In the aftermath of G-22, new catastrophe looming

by Jeffrey Steinberg

On April 23, the Singapore *Business Times* published an editorial, perfectly summing up the previous week's Group of Seven and G-22 economic summits in Washington, D.C. "The East Asian economic turmoil, by uncovering weaknesses in the foundations of the global financial system, has produced a healthy debate on creating mechanisms to prevent and contain future crises," the editorial began. "But ironically, they are being presented at a time when it is all but obvious that any attempt to implement any of them will be constrained by unresponsive national governments and unpredictable financial markets. . . . And while it is hard to argue with [U.S. Treasury Secretary Robert] Rubin's call to ensure that private investors pay at least some of the costs of their mistakes, no one has yet devised an acceptable and workable formula for doing this."

The authors zeroed in on the problem that surfaced most visibly at the G-22 meeting on April 16, according to reports that *EIR* received from several participating governments: "These and other obstacles on the road to global monetary reform demonstrate that, impressive as the new architectural designs may be, the building blocks to put them into effect are not yet in place. . . . There is no paucity of ideas; what is lacking is the will to do what is necessary."

The lack of will, or, more precisely, the unwillingness on the part of key participants in the G-7 and G-22 meetings to stage an open policy brawl over the need for a New Bretton Woods "global financial architecture," leaves the world careening ever more rapidly toward the kind of global financial explosion and new Dark Age that Lyndon LaRouche has been warning of for years.

This view was echoed in the April 18 speech by Malaysian Deputy Prime Minister and Finance Minister Anwar Ibrahim, in New York City. Ibrahim was speaking in his capacity as the new chairman of the World Bank-International Monetary Fund (IMF) Development Committee, at a meeting of the United Nations Economic and Social Council. The Asia financial crisis has taken the region "from Paradiso to Inferno in a matter of months," he said. "It's unfair, it's altogether unjust simply to blame the governments . . . for the crisis. . . . If the fundamental flaws in the global financial system . . . such as the unpredictability of the international capital markets and the systemic fragility of the international monetary system . . . are not remedied soon, the world is headed for a series of financial convulsions of increasing severity."

Ibrahim had met for 45 minutes with Treasury Secretary Rubin the day before he delivered the New York speech.

Hidden dangers

There is no doubt that Ibrahim's speech echoed the sentiments of Secretary Rubin. According to a half-dozen participants in the G-22 Madison Hotel meeting of April 16 who spoke to *EIR* afterwards, Rubin stressed that the so-called "Asia crisis" was just a manifestation of a global systemic crisis that jeopardizes every nation. He reiterated his "not one nickel" to bail out the banks formulation, which he first stated publicly on Dec. 24, 1997, and later in a speech at Georgetown University.

According to one G-22 participant, Rubin laid out a series of concrete proposals. He stressed the danger of hidden, off-balance-sheet derivatives and other liabilities, which must be fully exposed, or else no new financial architecture can be solidly established. The fact that Rubin cited derivatives as one potentially devastating source of global financial instability, is of significance. *EIR* has shown that the $140 trillion derivatives bubble is so enormous that it proves the folly of even attempting a hyperinflationary bailout of the banks.

Treasury Secretary Robert Rubin (left) enters the Madison Hotel in Washington, for the meeting of the Group of 22 on April 16.

The most public feature of Rubin's remarks to the G-22 finance ministers and central bankers was his attack on the hedge funds and other currency speculators, who bear the greatest responsibility for the collapse of the "Asia Tiger" currencies since February 1997.

While Rubin, as well as the representatives of several Asian countries, put the question of fixed exchange rates on the table, there was no serious deliberation, and certainly no agreement on the matter.

To his credit, Rubin stressed that there can be no bailout of the banks, and therefore, new provisions must be made for orderly bankruptcy reorganization of leading financial institutions and whole national economies. Rubin stressed that, in the rush to globalize financial markets, the role of sovereign nation-states in world economic affairs had been diminished to a dangerous extent. Therefore, it was essential for bankruptcy reorganization guidelines to be established, based on cooperation among nations, not through a supranational bankruptcy court, or similar world federalist institution. Rubin also stressed that the old financial architecture had proven to be a very unjust system, favoring certain nations and causing great hardship to others. He urged that the 21st century "new architecture" should be a "more just international economic order."

While these ideas are certainly appropriate, several European and Asian participants in the G-22 meeting complained that the framework had not been laid for a serious discussion of the New Bretton Woods proposal, most famously associated with Lyndon LaRouche, and increasingly cited by other world leaders in the run-up to the April 16 event. As one Asian participant put it, "We would have come across like Don Quixote," if we had raised the Bretton Woods proposal.

It was the case, according to one European participant in the G-22 meeting, that the abject failure of the IMF to adequately deal with the Mexico crisis of 1995 or the Asia crises of 1997, was a hot topic of discussion.

