The Way Forward

Imagine, if you will, a world where people trade in an agreed currency, where the exchange rate is established by common consent, where trade in non-capital assets, like debt, is discouraged and people deal in real capital assets. The stock market remains essentially as it is, a casino, but no longer an indicator of the state of the world economies.

Is such a utopia possible? I think it is. I am no economist but the way forward out of the world financial crisis was established many years ago. It was 1944 when the Bretton Woods Agreement was signed at Bretton Woods in New Hampshire, USA, paving the way for the world's post war recovery.

Volatility is the death knell for people trading in goods and services. True stock market traders have done well out of the ups and downs of the market, but in their bid to increase their return they have introduced financial products that are dubious and are likely to work against the best interests of the real asset traders, the people who keep our economy ticking.

You can't blame these freebooters exclusively for the error of their ways, They were actually encouraged by their free market governments to do exactly what they did. The market could do no wrong. Anglophiles tend to blame Margaret Thatcher. Other sources suggest the malaise set in or around 1969.

According to James Cumes in his remarkable prescient work *America's Suicidal Statecraft* [i]the trouble started when the US Federal Reserve Bank started using its interest rates as a blunt instrument to protect the economy from the terrors of inflation or worse stagflation.

I have always had a problem with this proposition. When working in Canada during the late'50s and early '60s I had a newspaper friend who moved to Portland, Oregon with a wife and two kids, no money but a job with the Portland newspaper. When I saw the family about six months after they made the move, Peter and his wife Meta were living in a comfortable suburban home with a new Chev' out the front. All this with no down deposit.

This I believed was the reason why the American economy worked. There was unlimited credit. It was why their standard of living was so much better than ours.

I still think that there is a modicum of truth in this proposition but now that I have re-read Dr Cumes admirable work, it's a thick book with lots of graphs, I now realise that the way loans were arranged in the early '60s was very different from loaning practises decades later.

Dr Cumes is inclined to blame President Nixon. But it was really the Federal Reserve Bank who threw out the baby with the bathwater, allowing non-banking institutions to enter the loan market and remove all restrictions on the way loans were granted, dispensing the need for credit checks and collateral.

When we lived in North America the local Credit Bureau was one of the foundation stones of the local community. Both professional and commercial services routinely checked with the local Credit Bureau to make sure that a person applying for credit was able to service the debt. In addition to running an investigation into the credit applicant's assets, anything like a criminal record was frowned on and immediately resulted in the credit being refused.

While such practises still exist in Canada, they are no longer the routine practise of small town America. More's the pity.

There was a fundamental shift in the way the American government viewed its economy. Milton Friedman and the Chicago School of Economics, reinforced the Federal Reserve Bank's position by claiming that the economy could be controlled by the money supply, the so-called Monetary policy.

Monetarism, an economic policy based on the control of the country's money supply, assumes that the quantity of money in an economy determines its economic activity and particularly its rate of inflation.[ii]

The main problem with monetarism, as I see it (Dr Cumes may or may not agree), is that it is inclined to ignore what is happening outside of that economy and trends in world trade. With a floating currency subject to the whims of the currency speculators it is simply not possible for the central bank to control what is happening in the national economy, especially when there is a run on that economy's currency.

Remember what happened when George Soros caused a run on the British pound? That was in 1992 and I well remember as a government information officer working for the British Foreign Office, reporting on the chancellor of the exchequer being forced to go to the IMF in Washington to get a loan. The Foreign Office never forgave George Soros.

I am not saying that currency speculation is responsible for our current dilemma. Although it may well be in the case of Australia. What I am saying is that currency speculation is at least partly responsible for the current volatility which is an anathema to sound trading and banking practises.

Paul Keating might think that floating the Australian dollar was the biggest step forward in his treasury, and I agree it did go a long way to making Australia more competitive and removed some of the deadwood. But these laudable aims were achieved at a price. That price was stability.

The free market does not believe in stability. It believes in market forces. Survival of the fittest.

This proposition has worked in the past but in an age of shrinking raw resources, the demands of emerging nations and the threat of climate change, there is clearly a need to step back and take another look at the market place.

In the days of Adam Smith there was a economist called Malthus[iii] who believed that wars, famines and plagues were God's way of controlling the excesses of the free market to allow supply to meet demand.

One would like to think that we have moved on since Malthus. However there is still a lot of support for Adam Smith.

There is no denying that the free market has brought prosperity to many. But once again there was a price to be paid. Very little has been done to help the African economies and the introduction of free market principles has been something of a mixed blessing for the former Soviet Union.

I don’t believe we need to follow Ben Chiefly into that vale of tears which had Bert Evatt appearing before the privy council to defend Canberra’s right to nationalise the banks.

But we do need to do something almost as radical.

In July 1944, delegates from 44 nations met at the United Nations Monetary and Financial Conference at Bretton Woods, New Hampshire. A Canadian Government source described the conference in these terms:

“The delegates at Bretton Woods reached an agreement known as the Bretton Woods Agreement to establish a post war international monetary system of convertible currencies, fixed exchange rates and free trade. To facilitate these objectives, the agreement created two international institutions: the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (the World Bank). The intention was to provide economic aid for reconstruction of post Europe. An initial loan of $250 million to France in 1947 was the World Bank’s first act.”[iv]

The need for a new Bretton Woods Agreement has been recognised by the British Prime Minister Gordon Brown.

In October 2008 the *Scotsman* newspaper carried a story quoting the prime minister as saying:

“Around us we must build a new Bretton Woods- a new financial architecture for the years ahead.”[v]

According to the story Prime Minister Brown had been thinking about the need for a new international monetary system for some time but nobody was ready to listen. Now at last they are.

