

there exist about 8,000 hedge funds worldwide, managing about \$1 trillion in capital, compared to 4,500 hedge funds and \$600 billion in capital just two years ago. When LTCM was going under in 1998, for every dollar of its capital, it had borrowed \$30 from banks at was running at least \$400 in derivatives bets.

Allegedly, the average leverage of hedge funds today is much lower than in the case of LTCM. At least one in ten existing hedge funds, in most cases the smaller ones, are quietly being closed down every year, while at the same time many more are being set up new.

A public debate on the regulation of hedge funds has already erupted both in Britain and Germany. On top of the fears for a systemic breakdown, there is the imminent concern that private equity funds and hedge funds are, right now, taking over or manipulating the stock prices of thousands of corporations in both countries. John Sunderland, the President of the Confederation of British Industry (CBI) came out with an attack on such funds, sounding similar to German Social Democratic Party chairman Franz Müntefering's famous earlier "swarm of locusts" statements. CBI Director General Digby Jones raised the alarm bells concerning certain derivatives—"contracts for differences" (CFD)—by which hedge funds are able to secretly build up stakes in corporations.

In Germany, the chief executive officer of Commerzbank, Klaus-Peter Müller, who also heads the German banking association, raised the question: Why are we regulating small banks, while hedge funds, moving much larger capital, are not being regulated at all? Bundesbank board member Edgar Meister described hedge funds as the "white spots on the map of supervisors," which are growing at alarming speed. Even Rolf E. Breuer, who just resigned as supervisory board chairman of the Frankfurt stock exchange (Deutsche Börse) after losing a power fight with the British hedge fund TCI, has now astonished the banking scene with a surprising conversion. The same person who, as head of Deutsche Bank, had praised derivatives trading as the shortest way to paradise on Earth, and become known in some circles as Germany's "Mr. Derivatives," is suddenly denouncing the short-term speculative investments of hedge funds, that are colliding with the need for long-term productive investments and therefore could "devastate the German economy."

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EIR Testimony Scored Scorched-Earth Looters

by John Hoefle

This article originally appeared in EIR on Sept. 17, 1993, reporting on testimony to the House Banking Committee.

A warning of the impending collapse of the international derivatives market, triggering the biggest financial blowout in centuries, was delivered by this writer to the House Banking Committee on Sept. 8, 1993, in testimony on the impact of the North American Free Trade Agreement (NAFTA) upon the U.S. banking system.

My appearance before the banking committee was requested by committee chairman Henry B. Gonzalez (D-Tex.), one of the few men in Washington with the courage to take on the international bankers and their scorched-earth looting policies.

"NAFTA is fundamentally a financial agreement, and to understand it, one must understand the systemic crisis facing the banking system today," I testified.

"Since 1978, the financial community has repeatedly insisted upon the deregulation of banks and other financial institutions, while demanding austerity and cutbacks everywhere else. Every time we have done this, it has led to disaster, as the destruction of the airlines and the S&Ls, and of the U.S. work force attest.

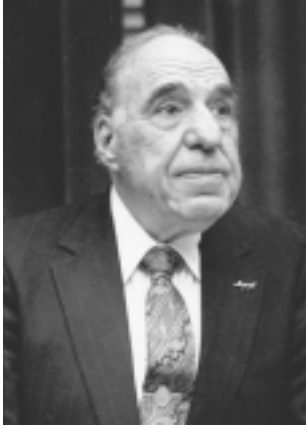
"In response to these disasters, the bankers demand further deregulation and deeper cuts.

"Now, with NAFTA, the bankers are demanding that the United States deregulate its international political and financial relations the same way we've deregulated internally. The purpose of NAFTA is to open up Mexico and eventually all of Latin America for unbridled speculation and looting, of the sort that has already devastated the American economy and bankrupted our banking system.

"When are we ever going to learn that the answer lies not in more deregulation, but rather in the abandonment of the policy of deregulation, and the return to rational rules and regulation?"