British obstruction

U.S. officials involved in the G-7 and G-22 sessions noted, with some frustration, that the British delegation was out to obstruct any discussion of curbing the speculators (the IMF issued a report in mid-April exonerating the hedge funds of any responsibility for the Asian currency crashes—see *Documentation*), or advocating any kind of currency regulation. The German and French delegations, while backing Rubin, the Japanese, and several Association of Southeast Asian Nations (ASEAN) participants, on the pivotal role of the speculators in triggering the Asia crisis, balked at any talk of "new architecture," preferring instead to defer any such discussion until the European Monetary Union is fully in place—next January!

One of the clearest indications of the level of unreality that prevailed at the otherwise useful G-22 session, was the

implementation aspect. Three task forces were created, to conduct ongoing studies of the crisis. Their written recommendations are not even scheduled to be submitted until October.

Long before October, the global financial collapse will have gone through several more phases, bringing suffering and death to millions all over the globe.

In fact, within days of the G-7, IMF Interim Committee, and G-22 events in Washington, there were renewed signs of an imminent market crash. But this time, the warnings pointed to the United States and Europe, where the stock exchanges have gone through another bout of "irrational exuberance."

The April 18 London *Economist* published a three-page feature on "America's Bubble Economy." In an accompanying editorial, the *Economist* wrote, "This week's spring meetings of the IMF and the World Bank were dominated by talks about the slump in Japan and how to prevent another financial crisis like that in East Asia. These subjects certainly still matter. But is asset-price inflation, especially in the United States, that now poses a potentially bigger and more imminent threat to the global economy."

On April 22, the *Financial Times* editorially warned that in addition to the grave crisis of the Japanese banking system, equally worrisome is the overheating stock market bubble in the United States and Europe. This bubble is "unsustainable," it said, especially given the highly leveraged and fragile state of the world economy.

Privately, traders in London have told *EIR* that they anticipate a major Wall Street collapse before July. Lyndon LaRouche has warned of a 30-40% "correction." Already, major American corporations, such as Boeing, are posting huge declines in their quarterly profits, largely because of deferred or cancelled Asian orders. According to data released by the U.S. Commerce Department on April 20, U.S. exports to eight major Asian trading partners fell by more than 22% in the first two months of 1998. Trade with Indonesia fell by 64.2%.

A London source told *EIR* on April 21, "I've seen a total shift in the last two weeks on the U.S. market. Now the debate in financial markets is not if the Fed raises rates in the near future, but, rather, when. And when they finally do, it will unleash global pandemonium far worse than in the bond markets after February 1994. . . . Margin debt in the U.S. is now at a record high, some $130 billion, a year-to-year rise of more than 30%. . . . When the market finally does crash, at least a few trillions in values will disappear very fast."

In Southeast Asia, this financial crisis is taking the form of starvation. Collapsed currencies in Indonesia and Malaysia, in particular, are fueling fears of food shortages and social chaos. In eastern Europe, the global collapse has become apparent through an epidemic increase in AIDS, in part caused by dramatic increases in illegal drug use. Under these circumstances, the need for a New Bretton Woods call is becoming clearer by the minute.

Documentation

Titanic sails ahead, toward the iceberg

Warnings by world leaders

French Interior Minister Jean-Pierre Chevènement, in an interview with the April 16 German weekly *Die Woche,* criticized the alleged soundness of the European Monetary Union (EMU) project as an "impression, which the technocrats want to create." He said, "I believe it is like the *Titanic*. The sea is calm, the dining salon is superb, everything is very comfortable and full of luxury. The orchestra plays, it's a dream. But the ship is charging at full steam toward the pack ice. By the time we see the iceberg, perhaps it will be too late."

Chevènement added, "Nothing is secure. We have entered an extremely dangerous zone, with the ship's speed ever increasing, and the number of icebergs as well."

He warned of "asymmetric shocks" created by the absence of exchange-rate flexibility within the EMU zone, with each nation blaming its difficulties on its neighbor. The fight against mass unemployment will not be among the priorities of the monetarist European Central Bank, so a counterbalance should be created: a "growth pact," and a "strong European economic government." Only that could secure annual growth rates of 3.5-3.75%, which, after five or six years, would reduce unemployment to 7.5% of the working-age population in Europe.

This counterbalance is not yet in place, leaving the EMU in a situation resembling that of the *Titanic,* he repeated. "One can only pray and sing, 'Nearer My God to Thee.'. . . This is a hymn that was played by the orchestra on the *Titanic*. Very courageous, that orchestra."

Malaysian Deputy Prime Minister and Finance Minister Anwar Ibrahim said that "the world is headed for a series of financial convulsions of increasing severity," in a speech in his capacity as chairman of the World Bank/IMF Development Committee at the UN Economic and Social Council Meeting in New York City on April 18.

