How Financial Brokers Became Bookies: The Insidious Transformation of Markets Into Casinos

By Ellen Brown
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"You all are the house, you're the bookie. [Your clients] are booking their bets with you. I don't know why we need to dress it up. It's a bet."
Senator Claire McCaskill, Senate Subcommittee on Investigations, investigating Goldman Sachs (Washington Post, April 27, 2010)

Ever since December 2008, the Federal Reserve has held short-term interest rates near zero. This was not only to try to stimulate the housing and credit markets but also to allow the federal government to increase its debt levels without increasing the interest tab picked up by the taxpayers. The total public U.S. debt increased by nearly 50% from 2006 to the end of 2009 (from about $8.5 trillion to $12.3 trillion), but the interest bill on the debt actually dropped (from $406 billion to $383 billion), because of this reduction in interest rates.

One of the dire unintended consequences of that maneuver, however, was that municipal governments across the country have been saddled with very costly bad derivatives bets. They were persuaded by their Wall Street advisers to buy credit default swaps to protect their loans against interest rates shooting up. Instead, rates proceeded to drop through the floor, a wholly unforeseeable and unnatural market condition caused by rate manipulations by the Fed. Instead of the banks bearing the losses in return for premiums paid by municipal governments, the governments have had to pay massive sums to the banks – to the point of bankrupting at least one city (Montgomery, Alabama).

Another unintended consequence of the plunge in interest rates has been that "savers" have been forced to become "speculators" or gamblers. When interest rates on safe corporate bonds were around 8%, a couple could aim for saving half a million dollars in their working careers and count on reaping $40,000 yearly in investment income, a sum that, along with social security, could make for a comfortable retirement. But very low interest rates on bonds have forced these once-prudent savers into the riskier and less predictable stock market, and the collapse of the stock market has forced them into even more speculative ventures in the form of derivatives, a glorified form of gambling. Pension funds, which have binding pension contracts entered into when interest was at much higher levels, are so strapped for returns that they actually seek out the riskier investments, which have higher returns. That means they can and do regularly get fleeced when the risk occurs.

Derivatives are basically just bets. Like at a racetrack, you don't need to own the thing you're betting on in order to play. Derivative casinos have opened up on virtually anything that can go up or down or have a variable future outcome. You can bet on the price of tea in China, the success or failure of a movie, whether a country will default on its debt, or whether a particular piece of legislation will pass. The global market in derivative trades is now well over a quadrillion dollars – that's a thousand trillion – and it is eating up resources that were at one time invested in productive enterprises. Why risk lending money to a corporation or buying its stock, when you can reap a better return betting on whether the stock will rise or fall?

The shift from investing to gambling means that not only are investors making very little of their money available to companies to produce goods and services, but the parties on one side of every speculative trade now have an interest in seeing the object of the bet fail, whether a company, a movie, a politician, or a country. Worse, high-speed program traders can actually manipulate the market so that the thing bet on is more likely to fail.

High frequency traders — a field led by Goldman Sachs — use computer algorithms to automatically bet huge sums of money on minor shifts in price. These bets send signals to the market which can themselves cause the price of assets to shoot up or tumble down. By placing high-volume trades, the largest speculative traders can thus intentionally "fix" prices in any direction they want.

"Prediction" Markets

Casinos for betting on what something will do in the future have been promoted as reliable "prediction" markets, and they can cover a broad range of issues. MIT's Technology Review launched a futures market for technological innovations, in order to bet on upcoming developments. The NewsFutures and TradeSports Exchanges enable people to wager on matters such as whether Tiger Woods will take another lover, or whether Bin Laden will be found in Afghanistan.

A 2008 conference of sports leaders in Auckland, New Zealand, featured Mark Davies, head of a sport betting exchange called Betfair. Davies observed that these betting exchanges, while clearly gambling forums, are little different from the trading done by financial firms such as JPMorgan. He said:
"I used to trade bonds at JPMorgan, and I can tell you that what our customers do is exactly the same as what I used to do in my previous life, with the single exception that where I had to pore over balance sheets and income statements, they pore over form and team-sheets."

