others, echoes of various formulations published by LaRouche to deal with the crisis. The single most dramatic example, is the proposal to tax derivatives speculation. On March 10, 1993, LaRouche proposed that the U.S. government place a 0.1% tax on all derivatives transactions, for the purposes of beginning to control and dry up this cancerous speculation, and to make way for other financial and economic emergency measures to revive the physical economy.

In early 1993, most congressional offices could not even tell you what derivatives were, let alone what you should do about them. But subsequently, Rep. Henry Gonzalez (D-Tex.), then-chairman of the House Banking Committee, held hearings and made speeches drawing attention to the danger of derivatives and other speculation.

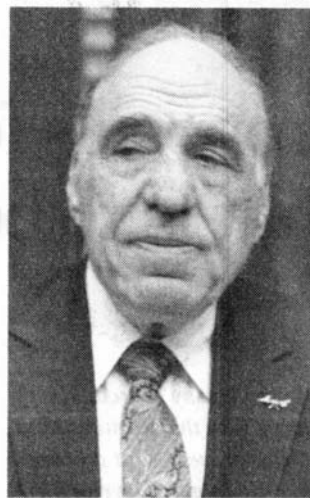
Representative Gonzalez himself introduced legislation in 1994 calling for a 0.1% tax on derivatives transactions.



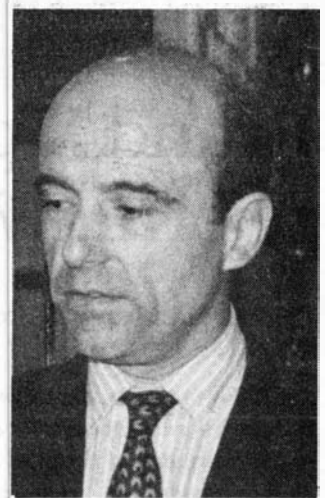
Helmut Schmidt



James Tobin



Henry Gonzalez



Alain Juppé

Now, more such bills have been introduced in the United States, and similar proposals have been made in France and other countries.

Thus, if you go back 25 years, there is a very short list, with Lyndon LaRouche most prominent, of those who forewarned of the dangers of the “bubble economy,” from about 1970 through 1993. In the last two years, you hear many more cries of alarm each week—at least if you are outside Washington.

What they say should be done

We will give here a summary picture of what people are saying should be done. This is relatively easy, because what those who are speaking out are saying, unfortunately, is very limited and easy to summarize. That is, most proposals are simple-minded.

We present a selection of these proposals on aspects of the financial breakdown crisis, grouped under three headings: currency chaos, derivatives blowouts, and national and institutional debt crisis.

The fourth category of proposals, which are development initiatives to deal with breakdown conditions of the physical economy of various regions, we will not include here, because they were summarized in the Jan. 1, 1995 special color issue of the *EIR*, and *EIR* news reports have followed since. Such initiatives include the Middle East Development Bank and multi-nation proposed infrastructure projects, as outlined at the Casablanca conference in November 1994.

What should be done?

There are broadly two camps: those who want to curb speculation and end what they often call “turbulence” in currencies; and those who oppose any such moves, in the name of protecting global “liquidity.” There is an estimated \$1 trillion a day in worldwide currency speculation at present, with about one-third of that centered in London. The

notional value of outstanding derivatives being traded globally has now reached \$45 trillion.

Those who defend this bubble in the name of “liquidity”—the U.S. Federal Reserve, the City of London and related circles—are, in fact, gasping for more hot air for their disintegrating bubble.

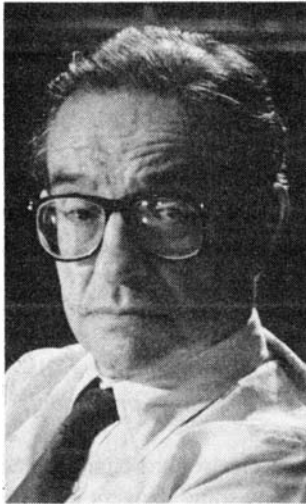
Otherwise, apart from the split between those for and against speculation, you will find proposals from both camps for putting the International Monetary Fund in charge of “reform” of the disintegrating financial system, despite the IMF’s role in bringing it down.

