EIGTH SESSION

Deregulation and Globalization of Financial Markets and Implicit Dangers

Seoul, Republic of Korea
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Speaking on the subject as a political economist, I have to warn you from the beginning. Politicians and economists belong to one and the same category of unreliable people. They talk today about problems which they will understand only tomorrow. And economists in particular are fellows who will be able to explain tomorrow why the things which they said yesterday did not happen today.

After this cautioning, let me tell you what I am going to talk about: first about the present consequences of the dismantling of the international authority, competence and power of the International Monetary Fund since the early seventies; secondly about the consequences of this new age of intranational deregulation and the field of banking and financial services; thirdly on what kind of remedies may be thinkable; and in the fourth place a rather extended footnote on the proposal for a European System of Central Banks within the European Community.

I.

The **flow of financial funds all over the globe** since the almost total liberalization of capital flows in the most important countries has led over the last five or six years to a net flow of credit and capital into the United States in the order of about 120 billion US dollars per year. The United States have become the by far greatest international debtor in the world — netwise in the order of between 700 and 800 billion US dollars. By the time of the next presidential elections (1992), they will have reached a net indebtedness in the order of a trillion US dollars.

On the other hand we see the flow netwise coming in the main, directly and indirectly, from Japan, Germany and a few others. Japan and Germany together have a net export of credit and capital in that same order of 120 billion US dollars annually. And also do we see a net flow of funds from the developing countries to the North in considerable measures. It is necessary in my view to redirect this flow of funds; but no real efforts are being undertaken.

I would think that we should concentrate Official Development Assistance (ODA) towards the least developed countries and give it under three conditions:

1) that they reduce their military expenditures to at least no more than 2 per cent of their GNP. I just saw the latest report of the SIPRI-Institute in Stockholm stating that in 1989 the developing countries altogether have spent 140 billion US dollars for military expenditures, which is about six or seven times as much as they do receive in terms of development aid;

2) that they set up and execute programmes for the maintenance of the natural environment;

3) that they set up and follow programmes to dampen their population explosion.

I have no illusions that such a concentration of ODA would only be possible if the great economic powers worked together with the developing countries. This is, so to speak, a medium-term or even long-term programme.

I would like to point to the fact that right now we do not any longer have **national share markets**. The Japanese stock exchange or share market is about the last national one; but it also will become internationalized very quickly because people in the world will buy Japanese shares. The Japanese themselves have bought shares in almost every country already. **We also do not any longer have national bond markets, we even do not any longer have national markets for daily money.**

Formerly, we had regulatory agencies in all our countries to control and oversee the national market, but their controlling efficiency has been diminished largely due to the fact that there is no longer a national market to control. What happens in the futures markets in Chicago or the options markets in Philadelphia will lead to reactions in Tokyo within less than 30 seconds —I mean exactly what I am saying— and vice versa. And what happens in the Hong Kong banks does lead to reactions and repercussions, let us say in Zurich or London, also within less than 30 seconds and I literally mean 30 seconds. The chief executives of the banks will only in the course of the afternoon learn what their young men in their shirt sleeves have been doing before lunch. Even the bank executives themselves are not really in command.

I want to point to the fact that, since 1973, since the floating system of **exchange rates, we have seen extravagant movements of some currencies, particularly of the United States dollar.** The United States dollar still is the most important reserve currency. But in the course of the last years, if compared with other reserve currencies like the yen or Deutschmark or Swiss franc, the markets first doubled the exchange rate of the dollar and then decreased it again down to one half. Nobody is in charge of the dollar.

This loosening of the monetary system of the world started out with **the dismantling of the International Monetary Fund** and then with the creation of the so-called Euro-currencies which means that a Swiss bank, in the main dealing in Swiss francs, gives a credit to somebody in Africa in the currency of somebody in Asia. This is the meaning of the word "Euro-currencies", it started out with Euro-dollars.

