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LaRouche told you so, 1993-98

The following three-part chronology shows: how Lyndon LaRouche repeatedly warned of the menace of derivatives; how Federal Reserve Chairman Alan Greenspan and others defended derivatives and speculation; and what took place.

LaRouche told you so

1993

March 9: LaRouche proposes a 0.1% transaction tax on derivatives, and proposes emergency measures to restore the physical economy. "The derivatives bubble, by the very nature of these transactions, is a financial bubble in the tradition of the more primitive, more rudimentary, and far less dangerous bubbles of the 18th century, such as the John Law bubble in France, and the South Sea island bubble in England in the same period of time. This is the John Law bubble gone mad. The vulnerability to the entire financial system, the chaos and destruction of actual physical processes of production, distribution, employment, and so forth is incalculable in potential, and therefore this thing must be brought under control promptly."

July: In a mass-circulation pamphlet, "Tax Derivatives Speculation; Pop the Financial Bubble, Rebuild the World Economy," published by the *New Federalist* newspaper, LaRouche warns of "the prospect of a derivatives bubble which grows like a cancer at the expense of its host, and shrinks its host, at the same time its appetite is growing, while the means of satisfying that appetite are collapsing."

Aug. 12: The LaRouche Exploratory Committee for a LaRouche Presidential campaign is set up, with anti-speculation and economic growth policies as the keystone issue.

Lyndon H. LaRouche, Jr.

What Greenspan and others said

1993

Feb. 19: "I would not be overly concerned about the future," Greenspan says in the Federal Reserve's semi-annual report to Congress. "If we can keep this process [of budget cutting] going . . . then I think the outlook looks to me a lot more hopeful than I think it looked fairly recently."

Federal Reserve Chairman Alan Greenspan

March 19: *Forbes*'s cover story promotes derivatives.

July: A new report, "Derivatives: Practices and Principles," is released by the Group of 30 top executives from money-center banks (Dennis Weatherstone, chairman of J.P. Morgan, Inc., heads the group, which includes former U.S. Fed Chairman Paul Volcker). The report asserts that there is no cause to worry about derivatives.

1994

May 25: Bank of England Executive Director Brian Quinn praises derivatives before a conference co-sponsored by the Futures and Options Association and the Futures Industry Association: "The ingenuity of the specialists who design and price derivatives products . . . seems boundless. . . . Derivatives do not entail any new risks. . . . If the presence of derivatives makes prices of financial assets more volatile, does this necessarily mean the financial system is inherently less stable? The instinctive an-

What went on

1993

May: Notional principal value of derivatives contracts in the United States is in range of $16 trillions. Several Ohio counties rack up huge derivatives losses: Sandusky, $5.5 million; Portage, $5 million; and Putnam, $0.5 million.

June: Rep. Henry Gonzalez (D-Tex.), chairman of the House Banking Committee, makes a series of speeches in the House, deriding derivatives as "a fancy name for gambling." He calls for an investigation of George Soros's profiteering in the 1992 turmoil in European currencies. He scores Citibank and other major banks for off-balance-sheet derivatives speculation. "Is there money out there in these international markets for the procurement of goods, for firing the engines of manufacturing and production? No. it is paper chasing paper."

August: Feruzzi, the multinational food giant, reveals $3 billions of derivatives losses.

September: The House Banking Committee holds hearings on the financial protocols of NAFTA, including testimony by *EIR*'s John Hoefle, who warns of the spreading speculation and derivatives.

Oct. 28: The House Banking Committee holds first-ever hearings on derivatives, on Oct. 28. *EIR* submits written testimony, entitled "Tax and Dry Out the Derivatives Market; Don't Regulate It."

December: Big derivatives losers are Germany's Metallgesellschaft, $1.34 billion; Malaysia's Bank Negara, $3 billion.

1994

February: Fed raises interest rates slightly, for the first time in five years, which is seen as an attempt to slow speculative bubbles. The result is a bloodbath in speculative markets. Hedge funds lose billions; the mortgage-backed securities market disintegrates. Rumors fly that there is trouble at Bankers Trust.

Long Term Capital Management (LTC) hedge fund starts up.

