

The Game Is Up: The Fed Is Bankrupt

by Dennis Small

March 5—In late February, the cat was let out of the bag: The Federal Reserve System of the United States is bankrupt. When the Fed's epitaph is written, it may well cite the cause of death as "the undue diversion of funds into speculative operations." The same applies to the thoroughly bankrupt U.S. banking system, guided by the Fed, and to the British Empire's entire trans-Atlantic financial system as well. As we will show below, the policy of endless hyperinflationary bailouts has finally come to the end of the line.

The public announcement of defunction came on Feb. 26. On that date, Bloomberg News reported that the New York-based risk analysis company MSCI had just completed a stress test on the U.S. Federal Reserve System, which found that, under the "adverse" scenario of a Fed "exit" from quantitative easing (QE)—i.e., selling off the \$3 trillion in assets that the Fed has accumulated as part of QE—the mark-to-market loss on the Fed's asset book would be some \$547 billion over three years. That is many times the value of the Fed's capital, and it means that the Fed is in fact *bankrupt*, by any honest accounting measure.

MSCI is the same high-roller company which the Fed itself uses to perform stress tests on the 19 largest U.S. banks. The current study, commissioned by Bloomberg News, applied the same criteria it uses on the banks, to study the Fed's own solvency. "The potential losses are unprecedented in the Fed's 100-year history," Bloomberg wrote in its wire.

The release of the MSCI study was impeccably timed to coincide, almost to the hour, with Fed Chairman Ben Bernanke's annual appearance before the Senate Banking Committee and the House Financial Services Committee, Feb. 26 and Feb. 27, respectively. None of the Congressmen or Senators on the committees were sufficiently emboldened to raise the issue of returning to Franklin Roosevelt's 1933 Glass-Steagall Act as the obvious solution to the looming catastrophe.

A few did take note, however, of the huge losses that would be suffered as the Fed unwinds its QE purchases, and Sen. Bob Corker (R-Tenn.) went so far as to shoot off an open letter to Bernanke the same day he testified before the Senate, demanding to know: "If interest rates were to rise and your securities portfolio were marked to market, is it not possible that you could be rendered insolvent, at least on a balance-sheet basis? And if so, what kind of risk would that present?"

When a ranking Senator of the United States publicly asks the chairman of the Fed if the Federal Reserve Bank is not "insolvent," you know that things have gone very far.

Members of the Congressional committees may have shied away from talking openly about what many admit in private, is the only workable solution to the system's bankruptcy: Glass-Steagall. But not so organizers for LaRouchePAC, who were all over Capitol Hill, even as Bernanke was testifying—urging adoption of HR 129, which calls for a return to

FDR's Glass-Steagall, and distributing the first 500 copies of LaRouchePAC's "Draft Legislation To Restore the Bank of the United States," the necessary companion-piece of a return to the Glass-Steagall standard (see p. 4).

The report of the Fed's bankruptcy comes as a shock only to those who have not followed Lyndon LaRouche's writings over the years (see box). But that reality now finally appears to be dawning on large numbers of major players within the trans-Atlantic financial community—including the Fed itself, the Wall Street

banking crowd, and their British senior partners—namely, that the Fed itself is flat-out bankrupt.

Easing Your Way into Bankruptcy

The Fed is now reaping what it itself has sowed, at London's insistence, with its policy of hyperinflationary quantitative easing, in response to the 2008 blowout of the world financial bubble. From 2008, through the end of 2012, the Fed issued over \$2.5 trillion in new funds simply pumped into the banking system. In 2013, the Fed is on course to pump in an additional \$1 trillion, through QE. (The total bailout of the banks is much larger than that, by an order of magnitude; the QE is simply the new cash that the Fed has pumped in directly).

The argument put forth by the Obama Administration for public consumption to justify these bailouts, has been along the lines of: "Hey, we have to help out the banks, so that they can in turn resume lending to businesses and consumers." But that was neither the result, nor the real intention. Over the same period in which U.S. QE totaled over \$2.5 trillion, bank deposits did in fact rise by nearly \$1.7 trillion. But was this money then lent out by the banks? Of course not: It went to feed the speculative cancer. As a result, total bank lending *contracted* by nearly \$1 trillion between 2008 and 2012, at the same time that QE rose by \$2.5 trillion.

