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FROM GLOBAL FINANCIAL HEGEMONY TOWARDS A DECENTRALISED RESERVE SYSTEM

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The proposal for a New International Economic Order adopted by the General Assembly of the United Nations towards the end of 1974 was primarily a political expression of the growing dissatisfaction among the countries of the Third World with the processes of decision making in international economic affairs and the domination of the advanced industrial countries over these processes. The inadequacies and inequities arising therefrom had become blatantly obvious in the failure to fulfil even the modest targets set earlier in regard to development assistance, in the refusal to countenance and kind of link between methods of supplementing international liquidity and methods of strengthening the channels for such resource transfer, and in the tendency to enlarge the areas of protectionism along with the integration of the economies of developed countries. The disarray of the international monetary system following the break-down of the Bretton Woods regime in 1972, and the apparent success of the OPEC countries in asserting their economic and political power in 1973, appeared therefore to be factors favourable to a reconsideration of the entire basis of international economic relations.

This expectation turned out to be premature for a number of reasons. In the first place, the immediate effect of the breakdown of the Bretton Woods System was to widen rather than narrow the range

+Paper prepared for the South-South Conference in Beijing on April 4 to 7, 1983 sponsored by the Third World Foundation for Social and Economic Studies (London) and Chinese Academy of Social Sciences (Beijing) of options available to the most advanced capitalist countries; this opportunity was used to eliminate restrictions on international movements of private capital, and thereby develop supra-national money and capital markets unfettered by any national authority or international understanding. Secondly, the unprecedented volume of funds that accrued to the OPEC countries, together with their inexperience in finding suitable investment outlets, helped to enlarge the resources available to these supra-national markets to a degree that was totally unexpected; consequently the economic and financial power that could be exercised through these markets by the countries in dominant positions was enhanced rather than diminished, and this also strengthened those who were opposed to any greater reliance being placed on international institutions as development media. Above all the inflationary pressures which gathered momentum in the subsequent years created an environment in which interest in longer term issues and perspectives was foreshadowed by short-run considerations. In essence these have been the main reasons for the stalemate in global discussions since the middle of the 1970's, despite initiatives made by Third World countries (such as at Arusha) for a fresh approach towards international monetary and financial arrangements.

However, the experience of the last decade, and more particularly the global slump that has now assumed grave proportions, have revealed a number of contradictions and conflicts of interest which must render unviable any approach that does not take into account the need for concerted international efforts. Even within the United

States, the leading country in the capitalist world, there has apparently developed a basic incompatibility between the policies it needs to follow for maintaining and improving its competitive position as an industrial power and the policies it finds compelled to follow for strengthening its financial hegemony and its investment activities abroad. Important differences in perception have also developed between the United States and its closest allies. Taken together with the growing unemployment and world-wide economic stagnation, and the threat of an even more calamitous breakdown precipitated by financial crises, the case for initiating discussions on a global scale is now being recognized even in quarters that were hitherto opposed to it.

For such a resumption of discussions to lead to tangible results in the present context it is important however to have a clear idea of the factors underlying the global slump, of the constraints it imposes, and therefore of the feasible policy options in the immediate future. This paper attempts to set out some preliminary thoughts on these issues.

A broad historical interpretation of the slump in capitalist countries is that it marks the end of a period of unprecedented growth in productivity made possible by a special set of circumstances following the Second World War. Essentially this was a period during which the technological and organisational advances made earlier in the United States, and the patterns of consumption so fostered, got transmitted to and widely spread in about 10 to 15 countries. These countries, mostly in Western Europe but including also others such as Japan and Australia, were already developed industrially and had most of the pre-requisites for achieving high levels of productivity; but their further progress had been retarded by the two World Wars and the political and economic upheavels in between. After 1945 they were brought together in a variety of political, economic and military arrangements under the leadership of the United States, and this provided the framework in which rapid gains could be made, spurred forward by high rates of investment and phenomenal growth in inter-country trading opportunities. The high tide of this great post-War boom was in the first half of the 1960's.

We have some broad dimensional estimates of the productivity gains achieved by these countries in this way in the course of two decades. In 1950 the average output per worker in ten of them (including Japan), valued at the relative prices prevailing in the United States, was only about half as much as in that country. In the following period productivity rose as fast as ever in the United States, but the rate of increase was so much faster in these countries that by 1970 their mean output per worker was 70 per cent as high. Actually in some of them, such as in France, West Germany and Japan, where extensive technological upgrading and modernization were undertaken along with the rebuilding of industry after the War, the differences in productivity were narrowed even more and the levels in the United States overtaken in the case of some important industries. On the other hand, the gap was evidently narrowed very much less in the case of Britain, which did not use the opportunity to raise its rate of investment to the extent required and lived joyfully through the good times of the boom, only to find itself handicapped with an increasingly obsolescent industrial structure.

