

# Global Economic Volatility and Slap-Dash Repairs to the International Financial Architecture

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## Abstract

The expansion of the global economy's financial sector in the context of relative productive sector stagnation tendencies can be read as a classical overaccumulation crisis. This chapter considers the way the leading powerbrokers reacted to the crisis through 'devalorization' of large parts of the Third World alongside the write down of selected financially volatile and vulnerable markets in the North (e.g. dot.com, real estate and other derivatives bubbles). In contrast to the 1930s, this set of partial write-downs of financial capital – kept in check by a system-wide response in late 2008 and 2009 – did not create such generalized panic and crisis contagion as to erode the entire system's integrity, although October 2008 was a month in which that threat rose to extreme levels. The 'shifting and stalling' of the devalorization of overaccumulated capital meant that most major Northern financial institutions survived. But they did so through intensified extra-economic coercion, including gendered and environmental stresses. The result is a world economy that concentrates wealth and poverty in more extreme ways, geographically, and brings markets and the non-market spheres of society and nature together in a manner adverse to the latter. Is reform of the system possible? If so, ideas for revitalized multilateral financial institutions, following Keynes' International Clearing Union proposal, are worth revisiting. However, what such ideas 'from above' require for consideration are extremely powerful social movements 'from below', like Occupy, which change the relationship between civil society, state and financiers.

## Introduction

The crisis that is today still undermining the international financial architecture – in 2012 most obviously manifest in the Euro's untenability – is profound, by all accounts. Consider this frightened view from the mainstream economics tradition of the International Monetary Fund:

The global economy has entered a period of unprecedented turmoil, with the prospect of a prolonged economic downturn, heightened financial volatility, and social instability. *Weakly coordinated macroeconomic policies among major world economies, deficient financial regulation, and insufficient commitment to financial stability* as a public good have each contributed to the current global economic conditions. The world needs a multilateral institution at the center of the world economy to *help anchor global financial stability*. Achieving that aim depends on *the monitoring of risks, coordinated policy responses, and agreed norms and standards to which all countries subscribe*. To be effective, the institution

requires a strong and respected voice, human and financial resources appropriate to its mission, and it must be accountable to its members. It must also work closely with other international organizations and standard setters, and provide a focal point for discussions on crisis management and the macroeconomics of financial regulation. The International Monetary Fund is well placed to be this institution, but it needs *a re-energized multilateral mandate* to reflect the evolution of the world economy and *to increase its legitimacy* and effectiveness in addressing today's global challenges. *Few of the conditions outlined above are currently being met.* [emphasis added]

– International Monetary Fund Committee on Governance Reform, March 2009

This mainstream view diagnoses the global financial crisis only in terms of 'weakly coordinated macroeconomic policies' and deficient regulation. Then, in seeking a solution, the mainstream perspective advocates a larger role for the IMF in rather limited terms: monitoring risk, coordinating policy and establishing norms and standards. These are functions they have already, yet the IMF was notable for its failure to predict and monitor the nature of the crisis (which continues into new terrains of financial destruction including the bonds of Greece, Ireland, Portugal, Spain and Italy), much less to identify the appropriate norms and standards or to support a coherent counter-cyclical policy.

After all, during the crisis, much of the South – especially Africa – was given rehashed IMF pro-cyclical policy advice, and in the wake of the worst manifestations, the IMF has returned to relatively unchanged neoliberal austerity demands for its new set of European borrowers. The only genuinely new factor in the IMF's repertoire is its flush accounts, for in 2008 the Fund was losing large amounts of capital, borrowers and staff. The revival of neoliberalism was possible because the IMF did indeed receive a 're-energized multilateral mandate' in April 2009, in the form of a vast funding increase (said to be more than a trillion dollars in real value), and in November 2010 a decision was taken to adjust its voting power (by 6 percent) and to shift two board positions (from Europe to emerging markets) – albeit with both to take effect only in 2012 – so that IMF Managing Director Dominique Strauss-Kahn could claim a new 'legitimacy'. In May 2011 he lost this, of course, and French Finance Minister Christine Lagarde's 'election' to an office that apparently has a 'Europeans Only' sign on it, confirms what some South Africans (who remember this sign well) term 'global apartheid'.

Even if a profound critique can be offered of 'false-flag' IMF Keynesianism, it cannot be denied that in search of legitimacy, the IMF's neoliberal economic managers have permitted increased national sovereignty in relation to capital flows. The opportunities to impose both inward and outward exchange controls increased after the 1980s-90s liberalization experience did so much damage, especially in the 1997-98 and 2008-09 crises, as well as at present. The main opposition to the kind of international financial architecture that would permit currency controls, as an example, comes from financiers themselves, as well as their most enthusiastic advocates, professional economists. Still by way of introduction, it is useful to consider why the discipline of neoliberal economics is in disrepute, even if it remains in power.

An important component in the debate over the new international financial architecture is foundational ideology. The revival of neoliberalism notwithstanding the ongoing financial meltdown, reflects the strong, residual credibility of economists. The leaders of this profession came to occupy a greater power within academia and society since the 1980s, because of their claims to having developed 'an all-encompassing, intellectually elegant approach that also gave

economists a chance to show off their mathematical prowess,' according to Nobel Prize laureate and Princeton professor Paul Krugman. A few economists 'questioned the belief that financial markets can be trusted and pointed to the long history of financial crises that had devastating economic consequences. But they were swimming against the tide, unable to make much headway against a pervasive and, in retrospect, foolish complacency.'<sup>1</sup> Added University of Texas professor James K. Galbraith,

Leading active members of today's economics profession... have formed themselves into a kind of Politburo for correct economic thinking... They oppose the most basic, decent and sensible reforms, while offering placebos instead. They are always surprised when something untoward (like a recession) actually occurs. And when finally they sense that some position cannot be sustained, they do not reexamine their ideas. They do not consider the possibility of a flaw in logic or theory. Rather, they simply change the subject. No one loses face, in this club, for having been wrong.<sup>2</sup>

The financial markets offered some of the greatest instances of flawed economic reasoning based on the 'efficient markets hypothesis' and a general commitment to liberalization. One high-profile economist, Columbia University's Jagdish Baghwati, argues for trade liberalization but not capital liberalization. But most have resisted the necessary move towards reregulation of capital accounts on grounds of incorrect economic thinking. In contrast, the greatest economist of the 20<sup>th</sup> century, John Maynard Keynes, had a much deeper understanding of intrinsic contradictions within capitalism, and as a result, he opposed the neoliberal (then called 'Treasury View') commitment to a footloose flow of capital because such a policy

assumes that it is right and desirable to have an equalisation of interest rates in all parts of the world. In my view the whole management of the domestic economy depends upon being free to have the appropriate interest rate without reference to the rates prevailing in the rest of the world. Capital controls is a corollary to this.<sup>3</sup>

Keeping in mind the need for capital controls, Keynes advocated an International Currency Union as the name for an international financial architecture to be negotiated at Bretton Woods, New Hampshire in mid-1944. However, in the arrangement that was arrived at, and that lasted from 1944-71, Keynes failed to persuade the dominant US negotiators of the need for a more expansive strategy based on penalizing countries with persistent trade surpluses. His defeat at the Bretton Woods and 1946 Savannah conferences reportedly left Keynes despondent, and he soon died of a heart attack.<sup>4</sup> Keynes' most forceful statement of the merits of inward-oriented development in a context of *socio-political* globalization is as follows, from the 1933 *Yale Review*:

I sympathise with those who would minimise, rather than with those who would maximise, economic entanglement among nations. Ideas, knowledge, science, hospitality, travel – these are the things which should of their nature be international.

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1. Krugman, P. (2009), 'How did Economists get it so Wrong?', *New York Times Magazine*, 6 September.

2. Galbraith, J. (2009), 'Who Are These Economists, Anyway?', *Thought and Action*, 85, Fall.

3. Moggeridge, D. (Ed), *The Collected Works of J. M. Keynes*, Vol.25, London, Macmillan, p.149.

4. 'Keynes had argued so bitterly at Savannah with US Treasury Secretary Fred Vinson and was so distressed by the course on which the Bank seemed to be set that his friends blamed the meeting for the heart attack he suffered on the train back to Washington, and for a second, a month later, which killed him at the age of 63.' Caufield, C. (1997), *Masters of Illusion: The World Bank and the Poverty of Nations*, London, Macmillan, p.47.

But let goods be homespun whenever it is reasonably and conveniently possible and, above all, let finance be primarily national.<sup>5</sup>

Given the pre-Keynesian context of both the economics discipline and economic policy-makers, it is important to view international financial turmoil historically, and to establish the roots and patterns associated with financial crises and the rise and collapse of financial architectures.

### Repetitive global crises

A financial crisis typically consummates a period of irrational speculation, in the wake of monetary/credit expansion during a structural stagnation (or even decline) in underlying economic growth rates, at the peak of a crisis of overaccumulation.<sup>6</sup> Starting with the 1720 South Sea Company bubble, panics occurred in financial, commodity or property markets in 1763, 1772, 1793, 1797, 1799 and 1810. Such panics reflected relatively immature markets, underdeveloped institutions, the uneven expansion of financial systems, the gullibility of investors, and systemic vulnerability to emotion. Wars and geopolitical conflict were often catalysts. In this earlier era, both the Bank of England and City of Amsterdam performed lender-of-last-resort functions. As capitalism matured, however, the tendency to generate period financial crises did not wane but instead became more acute. There were episodes of stagnation, speculation and crashes from 1815-48, 1873-96, 1917-48, and 1974-present (the exact beginnings and endings are subject to dispute), featuring international financial influences.

