Lessons of the Enron Debacle: Roll Back Deregulation!

by John Hoefle

EIR*'s John Hoefle prepared the following written testimony on "Enron: The Convergence of Energy and Financial Deregulation, and the End of the Off-Balance-Sheet Era," for the Feb. 6, 2002 hearings on "The Effects of Changes to the PUHCA" convened by the Senate Committee on Energy and Natural Resources. The PUHCA (Public Utility Holding Company Act) was pushed through in 1935 by President Franklin Roosevelt, to break up the Morgan electricity cartel (see* EIR*, June 15, 2001).*

With every day that passes, it becomes more obvious that Enron was a thoroughly corrupt corporation, which cooked its books through a variety of schemes, including the use of special-purpose entities and off-balance-sheet partnerships. As a result of these machinations, Enron presented a completely false face to the public—it was a financial scam, masquerading as an energy company.

At this point, few would argue that Enron was out of control, operating well outside the bounds of ethics and apparently outside the law; and few would argue that those officers and directors of Enron, as well as its accountants and lawyers, should be held accountable for their actions, or the lack thereof.

There is another group which should be held accountable, and that group includes the policymakers who have systematically stripped away the body of protections which had been written into state and Federal laws and regulations, in order to keep the Enrons of the world in check.

Lyndon LaRouche, the Founding Editor of *EIR* News Service, has, both through this news service and through his role as a pre-candidate for the 2004 Presidential election, led the mobilization against energy deregulation, focussing the attention of California, the nation, and the internpational community on the destructive nature of deregulation, and the key role Enron has played in that process. LaRouche has also led the fight against the out-of-control speculation in the derivatives markets, where Enron also played.

The Enron debacle now gives Congress, and this Committee, the opportunity to re-visit the nation's approach to deregulation, to confront and correct the errors which are destroying out nation's economy. It is an opportunity which should not be wasted.

Beyond the Culture of Corruption

The "culture of corruption" which thrived at Enron is nothing new; history is replete with similar examples of untrammeled greed, and of the need to protect populations from that greed. The strength of our nation is based in part on the creativity of our people; and for that creativity to flourish, the public must be protected from exploitation. Creativity is the rising tide which lifts all boats, but those boats must also be protected from pirates.

In its investigation of the Enron affair, the Congress must look not just at the company, but at the environment in which the company operated. In this case, that means looking at how deregulation created the conditions under which Enron's activities became possible.

One of the founding principles of the United States, is that the government has, not just the right, but the duty, to advance and protect the General Welfare of the People. In the wake of the Great Depression, a number of laws were passed to protect the People from abuses: prominent among them the Glass-Steagall Act, which was designed to prevent financial insiders from profiting at the expense of the general public; and the

Enron is neither an isolated collapse, nor an isolated criminality, but the soul of 1990s U.S. energy and economic policy. The Texas-centered "Southern Strategy" of such as James Baker III (center), Enron Chairman Ken Lay (top right), and Sen. Phil Gramm (bottom right), tore up the 60-year-old laws which had given the U.S. reliable energy; created Enron in the process; and was completing, through Vice President Cheney's task force, a national energy policy made for collapse.

Public Utilities Holding Company Act, which was designed to protect the People from the machinations of the giant Morgan and Insull electricity cartels, whose holding company structures were in many respects the equivalents of today's off-balance-sheet structures.

Congress passed these laws because events proved them necessary—they were necessary then, and they are necessary today.

Over the years, most of the protections implemented during the Roosevelt era have been stripped away. Glass-Steagall was gutted, then repealed, and an already-weakened PUHCA is facing a similar fate unless wiser minds prevail. The combination of energy deregulation, and the surge in mergers among regulated utility holding companies, has created an environment in which the electricity market is increasingly coming to resemble the *casino mondiale* financial markets.

Enron, in many respects, reflects the deadly convergence of financial and energy deregulation. In its SEC filings, Enron described itself as an investment bank, and testimony before this Congress has detailed the extent to which Enron was a derivatives trading firm rather than an energy company. What Enron was doing, was applying to the deregulated energy markets, the same kinds of speculative derivatives trading that the big investment and commercial banks—a distinction which is fast disappearing—have long applied to the deregulated financial markets.

In its off-balance-sheet activities, Enron was following a trend which began in the banking world. Until recently, every issue of the Federal Deposit Insurance Corp.'s Quarterly Banking Profile contained a line item for "off-balance-sheet derivatives." The FDIC has discreetly dropped the "off-balance-sheet" portion of the designation, but the derivatives remain—$51.7 trillion of them, backed by $6.6 trillion in assets and $586 billion in equity capital. A loss equivalent to just 1.1% of the total derivatives portfolio would be sufficient to wipe out the entire equity capital of the U.S. banking system.

Congressional Policy Created Problem

The most egregious example of derivatives speculation is J.P. Morgan Chase & Co., which by itself has a $24 trillion derivatives portfolio, roughly half of the total derivatives held by all U.S. bank holding companies. That figure is as of the third quarter, at which point Morgan Chase reported assets of $799 billion and equity capital of $42.7 billion, meaning that a loss equivalent to less than 0.2% of its derivatives portfolio would wipe out its equity base. At Citigroup and Bank of America, which between them have another $18 trillion in derivatives, it would take only 0.5%.

