The Salomon Brothers debacle is spreading

by Chris White

The crisis around Salomon Brothers' rigging of the more than \$2 trillion annual market in U.S. government securities, is the most visible evidence of the potential for an earthquake in U.S. credit markets and dollar-based monetary arrangements this fall.

The reality is that the crimes admitted by Salomon's former team of directors under John Gutfreund—the model for what the company's traders call a "big swinging dick"—have been the principal means by which the U.S. Treasury has marketed its debt over the past period. But with Treasury debt sales and refinancing requirements now running at \$500 billion every three months, what will they do for an encore?

The sane approach would be to admit that the government's mounting funding requirements reflect the bankruptcy which has destroyed savings and loan associations, insurance companies, commercial banks, and pension funds, and the depression which has destroyed the revenue base at all levels of government, and to return to the kind of credit and financing system which is provided for in Article I of the U.S. Constitution. This has been proposed repeatedly by Bush's political prisoner Lyndon LaRouche since the late 1970s. Return to Treasury issuance of gold-backed reserve notes, eliminate the Keynesian financial multiplier effect of Federal Reserve money-market management, and use the credit issued for productive investment in industry, agriculture, and infrastructure development, to generate wealth and useful skilled employment.

But Treasury Secretary Nicholas Brady, Federal Reserve chairman Alan Greenspan, and the other financial mucketymucks insist that they have the power to keep such matters under control. What idiots! They insist that since Treasury security issues have generally been oversubscribed, there is no problem with continuing to do what they have been doing hitherto.

Well, suppose most of those bids have been no more real than the bids Salomon was making. There's good reason to assume that, since Salomon, according to Japanese traders, has been accustomed to act on behalf of the other dealers anyway. There goes the market in U.S. government securities, and the U.S. dollar.

Far-fetched? The Swiss-based Bank for International Settlements (BIS), the central bankers' central bank, charged in its last annual report, that reported flows of funds into and out of the United States and Japan are riddled with discrepancies: that the accounts do not match up. Unstated was the charge that both the U.S. and Japan have been cooking the books to maintain the appearance that all is well. The Salomon case says that the BIS was right. Maybe the 135 subpoenas which have been issued to all dealers in the primary and secondary markets in U.S. government securities will help produce some more proof.

The budget, and the presidential election

The crisis at Salomon coincides with another crisis around the funding of U.S. government debt. Last year's budget agreement, designed in part to keep budget fights out of the limelight until after the 1992 presidential election, was a complete fraud. The economic collapse has undermined that budget agreement, revenues have collapsed, more has had to be put into S&Ls than was provided for, and unemployment has reached crisis proportions.

Opportunistically, U.S. legislators have seized on the developments inside the former Soviet Union, as a weapon to use against the disastrous two-year budget pact concluded in October 1990. Sen. Bill Bradley (D-N.J.) and Rep. Les Aspin (D-Wisc.) now insist that "changed circumstances" in the former Soviet Union make the budget agreement obsolete. The two have been angrily denounced by President Bush and Defense Secretary Richard Cheney, for their proposal to review defense spending in order to provide funds to aid the former Soviet republics and to cover domestic expenditure requirements.

Whatever Bradley and Aspin might be up to, there's much more involved than another Washington dog and pony show about the defense budget. And it is quite relevant to what is unfolding around the Salomon case.

The unemployment crisis

The number of Americans who exhausted unemployment benefits during the month of July was more than 300,000. This is the highest one-month total in at least 40 years. By the end of this year, according to the Washington, D.C.-based Center on Budget and Policy Priorities, the number of Americans who run out of unemployment insurance will exceed that of any year since the unemployment insurance program was established during the Depression of the 1930s. During the first seven months of this year, 1.8 million Americans exhausted their benefits. With a six-month lag between losing employment and exhausting insurance benefits, hardly any of those who lost their jobs this year have yet been added to that number. And this, of course, is the official lie; the reality is much worse. The inevitable increase in unemployment over the next months is certain to fuel a growing political crisis, especially when added to the growing ranks of the homeless.

Yet, within the framework of last year's budget agreement, federal funds cannot be provided for the unemployed without either cutting other areas of expenditure—and defense and debt service are the only real candidates—or declaring a state of economic emergency. Something will have to give. But this now comes forward exactly as the entire procedure for financing the government's debt is called into question.

In a strange coincidence, on Aug. 19, right on the eve of the Russian coup-plotters' declaration of a state of emergency, Bush, vacationing in Kennebunkport, Maine, refused to declare his own state of emergency. Such a declaration then would have made it possible to release $5.2 billion to finance the extension of unemployment benefits for 26 weeks beyond the 26-week standard, which had been voted up overwhelmingly by both House and Senate before the August recess.

The funding crisis in unemployment benefits affects other social programs, such as health care, education, and welfare. Bush chooses instead to put his faith in what he calls "the Recovery."

What Bush refused to do on Aug. 19, and again when he rejected the Bradley-Aspin proposal, he may be compelled to do after Congress returns to Washington on Sept. 10. At that time, Congress will take up a proposal to provide funding for the extension of unemployment benefits by cutting back the defense budget. As the numbers of benefit-less unemployed climb to 3 million and then 4 million, and thus become a more visible part of the economic collapse than they are now, Bush will find out how much good his faith in the "Recovery" will do him.

But that brings us back to Salomon.

Salomon's debt rating downgraded

Thirteen billion dollars of Salomon Brothers' debt was downgraded by Moody's Investors' Services rating agency on Aug. 29. Standard and Poors subsequently followed Moody's. Salomon is said to have an annual funding requirement of about $120 billion, and it is expected that the investment house is going to have to begin to unload some of its assets by the middle of September, when $2 billion of its present credit lines come up for refinancing.

Moody's acted because of "uncertainties" about how it will fare in ongoing civil and criminal investigations. Interestingly, beyond the government's criminal investigation, at least three class action lawsuits have been filed by shareholders and investors in the state of Delaware. These lawsuits seek redress from all Salomon's directors, including Warren Buffett and the team which is now taking over the company under his direction. It is alleged that all directors knew, and benefited from, the alleged crimes which were perpetrated by the brokerage firm in attempting to monopolize government security auctions.

Meanwhile, the government's investigation of market rigging has expanded to encompass the secondary market, that is, those who buy from primary dealers like Salomon. One hundred and thirty-five subpoenas have been issued by the Securities and Exchange Commission to firms participating in the secondary market. In addition, three House committees and one Senate committee will begin investigations soon. And, the state of Missouri has taken the initiative to form a national task force, made up of representatives of the states, to investigate crimes committed against state agencies. Texas, Wisconsin, Massachusetts, Connecticut, California, and Colorado have all withdrawn their business from the company.

Moody's downgrade of the investment house's debt is the first since the Drexel Burnham case one and a half years ago. Drexel Burnham ended up in the bankruptcy court, where it can be expected that Salomon Brothers will soon be headed.

There is more to it though. Attention is also drawn to the actions of a secretive committee, made up of representatives of the Treasury, the New York Federal Reserve, and the primary dealers. This committee meets each quarter, during the week before the U.S. government's quarterly refinancing, to decide how the auction would be organized. It seems it is only a matter of time before the entirety of the process by which the U.S. government markets its debt is called into question. Salomon Brothers provided the chairman of this committee until the end of August, when a representative from Bear Stearns replaced the disgraced Salomon representative.

The combination of the crimes at Salomon Brothers, and the crisis around the fake budget, may well turn out to be more than Brady, Greenspan, and company are capable of handling.