No answers from finance capital's "wise men"

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The testimony of US Federal Reserve chairman Alan Greenspan and outgoing US Treasury Secretary Robert Rubin to the House of Representatives Banking Committee last week was a further demonstration of the fact that those in charge of the world financial system have no real understanding of the crisis which swept through global markets last year, let alone how to prevent its next eruption.

Greenspan began his testimony with an obligatory reference to the efficiency of the market, claiming that the "major dismantling of the impediments to the free flow of trade and capital" had created a new financial system. "Despite recent setbacks", this had been a "major factor in the marked increase in living standards for those economies that have chosen to participate in it."

In fact the only layer of society to have experienced a "marked increase in living standards" has been the thin stratum directly benefiting from the global operations of finance capital. Their exponential rise in wealth has formed a stark contrast with the experiences of millions of workers in South-East Asia who have lost their jobs, and the ever-growing number of workers in the United States and elsewhere who have suffered reductions in wages as a result of being "downsized" in the drive for increased "shareholder value."

However, even as he praised the "demonstrable advantages of the new financial system", Greenspan was forced to acknowledge that "the Mexican financial breakdown in late 1994 and ... the most recent episodes in East Asia and elsewhere have raised questions about the inherent stability of this new system."

According to Greenspan, the source of the crisis lay in the exposure of "newly open markets" to a "huge expansion in capital flows that their economic and financial systems were not ready to absorb"—flows that were "engendered by the increasing diversification out of industrial country investment portfolios, augmented by huge capital gains through 1997."

New capital inflows into the so-called "emerging markets" quadrupled between 1990 and the onset of the Asian crisis in 1997, but these countries were "ill prepared to absorb such volumes of funds." "There were simply not enough investment opportunities to yield the returns that investors in the West were seeking. It was perhaps inevitable then that the excess cash found its way in too many instances into ill conceived and unwisely financed real estate ventures."

This explanation, however, raises more questions than it answers. No analysis is provided as to why capital had to pour out of the major industrial countries in search of profits, nor why there were insufficient "investment opportunities" in the "emerging markets."

To have probed these issues would have required an examination of the underlying crisis of the profit system as a whole, of which these violent movements of finance capital were the market expression.

Instead what was offered was a self-serving rationale for the actions of the global financial authorities, who were hailing the "Asian miracle" as testimony to the power of free market capitalism—even as the crisis was beginning to break.

Greenspan insisted that while it might have seemed that the consequences of these huge financial flows "were easily discernible, they were not". Instead, the "size of the crisis became evident only when the normal buffers that any economy builds up to absorb shocks were, in the case of the East Asian economies, so readily breached under pressure."

So much for the wisdom of bourgeois economics. Those in charge of the global financial system, with all the information and economic models at their disposal, were only able to recognise a crisis when it broke over their heads.

According to Greenspan, the problems lay in the differences between the financial systems in the advanced capitalist countries and those in "emerging markets".

"It has taken the longstanding participants in the international financial community many decades to build sophisticated financial and legal infrastructures that buffer shocks. Those infrastructures discourage speculative attacks against a well-entrenched currency because financial systems are robust and are able to withstand the consequences of vigorous policy responses to such attacks. For the newer participants in global finance, their institutions, until recently, had not been tested against the rigors of major league pitching, to use a baseball analogy."

Such an explanation, however, collapses upon the first serious examination. The high point of the financial crisis did not occur in Asia but on Wall Street.

When the Long Term Capital Management hedge fund collapsed in September, the US Federal Reserve Board, under Greenspan's direction, organised a $3 billion bailout, followed by three successive cuts in interest rates in order to counter a liquidity squeeze throughout the financial system.

As subsequent analysis revealed, the problem was not that LTCM was some kind of "rogue operator" but the reverse. It had been backed by some of the most well-established financial institutions, including the Central Bank of Italy, and its investment activities in financial markets mirrored those of its major backers. In other words, had LTCM gone down, the "robust" financial institutions of the major capitalist countries would have experienced a "systemic crisis."

The response of US financial authorities to the LTCM failure formed a stark contrast to the prescriptions handed down in Asia.

Whereas the International Monetary Fund, taking its directions from Rubin and the US Treasury, demanded the closure of failed banks and the lifting of interest rates in Thailand, Indonesia and Korea, when the crisis reached Wall Street the Federal Reserve Board pumped more liquidity into the financial system, bringing a further expansion in the stockmarket bubble.