But this is only the beginning of the story. We need to understand what brought this great post-war boom to an end, and above all with the reasons for the inflation that set in soon afterwards, the continuing stagnation and decline in economic activity, and the apparent inability of the leading countries in the capitalist world to act in concert and reverse these trends.

Many explanations have been put forward. Some of the blame the trade unions in these countries for hiking up wages unreasonably and the monetary and fiscal authorities for following policies that made it possible for prices and wages to rise cumulatively. Some hold the OPEC countries responsible for unleashing waves of price and cost increases through sharp and successive hikes in the price of oil. Some others have taken the view that, below all these phenomena on the surface, are the uncontrolled activities of oligopolistic enterprises (including multi-nationals) seeking higher profit margins regardless of what happens to prices, output or employment.

What all these explanations have however left out of account are the important developments that adversely affected the competitive power of American manufacturing industry towards the second half of the 1960's, the policies followed by the United States thereafter to overcome the handicaps on this account, the consequences these policies had on the world economy, and how they have all contributed very materially to the present global slump. The main links in this chain of developments can be briefly summarized as follows:

(i) the industrial dynamism of the United States, hitherto resting heavily on steel and cheap sources of energy, was seriously undermined from the middle of the 1960s by both obsolesence of the earlier steel technology* and by the subsequent rise in energy costs;

(ii) in the absence of a compensating technological break-through, not only did industrial productivity cease to grow at the same rate as before, but the trend of rising wages, set moving in the earlier period of rapidly increasing productivity, raised unit labour costs and cut quite significantly into the relative share of profits in U.S. industry;

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*In popular literature, Peter Drucker was perhaps the first to point out very clearly towards the end of the 1960's that the steel-making processes embodied in the existing industry had become grossly uneconomical. Nothing was more expensive, he observed, than creating high temperatures; and yet these processes involves such creation of high temperatures three times over, only to quench them immediately thereafter (which was just as expensive as heating). No less expensive in terms of cost and effort was moving of heavy weights, and yet in steel-making hot melted steel in highly corrosive form had to be moved again and again over long distances. To regain its growth dynamics, he added, the cost of steel would have to be lowered by at least one-third, and such a technological [illegible] tion in steel making had only just begun. Cf.Peter Dr[illegible] _The Age of Discontinuity_ (1968).

(iii) since the newer industrial structures of countries like Japan had incorporated the more efficient steel technology,+ and were moreover better designed to save energy and other input costs, American industry also suffered serious setbacks in its competitive strength relatively to these countries, and could not therefore maintain its position without the support of extraneous measures such as devaluation of the dollar and various forms of preference and protection;

(iv) at the same time, the decline in the profitability of industry within the United States, together with the prospect of earning higher returns abroad opened up by American multi-nationals, stimulated a considerable outflow of capital, particularly after the middle of the 1960's; and this process was been enormously helped by the dominant position of the dollar as reserve currency after 1971, the rapid growth of the Euro-currency markets in the following years, ahd above all by the ability of the United States with its political, military and financial power to attract and recycle through American banks a very high proportion of the dollars paid out to OPEC countries;

+Since Japan began the phenomenal expansion of its steel industry rather late, it has been able to adopt the new oxygen process (a major step, as Peter Drucker pointed out, towards converting steel-making from a mechanical to a chemical industry) as well as the new technique of 'continuous casting' ("which eliminates wastes of temperature and substitutes gravity flow of raw steel to and through the finishing equipment for the expensive and dangerous lifting, hauling, and moving of individual batches"). Moreover the new gigantic steel plants of Japan are located near deep-water ports where iron ore can be transported to and unloaded at relatively low cost.

(v) Consequently, while gross corporate profits from domestic manufacture in the United States amounted to less than \$75 billion in 1980 (just about 5 per cent of its gross national product), the gross profits of financial companies (excluding Federal Reserve Banks) were nearly \$19 billion and the corporate profits earned abroad amounted to over \$31 billion; the last two added up therefore to as much as two-thirds of the first in 1980 (while they amounted to only one-fifth in 1950 and about one-quarter even as late as 1965), reflecting the considerable growth in importance of financial and external business interests relative to that of manufacturing interests within the country during the last decade and a half; and lastly,

(vi) while the decision to float the dollar early in 1974 faciliated the outflow of private capital from the United States (without in fact any surpluses on current account to back it up), and at the same time helped to improve the competitiveness of American manufacturing industry (through the considerable depreciation in its value compared to currencies such as the deutsche mark and the yen), it also contributed substantially to escalation of inflationary pressures the world over and to serious weakening of confidence in the dollar as a reserve asset (which got reflected in sharp rise in gold prices), and thus required from the late 1970's the adoption f severe deflationary policies which have had grave repercussions on investment and employment within the United States and abroad.