I would like to point to the fact that **off-shore banks are a ridiculous invention.** The only purpose of it is to allow your clients to evade taxation in their home countries and also to allow the mother banks to circumvent taxation in their own country and to avoid minimum reserve requirements which otherwise they would have to meet vis-a-vis their own central bank system at home.

It is ridiculous that we have allowed this so-called off-shore banking. Let me give you as example Hong Kong. If something grave should happen in the People's Republic of China, it would certainly have psychological repercussions in Hong Kong. If the Hong Kong Chinese would rush to their banks trying to get their money out of the banks and leave Hong Kong, they would not ask for Hong Kong dollars but for other hard currencies. The Hong Kong banks would not be able to shell out the amounts that might be asked for. If this happens in London or in Paris or in Washington, in such case the central bank system would act as the so-called lender of last resort. But there is no lender of last resort for Hong Kong or Kuwait nor for any other of the off-shore banks. The central banks of the industrialized countries might, in an immediate action, try to cooperatively save an off-shore banking center. They might succeed, they might not — nobody knows. There is no obligation for any foreign central bank to save and bail out off-shore banking centers.

II.

The almost total liberalization of the international flow of capital has made possible the enormous **indebtedness of a great number of countries.** It started out during the two oil price explosions 1973/74 and 1979/80, originated by decisions of OPEC. The commercial banks got all the surpluses of Saudi Arabia and other oil-exporting countries by way of 3-month deposits. They then gave credits on 3-month basis to the Brazils and the Argentinas in Latin America and also to others in Eastern Europe and in Africa. But after three months the Brazilians needed a fresh credit to pay for the oil bills of the next three months. The oil crisis in the meantime had quadrupled prices and afterwards they increased in the peak to 20 times as much as the original price, if you compare the peak of 1980 with the former prices of 1972. But the

Brazils have not been able to export 20 times as much coffee, or cotton, or whatever, so they had to borrow the money to pay for their oil. They borrowed it from the western banking system on a 3-month basis, but after 3 months they needed a new credit. The banks rolled over the old credit and added a new one. This is the way by which the enormous indebtedness has occurred. It has to be noted that neither the regulatory authorities in the United States nor in Britain, Japan, Germany nor in other states did understand what was happening. Nor did the commercial banks themselves understand what was happening. Nor did all our national central bank system understand what was happening — until 1982 when the first collapse came because Mexico was not any longer able to service its outstanding debt. Still today no authority in America or in Germany or in other financial economies is really looking after the way in which credit is given beyond the borders.

There are other shortcomings to be noted: national shortcomings, or as I said earlier, "intra-national". For instance, nobody prevented US savings and loan associations from floating or buying **junk bonds**. The name junk in itself characterizes the value of the bond. They were **used for leveraged buy-outs**, for unfriendly takeovers. Flourishing concerns are being destroyed and destructed in order to make a big profit. This leveraged buy-out-sickness started in the United States; in the meantime it has fully reached Britain, it has reached Northern Italy, it is now spreading over unto continental Europe. Nobody is taking measures against it as yet.

In that same context, the savings and loan associations' situation in America is a scandal. Nobody took action although already early on there were some people in Washington who understood what was happening. Milton Hudson thinks it is not just 500 billion US dollars that is at stake but a lesser total amount. But obviously a lot of money is at stake and, obviously, it does add considerably to the annual budgetary deficit of the United States because the United States Government is the guarantor.

The annual deficit of the United States is one of the grave undermining factors as regards the world's financial network. Another potential danger in some of our countries is the fact that **the authorities have allowed undercapitalization of commercial banks**, not so much in continental Europe, but certainly so in the United States.

Another **potential danger** —and I do not wish to appear as somebody who is too much alarmed in too many fields at one time— is implied in the trend towards **universal banking in combination with insurance services and other financial services** under one and the same roof of one and the same house. They are now talking of offering "new products" to their banking and insurance clients. I wonder if all these banks really do know what they are entering into.

