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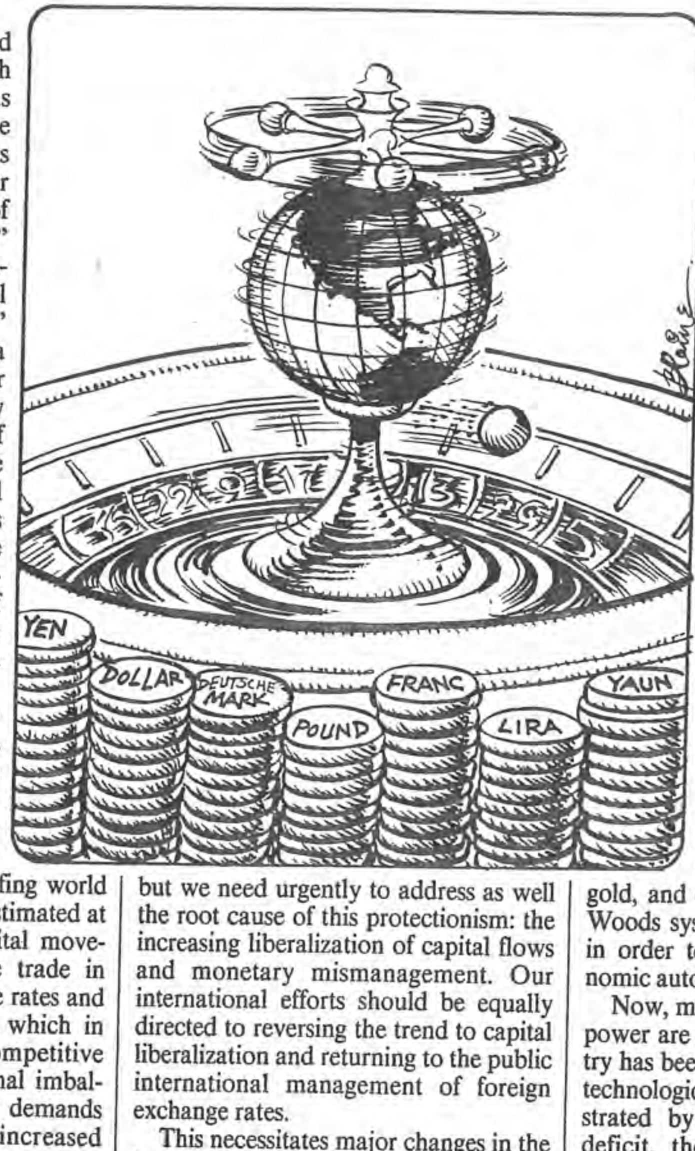
Coping with Casino Capitalism

Canada can and should take a constructive part in the essential restructuring of the international financial system



Cartoon: *Blaine*

The nature of the world economy within which Canada must operate has fundamentally altered. The most significant feature has been identified by Peter Drucker as the decoupling of the financial or "symbol" economy, consisting of capital movements and financial transactions, from the "real" economy. Money itself is a dominant commodity, rather than simply a symbol by which to measure the sale of real goods and services. The internationalization of capital markets that now permits billions of dollars to be shifted by private transnational actors at the speed of an electronic impulse has given rise to a formidable speculative force.

Casino capitalism is now the driving force of both international and domestic economies. Foreign exchange transactions currently amount to approximately $35 trillion per annum, dwarfing world trade in goods and services, estimated at $3 trillion. International capital movements increasingly dominate trade in the determination of exchange rates and the value of our currencies, which in turn distorts underlying competitive positions and produces external imbalances that generate domestic demands for trade restrictions and increased protectionism.

Yet despite this new causal connection between capital flows and trade restrictions, we nevertheless continue to focus our international efforts on directly attacking barriers to trade through traditional forums like the General Agreement on Tariffs and Trade (GATT). A concern with reducing trade protectionism is of course important, but we need urgently to address as well the root cause of this protectionism: the increasing liberalization of capital flows and monetary mismanagement. Our international efforts should be equally directed to reversing the trend to capital liberalization and returning to the public international management of foreign exchange rates.

This necessitates major changes in the international financial and monetary system. The age of free trade as an organizing principle of the international economy may be over. The challenges we face today are primarily industrial and technological in character. They involve relative positions in critical industries such as electronics and biotechnology, not relative shares of total international trade flows.

The need for a new international financial and monetary system is all the more obvious in light of two other significant and related developments in the world economy: the decline of American power, and the international debt crisis.

The post war system has depended critically on the American dollar as the world reserve currency, and the willingness of the USA to provide stability to the world economy through subordinating, if necessary, its domestic economic policies in order to maintain the value of the dollar and ensure an open trade and payments system.

It is increasingly clear, however, that the USA is no longer able or willing to provide such leadership. This was demonstrated as early as 1970-71 when the USA unilaterally terminated the convertibility of dollars into gold, and effectively ended the Bretton Woods system of fixed exchange rates, in order to enhance its domestic economic autonomy.