But the real problem is even worse than that, because a quick rule of thumb is that perhaps half, at most, of bank lending in any given year is actually productive. The other half is speculative by its nature, consisting of interbank lending, placing bets on mortgages, and so on.

Nor is this policy limited to the United States. The British Empire's entire trans-Atlantic financial system has been hollowed out by this same speculative lunacy.

In the United Kingdom, over the same period, the Bank of England has likewise issued some \$590 billion in QE, and bank deposits have also risen—by a dramatic \$1.1 trillion, a 42% jump. Bank lending predictably *fell* in the U.K. during this period, just as it did in the U.S., in this case, by some £80 billion (or \$125 billion, at the current exchange rate), a 5% drop.

The same holds true for the policy of the European Central Bank (ECB) for continental Europe. Over this same period, the European equivalent of QE—quaintly known as LTRO, or Long-Term Refinancing Operations—has weighed in with over \$1.3 trillion in new funny money, to try to bail out the bankrupt European

LaRouche in August 2009: The Fed Is Bankrupt!

During an Aug. 1, 2009, webcast, Lyndon LaRouche emphasized the need for a Third National Bank of the United States:

First of all, I think we're going to have to recognize that the Federal Reserve System is, by any appropriate approach, bankrupt. It is a private corporation, which was created, unfortunately, by the U.S. government, in a certain manner of speaking, under Woodrow Wilson. It is bankrupt. Who is going to pay those debts? All this money issued is a debt. All this utterance is a debt. Who is supposed to pay? Who contracted to pay that debt?

I know that the Federal Reserve System is bankrupt. It covers up for its bankruptcy by printing money. This reminds us of Germany in 1923, doesn't it? Therefore, look, the point is, the United States has to have the guts to declare the Federal Reserve System bankrupt. That's the way to get at it. It is bankrupt, so let it prove that it has assets, to cover this utterance. If not, we put it into bankruptcy.

What we do is, we simply get rid of it by bankruptcy. Just take it off the books. It's bankrupt; it took itself off the books, by going bankrupt. Easiest way of skinning that cat. Now, then what we're going to have to do is, we're going to have to develop the Third National Bank of the United States.

banking giants, while bank lending continues to stagnate across Europe.

The combined picture for the entire trans-Atlantic financial system is summarized in (Figure 1). Cumulative QE hyperinflated the financial system to the tune of \$4.4 trillion by the end of 2012, and is soaring towards \$5.5-\$6 trillion in 2013. And all the while, bank lending has declined by about \$1 trillion.

As LaRouche has repeatedly warned: “The entire world system is in a crisis. It’s a general breakdown crisis which is centered in the trans-Atlantic community... [This is] a systemic rupture in the entire trans-Atlantic financial and monetary facade.”

Derivatives: Double-or-Nothing Gambling

The last five years of QE hyperinflation, comes on top of the unleashing of the derivatives bubble with the 1999 repeal of Glass-Steagall, and that in turn was the follow-up to the 1971 demise of the Bretton Woods system and the systematic takedown of the productive economy in the wake of the Kennedy assassination.