David Askin's "toxic waste" mortgage-backed securities hedge fund, Granite Partners, collapses. Askin was the principal

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1994

June 13: LaRouche releases his "Ninth Forecast," published in *EIR* on June 24 ("The Coming Disintegration of Financial Markets"). "The presently existing global financial and monetary system will disintegrate in the near term. The collapse might occur this spring, or summer, or next autumn; it could come next year. . . . That collapse into disintegration is inevitable, because it could not be stopped now by anything but the politically improbable decision by leading governments to put the relevant financial and monetary institutions into bankruptcy reorganization."

FIGURE 10
U.S. at ground zero of derivatives explosion
(share of global derivatives exposure)

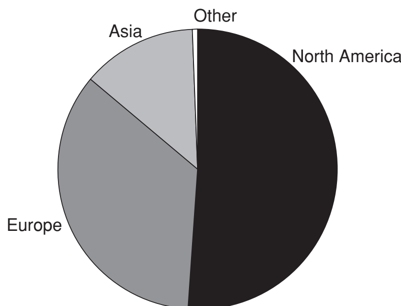
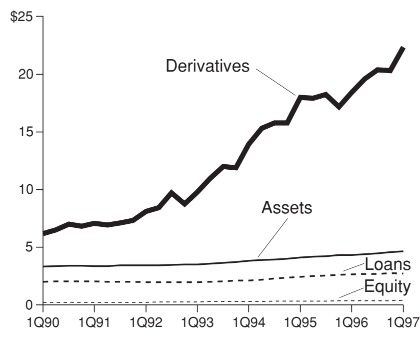


FIGURE 11
U.S. banks addicted to derivatives: derivatives versus assets, loans, and equity
(trillions $)



Figures reprinted from EIR, *Sept. 25, 1998.*

swer to this question seems to be 'yes.' However, academic work—while inconclusive—suggests that, if anything, the opposite is the case."

May 26: Greenspan testifies before the House Finance Subcommittee hearings on derivatives, telling them, don't worry, and don't regulate. "There is nothing involved in federal regulation per se which makes it superior to market regulation. Today's markets and firms, especially those firms that deal in derivatives, are heavily regulated by private counterparties who for self-protection insist that dealers maintain adequate capital and liquidity."

July 14: Felix Rohatyn, senior partner of Lazard Frères, argues in the *New York Review of Books* for the freedom of the "global private capital markets": "A genuine worldwide market in stocks, bonds, currencies, and other financial instruments has emerged, tied together by modern data-processing and communications technology, and operating 24 hours a day. . . . The cold-blooded selection process by which world capital is invested will determine the economic progress of many nations."

Dec. 7: Greenspan tells the Congressional Joint Economic Committee, that no Federal regulation of derivatives is called for. "I do think we are in a period of evolving both private market and supervisory procedures in this regard. We are dealing with a very rapidly growing market in which there are very complex techniques involved in creating various products to unbundle risk. It is not easy to determine what the optimum amount of disclosure is, because if you're talking about full disclosure in all respects and all regards, then everyone is going to have to disclose very elaborate mathematical models with extraordinary detail involved in it, which would not serve anybody's purpose." (At this time, the Long Term Capital Management hedge fund was in the process of being formed based on mathematical formulae, e.g. "Black-Scholes," see p. 00.)

"waste" disposal unit for GE's Kidder Peabody.

April: Crisis surfaces at the venerable Kidder Peabody investment house; in August, GE dumps it.

Derivatives losers over the spring months, include hedge funds: George Soros, $600 million; Julian Robertson, $875 million; Michael Steinhardt, $1 billion; Askin Securities, $600 million; Vaircana Ltd., $700 million. Others: Bankers Trust, $250 million; Gibson Greetings, $23 million; Cargill, $100 million. Public funds and entities include: City Colleges of Chicago/Cook County, $19.2 million; Eastern Shoshone Tribe of Wyoming, $700,000.

September: Gibson Greeting Cards sues Bankers Trust over derivatives losses.

October: Procter & Gamble sues Bankers Trust over derivatives losses.

November: SEC and CFTC investigate Bankers Trust, which fires its derivatives executives.