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The explanation for these divergent responses lies in the agenda pursued by US finance capital.

When the crisis broke in Asia it was eagerly seized upon as a means of battering down restrictions on the penetration of US capital—restrictions that had worked to the benefit of its chief rival in the region, Japan. This was why proposals initially advanced by Japan for a $100 billion bailout fund were brushed aside as the IMF moved to take control.

Long-standing demands for the ending of restrictions on the inflow of capital and the foreign ownership of capital were brought forward with the demand to end “crony capitalism” and this was made the condition for the receipt of IMF loans.

But when the crisis came to the US, these “free market” prescriptions were shelved and the Federal Reserve organised a rescue operation.

Rubin's testimony offered a similar mixture of self-serving platitudes and outright bewilderment in the face of the deepening financial turmoil.

He told the committee that the “role of the private sector in resolving crises is one of the most complex issues we face today, involving powerful competing considerations.” On the one hand, it was necessary to ensure that countries' obligations to pay their debts was not undermined, while, on the other, the high yields on many “emerging market debts” indicated expectations that some of these debts will not be repaid.

What answer did he offer to this dilemma? Essentially that there is none.

“We must strike the right balance between these considerations on a practical case-by-case basis,” he said.

In other words, for all the talk of a “new financial architecture”, rules for greater disclosure, more transparency, the development of best practice and all the other buzz words and phrases which have filled Rubin's speeches and those of many others, the US and international financial authorities remain as unprepared for the next financial crisis as they were for the last one.

Rubin did offer some new-found wisdom on the cause of last year's turmoil. He said that at the core of each recent crisis had been a rigid exchange rate regime that had ultimately proved unsustainable.

“We believe that the international community should not provide exceptional, large-scale official finance to countries intervening heavily to defend an exchange-rate peg, except where the peg is judged sustainable and certain exceptional conditions have been met, such as potential systemic threat.”

For “systemic threat” read the interests of US banks and financial institutions. Rubin did not explain, in the light of this new-found knowledge, why major bailout operations were organised to try to sustain the value of the Russian ruble and then the Brazilian real. The reason is that the bailouts were not aimed at providing currency stability but at ensuring US investors had sufficient time to withdraw their funds before the currencies were devalued.

Rubin closed his remarks with obligatory praise for the market, insisting that “our approach to reforming the global financial architecture is based on the fundamental belief that market-based systems create the best prospects for job creation, economic growth and rising living standards both in the US and around the world.”

But even as these reassurances were issued, an alarm was being sounded on the other side of the world that the inherent instability of the global financial system had not disappeared and could soon manifest itself again, with even more devastating consequences.

In an interview with the *Australian Financial Review* the pu... week, Japan's chief international financial negotiator, Eisuke Sakakibara, the vice minister for international affairs in the Ministry of Finance, warned that global capitalism could collapse in the event of a slump in the US economy.

While last year's financial crisis had passed, deep structural flaws in the global financial system remained, he said. The US economy had some worrying features, including a “bubble aspect”, a lack of domestic savings, and growing international indebtedness.

“The US, right now, is the centre of global capitalism, and if the centre collapses, the world system could collapse. And the situation in the US is not sustainable.”

Last year, “we were on the verge of collapse,” he said. “I recall Larry Summers [now US Treasury Secretary designate] saying to me, ‘The world is collapsing.'”

Sakakibara warned that while the immediate crisis had passed, Wall Street had forgotten that the basic structure is the same.

“The US authorities have manoeuvred the situation very skillfully, but the basic structure of global capitalism is unchanged. The basic problem of this globalised and virtualised economy has not been overcome, so it may recur. And that is huge amounts of money, highly leveraged, moving across borders very quickly.”

He pointed out that the US savings rate was negative and net indebtedness had doubled in recent years, making the American economy vulnerable to a sudden capital outflow. While it was possible for the US to have a “soft landing” it was also possible that “the Dow will crash.”

The interview provided some insight into the depth of the conflict between the US and Japan over the Japanese proposal for a $100 billion Asian bailout fund. Sakakibara said that while Asian countries responded “very favourably” to the proposal, Summers “somehow got information about it, and he didn't like it at all” resulting in “the tensest time” in the two-year crisis.

While identifying some of the features of global financial instability, Sakakibara was no nearer to advancing a solution than his counterparts in the US. There were no “uniform prescriptions”, he said. The actions of the IMF had demonstrated “the deficiencies of uniform prescriptions.”

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