loans it has, as the $4.2 billion simply cannot be paid, the company said in a release. In return, they offered to cut 30% of the workforce, or 2,000 employees, and have senior management resign. Japan's construction sector has been devastated by cancellation of projects all over Asia. Kumagai's main banker, Sumitomo Bank, is being asked to waive $2.3 billion and Shinsei Bank $1 billion, with the rest to be forgiven by 13 other creditors. Shinsei recently lost $1 billion in the $6.3 billion crash of Sogo Department Stores.

War over the AMF

Most of the 20-40% declines in Asian stock markets this year have occurred since the July 31 Okinawa Group of Eight summit, at which the U.S. Treasury and the British Exchequer flatly denied Asian finance ministers' demands, mediated by Japan, for regulation of "hot-money" dollar speculation and hedge funds. As *EIR* reported on Aug. 18 (p. 5), the Okinawa G-8 communiqué instead endorsed the current speculative IMF-centered system.

The Sept. 10 communiqué issued by finance ministers from the APEC forum similarly endorsed the IMF again, but reflected more of the fight which has been coming from the Asian side, one official told *EIR*. "The Okinawa Communiqué read like a surrender document, but the APEC Communiqué reads like a war report, so you know there are two sides in the fight," he said. The 37-point APEC communiqué has "some of our language," he noted, including a critique of globalization which "may also increase economies' susceptibility to external shocks and social dislocation." Item 13 also emphasizes that "regulation should be considered" for hedge funds and hot-money speculation if it becomes clear "that the Okinawa result of no regulation isn't working," he added. The official also pointed out that item 18 welcomes the Chiang Mai Initiative by name, although placing the idea within the context of continued world dominance by the IMF.

The U.S. Treasury, however, has delayed creation of the CMI's proposed $200 billion pooling of foreign exchange by Japan, China, Korea, and the ASEAN allies. The pool was to be used independently by Asian nations to support each other's currencies in case of attacks just like those now in process. The United States, however, is demanding that the CMI cash be put under IMF control, such that any country needing to defend its currency would first have to go to the IMF for cash, and get an IMF "conditionalities" regimen. After that, the country could then go to its CMI allies and get cash from the CMI pool as a "second line of defense," in Treasury's terminology. "This would mean we would have to submit to IMF economic dictats as part of Chiang Mai—when our whole purpose was to get away from the IMF," one irate official told *EIR*. The United States has put so much pressure on Japan in particular, one source told *EIR*, that the Japanese Finance Ministry is considering supporting the "IMF second line of defense" folly. Meanwhile, the region's currencies are burning down again.

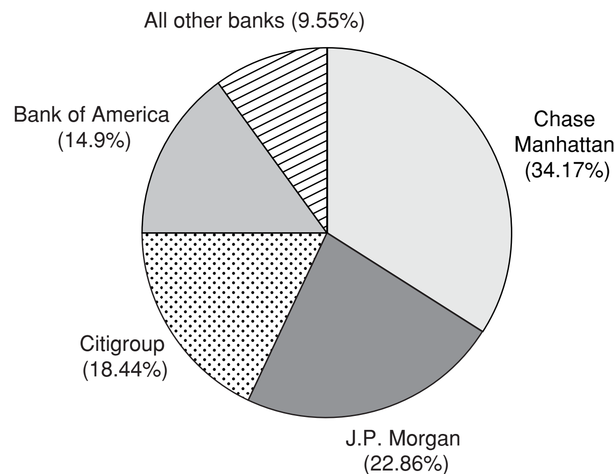
Chase-Morgan Merger Is a Derivatives Disaster

by John Hoefle

Lyndon LaRouche once observed of a major financial merger, that it was like two staggering drunks attempting to remain upright by leaning on each other. That image comes quickly to mind with the blockbuster—or, perhaps, bubblebuster—announcement on Sept. 13, that Chase Manhattan Corp., already the largest derivatives institution in the world, was buying J.P. Morgan & Co., the second-largest U.S. derivatives holder. While presented to the public as the combination of two strong banks to create an even stronger one, the likelihood is that both banks are using the merger to hide some of their dirty derivatives laundry. This deal is damage control, of the sort which itself does more damage than good.

