EIR Testimony Scored Scorched-Earth Looters

by John Hoefle

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A warning of the impending collapse of the international derivatives market, triggering the biggest financial blowout in centuries, was delivered by this writer to the House Banking Committee on Sept. 8, 1993, in testimony on the impact of the North American Free Trade Agreement (NAFTA) upon the U.S. banking system.

My appearance before the banking committee was requested by committee chairman Henry B. Gonzalez (D-Tex.), one of the few men in Washington with the courage to take on the international bankers and their scorched-earth looting policies.

"NAFTA is fundamentally a financial agreement, and to understand it, one must understand the systemic crisis facing the banking system today," I testified.

"Since 1978, the financial community has repeatedly insisted upon the deregulation of banks and other financial institutions, while demanding austerity and cutbacks everywhere else. Every time we have done this, it has led to disaster, as the destruction of the airlines and the S&Ls, and of the U.S. work force attest.

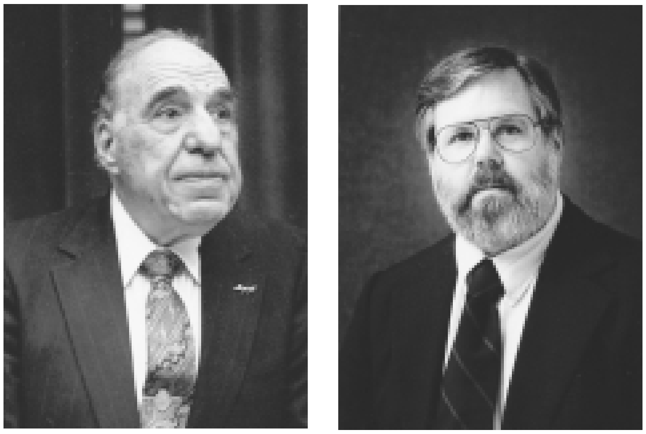
"In response to these disasters, the bankers demand further deregulation and deeper cuts.

"Now, with NAFTA, the bankers are demanding that the United States deregulate its international political and financial relations the same way we've deregulated internally. The purpose of NAFTA is to open up Mexico and eventually all of Latin America for unbridled speculation and looting, of the sort that has already devastated the American economy and bankrupted our banking system.

"When are we ever going to learn that the answer lies not in more deregulation, but rather in the abandonment of the policy of deregulation, and the return to rational rules and regulation?

Deregulation Killed Citicorp

"Take Citicorp, for example. Here's a bank that jumped with both feet into every harebrained, quick-buck scheme they could find. Citicorp made a killing in the 1980s, growing almost as much in 10 years as it had in the previous 168. This



The late Rep. Henry Gonzalez (left), as chairman of the House Banking, Finance, and Urban Affairs Committee, invited EIR *economist John Hoefle (right) to testify on the derivatives danger in September 1993. "I've been reading Mr. Hoefle's articles for two and one-half years," Gonzalez said. "He gets information I have been unable to get."*

growth came, not from real economic activity, but from the growth of a huge speculative bubble, in real estate, junk bonds, derivatives, and other paper transactions which looked good until the bills came due.

"Citicorp's great deals of the 1980s have become the spectacular financial disasters of the 1990s. The list, which includes blowouts such as Olympia & York and Citicorp's humiliation in London after the Big Bang [the Oct. 27, 1986 deregulation of the British stock market], keeps on growing as the real economy dies. Citicorp has demonstrated an astonishing knack for losing money. It's the ambulance-chaser of banks: Every time you find a disaster, Citicorp is there.

"Citicorp made a killing all right—it killed itself.

"If Citicorp were headquartered in San Antonio, Mr. Chairman, it would have already been closed and its officers publicly humiliated and thrown in jail. But Citicorp is not headquartered in San Antonio. It's in New York, where a far different set of rules apply.

"So instead, the government—or rather, the Federal Reserve, which acts like it's the government, but is really owned by the banks—launched the biggest bailout in U.S. history.

"Three years ago, the Federal Reserve Bank of New York took the bankrupt Citicorp over, putting it into de facto receivership. Naturally, this was a secret action, since were the banks' depositors to know just how damaged their bank was, they would have run for the hills.

"Citicorp lied about its financial condition, and published phony financial reports. When Rep. John Dingell [D-Mich.] revealed that Citicorp was technically insolvent, Citicorp angrily denied it. And so did the banking regulators, who are supposed to serve the public, but who clearly serve the banks instead.

