EIR News Analysis

Support grows for capital controls, LaRouche solution

by Mark Burdman and Marcia Merry Baker

As the world economy careens toward a generalized breakdown crisis, the debate intensifies in favor of a global regime of capital and exchange controls imposed by sovereign national governments, to stem the ravages brought about by "globalization." The growing sentiment in favor of such measures has been catalyzed by the wide circulation of economist Lyndon LaRouche's program for a "New Bretton Woods," by his specific advisories to Brazil, Russia, and elsewhere on capital controls, as well as by the positive examples posed by countries that utilize capital controls, such as Malaysia and China.

A growing consensus in favor of controls on the flows of speculative capital was in evidence at the Group of 15 annual meeting, in Montego Bay, Jamaica on Feb. 6-12. (The G-15 was founded nine years ago to promote South-South political and economic relations, and now includes 17 nations—Malaysia, India, Indonesia, Sri Lanka, Argentina, Brazil, Chile, Mexico, Peru, Venezuela, Jamaica, Egypt, Algeria, Kenya, Nigeria, Senegal, Zimbabwe—with the induction this year of Sri Lanka.)

On Feb. 10, at the opening ceremony of the plenary session, Malaysian Prime Minister Datuk Seri Dr. Mahathir bin Mohamad spoke on behalf of all the Asian member-states of the Group of 15. Receiving thunderous applause from the crowd, which included seven other heads of state, Dr. Mahathir denounced the devastation caused by the free flow of speculative short-term capital. Speaking of events in East Asia, he said, "From being miracle economies, we have now become impoverished nations." He denounced the "super-big" foreign corporations now moving to take advantage of the situation, and called for joint action by the Group of 15 and others, to preserve national and economic independence. "Clearly, if we want to safeguard our future, we have to be aware of the forces around us, to consult with each other more often and to have a common stand on most issues."

The Group of 15 draft communiqué contained specific reference to the need for new financial control measures. Moreover, the Group plans to coordinate a potential consensus program for protecting national interests, before the November World Trade Organization (WTO) this year. India has volunteered to host a pre-meeting. Prime Minister Atal Behari Vajpayee was the first Indian head of government to attend the Group meeting since 1996. Vajpayee said, on departing India for Jamaica, "At a time of unprecedented economic upheavals in the global economy, particularly affecting the developing countries, greater coordination between the G-15 member-nations can prove to be of mutual benefit. . . . We have made some suggestions for reform of the global financial architecture. This issue will figure prominently at the forthcoming meeting of the G-15."

The leadership of the Group of 15 movement is thus on a direct collision course with the policy enunciated on Jan. 29 at the World Economic Forum at Davos, Switzerland by Vice President Al Gore, who was speaking on behalf of the globalist interests. Gore declaimed that the November WTO meeting in Seattle must approve even more sweeping globalist prerogatives to "free" flows of money, trade, "intellectual property" rights, food, and agriculture control.

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In Russia, the debate on national-interest measures is intense. The Feb. 11 issue of the Russian weekly *Ekonomicheskaya Gazeta* reported on a Feb. 4 seminar on the subject held by the Institute of Comparative Political Science of the Russian Academy of Sciences. Hosted by Dr. G.G. Pirogov, the main speaker was Prof. Taras Muranivsky, president of the Schiller Institute for Science and Culture (Moscow), on the theme of "The Third Phase of World Systemic Crisis." Professor Muranivsky, whose remarks were carried in an article in *Ekonomicheskaya Gazeta,* reviewed the 1997 Asian phase of the crisis, then the Russian phase, and now the Brazil crisis, summarizing, "As we have written before, the American economist Lyndon LaRouche has termed the current state of the world finanical system—revolutionary." Change will be abrupt. There are new schemes for reorganizing the financial system. "For some people, such a reorganization should lead to solving the crisis and establishing a new, just economic order in the world, while others seek to create a more refined mechanism for exploiting and looting the majority of the world's nations and peoples."

A signal from the City of London

At the same time, voices are being raised even from within the British-American-Commonwealth (BAC) power structure, favoring selective capital controls and stable exchange rates.

