for the global economy. So far, the menacing word of a systemic crisis is only being whispered." But, in addition to the "overall perplexity" of how to deal with the Japan problem, "there is growing fear of tectonic shocks to the world monetary and financial system."

### IMF's official word

But what does the IMF say? We leave mention of this until last, since the IMF is part of the disease, not the cure, for financial crises. On April 13, the IMF released its report, "IMF World Economic Outlook," which has been coming out yearly, or twice yearly, since 1980, covering what the IMF calls "ongoing surveillance of economic developments and policies" in its 180 member-countries. The report contains begrudging references to some "risk" in globalized financial markets; but otherwise, the IMF goes out of its way to absolve hedge funds of any responsibility of causing harm to nations.

As for the IMF view on the overall condition of the world economy, the IMF report states that "financial turmoil in Asia that erupted in mid-1997 has abated since January. . . . Nevertheless . . . considerable uncertainty remains about the resolution of the crisis." Therefore, according to the report, the IMF has revised its global growth forecasts downward. In Chapter I, it said, "This issue of the *World Economic Outlook* projects world output growth in 1998 at just over 3%, compared with projections of 3½% in the December *Interim Assessment* and 4¼% in the October 1997 *World Economic Outlook*."

IMF Research Director Michael Mussa added on April 13, at a press conference releasing the report, "The growth forecasts for Japan as of the published version of the *World Economic Outlook* has been knocked to a flat zero. Given recent data for Japan, it now looks as if zero may be a little bit difficult to materialize."

## Documentation

# Growing nervousness about the systemic crisis

### From the G-7 communiqué

Paragraph 8, "Exchange rates":

"We reaffirmed our view that exchange rates should reflect economic fundamentals, and that excess volatility and significant deviations from fundamentals are undesirable. We emphasized that it is important to avoid excessive depreciation where this could exacerbate large imbalances. In light of this, we support appropriate steps by Japan aimed at stimulating domestic demand and reducing external imbalances, also correcting the excessive depreciation of the yen. We will continue to monitor developments in exchange markets and to cooperate as appropriate."

### Participants in the Washington meetings

From **Japanese Deputy Finance Minister Eisuke Sakakibara's** a press conference in Washington, April 15:

*EIR* asked Sakakibara: "As you know, the American economist Lyndon LaRouche already in February 1997 called for a New Bretton Woods monetary system, as have you, Romano Prodi of Italy, and other world leaders. Please share with us your ideas on how to create a New Bretton Woods."

Sakakibara replied: "I recall being quoted about this, but I did not call for a New Bretton Woods. What is being discussed now are modifications to the IMF, and then possibilities for a new world financial architecture. At the G-7 meeting, as Dr. Hayami explained, Japan made two proposals. First, that the IMF disclose all their operations and documents, including letters of intent, policy framework papers, conditionalities, and so on; and second, that the IMF report to us on a study of ways in which we can monitor excessive flows of short-term capital."

At the close of the press conference, *EIR*'s correspondent showed Sakakibara a copy of his March 1 *Mainichi News* interview, in which he was quoted, "I believe that many world leaders may well be starting to contemplate the idea of a financial agreeement along the lines of the Bretton Woods agreement."

"Well, I see that you are right, it seems that I *did* say that!" Sakakibara answered.

"Everyone talks about the bad debt of the Japanese banks," *EIR* then asked, "but just now, you mentioned the problems on Wall Street. What about the giant derivative holdings of New York banks such as J.P. Morgan? Don't you think all that speculative debt on both sides of the Pacific has to be reorganized, to have any new financial architecture?"

"Well, you are right, and as Federal Reserve Chairman Greenspan says, there are certainly also some financial excesses in the United States," Sakakibara replied.

**Choi Joong-Kyung, Republic of Korea, director of the Financial Cooperation Division of the International Finance Bureau, Ministry of Finance and Economy,** statement to *EIR* in Washington on April 15:

Fixed exchange rates are "ideal," but hot money poses increasing risks to the world financial system, Mr. Choi said, during the IMF annual meeting. "A fixed-rate system would be the ideal world monetary system, because excessive movements in exchange rates are harmful to trade, investment, and most importantly, to the development of our people and our national economies," he said. He was responding to Lyndon LaRouche's proposal for a New Bretton Woods system.

International currency "hedge funds" and similar speculators, however, have created an intractable problem for the monetary system, Choi pointed out. "The problem today is



© 1998 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

that we have no way to monitor or control the effects of rapid motion of cross-border capital flows, so-called 'hot money,' which can do a lot of damage in a short time to years of a country's hard work."

