1992-97: The global financial mudslide becomes unstoppable

by Jonathan Tennenbaum

Following the sabotage of Lyndon LaRouche's proposed Paris-Berlin-Vienna Productive Triangle by British Prime Minister Margaret Thatcher, French President François Mitterrand, and President George Bush during 1989-92, the world economy began its decisive plunge into what LaRouche has called "the worst financial and monetary collapse in history." Throughout 1992, LaRouche and *EIR* repeatedly sounded the warning, that an irreversible "mudslide" had begun in the world's financial markets. Since LaRouche's warning was issued, that mudslide has indeed never stopped, but has picked up more and more momentum, wiping out every vestige of prosperity and economic stability.

By early 1992, there was no lack of signs, that a financial mudslide had in fact begun. The crisis of Lloyd's of London, which broke into public view in February, signalled that the world was no longer the same. In March came the insolvency of Olympia and York, the largest real estate company in North America, followed in May by its official bankruptcy. In fall 1992, the European Monetary System was shaken by the first of a series of violent speculative attacks, in which the Italian lira fell 30%, and the lira and the British pound were forced out of the system of relative parities.

In September 1992, LaRouche wrote, "As of this point, the world has officially entered into the second and greatest worldwide depression of the 20th century." In spring 1993, Europe was shaken by one of the largest corporate bankruptcies in history: the derivatives-linked collapse of Italy's second-largest industrial group, Feruzzi. In spring, a second wave of speculative attacks hit the European Monetary System, once again breaking up the bloc of currencies and forcing the French Central Bank to massively deplete its currency reserves. This was followed at the end of 1993 by the crisis of Germany's Metallgesellschaft and the collapse of Spain's fourth-largest bank, Banco Español de Crédito (Banesto).

By fall 1993, other voices joined LaRouche in warning that a world financial crisis was under way. In a series of newspaper articles, French Nobel Prize economist Maurice Allais declared that "the entire West is now in a fundamentally unstable financial situation. Poorly considered decisions could bring the whole world into a collapse, compared to which the stock market crisis of 1987 will seem negligible."

Unfortunately, the key decisions had already been made, which made financial catastrophe virtually inevitable. The Maastricht Treaty, a direct product of the Thatcher-Mitterrand-Bush policy to destroy the German industrial economy and the possibility of economic reconstruction in eastern Europe, was signed in February 1992. The ultra-monetarist "conditionalities" demanded by Maastricht in the name of preparation for a common European currency, imposed a regime of drastic austerity on the European countries which resulted in the highest rates of unemployment since World War II. Parallel with this, the successors of the late Alfred Herrhausen, the head of Germany's largest bank, Deutsche Bank, assassinated in November 1989, proclaimed a radical shift in German banking, away from its traditional industrial orientation, to embrace the British model of investment banking. The radical de-industrialization of East Germany was accelerated, while in the western part of Germany a gigantic downsizing of employment in key machine-building and related sectors occurred. Together with a Japan ravaged by the "bubble economy," the last relatively strong industrial economy in the West went into precipitous decline. By the end of 1997, more than 5 million industrial jobs had been eliminated in Germany, half of them in the formerly prosperous western part.

The results of shock therapy

Meanwhile, the disaster of International Monetary Fund (IMF) shock therapy in the former Soviet Union was displayed for the world to see by October 1993, as Russian Interior Ministry troops opened fire on the Russian Parliament building, de facto ending that country's experiment in parliamentary democracy. Although the conflict between the President and the Duma had strong political overtones, the underlying reality was a precipitous collapse of production and living standards. During the first six months of 1993 alone, consumer prices rose in Russia by 344%, while industrial production plunged by 18%. By 1996, Russia's physical production and investment had fallen to 30-40% of pre-"reform" levels, and the country was importing 60% of its food.

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The worldwide financial mudslide accelerated greatly during 1994, leading up to the explosion of the Mexican crisis at the end of that year. In January, Venezuela's second-largest bank was closed down by the government. In March, French authorities had to intervene with guarantees of 40 billion francs to prevent the insolvency of the giant state-owned bank Crédit Lyonnais, connected with the collapse of France's real estate bubble. In early spring, world financial markets experienced a wave of turbulence, which included drops of 30-40% in stock market values in Mexico and Venezuela. In mid-May 1994, LaRouche stated: "What Maurice Allais is saying about the financial bubble and the 'casino' type of economy, is absolutely accurate, as far as he goes. What Allais failed to address, and what must be dealt with more than anything, is something that the average person does not want to realize, could occur. . . . What is inevitable is a complete breakdown of the entire IMF-dominated, Federal Reserve Bank-dominated, global financial and monetary system. There is nothing that can be done to stop that system from collapsing, unless we shut it down first. When the breakdown comes, we are going to have to start from the beginning again and build a new monetary system, a new banking system and a new credit system generally."