Such periodic cycles (or 'long waves') suggest that a crescendo of financial turbulence may contribute to economic catharsis and renewed capital accumulation. Yet discrete crashes are sometimes insufficient to restore conditions for recovery, generating instead 'payment-freeze' which in turn makes commerce or investment very difficult to finance in subsequent years. Past cycles were interrupted by severe financial panics – 1873, 1882, 1890, 1893; 1920, 1929, 1931; and various 1980s-90s crises – which did not immediately rejuvenate growth. Instead, it was only much more dramatic economic devaluations that laid the basis for a revival of accumulation. Within the long-wave of accumulation, there are even more obvious 'Kuznets cycles' of fifteen years to three decades duration witnessed in particular by labour migration patterns and investment in buildings, infrastructure and other facets of the built environment. Ultimately, as in the 1929-45 period, massive devaluations of both financial and real capital – 'creative destruction' as Joseph Schumpeter would say (even if war is very uncreative) – are typically required to remove excess capacity, invoke technological innovation, and thus begin a new round of accumulation.<sup>7</sup>

Before reaching the stage of system-wide devaluation, partial devaluations occur, and increasingly, financiers gain the power to direct the austerity process, even when financial markets are in chaos. Financial panics have caused enormous economic, social and ecological harm, often to firms, workers or entire societies which were innocent of speculation. As contemporary speculator George Soros put it, financial markets 'move in a herd-like fashion in

5. Keynes, J.M. (1933), 'National Self-Sufficiency,' *Yale Review*, 22, 4, p.769.

6. The notion of overaccumulation comes from Marx's *Das Kapital* and refers to a situation in which excessive investment has occurred and hence goods cannot be brought to market profitably, leaving capital to pile up in sectoral bottlenecks or speculative outlets without being put back into new productive investment. Other symptoms include unused plant and equipment; huge gluts of unsold commodities; an unusually large number of unemployed workers; and the inordinate rise of financial markets.

7. Harvey, D. (1982), *The Limits to Capital*, Chicago, University of Chicago Press.

both directions. The excess always begins with overexpansion, and the correction is always associated with pain.<sup>8</sup> The Bretton Woods Institutions and US government will often bail out investors and institutions instead of assisting the victims of finance. Their propensities to impose austerity and enforce extractive-oriented export-led economic strategies are typically justified as necessary for debt repayment.

Hence the asymmetric liability (or 'moral hazard') for the enormous costs associated with recent and ongoing financial meltdowns is one important reason for the challenge to 'Washington Consensus' economic policy. However, given the adverse power relationships and context of deeper economic crisis, elite reforms to the international financial system have failed to address imbalanced power; indeed, most mainstream reform proposals amplify banker power. Before exploring why, it is useful to locate the development of globalized finance within an understanding of economic crisis.

### **International financial architecture and accumulation crises since the early 1970s**

Moving to the next step, we can verify the rise and fall of finance during the course of accumulation cycles, especially at the global scale, and hence the ways that the international financial architecture was constructed under stress. During four periods – the late 1820s, 1870s, 1930s and 1980s – at least one third of all national states fell into effective default on their external debt following an unsustainable upswing of borrowing (*Figure 1*). With the exception of the 1980s (in which there was a significant lag), the onset of global debt crisis was the precursor for the onset of decades-long downswings in the Kondratieff cycles, also known as 'long waves' of accumulation followed by crisis. The reason for sustained financial speculation (instead of a full-fledged global crash), was the *bailout* role of the international financial architecture, in which the IMF and World Bank provided debt 'restructuring' instead of permitting the kinds of national defaults that had been required to systemically clear away financial deadwood in earlier epochs, a topic to which we will return.

Drawing on the world-systems perspective pioneered by Immanuel Wallerstein, Christian Suter explains the 'global debt cycle' by way of stages in the long wave, beginning with technological innovation and utilising international product cycle theory. At the upswing of a Kondratieff cycle, as basic technological innovations are introduced in a labour-intensive and unstandardised manner, both the demand for and supply of external financing are typically low, and in any case the residue of financial crisis in the previous long-cycle does not permit rapid expansion of credit or other financial assets into high-risk investments. As innovations gradually spread, however, peripheral geographical areas become more tightly integrated into the world economy, supported by international financial networks. However, as the power of innovation-led growth subsides, and as the consumer markets of the advanced capitalist countries become saturated, profit rates decline in the core. This pushes waves of financial capital into peripheral areas, where instead of achieving balanced accumulation and growth, low returns on investment plus a variety of other political and economic constraints inexorably lead to sovereign default. In sum, at the global scale there is a three-stage process characterised by, as Suter puts it, 'first, intense core capital exports and corresponding booms in credit raising activity of peripheries; second, the occurrence of debt service incapacity among peripheral countries; and third, the negotiation of debt settlement

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8. Soros, G. (1997), 'Avoiding a Breakdown', *Financial Times*, 31 December.

agreements between debtors and creditors.<sup>9</sup>

One of the reasons that debt crises took the form they did was the failure of monetary systems to retain the integrity required to halt excessive credit creation. The weak anchoring of international financial integration, followed by a demoooring that signified financial autonomy, can be understood in part through considering the prevailing international financial architecture. Columbia University monetary specialist Robert Mundell set out a chronology for the international financial architecture over two centuries, with distinct periods entailing combinations of monetary bases (*Table*). Simplifying Mundell, in modern economic history, five core strategies were used at various times:

- Gold Standard (pre-1932)
- Anchored \$ Standard (1944-71)
- Flexible Exchange Rates (1973-85)
- Managed Exchange Rates (1985-99)
- Dollar and Euro (1999-present)

The chaotic architecture's wobbly add-ons permitted severe slippage, especially with respect to financial regulation and currency valuation, and especially as banks and other financial institutions internationalized their activities in recent decades. Based upon University of California economist Maurice Obstfeld's studies of international financial integration, World Bank researcher Stijn Claessens has loosely charted the extent to which the globalization of finance proceeded during the last century and a half, with high points of integration reflecting extreme vulnerability in geopolitics (1914) and economics (1929, late 2000s) (*Figure 2*).

The current period of excessive financial integration began in 1971. It is therefore instructive to review how the Bretton Woods system broke down at the outset of a general rise in financial turbulence, and how over the subsequent four decades the monetary and financial systems reacted, leaving us with the desperate need for a new international financial architecture. Over the last four decades, a series of speculative bubbles and panics ensued, reflecting uncontrolled financial turbulence. To some extent these were offset by bailouts, but they generally destroyed more than 15 percent of the value of financial assets at stake within a short period of time: the dollar crash (1970s), gold and silver turbulence (1970s-80s), Third World debt crisis (1980s), US farmland collapse (1980s), energy finance shocks (mid 1980s), crashes of international stock (1987) and property (1991-93) markets, the long fall (from 1973-2002) in non-petroleum commodity prices and related securities, and after the dot.com crash of 2000-01, vast new devaluations of real estate, commodities, financial institutions and exposed sovereign securities in Europe (2007-12). Emerging markets offered spectacular examples of financial panic, including Mexico (1995), South Africa (1996, 1998 and 2001), Southeast Asia (1997-98), South Korea (1998), Russia (1998), Brazil and Ecuador (early 1999), Argentina (2001-02) and Turkey (2001-03). Trouble moved north, as far as Iceland (2008), Ireland (2009), Greece (2010) and Spain (2011). Other examples of investment gambles gone sour included derivatives speculation, exotic stock market positions, and bad bets on currency, commodity and interest rate options, futures and swaps, with specific victims covering enormous losses.

Chronologically, we can see how the following dozen moments of fragility reflect systemic global

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9. Suter, C. (1992), *Debt Cycles in the World Economy*, Boulder, Westview Press, p. 41.

financial volatility. Because international policymakers generally reacted with increasing commitments to fiscal bailouts, the problems were merely displaced to more extreme levels, as we see presently in Europe:

