Financial and Monetary Crisis

1. The International Development Bank

At a press conference in Bonn, West Germany, on April 24, 1975, excerpted here, Lyndon LaRouche laid out his plan for an International Development Bank. The proposal was elaborated in a pamphlet titled "IBD: How the International Development Bank Will Work" (see p. 37 for an excerpt on the development of Mideast agriculture).

We propose the immediate establishment of an International Development Bank as a three-way agreement among the three principal world sectors, the industrialized capitalist sector, the so-called development sector, and socialist countries. The Bank would discount letters of credit and bills of exchange authorized by treaty agreement among nations and self-constituted groups of nations, and would thus act as a rediscount bank for those other letters of credit and bills of exchange generated in the course of supplying needs of final commodities producers producing for bookings issued under relevant international development bank treaty agreements.

For example, several key developing sector nations have demanded that the industrialized sector negotiate interlocking agreements concerning three items: energy, raw materials, and food. Our essential criticism of this agenda is that it included only three principal items, instead of the necessary four. The fourth item should be "development." Our remarks concerning this example are not conjectural, provided that suitable initiative proposals are generated by significant forces of the industrialized sector, key forces within the so-called "Third World" will be prepared to immediately begin working negotiations along the lines of such a four-point form of general treaty agreement with the industrialized sector.

On the basis of our own organization's studies, and our discussions of these studies with governments and leading political forces within the "Third World," we have determined to the point of certainty that the activities of an International Development Bank in connection with present wishes and consumption capabilities of the developing sector, would be sufficient to generate a higher rate of industrial expansion in the advanced sector than has been seen during the most prosperous intervals of the past quarter century.

The feasibility of this proposed program demands understanding of certain often neglected ABC's of Political Economy. Without understanding those principles, we should all be hopelessly caught in the worst disaster of human history.

The basic fact on which all political economy depends is the characteristic feature of economy. That is, that a proper use of means of production and means of personal consumption generates levels of output in excess of the prime costs incurred. The second basic fact, essential to this solution, is that all general development, including industrial development, depends upon creating a basis for growth in an abundant supply of adequate nutrition at relatively low social cost. To the extent that these two principles are observed in practice, and advancing technology emphasized to that end, it is feasible to generate very large amounts of long-term credit without inflationary effects.

We emphasize that a combined concentration on both industrial development and expanded food prodution are the absolute imperatives for this period. To the extent that long-term development credit to the developing sector places priority emphasis on rapidly increasing the amount and social productivity of world food production, any amount of credit can be issued over a 10- to 15-year term ultimately payable in expanded food, in increased masses of productive labor, and in the social productivity of human labor generally.

The immediate problem the new bank will face is this. In addition to the immediate potential for substantially increasing agricultural output and productivity generally, there are three regions of the developing sector which represent massive opportunities for increases in agricultural output. One of these, the Rio de la Plata region of South America, offers short-term major benefits for development as an agro-industrial region. The other two, the Sahel, and the India-Bangladesh-Pakistan region, represent potentially major world food-producing regions, but will require 10 to 15 years of massive engineering efforts and development to approach their enormous surplus potentials. Therefore, our problem is to provide a level of development equivalent to approximately a quarter-trillion current transferable rubles annually, concentrated on low-interest loans and grants with a typical maturity in the order of 10 to 15 years required for loans.

The apparent difficulty of conducting such programs is only apparent and not actual. To the extent that the industrialized sectors can generate large surpluses in excess of immediate reinvestment requirements within that sector, that portion of surplus can be issued as credits and grants without adverse economic effects. The only real problem involved is that of raising the gross level of industrial outputs to the scale the indicated undertaking requires. . . .

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2. Volcker's measures will lead to disaster

This statement was issued by LaRouche on Oct. 16, 1979:

I herewith submit a demand for the prompt impeachment of recently appointed Federal Reserve Chairman Paul Volcker.

Yesterday, appearing before a committee of the United States Senate, Volcker either lied or manifested gross incompetence in the course of a reply to Senator Paul Sarbanes, Democrat of Maryland. He stated, falsely, in his response, that the Federal Reserve System could not channel the flow of constricted liquidity in such a way as to ensure adequate credit for maintaining the operating capital of business employers.

In fact, the Federal Reserve System has the capability, with the consent of the Executive branch and Congress, to conduct precisely the sort of anti-depression measures which Senator Sarbanes proposed.

Mr. Volcker either knows this, in which case he committed perjury in sworn testimony before the Senate, or he does not know this, in which case he is impeachable for incompetence.

In earlier public statements, Mr. Volcker has stated himself to be a supporter of a doctrine of "controlled disintegration" for both the United States and the world economy. Now, under the semantic pretext of "anti-inflation" "fiscal austerity," Volcker has abused his powers as Federal Reserve chairman to implement measures which constitute an efficient effort to plunge the U.S. economy into misery, chaos, and confusion of the sort ultimately worse than the conditions experienced during the Great Depression of the 1930s. In light of the evidence of a conscious intent behind Mr. Volcker's attempts to ruin the U.S. economy, his conduct in office must be regarded as no better than treasonous in character, if not formally treason by the strict language of the U.S. Constitution.

As one of the world's leading economists, I have caused my staff to conduct a computer-based analysis of the near-term consequences of Volcker's measures (**Figures 1** and **2**).