Deregulation Killed Citicorp

"Take Citicorp, for example. Here's a bank that jumped with both feet into every harebrained, quick-buck scheme they could find. Citicorp made a killing in the 1980s, growing almost as much in 10 years as it had in the previous 168. This



The late Rep. Henry Gonzalez (left), as chairman of the House Banking, Finance, and Urban Affairs Committee, invited EIR economist John Hoefle (right) to testify on the derivatives danger in September 1993. "I've been reading Mr. Hoefle's articles for two and one-half years," Gonzalez said. "He gets information I have been unable to get."

growth came, not from real economic activity, but from the growth of a huge speculative bubble, in real estate, junk bonds, derivatives, and other paper transactions which looked good until the bills came due.

"Citicorp's great deals of the 1980s have become the spectacular financial disasters of the 1990s. The list, which includes blowouts such as Olympia & York and Citicorp's humiliation in London after the Big Bang [the Oct. 27, 1986 deregulation of the British stock market], keeps on growing as the real economy dies. Citicorp has demonstrated an astonishing knack for losing money. It's the ambulance-chaser of banks: Every time you find a disaster, Citicorp is there.

"Citicorp made a killing all right—it killed itself.

"If Citicorp were headquartered in San Antonio, Mr. Chairman, it would have already been closed and its officers publicly humiliated and thrown in jail. But Citicorp is not headquartered in San Antonio. It's in New York, where a far different set of rules apply.

"So instead, the government—or rather, the Federal Reserve, which acts like it's the government, but is really owned by the banks—launched the biggest bailout in U.S. history.

"Three years ago, the Federal Reserve Bank of New York took the bankrupt Citicorp over, putting it into de facto receivership. Naturally, this was a secret action, since were the banks' depositors to know just how damaged their bank was, they would have run for the hills.

"Citicorp lied about its financial condition, and published phony financial reports. When Rep. John Dingell [D-Mich.] revealed that Citicorp was technically insolvent, Citicorp angrily denied it. And so did the banking regulators, who are supposed to serve the public, but who clearly serve the banks instead.

"When the Texas S&Ls hid their losses, and the Federal

Home Loan Bank Board [FHLBB] looked the other way, the Justice Department created a task force to investigate, and poor [former FHLBB head] Danny Wall's career was ruined. But now, with Citicorp and the other big banks doing the lying, the attack dogs of the Justice Department and the press are silent. Executives of the Texas S&Ls were denounced as the symbols of greed and excess, but nobody says a word about Citicorp and John Reed.

Derivatives Bubble Ready To Pop

"We are on the verge of the biggest financial blowout in centuries, bigger than the Great Depression, bigger than the South Sea bubble, bigger than the Tulip bubble. The derivatives bubble, in which Citicorp, Morgan, and the other big New York banks are unsalvageably overexposed, is about to pop. The currency warfare operations of the Fed, George Soros, and Citicorp have generated billions of dollars in profits, but have destroyed the financial system in the process. The fleas have killed the dog, and thus they have killed themselves.

"What is required, as *EIR* founder Lyndon LaRouche has repeatedly stated, is a restructuring of the U.S. banking system, including the nationalization of the Federal Reserve, taking it out of the hands of the bankers and putting it back into the hands of the Congress as mandated by the Constitution. It is the welfare of the people which is paramount, not the maintenance of the speculative financial system. It's high time we put the speculators out of business, instead of surrendering to them even further by passing NAFTA.

"That's the issue. We'd better deal with it, and fast, while we still have a chance."

At the conclusion of this testimony, the silence was deafening: One could have heard a pin drop. Clearly, few of the committee members, staff personnel, or journalists present were accustomed to such forthright language, especially in contrast to the snake oil delivered earlier in the hearing by Citibank's Jack Guenther, vice president and senior international affairs officer. Guenther, in true banker doublespeak, insisted that NAFTA would create jobs in both the United States and Mexico.

The authority of my testimony was then underscored by Gonzalez, who put his respect for *EIR*'s analyses on the record. "I've been reading Mr. Hoefle's articles for two and one-half years," Gonzalez said. "He gets information I have been unable to get. For example, statistics of the off-balance-sheet liabilities of U.S. banks: We've been looking for those statistics and couldn't get them."

Speculators Running NAFTA Negotiations

The Banking Committee chairman then levelled his own broadside against the derivatives speculators.

"How can we sit here comfortably when bank profits, about half of them, come from the gambling known as the derivatives market?" Gonzalez asked. "Derivatives are not

so complicated. It's just a mega-Las Vegas. There are great dangers here. If NAFTA is passed, we'll be promoting the second-largest mega-Las Vegas."