"The Committee paid particular attention to the social aspects of the Asian crisis," he said. "They stress the need to strengthen social safety nets and the importance of shielding budget expenditures directed at the poor. Millions of people will be thrown back into absolute poverty unless steps are taken to protect the most vulnerable.

"There is a close link between structural issues and the resolution of the crisis. The Bank must strengthen further its skills in the financial sector, corporate restructuring and

governance, and poverty reduction and social sustainability. One of the lessons of the crisis is that it is a great mistake to focus on the macroeconomic issues without reference to these crucial factors. . . .

"It is unfair, if not altogether unjust, simply to blame the governments of affected economies for the crisis. From a near miracle to a near disaster; from Paradiso to Inferno in a matter of months. A decade of rapid growth has unhinged their governing systems, and they have committed themselves to reform, and continue to make the necessary adjustments. Their concerns, particularly in Asia, in reducing the poverty of hundreds of millions of people, is unprecedented in history. However, it has taken a long time for the world to acknowledge that the international financial architecture is equally, if not more, culpable. The fundamental flaws in the global financial system—such as the unpredictability of the international capital market, the destabilizing impact of short-term capital flows, and the systemic fragility of the international monetary system—need to be remedied, so as to avoid in future the world's financial convulsions of increasing severity.

"All the basic assumptions about growth and development, the free-market theology, and the role and effectiveness of multilateral institutions are under challenge. National economies need to institute significant economic and social reforms. At the same time, the fissures in the international financial architecture must be mended. No matter how robust a nation's financial system, it will not be able to insulate itself from external shocks and systemic risks, particularly those originating from short-term capital flows. The international financial system must also address the problem of moral hazard, and ensure that both borrowers and lenders are held accountable. . . ."

Thailand's Prime Minister Chuan Leekpai opened a meeting of the UN Economic and Social Commission for Asia and the Pacific (ESCAP) in Bangkok, by warning that the economic and financial aspects of the Asian crisis serve "as only a prelude to a host of other problems, ranging from rising unemployment to increasing pressures upon our society as a whole, be it in health care, education, and social services in general," *The Nation* reported on April 20. With over half the world's population, Chuan said, "it is time we viewed people as more than just resources, more than cheap labor to fuel Asia's growth machine. It is time we viewed people not as the means to development, but as the end."

Indonesian Foreign Minister Ali Alatas, speaking at the ESCAP meeting in Bangkok, called for a "framework of surveillance and supervision" over private international capital flows, according to the *Journal of Commerce* on April 21. "In this era of global movements of money and capital, private financial flows cannot be left entirely to market forces without incurring tremendous risks," Alatas said.

He warned that if there is no recovery soon, "the economic, social, and political repercussions on the region as a whole could be devastating." "Worse," Alatas continued, "driven by globalization and interdependence, the contagion effect could reach global proportions."

UN Secretary General Kofi Annan warned about the effects of globalization, in an address before the ESCAP meeting, in Bangkok on April 18. The social and political consequences of the Asian economic crisis "are vivid proof of the risks that come from the benefits of globalization. They are also stark evidence that closer cooperation between the UN and the Bretton Woods institutions is imperative. The question to be addressed is whether we can find ways to preserve the benefits of open financial markets while reducing the risks of crises and designing tools to deal with them that will be less costly . . . in human terms," he said.

He questioned the impact of IMF recommendations to crisis-struck countries in Asia, warning that "short-term concerns can lead to a neglect of the fundamentals of longer-term development." He expressed concern about "the harsh toll these crises impose on an entire citizenry," and warned that "the collateral damage" is far greater in developing countries, where "the hardest hit are usually the most vulnerable. . . . There is a real risk that successes built up over years in reducing poverty will be reversed. The United Nations has a role to play both in easing the impact of such crises and in the longer-term preventive aspects."

IMF defends the speculators

The ***World Economic Outlook,*** a report released on April 13 by the International Monetary Fund, comes to the aid of speculators and hedge funds, and against sovereign countries defending their currencies against predators. "Should hedge funds be subjected to greater regulatory and disclosure requirements?" asks the IMF paper. The answer is: No. "Regulators in the U.S. and United Kingdom, where the most important hedge funds operate, see little need for a specialized policy response to regulate and limit the funds' activities in order to increase financial market stability."

Why? because the hedge funds assault only countries that deserve it. "In the prevailing view, hedge funds that take short positions against foreign currencies do so in response to evidence of inconsistent policies likely to render currency pegs unsustainable." In fact, these funds have a "stabilizing" function. "Insofar as hedge funds buy sharply depreciated currencies in the wake of a speculative crisis, they are sources of liquidity and stabilizing speculation that dampen market fluctuations. . . . It is not clear, therefore, that discouraging positions taken by hedge funds would reduce volatility in currency or other asset markets. The most important action policymakers can take to protect their economies is to avoid offering one-way bets in the form of inconsistent policies and indefensible currency pegs."