On June 24, 1994, LaRouche's "Ninth Forecast" was published in *EIR* ("The Coming Disintegration of the Financial Markets"), warning that "the presently existing global financial and monetary system will disintegrate. . . . The collapse is inevitable because it could not be stopped now by anything, except a politically improbable decision by leading governments to put the relevant financial and monetary institutions into bankruptcy reorganization."

Half a year later, only a fool would have denied that LaRouche was right. On June 24, 1994, the London government bond market suffered its sharpest decline since 1914. Roland Leuschel, the chief economist of Banque Bruxelles Lambert, commented in a British newspaper, "The countdown to the crash has begun." In August 1994, the MMM company, Russia's biggest private investment firm, collapsed, leaving millions of small investors with the losses. In late fall, the financial markets were hit with another round of turbulence. Then, on Dec. 6, a bombshell hit: the bankruptcy of Orange County, California, the richest county in the United States, as a result of an estimated $3 billion in losses on financial derivatives contracts.

Two weeks later, the Mexican peso collapsed precipitously, bringing Mexico to the brink of default on its foreign debt, and triggering currency and stock market plunges throughout Ibero-America. A chain reaction of defaults, which could have spread around the world, was prevented at the last moment by a record $40 billion of credit guarantees pledged to Mexico by the U.S. government and IMF. Justifying the unprecedented scale of the Mexican bailout package, IMF Managing Director Michel Camdessus stated, "Mexico was in imminent danger of having to resort to exchange controls. Had that happened, it would have triggered a true world catastrophe."

While the world had its eyes focussed on the ongoing Ibero-American crisis, another bombshell struck: the bankruptcy of the Asia-centered British bank Barings on Feb. 25-26, 1995, as the result of losses of $1 billion in derivatives in Asia. While dismissed by many as an "isolated event," the Barings collapse pointed to the rapidly nearing end of the Asian financial bubble.

In an April 18, 1995 press release circulated internationally, LaRouche warned that Japan was being pushed toward the point of breakdown, by the refusal of the U.S. government to acknowledge the severity of the global financial crisis. LaRouche added: "Although many economists, such as France's Maurice Allais, have warned of the danger inhering in the ballooning bubble of the derivatives speculation . . . I am the only known economist internationally who has accurately described the process of cancer-like inevitability of the ongoing systemic collapse of the international monetary and financial system as a whole."

At the beginning of June 1995, Japan's Finance Ministry admitted that bad loans in the Japanese banking system exceeded $471 billion. Leading international financial experts put the real figure at more than $1,000 billion. While in the course of 1995 more and more signs were pointing toward a coming "meltdown" of the Japanese financial system, a secret agreement was reportedly reached between the Japanese and U.S. governments, for the United States to provide up to $500 billion in emergency credit lines, if necessary, in case of a threatened chain reaction of bank failures.

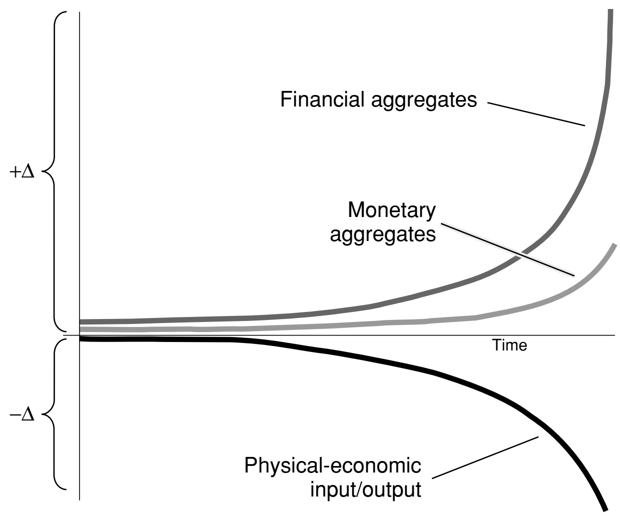
Halifax: Prop up the bubble at all costs

In mid-June, the Group of Seven economic summit, in Halifax, Canada, rather than initiate an urgent bankruptcy reorganization of the world financial system along the lines called for by LaRouche, *made the very opposite decision:* to prop up the global financial bubble at all costs, through a policy of deliberate reflation of the financial markets. After Halifax, central banks, led by Japan, began to pump cheap liquidity into the financial system at record rates, launching (among other things) a spectacular rise of stock market values in Asia, Europe, and the United States.