The derivatives exposure of J.P. Morgan Chase & Co., as Chase will be known after the purchase, is extraordinary. As of June 30, 2000, Chase had $14.4 trillion in off-balance-sheet derivatives, while Morgan had $9.6 trillion in derivatives. Combined, the new Morgan Chase will have a whopping $24 trillion in derivatives, or 57% of the $42 trillion in derivatives officially held by U.S. bank holding companies (**Figure 1**), and more than one-third of the derivatives held by all U.S.

FIGURE 1
Concentration of Derivatives at U.S. Bank Holding Companies



Source: Comptroller of the Currency.

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financial institutions, including commercial banks, investment banks, and insurance companies, many of which are themselves vastly overexposed (**Table 1**).

Super Tear, Oops, Tier

The joint press conference held by Chase and Morgan to announce the merger (Chase is buying Morgan for some $33 billion, mostly in stock), was filled with the usual perception-management superlatives, a class of statement rarely confused with the truth.

"This merger is a breakthrough for J.P. Morgan and Chase that will position the new firm as a global powerhouse," said Morgan chairman Douglas A. Warner III, who will chair—but not run—the new bank.

"This transaction combines the most comprehensive group of clients with extensive financial and intellectual capital. . . . Our new firm will have leadership positions across a broad array of businesses in growth markets," added Chase chairman William B. Harrison, Jr., who will run Morgan Chase as president and chief executive officer.

That the deal represented perhaps the most dangerous concentration of financial toxicity in world history, was somehow overlooked in the press conference and the resulting media coverage.

The deal was, naturally, given significant, and shamelessly friendly, play in the major Wall Street-controlled press outlets such as the *New York Times* and the *Wall Street Journal*. The *Journal* (known in some circles as the *Urinal*) even went so far as to name what it asserts will become the "super tier of global players. In the banking sector, there will be Citigroup, J.P. Morgan Chase, Credit Suisse First Boston, and Deutsche Bank. In the investment banking world: banks Goldman Sachs Group, Morgan Stanley Dean Witter, and Merrill Lynch. Among insurers, American International Group, Germany's Allianz, and AXA of France top the list."

But the super-tier shows signs of turning into a super tear. The mergers of recent years have created a class of giant banks in the $700-800 billion asset range, with three Japanese banks set to merge into the world's first trillion-dollar bank—if they survive that long. Of course, a trillion dollars isn't what it used to be, and when the hyperinflation really gets rolling, trillionaires will be commonplace. As the old joke goes: The good news is that you're worth a trillion dollars; the bad news is that a loaf of bread costs $2 trillion, if you can find one.

TABLE 1

Major U.S. Derivatives Dealers, Holdings at Year-End, 1999

(Trillions $)

Dealer	Derivatives
Chase Manhattan	12.9
J.P. Morgan	8.9
Citigroup	7.4
Goldman Sachs	5.2
Bank of America	5.1
Merrill Lynch	3.9
Morgan Stanley	3.4
Lehman Brothers	2.9
Bank One	1.0
Berkshire Hathaway	0.9

Sources: Comptroller of the Currency; *Swaps Monitor.*

One Disaster after Another

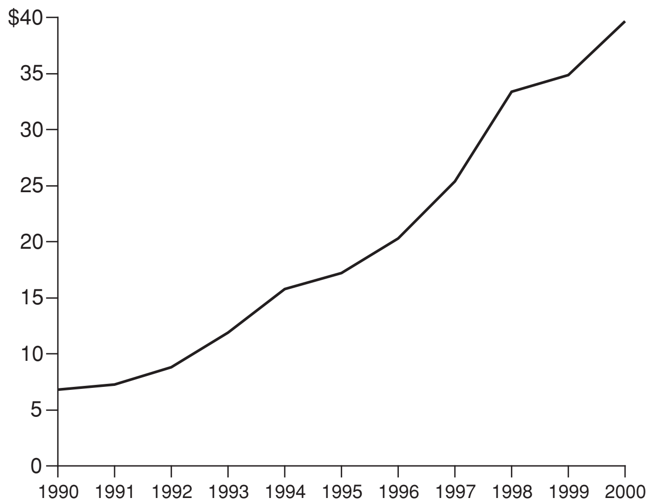
With the banking crisis of the late 1980s, spurred by the collapse of the junk bond and real estate markets, the decision was made to rescue the financial system by jumping whole-hog into the derivatives market. To lead the charge, J.P. Morgan and Bankers Trust—a bank created decades earlier by the Morgan interests—began the process of transforming themselves from commercial banks into investment banks, despite the fact that it was illegal under U.S. law for banks to engage in securities trading. Bankers Trust was assigned the lead role, and rapidly became the poster-boy for the derivatives movement. The pundits came out of the woodwork to praise the bank's revolutionary business model, right up until 1994, when Bankers Trust blew up.