December: Orange County, California, one of the nation's richest, files for bankruptcy after losing $1.7 billion in the derivatives market. Runs spread to TexPool, in Texas.

Derivatives losses become a byword across the country, ranging from Minnesota Orchestral Association, $2 million; to Odessa College, Texas, $11 million; to Piper Jaffrey Mutual Funds, $700 million. The states of Florida, Ohio, South Carolina, Colorado, and Maine are also hit.

Mexico's financial system implodes, with an imminent worldwide blowout, which is averted only by a $500 billion rescue package organized by the U.S. and other governments.

SEC/CFTC and Bankers Trust reach agreement, in which the government takes control of the bank, and Bankers Trust pays a $10 million fine.

Dec. 7: The Joint Economic Committee of Congress calls Greenspan to testify and grills him on derivatives. Committee Chairman Kweisi Mfume (D-Md.) remarks: "The action that the Fed took with respect to Banker's Trust is a welcome one, but I personally am not convinced that this Federal action alone constitutes an adequate Federal response for the very significant amount of financial exposure that our country seems to be facing, as a result of derivatives."

Rep. Ron Wyden (D-Ore.) asks: "The Fed, and I believe you personally, have taken the position in the past that no legislation is required to deal with this issue. Again, given the innumerable, large financial players, municipalities, and others that seem to now be caught in the spiral of financial woe as a result of derivatives, is the Fed rethinking its position with respect to whether or not some legislation may be necessary?"

LaRouche told you so

1995

Feb. 1: LaRouche tells the "EIR Talks" radio interviewer: "We are now in the middle of a new phase of disintegration of the global monetary and financial system."

April 18: LaRouche produces an economic memorandum, "Global Financial Crisis: 'To Be, or Not to Be,' " (*EIR*, April 28): "Today, the political and financial system of Japan has been brought to near a point of discontinuity, by the failure of U.S. representatives to acknowledge the severity of the ongoing, global financial collapse of the international monetary and financial system. Although the U.S. government's refusal, thus far, to face the reality of this ongoing systemic breakdown is no worse than virtually every leading government in the world, Japan's relations with the United States are of a very special nature; a lack of adequate response to Japan from Washington could set forth a chain-reaction of collapse of every vital U.S. policy-interest in East Asia, and beyond."

July 14: In an *EIR* Feature on "Why Most Nobel Prize Economists Are Quacks," LaRouche said: "Today, every nation on this planet is under the domination of a single, worldwide, monetary and financial system: the so-called International Monetary Fund system. That system is about to go out of existence. The worst financial collapse of the Twentieth Century could erupt within as soon as weeks, or, in the unlikely case, the disintegration of the system could be postponed until as late as early 1997."

Dec. 2: At conferences in Italy and Germany, LaRouche releases his "Triple Curve" Typical Collapse Function schematic (see p. 00). He describes it as follows: "This figure is a summary of three curves which are characteristic of the process of monetary and financial disintegration of the world economy." (See *EIR*, Jan. 1, 1996.)

1996

April 24: LaRouche addresses a roundtable discussion in Moscow, sponsored by the Institute for Socio-Political Research of the Russian Academy of Sciences, the Free Economic Society of Russia, and the Schiller Institute for Science and Culture of Moscow: "We are in the middle of the worst international monetary and financial crisis of the century. The financial crisis has two dimensions: its severity, and the efforts of many leading institutions in the world to pretend it doesn't exist."

What Greenspan and others said

1995

March 8: Speaking to a House Budget Committee hearing, Greenspan stressed a goal of a balanced Federal budget. "I think that we would find that the general state of the financial markets would be far more solid than I think we have seen in a particularly long period of time. I think the underlying outlook would be significantly improved for long-term economic growth sustained and perhaps hopefully accelerated into the 21st century."

1996

January-February: Ethan D. Kapstein, Director of Studies for the New York Council on Foreign Relations, writes in the Council's journal *Foreign Affairs,* under the headline, "Shockproof: The End of the Financial Crisis": "Many Chicken Littles had predicted during the late 1980s and early 1990s that trading in derivatives—futures, swaps, and options—would trigger the next global financial crisis. But they overlooked the important role that derivatives have played in moderating systemic risk, providing banks with increased opportunities to diversify their portfolios and protect themselves from sudden market shifts. . . . The international financial markets have not suffered because the roots of the disease have largely been eradicated."