Starting December 1995, LaRouche introduced his "Triple Curve," a mathematical-pedagogical device for explaining the process leading to the disintegration of the world financial system (**Figure 1**). The Typical Collapse Function characterizes how a "hyperbolic" expansion of the nominal value of financial aggregates is inseparably linked to an accelerating collapse of the real physical output of the world economy relative to levels required for mere maintenance of the economic base, while the size of monetary aggregates increases at a slower rate. A hysterical reaction to LaRouche's analysis was published in February 1996 in *Foreign Affairs,* the magazine of the New York Council on Foreign Relations,

FIGURE 1

A typical collapse function



a mouthpiece of the Anglo-American financiers' "Eastern Establishment." Entitled "Shockproof: The End of Financial Crisis," author Ethan Capstein put forward the insane claim, "We have found a way to contain crisis. . . . Over the last 20 years, the leading economic powers have created a regulatory structure that has permitted financial markets to continue toward globalization without the threat of systemic collapse. . . . The financial difficulties of 1995 point to the strength, not the weakness, of the international regulatory structure."

But, the Asian financial crisis was already well on its way. August 1995 saw the bankruptcies of Japan's second-largest credit union, Kizu Shinyo Kumai, and of Hyugo bank, the first bank failure in postwar Japanese history. Panic spread throughout the Japanese population, who began to withdraw funds from the private banking system, placing them instead in the government-owned Postal Bank. In June 1996 came the announcement of gigantic losses, in the $2-4 billion range, incurred by Japan's Sumitomo Corp., in connection with trading in financial derivatives.

The Southeast Asian crisis

By March 1997, at the latest, the first tremors of the Southeast Asia crisis were already being felt. At a time when the New York stock market and other major stock markets were soaring on a wave of euphoria, Thailand was shaken by the bankruptcy of its largest financial company, Finance One Plc. In mid-May 1997, the value of the Thai baht began to plunge under a barrage of speculative attacks. On June 27, Thailand suspended operation of 16 banks. Just a couple of weeks later came the first devastating wave of collapse of Southeast Asian currencies, including the Malaysian ringgit, the Philippines peso, and the Hong Kong dollar. At the same time, in Japan, emergency measures were taken to avert the collapse of several major banks, such as the Nippon Credit Bank and the Hokkaido Takushoko Bank.

By August, the Southeast Asia crisis was threatening to trigger a worldwide collapse, as stock market declines circled the globe. On Aug. 15, the Dow Jones average fell 247 points, and the London stock market experienced the biggest collapse since 1987. The IMF rushed in with the announcement of a $17.2 billion aid package for Thailand. Meanwhile, the situation in Indonesia and South Korea deteriorated rapidly. In October 1997, the entire Southeast Asian financial system exploded: In four days, the Hong Kong stock market lost nearly one-quarter of its value; the Indonesian currency plunged in free fall. At the end of October, the New York stock market collapsed by 550 points in a single day. A total panic was prevented only by massive manipulations by the Federal Reserve and large U.S. companies, which bought up blocks of their own stocks in a temporarily successful effort to prop up the market.

In the middle of this rapidly developing crisis, LaRouche delivered a speech at an *EIR*-sponsored conference in Bonn, Germany, on creating a "New Bretton Woods System." LaRouche stressed the fundamental differences between the financial collapse and depression of the 1930s, and the present process of global financial disintegration: The latter is a crisis of civilization as a whole, which can only be overcome by a radical change in the basic axioms of policy.

As LaRouche spoke, it was clear that leading institutions and governments were by no means ready to undertake such action. Instead, the hopelessly inadequate approach of "crisis management" was continued. In October 1997, the IMF pledged $12 billion in emergency assistance to Indonesia, and then in December 1997, some $57 billion to South Korea. Not only did these pledges do nothing to address the basic global causes of the crisis, but the conditionalities imposed by the IMF—besides being tantamount to the elimination of national sovereignty—ensured that no real recovery could possibly take place.

Meanwhile, the Japanese financial crisis continued to deepen. In November 1997, the Japanese government was forced to take emergency measures to reorganize the bankrupt Hokkaido Takoshuko Bank, the tenth-largest in the country. On Nov. 23, Yamaichi Securities, the fourth-largest securities company in Japan, went officially bankrupt.

As 1998 began, it was clear that the Southeast Asia crisis had not ended, but had actually just begun. On Jan. 12, the bankruptcy of the Hong Kong financial company Peregrine Investment triggered a new worldwide round of stock market collapses. LaRouche repeatedly attacked the insane delusion, that the crisis in Southeast Asia is the result of local causes. In February, LaRouche forecast that a second crisis is going to explode, which will include not only Japan, but also Russia and parts of South America, and which is bound to finally hit the United States "with terrifying force."