Between 1989 and 1994, the Federal Reserve and the Bush Administration acted in concert to revive the then-actually, though not officially, bankrupt U.S. banking system. The Fed lowered interest rates repeatedly to pump money into the banks and the derivatives market, while the Bush Administration leaned heavily on Federal bank examiners to ignore bad loans and other unpleasant balance sheet items. Citicorp was secretly taken over by the Fed and nursed back to the appearance of health by huge cash infusions and market manipulations. A wave of big bank mergers in 1991 took care of some of the more pressing disasters, and the orchestrated European currency crisis of 1992 pumped billions of dollars into Citicorp, Morgan, and other Anglo-American insiders.

The result was, predictably, the emergence of a derivatives bubble (**Figure 2**), which, in its clumsy slam-on-the-accelerator and then slam-on-the-brakes style, the Fed decided to restrain. In 1994, the Fed reversed its interest-rate policy and began raising rates. The rise in rates almost immediately blew out the market in mortgage-backed securities and bankrupted that market's largest player, Kidder Peabody. It also blew up the derivatives poster-boy, Bankers Trust.

By mid-1994, Bankers Trust was coming noticeably unglued. In desperation, it began blatantly cheating its customers (ripping off customers is an honored tradition on Wall Street, but there are rules by which the predatory game must be played, the first of which is don't get caught). This cheating, rather than being dealt with behind the scenes in the usual manner, was instead deliberately blown up into a major

FIGURE 2
Off-Balance-Sheet Derivatives at FDIC-Insured Commercial Banks, at Year-End
(Trillions $)



Source: FDIC.

TABLE 2
Top 25 U.S. Bank Holding Companies with Derivatives, as of June 30, 2000

Bank Holding Company	Assets (Billions $)	Derivatives (Billions $)	Dollars of Derivatives per Dollar of Assets
Chase Manhattan	396	14,386	36.33
J.P. Morgan	266	9,626	36.14
Citigroup	791	7,763	9.81
Bank of America	680	6,304	9.28
First Union	258	973	3.77
Bank One	273	911	3.34
FleetBoston	181	392	2.16
Bank of New York	77	361	4.70
HSBC North America	85	272	3.21
Taunus (Deutsche Bank)	195	237	1.21
Wells Fargo	234	199	0.85
State Street	65	173	2.67
KeyCorp	84	69	0.82
National City	85	59	0.70
Mellon	46	59	1.28
ABN Amro North America	67	54	0.80
PNC	76	58	0.77
SunTrust	100	33	0.33
Wachovia	71	33	0.47
First Tennessee	20	30	1.52
Bankmont Finanical	45	21	0.47
Northern Trust	37	22	0.61
UnionBanCal	34	15	0.44
Comerica	41	14	0.33
U.S. Bancorp	86	12	0.14
Top 25 derivatives banks	**4,293**	**42,077**	**9.80**

Sources: Office of the Comptroller of the Currency; *EIR.*

scandal, and that scandal was then used as the pretext for the Fed and the Treasury to take over the bankrupt bank. The old management was run off, the derivatives portfolio sanitized, and the bank was eventually sold off to Deutsche Bank.

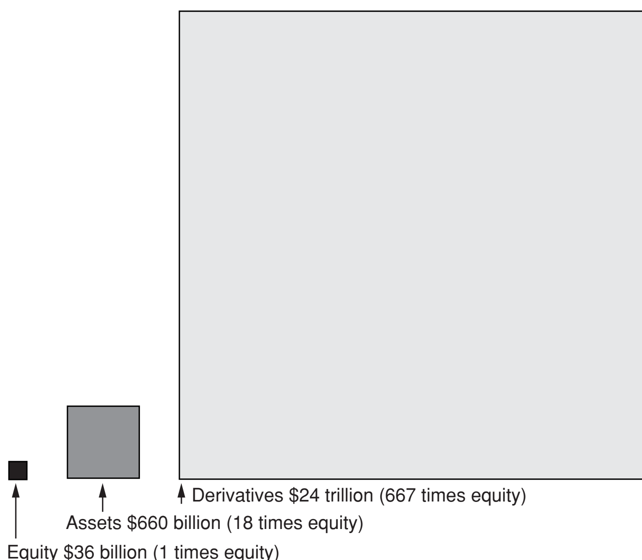
1994 also saw the shocking bankruptcy of Orange County, California, due to a couple of billion dollars in derivatives losses, as well as a rash of multimillion-dollar losses in state and local governments across the nation. It was the year that derivatives became a household word, one with unpleasant connotations.

