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Freeze the 1.5 Quadrillion Derivatives Bubble as a First Step Towards World Economic Recovery

The Underlying Cause of the Financial Meltdown

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Washington DC, March 22 – On the eve of the long-awaited London conference of the G-20 nations, we are rapidly descending into the chaos of a Second World Economic Depression of catastrophic proportions. In the year since the collapse of Bear Stearns, we have moved toward the disintegration of the entire globalized world financial system, based on the residual status of the US dollar as a reserve currency, and expressed through the banking hegemony of London, New York, and the US-UK controlled international lending institutions like the International Monetary fund and the World Bank. This is a breakdown crisis of world civilization, prepared over decades by the folly of deindustrialization and the illusions of a postindustrial society, further complicated by the deregulation and privatization of the leading economies based on the Washington Consensus, itself a distillation of the economic misconceptions of the Austrian and Chicago monetarist schools. If current policies are maintained, we face the acute danger of a terminal dollar disintegration and world hyperinflation.

The G-20 leaders are must deliberate a new set of policies capable of leading humanity out of the current crisis. We must first identify the immediate cause which has detonated the present unprecedented turbulence. That cause is unquestionably the **$1.5 quadrillion derivatives bubble**. Derivatives have provoked the downfall of Bear Stearns, Countrywide, Northern Rock, Lehman Brothers, AIG, Merrill Lynch, and Wachovia, and most other institutions which have succumbed. Derivatives have made J.P. Morgan Chase, Bank of America, Citibank, Wells Fargo, Bank of New York Mellon, Deutsche Bank, Société Générale, Barclays, RBS, and money center banks of the world into **Zombie Banks.**

Derivatives are financial instruments based on other financial instruments – paper based on paper. Derivatives are one giant step away from the world of production and consumption, plant and equipment, wages and employment in the production of tangible physical wealth or hard commodities. In the present hysteria of the globalized financial oligarchy, the very term of "derivative" has become taboo: commentators prefer to speak of toxic assets, complex securities, exotic instruments, and counterparty arrangements. At the time of the Bear Stearns bankruptcy, Bernanke warned against "chaotic unwinding." All of these code words are signals that derivatives are being talked about. Derivatives include such exchange traded speculative instruments as options and futures; beyond these are the over-the-counter derivatives, structured notes, and designer derivatives. Derivatives include the credit default swaps so prominent in the fall of AIG, collateralized debt obligations, structured investment vehicles, asset-backed securities, mortgage backed securities, auction rate securities, and a myriad of other toxic variations. These derivatives, in turn, are pyramided one on top of the other, thus creating a house of cards reaching into interplanetary space.

As long as this huge mass of kited derivatives was experiencing positive cash flow and positive leverage, the profits generated at the apex of the pyramid were astronomical. But disturbances at the base of the pyramid turned the cash flow and exponential leverage negative, and the losses at the top of the pyramid became immense and uncontrollable. By 2005-6, the disturbances were visible in the form of a looming crisis of the automobile sector, plus the slowing of the housing bubble cynically and deliberately created by the Federal Reserve in the wake of the collapse of the dot com bubble, the third world debt bubble. and the other asset bubbles favored by Greenspan. Financiers are trying to blame the current depression on poor people who acquired properties with the help of subprime mortgages, and then defaulted, thus – it is alleged — bringing down the entire world banking system! This is a fantastic and reactionary myth. The cause of the depression is derivatives, and this means that the perpetrators to be held responsible are not poor mortgage holders, but rather globalized investment bankers and hedge fund operators, the derivatives merchants. We are now in the throes of a world wide derivatives panic. This panic has been gathering momentum for at least a year, since the fall of Bear Stearns. There is no power on earth which can prevent this panic from destroying most of the current mass of toxic derivatives. It is however possible that the ongoing attempts to bail out, shore up, and otherwise preserve the deadly mass of derivatives will destroy human civilization as we have known it. We must choose between the continued existence of derivatives speculation on the one hand, and the survival of human society worldwide on the other. If this be crude populism, make the most of it.

