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EIR Feature

1998 was the year that globalization finally died

by John Hoefle

If 1997 was, as Lyndon LaRouche described it, the year the financial system announced its doom, then 1998 will go down as the year globalization died. One can even put a precise date on that death: Aug. 17, 1998, the date that the government of Russia did what the bankers considered the unthinkable, declaring a moratorium on some of the nation's debt and devaluing the ruble. This act of national sovereignty sent shockwaves pulsing through the global financial system, sparking sheer panic among bankers who think that the only hope they have of surviving, is a global bankers' dictatorship, in which governments serve merely to enforce the bankers' imperial demands for loot.

The fantasy of the bankers, is that by establishing new supranational institutions to dictate economic policies to nations, they can remain in control, and save themselves and their institutions. But their plan has a fatal flaw, which is that it can't work. Giving the patient more of the poison which is already killing him, is hardly a workable plan.

Faced with the demands to impose deadly austerity upon their populations while throwing away decades of hard-won economic growth, some of the more rational and courageous nations are fighting back. Malaysia's Dr. Mahathir bin Mohamad has publicly asserted the right of his nation to defend itself and run its own affairs, as has China, and the recent discussions between China and Japan over the development of the Eurasian Land-Bridge, suggest that resistance, if not outright defiance, is growing, to the bankers' demand for more blood. Such resistance should be encouraged, and nurtured, because with it lies the future of mankind.

Cracks in the system

Even were all the world's nations to surrender to the demands of the bankers, the bankers and their system is still doomed. What is killing them, is their belief that money, especially their money, is primary, and that all else must be sacrificed

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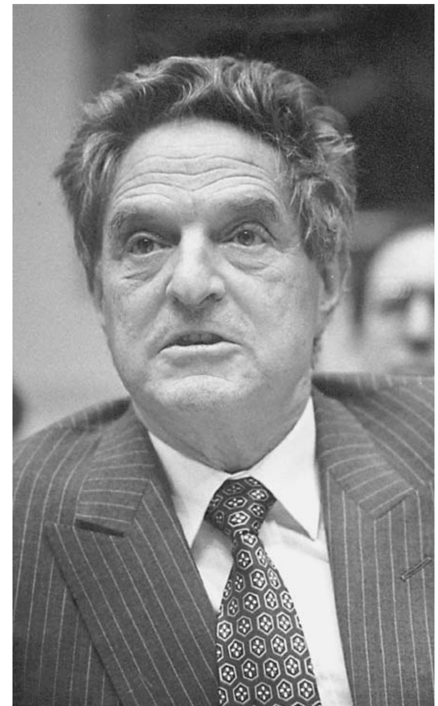


The architects of globalization are desperately trying to prop up their speculative bubble, but their system is doomed. Left to right: IMF Managing Director Michel Camdessus, Federal Reserve Chairman Alan Greenspan, and billionaire speculator George Soros.

to protect monetary assets. For decades, the International Monetary Fund (IMF) was their chief enforcer, demanding that nations shut down infrastructure programs which provided for essential water, power, health, education, transportation, agriculture, and industrial needs. That such projects were lifting those nations out of poverty and into the modern world, and that shutting down the projects would condemn billions of people to poverty and death, did not bother the loan-sharks of the IMF; in fact, it was part of the plan.

Early in the so-called Asian crisis, the claim was made in the West that not only would the United States and Europe not be harmed by the devastation in Asia, but that we would actually benefit, due to capital fleeing Asia into Western markets, and lower prices on goods imported from the region. The U.S. and major European markets did, after a rocky October, rebound sharply in late 1997 and early 1998, to record highs. The Dow Jones Industrial Average, the premier U.S. perception-management index, hit an all-time high of 9,338 points on July 17, 1998 (**Figure 1**), triggering visions of 10,000 points in the minds of many. Instead, the Dow went into a virtual free-fall; by the end of August, the Dow dropped 1,800 points—19%—to 7,539. The other major U.S. stock indices were also down over the same period, the S&P 500 dropping 19%, the Wilshire 5000 dropping 21%, the NASDAQ Composite dropping 25%, and the Russell 2000 dropping 27% (**Figure 2**).

Since the end of August, and particularly in October, the big U.S. indices skyrocketted to record highs, thanks to three interest rate cuts by the Federal Reserve. The Russell 2000 also rose sharply, but only regained about half of its losses. The Russell had begun falling in April, dropping 36% between April and early October, reflecting the decline of the smaller stocks in the market, relative to the giant companies which dominate the other indices.

A similar pattern occurred in Europe, where the major indices, such as the Frankfurt, Germany DAX, are all down significantly from their mid-year record highs (**Figure 3**).