The online news outlet Slate monitors various prediction markets to provide readers with up-to-date information on the potential outcomes of political races. Two of the markets covered are the Iowa Electronic Markets and Intrade. Slate claims that these political casinos are consistently better at forecasting winners than pre-election polls. Participants bet real money 24 hours a day on the outcomes of a range of issues, including political races. Newsfutures and Casualobserver are similar, smaller exchanges.

Besides shifting the emphasis to gambling ("Why Vote When You Can Bet?" says Slate's "Guide to All Political Markets"), prediction markets can be manipulated so that they actually affect outcomes. This became evident, for example, in 2008, when the John McCain campaign used the InTrade market to shift perception of his chances of winning. A supporter was able to single-handedly manipulate the price of McCain's contract, causing it to move up in the market and prompting some mainstream media to report it as evidence that McCain was gaining in popularity.

Betting on Terrorism

The destructive potential of betting on political outcomes became particularly apparent in a notorious prediction market sponsored by the Pentagon, called the “policy analysis market” (PAM) or “terror futures market.” PAM was an attempt to use the predictive power of markets to forecast political events tied to the Middle East, including terrorist attacks. Trading in American Airlines shares in the days before the September 11th attack on the World Trade Center was one of the bases of the Pentagon’s justification for the program. According to the New York Times, the PAM would have allowed trading of futures on political developments including terrorist attacks, coups d’état, and assassinations.

The exchange was shut down a day after it launched, after commentators pointed out that the system made it ridiculously easy to make money with terror attacks.
At a July 28, 2003 press conference, Senators Byron L. Dorgan (D-ND) and Ron Wyden (D-OR) spoke out against the exchange. Wyden stated, “The idea of a federal betting parlor on atrocities and terrorism is ridiculous and it’s grotesque,” while Dorgan called it “useless, offensive and unbelievably stupid”.
“This appears to encourage terrorists to participate, either to profit from their terrorist activities or to bet against them in order to mislead U.S. intelligence authorities,” they said in a letter to Admiral John Poindexter, the director of the Terrorism Information Awareness Office, which developed the idea. A week after the exchange closed, Poindexter offered his resignation.

Carbon Credit Trading

A massive new derivatives market that could be as destructive as the derivatives that contributed to the current economic meltdown is the trading platform called Carbon Credit Trading, which is on its way to dwarfing world oil trade. The program would allow trading not only in “carbon allowances” (permitting companies to emit greenhouse gases) and “carbon offsets” (allowing companies to emit beyond their allowance if they invest in emission-reducing projects elsewhere), but carbon derivatives — such as futures contracts to deliver a certain number of allowances at an agreed price and time. Eoin O’Carroll cautioned in the Christian Science Monitor:

“Many critics are pointing out that this new market for carbon derivatives could, without effective oversight, usher in another Wall Street free-for-all just like the one that precipitated the implosion of the global economy. . . . Just as the inability of homeowners to make good on their subprime mortgages ended up pulling the rug out from under the credit market, carbon offsets that are based on shaky greenhouse-gas mitigation projects could cause the carbon market to tank, with implications for the broader economy.”

Robert Shapiro, former undersecretary of commerce in the Clinton administration and a cofounder of the U.S. Climate Task Force, warns, “We are on the verge of creating a new trillion-dollar market in financial assets that will be securitized, derivatized, and speculated by Wall Street like the mortgage-backed securities market.”

The proposed form of cap and trade has not yet been passed in the U.S., but a new market in which traders can speculate on the future of allowances and offsets has already been launched. The largest players in the carbon credit trading market include firms such as Morgan Stanley, Barclays Capital, Fortis, Deutsche Bank, Rabobank, BNP Paribas, Sumitomo, Kommunalkredit, Credit Suisse, Merrill Lynch and Cantor Fitzgerald. Last year, the financial services industry had 130 lobbyists working on climate issues, compared to almost none in 2003. The lobbyists represented companies such as Goldman Sachs and JPMorgan Chase.