An interesting signal article in this direction was published in the London *Financial Times,* the mouthpiece for the City of London, on Feb. 9. It was authored by Ronald I. McKinnon, economics professor at Stanford University and a visiting fellow at the Bank of England. His argument was that the economies of Europe and Asia have achieved their highest rates of growth under conditions of stable exchange rates and capital controls.

After explicitly rejecting the International Monetary Fund (IMF) dogma of "flexible" exchange rates, McKinnon wrote: "Even without a return to par values for exchange rates on the world scale of the 1944 Bretton Woods agreement, progress on a regional basis to secure exchange rates among countries that are closely connected in trade and finance is still feasible." McKinnon referred to the 1948-51 Marshall Plan as the "most striking example of successful international lending to a group of countries," and stressed: "The capstone was the formation of the European Payments Union in September 1950. For clearing payments multilaterally, each country declared an exact exchange parity against the dollar and hence, against each other. In the subsequent era of incredibly high real economic growth, this system of fixed exchange rates lasted for almost 20 years."

As for Asia, "a common East Asian monetary standard existed before the crisis of 1997." Indonesia, Korea, Malaysia, Hong Kong, Singapore, and Taiwan kept up stable foreign exchange rates to the dollar during "their rapid economic growth in the 1980s through 1996. Similarly, a credible peg of 360 yen to the dollar was the monetary anchor in Japan's own great era of high growth and rapid financial transformation in the 1950s and 1960s." In respect to the smaller East Asian countries, McKinnon continued, "China could be the model. With the help of capital controls, the [Chinese] yuan has been successfully pegged at about 8.3 yuan to the dollar for almost five years, inflation has come down to low American levels and China's output growth remains more robust than that of her neighbors. With proper bank regulation or capital controls in place, a restored dollar-based exchange rate regime would again protect the smaller East Asian economies from competitive devaluations."

In a Feb. 9 discussion with *EIR,* McKinnon stressed that his proposal is for "capital controls for developing countries with weak banking systems." He said that it was "applicable to the East Asian situation," but should also be extended to cases like Brazil and Russia. Brazil, he noted, "is a little bit like Malaysia. In the case of a complete loss of confidence, it may be better to use capital controls." Respecting Russia, he said, "The Russians made a big mistake in 1992, with the removal of capital controls. That was a huge error."

McKinnon insisted that "capital controls are not desirable as a general principle. It's a subtle matter. The big industrialized countries should maintain open capital markets, or the entire system of international payments would break down."

While obviously stepping back from proposing a generalized reorganization of the bankrupt global financial system, McKinnon indicated that his proposal would help deflate the vast speculative derivatives market. He claimed: "We need more confidence in long-term exchange stability. When you have a floating exchange system, and there is no confidence in any exchange rate, people start going into fancy derivatives contracts. But if we had a stable exchange-rate system, something like the gold standard, people would move out of these fancy derivatives contracts."

McKinnon's article appears to be a trial balloon, from certain elements in the Bank of England. It may not be coincidental, that one day after his *Financial Times* article, Bank of England Governor Eddie George spoke to a conference in London, warning about the volatile state of the world economy, both in recent times and in the period ahead. Under the headline "Strong Nerves Needed, Warns George," the London *Daily Telegraph* quoted him. Although talking in "bankspeak," George's message was clear: "Managing the global economy will be a considerable challenge for policymakers over the next few years, and helping finance it will be a considerable challenge for international bond markets. The fact that you are all here after the past remarkable year suggests that you have strong nerves. You may well need them in the period ahead."

Splits at Davos and the G-7

Other voices are being raised, who have been cautioning against the globalized monetarist madness.

On Jan. 31, Nobel Prize economist James Tobin gave an interview to the Argentine daily *Página 12,* attacking the notion of a currency board system, which already exists in Argentina, and whose architect, former Finance Minister Domingo Cavallo, is trying to peddle the idea far and wide, from next-door Brazil to faraway Russia. Tobin said a currency board is an "archaic and brutal" system, adding, "It isn't easy to sustain, and requires much pain. If anyone had a minimum of nationalist interest, they perhaps would like to have their peso continue to exist. It's not very nice for a country to be without a currency."

Tobin is the author of a proposal, known widely as the "Tobin Tax," for a tax on speculative financial flows.