March 5: Greenspan speaks to the National Governors Association, praising the "ever-increasing conceptualization of our gross domestic product—a substitution, in effect, of ideas for physical matter in the creation of economic values." These "trends toward conceptualization," he argues, "have focused today's views of economic leadership" away from "output of such products as steel, motor vehicles, and heavy machinery" and toward "down-sized, smaller, less palpable evidence of outputs."

What went on

1995

February: Barings Bank, one of the oldest, most prestigious institutions, connected to Britain's royal family, fails over Asian derivatives. Blame is placed on a "loan assassin," Nick Leeson, of its Singapore office.

May-November: Swiss Bank Corp. acquires S.G. Warburg, as huge waves of mergers occur: Dresdner Bank acquires Kleinwort Benson; First Union-First Fidelity merger announced.

December: Derivatives losers for the year include dozens of counties in Wisconsin, Missouri, Florida, and other states, plus the U.S. Army Welfare Fund, the State of Connecticut pension fund, etc.

1996

January-August: More localities are hit by derivatives losses: Collier County, Florida; Wisconsin state retirement fund; Vista Irrigation District in California; Pennsylvania school districts of Bethel Park, Moon Township, and New Brighton.

June: Pennsylvania State Rep. Harold James (D-Phila.) introduces House Bill 2833, to levy a state tax at the rate of two-tenths of 1% on the transfer or sale of "any bond, stock, security, future, option, swap or derivative." James urges immediate adoption of the bill, both for revenues to back state medical and other urgent services, and to discourage speculation. Similar bills are proposed in Louisiana, Alabama, and New Hampshire.

September: RhumbLine, a Massachusetts-based asset management company, racks up derivatives-based losses from January 1995 through September 1996, including $12 million in losses for the Massachusetts state employees and teachers fund; and $150 million for the AT&T pension fund.

December: Year-end U.S. statistics document trouble—a record 1 million bankruptcy filings; U.S. credit cards show $4 billion in delinquent accounts; U.S. corporate layoffs add up to 477,147 for 1996.

LaRouche told you so	What Greenspan and others said	What went on

LaRouche told you so

1997

Feb. 5: Interviewed by "EIR Talks," LaRouche, for the first time, warns individuals of the danger of staying in the stock market, and of speculation. "The only thing I can say, is that the persons—and there are about 40 million Americans, I think, who are exposed to this, who are betting that they have a pension, and a future invested in mutual funds, onto the stock market, or some plan of that sort—if they stay, they're going to be slaughtered. They'll lose everything. . . .

"Sure, Treasuries don't yield as much, but you've got one advantage with Treasuries: The government has agreed to back them up, and you've got something. Whereas, on these indexes, these futures, these options, when that market goes, you've got less than nothing."

June: LaRouche tells "EIR Talks": "Sometime very soon, between now and the end of the year, possibly in the month of August—more probably, *no later than October,* but certainly, by around the end of the year—this world is going through one or two of the greatest shocks, financial shocks of the century."

1998

Jan. 17: Speaking at a Martin Luther King Day conference, LaRouche says, "If you think things are scary now, come back in about four weeks from now, and then tell me how scary it's become."

March 18: LaRouche tells a Washington, D.C. *EIR* seminar that we need a "New Bretton Woods" effort: "The fact that the present crisis is *global and systemic,* rather than *regional* or *cyclical,* must be acknowledged."

April 2: At a New Bretton Woods meeting in Rome, Italy, LaRouche said, "The system is essentially bankrupt. The international financial system is bankrupt. There is only the prosperity of fools in the system. We have in the world presently, dominated by so-called derivatives, about $140 trillion equivalent of short-term gambling debts. In the recent years, especially since 1982, and most emphatically since 1987, the growth of derivatives has taken over and eaten up the banking system itself."

What Greenspan and others said

1997

Feb. 21: Greenspan tells the Atlanta Federal Reserve meeting in Coral Gables, Florida: "There have been occasions when we have been on the edge of a significant breakout," but thus far, the Federal Reserve's response has "turned out to be adequate to stem the atomic erosion."