III.

What kind of remedies are thinkable to all these sicknesses? As regards exchange rates and the stability of currencies a revamping or re-establishing of the International Monetary Fund (IMF) seems very unlikely. Too many members, too many governments want to vote, too much bickering for prestige, and too great conflict in basic ideology.

I think it is almost as much unlikely to embark on a re-establishment of fixed but adjustable exchange rates for the most important currencies of today which right now are the dollar, the yen and a very few others. It is very unlikely that we bring stable currencies about, although it would be a good thing for the world.

A third possibility might be United States leadership by giving good examples to the rest of the world in the field of self-stabilization of one's own exchange rate and in the field of authoritative controlling of what one's commercial banks do. It again seems rather unlikely that the United States are going to give a good example —rather than in the present giving the worst examples that one could find— except in the developing countries.

But even if the United States were in a position to give good examples and if they would try and more or less convince or impose their good policies unto others, it would never have the same good effect that it had 45 and 40 years ago after the war because the United States do not right now have any considerable international financing power — I am talking about the United States government. No considerable international financing power — they are borrowing from the rest of the world, they are not lending to the rest of the world. And if you cannot lend you are not in a position to impose your rules unto others.

It seems to me that the best thing that one could reach would be an attempt or a trial which may seem very moderate in outlook: namely **to establish close cooperation between the three most important central banks in the world** (and their governments). I am talking of the US dollar and the American Federal Reserve System, the Bank of Japan as regards the yen, and finally the System of Central Banks in Europe as regards the Ecu—both of which do not exist as yet.

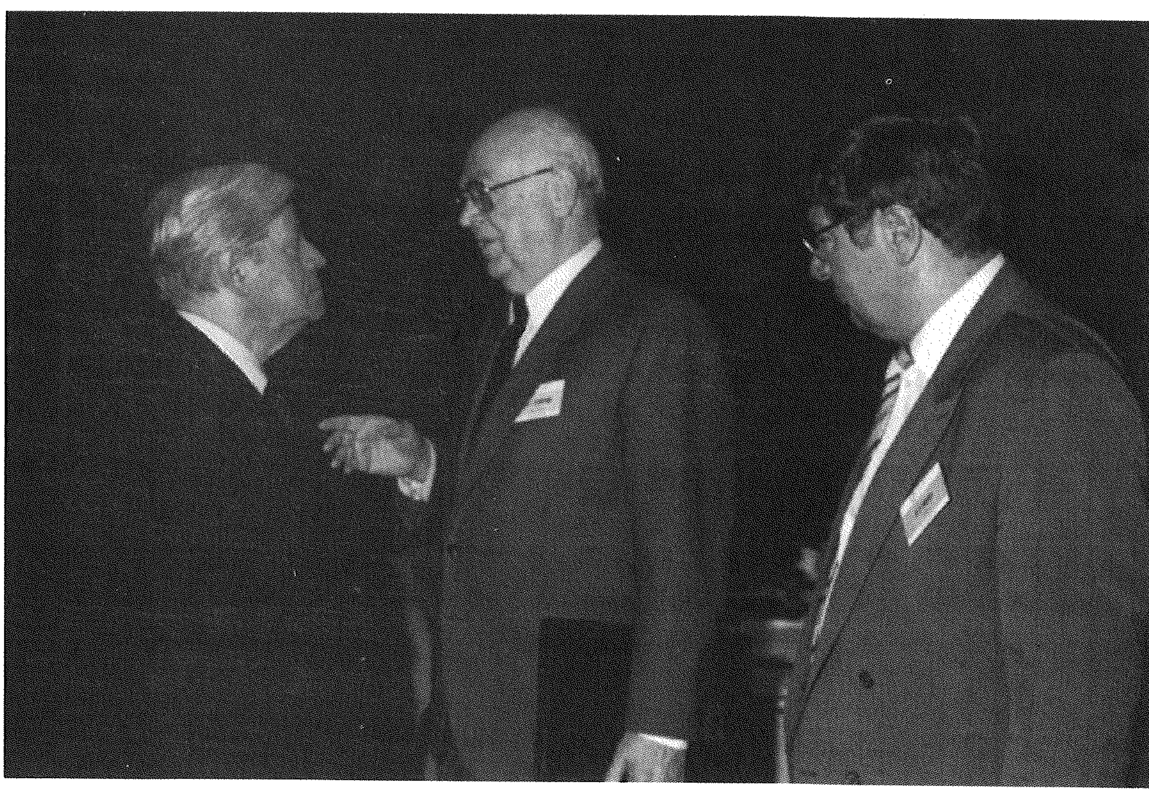
IV.