FIGURE 1
U.S. economy: effects of Federal Reserve credit policy

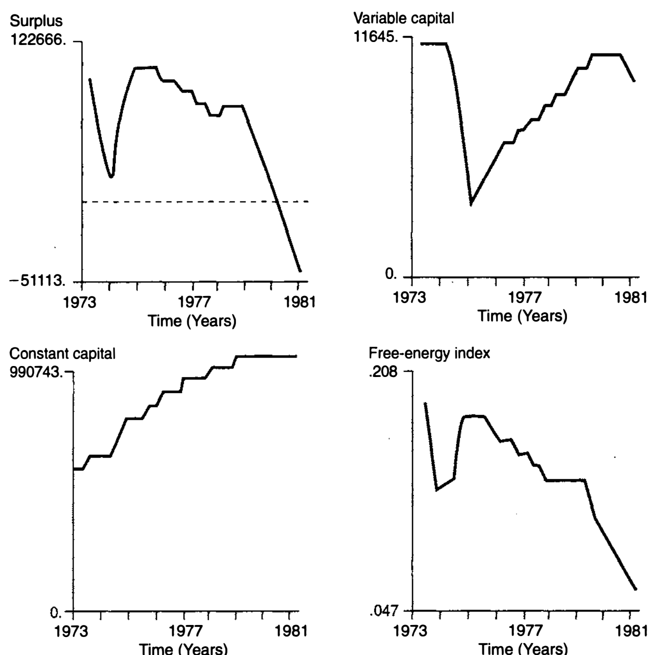
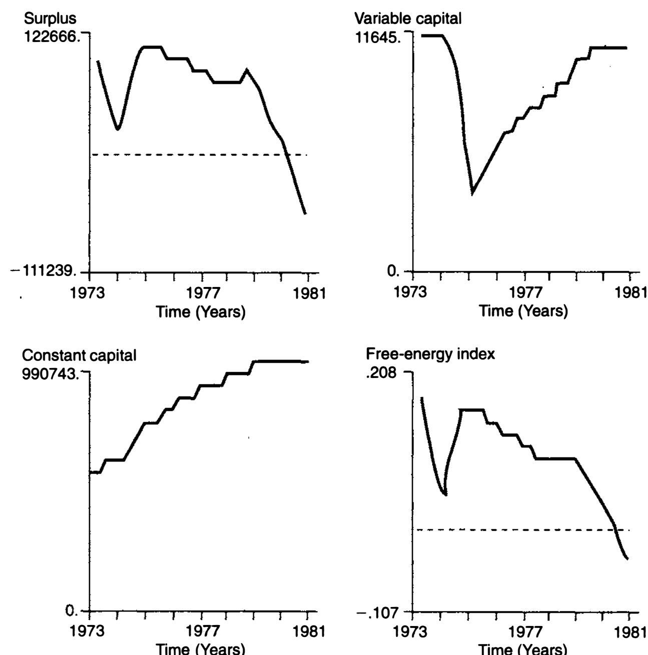


FIGURE 2
U.S. economy: effects of Federal Reserve credit policy plus $30 per barrel oil price



Surplus shows the total volume of tangible goods production available for investment the following year; variable capital is the total volume of tangible production required to employ goods-producing workforce; constant capital is the cost of maintaining productive facilities plus the cost of raw materials; free-energy index measures the economy's capacity to grow in the future (surplus divided by the sum of variable capital plus constant capital).

Those results, coinciding with the estimates of other analysts reporting independently, indicate that the measures already enacted by Volcker will cause a 15% recession in the U.S. economy, probably putting the United States into a recession twice as severe as that of 1974.

The computer-based analysis has been conducted for two cases. In the first case, the computer run assumed no increase in the average price of energy materials. The computer run showed the 15% decline in the U.S. economy over the months immediately ahead. The second case took into account the estimated 15% further increase in the price of world-market petroleum expected to occur at the end of this year. That case would bring us close to a depression. If loose money measures were used by the Carter administration beginning next Spring, because of election-year considerations, the near-depression might be postponed, but at the price of pushing present 20% inflation rates up toward triple-digit inflation rates around the close of 1980.

Furthermore, the argument that Volcker's "fiscal austerity" will hinder inflation is a hoax. Although there might be some temporary leveling off of inflation-rates during the weeks just ahead, by about January 1980, Volcker's measures would begin to send inflation-rates spiraling upward again. This new spurt of inflation would be caused by the effort to offset higher borrowing costs for operating capital plus efforts to bring total income-volumes of firms back above break-even levels under conditions of a substantially shrunken market.

There are two immediate measures which would ameliorate the present crisis. First, the U.S. gold reserves must be valued at an adjusted current world market value, a value to be negotiated with both the European Monetary System member-nations and the OPEC the "petrodollar" holders. This would stabilize the value of the dollar and take the worst pressures off dollar liquidity. Second, the Federal Reserve must immediately implement the kind of selective credit-flow controls which Senator Sarbanes proposed. This would not solve our nation's problems, but would give us breathing-room for developing a comprehensive, long-term set of monetary and investment-incentive measures.

A depression is not necessary. Any official who adopts a policy of "controlled disintegration" of the United States economy is engaged in a treasonous undermining of our nation's overall security at this juncture.