In Asia, the major stock markets also plummeted in the third quarter, rebounding slightly in the past two months, but still 30-50% below where they were in mid-1997. The Japanese Nikkei 225, which fell below 13,000 points in early October, is now hovering just above the 14,000 level (**Figure 4**). By comparison, the Nikkei stood at 39,000 points at the end of 1989.

The sudden downturn of the Western markets in mid-July, marked a turning point in the financial crisis. With the stock markets going down worldwide, there was no longer a safe haven in stocks.

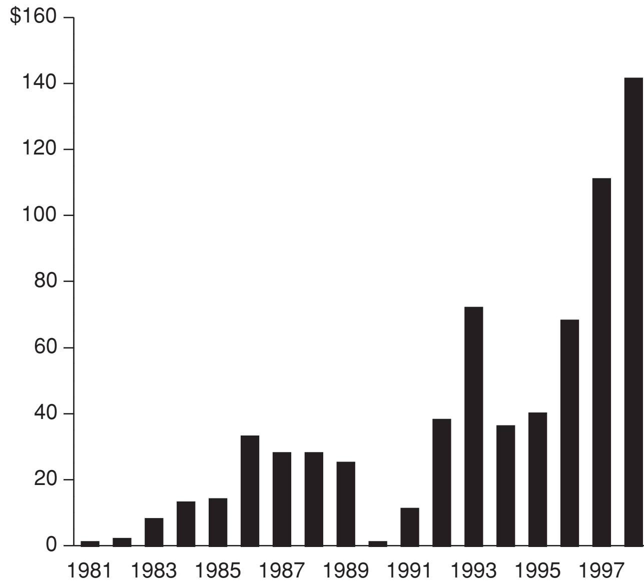
The bond markets were not any safer. The issuance of corporate and government debt through the bond markets had been a booming business during the 1990s. To see the level of insanity which prevailed, one need look no further than the junk-bond market.

In 1986, at the peak of Drexel Burnham Lambert's and Michael Milken's junk-bond machine, $33 billion in junk bonds was issued, raising the total issued since 1980 to about

FIGURE 1

Junk bonds issued, 1981-98

(billions $)



Source: Securities Data Corp.

FIGURE 2

Russell 2000

Source: *EIR.*

FIGURE 3

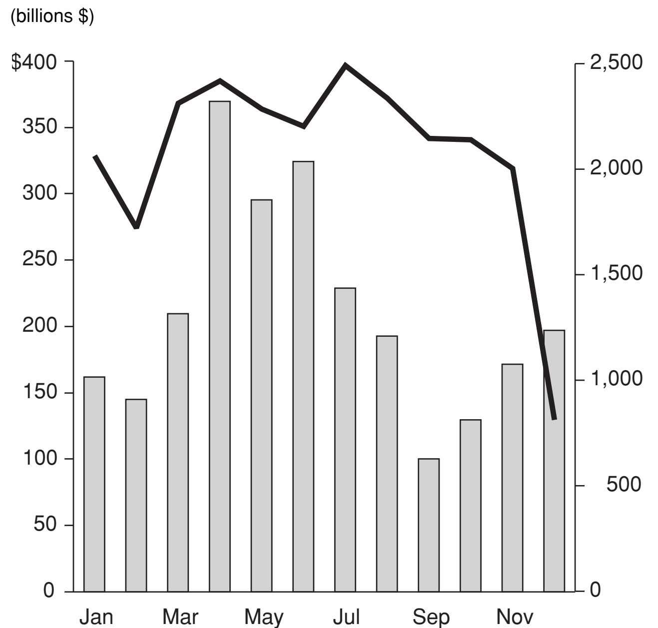
Frankfurt DAX

Source: *EIR.*

FIGURE 4

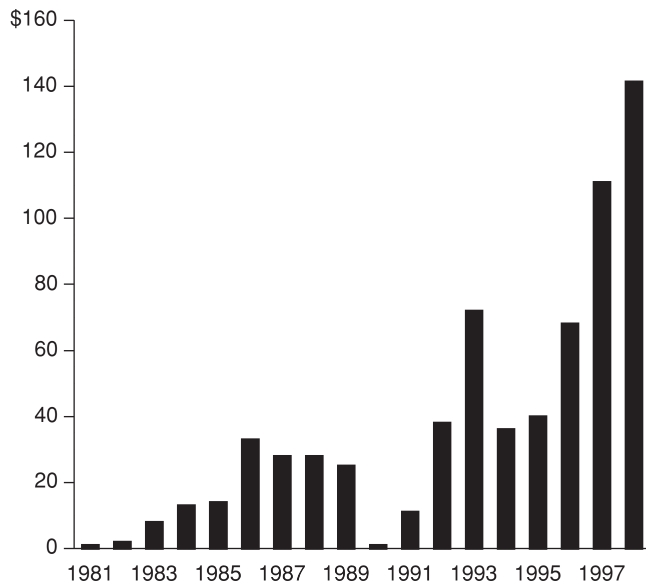
Global mergers & acquisition announcements, 1998