- in 1973, the Bretton Woods agreement on Western countries' fixed exchange rates – by which from 1944-71, an ounce of gold was valued at US\$35 and served to anchor other major currencies – disintegrated when the US unilaterally ended its payment obligations, representing a default of approximately \$80 billion, leading the price of gold to rise to \$850/ounce within a decade, and at the same time, several Arab countries led the formation of the Oil Producing Exporting Countries (OPEC) cartel, which raised the price of petroleum dramatically and in the process transferred and centralized inflows from world oil consumers to their New York bank accounts ('petrodollars');
- from 1973, 'los Chicago Boys' of Milton Friedman – the young Chilean bureaucrats with doctorates in economics from the University of Chicago – began to reshape Chile in the wake of Augusto Pinochet's coup against the democratically-elected Salvador Allende, representing the birth pangs of neoliberalism;
- in 1976, the International Monetary Fund signalled its growing power by forcing austerity on Britain at a point where the ruling labor Party was desperate for a loan, even prior to Margaret Thatcher's ascent to power in 1979;
- in 1979 the US Federal Reserve addressed the dollar's decline and US inflation by dramatically raising interest rates, in turn catalyzing a severe recession and the Third World debt crisis, especially in Mexico and Poland in 1982, Argentina in 1984, South Africa in 1985 and Brazil in 1987 (in the latter case leading to a default that lasted only six months due to intense pressure on the Sarney government to repay);
- at the same time, the World Bank shifted from project funding to the imposition of structural adjustment and sectoral adjustment (supported by the IMF and the 'Paris Club' cartel of donors), in order to assure surpluses would be drawn for the purpose of debt repayment, and in the name of making countries more competitive and efficient;
- the overvaluation of the US dollar thanks to the Fed's high real interest rates was addressed by formal agreements between five leading governments that devalued the dollar in 1985 (Louvre Accord), but with a 51 percent fall against the yen, led to a 1987 revaluation (Plaza Accord);
- once the Japanese economy overheated during the late 1980s, a stock market crash of 40 percent and a serious real estate downturn followed from 1990, and indeed not even negative real interest rates could shake Japan from a long-term series of recessions;
- during the late 1980s and early 1990s, Washington adopted a series of financial crisis-management techniques – such as the US Treasury's Baker and Brady Plans – so as to write off (with tax breaks) part of the \$1.3 trillion in potentially dangerous Third World debt due to the New York, London, Frankfurt, Zurich and Tokyo banks which were exposed in Latin America, Asia, Africa and Eastern Europe (although notwithstanding the socialization of the banks' losses, debt relief was denied the borrowers);
- in late 1987, crashes in the New York and Chicago financial markets (unprecedented since 1929) were immediately averted with a promise of unlimited liquidity by Alan Greenspan's Federal Reserve, a philosophy which in turn allowed the bailout of the Savings and Loan industry and various large commercial banks (including Citibank) in the late 1980s notwithstanding a recession and serious real estate crash during the early 1990s;
- likewise in 1998, when a New York hedge fund – Long Term Capital Management (founded by Nobel Prize-winning financial economists) – was losing billions in bad investments in Russia,

the New York Fed arranged a bailout, on grounds the world's financial system was potentially at risk;

- starting with Mexico in late 1994, the US Treasury's management of the mid- and late 1990s 'emerging markets' crises again imposed austerity on the Third World while offering further bailouts for investment bankers exposed in various regions and countries – Eastern Europe (1996), Thailand (1997), Indonesia (1997), Malaysia (1997), Korea (1998), Russia (1998), South Africa (1998, 2001), Brazil (1999), Turkey (2001) and Argentina (2001) – whose hard currency reserves were suddenly emptied by runs; and
- in addition to a vastly overinflated US economy (with record trade, capital and budget deficits) whose various excesses have occasionally unraveled – as with the dot.com stock market (2000) and real estate (2007) bubbles – the two largest Asian societies, China and India, picked up the slack in global materials and consumer demand during the 2000s, but not without extreme stresses and contradictions that in coming years threaten world finances, geopolitical arrangements and environmental sustainability.

### Underlying factors

Powerful underlying forces are the main reason for such extreme financialization. Recall that the world's per capita annual GDP increase fell from 3.6 percent during the 1960s, to 2.1 percent during the 1970s, to 1.3 percent during the 1980s to 1.1 percent during the 1990s followed by a rise to 2.5 percent for the first half of the 2000s, but then a crash in absolute terms at the end of the 2000s, according to the World Bank (*Figure 3*). To be sure, the bundle of goods measured over time has changed (high technology products enjoyed today were not available in the last century). Yet overall, GDP measures are notorious overestimates, especially since environmental degradation became more extreme from the mid-1970s, when a 'genuine progress indicator' went into deficit (*Figure 4*).

Related debates unfold over what is mainly a symptom of economic crisis: declines in the corporate rate of profit during the 1970s-90s, emanating from the United States. At first glance, the after-tax US corporate profit rate appeared to recover from 1984, nearly reaching 1960s-70s highs (although it must be said that tax rates were much lower in the recent period). On other hand, interest payments remained at record high levels throughout the 1980s-90s. By subtracting real (inflation-adjusted) interest expenses we have a better sense of net revenue available to the firm for future investment and accumulation, which remained far lower than earlier periods (*Figure 5*). Furthermore, we can trace, with the help of Gérard Duménil and Dominique Lévy, the ways that US corporations responded to declining manufacturing-sector accumulation. Manufacturing revenues were responsible for roughly half of total (before-tax) corporate profits during the quarter-century post-war 'Golden Age', but fell to below 20 percent by the early 2000s. In contrast, profits were soon much stronger in the financial sector (rising from the 10-20 percent range during the 1950s-60s, to above 30 percent by 2000) and in corporations' global operations (rising from 4-8 percent to above 20 percent by 2000) (*Figure 5*). Dumenil and Levy show that since the 1979 'Volcker Shock' (dramatic interest rate increases imposed by Paul Volcker) (*Figure 6*) changed the interest/profit calculus, there have been more revenues accruing to capital based in finance than in the non-financial sector, to the extent that financiers doubled their asset base in relation to non-financiers during the 1980s-90s.

Many such trends continued into the 2000s, with low investment rates (especially after the dot.com software bubble burst) (*Figures 7 and 8*), high debt loads and even bankruptcy threats to



what were once some of the US' most powerful auto companies. Hence the restoration of profits for capital in general disguised the difficulty of extraction of surplus value, leaving most accumulation hollow, based increasingly upon financial and commercial activity rather than production. Although productivity increased and wage levels fell, profitability was mainly found outside the production process, especially in finance (*Figures 9-11*). Nevertheless, with much lower interest rates, low inflation and relatively low unemployment (*Figure 12*), resulting in steady GDP, a rising stock market and recovery from earlier outbreaks of currency volatility (*Figure 13*), it appeared to many investors that the US economy could continue along this trajectory.

This naivety changed immediately in 2008, as the world economy began what initially appeared to be an even worse decline than in 1929-30, in terms of crashed industrial output (*Figure 14*), trade (*Figure 15*), and stock market valuation (*Figure 16*). Commodity prices crashed by record amounts (*Figure 17*), and world GDP, industrial production and Foreign Direct Investment levels plummeted (*Figure 18*). The extreme devalorisation and required several major interventions: very rapid increases in government debt (*Figure 19*), dramatic declines in interest rates (*Figure 20*) and a vast inflow of new liquidity from the US Federal Reserve ('Quantitative Easing' on two occasions) (*Figure 21*), which raised global money supply after a break associated with the 2008 crash (*Figure 22*).

Volatility associated with ongoing financial processes and minimalist intrastate regulation is addressed later, but David Harvey's analyses of spatio-temporal 'fixes' (not resolutions) and of systems of 'accumulation by dispossession', are also appealing as theoretical tools.<sup>10</sup> They help explain why economic crisis doesn't automatically generate the sorts of payments-system breakdowns and mass unemployment problems witnessed on the main previous conjuncture of overaccumulation, the Great Depression. Several obvious variables – the rise in US debt in comparison to the production of goods in the US economy, the rise of financial sector debt (in relation to other sectors), the rise of profits attributable to financial (not productive) activity, underinvestment and rising inventories – were all quite extreme during the 2000s.

Is there a framework that explains these events? Based on Harvey's broader theory of historical-geographical-materialism, four core arguments emerge about the way financial volatility relates to social power and global macroeconomic management:

- first, the durable late 20th century condition of overaccumulation of capital – as witnessed in huge gluts in many markets, declining increases in per capita GDP growth, and falling corporate profit rates – was displaced and mitigated ('shifted and stalled' geographically and temporally) at the cost of much more severe tensions and potential market volatility in months and years ahead;
- second, the temporary dampening of crisis conditions through increased credit and financial market activity has resulted in the expansion of 'fictitious capital' – especially in real estate but other speculative markets based upon trading paper representations of capital ('derivatives') – far beyond the ability of production to meet the paper values;
- third, geographical shifts in production and finance continue to generate economic volatility and regional geopolitical tensions, contributing to unevenness in currencies and markets as well as pressure to 'combine' market and non-market spheres of society and

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10. Harvey, *The Limits to Capital*, op cit.

- nature in search of restored profitability; and
- fourth, capital uses power associated with the two stalling and shifting (temporal and spatial displacement) tools above to draw additional surpluses from non-market spheres (environmental commons, women's unpaid labor, indigenous economies), via extra-economic kinds of coercions ranging from biopiracy and privatization to deepened reliance on unpaid women's labor for household reproduction in an ever-expanding process of long-distance labor migrancy.

This background gives a better sense of why damage from termites, from sinking foundations, from from periodic earthquakes and from uncontained financial fires have not only left the international financial architecture on the verge of collapse, but have also wrecked national economies because of their excessive reliance upon international financial flows. There are even more severe challenges just ahead, however, and the existing architecture is not likely to withstand the rising structural pressures that will undermine and potentially even collapse international finance.

### **Volatile global financial architecture**

One of the strongest statements about why the current international financial architecture is fundamentally unsound came from the South Centre advisor Yilmaz Akyuz in 2010:

- There are no effective rules and regulations to bring inherently unstable international financial market and capital flows under control.
- There is no multilateral discipline over misguided monetary, financial and exchange rate policies in systemically important countries despite their strong adverse international spillovers.
- National and international policy makers are preoccupied primarily with resolving crises by supporting those who are responsible for these crises, rather than introducing institutional arrangements to reduce the likelihood of their recurrence. Through such interventions, they are creating more problems than they are solving, and indeed sowing the seeds for future difficulties.<sup>11</sup>

These problems became increasingly evident since, especially in the European debt market. There are several specific challenges that emerged as a result of the 1970s destruction of the Bretton Woods architecture, and especially since the financial meltdown of 2008, which any new international financial architecture would have to tackle: currency imbalances and volatility; fiscal deficits and the limits to neo-Keynesianism; US monetary 'quantitative easing'; global and local real estate; European national sovereign debt; and US state/municipal debt.