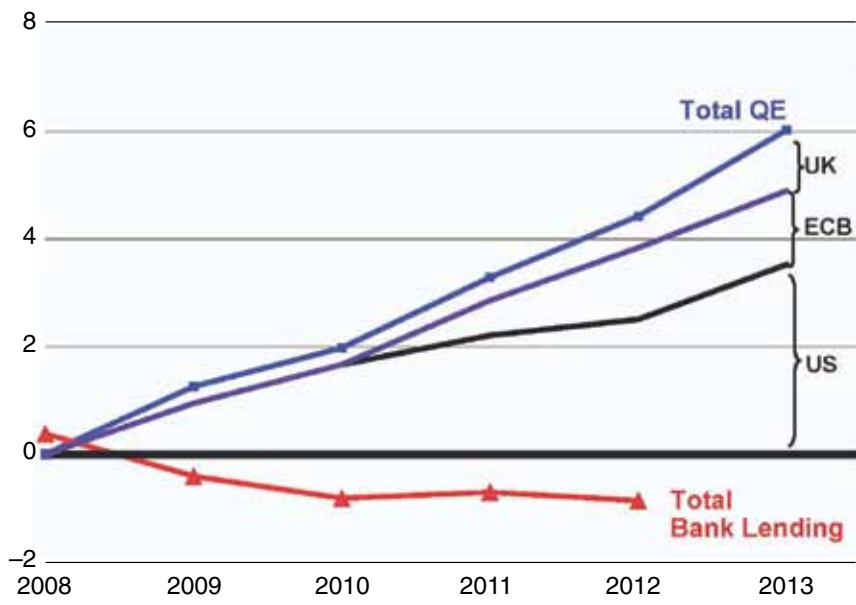
The derivatives aspect of the problem deserves a moment’s attention, since the most common question that comes up when angry citizens try to grapple with what is happening, is: “So what the hell are derivatives, anyway?”

That is a very good question.

Financial derivatives are, by far, the largest component of all financial aggregates in the world. Figure 2 shows the growth of these aggregates from 1980 to 2005, which, at that point, totaled just shy of \$1 quadrillion (a thousand trillion), according to *EIR*’s best estimate. Today the total is probably closer to \$1.5 quadrillion—although the number is essentially meaningless, as are the derivatives themselves.

The point is, that the total fi-

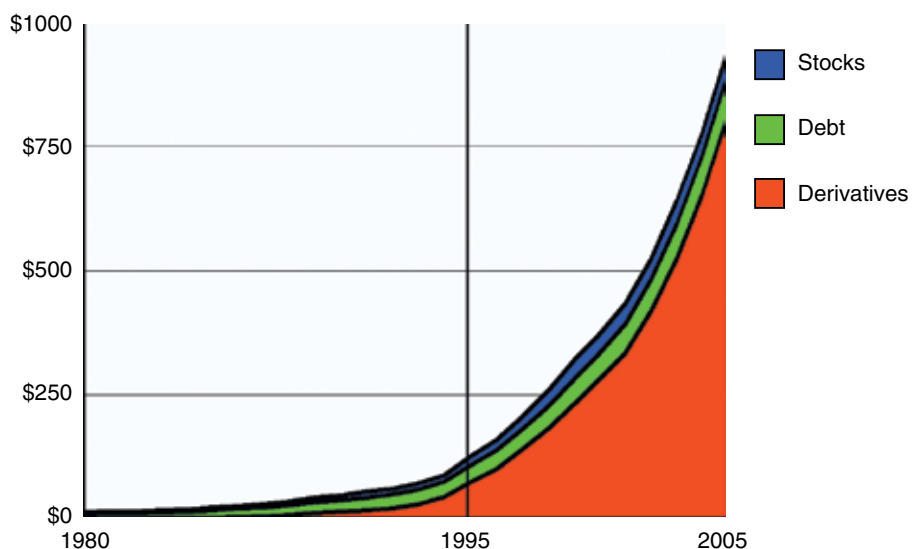
FIGURE 1
Trans-Atlantic QE and Bank Lending



Sources: Federal Reserve, European Central Bank, Bank of England

ancial aggregates are *not* made up principally of all of the stock markets in the world (overvalued as they are), nor of all the government, corporate, and personal debt in the world (as overvalued as that is). The lion’s share—more than 80% of the total—is financial derivatives.

FIGURE 2
World Financial Aggregates
(\$ Trillions)



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So, again: What the hell are derivatives, anyway?

Derivatives have been described, accurately, as essentially a way to lie and cover up a loss that has already occurred. Rather than facing up to the loss, and recognizing, “I guess I have to pay up or declare bankruptcy if I can’t pay the debt,” the speculator instead borrows more money in order to place a bet (a derivative) to cover up the loss by speculating on some hypothetical future gain. When that second loss comes due, he again covers the loss by a further bet, in the hopes that eventually he won’t have to pay the increased loss.