It is time to cease playing political theater with the election campaign. It is time for the citizens to cease treating politics as a matter of attaching oneself to popular political actors in an electoral beauty-pageant, and to pay attention to the fundamental interests of our nation, especially to those vital interests which determine the condition of individual life and the kind of world and nation we work to leave to our posterity. It is time to force the impeachment of treasous forces such as Paul Volcker.

3. Keep the local banks functioning

This statement was issued by LaRouche on March 18, 1987 and was published in The LaRouche Record: Selection of the Candidate's Policy Statements 1986-87, *by the LaRouche Democratic Campaign. The statement was issued during a period of widespread collapse of the oil-belt banking system.*

The Federal government must take new forms of action now, to deal with the rapidly accelerating rate of banking failures.

First, the government must proceed on the basis of the fact, that most of the banking failures are the fault of neither the banks nor their borrowers. This tidal wave of failures is the result of a general, international financial crisis, combined with a deepening economic depression, which threatens to bring down almost the entirety of the banking system and other classes of financial institutions.

Second, the wave of collapse of local banking institutions must be seen as adjunct to liquidation of farms and plant shutdowns. The loss of a large number of these institutions, during the present economic depression, would represent a major loss of essential structure of the U.S. economy, a loss of structure which could make an economic recovery very difficult to mobilize.

Third, under conditions of economic recovery, many of these banks, farms, and industries would be viable economic entities. Since it must be our intent, to make those changes in policy which bring about such an economic recovery, it should also be our policy to save those banks, farms, and industries which would resume economic viability under recovery conditions.

Therefore, our policy should be, to prevent precipitous collapse of banking institutions, and to take measures to maintain operations of those banks which would become viable under recovery conditions.

Emergency action

It should be determined, whether it were better to take the appropriate action under the President's emergency powers, or whether an emergency, clean bill must be enacted by Congress for this purpose. Were the latter deemed feasible, it were to be preferred, for rather obvious reasons.

An emergency action under law must provide for: the orderly and efficient determination of which imperilled banking institutions could be successfully reorganized under

conditions of economic recovery, and emergency measures of reorganization to provide for the continued operation of banking institutions falling into the latter category.

The following considerations should be included.

1. Congress should resolve that a condition of threatened international financial crisis and economic depression exists, and that the government is resolved to effect such changes in current monetary, fiscal, and economic policies as may be needed to begin an immediate and durable economic recovery.

2. The general approach to financial reorganization should be to classify non-performing assets as ceasing to accrue debt-service charges according to law.

3. Non-performing loans which might become performing assets, in respect to unpaid principal, under conditions of economic recovery, should be considered as potentially performing loans, and that amount of value of unpaid principal should be classed as a frozen asset. If the bank is solvent on this basis, then the bank should be kept in operation.

4. If there is no prospect for successful reorganization under conditions of economic recovery, and if greater damage to depositors would result from continuing operations than otherwise, the best mode of liquidation should be adopted.

Non-performing debts

The same approach should be adopted, on principle, for the case of foreign non-performing debts. Banks holding loans which are non-performing, should carry balances without accruing debt-service charges, unless the bank should elect to write off the entirety or a portion of this unpaid balance, carrying only some residue as a balance.

In the case of currently non-performing debts of foreign governments, except in the case of the so-called "least-developed nations," it should be assumed that a successful reorganization of payment of either all or a substantial portion of the principal amount of the unpaid balance will occur. In the latter case, the amount of unpaid principal shall be carried as not accruing debt-service earnings, subject to negotiated reduction of this principal.

The greatest danger at the present time, would be a refusal to recognize that the threat to our banking system is part of a combined economic depression and an international financial crisis with many analogies to that of 1929-1932. If we pretend that there is no economic depression and no spiralling financial crisis, and if we continue to employ policies attuned to assumed normal business conditions, we invite an unnecessary, deep catastrophe. If we recognize that such crises are deepening, and also resolve to launch an economic recovery, the correct treatment of temporarily embarrassed banking institutions follows more or less as a matter of applied common sense.

4. Forecast: financial crisis of October 1987

This statement was issued by LaRouche on May 27, 1987, and was published in EIR *on June 5, 1987. The financial blowout forecast by LaRouche began on Oct. 6, when the New York stock market's Dow-Jones index (or, as LaRouche called it, "the Davey-Jones Index") dropped by more than 91 points. The crisis culminated in Wall Street's more than 500-point crash on "Black Monday," Oct. 19. Some $1.5-2 trillion worth of equity in U.S. markets was wiped out from Aug. 25 to Oct. 19, 1997.*

Leading European financial officials have warned my associates, that we should expect to see the beginning of the world's biggest financial crash by October of this year. My comment on that forecast: It might not occur in just that way, but, if the Reagan administration continues its present policies, it is certain that the world's economic situation will become much worse than it is today over the summer months.

I don't welcome this worsening of the situation. It will cause enormous suffering, for one thing. Also, in the defendant's motion which the Soviet government submitted to a Paris court last Friday, Moscow makes implicitly clear that it will react with efforts to assassinate me as soon as possible, for fear that such a crash might bring me at least close to gaining the 1988 Democratic presidential nomination.

Nonetheless, in history, usually, only the eruption of terrible events brings governments and peoples to their senses. It is when the bombs drop on London or Pearl Harbor—or, something like that—that the English-speaking peoples seem to come out of foolish dreaming, and awaken to reality. It is probable that only a growing sense of the reality of the AIDS menace, combined with a financial disaster, combined with awakening to the reality of the Soviet threat, will get the majority of U.S. citizens out of their present wishful stupor before their TV sets.