March 4: Sen. Phil Gramm (R-Tex.), before the Securities Subcommittee of the Senate Banking Committee, opposes proposed Security and Exchange Commission regulations, issued Jan. 26, to force U.S. corporations to disclose their derivatives exposure, complaining that the regulations "will induce firms to use derivatives less." Gramm insists that the derivatives "industry" must be left to regulate itself; and that derivatives losses by Orange County, Procter & Gamble, and others are "isolated" events.

April 12: Greenspan touts virtues of "private regulation," in a speech to the Association of Private Enterprise Education in Virginia, saying, "private market regulation can be quite effective," while "regulation by government unavoidably involves some elements of perverse incentives."

July: Greenspan writes three letters to the Financial Accounting Standards Board, vehemently opposing its proposal that derivatives contracts be listed on corporate books. In his third letter, released on July 31, he writes: "The FASB proposal may discourage prudent risk management activities and in some cases could present misleading financial information." He says that his letter was endorsed by the heads of 22 "major companies in a number of industries that use derivatives [and] have expressed serious concerns about the FASB's proposed rules changes." These 22 corporate leaders are mostly bank heads.

1998

March: Greenspan opposes Commodities Futures Trading Commission head Brooksley Born's proposal to study U.S. derivatives trade.

Sept. 16: Greenspan assures Rep. Richard Baker (R-La.) that the risk in hedge funds is under control.

Sept. 23: The Fed moves to bail out Long Term Credit Managements's creditors; a $3.6 billion rescue fund is set up.

Oct. 1: Greenspan tells the House Banking Committee, don't study and don't touch derivatives. "The structure of counter-party interrelations is the main means of regulation."

What went on

1997

January-September: The notional principal value of off-balance-sheet derivatives holdings of U.S. commercial banks rises 26.5%, to a record $25.7 trillion, more than 62 times their equity capital.

April: The House Agriculture Subcommittee on Risk Management and Specialty Crops holds hearings on H.R. 467, the Commodity Exchange Act Amendments, which seek to further *deregulate* U.S. derivatives exchanges. The exchanges object that their "competitiveness" will be harmed by regulation. CFTC Chairman Brookesly Born warns that such deregulation would "pose grave dangers to the public interest." She is overridden.

July 2: Thailand floats baht (which drops 20%), after losing $4 billion in currency defense against hedge fund attacks. Soon, crisis rips through all East Asia, then South Korea, Japan, and globally.

September: At IMF/World Bank annual meeting in Hong Kong, Malaysian Prime Minister Dr. Mahathir scores currency speculation, naming George Soros in particular.

October: "Black Monday" hits Oct. 20 on Asian markets; Oct. 23 in New York.

November: Yamaichi Securities, Japan's fourth largest investment house ($31 billion in assets), declares bankruptcy. Union Bank of Switzerland, one of the Swiss "Big Three," has huge derivatives losses.

Dec. 24: Treasury Secretary Robert Rubin commits aid to South Korea, stating that "not a nickel" of public money will go to aid world banks. *EIR* estimates world derivatives contracts are now $125-150 trillion.

1998

January: East Asia crisis intensifies. Indonesian rupiah devalued 84% since August 1997. Major banks reporting billions in derivatives losses because of Asian exposure.

Spring: Commodities markets collapse (oil, wheat, corn, metals, etc.). Oil-producing nations plunged into crisis. Food shortages intensify in Indonesia, Russia.

April 16: Group of 22 meets in Washington, on "new financial architecture."

July 13: IMF and Russia announce a two-year, $22.6 billion rescue package; it fails.

Aug. 17: Russian government imposes capital and currency exchange controls.

Sept. 1: Malaysia announces capital and exchange controls to thwart speculators. Taiwan disallows George Soros; Hong Kong/China move against stock speculators.

Sept. 14: President Clinton calls for G-22 meeting within 30 days. (Later set for Oct. 5.)

Sept. 23: Long Term Capital Management fails, having once had derivatives transactions outstanding totalling $1.5 trillion face value.