Now, major shifts in global economic power are under way. American industry has been slow to adjust to the global technological revolution and, as demonstrated by the huge American trade deficit, the international balance of economic power is decisively shifting to Japan and the emerging nations. Reagan's disastrous experiment with supply-side tax cuts, together with a rapid build-up in military expenditures and a monetarist policy of high interest rates, has resulted in a vastly overvalued dollar and an enormous budget deficit which the government continues to refuse to finance internally.

The United States now depends on massive inflows of foreign capital to finance both its trade and budget deficits. Foreigners now own more U.S. investments than U.S. citizens hold in foreign investments. The International Monetary Fund recently estimated that, by the end of the 1980s, the net indebtedness of the USA could reach as much as $800 billion.

The conditions are ripe for a classic crisis which will have a tremendous destabilizing impact on the international financial and monetary system. Foreign investors are becoming increasingly reluctant to hold on to more and more U.S. dollar-denominated debt, with the result that the value of the dollar is dropping and interest rates are gradually rising. Inflation in the United States crept up to over 5 percent by mid 1987, and will likely go higher as the dollar falls further and American interest rates move upward.

All these developments will, in turn, impact on the other significant current feature of the world economy: the international debt crisis. As the American economy is pushed into recession, demand for developing country products will fall off and exacerbate the ability of Third World debtors to earn the foreign exchange required to service the already unsustainable burden of foreign debt. Total developing country debt now exceeds one trillion dollars and the larger debtors, notably Brazil, have already instituted a variety of forms of moratoriums on debt repayments. Meanwhile, though there has lately been some increased provision for write-offs, for the most part the international banks continue to maintain the fiction that their loans are in good standing by constant reschedulings.

The seriousness of the crisis is underlined by the fact that private capital flows to many developing countries have stagnated as foreign investment has been diverted to the United States. This is causing the debt problems and growth prospects of developing countries to deteriorate further. The USA has increased its share of foreign investment from 10 percent to 60 percent in the past decade, while the poorer countries' share has fallen to 20 percent from 35 percent in the past six years.

The ultimate irony in this disturbing situation, however, is found in the recent evidence that much of the Third World debt and the U.S. debt are the same debt. More specifically, estimates of capital flight from private sources in Latin America debtor countries reveal that consequential increases in private holdings of external assets match the public external indebtedness of the debtor country. So, for example, Citibank is now close to owing more to Latin America than it is owed since, while insisting that the debtor country repay its sovereign debt, it meanwhile assists in channelling the private capital flight.

It should now be clear that if we are to prevent the threatened breakdown of the ever more integrated world economic and financial system, the time is long overdue for a determined multilateral effort to build a new international system. This must establish public international management of exchange rates, perhaps through reference zones; regulate the global activities of multinational financial institutions; and attempt to reverse the trend to the liberalization of capital flows.

In addition, it must involve much greater policy coordination among industrial countries, and between them and the developing countries, as well as ensure that the burden of international adjustment is shared equitably between creditor and debtor countries. Finally, it must abandon the American dollar as the world reserve currency and focus instead on enhancing the role of the Special Drawing Rights (SDR), now issued from time to time to member countries by the International Monetary Fund, as the central reserve asset.

As a country in which a large proportion of economic activity is dependent on trade, Canada should be especially interested in promoting a revamped international financial and monetary system that will more accurately reflect the new structure of global economic power and provide a feasible alternative to the hegemony of the United States. That is the way to facilitate access to world markets for our goods and services, particularly in respect of knowledge-intensive industries such as telecommunications and engineering services. Our recent fixation on bilateral trade negotiations with the United States is obscuring the importance of securing world markets, particularly in the Pacific Rim and South and Central America, and of shifting away from reliance on exports of natural resources and goods with little value added.

By pursuing bilateral free trade, we have allowed ourselves to be coopted into the strategy of an increasingly vulnerable hegemon seeking to compensate for its rapidly declining clout in multilateral circles by establishing bilateral relationships which it can still dominate.

This bilateralist American strategy is being played out in other ways and in other spheres. Fred Bergsten of the influential Institute for International Economics is now openly advocating that the U.S. and Japan establish a "bigemony" or Group of Two to arrogate to themselves the effective management of the world financial system and their respective currency values. Of course, it cannot be denied that American-Japanese interdependence is highly significant and continues to intensify. Japan depends on the American market for its economic growth and on the USA for its national security, while the USA depends on Japanese financing for its trade and budget deficits. But this ought not to lead to a bipolar financial world and a bilateral as opposed to a multilateral framework for international economic management.

It should now be clear that the USA is no longer seeking international solutions to its economic problems. Even its vocal advocacy of a new multilateral trade round really reflects a short term tactic to discourage Congress from enacting protectionist legislation, not a long term commitment to a general free trade and payments system.

Instead, the evidence of a major shift in basic American attitudes regarding the international system is all too convincing. For example, in recent years the United States has demonstrated a marked antipathy towards the World Bank (especially the replenishments of its soft-loan arm, the International Development Agency) and regional development banks. It has been reluctant to use either the International Monetary Fund or the OECD to coordinate economic policies among the major industrial countries, preferring instead to focus on the *ad hoc* meetings of the Group of Seven (G-7).