Asked about the questionable $25 trillion derivatives holdings of Wall Street banks such as J.P. Morgan, which are pressuring Korea about its financial problems, but concealing these bad assets of their own, Choi agreed that we have a *global* financial crisis, not just an "Asian" crisis, which should concern people around the world.

"Financial derivatives are another example of highly-speculative financial instruments which have attained a great weight in the international financial system, amounting to trillions of U.S. dollars worth of assets," he noted.

Without addressing these gigantic hot-money flows, off-balance-sheet derivatives assets, and the rise of similar speculative paper, he said, a rational fixed-exchange-rate currency system is impossible. "Because of these problems, we can't fix exchange rates today, so while the fixed-rate system is the ideal system, today the floating-rate system is the practical system which is left to us."

Americans as well as Asians need to take a hard look at these speculative processes, because they pose increasing risk to the world economy as a whole, he concluded. "As the IMF's *World Economic Outlook* notes, 'the risk of crisis is rising, including the scope for international contagion,' because of these financial methods," Choi said. "The entire global financial system is now running at higher and higher risk.

"This problem of speculative risk is a global problem which should concern citizens in the Western countries, as well as in Asian countries."

## World leaders speak out

**Italian Foreign Minister Lamberto Dini,** in an interview with the daily *La Repubblica* published on April 14, calls for reform of the International Monetary Fund:

"The IMF is an institution born after the war, which so far has undergone few changes in structure and operational methods. We need a deep reform and a rethinking of the whole logic through which it operates," Dini said. "Just think that when it was founded, global markets did not exist. They started in the seventies, with the eurodollar market. Reality has totally changed."

On the IMF intervention in Asia, Dini said: "There is the impression that we are limiting ourselves to general bailout interventions, that we do not succeed in clarifying once and for all that crises must be paid for by creditors, that enterprises can fail. Instead, the awareness was created, that any investment, even if failing, will not cause losses, because someone, such as the IMF, will pay the bill."

On the Asia crisis itself, Dini said that "the development was too much based on credit and too little on the creation of a financial and industrial base. . . . The IMF should have paid attention. . . . I am not surprised that sectors of the U.S. Congress halted the refinancing of the Fund; it is not a political quarrel against Clinton, but a substantial issue."

Dini also criticized the idea of a currency board, such as that proposed for Indonesia: "In such a way, despite appearances, a country loses monetary sovereignty instead of recovering it, loses the possibility of intervening reasonably, case by case."

A journalistic source pointed out to *EIR* the fact that Dini dared to come out against the IMF exactly when the IMF is intervening in Italy, through its semi-annual report, calling for more radical "structural reforms."

Dini had recently called for the reorganization of bankrupt chunks of the world financial system, with "a sort of international bankruptcy court, to establish the principle that creditors pay for failures, and that an investment has a risk factor. As with private firms: When one goes bankrupt, you list the creditors; you may reach an agreement, but no one recovers every last penny."

**Malaysian Prime Minister Dr. Mahathir Mohamed,** speaking at the University of Sarawak in Malaysia on April 14, as reported by *The Star Online,* Kuala Lumpur, April 15:

Dr. Mahathir opened a seminar on "Virtual Reality," using currency trading as an example. "Where before, we had to deal in real money, goods, and services, today none of these is really necessary. As a result, there seems to be no limit to the amount of business that can be done and profits made. Unfortunately, in the process, real money, real jobs, and real business can be very badly damaged. Now, in the rule devised by the currency traders, the currency depreciates in value every time it is sold. In normal commodity trading, the price remains so long as there is a willing buyer and willing seller. But currency traders dealing with virtual money are not constrained by the supply of the currency. . . . The trading is in virtual money, but the effect of devaluation is very real. Today, whole countries and regions are impoverished because of currency trading."

He commented on a report he had received, in which the IMF concedes that there may be a need for some regulation, but Mahathir said that implementation of such measures would depend on whether developed countries, which "could have gained" from speculation, will accept this.

He cited the Internet as an example of how man determines whether his inventions will be used for the benefit of mankind, or against it. The Internet can be used to spread lies and foment "unacceptable activities," or to tell the truth, he said.

## Press commentary

***Neue Zürcher Zeitung,*** Switzerland, "Asia Crisis Shifting Into a Second Phase," April 14:

The weekly "Eurobond column" column quotes Steven Roach of Morgan Stanley Dean Witter, describing the "second phase" of the Asia crisis as much more dangerous than the first, because this time Japan will be in the center of events. The more the yen plunges against the dollar, the higher the risk that the deepening recession in Japan will trigger another round of currency devaluations, not only in Asia, but in Latin America und eastern Europe as well.