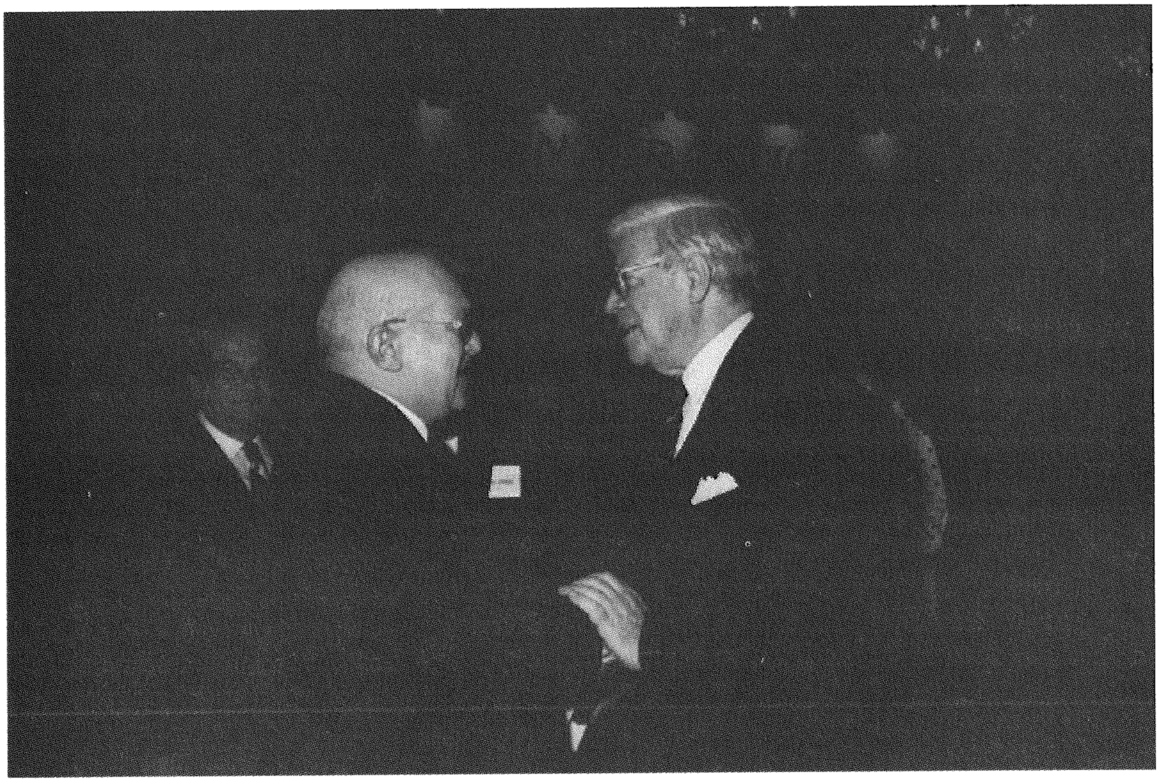
Europe —the European Community (EC)—, will be an enormous industrial complex, but it will be a rather uncommon market, not a common market. EC is trying to create a common market with 11 currencies (thank God, the Luxembourg people did not invent their own currency, otherwise it would have been twelve). One has never seen a common market in world's history with 11 currencies. There is no common authority as regards monetary policies. The future system that I would wish for Europe is a **federative system of European central banks** — rather similar to the Federal **Reserve System in the United States.** It would exercise one monetary policy over all of western Europe, like you have one monetary policy in the United States between San Diego in California and Boston in Massachusetts. Like one dollar for the USA, one Ecu for 12 states in Europe.

