G7 papers over growing problems

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Finance minister from the Group of Seven (G7) managed to put together a communiqué at their meeting over the weekend that papered over differences while seeming to offer something for everyone. But they failed to even address, let alone begin to resolve, the fundamental imbalances which pose a growing threat to the stability of the world capitalist economy.

The communiqué warned that “excess volatility and disorderly movements in exchange rates” were “undesirable” for economic growth. This was seen as a concession to European complaints that the rise of the euro against the dollar—around 12 percent since the G7 meeting in Dubai last September—was too rapid.

Last month the European Central Bank president Jean-Claude Trichet described the rise of the euro as “brutal”, reflecting concerns by key sections of European industry that they are being priced out of world markets. Speaking after the meeting, German Finance Minister Hans Eichel also pointed to these dangers. “It is important that the exchange rate reflects the fundamentals and that we don’t have abrupt changes because that would be harmful for the growth of all, even if there are short-term advantages.”

While the Europeans received some concessions on the speed of the dollar’s fall, the US, Canada and Britain, were able to retain a commitment to the operation of market forces in determining exchange rates. “More flexibility in exchange rates,” the ministers declared, “is desirable for major currencies or economic areas that lack such flexibility to promote smooth and widespread adjustments in the international financial system, based on market mechanisms.”

Speaking at the conclusion of the meeting, Trichet made it clear that Europe was not a target for greater flexibility. “The various currencies that are not flexible will recognise themselves,” he said. “There is not only one, there are quite a few.” This interpretation was made necessary by the rapid rise of the euro after last September’s G7 meeting when a similar call for flexibility was issued.

Now the main target is China and to some extent Japan where the central banks have been purchasing US dollars to try to keep down the value of the yuan and the yen respectively. China is not a member of the G7 and there was no immediate comment from financial authorities. But the Japanese Finance Minister Sadakazu Tanigaki was quick to deny that the statement referred to Japan. “Japan’s currency is not one that lacks flexibility,” he declared. “Today’s statement sends the right message to the currency market. It rectifies the misunderstanding that came out of the Dubai meeting.”

His claims are belied by the latest statistics. These show the unprecedented spending by the Japanese Central Bank to try to prevent a rise in the yen. In the last 13 months alone, Japanese authorities have spent 27 trillion yen (equivalent to around $250 billion) in foreign currency markets with data released last week showing that Japan’s foreign currency reserves increased by $67.7 billion in January alone. It was the largest monthly increase and took the country’s total reserves to $636 billion.

At the same time, the United States balance of payments deficit stands at $500 billion a year, the external debt is close to $3 trillion and the American economy requires a capital inflow of around $2 billion every working day.

These financial imbalances are the expression of a fundamental disequilibrium in the world economy as a whole. While the US economy is growing at around 4 percent a year—largely as a result of increased debt, financed in the final analysis by the inflow of funds from Japan and China—key sectors of the world economy are stagnant. European growth is expected to be only 2 percent this year while there are doubts about whether Japanese economic recovery will be sustained.

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China is growing at around 8 percent but its imports account for only about 1 percent of world output.

But these deepening problems of the world economy were not even discussed. Instead the G7 ministers proclaimed that the global economic recovery has "strengthened significantly" in recent months, and declared that they would monitor exchange markets closely and "co-operate as appropriate" without giving any specific details.

These words are largely window-dressing for, as the *Financial Times* correspondent Wolfgang Munchau put it, neither the Europeans nor the Americans have a plan B and there is no agreement as to how far the dollar should fall before the undefined co-operation should begin.

The final communiqué, he noted, was a triumph of financial diplomacy but in terms of content it was largely hot air. "There is no chance that countries with a dollar peg, such as China, will revalue or even float their currencies. The G7 meeting has not changed the fundamental reality that the euro's rise against the dollar remains in grave danger of overshooting, with serious consequences for the eurozone economy."

He also pointed out that the statement was internally contradictory, insisting that exchange rates should reflect economic fundamentals and not move in a disorderly fashion. But the "truth is that the need to adjust to fundamental economic imbalances is one of the main reasons why the dollar has fallen in such a disorderly fashion over the past year."

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