These aren't banks, any more than Enron was an energy company. Enron's reported $200 billion derivatives portfolio pales by comparison to the holdings of the big banks, but Enron was just getting started. The big banks were already involved in energy trading, and with Enron's demise have strengthened their position in the market.

The extraordinary danger presented by such derivatives speculation is clear in the Enron case, where derivatives were used to hide the company's condition. But again, this is just a case of Enron following the example of its banking peers, as investigations by the Japanese government have brought to light numerous examples where Wall Street firms employed derivatives to help Japanese companies hide losses. Derivatives were also at the root of the 1998 failure of Long-Term Capital Management, and before that, the wave of derivatives losses which swept the country in the early 1990s. The shocking $105 billion drop in assets at Morgan Chase during the fourth quarter suggests that the derivatives losses have not gone away, but are just better hidden in a complex of off-balance-sheet structures of the type we see in the Enron case.

Had Congress and the states not dismantled the nation's regulatory protections, there would be no need for these hearings. This hearing provides the Senate with the opportunity to return to a policy of sound regulation in the public interest. PUHCA must be strengthened, not weakened, as the first step in rolling back deregulation. Congress must choose between servicing the casino at the expense of the population, and protecting the General Welfare by rebuilding the protections which have been stripped away.

The Energy Committee, in particular, has the responsibility of "picking up the pieces" from the "Enronomics" era, so that the nation may begin to reverse the damage done by deregulation. As LaRouche outlines in his forthcoming special report, *Economics: At the End of a Delusion,* we can build our way out of this deepening global depression, if we choose to do so, but it requires the courage to admit that we must abandon the policies which have created this disaster.

Energy Re-Regulation and Recovery Program

LaRouche outlined the measures which are required in the energy realm in an international webcast on Jan. 24, 2002, in an exchange with State Sen. Joe Neal (D-Las Vegas), a senior Nevada lawmaker, who successfully led the fight against deregulation, and against Enron, in his state, and also in other states and in Mexico.

In response to Neal's question about the reasons for the collapse of Enron and what it means for the country, LaRouche responded:

"I would go backwards, and go from the end-result of the crash of Enron, rather than trying to, say, re-write the history of what Enron's history should have been.

"First of all, we face a major energy crisis in the United States. The severity of this crisis is hidden by the fact of the collapse of our industries. If we were to rev up the economy overnight, we couldn't support it. "People don't realize that we have been exporting our industries. In shutting down whole sections of the functions of our economy, we have *lowered* the requirement of energy! If we were to try to *restore* the economy, to what it was, at, say, 1980 or earlier, we would have to have a large amount of new energy.

"So, therefore, we have the need for a national energy recovery program, which would cover, inclusively, the problems which are illustrated by, and posed by Enron, and similar institutions. That means we have to repeal deregulation; go back to the system of regulation we used to have: I think we'd just go back to that; that's adequate, because it would *work.* There are precedents; the machinery is all understood—it would work. Just do it.

But set also into motion—see, President Bush is trying to find out ways of stimulating the economy, and he doesn't know how to do it. Well, this is one of the ways of doing it. If you take Federal money, and use it—not just as Federal printed money, but Federal credit—and you put it into a national *energy* program, which is going to fix the national energy grid system, to make it more usable and to improve its performance: That, in itself, is a good way to make the economy grow. And, it's typical of the various measures, which government *can* take, which are largely in the area of infrastructure and special projects; not in the private sector, as such, but in those areas alone, which will cause the economy to grow."

Stop Kidding Us Over Enron!

by Lyndon H. LaRouche, Jr.

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I smell an attempted "cover-up" afoot, now spilling over into some features of the current Enron hearings by Congressional committees. I am reminded of a case I studied in some detail about 60 years ago, the case of the famous privateer, Captain Kidd.

Captain Kidd, like Enron, was, in his time, a chartered captain of legalized rapine and theft; like Enron, a "privateer." His charter for his voyages was issued on behalf of England's monarchy, but deployed from the English colonies in North America. According to the records compiled for his subsequent trial and execution, there came a time when a mutinous mood spread among the lustily larcenous members of Kidd's crew. The apparent cause of this was the prolonged interval at sea without taking a legal target of the type for which that privateering venture had been licensed. Kidd himself was reported to have been threatened with death should he fail to take a rich prize.

According to the judgment of the time, under these mutinous pressures from the crew, a rich, but unlawful prize was taken—which is to say, as in the Enron case, outside of the bounds of the thievery for which the privateering expedition had been explicitly licensed. How much was taken in this act of piracy is unknown to the present day; Kidd's alleged treasure was, apparently, never found. Those in America who had backed Kidd's venture, were displeased by their failure to obtain a profit. They dumped their protégé, Kidd, who was captured and taken to London, and executed.

More than a half-century ago, the excellent rare books section of the Boston Public Library provided me access to the memorable documents on the matter, including the death sentence which ostensibly should have concluded the case. Unfortunately, over the subsequent centuries, the crucial implications of the case were often overlooked, in the zeal of some to discover where Kidd's rumored treasure might have been buried. Decades have passed since I studied those records, and the morals of our nation have changed, for the worse. There is a lesson to be learned about the way in which those morals have changed.

The crime of which Kidd was charged, was, like the dubious doings of Enron, not so much of a personal, as of a more serious, systemic nature. Like the case of Kidd, the systemic character of the crime of Enron, the system of privateering itself, was overlooked by those who preferred to store up