The article features a new study by Credit Suisse First Boston, stating that a second round of the Asian crisis is soon to erupt. The bank warns that Asian currencies and stock market prices could even fall below the levels reached at the climax of the first phase of the crisis. This would massively hit Europe and the United States. "Once the prices of Japanese stocks, government bonds, and the yen start to plunge simultaneously, there would be an immediate danger of an overall capital flight out of Japan, and thereby a collapse of Japanese financial markets," writes the paper, summarizing the CS First Boston argument.

The United States and Europe are threatened by an "over-confidence syndrome," due to booming stock markets and low interest rates. A similar "over-confidence syndrome" had been visible in Japan during the 1980s and during the "financial euphoria" leading into the Asian crisis of the 1990s, states CS First Boston.

***Folha de São Paulo,*** Brazil, by Clovis Rossi, "Time to Show Your Face," April 14:

Brazilian central bank chief Gustavo Franco gave *Folha de São Paulo* reporter Rossi two reasons for his belief that the results of the April 16 G-22 meeting are unpredictable: first, because the Asian countries will be present, and their "wounds are still open" from the financial crisis; second, because it is "certain" that countries such as India will present unorthodox proposals for controlling global capital flows.

Rossi comments that, in any case, "Thursday's meeting will be more than a round-table on the international financial system," because three ongoing working groups will be set up out of the meeting, each including at least one representative from a G-7 country, and a representative from one or more other countries.

Rossi complains that Brazil will not bring to Washington any concrete proposal for controls on international capital flows, even though, he writes, Itamaraty (the Foreign Ministry), and President Fernando Henrique Cardoso had argued that Brazil should do just that. The central bank and the Treasury Ministry (who are attending the meeting) argued that were Brazil to present any such proposal, it "would be equivalent to confessing that the country does not have the means to face a crisis." The most that Brazil will do, is oppose any proposal for the total deregulation of capital flows.

President Cardoso told *Folha* that he is enthusiastic about the April 16 meeting, claiming that the mere fact of its occurrence represents an acceptance, in some form, of *his* proposals on the international financial system, and because it is a first step toward a future expansion of the Group of 7, in which Brazil, no doubt, will be included.

## The IMF's own commentary

***World Economic Outlook,*** IMF report issued on April 15:

Globalization poses an increasing level of risk in the world financial system, and some sort of "modification" of floating rates may be necessary, the IMF admits. This statement reflects extreme pressure by Malaysia, Indonesia, Japan, Korea, and other nations represented on the IMF Executive Directors' board.

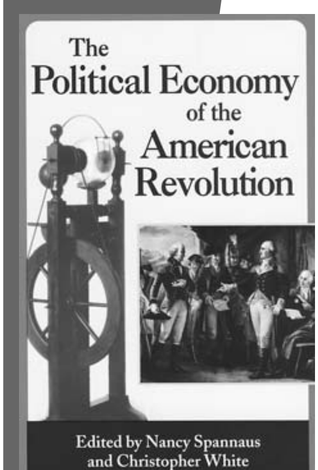
"With the increasing globalization of financial markets and the apparent tendency for investors to react exuberantly to success, belatedly to emerging concerns, and eventually to overreact as sentiment changes, it may well be that the risk of crises is rising, including the scope for international contagion. Countering the potential for new crises is a considerable challenge that needs to be met through increased vigilance of national policymakers and private investors. . . .

"A key task for policymakers is to identify weaknesses early enough to address them before crises erupt. . . .

"In some cases, modifying the exchange rate regime may need to be considered. Currency pegs, currency unions, and currency boards have served many countries well . . . and the successful defense of a relatively fixed exchange rate arrangement can bring benefits that outweight the shorter-run costs. But adjustable pegs have become increasingly difficult to maintain in the face of large-scale financial flows. . . ."

DO YOU KNOW

• that the American Revolution was fought *against* British "free trade" economics?
• that Washington and Franklin championed Big Government?
• that the Founding Fathers promoted partnership between private industry and central government?




**READ**

The Political Economy of the American Revolution

edited by Nancy Spannaus and Christopher White

Order from:
**Ben Franklin Booksellers**
P.O. Box 1707
Leesburg, Va 20177
Toll-Free: 1-800-453-4108

$15.00 plus
$4 shipping and handling

We accept MasterCard, VISA, American Express and Discover.