Billionaire financier George Soros says cap-and-trade will be easy for speculators to rig. “The system can be gamed,” he said last July at a London School of Economics seminar. “That’s why financial types like me like it — because there are financial opportunities.”

Time to Board Up the Casinos and Rethink Our Social Safety Net?

At one time, gambling was called a sin and was illegal. Derivative trading was originally considered an illegal form of gambling. Perhaps it is time to reinstate the gambling laws, board up the derivatives casinos, and return the stock market to what it was designed to be: a means of funneling the capital of investors into productive businesses.

Short of banning derivatives altogether, the derivatives business could be slowed up considerably by imposing a Tobin tax, a small tax on every financial trade. “Financial products” are virtually the only products left on the planet that are not currently subject to a sales tax.

A larger issue is how to ensure adequate retirement income for the population without forcing people into gambling with their life savings to supplement their meager social security checks. It may be time to rethink not only our banking and financial structure but the entire social umbrella that our Founding Fathers called the Common Wealth.

Deficit hawks cry that we cannot afford more spending. But according to Richard Cook, who formerly served at the U.S. Treasury Department, the government could print and spend several trillion new dollars into the money supply without causing price inflation. Writing in Global Research in April 2007, he noted that the U.S. Gross Domestic Product in 2006 came to $12.98 trillion, while the total national income came to only $10.23 trillion; and at least 10 percent of that income was reinvested rather than spent on goods and services.

Total available purchasing power was thus only about $9.21 trillion, or $3.77 trillion less than the collective price of goods and services sold. Where did consumers get the extra $3.77 trillion? They had to borrow it, and they borrowed it from banks that created it with accounting entries on their books. If the government had replaced this bank-created money with debt-free government-created money, the total money supply would have remained unchanged. That means a whopping $3.77 trillion in new government-issued money could have been fed into the economy in 2006 without increasing the inflation rate.

In a 1924 book called Social Credit, C. H. Douglas suggested that government-issued money could be used to pay a guaranteed basic income for all. Richard Cook proposes a national dividend of $10,000 per adult and $5,000 per dependent child annually. In 2007, that would have worked out to about $2.6 trillion to provide a basic security blanket for everyone.

The Federal Reserve has funneled $4.6 trillion to Wall Street in bailout money, most of it generated via “quantitative easing” (in effect, printing money); yet hyperinflation has not resulted. To the contrary, what we have today is dangerous deflation. The M3 money supply shrank in the last year by 5.5 percent, and the rate at which it is shrinking is accelerating. The explanation for this anomaly is that the Fed’s $4.6 trillion added by quantitative easing fell far short of the estimated $10 trillion that disappeared from the money supply when the “shadow lenders” exited the market, after discovering that the “triple-A” mortgage-backed securities they had been purchasing from Wall Street were actually very risky investments.

Whether or not a national dividend is the best way to reflate the money supply, the important point here is that the government might be able to issue and spend several trillion dollars into the economy without creating hyperinflation. The money would merely make up for the shortfall between GDP and purchasing power, replacing the debt-money created as loans by private banks. As long as resources are sitting idle and people are unemployed — and as long as the new money is used to put these resources together productively to create new goods and services — price inflation will not result. Creating the national money supply is the sovereign right of governments, not of banks; and if the government wants to remain sovereign, it needs to exercise that right.

Ellen Brown *developed her research skills as an attorney practicing civil litigation in Los Angeles. In Web of Debt, her latest of eleven books, she turns those skills to an analysis of the Federal Reserve and "the money trust." She shows how this private cartel has usurped the power to create money from the people themselves, and how we the people can get it back. Her websites are www.webofdebt.com, www.ellenbrown.com, andwww.public-banking.com.*

Niko Kyriakou contributed to this article.

