Click here for Full Issue of EIR Volume 29, Number 30, August 9, 2002

Senate Probe Discovers How Banks Created 'Enronomics'

by Marcia Merry Baker

Newly released Senate Permanent Investigations Subcommittee (SPIS) evidence proves how major U.S., London, Canadian, and other banks, including J.P. Morgan Chase, Citigroup, Barclays, Crédit Suisse, Toronto Dominion, secreted billions of dollars in the energy-trade bubble run by Enron, Dynegy, Mirant, Williams, and many other big energy pirate companies, now bankrupt or nearly so. What *EIR*'s economic analyst John Hoefle wrote in 2001, in both Congressional testimony and articles on Enron's failure, is now being "discovered" on the Hill: The big banks were the sponsors, and even the creators, of Enron's and the others' off-balance-sheet looting schemes. Now, rumors are flying of a derivatives crisis hitting J.P. Morgan Chase and Citicorp, the top players in the "Enronomics" scandal.

Steps to save the real economy from the continuing explosion of this Wall Street debt bubble, was the focus of *EIR*'s testimony for hearings on "The Financial Institutions and Enron's Collapse," held July 23 and 30 by the SPIS of the Senate Government Affairs Committee and chaired by Carl Levin (D-Mich.). The testimony also supplied Congress with the Lyndon LaRouche's evaluation: "What we are facing today is the collapse of the financial system itself, not merely discrete sectors or the harm from isolated perpetrators of crimes."

'Pre-Pays' and Other Scams

July 23, Robert Roach, Counsel and Chief Investigator of the SPIS, released a bipartisan report on the role of the banks in the Enron collapse, with over 170 exhibits.

Roach said that not only did the banks know that Enron was cooking its books, but "some financial institutions . . . actively aided Enron in return for fees and favorable considerations in other business dealings. . . . The evidence indicates that Enron would not have been able to engage in the extent of the deceptions it did . . . were it not for the active participa-

FIGURE 1

Chase/Mahonia

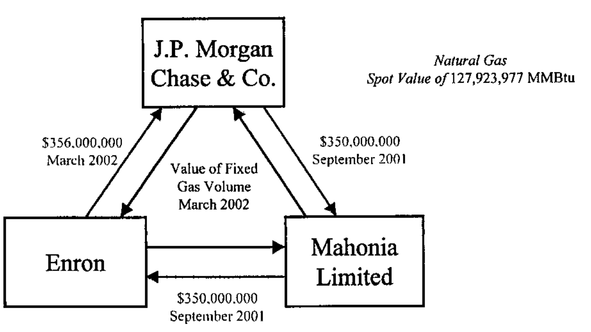
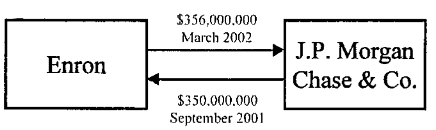


FIGURE 2

Chase/Mahonia Collapsed into Loan



These two figures (Exhibits 105 and 106) were prepared by SPIS for the hearings. The figures show how a debt magically becomes an asset with "creative bookkeeping."

© 2002 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

tion of major financial institutions willing to go along with and even expand upon Enron's activities. The evidence also indicates that some of these financial institutions knowingly allowed investors to rely on Enron financial statements that they knew, or should have been known, were misleading."

Roach detailed Enron's use of "pre-pay" transactions with banks, wherein loans were disguised as paid-in-advance energy trades (bringing into Enron some $8 billion in pre-pays from banks over six years). This allowed Enron to understate its debt by 40% and overstate its funds flow from operations by 50%.

Morgan Chase and Citigroup pitched the pre-pay strategy. **Figure 1** was prepared by SPIS staff to show how a "special purpose vehicle" (an SPV; in this case, Mahonia) functioned as a deception mechanism for Morgan Chase to shunt money to Enron. In fact, the advance was a debt, as **Figure 2** shows.