The underlying problem, however, remains an imbalance in the real economy. 'As I have been saying repeatedly,' insisted Yale University sociologist Immanuel Wallerstein in January 2011, 'we are not in a recession but in a depression.' In these circumstances, 'politicians look for quick fixes. They call for 'austerity,' which means cutting pensions and education and child care even

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11. Akyuz, Y. (2010), 'South Centre Paper Argues That the G20 Agenda Misses Some of the Key Issues for Reform of the International Monetary System', Geneva, South Centre, [http://www.southcentre.org/index.php?option=com\\_content&view=article&id=1407:sb51&catid=144:south-bulletin-individual-articles&Itemid=287&lang=fr](http://www.southcentre.org/index.php?option=com_content&view=article&id=1407:sb51&catid=144:south-bulletin-individual-articles&Itemid=287&lang=fr)

further.' Wallerstein warns, 'The governments of Russia, India, and South Africa are all facing rumbling discontent from large parts of their populations who seemed to have escaped the benefits of presumed economic growth.' He predicts continuing 'sharp rises in the prices of energy, food, and water, and thus a struggle for these basic goods, a struggle that could turn deadly.'<sup>12</sup>

Financial crisis is also hitting the middle class even in sites such as the United States and Ireland considered earlier in the decade to be amongst the world's leading capitalist success stories. Currency volatility will continue, with imbalances in trade and payments still at all-time highs. The November G20 meeting in Seoul narrowly avoided a currency war between the US and China, because no one would support Washington's saber-rattling rhetoric. The Obama administration lost credibility after Federal Reserve Board ('Fed') chair Ben Bernanke pushed \$600 billion through the banks a few days earlier. Yet even Goldman Sachs economists opined that \$4 trillion more of this 'quantitative easing' would be required to pull the US economy out of its stagnation.<sup>13</sup>

Other Northern governments are stuck even deeper in the mire. But unlike the US, which has the power to print dollars, the central bankers of Portugal, Ireland, Italy, Greece, Spain (the 'PIIGS') and even Belgium and Austria are trapped by Eurozone membership: they can't run the printing press the way Washington does. In many of these countries, riots and political protests confronted austerity policies. The recent unrest was also intense in Britain – with its revitalized student movement unwilling to accept the extreme Tory-Liberal tuition hikes – and France due to retirees' resistance to longer work-lives.

Other troubling economic weaknesses are finally being noticed within the alleged world 'recovery'. US real estate continues to rot, even though Bernanke bought over \$1 trillion worth of mortgage-backed securities from banks that would have gone belly-up otherwise. Residential properties and commercial real estate – especially shopping malls – keep shrinking in value. One of the very few outspoken US politicians, Vermont's independent socialist Senator Bernie Sanders, explained in December, 'After years of stonewalling by the Fed, the American people are finally learning the incredible and jaw-dropping details of the Fed's multitrillion-dollar bailout of Wall Street and corporate America.'<sup>14</sup> In 2010, it was finally revealed that between March 2008 and May 2009, Bernanke not only pumped in \$3 trillion into the US economy as emergency liquidity, but also secretly lent \$9 trillion to bail out 18 financial institutions deemed 'too big to fail'. Citigroup, Merrill Lynch and Morgan Stanley were at such risk that they approached Bernanke for cheap loans on more than 100 occasions. Goldman Sachs went 84 times. It was not only the US taxpayer and all holders of dollars who lose in the process. Sanders remarks that ordinary homeowners are victims: 'Banks are foreclosing on untold numbers of families who have never missed a payment, because rushing to foreclosure generates lucrative fees for the banks, whatever the costs to families and investors.'<sup>15</sup>

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12. Wallerstein, I. (2011), 'End of the Recession? Who's Kidding Whom?', Braudel Centre Commentary 296, <http://www2.binghamton.edu/fbc/archive/296en.htm>.

13. Barr, C. (2010), 'Goldman says Fed faces \$4 trillion Hole', *CNNMoney*, 25 October, <http://finance.fortune.cnn.com/2010/10/25/goldman-says-fed-faces-4-trillion-hole/>

14. Sanders, B. (2010), 'A Real Jaw Dropper at the Fed', 3 December, <http://www.rense.com/general92/sen.htm>

15. *Ibid.*

There are also other sources of financial turmoil awaiting, including major disruptions to Bank of America and other large banks and mortgage companies that acted illegally in the recent wave of millions of home foreclosures, millions more foreclosures that could sink the property market further, more 'flash crash' financial markets incidents (as in May 2010 when the Dow Jones Index crashed 700 points within minutes), and much higher energy and especially oil prices.<sup>16</sup> These kinds of factors suggest the urgent need to shore up the international financial architecture, especially so as to protect low-income countries' economies from adverse exposure to monetary, fiscal and other macroeconomic tsunamis or earthquakes whose Ground Zeros will continue to be the US and Europe. A variety of options are on the table, including from the existing institutions, but these appear inadequate to the task at hand.

### Ongoing architectural decay

As in any such system-threatening situation, the choices for reconstructing a new architecture include mere interior design, some exterior rehabilitation, full remodeling and demolition followed by rebuilding. So far, because of insufficient political will, no substantive work (aside from repainting) has begun, so the existing architecture<sup>17</sup> continues to decay, punctuated by extreme shocks that weaken the global system. As has often been remarked upon, the same arsonists who set the financial fires remain at the heads of international banks, national governments (especially the US) and multilateral institutions (especially the Bretton Woods Institutions). To ask the arsonists for a new, fire-proof architecture, is to ask the fox to guard the henhouse.

To illustrate the limitations of those who hold power at present, a typical mainstream perspective on fixing the architecture would stress the following: transparency, crisis prevention, flexible exchange rates and ongoing capital mobility. Since the 1995 Mexican currency crash, the IMF has permitted a slight deviation from orthodoxy in the form of capital controls on incoming flows of funds (e.g. the 'speedbump' on portfolio inflows so as to keep them in a given financial market for a minimum period). But the general regime of neoliberal financial deregulation and pro-cyclical macroeconomic policy remains.

For example, protection for US consumers from predatory finance was promised in legislation sponsored by Senator Christopher Dodd and Representative Barney Frank in 2010, but ultimately amounted to a slap-dash paint job on the existing architecture. As Jane D'Arista (2011, 1) remarked, although the Dodd-Frank Act at least began to 'deal with the interconnectedness of financial institutions,' it 'failed in identifying and addressing structural faults in the global system' because of its 'reaffirmation of pro-cyclical capital requirements as the primary tool in the post-crisis regulatory

16. Bottari, M. (2011), 'Full catastrophe banking in 2011', *Bankster*, <http://www.banksterusa.org/content/full-catastrophe-banking-2011>

17. In addition to the Bank for International Settlements (BIS) in Basel and each country's central bank and finance ministry, there is a dizzying array of institutions involved in the international architecture, as it now stands:

- intergovernmental fora representing the leading economic powers (especially the G7 finance ministers and G8 heads of state, and their expansion into the G20 group of major economies),
- international financial institutions charged with the surveillance of different aspects of domestic and international financial systems (IMF, World Bank, OECD),
- sector-specific international groupings of regulators and supervisors,
- committees of central bank experts concerned with market infrastructure and functioning, and
- a cross-sectoral international grouping – the Financial Stability Forum – in which national authorities, international financial institutions, sector-specific international groupings of regulators and supervisors as well as the committees of central bank experts are represented.

framework.’ Aside from the 2008-09 failure of several major US institutions and the purchase of their downgraded assets by newly centralized private financiers in the wake of US government bailouts of investors, none of the needed rehabilitations were made. There was no restructuring of the financial architecture comparable to Washington’s early 1930s banking legislation which separated credit from investment and which maintained strict geographical controls limiting banks to operations within a single US state.

Many of the multilateral functions broke down fairly conclusively in 2008-09, when some of the world’s largest financial institutions failed as a result. It may be possible to offer a kind of interior design strategy to relegitimize the architecture, as was attempted for the IMF at the G20’s April 2009 meeting in London with substantial added funding and at the Seoul meeting in October 2010 with a minor degree of Board representation (a 6 percent shift in voting power that mainly benefited China). But all other indications suggest that elite managers have reached the limits of crisis management, both in terms of their analytical ability and their vision for architectural reform.

### **Conventional analysis and strategies for architectural repair**

Although the roots are decades old, the most proximate cause of the ongoing international financial crisis can be traced to weak United States financial institutions. The 2008 crash of a variety of the main investments banks, the two main home mortgage guarantors, the largest insurance company, the largest-ever bank to collapse and the Dow Jones itself (which on 29 September 2008 had the biggest-ever fall in share prices) was superficially explained by mainstream commentators. Many mention deregulation, corruption, greed, feckless borrowing by debt-addicted consumers, or a combination. Joseph Stiglitz adds ‘ideology, special-interest pressure, populist politics, and sheer incompetence’.