Another way of describing derivatives, is the case of the gambling addict who is always losing at the roulette table, and rather than pay up and call it a day (and face the wrath of his wife, or his boss), instead says: “No, let’s play double-or-nothing!” And when he loses again, he again insists frenetically: “Double-or-nothing! Double-or-nothing!”

In short, derivatives are double-or-nothing speculative bets designed to cover up massive losses, de facto bankruptcy, that are being suffered throughout the economy.

But at a certain point, the game is up, and reality asserts itself. That point is now.

Reality Strikes Wall Street and London

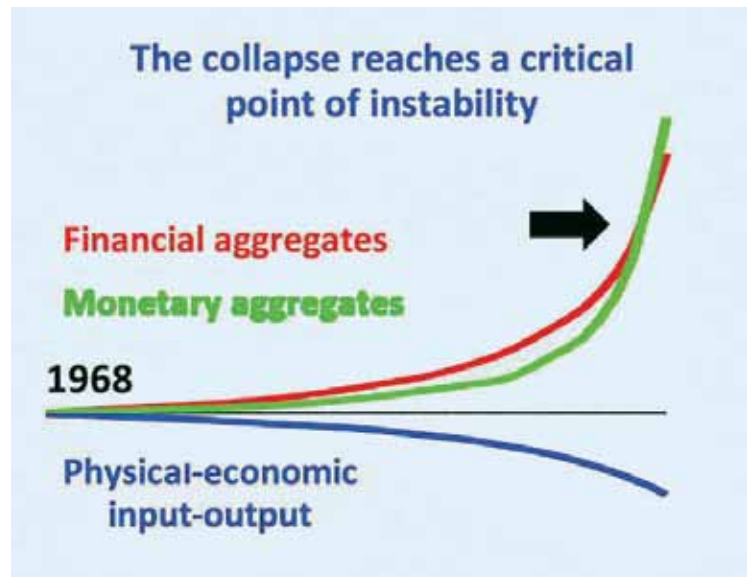
That realization is behind the public barroom brawl over financial policy that has broken out in world banking centers, from Great Britain, to the United States, to Japan and China, over how to address the hyperinflation “meteorite” that is about to strike Planet Earth.

In the U.K., Moody’s, on Feb. 22, downgraded the government’s debt rating from AAA to AA1, in the wake of a stronger-than-usual vote in the Bank of England’s Monetary Policy Committee on further quantitative easing (three members of the MPC voted in favor, including Governor Mervyn King; six voted against). In Japan, Prime Minister Shinzo@am Abe visited Washington to discuss, among other things, his plan to use “hyper-easy monetary policy” to try to revive the Japanese economy. And in the United States, Fed governors and economists are warring openly over whether or not Bernanke’s QE policy will unleash uncontrolled hyperinflation.

Growing numbers of panicked U.S. bankers and

FIGURE 3

LaRouche’s Typical Collapse Function



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economists are now pointing out that, since the Fed has gotten in so deep with QE, if and when it tries to stop the process and sell off all or part of its asset book, it will trigger a sharp rise in interest rates and a consequent plunge in the value of the Treasuries and MBS toxic assets it now holds.

The warning surfaced at the Jan. 29-30 meeting of the Fed’s Federal Open Market Committee (FOMC), where “many” members of the Committee openly disagreed with Bernanke’s policy of unlimited QE.

On Jan. 31, Bill Gross of PIMCO, the world’s largest bond trading company, published an article, “Credit Supernova,” warning that a hyperinflationary firestorm had been created, with no end in site.

Then on Feb. 5, the Treasury Borrowing Advisory Committee (consisting of 15 top Wall Street bankers) also raised the danger of a QE “exit” blowing out the Fed itself.

And on Feb. 22, at a New York meeting of the University of Chicago’s U.S. Monetary Policy Forum, a group of four monetary economists, headed by Frederic Mishkin (a former Fed governor and co-author of other writings with Bernanke) presented a paper warning that QE had gone so far, that an eventual Fed “exit” from QE could lead to serious losses in the Fed asset book, and unleash further severe inflation. Mishkin further warned that the public attacks on the Fed “are the worst I’ve

seen in my 40 years as a monetary policy economist.”