Whether the great financial crash of 1987 erupts by October, or later, will depend upon what leading governments do at the international monetary "summit" held in Venice on June 12. Those bankers who are expecting a crash by October, make that forecast on the basis of assuming that the U.S. government's role at Venice will be a continuation of the foolish international monetary policy which the Reagan administration has followed over the past five years. In that case, a crash in October would not be absolutely certain, but it would be, at least, a very good guess.

This forecast is based on the observation, that even now, President Reagan is clinging stubbornly to belief in a "Reagan economic recovery" which never actually occurred. The President believes in that non-existent "recovery" for ideological reasons; he wishes, desperately, to believe that his economic policies have been successful ones. As long as the official line of the administration is to stick to the "successful economic policies" of the past five years, the Reagan administration is likely to stick to those policies. This would turn the Venice "summit" into a disaster, destroying the last bit of confidence in the U.S. dollar in international financial markets. Under those conditions, an October crash would be very probable.

Follies in international monetary policy

Take, for example, one of the most recent developments on the international financial markets. The way in which a small loan was granted to Egypt by the international bankers' club called the "Club of Paris."

Egypt was blackmailed into signing what is called an "IMF letter of intent." Egypt was told, all credit would be cut off, unless it signed that letter. The letter required the consent of the Egyptian government to devalaing its currency, and shutting off the highly successful land-reclamation projects which are the only hope for a basic solution to the problems of Egypt's economy. Reluctantly, Egypt signed, and was then promptly given new lines of credit. Egypt received, however, much less than it lost by devaluing its currency, the pound.

This has been the pattern of U.S. support for IMF "conditionalities" policy. The key margin of increase of the U.S. trade-deficit, has been the collapse of U.S. exports to, and increasing imports from, developing nations which have submitted to the terms of such "conditionalities." The "conditionalities" have, in each case, turned a poor debt-repayment possibility by these countries, into an impossible one, in each case.

This affects the internal economy of the U.S. directly. Take for example, the Reagan administration's reaction to the drop in OPEC petroleum prices.

Continued production of U.S. petroleum requires a price of about $24 a barrel. Without that U.S. petroleum production, we are dependent upon increasingly uncertain flows of cheaper oil from the Persian Gulf's war-zone. Instead of putting a price-triggered import charge on imported petroleum, to defend domestic petroleum production, the U.S. government decided to go with dependency on cheaper Persian Gulf oil. This, combined with the U.S. Agriculture Department's policy of collapsing U.S. agriculture, was the cause of the financial crisis among the regional banks of Texas, Oklahoma, Louisiana, Wyoming, Montana, and so forth.

Our government's follies in international monetary policy usually come home to cause suffering inside the United States.

A "zero-economic-growth mafia" inside the IMF and World Bank bureaucracies, acting with U.S. government support, has been collapsing the internal economies and world trade of both developing and Western industrialized nations, while piling up the financial obligations of both developing and industrialized nations. We have been increasing nations' obligations to pay debt, while destroying their means for paying that debt.

Inside the U.S. itself, one of the mechanisms which has been used to prop up apparent consumer purchases, has been a process of increasing average consumer debt, while average consumer income fell. This has been the leading basis for President Reagan's wishful belief in an economic recovery—consumers going deeper into debt to maintain ordinary levels of consumer spending, while average, after-inflation levels of household income have been falling. Now, the growth of consumer debt has reached approximately a saturation-level.

Meanwhile, the prices on the world's stock exchanges have zoomed into the financial stratosphere. Present stock prices are way, way above anything justified by the price-earnings ratio. The bond markets have been sliding down for weeks. About 1,500 U.S. banks are in bad trouble, and more than 200 in immediately serious trouble. Any significant rise in interest-rates could sink as much as half of the savings institutions, and could blow out the banking system generally. If this inflated financial structure collapses significantly in any one sector, all sectors could blow. Any collapse would reveal quickly, that most of the values of financial paper depend upon mere "hot air," such as so-called "junk bonds" or similarly dubious book-keeping accounts.

When the system blows, more than half of the more than $13 trillion of hard-core debt-obligations could blow, more than half of this inside the United States.

The problem is approximately twenty years of bad monetary and economic policies by all Western industrialized nations excepting Japan. (We sometimes complain that Japan is being "unfair," because it refuses to be as stupid as the governments of other industrialized nations.)

Now, during recent weeks, many of the world's leading bankers have awakened to the seriousness of the situation. Except for the governments of Japan and of France's Prime Minister Jacques Chirac, the governments, and political party leaderships of the other Western industrialized nations are still as much in dreamland on the economic situation as they are on the subject of the AIDS pandemic.

Technically, on any day that the U.S. government came to its senses, this crisis could be brought under control. The crash of 1987 is not inevitable. However, unless the governments come to their senses, it is inevitable. During the Venice monetary "summit," and during the weeks following that, we shall see whether the crash occurs as leading European bankers now suspect it will.

5. Federal Reserve Nationalization Act

LaRouche's Presidential campaign organization announced, on Feb. 25, 1992, the release of a draft Federal Reserve Nationalization Act of 1992 (excerpted here), which would nationalize the Federal Reserve System to create a new National Bank of the United States. The legislation is based on the proposal by LaRouche, to return the United States to the method of central banking originally envisioned by Alexander Hamilton, the nation's first Treasury secretary, and mandated in Article I of the U.S. Constitution.