It is clear that so far Britain wants to stay out, she is creating difficulties every once in a quarter when the related questions have to be dealt with in the ministerial councils of EC. Britain will only come in later. But we have the so-called "Plan Delors", which is a good document written by a committe of eleven central bankers under the chairmanship of Jacques Delors, President of the Commission of the European Community. The Plan Delors leaves a few questions open, particularly the question of the timing in what periods of time are they going from one stage to the next, which means that governments can still create many obstacles and conditions. And they are doing so — not only the British government, also the German government; not only governments but also central banks can create obstacles; and some do and certainly the German Bundesbank.

If one is concerned about **the future economic power of the united Germany,** it would be wise —in order to prevent such an overwhelming economic power— to create one currency and one European monetary policy. Otherwise the Deutsche Mark inevitably will become the by far most important currency in Europe and we will get a triangle between Dollar and Yen and Deutsche Mark rather than between Dollar and Yen and Ecu! Such **rise of Deutsche Mark would create great negative psychological and political consequences.** But governments at present are too dumb to understand that — almost all of them.

In order to explain once again what a common currency means: the fact that the United States —with the exception of some years during the Civil War in the last century— from the 13 states in the beginning until the 50 states presently always had one currency only, and did not allow Texas or Idaho or California to have their own currency, not even Puerto Rico, this fact has created the great common market of the United States and the enormous advantages of an economy of great scale. Otherwise, the United States would still be a compound of medium-sized economies. The fact that an airline based in Atlanta wishing to buy airplanes from Boeing in Seattle at the West Coast, does this in one and the same currency, under one and the same general conditions as regards insurance, as regards credit terms, and so on, has given the United States this enormous edge over the rest of the industrialized world. No Californian politician is seeking to balance the account of payments between California and let me say Arizona or Oregon, or between North Carolina and South Carolina. Nobody ever knows whether there is a positive or negative balance of payments between states — and nobody is interested to know.





Right now in Europe, they are looking at the German surpluses and the Italian deficits or what have you, and surpluses and deficits in current accounts are a matter of concern for governments — they do not understand it really but they understand if they are in deficit. These bilateral deficits and surpluses within the so-called common market of Europe are a great obstacle toward the development of a real common European market, whereas they are totally non-existent in the real common market of the United States. They are totally non-existent in Japan; Japan also has one currency between the island of Okinawa in the South and the island of Hokkaido in the North - one currency only, one monetary policy for all of Japan, like one monetary policy for all of the United States.

The proposed federative European system of central banks will lead to one monetary policy for all of EC-Europe. This monetary policy will indirectly have an enormous influence on the budgetary behavior of the 12 governments. If a government cannot any longer print money, then it has to behave either or to get itself into debt and pay higher interest rates. You see in the United States that some communities have to pay higher interest than others. Some of the states are being regarded as better debtors than other states, and some cities have to pay less interest and some cities have to pay higher interest. I guess under the one and the same monetary policy in Europe, for instance the Italian government in the beginning will have to pay higher interest rates than the Dutch Government.