Bernanke’s rejoinder to all of the alarmed criticism, sounds for all the world like what Lehman Brother’s CEO Richard Fuld was saying in 2007 and 2008, before Lehman imploded in September 2008: *We don’t have to mark-to-market. We’re the Fed. We can always print more funny-money to cover our skyrocketing losses. We can keep doing this forever.*

Double-or-nothing, anyone?

LaRouche’s Triple Curve

The only thing that is *actually* surprising about the looming hyperinflation, is that people are surprised to discover it. LaRouche has been warning about this for decades, and providing a programmatic solution.

The single best pedagogical tool for understanding the hyperinflationary implosion that is underway, remains LaRouche’s famous “Triple Curve” or “Typical Collapse Function” (**Figure 3**), which he first presented at a 1995 seminar at the Vatican—nearly two decades ago.

First, it is necessary to dismiss the usual textbook definition of inflation as poppycock. The idea that inflation is “more money chasing fewer goods” is nonsense. It is a mistake to try to locate the process of hyperinflation today in a simple expression, such as rising prices on the consumer market. There is no question that that is going on as well—just look at the doubling of the price of gasoline at the pump during Obama’s watch, or the soaring prices of food at the supermarket. But what is actually going on with hyperinflation, is more like a giant pressure-cooker, where a huge explosive charge is building up within the financial aggregates themselves. Sooner or later, the pressure cooker will blow, and then the hyperinflation will transfer rapidly, explosively, into the consumer and producer economy itself.

Now look at LaRouche’s Triple Curve. First of all, these should not be viewed as three independent curves. They are aspects of a single unified process: You have the rate of growth of financial aggregates; the rate of growth of monetary aggregates (which, at a certain point, exceeds that of the financial aggregates, if you have a cancerous bubble developing, as we have today); and then you have the third curve, reflecting the real physical economy.

This is where LaRouche’s science of physical economy is absolutely unique, in its understanding of the relationship of the financial side to the third, lower

curve of physical economic input/output. And it is where most people have difficulty digesting what LaRouche is getting at.

This third curve has nothing to do with Gross Domestic Product (GDP). GDP does not reflect the actual physical economy. GDP is a monetary calculation, based on what the market will bear, on “effective demand”—in other words, on whatever sells. Thus, you have the spectacle of the International Monetary Fund stating explicitly, in published documents, that drug production in countries such as Colombia must be included in the calculation of GDP. Why? Because it sells! If it sells, somebody wants it. That is called “effective demand,” and therefore it has to be counted in GDP.

So, GDP is a completely phony (not to mention, amoral) measure. It’s phony because its content includes actually unproductive and destructive things such as, for example, drug production—or, for that matter, payments made to the economics profession for teaching this garbage at universities, which is just as destructive, if not more so, than the drugs themselves.

But GDP is also false in its axiomatics. The premise is that there’s a one-to-one monetary calculation that can be made, a scalar monetary unit of account, that can be used to describe a physical economy. But what actually is involved in physical economy, is that the only source of true wealth, and therefore the only metric, is the expansion of the productive powers of labor.

The crucial question in the success or failure of a physical economy is the degree to which adopted policies increase the productive powers of labor, that is to say, the efficiency of man’s general activity based on creative advances in science, technology, and Classical culture. This in turn drives the discovery and dissemination of production technologies, of rising energy-flux densities, that allow man to transform his relationship to the universe, of which he is a leading part.

That intentional, directed improvement in the productive powers of labor is the only actual metric that applies to a physical economy. It is, however, a *changing metric*. It is not a ruler or yardstick where you can say that one unit equals one unit equals one unit. Rather, the metric changes, because the physical economy which it is measuring also changes in its essential characteristics, as with any living organism. A physical economy is a dynamic process, where the driving force

of creativity itself changes the essential parameters of the physical economy.

