Doubts already surfacing on G7 plan for world financial crisis

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The leaders of the seven major capitalist powers are sparing no effort to create the impression that their Group of Seven (G7) plan announced last Friday, while not a complete solution to the global financial crisis, is at least a step towards overcoming turmoil on world markets.

Announcing the plan on behalf of the G7 finance ministers, the Chancellor of the Exchequer in the British Labour government, Gordon Brown, said they had agreed that in the new age of an interdependent and instantaneous global marketplace it was necessary to create 'systems for supervision, transparency, regulation and stability that are as sophisticated as the markets they have to work with'.

'The new way forward for the global economy, where each economy can affect every economy, is sensible financial regulation,' he said.

The centrepiece of the proposals is the creation of a new line of credit under the supervision of the International Monetary Fund. The US-initiated scheme would make billions of dollars available to countries whose markets come under pressure as a result of economic problems elsewhere in the world. The aim of the new credit facility is to provide assistance to such countries before a full-blown financial crisis has developed.

In seeking to create the impression that the central bankers and financial authorities have stepped in to control the turbulence, the official statement called for global action to promote greater openness of markets, enhanced surveillance of national financial systems and the establishment of good practice in social policy to protect the most vulnerable. It emphasised that the G7 must do more to 'build a modern framework for the global markets of the 21st century and to limit the swings of boom and bust that destroy hope and diminish wealth'.

But anyone inclined to believe that, after 18 months of the greatest financial turmoil in more than 50 years, the political and financial leaders of the major capitalist powers have developed some new economic plan would do well to consider the record.

The so-called 'Asian crisis' broke out last year right at the point where the IMF and the World Bank had organised their 1997 annual general meeting as a celebration of the 'Asian miracle' and the triumph of the global market. The crisis was dismissed as a 'glitch', with assurances that it would not spread.

However, IMF-imposed measures, based on reduced government spending and higher interest rates, helped plunge the entire region into recession. The loss of wealth has been estimated to be at least $1.5 trillion (an amount equivalent to 5 percent of the world's gross domestic product), representing the greatest downturn since the Great Depression of the 1930s.

Then came the debacle in Russia, where the IMF bailout plan of more than $22 billion announced in July collapsed within a month. This was followed in short order by the failure of the US hedge fund Long Term Capital Management and the subsequent bailout organised by the US Federal Reserve in order to prevent the collapse of the global financial system.

From one crisis to another

Rather than working to a strategic plan to bring the crisis under control, the G7 authorities are, to a great extent, making it up as they go along.

One of the chief motivating factors for the G7 measures--and especially the measures for new credit facilities--is US pressure for a bailout plan to meet the financial crisis in Brazil, following the flight of some $30 billion since the Russian crisis in mid-August. American banks and finance houses have the heaviest investments in Brazil. A default there would affect the US economy far more than the Russian breakdown has.

The new line of credit will be financed by the increase in IMF funds resulting from last month's long-delayed decision by the US Congress to authorise the provision of an additional $18 billion. Under the terms of the G7 statement the new loans will be on a short-term basis and will attract interest rates at between 3 and 5 percentage points higher than normal IMF rates.

US President Clinton hailed the new line of credit as a 'powerful new tool that can be used when it will do the most good at the lowest cost before the trouble starts'.

But doubts have already surfaced about how the facility will operate. According to a report in the *Financial Times*: 'The G7's expression of support for the precautionary credit line proposal does not mean there is a fully worked out mechanism ready. Indeed, there is resentment in Washington [at the IMF headquarters] that the proposal is being foisted on the IMF staff and even its executive directors without adequate thought.'

The G7 statement insisted that the short-term credit facilities would only be issued to countries which had 'strong IMF-approved' policies in place. But already the question has been raised as to whether credit would be withdrawn if so-called 'strong' policies were weakened. If such a withdrawal were to take place it could trigger a full-blown crisis with international repercussions. In other words, rather than alleviating a crisis, the short-term credit facility may widen its scope.

While the leaders of the G7 presented a united front in presenting the statement, the deep divisions which preceded it have not been overcome. Last month, when the Clinton administration's credit line plan was presented to the annual meeting of the IMF, the G7 members could only agree to 'explore' the issue further, largely because of opposition from Germany.

In addition to the new credit facilities, the G7 also called for increased scrutiny of national financial policies, including annual audits by the IMF, the adoption of international standards for disclosure by financial institutions and an examination of the operations of highly-leveraged hedge funds and offshore financial institutions.

Here, as the saying goes, the devil will be in the detail. Questions such as what measures should be introduced, how broadly they should apply, how they would be enforced, whether controls on capital movements would be included, and what body should monitor the world financial system have not been decided.

The latest proposals are the outcome of a series of manoeuvres involving the US and European powers. The calls for closer supervision of the financial system came from meetings of the so-called G22 group of nations. The G22 itself was brought together by the US earlier this year because Washington considered there was an over-representation of smaller European powers in the IMF's managing 'interim committee' and the Group of 10.

The G22 has now been expanded to 26 as a result of pressure from the European powers, which argued that while they had extended credit to the IMF they were being excluded by the US from negotiations on the new measures.

Another potential area of conflict is the G7 call for a 'orderly and progressive approach' to the continued opening of financial markets around the world. The US is bitterly opposed to the imposition of controls on capital movements or any other form of restrictions. But the violent movement of funds over the past two months has led to increased support for some form of control in both Japan and Europe.

See Also:
Banks, not hedge funds, at centre of world financial crisis

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