(billions $)



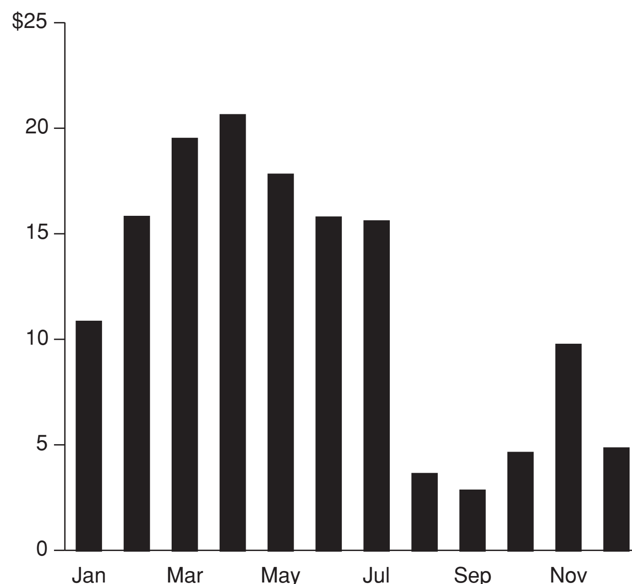
Source: Securities Data Corp.

FIGURE 5
Junk bonds issued, 1981-98
(billions $)



Source: Securities Data Corp.

FIGURE 6
Junk bonds issued, 1998
(billions $)



Source: Securities Data Corp.

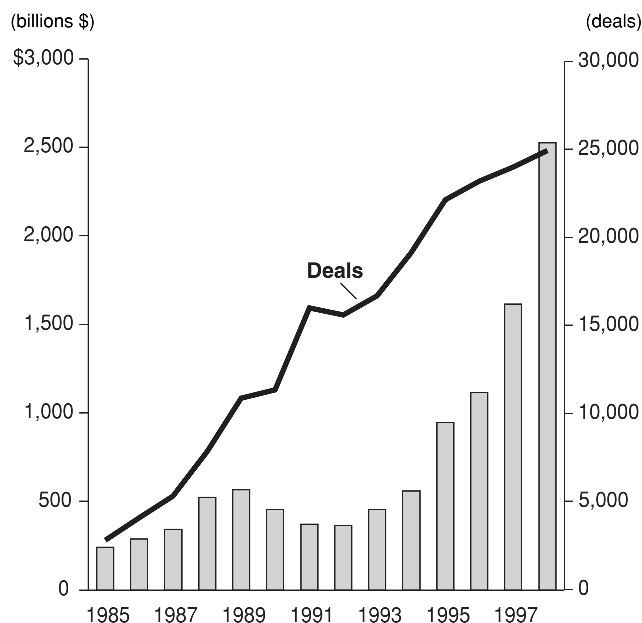
$70 billion. During the next three years, another $80 billion was issued, bringing the decade's total to $150 billion. The demise of Drexel and the indictment of Milken dried up the junk-bond market in 1990, but the market was soon reorganized by the Morgan/Rothschild networks which had created Milken.

In 1997, a record $119 billion in junk bonds was issued, and that figure has been surpassed in 1998, with $141 billion in junk bonds issued through mid-December, according to Securities Data Corp. In just the last two years, nearly twice the volume of junk bonds have been issued, as were issued during the entire Milken era (**Figure 5**).

However, just as with the stock markets, the junk bond market took a dive in the third quarter. The level of junk issues peaked in April, with nearly $21 billion in new junk bonds issued in one month, and by July, $116 billion had been issued. Then the bottom fell out (**Figure 6**). During August, only $3.6 billion in junk was issued, followed by $2.8 billion in September, and $4.6 billion in October.