In LaRouche's Triple Curve, the monetary and financial aggregates (on the one hand), and the physical input-output (on the other hand), are *incomensurable* processes: They are not measurable with the same metric. Note, in that regard, that the Triple Curve does not show absolute values for any of the curves, but rather *rates of change*.

Under today's typical collapse function, what is happening, as Shakespeare's Hamlet put it, in a similar context, is that "the time is out of joint." There is a fundamental disconnect or disjointedness between the cancerous growth of monetary and financial aggregates (such as derivatives), and the collapse of the actual physical-economic process, as reflected in energy-flux density and the ability of the human species to reproduce itself at a higher level for the next period, to increase the potential relative population density of our species.

For this reason, there is no explanation, no understanding, and certainly no *solution* to the problem of hyperinflation without the concepts underlying LaRouche's Triple Curve pedagogy.

Successful Genocide

Let us now turn to look at some of the results of the British Empire's policy in terms of that physical economy.

In evaluating these results, people will often comment: "Oh, gee, the policies of the IMF and the Troika have failed; they haven't produced the recovery they promised they would produce." Or, "The Federal Reserve policies have failed; why, they have led to a bad situation, and the danger of hyperinflation."

But the contrary is true. The IMF's policies have not failed; they have *succeeded*—because the *intent* of their policy has been to kill people. The Fed policies have been completely successful, because the intent of the policy was never to bring about some sort of an economic recovery. The intent was to produce exactly the hyperinflationary bailout and genocide which it is in fact producing.

Greece today is not an IMF *failure*. It is a success story! They're killing off the population, which is what these policies were intended to do. The publicly stated British imperial policy is depopulation, and that is precisely what they are achieving.

There are many ways that one can approach the question of physical economy, but none better than looking at what is going on with the labor force. This is the single, best way to get at the concept behind the third curve of LaRouche's Triple Curve.

If it is the case that the only actual source of wealth is an increase of the productive powers of labor, then clearly, the most important thing to do in an economy is to generate, not only new jobs for youth, but *productive*, high-technology jobs for youth, and to educate young people and train them so that the overall scientific level, the Classical cultural level, the technological level of the society is rising. In that way, society can mobilize technologies embodying rising energy-flux densities, and achieve leaps in the overall productive powers of labor.

Now, take a look at youth unemployment today, under the British Empire's euro and Troika dictatorship. In the case of tortured Greece, youth unemployment hit 62% in early 2013. In the case of Spain (**Figure 4**), in little less than a decade, total official unemployment (which actually understates the true situation) has risen to about 26% of the total labor force. That is bad enough, but if you look at what has happened to youth unemployment, people between 18 and 24, by the end of 2012, over 50% of the total youth

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—Lyndon LaRouche,
Feb. 11, 2013

labor force was unemployed. And the projection is that by the end of this year, that will hit 60%.

Now, stop for a second and think about what that means. What does it mean for the survival of a country or an economy, when close to two-thirds of youth have been thrown on the scrap-heap? They don't have jobs, let alone productive, or high-tech jobs. They have no future! This means that the country is being killed; it is being destroyed.

And I ask you: What is the difference between this destruction of a country, and the concentration camps of Adolf Hitler—which, like the Troika policy, was inspired by the British? There is absolutely no systematic difference between the two. What is going on is genocide, pure and simple; and it is intentional genocide.

In **Figure 5**, we show those countries in Europe where official youth unemployment today exceeds 20%—half of the EU27 roster of nations. Spain and Greece are the future of all Europe, and of the entire trans-Atlantic system, under the policies of the Fed, the Troika, and their British senior partners.

