'Casino economy' veers out of control, collapse looms

by Richard Freeman

The German weekly *Der Spiegel,* in an article entitled "Speculation: The Big Boys and Their Slaves," delivered an indictment of global financial speculation, indicating that the world monetary system infested with this speculation, could collapse. Normally, one does not find even economics publications circulating this thesis, let alone a mass-circulation magazine that is the German equivalent of America's *Time* or *Newsweek.* Apparently, some European influentials want this story out.

The *Spiegel* article represents the latest in an international brawl over the conception presented by economist and U.S. Presidential candidate Lyndon LaRouche, that world financial and monetary aggregates are growing at a hyperbolic rate, while physical output collapses; this trend cannot be sustained, and must lead to an implosion. That implosion will cause the biggest financial disintegration in 650 years. Each passing day adds confirmation to LaRouche's forecast.

Yet, this idea is being furiously contested by the international financial oligarchy and its mouthpieces. The most notable expression is a piece by Ethan Kapstein, director of studies of the New York Council on Foreign Relations, in the January-February issue of the CFR publication *Foreign Affairs.* In that article, entitled "Shockproof: The End of Financial Crisis," Kapstein contends that the world financial system cannot collapse. He reviews the dangers of the world financial system, beginning with the 1974-75 collapses of the Germany-based Bankhaus Herstatt and the New York-based Franklin National Bank. The Herstatt failure had contagious effects: Interest rates rose, the Euromarkets (the London-based markets for dollars and other hard currencies) contracted, and the integrity of the world inter-bank payments system was threatened.

In 1975, in response to this, the central bankers of the Standing Committee on Banking Regulations and Supervisory Practices, now known as the Basel Committee, adopted the Basel Concordat, which set up information sharing among the world's central banks and regulatory authorities.

In 1982, there was a new series of shocks. The Italian Banco Ambrosiano failed during the summer, and then, on Aug. 12, 1982, Mexican President José López Portillo announced that he was nationalizing Mexico's banking system, and that the payment of hard currency to meet Mexico's obligations to foreign creditors would be greatly reduced, because Mexico did not have sufficient funds. Kapstein quotes an authority speaking of the spreading panic: "Should the Mexican storm spread to other major Latin borrowers . . . there was no telling what might happen to the structure of international finance—or to the whole world economy for that matter."

In 1983, the United States increased its contribution to the International Monetary Fund by $8.4 billion, and other industrial countries also increased their quota contributions. In 1987, the Basel Committee adopted a system of mandatory capital-to-asset ratios for the world's major banks, allegedly tying capital levels also to the level of portfolio risks the banks have.

Kapstein believes that this 1987 agreement, called the Basel Accord, which was approved by the Group of 10 industrial nations, solved many of the banking problems. Incredibly, he even believes that derivatives instruments (dangerous, highly speculative side-bets on already existing financial instruments) are the major agency providing "stability" to the world financial system. Kapstein coos: "Many chicken littles had predicted during the late 1980s and early 1990s that trading in derivatives—futures, swaps, and options—would trigger the next global financial crisis. But they overlooked the important role that derivatives have played in moderating systemic-risk, providing banks with increased opportunities to diversify their portfolios and protect themselves from sudden market shifts. The Basel Committee has amended its accord to account for derivatives trading."

For this reason, Kapstein alleges, during the Mexico peso crisis of December 1994, and the February 1995 collapse of Barings Bank, "the markets responded to these financial crises with little more than a 'ho hum.' "

An informed European source told *EIR* on Feb. 5, that he believes that Kapstein is out of his mind, and that in the halls of power, behind the scenes, the issue of international collapse, which Kapstein tries to deny, is being debated intensively.