Now, I would like to give you a historical proof of what I say. You will remember that the Roman Empire 2000 years ago was a common economy, a common market. About the year 32 or 33, Jesus of Nazareth came to Jerusalem and the priests, who disliked him, tried to build a trap for him in order to enable the authorities to put him on trial (you can find this in the New Testament in three different versions). They therefore asked this question of him: Do we have to pay the toll or the tax —in Britain nowadays they would call it the poll tax— or don't we have to pay? If he had answered in the affirmative, he might have lost his followers, if in the negative, he would have been prosecuted. He said: show me a denar. They gave him a coin and he showed the coin to the audience, but anybody knew the coin and at the face of it the picture of Emperor Augustus. And Jesus said: who is that? The Emperor. So give the Emperor what is due to the Emperor, he said. He circumvented the question. He did not really give an answer, they could not put him on trial for that answer. They put him on trial for something else afterwards. What is important here to learn is this: The same denar was the currency in Jerusalem as much as in Rome, as much as in Greece, as much as in Spain, as much as in Gallia, which nowadays is France. Roman emperors paid their soldiers all over the Mediterranean in one and the same currency, whether they were situated in Cyprus or in Palestine or in present-day Germany or present-day France.

There are also other historical examples. I could cite the enormous importance of sterling at the time of the British Empire. That empire is gone, the Roman empire is gone, but the necessity of one currency for one market is clear.

If we get **a European system of central banks, it ought to be independent from government intervention and from political intervention.** The period of years for which the governors of that bank are being appointed ought to be not just 3 years or 4 years, but at least several years, in order to really make them independent from the necessity of being soon reappointed by 12 governments.

I would think that it would be good advice for anybody in the world, including the People's Republic of China who does not wish to listen to this, including the Soviet Union who does not wish to listen to this, including the developing countries: It would be good advice for anybody to **create central bank systems which are totally autonomous from governments and from politbureaus and from central committees and the like.** Because autonomy leads to a situation where the ambition of the central bank governors is to have low inflation rates and low interest rates. And not will it be their ambition to finance a new plan of the government here or there or to bring about a great splash which a present government needs in order to prevail in the next election over their opposition. I am deeply convinced of the necessity to have independent central banks.

If we had an independent central bank system within the EC as we already do have in the United States, as we not as yet really do have in Japan, then these three in cooperation could do a lot of good things in the world. They could also, by their advice, put great pressure on governments and parliaments to see to it that the laws which regulate the financial activities of insurances, of banks, of investment houses, that these laws be amended and ameliorated.

I think the best thing one could hope for is cooperation between these three currencies: Dollar, Yen and Eecu. But I am not too optimistic about an early probability of bringing it about. Maybe it should be put on the agenda of an economic summit of the seven!

Within brackets, I would like to mention here an idea which might sound exotic to most of you. I have since long toyed with the idea: Why not inviting the Soviet President and the Chinese leader to these summits? Since long these summits are not really taking decisions. We have been taking a few decisions in the first five, six years of these summits. Since then they have deteriorated into media affairs, 2000 journalists and seven heads of state, this is not to be avoided anymore now. When we first met in Rambouillet in 1975 at Valery Giscard's invitation, it was a very small room, about one-tenth of this hall, and we were just six or seven people, each of us accompanied by two ministers and one or two advisors sitting in the back — and the press was miles away. This was the habit in the beginning, now it has gotten a bit out of control. Nevertheless, these meetings still have a great value, because they force heads of state to listen to each other, which is quite something, and to answer questions of others which again is quite something. All of them learn! I have learned a lot in the eight summits in which I participated. I think it would be a good thing to give that opportunity to learn about the functions of the world's economy and of the world's financial systems to the heads of state of the two giant socialist states, China and the Soviet Union. Brackest closed, this was just a side remark.

I did warn you in the beginning as regards the economists like myself. Let me now end by giving you my qualification of the politicians to whom formerly I did belong myself as well. Politics is the art of looking for trouble, finding it almost everywhere, diagnosing it incorrectly and therefore applying the wrong remedies. I hope my diagnosis was incorrect in being too critical as regards the present situation. Nevertheless I do hope that my rather limited proposals for remedies may be suitable.