The glaring drawback of the well-taken proposals for countering the International Monetary Fund, and imposing currency stabilization measures, is the lack to-date of companion proposals to restore the functioning of the physical economy. The crisis conditions in Mexico, or the case of the shutdown of vital municipal services in Orange County, California (infrastructure maintenance, schools, health care) following financial breakdown, illustrate how essential are emergency economic measures, not just financial “reform.”

As of March, 15 out of the 50 U.S. states were reporting significant losses in derivatives by some agency or locality within their borders. Worldwide, reported municipal losses in derivatives add up to about \$10 billion.

The constituency exists in every nation for economic development-based financial reorganization proposals. Moreover, the opportunity now exists to put this on the official government agenda of nations. For example, at the end of April or in early May, there will be public hearings in the German parliament on the need to counter derivatives and other speculation.

The following compendium of “Brand X” proposals is presented as a reference for those mobilizing to force through the necessary changes before it is too late.



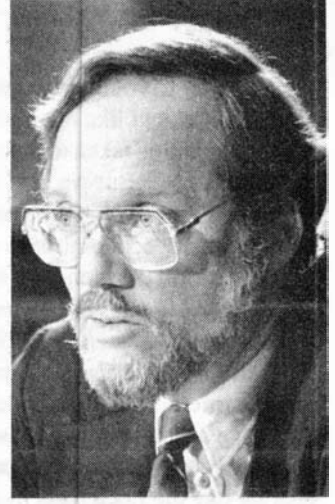
Alan Greenspan



Pope John Paul II



Alberto Fujimori



C. Fred Bergsten

Documentation

The following are selected recent comments addressed to aspects of the financial disintegration process.

I. Currency chaos

James Tobin, professor emeritus, Yale University, economics. Professor Tobin first put forward the view that foreign exchange speculation should be taxed in 1978. As of this year, there are many references to what is now called the "Tobin tax." From the Wall Street Journal, Dec. 22, 1992:

"An international tax should be levied on spot transactions in foreign exchange (including deliveries on futures contracts and options). . . . A 0.5% tax on currency transactions is equivalent to a four-percentage point difference in annual interest rates on three-month bills, a considerable deterrent to those contemplating a quick round trip to another currency."

Alain Juppé, foreign minister of France. The March 18, 1995 issue of the German daily Frankfurter Allgemeine Zeitung reported:

Minister Juppé told the March 18-19 meeting of European Union ministers in Carcassone that a reform of the international currency system is now indispensable. Otherwise, every country in the world will be exposed to foreign exchange turbulence with all its dangerous consequences for the economy and society.

Edgar Meister, board of directors, Bundesbank (central bank of Germany). The following are excerpts from an interview with the German economic weekly Wirtschaftswoche

published on March 19, 1995:

"Any proposal to restrict purely speculative transactions should be studied seriously. There are, however, serious technical problems. It is often hard to distinguish between purely speculative transactions and those deals which are rather based on arbitrage or hedging purposes."

Andre Ouellet, foreign minister, Canada. Reuters report from Ottawa, March 14, 1995:

"The information I have received is that there is genuine interest on the part of many to discuss this" tax on currency transactions at the June 15-17 Group of Seven summit in Halifax. "The very fact that it would be on the agenda and that it would be discussed in Halifax [would be] an immense step forward."

Lionel Jospin, Socialist Party candidate for President of France. Winter 1995:

In his "Manifesto for France," he calls for a 0.1% tax on the movement of speculative capital, "which would not penalize investments for 10 years, only placements for 10 days," to dampen currency turbulence, and incidents such as the Barings bankruptcy.

Edouard Balladur, prime minister of France. As reported by Reuters, March 14, 1995:

Proposed:

- a new common, world currency standard (can be a basket of currencies, ECU-style);

- a system requiring dealers to make deposit payments when making currency trade, to slow short-term international money flows;

- "In a world which moves around hundreds of billions of dollars every day by computer, could we not invent rules of market organization that would make speculative gains less easy?"

Masayoshi Takemura, finance minister, Japan. From a speech to the Diet (parliament), as reported by Reuters,

April 10, 1995:

"In order to counter the current rapid appreciation of the yen, Japan would like to emphasize policy coordination and joint intervention taken together with other nations, especially the U.S. . . . But we also need to think whether we can leave the current exchange rate system as it is now." It should be noted that "economists in several nations" are studying ways to reform the monetary system.

