Leading economist: Say goodbye to era of banker control

By Elisa Barwick

Discussions ahead of and during this year's Davos World Economic Forum bemoaned the end of the current form of globalisation. IMF chief Kristalina Georgieva expressed concerns over *deglobalisation* in a 22 May blog, warning that a "confluence of calamities" means the global economy is facing "perhaps its biggest test since the Second World War". On the other hand, European Central Bank head Christine Lagarde, in a 23 May blog, spoke of *hyper-globalisation*, where "geopolitics [becomes] more important for the structure of global supply chains", catalysed by the Russia-Ukraine war.

Either way the current form of global order has been shattered, and it has been a long time coming. In a lengthy article published 5 May by Defend Democracy Press, US economist James K. Galbraith, son of renowned economist and diplomat John K. Galbraith, reveals how the post-Bretton Woods neoliberal era, comprising the deconstruction of financial regulations, controls and borders, landed us in the swamp of financial globalisation in which we are presently drowning. The only life-raft in sight is China's economic miracle.

Galbraith works from the Lyndon B. Johnson School of Public Affairs at The University of Texas, but also served as Chief Technical Advisor for Macroeconomic Reform to the State Planning Commission of the People's Republic of China in 1993-97. While visiting Australia as a guest of the Whitlam Institute back in July 2001, Galbraith bluntly told the *Australian Financial Review* that America's economic bubble was going to burst, and that the world required a new regulatory financial architecture like that established in 1944 at the Bretton Woods conference, which opened a pathway for post-war reconstruction through international collaboration.

In his new piece, "The Dollar System in a Multi-Polar World", Galbraith documents how the destruction of the Bretton Woods financial architecture paved the way for a *private* takeover of the global financial system—which must be restored to its role as a "*public* good" shared by all nations. Only restoring the vision of international relations—financial or otherwise—to the shared custodianship of a multipolar world, can restore the economic health of the world, which as the *AAS*'s current Almanac series spells out, was the vision of US President Franklin D. Roosevelt. (*AAS* 18, 25 May, 1 June)

Lawlessness benefits bankers

Galbraith states at the outset that "the abolition of the Bretton Woods system set in motion the final defeat of [FDR's] New Deal banking law and of balanced international financial governance, in the end *restoring the financiers to the centre of American and world economic power*. For forty years that genie had been bottled up, internally by regulation, deposit insurance, and the *Glass-Steagall Act*, so that in the 1940s, 1950s, and 1960s banks were largely adjuncts to the large industrial corporations and under the fairly-effective discipline of the state. There were, accordingly, no financial crises from 1934 to 1974" (emphasis added).

Throughout the "apparently prosperous" 1970s, credit flowed, trade flourished and banks prospered, wrote Galbraith. Despite US President Richard Nixon in 1971 having removed the dollar's backing by gold, the US dollar remained hegemonic as the reserve currency for international trade, backed by US economic strength. (This included agreements with Middle Eastern oil powerhouses, to solely use the US dollar for oil sales, known as the "petrodollar".) A strong international dollar was "central to the power,

James K. Galbraith. Photo: Wikipedia

prestige, and worldview of the bankers", wrote Galbraith. But this system contained the means of its own demise. According to the economic orthodoxies of the new era of global competition, Federal Reserve Chairman Paul Volcker and President Ronald Reagan "sacrifice[d] labour and industry" to break the back of commodity prices, industrial wages and prices. Abandonment of capital controls and fixed exchange rates was matched by globalised production, with nations becoming either net-importers or sweatshops for exports.

Exchange rates became an "artifact of capital flows, asset transactions and relative rates of return", thus coming "under the influence if not the control of private financial power". If nations pursued the sanctioned orthodoxy, "confidence and capital inflow would bring on the simulacra of prosperity"; on the other hand, "Asymmetric bets, as against Mexico in 1994 and Thailand in 1997, could precipitate a crisis". An untethered financial order is easily manipulated. "When crises hit", wrote Galbraith, "funds would flee to the safety of US Treasury bonds, inefficiencies, excesses, and 'crony capitalism' would be duly discovered, and the IMF would be called in with ritual purgatives. No longer concerned with exchange-rate stabilisation, still less with financing a development plan, the Fund and Bank became enforcers of an austerian and neoliberal code of conduct—the 'Washington Consensus'."

With the "accelerating decay" of other regions, the Western dollar system reigned supreme, albeit "without the backing of a stranglehold over gold or the industrial and military superiority of the early and mid-20th century". The US camouflaged its deindustrialisation somewhat, wrote Galbraith, particularly after its defeat in Vietnam, with "a series of minor wars against apparently trivial opponents".

Additionally, there was a lack of any credible alternative to the dollar system, Galbraith noted. "The system has been held up, in short, by confidence in itself, and not, so far as one can see, by much of anything else." With each successive financial crisis, however, this top-heavy, illusory position of power progressively wilted, not least because according to a "dogmatic rhetorical commitment to free-market doctrines … the industrial base continued to wither while, *in each crisis, first and foremost, the banks were saved*." (Emphasis added.)

Enter China

But the rise of China changed that dynamic. Suddenly there was an alternative economic approach: "The illusion could persist only so long as there emerged no clearly different, functionally superior economic development model. Had the victory of the neoliberals been complete, they might have put off that day indefinitely. But it wasn't. And they couldn't. Enter China."