Roach's exhibits included quotes from internal communications of the principals in the scams. Some examples:

- From a Morgan Chase internal e-mail: "Enron loves these deals, as they are able to hide funded debt from their equity analysts because they (at the very least) book it as deferred rev[enue] or (better yet) bury it in their trading liabilities."
- From a Citigroup internal e-mail: "E[nron] gets money that gives them c[ash] flow but does not show up on books as big D Debt."
- From an internal e-mail, by Arthur Andersen employee auditing Enron: "Enron is continuing to pursue its various structures to get cash in the door without accounting for it as debt."

The July 30 hearings examined the relationship of investment bank Merrill Lynch to Enron. Two Merrill Lynch officers invoked the Fifth Amendment. A third explained why his company did business with Enron: "It was ranked as the most innovative company in the country for five straight years by the Fortune 500 company CEOs, board members, and senior management. It was ranked the top company for 'Quality of Management' " In one exhibit, the committee showed a videotape of Enron CFO Andy Fastow giving a presentation, and saying, "We've got to get the pension money coming in here," i.e., attract investments from pension funds.

EIR to Congress

John Hoefle introduced the *EIR* testimony, saying: "Our concern in providing this testimony, is to focus attention on the broad, urgent implications of the charge:

"1) We are right now at the end of a 30-year era characterized all along by policies tolerating or abetting such 'bubble-building' wrongful financial practices;

"2) We are in a process of economic breakdown;

"3) There must be measures on the scale of the 1930s 'FDR-period' policy responses, to replace the destructive policies of the past decades, with economy-building programs. Without that, no reforms, no tinkering, no indictments will do what's required."

Documentation

Enron Was How the U.S. Banking System Operates

This is part of the testimony submitted by EIR *to the July 30, 2002 Senate hearing on "The Role of the Financial Institutions in Enron's Collapse," held by the Committee on Governmental Affairs' Permanent Subcommittee on Investigations (SPIS).*

The committee's work opens the way for yet another layer to be peeled back from this rotten onion. We do not believe for a moment that Enron corrupted the financial institutions, but rather believe that Enron was the tool of certain financial interests and institutions who used the company as a battering ram for electricity deregulation and a vehicle for pumping up an energy-trading bubble. That energy bubble, along with the associated dot.com and telecom bubbles, were creatures of the "Wall of Money" used to jump-start the global financial system after its near-meltdown in 1998. Enron was an effect, not the cause, of a much larger financial scam. . . .

U.S. Debt Is Unpayable

One simple way to sum up the systemic financial crisis, is to look at the reality that the U.S. debt pyramid, built up over years of "Enronomics" of all kinds, *is unpayable.* Japan is in that state; other nations, such as Argentina are in chaos. But focus on the United States itself. In our issue of *EIR* for July 5, 2002, we published detailed graphs and statistics ("Rollover of U.S. Debt Will Yield Weimar Hyperinflation," by Richard Freeman and John Hoefle), from which we provide three summary graphs at the end of this testimony.

In short: By the end of 2001, total U.S. debt had reached $31.1 trillion. On average, over the last four years, U.S. debt has surged at the rate of $2.2 trillion per year, or almost $200 billion per month. The $31.1 trillion figure is composed of the basic categories of debt statistics kept by the Federal Reserve "Flow of Funds" reports for government debt (state and Federal), household debt, and corporate debt.

The U.S. debt pyramid has grown so large, that it is unsustainable, and all attempts to service it will not work. Moreover, every such attempt further destroys both the underlying U.S. physical economy, and its bankrupt financial system.

EIR's economics staff has determined, preliminarily, that by the end of 2001, on this outstanding debt, America's annual debt service bill—the interest payment, plus re-payment of a portion of the principal—had reached an unprecedented $7.4 trillion. This is equivalent to a staggering 72% of Gross Domestic Product.

It was as part of this rising debt balloon, that all kinds of "specialty bubbles" arose, including: