Divisions between major powers dominate G-7 meeting

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A meeting of G-7 finance ministers held outside London over the weekend was marked by widening differences over economic policy and concerns about the implications of the “quantitative easing” monetary policies of the world’s major central banks.

The differences over economic policy are being fuelled by the fact that almost five years since the global financial crisis erupted, the world economy, far from showing any signs of a sustained recovery, evinces deepening recessionary trends.

This has led to a situation in which each of the G-7 major powers--Britain, the US, France, Italy, Canada, Germany and Japan--is more and more openly and aggressively pushing an agenda that reflects its own national interests.

The meeting was convened by the current G-7 chairman Britain, somewhat surprisingly given that the G-20 had met in Washington little more than a month ago. The weekend meeting was viewed as a less formal gathering.

But the semi-formal character of the gathering and the absence of a final communiqué meant that the differences could emerge somewhat more clearly than otherwise might have been the case.

Before the meeting got underway, US Treasury Secretary Jacob Lew criticised the Europeans for their failure to revive the euro zone economy and repeated American demands that they somewhat ease their budget-cutting.

“We feel very strongly there needs to be a right balance between austerity and growth,” he said in a television interview. “Overall, Europe is going to need to do a little bit better. There’s room for progress.”

This brought the critical remark from Canadian Finance Minister Jim Flaherty that “some” in the G-7 have “ambiguous positions”. He added, “The Americans need to be more clear where they stand on this. They seem to be wanting to encourage growth more than fiscal responsibility.”

The US, however, is not a champion of fiscal expansion--the Obama administration has deepened spending cuts that are severely impacting widening sections of the American population. But it regards European austerity measures, and the resulting recession across the continent, as an impediment to US exports and growth prospects.

America’s chief opponent in Europe is Germany and clashes between the two powers during last month’s spring meeting of the International Monetary Fund have been widely described as “heated”. Germany is insisting that previously agreed budget deficit reduction programs must be adhered to.

Despite comments prior to the meeting that Germany’s position might be easing, Finance Minister Wolfgang Schäuble rejected American demands that so-called surplus countries, of which Germany is one, should do more to relax fiscal constraints. Schäuble insisted that such a policy shift would undermine confidence. “To enhance growth in Germany, you need to regain confidence,” he said.

The German policy is widely portrayed as irrational--*Financial Times* commentator Martin Wolf has published numerous articles to this effect--because it is counter-productive for every country, both in Europe and internationally, to try to cut back spending and increase exports at the same time.

However, such criticisms ignore the fact that Schäuble’s program expresses the interests of key sections of German finance capital. The austerity program being demanded by Berlin across Europe has the effect of keeping down the value of the euro--to the considerable benefit of major German exporters--and promotes the flow of money into the German banks and financial system.

Britain, whose economic agenda is aimed at maintaining the position of London as a key financial centre, is motivated by the same national concerns.

British Chancellor of the Exchequer George Osborne said the G-7 meeting presented an opportunity to consider “what monetary activism can do to support the recovery”. While the Tory-Liberal Democrat coalition government has imposed a severe austerity program, the Bank of England is a practitioner of the “quantitative easing” policy that funnels ultra-cheap money into the coffers of the banks.

Ever since its introduction by the US Federal Reserve more than four years ago, “quantitative easing” has been criticised as leading to currency wars because one of its effects is to lower the value of the currency of the country carrying it out. This issue has moved back into the spotlight at recent G-7 and G-20 meetings following the decision by the Bank of Japan, acting on the orders of the Abe government, to double the country’s money supply in an attempt to halt deflation and boost the economy.

At its meeting in February, the G-7 insisted that such a policy had to reflect domestic economic concerns and not attempts to engineer currency devaluation--a stipulation that was repeated at this weekend’s meeting. Japanese authorities have been happy to comply with the wording, declaring that they are not targeting the yen, and finance minister Taro Aso told journalists that the G-7 had levelled no criticism of Japan over its new monetary policy.

But the facts speak louder. Since the start of the year, the yen has fallen 15 percent against the dollar and 13 percent against the euro. On the eve of the G-7 meeting, the yen fell to a rate of 101.7 to the dollar, its lowest level in four years.

While American financial authorities feel somewhat constrained, at least to this point, in voicing criticisms because the Federal Reserve is carrying out the same policy, US Treasury Secretary Lew said the US was closely watching the situation.

“I’m just going to refer back to the ground rules and the fact that we’ve made clear that we’ll keep an eye on that,” he said.

In comments after the meeting, Canadian Finance Minister Flaherty did not mention Japan by name, but said there were “expressions of concern” about exchange rates, “although all countries in the G-7 consider themselves to be free-trading.”

The chief economist for the European Union, Olli Rehn, told reporters on the eve of the summit it was important that, in line with previous decisions at the G-20 and the International Monetary Fund meeting, “there is no talk about currency wars.”

But the war proceeds nonetheless. According to a calculation by the Bank of America, there have been almost 520 rate cuts by central banks around the world since June 2007. One of the most significant in the recent period was this week’s rate cut by the Reserve Bank of Australia, which pointed to the high value of the Australian dollar in announcing its decision.

Besides the issue of currency wars, there is also concern that the historically unprecedented actions of central banks in pumping hundreds of billions of dollars into the financial markets are creating new financial bubbles that could bring about a crash.

In a speech in Chicago on Friday, Federal Reserve Chairman Ben Bernanke said he was watching “particularly closely” for “excessive risk-taking”--marked by falling returns on riskier assets. However the Fed’s policies are promoting such activity. As the *Financial Times* noted last Friday: “The average yield on lowly rated corporate debt, or junk bonds, this week dipped below 5 percent to a record low that is less than US Treasury bonds yielded in 2007.”

With supplies of cheap money pouring into financial markets, the attitude of the banks and major financial institutions is to make hay while the sun shines and the devil take the hindmost. In a telling remark in a recent interview, Mohamed El-Arian, chief executive officer at PIMCO, the world’s largest bond trading firm, referred to the central banks as “our best friends”.