

Editorial

Rumblings on the derivatives front

From 1993 on, when economist Lyndon LaRouche first put forward his warnings about the derivatives bubble and urged the imposition of a nominal tax on derivatives transactions, discussion of the derivatives problem has been closely associated with LaRouche. When the exotic financial instruments hit the front pages in 1994, following the bankruptcy of Orange County, California, and then the mighty Barings Bank went belly-up after the failure of an estimated \$1.5 billion in derivatives in 1995, many people were astounded and forthright about how LaRouche had been right.

Despite periodic public debate about the threat of a derivatives blowout, including from the Bank for International Settlements, over the last four years, nothing substantial has been done. Derivatives exposure of the banking system internationally has grown like the cancer that it is.

Now, the rumblings of a major crisis are beginning to be heard, particularly in the context of the dramatic movements of currencies, but also due to the increasing bankruptcy of the major banking institutions.

The first big warning issued recently came in the context of the Russian state default. European banking experts put out the word in late August that the Russian government's freeze on certain currency transactions was a threat to settlement of as much as \$100 billion in over-the-counter ruble "forward contracts." A Russian failure to meet these obligations threatened to trigger a chain reaction among the Western derivatives "counter-parties," the warning went.

Over the last two weeks, there have been hints that such a chain reaction might have begun. Certain major Western banks, including Deutsche Bank and Republic Bank, have reported hundreds of millions of dollars in losses (probably conservative figures) in connection with their Russian exposure.

The second major alarm was issued by Japanese Finance Minister Kiichi Miyazawa on Aug. 25. Speaking to the Parliament's Lower House, Miyazawa stated his belief regarding Japan's de facto bankrupt Long

Term Credit Bank that "the notional amount of LTCB's derivatives trade is over 50 trillion" yen. If LTCB "should find difficulty in paying," he added, "then there is a danger of default." Reuters reported that he concluded saying that such a default "could lead to a Japan-triggered global financial depression."

Does anyone doubt that Japan's banking system is intimately connected with the global one?

Then, in the wake of the currency controls announced by the government of Malaysia on Sept. 1, new warnings began to be heard. Malaysia's imposition of capital controls "threw Asian capital markets into chaos, threatening an international payments crisis as billions of dollars in ringgit-denominated financial contracts that are no longer freely tradeable start to come," the *Wall Street Journal* wrote on Sept. 3. Banks fear a "chain reaction of payments failures," the *Journal* added.

One European banker, when asked about this danger, pointed to the particular vulnerability of the Singapore stock exchange, where many of the ringgit-denominated trades were made.

Should we worry about the derivatives traders? No, not one bit. Not one penny should be given to save these speculators—who have been amply warned—from losing their shirts. Many of these traders are big hedge funds that deserve to be wiped out, and the banks that lent to them are barely any better. These are the guys who have been bringing in money hand over fist, while the real economies on which people's lives depend are bled dry.

So, let the derivatives go. They were always doomed. What we have to worry about is reorganizing the financial and banking systems so that they serve the interests of nations and peoples. Pensions and jobs have to be saved, and cheap, directed credit provided for reconstruction. Governments have to retake control of their currencies so that they are instruments of trade and production once again. As to the derivatives—good riddance.