Populist conservative posturing aside, it is more instructive to consider the view from the financial power center, in Washington. Three leading IMF economists – Olivier Blanchard, Jaime Caruana and Reza Moghadam – typify what is wrong with the existing managers of global finance. In a 2009 paper for the IMF, ‘Initial Lessons of the Crisis’, the three addressed what they understood as the deficiencies in ‘regulation, macroeconomic policy and the global architecture for stability’. The causes were ‘optimism bred by a long period of high growth, low real interest rates and volatility, and policy failures in financial regulation... macroeconomic policies... and global architecture, where a fragmented surveillance system compounded the inability to see growing vulnerabilities and links.’ The lessons the three drew are ‘that flawed incentives and interconnections in modern financial systems can have huge macroeconomic consequences’, especially in relation to reform of the global financial architecture: ‘The fragmentation into silos of expertise needs to be overcome and senior policy makers engaged in promoting global stability, including via early warning exercises. The case for cooperation is pressing in financial regulation, especially the resolution of cross-border banks.’<sup>18</sup>

In other words, what the IMF economists are calling for is merely continuing occupation of the current architecture, with no major changes aside from more sophisticated residents who can

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18. Blanchard, O., J. Caruana and R. Moghadam (2009), ‘Initial Lessons of the Crisis,’ Research, Monetary and Capital Markets, and Strategy, Policy, and Review Departments, International Monetary Fund, Washington, <http://www.imf.org/external/np/pp/eng/2009/020609.pdf>.

utilize existing systems more effectively. Instead of seeing the financial crisis and collapsing architecture as indicative of broader financial power and long-term crisis, the IMF economists view the 2008-09 financial meltdown as the logical outcome of the *success* of the neoliberal project. Where the economists view market failure as a function of 'optimism bred by a long period of high growth, low real interest rates and volatility' during the 2000s, the reality is that the long era of *low* growth in the productive economy of the 1980s-90s was accompanied by *high* interest rates (the 1979 Volcker Shock and sustained positive levels far above the negative real rates of prior years) and then by volatility borne of the resulting political power to deregulate global finance.

A genuinely new architecture focusing on reregulation (not a 'more flexible perimeter' of regulation) and national-scale protection from financial vulnerability would be required to accomplish the anti-cyclical policy the economists acknowledge is necessary. There is no way to carry off this kind of task within the existing system given the adverse power relations and the lack of institutional controls over footloose finance. In sum, because the earlier Bretton Woods architecture was torn down during the 1970s, the possibilities for national regulation of finance were limited in the 1980s-90s by deregulation (the US was most notorious during the Clinton administration), the liberalization of financial markets was stressed as a condition for loans by multilateral creditors and for membership in the OECD, and the capital controls which had earlier established firewalls between national economies and global financial markets were torn down nearly completely. Very little of the prior architecture – which had hosted a higher-growth, more balanced and financially far less volatile world economy prior to the 1970s – remained and thus the IMF economists' call for 'better' regulation within the context of the deregulated system is incongruous.

### **Post-Washington Consensus reform proposals**

Since the mid-1990s, when the emerging markets crises began in Mexico, the void of reason on economics has been so great that even moderate reform efforts in both disciplinary terms (as noted in Section 1) and public policy have been foiled. There have been two main sources of advocacy for international financial architecture reform within the United Nations system, but neither – the UN Conference on Trade and Development (Unctad) or the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System (known as the Stiglitz Commission) – mustered sufficient clout to achieve their objectives. Nor were the objectives sufficient to address the foundational problems.

As Unctad argued,

The crisis dynamics reflect failures in national and international financial deregulation, persistent global imbalances, absence of an international monetary system and deep inconsistencies among global trading, financial and monetary policies. Market fundamentalist laissez-faire of the last 20 years has dramatically failed the test. Financial deregulation created the build-up of huge risky positions whose unwinding has pushed the global economy into a debt deflation that can only be countered by government debt inflation.<sup>19</sup>

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19. UN Conference on Trade and Development (2010), *The Global Economic Crisis*, Geneva, Unctad, [http://www.unctad.org/en/docs/gds20091\\_en.pdf](http://www.unctad.org/en/docs/gds20091_en.pdf)

In other words, it is merely neoliberal public policy that is to blame, and hence ‘this systemic failure can only be remedied through comprehensive reform and reregulation with a vigorous role by Governments working in unison. Contrary to traditional views, Governments are well positioned to judge price movements in those markets that are driven by financial speculation and should not hesitate to intervene whenever major disequilibria loom.’<sup>20</sup> But as for details, Unctad provided quite meek notions of reregulation. With regard to the ‘speculative bubbles’ in commodity markets, for example, ‘Regulators need access to more comprehensive trading data in order to be able to understand what is moving prices and intervene if certain trades look problematic, while key loopholes in regulation need to be closed to ensure that positions on currently unregulated over-the-counter markets do not lead to ‘excessive speculation’.’<sup>21</sup> Similarly, ‘The absence of a cooperative international system to manage exchange rate fluctuations has facilitated rampant currency speculation and increased the global imbalances.’ Yet Unctad merely desires that ‘Developing countries should not be subject to a ‘crisis rating’ by the same financial markets which have created their trouble.’ And while arguing that ‘Multilateral or even global exchange rate arrangements are urgently needed to maintain global stability, to avoid the collapse of the international trading system and to pre-empt pro-cyclical policies by crisis-stricken countries,’ this is a vague call with no strategic orientation for achieving a new international financial architecture.

The same reversion to orthodoxy was witnessed in Joseph Stiglitz’s January 2009 report on ‘Recommendations for Immediate Action’. The Stiglitz Commission’s brief statement consisted of a call to correct market imperfections (for which Stiglitz won the 2001 Nobel Prize) added to national Keynesianism. The gaps in the report were striking, especially because Stiglitz had once called for the replacement – not relegitimation/recapitalisation – of the IMF. His report failed to mention ongoing IMF austerity conditions. He failed to get the commission to explicitly support capital/exchange controls. There were no suggestions for converting bank bailout nationalizations into a genuine public utilities. The Jubilee movement’s projects of debt cancellation, Odious Debt and reparations were not mentioned. There were no detailed strategies to address ecological debt and the financing implications of climate crisis, or even unregulated hot money centres. There was no attempt at commodity price regulation. Instead, Stiglitz’s commission endorsed the tired Doha Agenda. The hard work of insulating national economies from international financial volatility was simply not advanced by Stiglitz’s group.

A few weeks later, Stiglitz’s Commission proposed a UN Global Economic Council (with 20-25 members) with similar status to the UN Security Council, a potential codification of the G20. On the other hand, the Commission also proposed a new currency and reserve system that would suffer relatively less veto power from the wealthy countries, plus a 1 percent GDP levy to redistribute from North to South.<sup>22</sup> However, none of these very minor reforms had any scope for being passed given the adverse power relations.

## **Challenges beyond the scope of the existing architecture**

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20. *Ibid.*

21. *Ibid.*

22. United Nations Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System (2010), ‘Final Report’, New York, [http://www.un.org/ga/econcrisissummit/docs/FinalReport\\_CoE.pdf](http://www.un.org/ga/econcrisissummit/docs/FinalReport_CoE.pdf)

The limits to reform of the existing architecture became obvious in 2007-10, as numerous financial markets and institutions collapsed. These limits will become even more obvious in coming years notwithstanding the alleged global recovery. The most important challenges in the world economy cannot be addressed using the strategies available within existing institutions, because those in charge have neither the analytical capacity nor political will to properly address them:

- the need to raise global effective demand (albeit in an environmentally more sustainable way), given that the IMF and World Bank have permitted only a momentary Keynesianism and remain committed to the Washington Consensus austerity and liberalization agendas;
- the need to transcend systemic false optimism about the state of the world economy, as revealed not only in repeated wishful thinking by economic forecasters, but also in G7 and G20 finance ministers' communiqués;
- the need to re-empower the politically most democratic multilateral institution, the UN, whose assessments of international financial architecture reforms (from Monterrey in 2002 to the 2009 Stiglitz Commission) failed to persuade those with real power to make the recommended changes;
- the need to address weaknesses in the banking standards of the Bank for International Settlements, whose emphasis on capital adequacy has been repeatedly unveiled as inadequate especially in view of derivatives market growth;
- the need to upgrade regional financial and monetary strategies, especially Asian and Latin American efforts to intervene in extremely uneven economic relationships;
- the need to redress geopolitical power imbalances in international finance and global financial and monetary governance, given the mainly cosmetic shifts accomplished through the G20;
- the need to systematize bilateral deal-making, including the Chinese government's currency swaps with various national authorities in other emerging markets, so as to avoid dollar-dependency; and
- the need, at the national level, to permit appropriate sovereign defaults and generate effective resolution ('workout') mechanisms (as recently pioneered by Argentina and Ecuador), which have not yet reached the critical mass of the 'debtors' cartel' advocated by courageous leaders of some states (Julius Nyerere in Tanzania and Fidel Castro in Cuba in the early 1980s, for example).

To these ends, a dramatically different approach will be needed. To address the challenges listed above, a new architecture with a pro-South bias is required, so that the persistent crises can be addressed with appropriate national insulation, while new institutions (such as the Bank of the South) emerge to replace the outgoing neoliberal institutions. Remaking the global architecture requires reversing current tendencies towards extractive-oriented, export-led growth in which uneven development is amplified by deregulated, free-flowing finance.