Earlier in the hearing, Gonzalez announced his intention to hold further hearings on NAFTA, to question the negotiators about who was involved, and how.

"I have found it very difficult since President Bush announced the agreement last December, to find out exactly what are the procedures, and who participated in what were really secret negotiations," Gonzalez said.

The difficulty of getting straight answers was exemplified by the elusive Guenther.

"Mr. Guenther, were you or any other Citibank personnel involved directly or indirectly in negotiations; that is, in these processes involving the financial services chapter of NAFTA?" Gonzalez asked. "Did you advise negotiators or did anyone from your bank? Did you review drafts of the agreement? And if so, would you be able to share with us the substance of your comments and advice, and to whom they were given? See . . . we in the Congress don't have the names of the individuals participating in these negotiations. We don't even know who is in there, and I think that that's a very important factor, and that's the only reason why we're going to have the second hearing."

"I don't think I could give you the answer that should really be the definitive answer on that," Guenther weaseled; he then admitted, "All through the past year or so, I've been attending weekly meetings" on the subject. "Mr. McDonough from the Fed would be there. . . . Our Washington office here has been working on this throughout . . . and I'm sure the answer is, yes, we participated in some indirect way. But I think I should undertake to get you a more precise description than that."

The financial community is also worried about a blowout of the derivatives market, which was made evident in an opinion column in the *Wall Street Journal* by Wendy Lee Gramm, entitled "In Defense of Derivatives," which appeared the same day as the Banking Committee's hearing. From 1988-93, Wendy Lee Gramm was chairman of the Commodity Futures Trading Commission, and promoted the burgeoning market in derivatives by exempting them from regulatory procedures. Her husband is Texas Republican, Sen. Phil Gramm, whose free market nostrums for the economy give cover to the "mega-Las Vegas" that Gonzalez referred to.

Wendy Lee Gramm's article complained that derivatives have been unfairly "characterized as purely speculative instruments" that "pose grave risks with potentially dire consequences for the whole financial system." But her article reads more like a plea not to blame *her* for the coming catastrophe. "Most important," she concluded, "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."

The Time Has Come for A New Bretton Woods

The dramatic collapse of the mainstays of U.S. productive capability, General Motors and Ford, and the looming monster crash of the financial markets leave no doubt that the time is now for a New Bretton Woods architecture. One nation's lawmakers have collectively voted up a resolution calling for an international meeting of heads of state "to create a new and more just global monetary and financial system." Italy's resolution, crafted in collaboration with the LaRouche political movement in Italy, emphasizes the problem of the huge speculative and predatory bubble economy crushing millions of people, while the real productive economy lies in ruins.

Now the call for a New Bretton Woods, re-issued by Schiller Institute president Helga Zepp-LaRouche in April, has already gathered top-level signatories from around the world, including many parliamentarians and government officials (see below).

The fight for a New Bretton Woods was launched eight years ago, on Jan. 4, 1997, when economist-statesman Lyndon LaRouche addressed a political forum in Washington, D.C., and laid out a policy orientation for the second Clinton Administration. LaRouche made two proposals: first that the U.S. President convene an international conference to establish a New Bretton Woods system, to put the world economy through bankruptcy proceedings and to reorganize it for productive development; and second, that the United States join in global projects of benefit to all mankind, with a special focus on the Eurasian Land-Bridge project.

Within a month, Italian Sen. Publio Fiori, a leader of the opposition National Alliance party and former Transport Minister, took up the fight, and introduced a parliamentary question to the government, asking whether, in view of the ongoing disintegration of the international monetary and financial system, Italy should take emergency measures, such as a New Bretton Woods conference, and a tax on derivatives speculation.

In February 1997, Helga Zepp-LaRouche, along with Ukrainian economist Natalia Vitrenko, a member of the Ukrainian Parliament, initiated an "Urgent Appeal to President Clinton to Convoke a New Bretton Woods Conference," which was circulated around the world and endorsed by public figures. Both LaRouches addressed meetings in Rome on the New Bretton Woods in April 1997, attended by members of Parliament, economists, journalists, and diplomats. A year later, in April 1998, the issue had become so prominent, that