In other words, though important segments of the industrial structure of the United States can maintain their external competitive power only if the value of the dollar in terms of currencies like the deutsche mark and yen is allowed to depreciate considerably, this has been found to affect adversely the confidence in i reserve asset and thereby the financial power the country is to exercise the world over; consequently it has by stages drif towards policies that help to retain its financial hegemony at cost of promoting deflationary pressures within the country and outside. Essentially this position has to be reversed if a process of strong revival is to be initiated and sustained in countries within the capitalist sphere. But this depends as much on political processes within the United States as outside, and there are therefore no easy solutions one can suggest. The practical question now is what can be attempted meanwhile, particularly by Third World countries in defence of their interests with a view also to expediting the political processes on a global scale.

One source of hope perhaps is that some of the policies the United States has been following in defence of its financial interests have themselves proved to be deterimental to financial stability (as was particularly clear during the recent crisis in Mexico). Since help as lenders of last resort may be essential for even big American banks to cope with such situations, the United States may be more willing than it has been hitherto to countenance the expansion of resources available to institutions like the International Monetary Fund and the World Bank. However, even if some progress in this direction becomes possible, it would make a significant difference only if it leads to a substantial addition to the resources available to the countries of the Third World after meeting debt service obligations, and if they are available for produc' investment without being hemmed in by various restrictive con ns affecting crucial policies and priorities. The prospects for a resource transfer through multilateral agencies are as yet far f bright, and this is likely to remain so as long as the policies followed by the United States are governed primarily by the prospects offered by its global financial hegemony.

In the circumstances the most promising line of advance now appears to be through the formation of groups of countries, with some complementarity in economic structures and mutually compatible objectives, for building up alternative modes and systems of cooperative action. They could be constituted partly on a regional or sub-regional basis but need not be wholly so since considerations of complementarity and compatibility could be stronger between countries belonging to different regions. What is important is that the countries wanting to form a group should perceive sufficient commonality of interests in promoting trade and other economic relationships among themselves to pool together agreed proportions of their respective foreign exchange reserves and set up a payments union for the settlement of mutual transactions with minimal use of the currencies of countries not belonging to this group. If several systems of this kind are set up around different groupings of countries, on however modest a scale initially, a beginning will have been made not only towards removing by stages some of the existing foreign exchange constraints on mutually desired economic relationships but in the search urgently needed to find acceptable substitutes for key currencies such as the doll[illegible] he maximum extent feasible within the present framework. To t[illegible] tent that the use of key currencies is dispensed with in intra-uni transactions, and the exchange margins and other costs levied on operations involving these currencies are saved, there are also other considerable direct economies to be secured through such arrangements.

Efforts to develop such payments unions in the past, particularly when confined to developing countries alone, have not always come up to expectations even though they succeeded in accelerating trade amongst such countries to a certain degree. But the important difference between such efforts and what now appears feasible is the prospect of associating many industrially advanced countries along with the less developed in these unions.

In fact the scope for the formation of such independent payments unions is likely to be now very much greater than it was even a decade ago, as several advanced countries such as France, Sweden, Italy, Canada and possibly even West Germany and Japan that are under strong deflationary pressure could gain significantly from participating in them along with countries of the Third World which are under similar pressure. It might be possible also to link the trade and payments arrangements among the socialist countries with payments unions of this kind to promote greater trade and closer economic cooperation.

As a number of reserve systems are developed as part of payments unions, in response to the requirements and collect interests of different groups of countries, opportunities can open up for framing investment programmes based to a large extent on the resources within each group but supplemented by resource flows from other groups or from the existing conventional sources. These are possibilities that will need to be explored at each stage in the light of experience, even though it may be wise to set the sights lower initially and proceed step by step. What is important to bear in mind is that the widening of the scope for each group to invest its resources in its own development programmes or in the programmes of other such groups, in consultation with each other, could prove to be an important way of utilizing the foreign exchange reserves of these countries to their own mutual advantage instead of making them available to the most advanced countries through their financial structures for use in whatever manner appears most advantageous to them as has been largely the case so far. To the extent these possibilities are realizable, the power exercised through existing financial structures can also therefore be significantly scaled down.

Since any radical reform of the international monetary system is necessarily constrained by the unwillingness of prospective surplus countries to accept a world-wide voting system in respect of the considerable resources they would have to contribute to the functioning of such a system, and a regime dominated by a few key currencies as now is open to both instability and abuse, Professor Robert Triffin had visualized even in the 1960's a decentralized reserve system built up along these lines as a necessary stage in the evolution towards a more truly international monetary system.** The objective conditions were however not favourable enough then for much progress to be made in this direction. With the fast-spreading global slump and the predicament now facing both the advanced countries and the not-so-developed countries the circumstances are perhaps now much more favourable. In any case it appears to offer today the only substantial defence for most countries against an international monetary system bordering on near-anarchy and subserving the interests of a very privileged few.

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**Robert Triffin, "Monetary Aspects of International Economic Integration", _Acta Oeconomica_, Vol.3, 1968.