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World needs to fall back on Keynes' idea

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WHEN commercial short-sightedness is compounded by lack of effective inter-governmental institutions and reinforced by ideological rigidity and then, by lack of compassion, made dangerous and deadly, it is difficult not to have sympathy for Datuk Seri Dr Mahathir Mohamad or Yevgeny Primakov of Russia who, in effect, are telling Western governments and their financial fireman, the International Monetary Fund, to go take a run and a jump.

Both the Prime Ministers are wrong but their wrongness is nothing compared with the West's.

Whether it be the loose talk about the need for moral hazard to serve the bankers and investors right (the US House of Representatives' economic experts are hot on this one); or the refusal by Alan Greenspan, chairman of the US Federal Reserve Board and Hans Tietmeyer, president of the German Bundesbank, to countenance an interest rate cut (still fighting the inflationary demons of yesteryear); or German Chancellor Helmut Kohl (according to the IMF) balking at another Russian bailout a month ago when the pro-capitalist reformers were still in power and beginning to make progress on Russia's main fiscal problem, the under-collection of taxes; or ... one could go on.

As if we didn't know what the cost is going to be. We need go no further back than the great debt crisis of the 1980s. According to the United Nations Children's Fund, 500,000 child deaths, two thirds of them in Africa, were directly caused by the 1980s recession and the debt crisis.

By the end of the decade urban real wages in Latin America were 20 per cent to 40 per cent below 1980 levels. In Uruguay, Peru and Argentina they were below 1970 levels.

This crisis already has caused nearly as much damage in Thailand, Indonesia, South Korea and Russia, and the hurricane is still on the move. If, as many predict, it spills over into Latin America and Africa and then into the Western world itself, it will drag half the world down and the poorest 20 per cent not only down but effectively out.

One of the ironies of the present situation for a columnist who covered the debate about the New Economic Order in the 1970s is to recall the uphill battle to try and convince Western capitals and financial markets of the economic potential and possibilities of the Third World. Now this once underdeveloped world smacks a collective punch that can send the West reeling and perhaps - we don't know yet - bring it down on the mat for a good count.

The argument then was about lowering trade barriers to make the world an equal opportunity employer; about encouraging investment and priming the educational, health and infrastructure pump with aid. In the end much was done by Western institutions and investors but we should never forget the developing countries did most of it themselves.

Even in the 1990s, capital inflows from outside amounted to only 10 per cent of domestic investment in emerging markets.

Nevertheless, the process was unnecessarily slow and many opportunities were missed to speed it up. Success could have come sooner and with less pain - and it would have been better for the West too, because these new marketplaces could have mushroomed earlier.

Going back to the 1980s debt crisis whose main sufferer was Latin America - they called it the lost decade - the pain was at least 75 per

cent unnecessary.

Professor Paul Krugman of the Massachusetts Institute of Technology wrote a very clever piece at the time in favour of debt write-offs, so that Latin America could escape the straitjacket it was bound in.

He argued that if half the debt were written down to 40 per cent of its face worth the investors would be better off in the long run. The borrowing countries would then more quickly recover and be able to pay a higher percentage than 40 per cent on the remaining half.

The same thought must be entertained today. What does the West gain from punishing yesterday's mistakes - by the banks and investors who lent too much or the developing countries who encouraged an overdose of inward investment and didn't monitor its use more carefully?

Punishment means widespread poverty and political unrest for them and nerve-racking economic insecurity for the West. It is a zero sum game. Indeed it could be worse than that in Russia where increased chaos and increased nationalism is nuclear armed.

For the future, to avoid more such crises it must be back to Keynes. Back to what he tried to do in 1944 at the Bretton Woods conference where he was overruled by America's short-sightedness.

Keynes proposed an IMF whose resources would be equal to one half of world imports. In practise today the IMF controls liquidity equal to only two per cent of world imports.

In an age when the combined reserves of all the world's central banks amount to one day's worth of foreign exchange trading, the ability of either the IMF or Western governments to stop a quite irrational haemorrhaging of the proportions we have recently witnessed, and could come to see in Latin America, is totally impossible.

Moreover, Keynes would have had no time for the present gamblers' paradise - the speedy entry into and exit from financial markets with no supervision or braking system.

We need a tax of say 0.5 per cent on international currency transactions. This would give useful second thoughts to volatile investors and thus dampen down the lemming-like instincts of the short-term investors. Also it would produce a revenue of US\$1.5 trillion (RM5.7 trillion) a year for the IMF.

When Kim Dae Jung won the presidency of South Korea last year as the east Asian financial storm gathered speed, he observed, "My country is standing between stagnation and rebirth".

Absolutely right and absolutely right for the rest of the world too.

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