

Stickier money
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John Greenwald

Can anything stop the financial panic that has swept from Asia to Russia to Latin America? On Wall Street last week, jittery traders dismissed the Federal Reserve's quarter-point cut in interest rates as too puny and sent the Dow Jones industrial average plunging 448 points in two days. In Washington State, farmers watched helplessly as their grain piled into huge drifts for lack of Asian buyers. In slumping Brazil, Ford and General Motors, which only recently completed new plants in the country, had to cut production drastically. And the future could be grimmer still, according to the International Monetary Fund, which reported at its annual assemblage of world finance ministers last week that "the risks of a deeper, wider and more prolonged downturn have escalated" throughout the developing world.

All this adds up to perhaps the gravest challenge to global capitalism since the Great Depression. And suddenly everyone from Malaysia's dictatorial Mahathir Mohamad to President Bill Clinton and British Prime Minister Tony Blair are calling for reform of the international monetary system that has held sway for a half-century. Their ideas range from Mahathir's ban on currency trading in depression-mired Malaysia to the Clinton Administration's talk of a new "global financial architecture" that would preserve a relatively free flow of capital while reducing the volatility of world financial markets. Says Treasury Secretary Robert Rubin: "Clearly, the time has come to build a stronger system." Among his proposals: speedier IMF loans to help countries ward off economic crises, and more honest public record-keeping by governments so investors can tell which nations are sound.

But talk about timing. This push comes as the Administration remains locked in a yearlong battle with Congress over Clinton's request for \$18 billion for the cash-strapped IMF. The outcome is still uncertain but crucial because other countries may not contribute their share of funding until the U.S. acts. Washington's failure to do so would be viewed as a sign of growing U.S. isolationism that could further shake markets and whip up protectionist sentiment, adding to the pressure for currency controls. Says Clinton: "This country has got to lead."

The stakes are sky-high for Americans and people around the world in the contest between financial openness and the growing trend toward controls on capital. If more and more countries manipulate their capital flows, currencies and merchandise imports for competitive advantage--as they did on the cusp of the Great Depression--the threat could spread to U.S. jobs. U.S. unemployment has already edged up from 4.5% in August to 4.6% in September, a month which also saw the slowest rate of job creation in nearly three years.

Haphazard controls are not even much help to countries that impose them, because they choke off foreign investment just when it is most sorely needed. To make matters worse, Malaysia looks ready to use its controls to ease pressure on Mahathir's debt-ridden cronies instead of attempting to fix its shattered economy. Meanwhile, Hong Kong authorities find themselves stuck with \$15 billion worth of stock that they purchased in August to prop up the market. Selling the shares now would drive down prices.

Yet controls remain tempting, partly because various types of restrictions have long been woven into the capitalist fabric. For example, both Argentina and Hong Kong use "currency boards" to peg their currencies to the U.S. dollar, even though that has obliged them to jack up interest rates to maintain the prescribed relationship. Argentina, for one, still swears by

the mechanism. (Closer to home, many U.S. mutual funds that invest in emerging markets impose penalties on investors who sell out before a specified period of time.)

With President Clinton fighting to stay in office and recession-plagued Japan saddled with yet another weak Prime Minister, little leadership has been exerted by the two biggest economies. Tokyo's banking crisis has curbed lending throughout Japan and the rest of Asia--contributing to the region's economic malaise and adding to the threat of global recession. But even as Japan, under U.S. pressure, began moving last week to clean up its banking mess by empowering a government agency to seize insolvent banks, the Fed in the U.S. was busy defending a private bailout of a high-flying hedge fund to protect its banking lenders, which hardly helps buttress American moral suasion.

While Tokyo and Washington fiddle, all eyes are on Brazil, which has been negotiating a bailout from the underfunded IMF. In the meantime, Brazil has been forced to draw down its foreign-exchange reserves to defend its currency, the real, which is pegged to the U.S. dollar. Any collapse of the real would clobber Latin America--and hurt the U.S., which sells 20% of its exports to the region.

All this has led Fed Chairman Alan Greenspan to use his rate-cutting powers to maintain the U.S. as the world's consumer of last resort. And his impact has never been greater, because whenever interest rates fall, they immediately put money in consumers' pockets through the widespread use of variable-rate mortgages.

Even so, Wall Street's thumbs-down reaction to last week's quarter-point cut only created more tumult. Confused investors managed to bid up both the price of gold--a traditional inflation hedge--and long-term bonds, which are normally a defense against deflation. Moral: in a world in which countries are tempted to barricade themselves behind destructive currency controls, small rate cuts alone can hardly allay a rising sense of panic.

--Reported by Bernard Baumohl/New York and Adam Zagorin/Washington, with other bureaus

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