

Organized crime's hostile takeover of the U.S. economy

by Harley Schlanger

Junk Bonds: How High Yield Securities Restructured Corporate America

by Glenn Yago

Oxford University Press, New York, 1991
249 pages, hardbound, \$21.95

The Money Machine: How KKR Manufactured Power and Profits

by Sarah Bartlett

Warner Books, New York, 1991
347 pages, hardbound, \$24.95

With a wave of mergers beginning in U.S. banking, and a consolidation, through mergers and acquisitions, likely in the teetering U.S. insurance industry, there is an attempt under way to rehabilitate the image of junk bonds and the huge leveraged buyouts (LBOs) they financed. The *New York Times* touted the "revival" of junk bonds in a page 1 story on June 26, while the *Wall Street Journal* persistently proclaims their virtues at the same time that it decries the harsh punishment meted out to the guru of junk, the jailed financier Michael Milken.

The journalistic and academic promoters of the explosion of takeover activity in the 1980s, which was fueled by "creative financing" (the preferred euphemism for the junk economy), blame the downturn in the junk markets in the late 1980s on regulatory "overreaction."

One such propagandist, with a Nobel Prize in economics, Merton H. Miller, has declared that the end-of-the-decade collapse of junk bond markets was not due to inflating corporate debt nearly tenfold during the 1980s, while dismantling infrastructure, industry, and slashing research and development programs to pay it down. Instead, he blames a "sequence of government initiatives," including the criminal indictments of leading investment bankers and stricter regulations on leveraged lending by

commercial banks, for the collapse.

This argument is further justified in *Junk Bonds*, by Glenn Yago, a professor of management at the State University of New York at Stony Brook. Yago says that junk bonds were essential to overcome the stagnation of the 1970s, due in part, he says, to lack of access to credit and capital. The "economic boom" of the 1980s, with its "robust economy and low unemployment," the professor opines, required an innovation to "democratize capital." "The primary tool to capital access was the high-yield bond" (junk bond), says Yago, repeating the party line of the free market fanatics. "Far from undermining our economy, junk bonds promoted the economic objectives Americans value: efficiency, productivity and growth." He proclaims that junk bonds have created a "new economic order."

The new order: post-industrial society

Yago says this new order has been realized in a manner consistent with such changes in the past. "In each period of entrepreneurial expansion, new financial technologies were created that yielded higher returns and promoted capital access to industrial innovators. . . . The rise of the junk bond market is only the most recent episode of the ongoing evolution of financial markets that reflects structural economic changes, business requirements for financing, and investor needs for higher returns on investment."

What Yago never gets around to answering is a simple question: What happened to the economy which required structural changes and higher returns? The answer is found in the nature of his "new economic order": It is a post-industrial order. The financial requirements of a post-industrial economy are far different from those of an industrial economy. He does admit that the debate is over "industrial policy versus supply-side economics." And, a chart he provides to show a net increase in jobs between 1980 and 1986, shows that the jobs gained due to mergers financed by junk bonds were all in the service sector, while manufacturing as a whole had a net loss in jobs.

Thus, one major effect of the "innovative" financing pioneered by Milken at Drexel was to help to transform the U.S. into a post-industrial economy, saddled with staggering amounts of uncollectible debt. Instead of enhancing U.S. "competitiveness" as Yago claims, the policies of the '80s have put the U.S. further behind Germany, Japan, and other industrialized nations, in the rate of growth of industrial productivity.

Yago offers a solution to that. Rather than admit the failure of this new financial paradigm, he says the U.S. must demand that nations of the Third World and eastern Europe apply the same "pattern of decentralization, deconglomeration, and democratization of the economy" as has the U.S.! Other free trade ideologues, such as Special Trade Representative Carla Hills, demand that western Europe and Japan adopt "democratization" of their financial markets.

Junk bonds and organized crime

There is a more pernicious facet of the transformation of the 1980s. As the economy was restructured, there was a basic shift in who controlled wealth and financial power in the U.S. This goes beyond the oft-repeated, yet accurate maxim that “the rich got richer, and the poor got poorer.” The essence of the “democratization” of capital praised by Yago and his ilk is that, through LBOs and Milken’s launching of the junk bond pyramid, financial power was increasingly centralized in the hands of organized crime, especially the network associated with the Anti-Defamation League (ADL). This network of takeover artists, corporate raiders, and wild speculators, was named “Milken’s Monsters” by one of its charter members, Meshulam Riklis, and its actions are described in *The Predators’ Ball* by Connie Bruck (see *EIR*, May 11, 1990, p. 18).