"When the Texas S&Ls hid their losses, and the Federal Home Loan Bank Board [FHLBB] looked the other way, the Justice Department created a task force to investigate, and poor [former FHLBB head] Danny Wall's career was ruined. But now, with Citicorp and the other big banks doing the lying, the attack dogs of the Justice Department and the press are silent. Executives of the Texas S&Ls were denounced as the symbols of greed and excess, but nobody says a word about Citicorp and John Reed.

Derivatives Bubble Ready To Pop

"We are on the verge of the biggest financial blowout in centuries, bigger than the Great Depression, bigger than the South Sea bubble, bigger than the Tulip bubble. The derivatives bubble, in which Citicorp, Morgan, and the other big New York banks are unsalvageably overexposed, is about to pop. The currency warfare operations of the Fed, George Soros, and Citicorp have generated billions of dollars in profits, but have destroyed the financial system in the process. The fleas have killed the dog, and thus they have killed themselves.

"What is required, as *EIR* founder Lyndon LaRouche has repeatedly stated, is a restructuring of the U.S. banking system, including the nationalization of the Federal Reserve, taking it out of the hands of the bankers and putting it back into the hands of the Congress as mandated by the Constitution. It is the welfare of the people which is paramount, not the maintenance of the speculative financial system. It's high time we put the speculators out of business, instead of surrendering to them even further by passing NAFTA.

"That's the issue. We'd better deal with it, and fast, while we still have a chance."

At the conclusion of this testimony, the silence was deafening: One could have heard a pin drop. Clearly, few of the committee members, staff personnel, or journalists present were accustomed to such forthright language, especially in contrast to the snake oil delivered earlier in the hearing by Citibank's Jack Guenther, vice president and senior international affairs officer. Guenther, in true banker doublespeak, insisted that NAFTA would create jobs in both the United States and Mexico.

The authority of my testimony was then underscored by Gonzalez, who put his respect for *EIR*'s analyses on the record. "I've been reading Mr. Hoefle's articles for two and one-half years," Gonzalez said. "He gets information I have been unable to get. For example, statistics of the off-balance-sheet liabilities of U.S. banks: We've been looking for those statistics and couldn't get them."

Speculators Running NAFTA Negotiations

The Banking Committee chairman then levelled his own broadside against the derivatives speculators.

"How can we sit here comfortably when bank profits, about half of them, come from the gambling known as the derivatives market?" Gonzalez asked. "Derivatives are not so complicated. It's just a mega-Las Vegas. There are great dangers here. If NAFTA is passed, we'll be promoting the second-largest mega-Las Vegas."

Earlier in the hearing, Gonzalez announced his intention to hold further hearings on NAFTA, to question the negotiators about who was involved, and how.

"I have found it very difficult since President Bush announced the agreement last December, to find out exactly what are the procedures, and who participated in what were really secret negotiations," Gonzalez said.

The difficulty of getting straight answers was exemplified by the elusive Guenther.

"Mr. Guenther, were you or any other Citibank personnel involved directly or indirectly in negotiations; that is, in these processes involving the financial services chapter of NAFTA?" Gonzalez asked. "Did you advise negotiators or did anyone from your bank? Did you review drafts of the agreement? And if so, would you be able to share with us the substance of your comments and advice, and to whom they were given? See . . . we in the Congress don't have the names of the individuals participating in these negotiations. We don't even know who is in there, and I think that that's a very important factor, and that's the only reason why we're going to have the second hearing."

"I don't think I could give you the answer that should really be the definitive answer on that," Guenther weaseled; he then admitted, "All through the past year or so, I've been attending weekly meetings" on the subject. "Mr. McDonough from the Fed would be there. . . . Our Washington office here has been working on this throughout . . . and I'm sure the answer is, yes, we participated in some indirect way. But I think I should undertake to get you a more precise description than that."

The financial community is also worried about a blowout of the derivatives market, which was made evident in an opinion column in the *Wall Street Journal* by Wendy Lee Gramm, entitled "In Defense of Derivatives," which appeared the same day as the Banking Committee's hearing. From 1988-93, Wendy Lee Gramm was chairman of the Commodity Futures Trading Commission, and promoted the burgeoning market in derivatives by exempting them from regulatory procedures. Her husband is Texas Republican, Sen. Phil Gramm, whose free market nostrums for the economy give cover to the "mega-Las Vegas" that Gonzalez referred to.

Wendy Lee Gramm's article complained that derivatives have been unfairly "characterized as purely speculative instruments" that "pose grave risks with potentially dire consequences for the whole financial system." But her article reads more like a plea not to blame *her* for the coming catastrophe. "Most important," she concluded, "if another major default or market shock occurs, we must all resist the urge to find scapegoats, or to over-regulate what we just do not understand."