The assertion of that "nationalist interest" has extended even into the domain of the pro-globalization Davos World Economic Forum, a fact which has the monetarist madmen very upset. On Feb. 9, the *Wall Street Journal* waxed hysterical in its feature on the Jan. 28-Feb. 2 Davos conference, written by the paper's principal editorial writer, Daniel Henninger. Henninger reported nervously that there was a growing backlash against " 'the boys in red suspenders in New York' ruining the world with a keyboard." He noted that the mood for some form of re-regulation was widespread in Davos, ranging from Egyptian President Hosni Mubarak and Singapore elder statesman Lee Kuan Yew, to German Finance Minister Oskar Lafontaine and British Chancellor of the Exchequer Gordon Brown. To these views, Henninger retorted that countries in the old meaning of the word have become obsolete in a globalized world and that the post-World War II nation-state is economically "inefficient" relative to the deregulated global market economy. An accompanying *Journal* piece argued that the very idea of national currencies had become obsolete, and was the cause of "recurring financial crisis."

The cracks and fissures in the leading policy structures were highlighted by the Feb. 5 *China Daily,* which claimed that the Davos conference had "exposed deep rifts in the Group of Seven (G-7)." The paper pointed to the contrast between the *laissez-faire* approach popular in Washington and the "increasingly loud calls for more government regulation of the free-wheeling financial markets, coming from key policymakers in Europe and Japan." According to *China Daily,* the calls for more government regulation coming from Europe "have a distinct interventionist overtone." Further: "At the heart of the debate over the future of the global financial system, are the huge cross-border flows of investment capital that are the lifeblood of the global economy. While many European officials and policymakers in crisis-wracked Asia say that investors wreak havoc by shifting billions of dollars without oversight, Washington insists that trying to police such shifts will cause more problems than it solves." Policy disputes also extend over "foreign-exchange policy," the official Chinese publication noted.

Support for Malaysian approach grows

In the meantime, significant progress toward a consensus on the need for capital controls was clear at the various G-15 meetings in Jamaica. Trade and economics ministers met on Feb. 6, then foreign ministers on Feb. 9, and heads of state and government on Feb. 10-12.

According to Anthony Hill, personal representative of host Prime Minister P.J. Patterson of Jamaica, the issue of putting controls on speculative capital flows was placed upfront on the agenda. Full credit for this, he said, goes to Malaysia's Dr. Mahathir bin Mohamad. Dr. Mahathir had first made this an issue when he hosted the G-15 summit in 1997 in Kuala Lumpur, but then, his analysis had to be published as a special statement, outside the joint communiqué. Last year's G-15 summit in Cairo devoted a few paragraphs in the final communiqué, to the issue. But this year, the G-15 sees "real urgency" in the matter of dealing with speculative capital flows.

According to the Feb. 8 *New Straits Times,* the Feb. 6 meeting of G-15 trade and economic ministers discussed at length, Malaysia's successful experience with selected capital controls, and several ministers supported the policy. The G-15 countries most opposed to repeating that experience, are Brazil, Argentina, and Mexico. Malaysian Foreign Minister Syed Hamid told his country's press corps in Jamaica on Feb. 9, that Malaysia's views on the global financial crisis are gaining ground, particularly the recognition of the devastating effects of the rapid inflow and outflow of short-term speculative capital, and the need to rein it in. There was also growing consensus, on the lack of success of the International Monetary Fund in various countries. He said that Malaysia was "quite happy" with the draft communiqué, which was drafted by the trade and economics ministers on Feb. 6, endorsed by foreign ministers on Feb. 9, and was discussed at the Feb. 10-12 meeting with eight heads of state and three deputy heads of state.

The draft communiqué included the appeal for urgent development of mechanisms and rules to monitor operations of large financial market players, including hedge funds and currency speculators, together with the advisory that such reforms must not hurt developing countries, which need capital and depend on official development assistance and concessional flows of funds.

India took the lead, at the G-15 meeting, in pushing for a consensus on global financial reform, and promoted ideas for "reform of the global financial architecture." On Feb. 9, Indian External Affairs Minister Jaswant Singh told a meeting of G-15 foreign ministers, that the crisis in Brazil, preceded by the ones in East Asia and Russia, clearly indicated that this was a *systemic* economic crisis that urgently required reform of the international financial architecture.