Rather than admit the error of their ways and abandon their casino, the bankers and their regulators redoubled their efforts to build their house of cards. Money was pumped into the bubble, markets were created in the "emerging" sector, and regulatory obstacles were swept away, sometimes legally, sometimes not. Exemplary was the 1998 purchase of Citicorp by Travelers Group, an insurance company which also owned the Salomon Smith Barney investment bank. The purchase was in direct, open violation of the Glass-Steagall Act, but no move was made to enforce the law. The law was not only ignored, it was condemned by Congress and banking regulators as an obstacle to the well-being of Mom, apple pie, and the American financial system. After some infighting among the commercial bankers, investment banks, and insurers over who would get to eat whom, the Glass-Steagall Act was repealed.

When one lone regulator, the Commodity Futures Trading Commission under chairman Brooksley Born, dared to suggest that billions of dollars of derivatives transactions were illegal under U.S. law, the Fed, the Treasury, and the Securities and Exchange Commission slammed her, and Congress threatened to shut the agency down. Parenthetically, it was the same CFTC under the chairmanship of Dr. Wendy Gramm, which had opened the derivatives floodgates in 1993 by illegally exempting certain over-the-counter derivatives deals. Dr. Gramm, the wife of Senate Banking Committee chairman Phil Gramm (R-Tex.), is now on the board of Enron, the Bush-linked U.S. electricity speculator.

By 1998, the bankruptcy of Long Term Capital Management triggered a multibillion-dollar bailout, and the Fed and other major central banks once again turned on the money pumps to stave off a blowout. Throughout 1999, the markets

FIGURE 3
J.P. Morgan Chase & Co., Equity, Assets, and Derivatives



Sources: Comptroller of the Currency; company reports.

were routinely manipulated to paper over derivatives disasters, such as Julian Robertson's now defunct Tiger Management, while rumors swept the markets that big names were fatally wounded. Among those most often cited was Goldman Sachs, which managed to recapitalize itself by going public.

This Summer has also seen a rash of mergers among the big derivatives players. Besides the Chase/Morgan deal, UBS—itself the product of a merger between Swiss Bank Corp. and the Union Bank of Switzerland—is buying PaineWebber, and rival Credit Suisse is buying Donaldson, Lufkin & Jenrette.

The result is that the derivatives market is bigger than ever, with many U.S. banks having derivatives bets in excess of their assets (**Table 2**). The new Morgan Chase touts its $36 billion in equity capital as a sign of strength—after all, only 30 U.S. bank holding companies reach that level in total assets—but the picture changes dramatically when the derivative holdings are factored in. The new Morgan Chase will have $667 in derivatives for every dollar of equity capital, or just $0.0015 in equity for every dollar of derivatives (**Figure 3**).

Too Dumb To Survive

While the demise of Bankers Trust and J.P. Morgan suggests to any sentient being that the derivatives-fed financial bubble is axiomatically flawed, many of the geniuses on Wall Street seem incapable of taking the hint, preferring to believe that the chaos they have unleashed will somehow lead to nirvana.

The *Wall Street Journal*'s "Heard on the Street" column demonstrated this preference for the virtual over reality on Sept. 14, in a discussion of the Chase-Morgan merger. After observing that "it was just a decade ago that J.P. Morgan and Bankers Trust New York were viewed as model banks of the future" with their emphasis on derivatives and currency trading, the *Journal* launched into a shameless attack on "old-style" banking for failing the get-rich-quick test.

"Old-style commercial banking," the *Journal* proclaimed, "has a fundamental flaw: It sticks the banks with big loan portfolios, and the best thing that can happen is that the lender gets his money back with a specified return. Investment banks, on the other hand, can focus on money-making ventures with, in effect, unlimited returns."

Thus the *Wall Street Journal,* one of the most prominent financial newspapers in the world, openly sides with the casino. After trillions of dollars of derivatives losses over the years, with companies, governments, and even nations bankrupted, on the verge of the greatest hyperinflationary blowout the world has ever seen, the *Journal,* and the Anglo-American financiers for whom it speaks, choose to watch it all blow up rather than to come to their senses.