The current Federal Reserve System's method of monetary creation via Federal Funds "open-market operations" is "unconstitutional," LaRouche stated, because it leaves "the power to create fiat credit in the hands of a powerful cartel of private bankers led by Citibank and Chase Manhattan Bank, "who dominate the Federal Funds markets." This system encourages the majority of funds to flow to speculative, nonproductive activities such as junk bonds, leveraged buyouts, and other inflationary activities.

Further information on the proposed Federal Reserve Nationalization Act can be found in The LaRouche Program to Save the Nation, *available from the Committee to Reverse the Accelerating Global Economic and Strategic Crisis: A LaRouche Exploratory Committee.*

Amendments to the Federal Reserve Act

The Federal Reserve Nationalization Act of 1992 completely revamps the Federal Reserve Act of 1913, which creted the Federal Reserve System, to create a National Bank under the Department of the Treasury. This is done through a series of amendments which:

1. Forbid the creation of new fiat credit through the Federal Reserve's current mechanism of *open market operations,* known as creation of "money supply";

2. Create instead large amounts of credit through the new National Bank's *discount window,* providing that all loans presented for discounting by private banks to the National Bank are earmarked for new real physical capital investment, production, or transport of tangible wealth; and

3. Re-regulate *reserve requirements* on deposits of private banks and use them to ensure banks maintain an adequate proportion of lending for purposes of real physical production.

1. Curtailing open market operations

The core of the problem with the Federal Reserve is to be found in the way in which it creates money. The Fed now adds new money supply to the banking system each week, by printing fresh Federal Reserve notes, the familiar dollar bills, for the purpose of *buying a certain portion of the U.S. Treasury debt* (Treasury bonds or bills), that portion of government debt which would not otherwise be purchased by money already in circulation in the banking system. This is known as "monetizing the government debt," printing fiat money to finance the U.S. budget deficit. It is thus axiomatic that since the nation's deficit has ballooned to the $200 billion annual mark during the 1980s, that the inflationary effects of Federal Reserve open-market operations have taken off.

Worse than the question of "how much fiat money?" is the question "whose"? In practice, the Federal Reserve does not purchase Treasury debt directly from the Treasury, but from the two dozen leading Wall Street government debt houses, such as Salomon Brothers and Goldman Sachs, which have bought up the debt from the Treasury Department in anticipation. . . .

The Federal Reserve Nationalization Act of 1992 therefore limits the new National Bank's open-market operations. . . . This means Article I of the Constitution, which arrogates to the U.S. government a monopoly in emitting legal tender, will be re-implemented, for new Federal Reserve notes will no longer be issued as the currency of the United States. Rather, they will be gradually withdrawn from circulation and replaced by U.S. Treasury bills. . . .

2. Expand productive credit via discount window

The Act then proposes that new, long-term, low-interest credit in the amount of approximately $1 trillion per annum be issued by the U.S. Treasury via the new National Bank to the U.S. physical economy by an entirely new mechanism. The National Bank is to open wide its *discount window* for general lending of *directed credit* to the productive, infrastructure, and related sectors of the physical economy. The bank may in fact create such credit indefinitely without fear of inflation, as long as it serves to create new productive wealth. . . .

3. Protective reserve requirements

To protect the safety of the banking system, and prevent banks from re-depositing for re-lending, for *non*productive purposes, large amounts of the new cheap discount credit, the act reregulates *reserve requirements* for private banks. . . .

From the Federal Reserve Nationalization Act of 1992

Sec. 1 Sec. 1 of the Federal Reserve Act of 1913 is hereby amended to read: "Under Article I of the Constitution per-

taining to the monopoly of the U.S. government in emitting legal tender, the Federal Reserve System is hereby nationalized and placed under the jurisdiction of the Department of the Treasury of the United States. Its name is hereby changed to the 'National Bank of the United States.' Regional headquarters of the Federal Reserve System shall henceforth be known as the appropriate regional branches of the National Bank of the United States. . . .

"Offices and personnel of the former Federal Reserve System shall continue normal functions at the new National Bank except for the amendments set forth below. . . .

"Private-sector member banks' of the former Federal Reserve System shall henceforth be known simply as U.S.-chartered banks. . . .

Sec. 2 Section 1 of the Federal Reserve Act is hereby amended to read: "The Federal Reserve shall immediately cease issuance of Federal Reserve notes as legal tender. As of the passage of this Act, the successor National Bank of the United States shall commence issuance of all new legal tender obligations of the United States in the form of U.S. Treasury bills, to be deposited with the National Bank by the Treasury Department. . . .

"Previously issued Federal Reserve notes may continue to be circulated as currency until such time as the Department of the Treasury shall formulate a currency reform plan for their orderly withdrawal, said plan to be promulgated no later than one year from the passage of this Act. . . ."