FREEZE DERIVATIVES FOR THE DURATION OF THE CRISIS

The G-20 must remove the crushing mass of derivatives which is now dragging down the world economy. Derivatives must be banned going forward, but this by itself will not be sufficient. The ultimate goal must be to wipe out and neutralize the existing mass of $1.5 quadrillion in notional values of toxic derivative instruments. Some governments may be able simply to decree that derivatives be shredded, deleted, and otherwise liquidated, and they should do so at once. Virtually all governments should be able to use their emergency economic powers to **freeze derivatives** and set them aside for at least five years or for the duration of the crisis, whichever lasts longer. Legal issues can be settled over the coming decades in the courts. Humanity is in agony, and we must act against derivatives now. Going forward, we must ban the paper pyramids of derivatives in the same way that the Public Utility Holding Company Act of 1935 banned the pyramiding of holding companies.

Derivatives were illegal in the United States between 1936 and 1983. In 1933, an attempt was made to corner the wheat futures market using options, and the resulting outcry led to a 1936 federal law banning such options on farm commodity markets. This ban was repealed by the Futures Trading Act of 1982, signed by President Reagan in January 1983. During the G.H.W. Bush administration, Wendy Gramm of the Commodity Future Trading Commission went further, promising a “safe harbor” for derivatives. Despite the key role of derivatives in the Orange County disaster during the Clinton years, a valiant attempt by Brooksley Born of the CFTC to make derivatives reportable and subject to regulation was defeated by a united front of Robert Rubin, Larry Summers (today running US economic policy), and Greenspan. Despite the central role of $1 trillion of derivatives in the Long Term Capital Management debacle of 1998, Phil Gramm’s Commodity Futures Modernization

Act of 2000 guaranteed that derivatives, notably credit default swaps, would remain totally unregulated. These pro-derivatives forces must bear responsibility for the current depression, and those still in power must be ousted

The Bush-Paulson-Obama-Geithner policy pursued by the United States, which amounts to a $10 trillion (Fed and Treasury) effort to bail out the world derivatives bubble on the backs of taxpayers, can only make the depression worse, will never lead to an economic recovery, and must therefore he rejected. Krugman is right: the **"zombie ideas"** rule Obama's Washington. The Fed's TALF amounts to subsidies for securitization, meaning more derivatives. The derivatives bailout was pioneered by Gordon Brown, Alistair Darling, and Mervyn King in the case of Northern Rock. These efforts are doomed to costly futility. The $1.5 quadrillion derivatives bubble is comparable to the black holes of astrophysics, those artifacts of gravity collapse which will irresistibly suck in all matter that comes near them. This compares to a world GDP of a mere $55 trillion, itself a figure inflated by financial speculation. The derivatives are the black holes of financial engineering, and can easily consume all the physical wealth and all the money in the world, and still be bankrupt. Gordon Brown's demand of $500 billion for the IMF is enough to bankrupt several nations, but pitifully inadequate to deal with the derivatives. They can only be dealt with by re-regulation — a quick freeze, leading to extinction and permanent illegality. We reject Brown's IMF world derivatives dictatorship.

Derivatives pose the question of fictitious capital — financial instruments created outside of the realm of production, and which destroy production. In 1931-2, fictitious capital appeared as tens of billions of dollars of reparations imposed on Germany, plus the war debts owed by Britain and France to the United States. These debts strangled world production and world trade. Bankers and statesmen tried desperately to maintain these debt structures. But US President Herbert Hoover proposed the Hoover Moratorium of 1931-1932, a temporary freeze on all these payments. The Lausanne Conference of June 1932 was the last chance to wipe out the debt permanently. But the Lausanne Conference failed to act decisively, and passed the buck. By the end of 1932, there was near-universal default on reparations and war debts anyway. And by January 1933, Hitler had seized power. We urge the London G-20 to defend world civilization against derivatives. It is time to lift the crushing weight of derivatives from the backs of humanity before the world economy and the major nations collapse into irreversible chaos and war, as seen during the 1930s.

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