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The Great Depression of the XXI Century

Michel Chossudovsky and Andrew Gavin Marshall (Editors)

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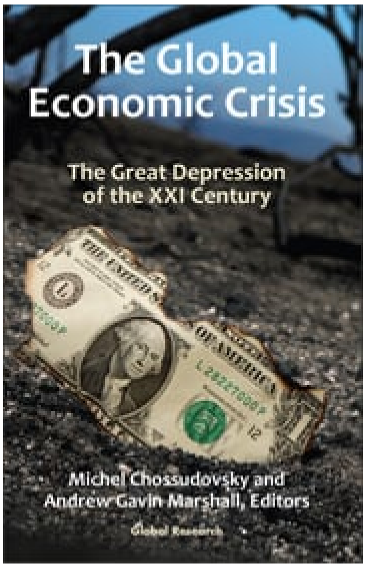

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Michel Chossudovsky is an award-winning author, Professor of Economics (Emeritus) at the University of Ottawa and Director of the Centre for Research on Globalization (CRG), Montreal. He is the author of *The Globalization of Poverty and The New World Order* (2003) and *America's "War on Terrorism"* (2005). He is also a contributor to the Encyclopaedia Britannica. His writings have been published in more than twenty languages.

Andrew Gavin Marshall is an independent writer both on the contemporary structures of capitalism as well as on the history of the global political economy. He is a Research Associate with the Centre for Research on Globalization (CRG).

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The Great Depression of the XXI Century

Michel Chossudovsky and Andrew Gavin Marshall (Editors)

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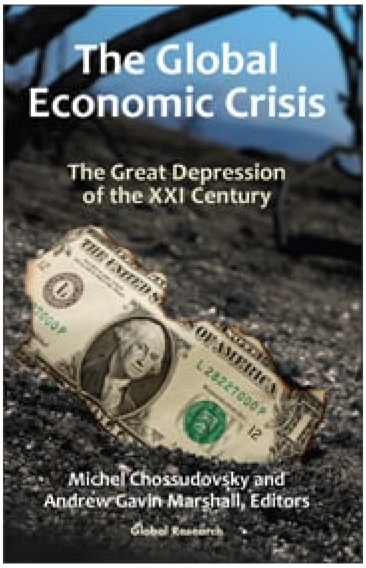

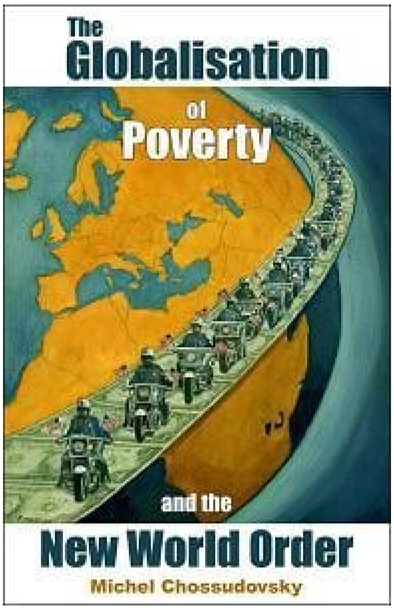

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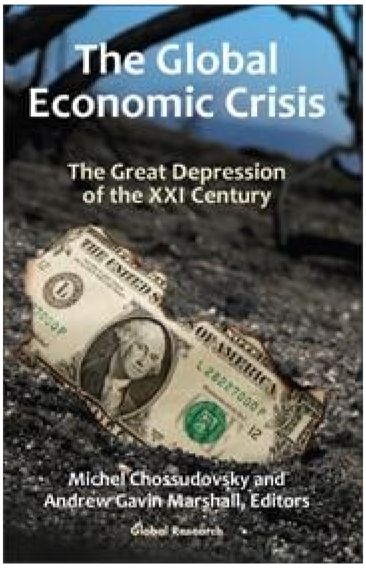

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