Sec. 3 Section 14 of the Federal Reserve Act of 1913 is hereby amended to include the following: "The power of the National Bank of the U.S. to purchase or sell bills, notes, and bonds of the United States shall be limited to these functions:

"a) The anticipation of tax revenues accruing not more than one year from the date of purchase of said bills, notes, and bonds, in order to help maintain an orderly flow of disbursements by the United States Treasury;

"b) To maintain an orderly market in the bills, notes, and bonds of the United States, and to meet the temporary liquidity needs of regional branches of the National Bank system and commercial banks in their districts;

"c) The purchase of such liabilities of the United States as may be presented by foreign governments for sale to the National Bank by said governments;

"The Federal government, however, may not create money supply by monetizing United States government debt. To ensure this, the total holdings by the National Bank of bills, notes, and bonds of the United States shall be set as an annual ceiling as of the enactment of this Act. Said holdings may vary in size in the course of each year, but may not increase in size at the end of the year, following enactment of this act and at annual intervals thereafter, except as a result of purchases of official liabilities of the United States from foreign governments."

Sec. 4 Section 14 of the Federal Reserve Act of 1913 is hereby amended to read: "Any regional branch of the National Bank may receive from any bank, and from the United States, deposits of current funds in lawful money, National Bank notes, Treasury bills or notes, or checks and drafts upon solvent U.S.-charted banks, payable upon presentation; or, solely for exchange purposes, may receive from other regional branches of the National Bank, deposits of current funds in lawful money; or checks and drafts upon solvent private banks or other branches of the National Bank, payable upon presentation. . . .

"Upon the endorsement of any U.S.-chartered bank, any branch of the National Bank may discount up to 50% of the face value of notes, drafts, and bills of exchange arising from the production of tangible wealth or capital improvements. . . . This shall be defined as the purchase of raw and intermediate materials and capital goods, construction of facilities, or employment of labor to produce or transport manufactured goods, agricultural commodities, and construction materials; to work mines; to build manufacturing, transportation, and mining facilities or dwellings; to produce and deliver energy in all forms; and to provide public utilities for communications.

"Such definition shall not include notes, drafts, bills, or loans issued or drawn for the purpose of conducting business except in the areas so defined, or for carrying on or trading in stocks, bonds, or other investment securities.

"Any National Bank branch may discount the full value of acceptances which are based on the exportation of goods, or 50% of the value of acceptances which are based on the importation of goods, provided that such goods conform to the restrictions set forth in the preceding paragraphs.

"All National Bank branches shall meet all such requests for discount of or participation in notes, drafts, bills, and loans made by U.S.-chartered banks, once the National Bank has determined that the purpose of such credit conforms to the restrictions set forth above. There shall be no restrictions applied to such discounts in furtherance of tangible wealth creation on the basis of private banks' capital positions. . . .

Sec. 5 Section 19 of the Federal Reserve Act of 1913 is hereby amended to include the following: "The above reserve requirements shall apply in the case that private banks maintain 60% of their total assets in the form of loans, bills, drafts, and advances to tangible weath-creating borrowers, of a type eligible for discount under Sec. 4 of this Act. For every 1 percent by which the bank's proportion of tangible wealth-creating assets falls below 60% of total assets, the National Bank shall require that banks place an additional 1 percent of demand deposits in reserve with the National Bank system. To permit orderly transition to this reserve rule, however, the formula shall apply only to new assets appearing on the balance sheets of banks after the date of enactment of this Act."

6. A universal derivatives tax

LaRouche issued this intelligence memorandum on March 9, 1993, dictated by telephone from his federal prison cell. "Derivatives" are financial instruments in which actual stocks or bonds are not exchanged, but only agreements by two parties to make payments on a future date at a price related to the performance of a commodity or currency. There are three basic types of derivatives: futures contracts, swaps, and options.

It is my proposal that some form of nominal but otherwise significant, universal tax be placed on individual derivative transactions, not only in the U.S., but abroad. The included purpose of this taxation is not merely to derive a new source of revenue, much needed tax revenue from a source whose taxation will be harmless to the real, that is, physical economy, but also to bring into the light of day, under penalties of law for non-payment of this tax, the magnitude and structure of a derivative bubble as a whole.

The John Law bubble gone mad

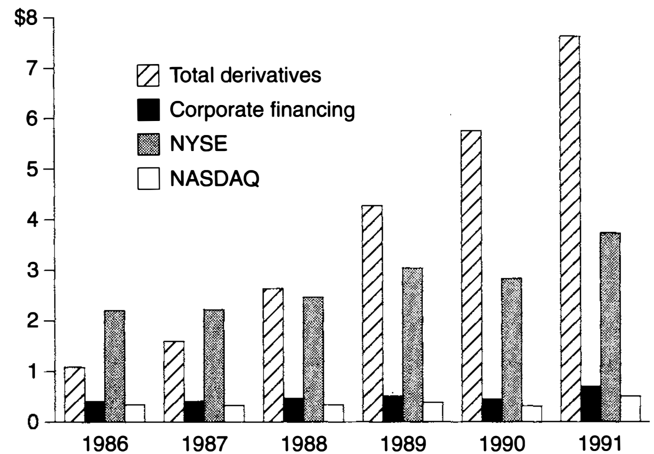
My additional comment qualifying this proposal, is that it is clear that the derivatives bubble, by the very nature of these transactions, is a financial bubble, in the tradition of the more primitive, more rudimentary, and far less dangerous bubbles of the Eighteenth Century, such as the John Law bubble in France and the South Sea Island bubble in England, at the same period of time.

This is the John Law bubble gone mad! The vulnerability to the entire financial system, the chaos and destruction of actual physical processes of production, distribution, employment, and so forth, is of incalculable potential, and therefore this thing must be brought under control promptly; otherwise all fine plans of stabilization of financial markets and economies go out the window, as empty pipe dreams.

