Meltdown of World Financial System Is Fully Under Way

by Helga Zepp-LaRouche

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What is playing out these days on the international financial markets, is unprecedented. Even if ordinary citizens don't yet understand it, the bankers and financiers are finding themselves in a state of shock. The collapse, which began in July with the U.S. mortgage crisis, and in August led into an international credit crunch, is proceeding inexorably and encompassing all sections of the world financial and economic system. The global financial system has "frozen up," and even though the financial institutions have not admitted it, in reality all the beautiful "creative financial instruments" which Alan Greenspan established, and which provided the foundation for "the greatest casino-economy of all times," have evaporated.

We find ourselves in an advanced phase of the greatest collapse in the history of financial markets. There is still the possibility of escaping the most horrific consequences of this systemic crisis—provided that governments are ready immediately to replace the totally bankrupt system of globalization with a new financial architecture: a New Bretton Woods system in the tradition of Franklin D. Roosevelt.

Look back a short time ago: On July 25, the American economic scientist Lyndon LaRouche declared at a webcast in Washington: "The global financial system has already collapsed—what we are now witnessing are only the effects, which are now coming gradually to light." And, in contradiction to the various ignoramuses and specialists in denial, who speak of "small rearrangements and adjustments" of a few small hedge funds, the developments of the past four and a half months have fully vindicated LaRouche.

The dollar has gone into a nosedive, which has been broken, at best for a few days, by interest rate cuts, only to then collapse further. The infusion of more than $750 billion in liquidity by the central banks, and the interest rate cuts, primarily by the Fed, which the other central banks were then compelled to follow, have led to a dangerous hyperinflationary process, which has included, first and foremost, agricultural products, energy, and raw materials prices.

After the longest possible deception maneuvers about their own losses, the banks, bit by bit, have admitted what they could no longer cover up. Only very hesitantly, the big investment banks began to write off billions in debt. Citigroup, for example, wrote off at first $6.5 billion, and then yet another $11 billion. Citigroup alone had $34 *trillion* in outstanding derivatives contracts, which could detonate the worldwide derivatives markets of an estimated $750 trillion, and with it, the whole world financial system. . . .

A Mountain of 'Junk'

The investment bankers are sitting on a gigantic mountain of so-called toxic waste, unsalable "creative" financial paper; no one trusts anyone else, because he doesn't know whether a newly issued loan can be paid back, and because he doesn't know what losses are still pending. The banks are hoarding liquidity, as if it were their grandmothers' prize preserves.

"What we are currently observing, is no less than a collapse of the modern banking system, a complex of leveraged lending, which is so difficult to understand that the head of the Federal Reserve himself, Ben Bernanke, back in August, needed a private course, face to face, from the hedge funds managers," said Bill Gross, the asset manager of the capital asset firm Pimco.

The mistrust is understandable, because the list of dead bodies that have been hidden in the cellar, is getting longer and longer. An array of investment banks is currently being investigated by the American Securities and Exchange Commission and New York Attorney General Andrew Cuomo, as to whether they sold risky mortgage-backed securities to investors worldwide in bad faith—knowing that they were as good as worthless.

Currently under investigation are Goldman Sachs, Deutsche Bank, Merrill Lynch, Bear Stearns, Morgan Stanley, and also the huge quasi-governmental mortgage insurers Fannie Mae and Freddie Mac. Deutsche Bank alone, which was warned of the junk status of the subprime mortgages in January 2006 by their chief appraiser, Greg Lippmann, had bought, during that year, paper nominally worth $28.6 billion, and then another $12 billion during the first nine months of 2007.

Not only have the mortgage-based securities been exposed as junk, but also the large mass of so-called Structured Investment Vehicles (SIV), from superpowerful investors, is finding itself devalued in the shortest period of time to the level of junk. Several have already found themselves in liquidation. Affected also are communities or schools, such as the Florida Local Government Investment Pool, in which its reserves, of which now very little remains, have been invested. And there is now no money to pay teachers, or to apply to social programs for the families who are becoming homeless, when their houses are foreclosed on.

Guilty: Alan Greenspan

If there is a person who bears more guilt for this mega-disaster than any one else, it is Alan Greenspan, the former head of the Fed. We have him to thank for the fact that we have all these wonderful "financial innovations," which his successor, Bernanke doesn't understand. When Greenspan took office in 1987, he responded to the then ongoing crash, which was comparable to the Black Friday of 1929, by establishing, bit by bit, all these "creative financial instruments," whose very complexity underlies the problem. To this category belong derivatives, credit-derivatives, the CDOs, the SIVs, the MBSs, and the ABCPs, but also the hedge funds, the investment companies, the special-purpose entities, the conduits, investment vehicles, etc. Thus was the lie spread, that all these instruments "spread the risk on many shoulders," and therefore minimize it—a milk-maid's accounting. . . .

Naturally, as long as the huge bubble of convoluted financial instruments was growing, as long as everyone in the casino-economy was participating in making super-profits, the profiteers could keep up the illusion that they had discovered the "perpetual motion machine." That 80% of the world's population was becoming ever poorer, yes—that was an inconvenient small side-effect, that could be ignored.

The only problem is that the bubble has to keep growing. At the moment there's a break in the market, as in this case of the American subprime mortgage market, the bubble comes to a point of collapse, in which the leverage reverses, which actually threatens what bankers call a "cluster-risk." When in March of 2000, the bubble of the IT market, the so-called "dot-com bubble," collapsed, and about $16 trillion in capital disappeared, Greenspan lowered the interest rates in order to save many of his banker-friends. Thus, he not only created a yet bigger bubble, but, with the subprime market, created such a high-risk business, that its ephemeral nature must be obvious to any thinking human being.

Now, a long while later, it has dawned on several economists, that a total systemic collapse has begun, and that the blue-chip mortgage market, the real estate market, have been affected by the MBS and CDO market, so that massive collapses in consumption and production are imminent, and that it could come to a *run* on the banks and other financial institutions. . . .

In the face of growing panic among the Wall Street bankers, the White House has recently leaked that the Administration will not fail to provide liquidity in an emergency. The problem is only: This is exactly what the Reichsbank did in 1923, and in November 1923 it ended, because the price rises had reached the absurd. On Nov. 15, 1923, 1 kilogram of rye bread cost 5.145 billion Reichsmarks. As a result of the hyperinflation, first everyone was a millionaire, and then people's savings disappeared. Today the problem is not limited to one country, as then, but spreads through the entire world. . . .

We Need LaRouche's New Bretton Woods!

The casino economy has already created an enormous redistribution of wealth from the poor to the rich. Some have become billionaires and multi-millionaires, and the politicians, who have made this possible through corresponding changes in the laws, have also not fared badly. The overwhelming majority, however, must suffer heavy losses in their living standard.

The reality is that only the reorganization of the global financial system proposed by Lyndon LaRouche can solve the problem. The unpayable debts must be cancelled, the "creative financial instruments," in any case; but the real economy, the general welfare, and the banks must be saved. The only good thing is that LaRouche's ideas are finding an ever broader circulation, as shown in the publication in the official Chinese press about LaRouche's proposal that the United States, China, Russia, and India must cooperate for a new organization of the world financial system (See *EIR*, Dec. 7, 2007). And many other notable politicians and statesmen are also speaking out now for a New Bretton Woods System or a New Deal for the world economy—among them Russian President Putin, Argentine President Kirchner, former Italian Economics Minister Tremonti, and former French Prime Minister Rocard, to name a few. And if Germany is to be saved, then in the coming period, some there will have to find the courage to propose a New Bretton Woods.