The most appropriate global combination to rebuild this architecture was identified by Keynes in the 1930s, but his defeat in the initial 1944-46 Bretton Woods System negotiations meant his proposals for an International Currency Union and a 'Bancor' international currency were not implemented. However, because of relatively deglobalized finance and economics during the 1930s, national exchange controls were common, and short of an ambitious attempt to build an appropriate international financial architecture, could be easily restored. In addition, other



controls – e.g. a financial transactions tax – can be applied at national level, along with the kinds of banking regulations and even nationalizations and mandates for banks to serve as public utilities. A variety of strategies and tactics will be necessary to restore the proper economic balance between the financial and the real economies, as well as between the economy and the environment. These are all considered in turn.

Keynes worried about the inappropriate international financial architecture from the early 1920s' Versailles austerity for Germany, through the 1930s when he wrote *The General Theory*, until his death in 1946. The 'Treasury View' – or what we now consider 'neoliberalism' and the 'Washington Consensus' – was fixated on orthodox strategies. Instead, very new and creative approaches would be needed to establish the basis for balanced economic development, he argued. In particular, he insisted, countries which export too much for the world economy's good should be compelled to spend – not hoard – the resulting foreign currency reserves, so as to then raise the value of their own currency, hence re-establishing equilibrium between economies and preventing untenable mismatches of trade and financial relations. In 1941, Keynes proposed an International Currency Union, led by an International Clearing Bank, based on:

a general and collective responsibility, applying to all countries alike, that a country finding itself in a creditor position *against the rest of the world as a whole* should enter into an obligation to dispose of this credit balance and not to allow it meanwhile to exercise a contractionist pressure against the world economy and, by repercussion, against the economy of the creditor country itself. [original emphasis]<sup>23</sup>

Accomplishing this coordination is possible, so long as every country (and its central bank) has

unqualified control over the capital transactions of its residents both outward and inward (subject to the obligations of a Surplus Bank), and it shall be entitled to call on the collaboration of other member banks to prevent unlicensed movements... The object, and it is a vital object, is to have a means of distinguishing (a) between movements of floating funds and genuine new investment for developing the world's resources; and (b) between movements, which will help to maintain equilibrium, from surplus countries, to deficiency countries and speculative movements or flights out of deficiency countries or from one surplus country to another. There is no country which can, in future, safely allow the flight of funds for political reasons or to evade domestic taxation or in anticipation of the owner turning refugee. Equally, there is no country that can safely receive fugitive funds which cannot safely be used for fixed investment and might turn it into a deficiency country against its will and contrary to the real facts.<sup>24</sup>

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23. J.M.Keynes (1941), 'Proposals for an International Currency Union', in D.Moggridge (ed) *The Collected Writings of John Maynard Keynes*, Volume XXV, Activities 1940-1944, Shaping the Post-war World: the Clearing Union. London: MacMillan, 1980, pp. 42-66.

24. Keynes continued by setting out six 'essential general principles':

- (i) All remittances must be canalised through central banks and the resulting balances cleared by them through the International Clearing Bank.
- (ii) No remittances in respect of the outstanding capital of existing or future assets owned by nonresidents shall be made except under licence of both the central banks concerned.
- (iii) The ownership of such assets may be freely shifted between non-residents, and non-residents may exchange one investment for another within a country.
- (iv) The net current income of such assets may be freely remitted together with an annual amortisation of capital not exceeding (say) 5 per cent.

This would be the ideal-type of international financial architecture for countries to achieve greater self-sufficiency and lower their dependence upon environmentally- and socially-destructive export-led growth strategies. Since the late 1990s, Keynes' ideas have been periodically revived. Sir John Eatwell and Lance Taylor advocated the establishment of a World Financial Authority.<sup>25</sup> Leading post-Keynesian economist Paul Davidson proposed an international clearing union providing for capital controls.<sup>26</sup> The former chief economist of the UN Conference on Trade and Development (Unctad), Yilmaz Akyuz, made similar calls.<sup>27</sup> Other far-sighted US economists – James Galbraith, William Darity and Dean Baker of the Financial Markets Center in Washington – suggested a new international public bank and regulatory framework.<sup>28</sup> The ideas of perhaps the most visionary and experienced of these reformers, Jane D'Arista, are worth special attention in our conclusion.

## Conclusion

To conclude, we must face up to a formidable challenge: the current balance of forces is terribly adverse, with the financial fraction of capital in control at both global and most national scales. If we seek world financial regulation, the basic barrier is that too many neoconservatives and neoliberals populate the multilateral institutions. After all, not since 1987 when the Montreal Protocol agreed upon chlorofluorocarbon emission reductions to halt ozone hole erosion, have we seen a serious global governance reform. In areas ranging from democratisation of the IFIs and UN Security Council, to climate change, to international aid and trade, efforts made to establish cooperative relations and promote reforms across North and South have utterly failed.

The hope for global economic reform *top down*, seems myopic. Instead, what kinds of examples can we find, *bottom-up*, that correspond to the pressures of global financial volatility, and social resistance? And how might we move from the practice of national strategies to counter world vulnerability, to a more coherent international financial architecture built on a stable footing? To answer, consider a few of Jane D'Arista's contributions to the debate.

Beginning with universal values, D'Arista testified to Congress in 2009 that her objectives in promoting far-reaching changes to the financial regulatory architecture were to 'moderate the growth of financial institutions, control excessive credit expansion and prevent the recurrence of the economic tragedy we have experienced as a result of the failure of our financial system.' Many of the needed changes she advocated were well within the purview of US legislators and

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(v) The offer of investments or assets to non-residents to be newly acquired by them shall require the approval of both the central banks concerned.

(vi) Floating and liquid funds, apart from those required to finance current trade through bills and acceptances and in connection with current banking business approved by the central bank concerned (much as in this country under present conditions) shall only be lent and borrowed between central banks.

25. Eatwell, J. and L.Taylor (1998), 'International Capital Markets and the Future of Economic Policy,' CEPA Working Paper Series III, Working Paper 9, New School for Social Research, New York, September.

26. Davidson, P. (1997), 'Are Grains of Sand in the Wheels of International Finance Sufficient to do the Job when Boulders are often Required?,' *The Economic Journal*, 107, and (1998), 'The Case for Regulating International Capital Flows,' Paper presented at the Social Market Foundation Seminar on Regulation of Capital Movements, 17 November.

27. Akyuz, Y. (1995), 'Taming International Finance,' in J.Michie and J.G.Smith (Eds), *Managing the Global Economy*, Oxford, Oxford University Press, and (1998), 'The East Asian Financial Crisis: Back to the Future,' in Jomo K.S. (Ed), *Tigers in Trouble*, London, Zed.

28. See <http://www.fmcenter.org>.

regulators, so some of her most effective commentaries are against the slap-dash cosmetic changes to Washington's architectural remodeling, such as the authorities' failure to address one of the root problems, securitization.<sup>29</sup>

What about the global-scale reforms required? In 1999, in the wake of the East Asian, Russian and Brazilian meltdowns, and prescient about coming crises, D'Arista proposed the rearrangement and re-empowerment of global financial regulatory institutions, to penalise exporters and mitigate processes of worsening uneven financial development between countries. As she put it,

A revision of Keynes' proposed structure is necessary because payments imbalances are no longer settled by transactions through central banks but through private financial institutions. An international clearing agency that would meet current needs and conditions would have to include a mechanism for clearing private cross-border payments as well as create a reserve system that would reinstate transactions among central banks as the primary channel for settling balance of payments surpluses and deficits.<sup>30</sup>

The rehabilitation of Keynes' global-scale financial governance proposal is critical, but such an agency's work would not be effective if there were not also reforms to address other symptoms of the crisis (which I highlight in italics to suggest their profound importance):

- a public international investment fund for emerging markets. Structured as a closed-end mutual fund, this investment vehicle would address the problems that have emerged with the extraordinary growth in cross-border securities investment transactions in the 1990s. The proposal advocates a role for the public sector in managing those problems so that private portfolio investment – now the dominant channel for flows into emerging markets – can promote steady, sustainable growth *rather than the boom and bust cycles that so far have been its primary contribution.*
- a new allocation of special drawing rights (SDRs), the international reserve asset issued by the International Monetary Fund (IMF). Issuing a new round of SDRs would provide substantial short-term relief from the *debt burdens that aggravate imbalances in nations' access to international liquidity and perpetuate policies favoring lower wages, fiscal and monetary austerity and deflation.*
- an alternative to the privatized, dollar-based international monetary system that is a root cause of global instability and market failure. This proposal would create an international transactions and payments system managed by a public international agency in which cross-border monetary exchanges can be made in each country's own currency. This critical feature would help governments and central banks conduct effective economic policies, including countercyclical initiatives, at a national level. Equally important, it would allow all countries — *not just a privileged few* — to service external debt with wealth generated in their domestic markets. Thus it would help end *the unsustainable paradigm of export-led*

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29. D'Arista, J. (2009), 'Statement of Jane D'Arista representing Americans for Financial Reform', US House of Representatives Committee on Financial Services Hearing on Systemic Regulation, Washington, 29 October, pp.6, 7.

30. D'Arista, J. (1999), 'Reforming the Privatized International Monetary and Financial Architecture', Philomont, VA, Financial Markets Center, reprinted in *Challenge*, May-June, 2000, 43, 3.