There have certainly been enough warnings about the present crisis. Here are some listed by Dr Cumes one of the many websites that carry his messages about what’s in store for the world economies.

In November 2003 the deputy leader of the Liberal Democrats in the UK said in the House of Commons: “The growth of the British economy is sustained by consumer spending pinned against record levels of personal debt which is secured, if at all, against house prices that the Bank of England describes as well above equilibrium level.”

In November 2004 Stephen Roach an senior executive with Morgan Stanley predicted an “ economic Armageddon.”

In September 2006 Dr Roubini, an economics professor at New York University told a meeting of the International Monetary Fund that a crisis was brewing. He said the United

States was likely to face a once-in-a-lifetime housing bust, an oil shock, sharply declining consumer confidence and, ultimately, a deep recession.

In my own experience I remember reading in the European edition of the *International Herald Tribune* in September 2006 a report that a recession in the United States was to be expected within the next 12 months. When I told my local stockbroker of this prediction, in late 2006, he tried to re-assure me that our market fortunes were no longer tied to the New York Stock Exchange. I should have put my investments in term deposits. Needless to say I didn't.

Now that there is growing support for a new international monetary system. What sort of system will it be? How will it correct the mistakes of the past and steer a steady course to the future.

In an article I wrote for AQ about a visit to the Canadian West Coast I made a passing reference to a *Vancouver Sun* story by one of their financial writers, Michael Campbell, floating the idea that in 20 years time there would be only three world trading currencies viz. a common North American currency, an Asian currency and the Euro.[vi]

It was shortly after I wrote this story that I made contact with Dr Cumes. After reading his book *America's Suicidal Statecraft* and experiencing the fallout from my own modest predictions, I began to think that the *Vancouver Sun* reporter with his passing reference to the need for three world currencies and Dr Cumes with his suggestion that there should be a new Bretton Woods Agreement had more in common than was immediately obvious.

What if the new Bretton Woods Agreement was negotiated now and there was immediate agreement that there would only three world trading currencies?

The original Bretton Woods Agreement was aimed at currencies to prevent currency competition and promote monetary co-operation among nations. The IMF had clearly lost control of this laudable aim when the United States embarked on its "suicidal policy" of unlimited credit, unregulated markets in untested and non-capital products and the firm belief that the market could do no wrong. This policy was not exclusively owned by George W Bush. It was a policy supported by both Democrat and Republican presidents.

The "suicidal policy" was aggravated by speculation in currencies and US board room decisions to move much of their manufacturing offshore in pursuit of better profit margins, totally ignoring the need to provide jobs at home so people could buy the products that were coming off the production lines in Asia's cheap labour nations.

The supporters of globalisation believed that there would be some kind of trade-off. In other words Americans who lost their jobs to Asia would find new jobs in a constantly evolving US economy. To some extent this was true with the growth of Silicon Valley and similar activities. But this was certainly not the case in the "rust belt" states of the mid-West.

To correct these problems is a tall order.

The first step would be for the IMF to call a meeting of all trading nations. These nations must include the so-called "Third World" nations and all nations would be given equal voting rights.

The meeting would have on its agenda the following financial plan.

(1) The creation of three world trade currency groups.
(2) Each nation to be invited to select a currency group for export business.
(3) Individual nations could still trade domestically in their own currency but all export trade would be limited to one of the three world trade currencies.
(4) The three world currencies would be administered by an IMF agency.
(5) This agency would be made up of members from the three trade currencies.
(6) The agency would meet regularly and every quarter would adjust the exchange rate between the trade currencies. This adjustment would have to be agreed by at least two of the three trade currency countries.
(7) Restrictions would be placed on the trade of international debt.
(8) The IMF would reserve the power, subject to the agreement of the world trading nations, to change the world trade currency groups but only at five to 10 yearly intervals and only with the majority agreement of the trading nations.

Such a proposal would end all currency speculation and introduce some stability to international trading. People like George Soros would be out of a job.

While volatility may have a place in the stock market, where " short sellers" have made large fortunes selling someone else's stock at a loss, such volatility is a serious problem in the world trade market with its disparity of living standards and distribution of resources. If the world is going to avoid future disruption to its economic well being it must accept that a free market is not always right. We must accept some responsibility for our actions, especially in a globalised world where a US Government decision to support biofuels can produce food shortages around the world.

As I suggested at the start the stock market is essentially a place for gamblers. It is not the place where sensible and well intentioned people can do business.

The sooner we can get rid of our fevered pre-occupation with the gyrations of the stock market the sooner we will be able to plan for a better future not only in the G 7 or G8 or G 20 but for all nations.

End

[i] Suicidal Statecraft by James Cumes, published by Booksurge, USA, 2006. Australian born James Cumes was raised in Queensland during the depression. He attended the University of Queensland where he received an

economics degree before joining up and serving on the Kokoda Track. He became one of Australia's first diplomatic cadets and served in various diplomatic posts overseas, including the post of ambassador. He received his PHD from the London School of Economics and is the author of a number of books on the economy as well as fiction. He is married to Heide Schulte von Bauminghaus who writes childrens' books. They live in Vienna. Early in 2008 James Cumes had his play The Lovers: The Outcasts, a play about the 1950s Petrov Affair performed in Europe.

[ii] Penguin Encyclopaedia edited by David Crystal published by Penguin 2006

[iii] Thomas Robert Malthus 1766-1834 the author of the article Essay on the Principle of Population (1798)

[iv] Government of Canada press notice 1944- Bretton Woods Agreement www.canadianeconomy.gc.ca

[v] news.scotsman.com 14 October 2008

[vi] AQ, Vol 80 issue 1 , The Threat of the Red Forest January-February 2008.