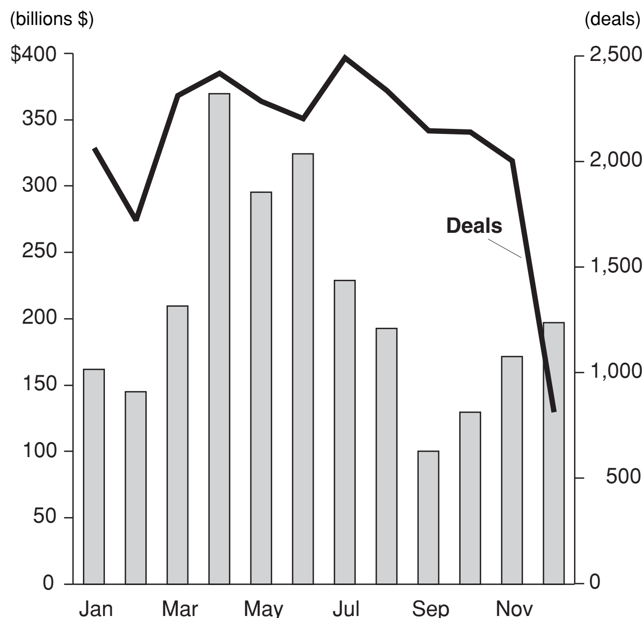
A similar process played out in the mergers and acquisition (M&A) sector, where the size and number of mergers has grown rapidly over the past decade. During 1997, a record $1.6 trillion in mergers was announced worldwide, and that amount was well on its way to doubling in 1998 (**Figure 7**). In April 1998 alone, $370 billion in mergers was announced (compared to $370 billion in all of 1991 and $365 billion in all of 1992), including the Travelers buyout of Citicorp and

FIGURE 7
Global mergers & acquisition announcements, 1985-98
(billions $) (deals)



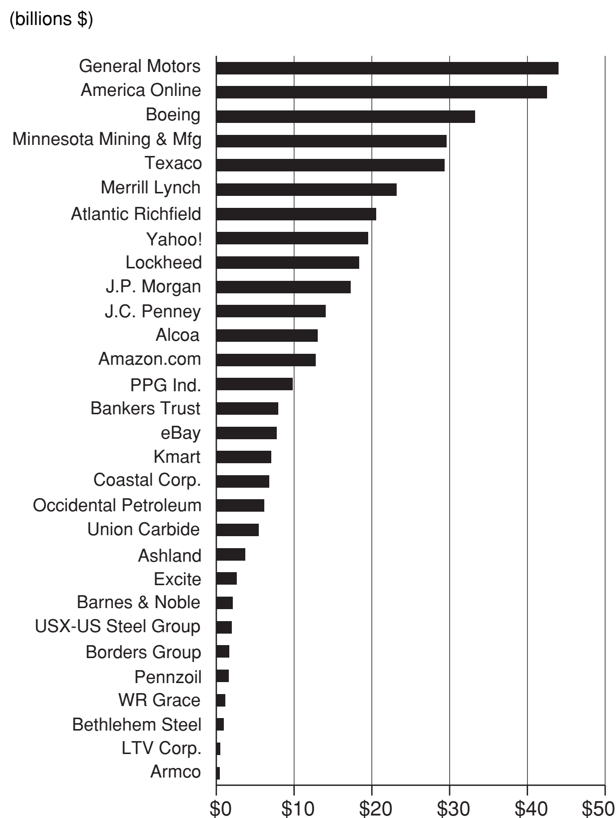
Source: Securities Data Corp.

FIGURE 8
Global mergers & acquisition announcements, 1998



Source: Securities Data Corp.

FIGURE 9
Market capitalization of selected companies (as of Dec. 15, 1998)



Source: *EIR.*

NationsBank's takeover of BankAmerica. But the bottom also dropped out of the M&A market in the third quarter, with activity dropping to $100 billion in September (**Figure 8**). Still, as of mid-December, $2.5 trillion in mergers had been announced for the year.

Panic sets in

The slide which began in some sectors in April, and hit nearly all sectors by mid-July, turned into a full-fledged panic with the Russian action on Aug. 17. Western banks and other investors had bought billions of dollars worth of Russian government-backed GKO bonds. But there were two problems with these bonds: First, the Russian government was broke, and second, they were denominated in rubles. The first was not considered such a problem, as the bankers specialize in extracting money from bankrupt nations. As for the second problem, they covered that by buying derivatives contracts from Russian banks, which would pay off if the ruble fell in value. When Russia froze much of its debt and devalued the ruble, the banks got squeezed from both sides; their ability to collect on their bonds was called into doubt, and even if they were ultimately to be repaid, they would take huge losses due to the decline of the ruble against Western currencies (the ruble, worth about 16¢ in early August, is worth about 5¢ today).

To cover their losses on the ruble, the banks tried to collect on their derivatives contracts, but payments on those contracts were also frozen, even if the counterparties were able to pay off.