*growth that now governs the global economy.*<sup>31</sup>

These are absolutely visionary reforms that address some of the most debilitating symptoms of the world economic crisis, to be sure. Most importantly, they are so logical that notwithstanding a terribly adverse balance of international forces, these reforms are beginning to take root in even rather inhospitable climes, mostly at national scales.

For example, the idea of a public fund to mediate emerging market relations with world finance finds a hint of resonance in discussions underway in early 2012 within the Brazil, Russia, India, China and South Africa (BRICS) bloc, which at their New Delhi summit mooted a development bank as an alternative to the Bretton Woods Institutions. If so designed, such a bank could potentially serve as such a fund, and if the Brazilians (with weak capital controls and a large development bank) or Chinese (with strong capital controls and a very uneven banking system) were to combine strengths, there are already clear institutional examples of how emerging markets can keep speculative finance at bay. But rigorous anti-inward-capital controls would be needed as well, for this to be the vehicle of choice for institutional investors seeking to diversify, a point we return to shortly.

The increased allocation of SDRs was achieved at the London G20 meeting in April 2009 alongside the IMF's tripling of lending resources, to the tune of \$250 billion. Many countries took immediate advantage of the new monies in their IMF accounts and helped to boost world effective demand at a point the crisis could have become much worse. Already at that stage, indications of a downward spiral far worse than the Great Depression were periodically announced by Barry Eichengreen and Kevin O'Rourke (2009) in their statistical series, 'A Tale of Two Depressions'.<sup>32</sup>

The crisis was deferred by Federal Reserve Quantitative Easing and the SDR allocations. But unfortunately, because even slightly left-of-centre leadership of the IMF (for Strauss-Kahn also promoted Keynesian ideology in the midst of world crisis) did (and could) not lead to substantive changes in the IMF's normal pro-cyclical, neoliberal approach. This problem remained evident in loan and advisory activity in low-income countries throughout the 2008-09 crisis, as well as in Ireland and Southern Europe after 2009. Strauss-Kahn's replacement Lagarde was even more dogmatically a proponent of the Washington Consensus. Indeed the continual recapitalization of the IMF has the opposite logic to that D'Arista proposes: it makes this ideological inclination even worse.

An ideological reversal of the IMF is, indeed, what D'Arista seemed to assume in 2009, when advocating 'issues of SDRs in exchange for the government debt of countries undertaking infrastructure projects and programmes related to health and education could make a real contribution. The IMF would not only act as a buyer for that debt on reasonable terms but would release the foreign exchange reserves needed to fund the programmes by substituting SDRs as backing for domestic credit expansion.'<sup>33</sup> Of course in reality, the SDRs flowed from IMF coffers to national elites who often used it not to benefit their societies, but to further entrench neoliberal policies, or to postpone these momentarily by maintaining existing spending

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31. *Ibid.*

32. Eichengreen, B. and K.O'Rourke (2009), 'A Tale of Two Depressions', Vox, <http://www.voxeu.org/index.php?q=node/3421>

33. D'Arista, J. (2009), 'The Evolving International Monetary System,' *Cambridge Journal of Economics*, 33, p.651.

programmes even without revenue. There are no publicized cases in which the SDR bonanza was genuinely directed to health, education or appropriate infrastructure.

As for managing global transactions and payments in an extremely volatile and uneven world financial system, D'Arista's important 2009 article in the *Cambridge Journal of Economics* addressed a variation on such a global fund, resurrecting the idea – originally mooted by economists A.G.Hart, Nicholas Kaldor, and Jan Tinbergen in 1964 – of a commodity-linked fund with the aims, D'Arista reminds, of 'adapting the world monetary structure to changes in world production and trade and contributing to the stabilisation of prices and trade in primary products.' But she acknowledged that an International Commodity Fund (ICF) worked only based upon 'the assumption of a continuation of the Bretton Woods agreements for settling payments balances between countries through their central banks and maintaining capital controls. Unless these conditions were reinstated, their proposal that only central banks could hold the reserve unit issued by the ICF would limit its use in settling payments imbalances.'<sup>34</sup>

In short, the resurrection of capital controls is a prerequisite for global financial governance of this sort. Is there a global substitute for national capital controls? As one component for disincentivizing cross-border financial flows in the spirit of Keynes, the idea of International Transaction Taxes has been posed regularly, even gaining the occasional support of governments and parliaments such as France and Canada. Whether for 'throwing sand in the wheels' of a speeding financial system, or raising funds for climate mitigation and adaptation (as suggested by the UN's Stiglitz Commission), there are potential applications of the 'Tobin Tax' now gaining increased credibility amongst more serious global reformers. Nobel Prize laureate James Tobin had suggested a 0.05-0.50 percent tax on cross-border financial transactions between major countries.<sup>35</sup>

There are important logistical updates for the implementation of financial transaction taxes that help the idea withstand criticism. For example, environmental economist Hazel Henderson also advocated the prevention of currency 'bear raids' by taxing electronic funds transfers (and requiring a transparent transaction reporting system).<sup>36</sup> To concerns that money would flee the major countries for off-shore centres (Bahama, Jersey, Guernsey, the Cayman Islands, Panama, etc), Tobin Tax advocates insist that any funds flowing to or from such sites could be penalised by concerted G8 action.<sup>37</sup> To concerns (expressed by Stiglitz) that the rise of derivatives trade and other financial innovations would make a Tobin Tax difficult to apply,<sup>38</sup> advocates suggest taxing profits *or* losses (through a 'contract for differences' payment mechanism) realised as a result of movements of the exchange rate relative to the notional principal amounts traded. In sum, logistical hurdles can be overcome. Establishing the European Union's common currency was, after

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34. *Ibid*, pp.645-646.

35. Tobin, J. (1978), 'A Proposal for International Monetary Reform,' *The Eastern Economic Journal*, 4, July/October; Eichengreen, B., J.Tobin and C.Wyplosz (1995), 'Two Cases for Sand in the Wheels of International Finance,' *Economic Journal*, 105; and Tobin, J. (1996) in M. ul Haq, I.Kaul and I.Grunberg (eds), *The Tobin Tax: Coping with Financial Volatility*, New York, Oxford University Press. See also Felix, D. (1995), 'Financial Globalization vs. Free Trade: The Case for the Tobin Tax,' Geneva, United Nations Conference on Trade and Development Discussion Paper 108.

36. Henderson, H. (1996), *Building a Win-Win World*, San Francisco, Berrett-Koehler.

37. Bank for International Settlements (1990), 'The Lamfalussy Report: Report of the Committee on Interbank Netting Schemes of the Central Banks of the Group of Ten Countries,' Basle.

38. Garber, P. and M.Taylor (1995), 'Sand in the Wheels of Foreign Exchange Markets: A Sceptical Note,' *The Economic Journal*, 105; Garber, P. (1998), 'Derivatives in International Capital Flow,' National Bureau of Economic Research Working Paper No. 6623, New York.

all, a far more difficult technical exercise, yet was accomplished with few problems because there was sufficient political will at the time.

However, aside from small progress in discussing a tax within the G20, and very slight moves to implement the idea within the European Union made under French President Nicolas Sarkozy's 2011 leadership, the only substantive step in this direction, has been the renewed interest in capital controls, especially because of the hot money financial portfolio flows that have been moving into emerging markets since 2009. Thanks largely to Keynes (arguing in 1944 against the American negotiating team at Bretton Woods), the IMF Articles of Agreement still allow member countries to 'exercise such controls as are necessary to regulate international capital movements.'<sup>39</sup>

As recently as 1990, 35 countries retained capital controls. But from the early 1990s, the US Treasury Department led a formidable attack on this provision, and not only forced South Korea's financial doors open as a condition for it joining the rich nations club known as the Organisation for Economic Cooperation and Development (OECD), but even attempted to change the IMF Articles of Agreement to ensure that all member states agreed to full financial liberalisation. After the 1997-98 Asian crisis, this became more difficult, but the leading financial system, in the US, proceeded throughout the late 1990s and 2000s – under both Clinton and Bush administration rule – to deregulate to the point that a burst financial bubble in one market (low-income housing) could spread like wildfire to the rest of the system, as happened in 2007-08. As a result especially of hot money flows in late 2010, a new round of capital controls were initiated, mainly to keep footloose portfolio finance out rather than lock in existing finance. These included new actions against speculative inflows by governments in Brazil, Thailand, Taiwan, China, South Korea and Indonesia. To illustrate, Thailand placed a 15 percent tax on short-term inflows into its bond market, South Korea and Taiwan limited assets accessible to foreign capital, and the 50-member UN Economic and Social Commission for Asia and the Pacific endorsed capital controls just prior to the G20 meeting in Seoul.

Still, intent on foiling a global, regional or national-scale restructuring of the international financial architecture, the US government continued to disapprove of these controls. As a result, a group of reform economists (including Stiglitz, Dani Rodrik and James Galbraith) wrote an open letter in November 2010 arguing that, 'Authoritative research recently published by the National Bureau of Economic Research, the IMF and elsewhere has found that limits on the inflow of short-term capital into developing nations can stem the development of dangerous asset bubbles and currency appreciations and generally grant nations more autonomy in monetary policy-making.' The economists warned, however, that,

many US free trade agreements and bilateral investment treaties contain provisions that strictly limit the ability of our trading partners to deploy capital controls. The 'capital transfers' provisions of such agreements require governments to permit all transfers relating to a covered investment to be made 'freely and without delay into and out of its territory.' Under these agreements, private foreign investors have the power to effectively sue governments in international tribunals over alleged violations of these provisions.<sup>40</sup>

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39. Henderson, H. (1996), *Building a Win-Win World*, San Francisco, Berrett-Koehler.