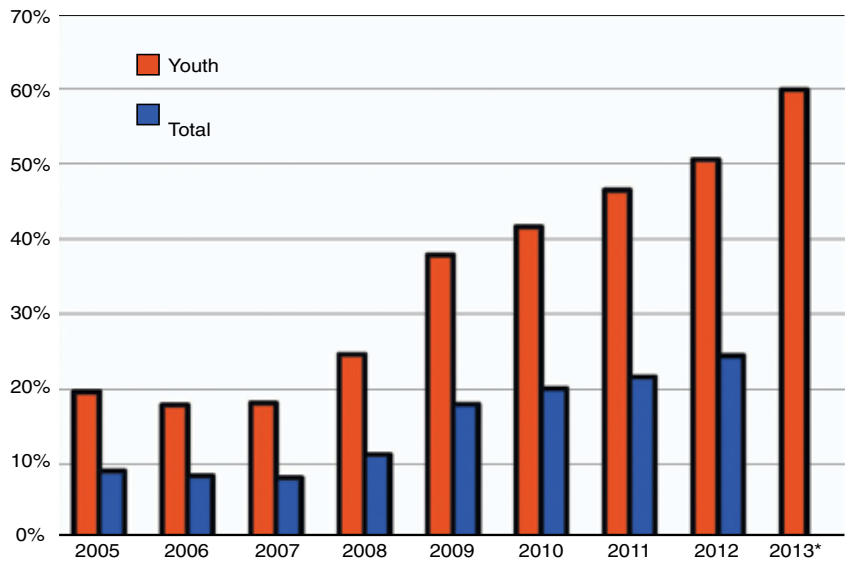
That is why LaRouche has repeatedly stated that the only choice that the world has today, is between a return to the Franklin Delano Roosevelt Glass-Steagall principle of 1933, or genocide.

That Glass-Steagall principle is presented in the very first sentence of the 1933 bill, which serves as a kind of preamble and conceptual summary of the whole document—in much the same way as the Preamble to the U.S. Constitution presents a single, unifying statement of intent. The Glass-Steagall bill states:

“An act, to provide for the safer and more effective use of the assets of banks, to regulate inter-bank control, to prevent the undue diversion of funds into speculative operations, and for other purposes.”

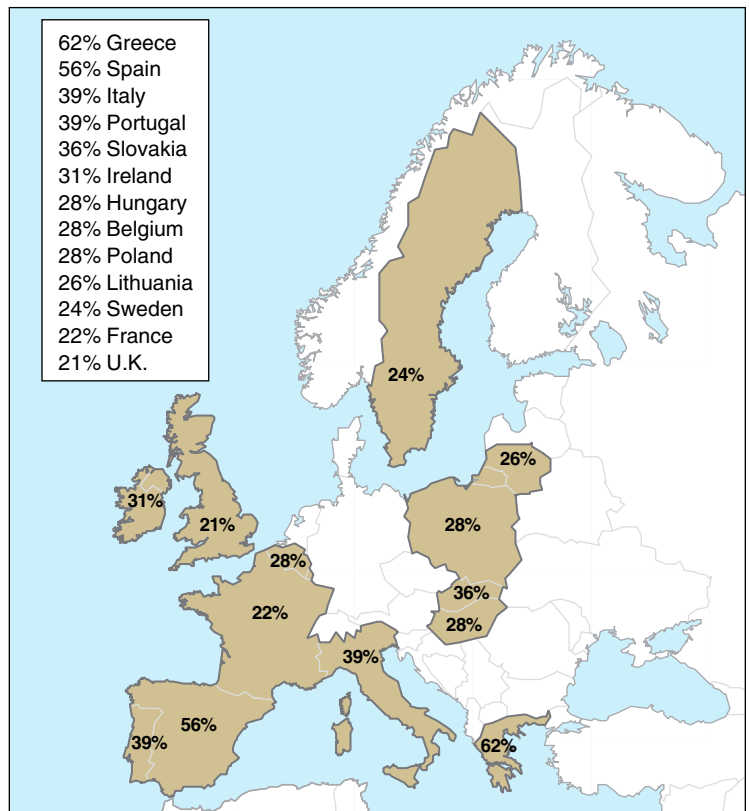
That would indeed be a worthy epitaph to write on the tombstone of the defunct Federal Reserve System of the United States.

FIGURE 4
Total and Youth Unemployment in Spain



Source: Bank of Spain

FIGURE 5
Countries of the EU27 With More than 20% Youth Unemployment



Source: Eurostat