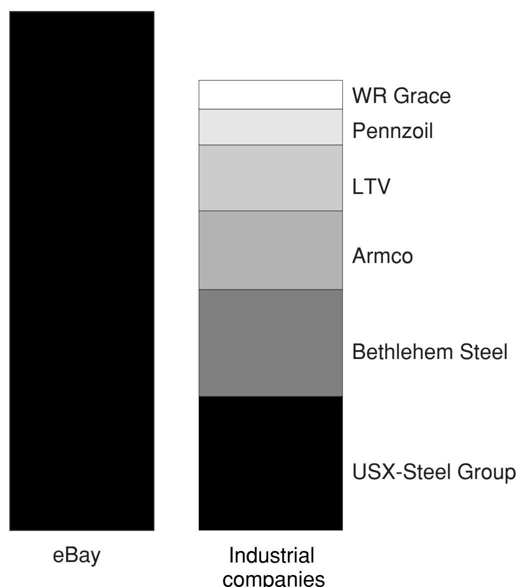
With a hole of large but unquantifiable proportions, and rumors of major disasters circulating through the markets, coming on top of a worldwide decline in the stock and bond markets, the psychology of the financial markets suddenly shifted. Instead of looking to maximize their yields, the players sought instead to protect their capital. Risky investments, which had been eagerly sought because they paid the highest yields, were avoided, with money fleeing into the relative safe havens of U.S. and German government-backed bonds.

The process of reverse leverage, in which investors were forced to liquidate holdings to cover losses and margin calls, which triggered declines in the values of those holdings, which in turn led to more losses and more liquidation, took hold. As this reverse leverage kicked in and the losses mounted, the fear turned into a full-fledged panic. The flight to safety caused the gap between the yields of government-backed securities and other securities—the junk in particular—to grow.

FIGURE 10

Market capitalization: eBay vs. industrial companies (as of Dec. 15, 1998)

(billions $)

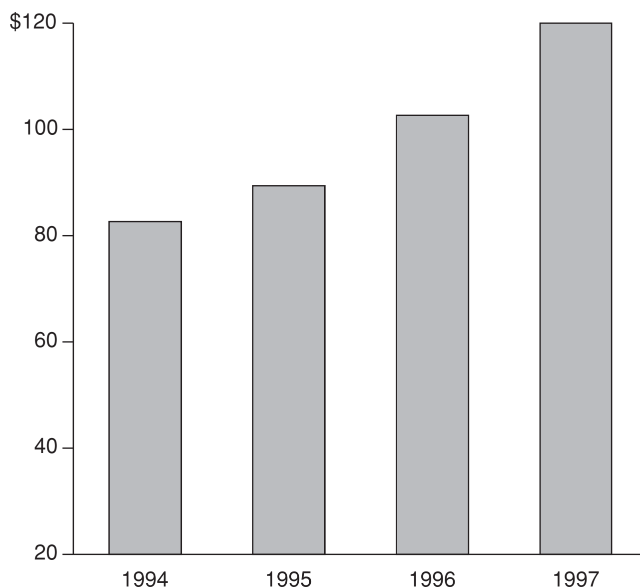


Source: *EIR.*

FIGURE 11

Derivatives at selected world financial institutions

(trillions $)



Source: Bank for International Settlements.

The crisis came to a head on Sept. 23, when the Federal Reserve called an emergency meeting of some of the most powerful commercial and investment banks in the world, to plug the trillion-dollar hole in the world derivatives market, caused by the failure of Long-Term Capital Management (LTCM), a Connecticut-based hedge fund, whose partners included Nobel laureates Robert Merton and Myron Scholes. The Fed and the banks were faced with a difficult choice: Either pump billions of dollars—money they couldn't afford—into LTCM, or let the fund default on its debt, an act which would likely trigger a chain-reaction collapse of the world derivatives markets and, consequently, of the entire global financial system. The banks chose to pay, pumping in $3.6 billion in capital and taking control of the fund.

During the third quarter, trillions of dollars of notional value of financial assets evaporated. Losses, and rumors of losses, sent bank stocks plummeting. According to *American Banker,* the top 100 world financial institutions saw their market capitalization fall $635 billion—22%—during the second and third quarters, with Citigroup falling 34%, Bank One falling 33%, and the new BankAmerica falling 27%.

Virtual reality

To stop this free-fall, the Western central banks launched a series of emergency interest rate cuts. Federal Reserve Chairman Alan Greenspan cut interest rates three times in a matter of weeks, signalling his intent to stand behind the bubble, and practically begging investors to go back into the markets. At the same time, the propagandists—Wall Street analysts, economists, and media pundits—were deployed to talk up the markets.