Financial Times of London, "Economics Notebook," by Peter Norman, March 27, 1995:

"An Old Idea Comes Up for Airing," is the headline of this article, which ridicules attempts to control foreign exchange speculation. It ends with a quote from a German economist, "A tax on exchange transactions keeps reappearing like the Loch Ness monster. Forget it."

II. Derivatives blowout

Wendy Lee Gramm, *chairman (1988-93), Commodities Futures Trading Commission, wife of Sen. Phil Gramm (R-Tex.). From a commentary in the Sept. 8, 1993 Wall Street Journal:*

"[Derivatives are a] vibrant and valuable sector of the U.S. financial market. . . . Most important, if another major default or market shock occurs, we must all resist the urge to find scapegoats, or to over-regulate what we just do not understand."

Social Democratic Party, *German Parliament, March 19, 1995:*

A "Grand Motion" was put to Parliament for a debate on derivatives and their risks. Rudolf Scharping, SPD national chairman, signed it.

The debate is expected to take place in late April or early May.

Helmut Schmidt, *former chancellor, West Germany. From an article by Schmidt in the German weekly Die Zeit, March 10, 1995, entitled "Wild Bet at Any Price":*

Three "necessary steps" with regard to derivatives must be taken: First, parliaments, including the Bundestag, must hold special open public hearings on derivatives, "in order to expand, if necessary, the existing credit system-laws."

Second, "banking control authorities must intervene in every individual case, in which it seems to them that the internal control system of a bank (with respect to derivatives) is inadequate."

Third, "to all non-banks, the participation in abstract financial derivatives deals is to be legally forbidden." In conclusion, "this is not an alarm call, but an admonition to timely, precautionary action."

Inter-Action Council, *Germany. This think-tank is associated with former Chancellor Helmut Schmidt. Discussion with a Council operative, March 14, 1995:*

The "turmoil in the financial markets," e.g., the collapse of Barings Bank, shows that "bankruptcy reorganization" is necessary. We are working on a proposal for "taxing financial transactions—derivatives, foreign currency, forex bonds, securities. . . . The fallout would be to dry up speculation, but the purpose would be to fund things that are needed but for which there is no money. . . . Nobody has the relevant statistics . . . at a time when there are more than 1.5 million derivatives contracts being concluded every day."

Henry Gonzalez (D-Tex.), *U.S. representative, then-chairman of the House Banking Committee, press conference on March 28, 1994:*

The derivatives market is "an electronic Ponzi scheme that eventually is going to cause us some dangers because it's like an inverted pyramid. . . . What I'm thinking of is trying to see if we can get our prime responsible forces like the Fed and the Treasury . . . to bring about a worldwide consortium. . . . You could stop it overnight if you just imposed a one-tenth of 1% tax on those transactions."

Henry Gonzalez, *U.S. representative, Jan. 4, 1995, urging passage of the "Derivatives Safety and Soundness Supervision Act of 1995":*

This is a law designed to meet a need that "has been heightened due to such recent calamities as the Orange County bankruptcy." It calls for:

Federal agencies to collaborate to set standards for entities trading in derivatives.

Additional disclosures by traders.

Trading proscribed unless under a written "prudential" management plan.

Ed Markey (D-Mass.), *U.S. representative, ranking member of the Telecommunications and Finance Subcommittee of the House Commerce Committee, from a press briefing, Feb. 27, 1995:*

Representative Markey introduced legislation to regulate derivatives dealers, saying that the collapse of Barings Bank "underscores the risks inherent in failing to assure that regulators have adequate tools on hand to minimize the potential for OTC [over the counter] derivatives to contribute to a major disruption in the financial markets, either through excessive speculation and over-leveraging, or due to inadequate internal controls and risk management on the part of major derivatives dealers or end-users."

Markey said that his legislation is "aimed at providing a framework for improved supervision and regulation of previously unregulated dealers and assuring appropriate protections for their customers."

Alan Greenspan, *chairman, Federal Reserve Bank, Senate Committee on Banking hearing, Jan. 5, 1995:*

"Although the convenience and the low cost of using derivative instruments to meet portfolio objectives may have facilitated some investors reaching for more unconventional

and possibly riskier strategies, it would be a serious mistake to respond to these developments by singling out derivative instruments for special regulatory treatment."