Spiegel's indictment

The *Spiegel* article, written as an introduction to the memoirs of the former high-roller Barings derivatives trader Nick Leeson (who is now in a Singapore jail), goes further. It states: "In many countries the economies are in bad shape, but stock market values are rising. More and more people are losing their jobs, while others become ever richer by speculating with foreign exchange and assets. Is the world in the hands of gamblers, has the worldwide financial system turned into a casino?" *Spiegel* warns that "the decisions on gigantic amounts are made more and more rapidly, and therefore the control of billions of dollars, pounds, marks, and francs becomes more and more difficult. Who really knows this monster, which is nowhere and everywhere? A monster that makes governments tremble, and can tear up whole economies. Nobody knows how big it is, and nobody has ever seen it. Financial markets have already become virtual reality."

Spiegel says that today's global "casino economy" resembles "betting on horses." It offers as an example the German bank "Trinkaus & Burkhardt, a subsidiary of the British Midland Bank, which in turn belongs to Hongkong and Shanghai Holding"—and which is now one of Germany's leading derivatives traders. A Trinkhaus employee proudly describes his company as "Germany's biggest gambling agency."

Can disaster be prevented? *Spiegel* cites the Mexico crisis of December 1994, during which President Clinton and International Monetary Fund Managing Director Michel Camdessus scrambled to stop a Mexico-triggered international financial meltdown, ominously described, in Camdessus's words, as the "first financial crisis of the 21st century." Moreover, *Spiegel* says, "It most likely will not have been the last." *Spiegel* concludes that it will be extremely difficult "to control or even manipulate the markets of billions, which are everywhere and nowhere, in order to prevent the whole system from collapsing."

'Financial Chernobyl'

These words were echoed in an analysis in the Feb. 6 French daily *Le Monde,* written by Eric Leser. He stated that potentially next on the agenda is a "financial Chernobyl." Leser warned that "big banking accidents" have multiplied in France in recent years, and that it is only "the intervention of States into the most important catastrophes" worldwide, that has averted "chain-reaction failures like those of the 1930s, with their incalculable economic consequences." These cannot be prevented much longer.

Meanwhile, Felix Rohatyn, of Lazard Frères investment bank, who has often expressed himself similarly on this theme, warned, in the Jan. 17 *International Herald Tribune,* that the games played by House Speaker Newt Gingrich (R-Ga.) and Sen. Phil Gramm (R-Tex.) in delaying an increase of the federal debt ceiling, could produce a U.S. "default on the national debt," which would lead to worldwide catastrophe. Such accurately alarmist statements may have cost him the number-two position at the Federal Reserve System, for which President Clinton had wished to nominate him, because Sen. Alfonse D'Amato (R-N.Y.), representing the banking community, mounted a fierce campaign to block Rohatyn's nomination.

However, joining Kapstein and the utopian New York banks, the head of Lazard Frères, Michel David-Weill, said Feb. 6 in the French daily *Le Figaro* that the world has entered an era of "considerable prosperity" which means that a "great financial crisis . . . is excluded."

A whiff of reality

In late February, the Bank of England's *Quarterly Bulletin* presented evidence that the derivatives market is continuing to mushroom. An article and a table broke down daily derivatives trading volume by the categories of those derivatives that are traded over-the-counter (OTC) and those that are exchange traded. During April 1995, on a daily basis worldwide, there were a total of $1.329 trillion OTC-traded derivatives, and a total of $2.215 trillion in exchange-traded derivatives.

The Bank of England did not report equity or commodities contracts which are traded on either exchanges or OTC—a sizable quantity. But with $3.544 trillion of derivatives traded per day, multiplied by 244 trading days in the year, the total annual volume of derivatives trading, of just the contracts for which information exists, is $865 trillion. Adding in the trading of the other contracts that the Bank of England does not report on, the figure is larger.

The "Kapstein debate," as it is coming to be called, represents a positive development in the sense that reality is impelling various influential figures to recognize the truth of LaRouche's warning of imminent financial collapse. This is paralleled by, and probably has helped to cause, the debate in the Democratic and Republican parties on real economic issues.

However, action must follow: The Chapter 11 bankruptcy reorganization of the decaying world financial system, recommended by LaRouche, is next on the agenda.