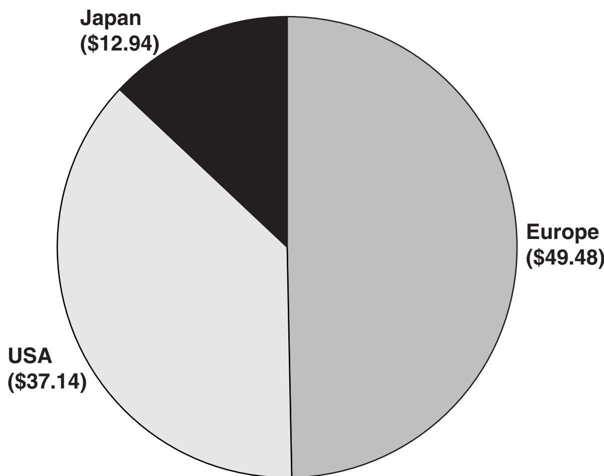
The operation was a success, at least in terms of raising the perception that the worst was over. The near meltdown of the entire system was just an aberration, and we're returning to "normal," thanks to the soundness of our "economic fundamentals," people were told.

Leading the way in this incredible (as in "not credible") recovery, was that great boon to economic productivity, the Internet.

America's obsession with the Internet stems from the belief that the Information Age has replaced the Industrial Age as the engine of economic growth, and that the Internet, by making information available at the click of a mouse, increases our national wealth and productivity.

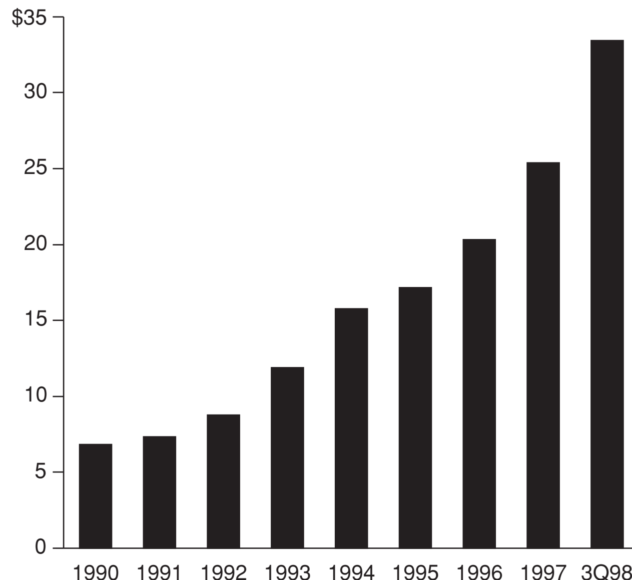
This misconception that information is our future, has caused the on-line and Internet companies to become the darlings of Wall Street. The biggest such company, America Online, had a market capitalization (the price per share multiplied by the number of shares) of $42.5 billion as of Dec. 15, making it only slightly less valuable than General Motors ($44 billion), and well ahead of Boeing, 3M, Texaco, and Merrill Lynch (**Figure 9**). Yahoo!, the Internet search service,

FIGURE 12
U.S. and Europe at 'ground zero' of derivatives crisis (1997 figures)
(notional principal value in trillions $)



Source: Bank for International Settlements.

FIGURE 13
Derivatives at U.S. commercial banks
(trillions $)



Source: Federal Deposit Insurance Corp.

is worth more than Lockheed and J.P. Morgan. Amazon.com, the virtual bookstore, has a market cap of $12.8 billion, more than three times the combined market cap of its two principal competitors, the bookstore chains Barnes & Noble and Borders, despite the fact that it has lost $74 million in the last six quarters.

Even more insane, is the valuation of eBay, an online flea market. eBay, which went public a couple of months ago, already has a market capitalization of $7.8 billion (and rising), making it nearly as big as Bankers Trust, and bigger than Kmart, Coastal Corp., Occidental Petroleum, and Union Carbide. In fact, eBay has a market capitalization greater than the combined market caps of USX-Steel Group, Bethlehem Steel, Armco, LTV, Pennzoil, and W.R. Grace *combined* (**Figure 10**).

The 'casino mondiale'

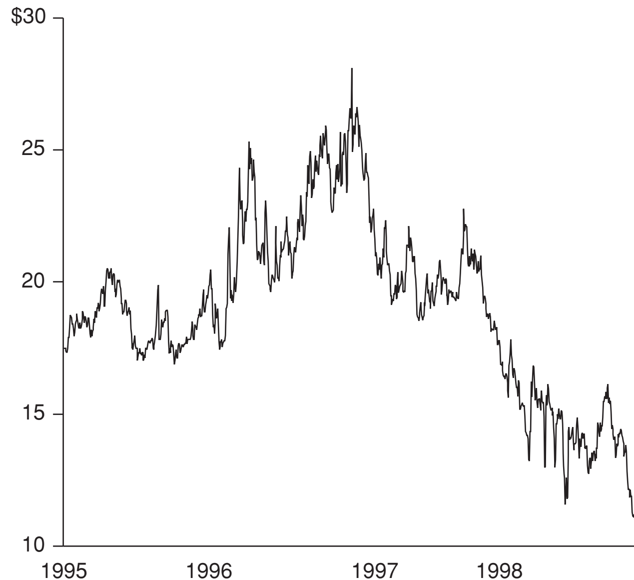
Beyond the insanity measured in billions, comes the insanity measured in trillions, the global derivatives market. The Bank for International Settlements (BIS), in its latest annual survey of the world derivatives market, put the notional value of the derivatives holdings of 78 major financial institutions at $103.5 trillion at the end of 1997, up $21 trillion—25%—from the $82.6 trillion reported at the end of 1996 (**Figure 11**). Note that this study is limited to the derivatives held by most, but not all, of the major banks and securities firms in ten Western nations and Japan; it covers neither all of the derivatives contracts in the 11 countries, nor any derivatives contracts between institutions in nations not included in the survey. As such, the BIS figure is an understatement of the total global derivatives market, which *EIR* estimates is in the range of $150 trillion.

Much has been made in recent months of the financial crisis in Japan. The financial devastation which has hit Asia since mid-1997, has hurt Japan and its regional trading partners, causing losses for Japanese corporations and banks. The size of the bad debts held by Japanese banks ranges from the official figure of $660 billion, to as high as $2 trillion according to some estimates, with the financial situation continuing to deteriorate.

According to the BIS, seven Japanese banks and two securities firms had $12.9 trillion in derivatives as of March 31, 1998, led by the Bank of Tokyo-Mitsubishi with $2.8 trillion and Fuji Bank with $2.0 trillion, with four other institutions holding between $1.0 and $1.8 trillion in derivatives. Were a major Japanese derivatives bank to fail, the entire system could blow. However, when it comes to the danger of a derivatives explosion, it is the United States, which has a derivatives exposure greater than any other nation in the world, and Europe, whose combined total exceeds that of the United States, which sit at ground zero (**Figure 12**).

U.S. commercial banks alone had $33.45 trillion in derivatives as of Sept. 30, according to the Federal Deposit Insurance Corp.'s latest Quarterly Banking Profile (**Figure 13**). The "banks' off-balance-sheet derivatives contracts rose by $4.6 trillion during the [third] quarter, more than twice the

FIGURE 14
The price of crude oil
($ per barrel)



Source: *EIR.*

FIGURE 15
The price of wheat
($ per bushel)

Source: *EIR.*

previous largest quarterly increase, partly because of turmoil in overseas financial markets," the FDIC stated. The FDIC also reported that profits at U.S. banks fell slightly in the third quarter, ending six consecutive quarters of record earnings. The agency attributed the decline to "weaknesses in overseas operations and the trading activities of a few of the largest banks."

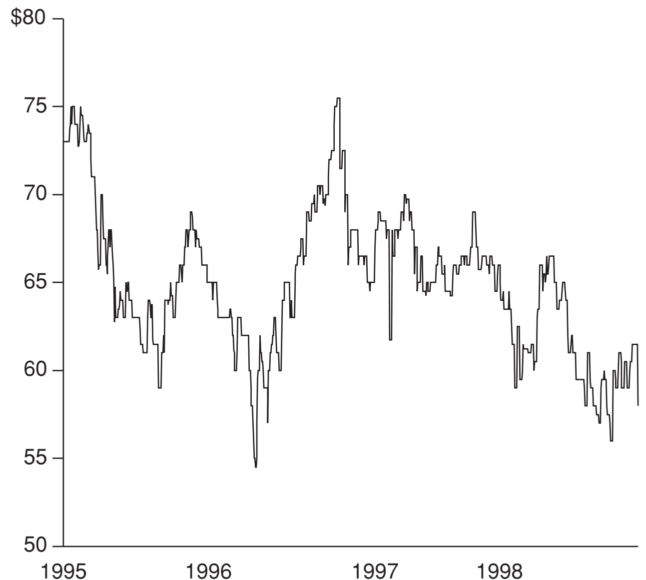
Economic decline

While the derivatives and related financial claims grow at record rates, the physical economy is collapsing at a record rate. One marker for this is the drop in the price of crude oil, reflecting a decline in oil purchases internationally (see **Figure 14** and article, p. 4). Sharp drops have also occurred in the price of wheat (**Figure 15**) and steers (**Figure 16**) in the United States. The price of gold has also dropped sharply in recent years.

Two factors are responsible for the drops in prices: a decrease in demand, and increasing cartelization. Oil, wheat, meat-packing, and gold are all dominated by cartels, which lower prices as a way of driving their non-cartel competitors out of business, and the current drive is a continuation of the moves by the financial oligarchy to control food, raw materials, precious metals, strategic minerals, and essential infrastructure in the post-crash world.

The decrease in demand is both ominous and deceptive, reflecting decreased physical economic activity due to the

FIGURE 16
The price of steers
($ per 100 lbs)



Source: *EIR.*

financial crisis. That means lower standards of living, poverty, starvation, and death for a growing portion of the world's population.

The only way out of this crisis, is to build our way out. If we are to survive 1999, we must put this virtual financial system through bankruptcy, and launch a crash program to build the Eurasian Land-Bridge and other great projects.

Greenspan sets off hyperinflationary time bomb

by Richard Freeman

During the last three months, U.S. Federal Reserve Board Chairman Alan Greenspan has been injecting giant volumes of liquidity into the banking and financial system. Greenspan has taken two parallel actions: First, he has "minted" new physical dollar bills; second, he has pumped in liquidity-reserves through the Federal Reserve's federal funds window. Greenspan's immediate objective is to rescue several large commercial and investment banks and hedge funds. He is also attempting to liquefy the derivatives, junk bond, collateralized securities, and several other markets. The banking system has heavily lent to or taken derivatives positions in these markets, and saving them, many of which are filled with speculative paper, has become Greenspan's top priority, as the way to "save" the banking system as a whole.

Greenspan believes that by propping up the bankrupt banking system, he can preserve a world economic order based on "post-industrial" utopianism, "free trade," and "globalization." Because of his fixation on this goal, Greenspan is blinded to the reality that, in its essentials, his pump-priming is following in the footsteps of the 1921-23 Weimar Germany hyperinflation. Economist Lyndon LaRouche has forecast that it is this hyperinflationary policy which, during the first months of 1999, will accelerate a blow-out of the financial system.

Two events spooked Greenspan and Europe's central bankers, and hastened his course of reckless action. On Aug. 17, the Russian government suspended payment on its Treasury debt, and there was a parallel payment suspension on categories of Russian corporate and bank debt. Negotiations on stretching out and writing down substantial parts of the debt are ongoing, but already Western banks have taken heavy losses, and the Russian payments suspension defined a new geometry for the world financial system. Second, in September, the Long-Term Capital Management hedge fund blew out. LTCM typifies the levels of speculation in the economy: By mid- to late-September, LTCM had a capital base of $600 million, against which it had a derivatives position of $1.25 trillion, a 2,083 to 1 leverage. From August through early October, while LTCM rocked the financial world, many other hedge funds took heavy losses or went out of business; the Dow Jones stock average in the United States and the stock indices in several leading Western countries fell by 20-30%; and, the Brazil crisis became more intense as flight capital reduced the country's foreign currency reserves by almost half.

The world financial disintegration was now roiling in a new phase of hyper-instability. On Sept. 29, just six days after the Federal Reserve had arranged an emergency private-sector bailout package for LTCM, Greenspan cut the federal funds rate by one-quarter of a percentage point, to 5.25%. On Oct. 15 and again on Nov. 17, Greenspan further cut the federal funds rate, each time by one-quarter of a percentage point (the operational points of this will be explained below).

Cranking up the printing press

Greenspan began running the printing presses full tilt in late August, shortly after the Russian payment suspension. Between the week ending Aug. 29 and the week ending Nov. 30 (the latest reporting week), Greenspan and the Fed printed up $13.8 billion worth of new dollar bills. The physical dollar bills are called the "currency in circulation." During this 13-week period, the U.S. currency in circulation has grown at an explosive compounded annualized rate of 11.4%. During the same period, U.S. M1 money supply, of which currency in circulation is one part, has grown at a 12.4% annualized rate; M2 money supply has grown at a 10.8% annualized rate; and M3 money supply, the broadest measure, has grown at a 13.5% annualized rate.

For the first nine months of 1998, the flawed measure of U.S. Gross Domestic Product, *unadjusted for inflation,* has grown only at a 4.52% annualized rate; consider, then, that the new currency in circulation—the printing of dollars—is growing more than twice as fast as the rate of GDP. Some 60% of the increase in currency in circulation is not used to circulate Gross Domestic Product; it's being used to save Greenspan's banker and hedge fund operator allies internationally.

Table 1 shows the Aug. 31 and Nov. 30 outstanding levels for currency in circulation and for the different primary measures of money supply; it also shows the growth rate for the 13 weeks ending Nov. 30, put on a compounded annualized basis.

The growth of currency in circulation—physical, dollar bills—is significant, because it occurs through what are called "Treasury pass-throughs," that is, the Federal Reserve purchases U.S. Treasury debt, by monetizing the debt, i.e., printing new bills. There have been several "Treasury pass-throughs" in the last few weeks.

(M1 money supply consists primarily of currency in circulation plus the funds in checking accounts. M2 consists of M1, plus savings accounts, money market funds, and small-