The IMF concludes that it is virtually impossible for any government to protect against these pirates.

Press commentary

Ta Kung Pao, a Beijing-owned daily newspaper published in Hong Kong, editorial, "The International Financial System Must Be Reformed," April 16:

The editorial cites the IMF's report exonerating the international hedge funds (see above), which, *Ta Kung Pao* states, "reveals that the international community can do nothing to repel attacks by all sorts of private funds, which . . . try to gain the greatest possible profit, to say nothing of the hedge funds, which have headquarters in the United States and Britain, and are registered in Bermuda and the Cayman Islands, paradises of tax evasion.

"Analysts have pointed out that the flow of private funds stimulated by the growing market economy and capital liberalization has posed a major threat to the national monetary and financial system. Some people refer to this new phenomenon as the '21st century-type crisis.' More and more people have realized that to avoid the recurrence of financial turmoil, it is necessary to reform the international financial system."

The editorial describes the most important recent events in the discussion on changing the "international financial infrastructure," including Japanese Deputy Finance Minister Eisuke Sakakibara calling "for setting up a new international system similar to the Bretton Woods system."

"All these tasks cannot be accomplished by relying upon the existing international financial leaders, nor by pursuing traditional fiscal and monetary policies," *Ta Kung Pao* continued. "On the other hand, some people have said that since the system established by the Bretton Woods Agreement has collapsed, the role that the IMF can play and the authority that the body has to get involved in the internal affairs of various countries, are open to question."

The Star, Malaysia, April 18:

The newspaper focusses on Malaysian Deputy Prime Minister and Finance Minister Anwar Ibrahim's 45-minute meeting with U.S. Treasury Secretary Robert Rubin on April 17. Anwar reportedly told Rubin that "transparency and disclosure" in the financial sector is a two-way requirement for lenders and borrowers, adding that, for example, European and U.S. banks should be made "transparent" regarding whom they are lending to, particularly in the case of currency speculators and hedge funds. Anwar reiterated to Malaysian journalists in Washington, that joint steps to ensure regulation and transparency of international currency trading are necessary, and that he hoped a financial system would evolve which was fair and could rein in activities of speculative currency traders.

The Nation, Thailand's English-language daily, on April 19 reported on the interventions of ASEAN members Malaysia, Indonesia, Thailand, and Singapore at the G-22 meeting in Washington. The first three are credited with insisting that reforms would be meaningless if markets remained open to manipulation from excessive currency speculation and short-term capital flows. *The Nation* sums up the G-22 meeting as "aimed at forging a durable global financial system that can withstand upheavals like that which sent Asian stocks and currencies crashing and slammed the brakes on the region's rapid economic growth." It adds that all attending, agreed that it was "critical" to have a more resilient global financial system.

Indonesia's Finance Minister, Fuad Bawazier, said the pace of financial reforms should be based on economic maturity, given that conditions are different in each country, however, "we are walking in the same direction." He also said adopting reforms is difficult when developing countries cannot get data on short-term capital, which can be "swift and dangerous" at times. Malaysia's Anwar, as well as officials from Thailand and Singapore, all seconded this line of attack on volatile short-term capital flows.

Singapore Business Times, editorial, April 23:

Reporting on the meetings in Washington the week of April 13, the editorial states, "The East Asian economic turmoil, by uncovering weaknesses in the foundations of the global financial system, has produced a healthy debate on creating mechanisms to prevent and contain future crises."

"But ironically," the editorial says of these proposals, "they are being presented at a time when it is all but obvious that any attempt to implement any of them will be constrained by unresponsive national governments and unpredictable financial markets. Take the case of Japan. There is little doubt that the floundering Japanese economy has become a major impediment to the resolution of the East Asian financial crisis as well as a threat to the health of the global economy. While the U.S. and other G-7 nations have been pressing Japan to stimulate its economy and restructure its financial institutions, the anaemic response from the political and economic elites in Tokyo has only encouraged investors to hammer down the yen, to the further detriment of both Asia's economies and global exchange rate stability. Indeed, the Japanese case, as well as the very evolution of the East Asian crisis, raises major doubts about the ability of supra-governmental institutions like the IMF to force national authorities to make much-needed major changes in economic and financial arrangements and policies.

"These and other obstacles on the road to global monetary reform demonstrate that impressive as the new architectural designs may be, the building blocks to put them into effect are not yet in place. . . . There is no paucity of ideas; what is lacking is the will to do what is necessary. Until this changes, the discipline of the markets will, by default, continue to be the only way in which errant governments and investors can be persuaded to do the right things."