40. Third World Resurgence (2011), 'Leading economists urge US to allow use of capital controls', *Third World Resurgence*. 245/246, January/February 2011, p 27, <http://www.twinside.org.sg/title2/resurgence/2011/245-246/cover06.htm>.

The challenge of controlling both incoming and outgoing capital is especially important so as to promote economic democracy. In his book *Capitalism's Achilles Heel*, Brookings Institution scholar Raymond Baker documents 'falsified pricing, haven and secrecy structures and the illicit movement of trillions of dollars out of developing and transitional economies... Laundered proceeds of drug trafficking, racketeering, corruption and terrorism tag along with other forms of dirty money to which the US and Europe extend a welcoming hand.'<sup>41</sup> Adds John Christensen of the Tax Justice Network, nearly one third of the value of the annual production in sub-Saharan Africa was taken offshore during the late 1990s. Across the world, eight million 'high net-worth individuals' have insulated \$11.5 trillion in assets in offshore-financial centres.<sup>42</sup>

In sum, extreme levels of financial turmoil and capital flight highlight the extent to which exchange control liberalization had occurred in the Third World. Ironically, IMF researchers – including the then chief economist, Kenneth Rogoff – finally admitted in 2003 that there was severe damage done through more than two decades of financial liberalization. Rogoff and his colleagues (Eswar Prasad, Shang-Jin Wei and Ayhan Kose) admitted 'sobering' findings, namely 'evidence that some countries may have experienced greater consumption volatility as a result... Recent crises in some more financially integrated countries suggest that financial integration may in fact have increased volatility'.<sup>43</sup> These conclusions are also conceded by the World Bank, which promoted financial liberalization with a vengeance during the 1980s-90s.<sup>44</sup>

Aside from capital controls, the final mode of national protection against the failure of the international financial architecture is unilateral debt restructuring, including default. Prior to 2001 when Latin Americans became more active, the most important sovereign defaults were Russia's in August 1998, Brazil's of 1987 and South Africa's of 1985. A few small countries with rogue regimes or completely bare treasuries also fall into regular default, including Zimbabwe. Others like Nigeria occasionally suffer poor foreign exchange management and miss payments, notwithstanding large oil-related inflows. To deal with these rare cases which were largely a function of emergency inability to pay, Unctad suggested extending to the international scale some form of national bankruptcy procedure (along the lines of the US Bankruptcy Code Chapters 9 and 11).<sup>45</sup>

These national strategies are most crucial, notwithstanding the need, ultimately, for global financial regulations. Keynes argued from the bottom up in his attempt to reconstruct an international financial architecture for the post-war era: 'the whole management of the domestic economy depends upon being free to have the appropriate interest rate without reference to the rates prevailing in the rest of the world. Capital controls is a corollary to this.'<sup>46</sup> The most important change in International Monetary Fund thinking in the wake of ongoing systemic crises appears to be its endorsement of inward-oriented exchange controls, although as noted from the Malaysian

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41. Baker, R. (2005), *Capitalism's Achilles Heel*, London, Wiley.

42. Campbell, D. (2005), 'Where they Hide the Cash', *Guardian*, 5 December.

43. Prasad, E., K.Rogoff, S.J.Wei and M.Ayhan Kose (2003), 'Effects of Financial Globalization on Developing Countries: Some Empirical Evidence,' Washington, International Monetary Fund, March 17, pp.6-7,37.

44. World Bank (2005), 'Meeting the Challenge of Africa's Development: A World Bank Group Action Plan', Africa Region, Washington, 7 September, pp.32-33.

45. In its *1998 Trade and Development Report*, Unctad proposed the establishment of an independent panel to determine when a country under attack by speculators can be permitted to impose exchange or capital controls (including debt standstills), consistent with the IMF's article VIII, section 2(b).

46. Keynes, J.M (1973), *The Collected Works of J. M. Keynes*, Vol.25, London, Macmillan, p.149.

experience, it is just as vital to regulate outward flows.

To conclude, the ways that we analyse the deep-seated contradictions in the world economy, and the ways we understand the prospects for ongoing interimperial rivalry amongst leading countries, should help inform us about the scale politics that are most appropriate for advocacy. Although fully respecting D'Arista's contribution to the debates, the bulk of this chapter attempted to locate the financial crisis in underlying tendencies towards the overaccumulation of capital, which are displaced through time and space via financial markets. In contrast, D'Arista (with Stephanie Griffith-Jones) argue that the contemporary crisis, like previous ones, is the result of 'inherent flaws in the way financial markets operate – such as their tendency to boom-bust behaviour and insufficient, incomplete and sometimes inappropriate regulation.'<sup>47</sup>

Given that minimalist approach, the most basic solutions are thus to be found in both regulatory fiddling – 'varying regulatory requirements for reserves, loan to asset value ratios, capital, provisioning against losses, etc according to the phase of the economic cycle' – and improved institutional strategies, of the sort discussed in these last pages. But as to why the present world ruling elite is unable to remodel the architecture so that these regulatory changes and institutions can fit the needs of the times, D'Arista concludes by criticizing the monetarist, neoliberal ideology that guides them: 'Their current focus on stimulus programmes and financial regulation suggests that the G20 may attempt to solve the crisis without addressing the monetary aspect that is exacerbating the problem. If so, one must hope that other governmental and non-governmental groups will exert pressure to take up the discussion at a level that can realise the needed reforms.'<sup>48</sup>

The contrasting argument I have tried to undergird with (marxian) insights into the core contradictions of capitalism and their manifestations in financial crisis symptoms, in the first half of this chapter, leads to a different cry of anguish than D'Arista's. Instead of expecting world elites to understand the insights D'Arista brings and to manage financial reform accordingly, it is worth recalling again that since the Montreal Protocol no such global governance has worked to solve global-scale problems (in 1987, the ozone hole's growth) with a global state solution (that ban on CFCs). What we should learn from the ongoing failure of global financial governance is a lesson much deeper than the way a durable ideology and short-sightedness foil reform aimed at weakening financial capital's enormous powers. For as everyone now recognizes, 'even the most practical man of affairs is usually in the thrall of the ideas of some long-dead economist.'<sup>49</sup>

The deeper lesson I propose is that during a capitalist crisis with financiers retaining hegemony as the core fraction of capital, still receiving bailouts at will and still defining global-scale policy-making, the scale of analysis required for reforms of the far-reaching nature D'Arista proposes, is not world-scale or even intra-G20, but instead national. This, perhaps, is where she may ultimately agree, cognizant of the lack of progress made in even modest international reforms. For in 2010 D'Arista and Korkut Erturk argued in *Challenge* along similar lines, that 'new policies are needed that will pursue the following three objectives: one, the reassertion of public control

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47. D'Arista, J. and S.Griffith-Jones (2010), 'Agenda and Criteria for Financial Regulatory Reform,' Forum on Debt and Development, Amsterdam, <http://www.fondad.org/uploaded/D%20Arista%20-%20Griffith-Jones/DArista-Griffith-Jones%20on%20Financial%20regulatory%20reform.pdf>, p.1.

48. D'Arista, 'The Evolving International Monetary System,' *op cit*, p.251.

49. Cited in Ferguson, N. (2009), 'History lesson for economists in thrall to Keynes', *The Financial Times*, <http://www.ft.com/intl/cms/s/0/a635d12c-4c7c-11de-a6c5-00144feabdc0.html>



over the credit-creation process; two, being prepared in case the dollar tanks; and, three, ensuring the resumption of the recycling of trade surpluses before contraction begins to destroy them.’<sup>50</sup> The latter appears impossible given pro-cyclical and residual speculative processes in global financial and monetary mismanagement, but if the dollar crashes and if rising demands for reflation in Southern Europe, the Third World and even the US are impossible to ignore, it will be exceptionally important for D’Arista’s insights on national economic policies – especially, macroeconomic and financial-regulatory – to be more widely communicated.

As a result, it makes more sense to identify nationally-based socio-political movements – of which Occupy is both most important for changing the ideological conversation and most relevant to Wall Street and Treasury/Fed reformers in D’Arista’s position – which might push harder for capital controls on both inwards and outward flows. (From where I write, South Africa, this role is played by the National Union of Metalworkers of South Africa, whereas in the US, the most vocal economists promoting capital controls have been those associated with the Triplecrisis blog, especially Kevin Gallagher: <http://triplecrisis.com/tag/capital-controls/>.) As argued above, this strategy is a prerequisite for what ultimately might need to be an updated Keynes-style international clearing agency... but once capitalism has been replaced as the world’s main mode of production, of course, because until then, it is by now fairly obvious that financiers and their state do not want the advice Jane D’Arista can so eloquently provide about how to save the system from its most visible contradictions.

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50. D’Arista, J. and K.Erturk, ‘The Monetary Explanation of the Crisis and the Ongoing Threat to the Global Economy’, *Challenge*, March-April 2010, [http://www.challengemagazine.com/extra/005\\_029.pdf](http://www.challengemagazine.com/extra/005_029.pdf), p.6.