China, continued Galbraith, "poses a lethal threat to neoliberal ideology, even though the Chinese themselves have made little effort to brand their experience and none whatever to export it as a competing economic model. China simply is, and as such it poses an interpretive challenge that neoliberalism cannot handle."

China is generally accused of one of three violations of the current order, observes Galbraith: that it has successfully transitioned to capitalism, beating the West at its own game (failure to accept that would be rather unsportsmanlike of the USA, he says); it gained unfair advantage by breaking the rules (but, Galbraith points out, so did we all—in the US such "systemic violation of 'the rules' even had a name: 'The American System'"); or, it made its relative gains by applying aggressive economic power through totalitarianism (which effectively admits the economic superiority of communism).

The Chinese approach does not fit within any of these "simple boxes", writes Galbraith, pointing to the country's unique forms of organisation, integration of purpose at all levels of economy, its state-owned banking system, and insulation from the "predations of international finance" via regulatory policy—the very things abandoned by neoliberalism in the West.

Now, accelerated by the outbreak of war in Ukraine and the Western sanctions imposed on Russia, many nations have realised the vulnerability of the US dollar system and a shift is inevitable. Given the close ties of "the Chinese engine" to Russia, and "the gravitational pull of the world's largest demographic, productive, and trading region—the emerging Eurasian Economic Union and Shanghai Cooperation Organisation" the question is: "Is the writing on the wall, at long last, for the dollar-based international order?" Galbraith reviews the efforts of the regional groupings that might form the underpinnings of an alternative financial system, and the problems associated therewith.

Galbraith concludes that the dollar system will survive for now, but that "there will be a significant non-dollar, non-eurozone carved out for those countries considered adversaries [of the USA/EU]" and their trading partners. Under such a "dual system", "China will act as a bridge between the two systems—the fixed-point of multi-polarity. Should similar harsh decisions [as with Russia] be taken with respect to China, then a true split of the world into mutually-isolated blocs, akin to the coldest years of the Cold War, would become a possibility."

As for the prospects of a truly multipolar financial order, Galbraith observes that the USA could, of course, survive such a shift, but not without significant political upheaval and a shift away from the "present extent of US military power projection" which goes hand-in-hand with its financial reach.

"Multi-polarity, in short, could be bad for oligarchy but good for democracy, sustainability, and public purpose. From these points of view, it would come not a moment too soon."

Divergent views: the Fed, China on financial stability

The US Federal Reserve in its May Financial Stability Report warned of worsening liquidity conditions, including in money markets and bond funds, increased market volatility, declining bank risk-based capital ratios, rising leverage at hedge funds, non-agency securitisation products reaching post-2008 highs, and large margin calls by central (derivatives clearing) counterparties.

The Fed report said: "Elevated inflation and rising rates in the United States could negatively affect domestic economic activity, asset prices, credit quality, and financial conditions more generally", adding that house prices "could be particularly sensitive to shocks".

The Fed's monetarist toolbox, however, locks it into these actions, even if they hamper economic growth. Likewise at the Bank of England, Governor Andrew Bailey has indicated the bank will raise rates even if it leads to recession: "We have to get [inflation] back to target", he said, "And that is clear." He admitted, "This is the biggest test of the monetary policy framework that we have had in its 25 years."

Less wedded to monetarist dogma, China is prioritising efforts to foster real economic growth. According to Xinhua news agency, at a 29 April session of the Political Bureau of the Chinese Communist Party Central Committee, President Xi Jinping "called for efforts to regulate and guide the healthy development of capital in China per the law and give play to the positive role of capital as a significant production factor". Xi encouraged plans to crack down on capital supporting "profit-seeking" and "corruption-related" behaviours and monopolies, along with management of capital governance to spot and resolve systemic financial risks.

The People's Bank of China, which studied the pronouncements of the meeting, said in a statement, that it would "guide financial institutions to better meet the financing needs in the real economy." It stressed proper regulation of financial activities, including proper prudential management of real estate finance.

Chen Yulu, Deputy Governor of the People's Bank of China, told Xinhua News Agency 7 May that "China's central bank will readjust its monetary policy to expand support for the real economy". Targeted credit will be issued through a 100 billion yuan (US$15 billion) "re-lending facility" into the logistics and warehousing sectors, hit hard by Omicron restrictions. Also, tax reductions, fee cuts, relief and assistance packages for industry and small businesses, and efforts to assure resource and energy price stability. Financing for infrastructure will be increased, with plans to build new high-speed rail lines and increase the speed of existing lines, creating a more rapid transport of people and products in the market.

Following a State Council meeting on 23 May, Premier Li Keqiang announced a 33-point policy package to get the economy back on track. New bonds will be issued, worth 300 billion yuan (US$45 billion) for railway construction, 350 billion yuan in bonds and emergency loans for aviation, plus rural road construction. Bank lending quotas for small and micro-sized businesses will be doubled. Li stressed that "One good thing is that we refrained from excessive money supply and mass stimulus in the past few years, and we still have policy tools in reserve." Meeting the same day, the PBC and China Banking and Insurance Regulatory Commission discussed policy tools to improve "financial support for the real economy", while moderating financial risk.

Due to China's unique approach, inflation increased by just 1.5 per cent in the month of March, year-on-year. Growth is expected to sit at 1.8 per cent for the second quarter, down from 4.8 per cent in the first quarter, likely meaning it will not quite reach 4 per cent for the full year; the annual target was around 5.5 per cent. US first-quarter GDP did not grow at all—it shrank at an annualised rate of 1.5 per cent.