In this new environment, Canada must be assertive if we are to avoid being either suffocated in fortress North America or swept up like so much flotsam in a dollar-yen dominated international economic order. We must, therefore, actively seek to create a new multilateral framework that will ensure for Canada and other countries a meaningful role in international economic management. To this end, we could at least begin by building on recent initiatives to enhance cooperation among the Group of Seven countries and to deal with the international debt crisis.

The Group of Seven has taken some steps towards greater international coordination of macroeconomic policies with a view to reducing international imbalances and stabilizing the value of the U.S. dollar. The outlook for such policy coordination is, however, not at all encouraging particularly in light of the magnitude of adjustment required on the part of the United States, to reduce its budget and trade deficits, and of Japan, to reduce its trade surplus. Both the U.S. trade deficit and the Japanese trade surplus reached approximately $150 billion in 1986.

This dismal prognosis for more meaningful coordination was confirmed at the most recent Group of Seven summit meeting in Venice in June 1987. There the seven leaders produced yet another "accord" on exchange rates and macroeconomic policy which was described by *The Economist* as containing "just enough substance to avoid being written off as a flop, but not enough to have any effect on economic policies—altogether a masterly piece of drafting."

More specifically, the G-7 countries agreed to provide each other with medium term projections for their economies. These will probably include growth of output, monetary growth, budget and current account deficits and exchange rates. For some extraordinary reason, the list of relevant economic indicators will be kept secret. The IMF will then monitor economic performance and, if it starts to deviate from the projections, the finance ministers will discuss what, if anything, to do about it. Clearly, this is a far cry from a commitment to positive action. Canada should press for much more at every opportunity, such as the 1988 G-7 summit which will take place in Ottawa.

With respect to the debt crisis, international efforts have been equally tentative and inadequate. The most concrete initiative—the so-called Baker Plan introduced at the annual IMF/World Bank meeting in October 1985—has enhanced cooperation between private financial institutions and the International Monetary Fund. The leading economic powers explicitly recognized the seriousness of the debt problem and the threat posed to the economic stability of the entire international community. The "plan of action" focused on the objective of "growth with adjustment" in debtor countries, in order to allow them to service their debts while gradually reducing their reliance on external finance.

But, as the North-South Institute noted in a recent assessment, the Baker Plan has had very little impact. The private financial institutions have proved extremely reluctant to increase their lending to developing countries, let alone meet the Baker target of an increase of $20 billion over three years. In addition, the Plan is fatally weakened by the absence of a clearly stipulated role for the major creditor countries, especially the United States, and any visible commitment from public authorities. As the North-South Institute concluded, the Baker initiative clearly is not adequate to meet the growing systemic threat posed by the crisis to the financial soundness of the creditor countries, including Canada, or to meet the development needs of debtor countries.

A case-by-case approach to resolving the debt crisis is preferred by the current American administration, primarily perhaps because this is oriented to the private market. But it clearly is not appropriate. There is need for greatly increased multilateral financial transfers to developing countries through international institutions; the forgiveness of some of the existing debt where appropriate and necessary; the conversion of some of the debt into equity; and the establishment of a revamped IMF as lender of last resort. New international rules are also required to govern markets for commodities such as grain, oil and minerals. It is the absence of such rules that is wreaking so much havoc in Canada's western provinces, besides most developing countries.

More generally, we must undertake a new concerted effort to accelerate our international development initiatives, particularly through longer-term structural adjustment lending by both the World Bank and the IMF and the implementation of more automatic mechanisms for development finance. We should also step up the pressure to reduce the wholly unacceptable level of global military expenditures, which now annually exceed the total amount of developing country debt!

Canada has a major role to play in encouraging the necessary systemic changes that must take place in the international financial and monetary system. We must build on our activist tradition in international monetary affairs. In the IMF, for example, we played an important role in the negotiations leading to the creation of the SDR in the late 1960s; we chaired the Committee of Twenty negotiations on monetary reform in the period 1973-75; and have since played a constructive bridging role between developing and developed country members on the Interim Committee on the International Monetary System. We were also influential within the Executive Board in negotiating the formula for the sixth increase of IMF quotas in 1976.

We should now deploy our diplomatic and other resources to help to bring about further change and meaningful collective management of the international system. We must recognize that a new international order not only will help us to confront the new global economy more effectively and lead to more equitable relations among states; it also will allow us to achieve greater autonomy from the United States particularly in respect of our monetary policy, something that is at least as important as maintaining our autonomy in respect of our trade policy. To this end, as Duncan Cameron suggests in a recent publication of the *International Journal*, we should no longer pursue our usual policy of supporting U.S. positions multilaterally, while attempting to maintain some bilateral independence. Rather, we should operate more broadly to build a kind of reform coalition, to include the major states of the Third World and like-minded industrial states, that would "attempt to integrate trade, financial, growth and development issues in a comprehensive strategy for medium term reform."

In this way we may be able to help make sustainable world recovery possible and move beyond *ad hoc* crisis management to effective international problem-solving, to the benefit of all members of the international community.

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