John Laware, member, Federal Reserve Board of Governors, to a meeting of Connecticut bankers, as reported by Reuters, Jan. 25, 1995:

It is "extraordinarily important" that Congress not try to control the sale of derivatives in the United States. "We must keep Congress out of this. . . . Derivatives are the crown jewel of U.S. capital markets and it would be a grave mistake to try to outlaw them."

Laware said that congressional prohibition could force the export of the derivatives market "to London, Tokyo, or elsewhere."

Eddie George, chairman, Bank of England, remarks to the "Forex 94" conference, London, June 1994:

"Worries over derivatives are vastly exaggerated. What are to be feared more than derivatives are stable foreign exchange rates of any kind. The establishment of a single European currency would increase unemployment in Europe and could lead to waves of migration of unemployed people across the borders of EU [European Union] member states. Do not attempt to reestablish an international system of fixed exchange rates like Bretton Woods."

Federal Reserve Bank of New York, "Code of Conduct" for Derivatives Dealers, Feb. 22, 1995:

A "Wholesale Transactions Code of Conduct" was circulated to the 10th annual conference of the International Swaps and Derivatives Association, prepared by the New York Fed and others. It advised that counterparties should assume an "arm's length" relationship in the derivatives deals, and "communications between them and the brokers cannot be construed as investment advice."

Mary L. Schapiro, chairman, U.S. Commodity Futures Trading Corp., comments at the National Futures Industry Conference, Boca Raton, Florida, March 16, 1995:

Integrating national bankruptcy laws is needed to prevent "the freezing [of] margins and positions of solvent customers within insolvent firms," such as Barings. In that case, without such laws, "virtually 18 hours a day, we talked, cajoled and pressured foreign exchanges and regulators to transfer positions from various Barings accounts. . . . The delays encountered in transferring positions and funds had potentially significant systemic risk implications."

C. Fred Bergsten, former U.S. treasury secretary; director, Institute for International Economics. From remarks at the Bretton Woods 50th year conference, Madrid, Sept. 9, 1994:

"The International Monetary Fund of the 21st century should become the steward of a system of currency target zones that could evolve, over time, into an effective regime of macroeconomic policy coordination among at least the European Union, Japan, and the United States."

He urged creation of an International Monetary Fund "council" of ministerial-level Group of Seven officials to work with central banks and the IMF board to enforce new target zones.

U.N. Development Program Report, June 1994:

"A world central bank is essential for the 21st century—for sound macroeconomic management, for global financial stability and for assisting the economic expansion of the poorer nations. It would perform five functions:

- 1) stabilize global economic activity;
- 2) act as a lender of last resort to financial institutions;
- 3) calm financial markets when they become jittery or disorderly;
- 4) regulate financial institutions, particularly the deposit banks;
- 5) create and regulate new international liquidity."

III. National debt

Anthony Ani, finance minister of Nigeria, remarks during the U.N. Summit on Social Development in Copenhagen, Denmark, March 12, 1995:

Reschedule, interest-free, Nigeria's \$29 billion national debt over a 75-year period. Grant a 5-10-year moratorium on repayments.

Alberto Fujimori, President of Peru, remarks during the U.N. Summit on Social Development in Copenhagen, Denmark, March 12, 1995:

Lighten the burden on social development by pardoning a portion of foreign debt.

Jim Leach (R-Iowa), U.S. representative, chairman, House Banking and Financial Services Committee. Article by Leach in the Wall Street Journal, April 10, 1995:

"What is needed today is a Chapter 11 process for the global financial system, a technique to keep nation-states and their people from the impoverishing implications of insolvency, while at the same time avoiding problems of moral hazard for both borrowing countries and their creditors. . . . The International Monetary Fund is the most logical institution to be given the responsibility for administering such a code [Chapter 11] internationally."

Pope John Paul II, from "As the Third Millennium Draws Near," Nov. 14, 1994; printed in Inside the Vatican, January 1995:

"In the sabbatical [every 7th] year, in addition to the freeing of the slaves the Law also provided for the cancellation of all debts in accordance with precise regulation. And all this was to be done in honor of God. What was true for the sabbatical year was also true for the jubilee year, which fell every 50 years. In the jubilee year, however, the customs of the sabbatical year were broadened and celebrated with even greater solemnity" (emphasis in original).