We must bring this under control, and the best way to do it, I believe, is to impose a universal tax on each individual transaction, as a percent of the nominal value of the matters which are traded in these credit, interest, and etc. swaps, and other similar derivatives. That is the only way that we'll bring the magnitude of this and the structure of this into the light of day, and force some rationality into the situation, and thus prepare ourselves to be able to take competent moves in order to bring the market as a whole under control.

The down side would be argued from certain sources, apart from the wild free market monetarist maniacs, will be that the number of related transactions, related to any single initiating trade, can be enormous, can be over a hundred individual transactions, can be tied to one actual trade, additional trade.

FIGURE 1
Derivatives compared to U.S. corporate financing and stock market capitalizations
(trillions $)



Sources: Bank for International Settlements; Securities Industries Association.

Fine! Tax them all! That's a big amount of paper, they will say. Fine! Tax them all! The burden of doing the paperwork will itself prevent you characters from ballooning this market in that way. If it costs you too much, in administrative work and effort, to account for a hundred transactions linked to one, then that itself will deter you from building up 50 to 100 or other significant amounts of transactions per initial transaction, and that in itself will be a good deterrent against the growth of the speculative bubble.

Financial blowout looms

Finally, in restatement, in summary: Unless we bring this derivatives market under control and begin to shut it down, at least to a significant degree, promptly, we're going to have the biggest blowout, financial blowout in history—bigger than the John Law-type bubbles of the early Eighteenth Century. And we'd better find out what we're doing, fast. We'd better bring it under control fast, and if we need to tax something, let's tax, say, one tenth of one percent of the nominal value, or 10% of the actual amounts, something like that. One of those two. But I think that a tax based on the nominal value would perhaps be a better tax, because of the differentials between those nations or banking systems which allow minting out and those which do not.

7. LaRouche's 'Ninth Economic Forecast'

Excerpts from an article by LaRouche published in EIR, *June 24, 1994, titled "The Coming Disintegration of Financial Markets." It was also issued as a mass-circulation* New Federalist *pamphlet, under the headline, "LaRouche's Ninth Forecast."*

It comes as no surprise that the name of the Bank of England's Eddie George is added to the list of which it must be said that "whom the gods would destroy, they first make mad." During the course of the current London meeting of the International Monetary Conference, Eddie joined the ranks of those greed-maddened public fools of finance who insist that the danger from the now metastatically cancerous financial bubble in derivatives speculation is being exaggerated by some critics.

It is a matter of some urgency that responsible governments subject all incumbent and prospective economics and central banking officials to the sanity test which Eddie George would have flunked gloriously. . . .

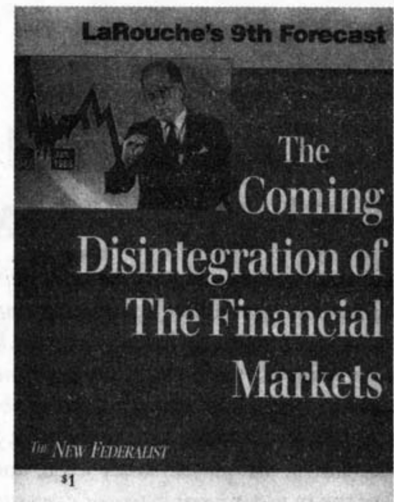
I say to you now, as I informed various relevant scientific institutions of Russia during the last week of this April past: *The presently existing global financial and monetary system will disintegrate during the near term. The collapse might occur this spring, or summer, or next autumn; it could come next year; it will almost certainly occur during President William Clinton's first term in office; it will occur soon. That collapse into disintegration is inevitable, because it could not be stopped now by anything but the politically improbable decision by leading governments to put the relevant financial and monetary institutions into bankruptcy reorganization.* That is LaRouche forecast No. 9—the addition to the list of eight, above. . . .

What is a 'cancerous bubble'?

The present global financial and monetary bubble goes one fatal step beyond a mere ballooning of fictitious capital gains. It has a dimension which marks it as fatally cancerous for the financial and monetary systems which it infests.

Asset-stripping is the key to this point.

Let us use the term "leverage" to identify the implied multiplier which converts an imputable annual rate of income-stream into a corresponding magnitude of nominal fictitious capital. In the case of the slumlord, looting the tenants to increase the income-stream from rental income is a way of increasing the imputable income-stream, and thus the fictitious capitalization of the property-title. The valuation of the secondary and tertiary fictitious capitalizations spun off from the imputable marginal gains in fictitious capitals are themselves so based upon leverage against the primary, real income-stream.



The valuation of the interconnected whole market in fictitious capital gains depends thus upon both the relative and corresponding absolute magnitudes of the primary income-streams taken as a whole. This fact is illustrated dramatically by the case of the asset-stripping needed to sustain the massive creation of fictitious capital in the RJR Nabisco operations. Without massive asset-stripping against the economy as a whole, the speculative bubble as a whole would have collapsed approximately a decade ago.

This is complicated by the fact that without an increase in the flow of fictitious capital gains at the top of the bubble, the bubble as a whole would collapse. For, without a continuing growth of the magnitude of fictitious capital gains, the bubble as a whole would collapse under pressures of reversed leverage.