The “monsters” include Carl Icahn, Nelson Peltz, Lawrence Tisch, Carl Lindner (whose protégé is Charles Keating of Lincoln S&L), Saul Steinberg, Victor Posner, Ronald Perelman, and the Belzbergs. Their assaults on corporate America were aided by the ADL-linked law firm of Skadden Arps, present home of former ADL National Chairman Kenneth Bialkin, who also was the lawyer for money launderer and fugitive Robert Vesco. Using methods pioneered by Meyer Lansky (and, in some cases, starting with fortunes created by Lansky and his criminal cohorts), these are the “captains of industry” and the “innovators” so loved by the “free traders.”

According to Riklis—Israeli Housing Minister Ariel Sharon’s financial godfather—Milken and Drexel needed a crew to disperse the billions of dollars they could raise from the sale of junk bonds to deregulated S&Ls and commercial banks, as well as to insurance companies and pension funds. Milken and Drexel “have to find the one, two, three, four guys who are ambitious, and they’re gonna give them the money, and they make the bids for companies, and they use these companies to make bids for other companies. . . . That’s what they’re doing, and they’re gonna have to do it more and more. They have to create—I call these guys the monsters” (quoted from *Predators’ Ball*).

George Bush’s friend, Henry Kravis

One of the more prominent “monsters,” Henry Kravis of Kohlberg, Kravis and Roberts (KKR), is the central focus of an interesting, but limited book, *The Money Machine*, by *New York Times* reporter Sarah Bartlett. This is the story of how KKR rose from its beginnings in 1976, when it was launched with a fund of \$120,000, to its present status as the undisputed leaders in LBOs. Bartlett explains how, from 1976 until 1990, KKR “convinced enough banks, pension funds, and insurance companies to lend them over \$58 billion to buy 36 companies.”

One of Bartlett’s themes is that the LBO was changed for the worse by the mid-1980s by Kravis and his cousin, George

Roberts, causing Kohlberg to leave the company. Between 1987 and 1989, KKR bought eight companies with a price tag of \$43.9 billion. Said Bartlett of this growing plunder, “It is clear that they became quite unhinged from the values and business practices the firm was founded on and to which they continued to pay lip service.”

Bartlett describes the enormous growth in the size of the deals, from their first \$300 million-plus deal in 1978 (Houdaille) to the unbelievable RJR Nabisco takeover, for more than \$26 billion. She chronicles some of the questionable practices employed, especially potential conflicts of interest in winning support from state pension funds, which invested hundreds of millions of dollars with KKR, and how they justified such actions: “To them, truth is adaptable.” She also identifies a simple truth about KKR’s relationship to the 1980s, saying KKR “consistently put short-term profit considerations ahead of long-term business interests,” which she said was “right in synch with the times.”

It should be no surprise to learn that Henry Kravis is a strong backer of President Bush. Kravis’s father, Ray, made a fortune through his discovery in the 1920s of tax shelters in oil investments. Among those who entrusted him with their money was Bostonian Joseph P. Kennedy, who had surplus cash from his bootlegging during Prohibition. Prescott Bush, George Bush’s father, and a partner in the Wall Street investment house Brown Brothers Harriman, was another friend of Ray Kravis. When George graduated from Yale in 1948, his father prevailed upon Kravis to give George a job in Tulsa. At the last minute, the young Bush declined the offer, moving instead to Texas.

As Henry Kravis became a heavy hitter on Wall Street, he turned his attention to politics, with an eye to stopping any laws to restrict hostile takeovers. He hosted a fundraising luncheon for Bush during the 1988 campaign, raising \$550,000, and later became a member of the Republican National Committee’s Team 100 after he and Roberts each gave it \$100,000. Henry was selected to be co-chair of Bush’s inaugural dinner.

Kravis told Bartlett that, though he would not characterize his relationship with Bush as close, “he writes me handwritten notes all the time and he calls me and stuff, and we talk. We talked on corporate debt . . . and what that meant to the private sector.” As Bush has supported the deregulation and free market slant which has allowed KKR and the LBO bandits free rein to loot the economy, it is clear that they are in agreement; Bush is in league with the monsters.

Speculating on whether KKR violated th“My own view is that it would be difficult to prove in court,” she concludes—Bartlett misses the point. Her subjects have profited enormously, looting the economy at will, using, and losing, other people’s money (much of the losses are yet to come—watch the shake-out in the insurance companies), while their actions have hastened the collapse of the U.S. into a new depression. For this, they and their co-monsters should be held accountable.