"Collapse" would be a most misleading sort of euphemism in that case. "Reversed leverage" in such a bubble is best approximated mathematically by the same Kolmogorov equations used to describe a chemical, fission, or thermonuclear explosion, or a firestorm like that which the British war-time Royal Air Force created at Hamburg and Dresden: in mathematical-physical terms, a "shock front," and a very hard one at that. In effect, one evening the financial markets appear normal, stable; by the end of the next day, or something approximating that, everything is rubble; the financial and monetary system built up since August 1971 has disintegrated, as it were, in a single day's trading.

As in the case of a heroin or methadone addict, the habit of looting the real-economic basis must be fed to prevent a collapse. Feeding the habit prevents the immediate collapse by hastening the date of total collapse. The addicted state is destroying the basis upon which it feeds to sustain itself. As is illustrated by the tragic fate of the enterprises gobbled up in the RJR Nabisco caper, this is the fate of the world's economy under the rule of the cancerous financial bubble marked by derivatives speculation. . . .

8. A typical collapse function

Excerpts from a speech by LaRouche to a conference of the International Caucus of Labor Committees and Schiller Institute, in Eltville, Germany, Dec. 2, 1995. The full text was published in EIR, *Jan. 1, 1996.*

. . .[**Figure 1**] is a summary of three curves which are characteristic of the process of monetary and financial disintegration of the world economy. . . .

The bottom of the three lines represents the decline in productivity, in physical terms: that is, physical product. It also includes things which are essential, as services, to physical productivity. . . .

Now the second of the three curves, although the per-capita output, physical output, and consumption around the world have declined over the period of the past 25 years, *especially* the past 25 years, there has been an *increase* in per-capita monetary turnover, monetary emission. The money supply has been growing while the physical output and consumption per capita in all the categories—production, infrastructure, and households—have been declining.

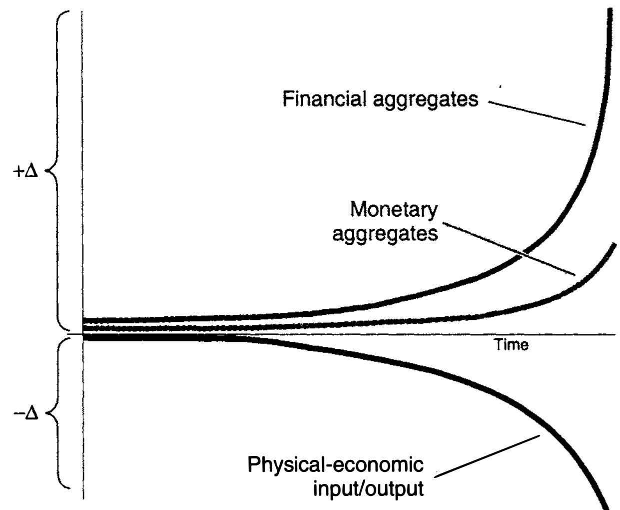
At the same time, a new process has entered in, which is the growth of financial turnover relative to monetary turnover. That is, central banks and similar institutions emit money which is put into circulation through lending in the form of loans emitted by banks cooperating with central banks. Central banks incur an implicit or actual debt obligation, as a result of the emission of that money under present terms. That's the largest part of the debt that governments incur, especially the government of the United States.

The debt is incurred *not* by government spending. The deficit growth is largely incurred as a result of a collapse in the tax revenue base, as a result of a collapse in the economy, and also an increase of debt to cause money to grow, to cause the money supply to grow faster than production. . . .

But, the worst part is the financial one. . . . If we include the best estimates on the off-balance-sheet portion of financial turnover, the financial turnover of this planet per day, now, is probably around *$3 trillion a day.* We're getting toward $600-700 trillion a year now, in terms of financial turnover. If we were to continue this system for another year or so, on the present trend, we would be going to about *$1 quadrillion value of financial turnover per year.*

Now, financial turnover also incurs financial obligations, which translates into various forms of indebtedness. However, in order to pay debt, you must pay it, ultimately, out of physical production. You must resolve the debt, finally, in physical production. Both the monetary debt or the debt related to monetary circulation, and the debt related to financial circulation.

FIGURE 1
A typical collapse function



Now, what you're seeing here, in the peculiar shape of this curve, and in the ratio of the financial curve to the monetary curve, are accurate representations of what the process looks like. Here, in the relationship between curves for monetary and for physical output, you get a tendency, in the past three years, toward a hyperbolic rate of growth of monetary emission to physical output. You get a more pronounced hyperbolic growth of financial obligations from the relationship between financial turnover and that of monetary aggregates.

That is, you pay financial debt in money terms. There's a ratio of financial obligations being generated to money being generated. You settle monetary debt in real terms, as by taxation of firms and persons and so forth. Therefore, the rate at which wealth is being generated, in respect to the rate at which money is generated, is another crucial value. The two values which are crucial: financial debt to the monetary debt, these two ratios here depicted, are the crux of the crisis. . . . We are entering a *discontinuity.*

The very fact that these ratios are changing the way they are, individually, and with respect to one another, indicates that the whole system has now reached the edge of the cliff. It is going to *end.* That does not mean that it's going to fall off the cliff. It *could* fall off the cliff, if we don't do the right thing.

So, the question is, will society continue past the death of the International Monetary Fund? Because the IMF is finished. It is dead. It cannot be saved. It is the *Titanic*, the "unsinkable *Titanic.*" . . .