THE POLITICAL ECONOMY OF GLOBAL ECONOMIC DISGOVERNANCE

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Abstract. Global economic disgovernance rather than governance characterizes today the world economy. Two facts substantiate this assessment: the recurring balance of payment crises in developing countries, and the present enormous current account deficit in the United States. The emergent markets' crises are essentially the outcome of a strategy that the North proposed to the South: the growth *cum* foreign savings strategy. Given the fact that the inflow of capitals evaluate the exchange rate, and that the countries did not face major investment opportunities in the 1990s, such strategy led not to increase in capital accumulation and growth but to large current account deficits and to balance of payment (financial) crises. On the other hand, the US current account deficit is a serious problem. The US is already a debtor country, but adjustment continues to be postponed. Thus, the probability of a soft landing is small. Both sources of instability are related with current account deficits and overvalued currencies. The political economy behind has a name: exchange rate populism, one of the two forms of economic populism (the other is fiscal populism). This is not surprising in developing countries, but could be in a developed country like the United States. Yet, when one considers the political and social retrocession that the American society is experiencing since the end of World War II, it is not.

Key words: Governance Current account deficit Exchange rate Populism

Global governance is an expression which became popular in the 1990s to convey the idea that, in the world arena, national states lost autonomy and relevance in so far as a multitude of other players – multilateral institutions, organizations of civil society, global social movements, multinational enterprises – have an increasing role to play. James N. Roseneau (1990, 1997) was probably the first theoretician to fully and in sophisticated academic level

discuss the theme, which, today, already accumulates a large bibliography. The general idea was that globalization was causing the nation-states to lose relevance, while a large number of other global actors, beginning with international financial institutions, passing by non-profit organizations constituting a global civil society, and ending in the multinational business enterprises, were creating a network that effectively governed the world. In other words, the world was changing from international into global. I am not going to discuss here this idea which I understand to be moderately based on reality and strongly charged of ideology. There is no doubt that since World War II mankind is gradually building an International Political System under the umbrella of the United Nations, that should not be confused with this fuzzy governance concept; it is also true that some kind of global civil society is emerging; but the idea that nation-states lost relevance because became more interdependent is a way through which developed countries try to check the competition coming from cheap labor middle income countries rather than a reality. In fact, greater interdependence among nation-states make them more directly competitive in the global arenas, and, thus, more strategic, not less.

On its turn, economic global governance is the transposition of the concept for the world level economic problems that nation-states face today. Since the major actors are by far the nation-states, we should speak of international economic governance rather than global economic governance. Independently however of the word that we use – international or global – what we see today is that world economic governance is precarious. First, because in so far as their respective nation-states are involved in intense international competitions, the respective national governments are not able to cooperate effectively and coordinate actions, thus, avoiding major crisis; second, because a fundamentalist belief in a self-regulating market prevents the necessary actions; third, because the differences of powers and levels of development among national states remain substantial, opening room for hegemonic patterns;[1] fourth, because old and new forms of economic populism – particularly exchange

[1] I could say 'imperialist' but I say 'hegemonic' just to distinguish classical imperialism, which implied colonies and direct economic pressures, from modern 'hegemony' or 'hegemonism', which uses ideological hegemony as a main instrument of domination. It is interesting to note that the word is used by Americans, but was first utilized by Gramsci to mean domestic ideological domination.

rate populism – plague poor and rich countries economic policies.[2] The first two causes make global economic governance ineffective in so far as it is unable to coordinate actions; the two later make the system unjust and instable, tending to balance of payment crises.

In this paper, my central question is to know if international economic governance really holds in the world today, or disgovernance is a better word to express present reality. Global governance per se is inexistent, since only nation states and the formal international organizations play relevant roles, but is international economic governance a fact or disgovernance is a word that better depicts what is happening? Do we see coordinated macroeconomic policies around the world, or, at least, among the rich countries, or what we see today are deep unbalances, a looming crisis, and an uncertain future? If this is so: why? Which are the immediate and particularly the structural and institutional causes behind? In order to answer these questions, I will focus my attention in the exchange rate and in the current account. My argument in this paper is that the world does not really count with economic global governance. We rather have global disgovernance, given the recurrent crises in the developing countries, and the huge current account deficit in the United States. Their direct causes are obviously poor macroeconomic policies on the part of all national actors. Their more indirect causes, however, lie in economic populism, or more specifically, in exchange rate populism, and in the recommendation to adopt the strategy of growth with foreign savings that rich countries have being giving to middle income ones. Economic populism is not surprising in developing countries, where societies are poorly organized, and elites are often corrupt. It is surprising, however, in the case of US. Yet, I will suggest some reasons why fiscal and exchange rate populism is today a real problem to this country. In the first session, I will make a brief survey of the previous attempts to create an international economic governance; in the second session, I will discuss the 'emerging markets' crises of the 1970s and particularly of the 1990s, and relate them with the strategy of growth with foreign savings; in the third, I will discuss the current account unbalance in the US and look for its indirect causes into exchange rate populism, and in the political and social retrocession

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[2] Observe that I am speaking of 'economic', not of 'political' populism. Economic populism takes place when wither the state organization or the nation-state, to expend more than it gets, incurring respectively in chronic budget deficits or in current account deficits; political

that this country is experiencing since World War II, probably as a consequence of the emergence of an aggressive individualism, which rejects the notion of the public and deprives it from the unique moral and political criterion adopted by modern secular societies.

Short update

In a relatively recent past, world economy counted with a governance system. It was clearly an international governance system, not a global one. It was created in 1944, in the Bretton Woods Conference. Its well-known objective was to set an economic governance system based on fixed exchange rates, where the IMF would play the role of chief financial controller and bank of last resource. We may say that the system was fragile and incomplete: that its main shortcoming was the prevalence of the US' approach to the problem over the proposal made by Keynes. The fact, however, is that we witnessed its demise in 1971, when the dollar floated. Since then, country after country, with the exception of some Asian economies, liberalized in several degrees their international flows and engaged in some sort of exchange rate floating.

With the floating of national currencies and the great increase in capital flows, the central Bretton Woods institution, the IMF, lost relevance as a lender of last resource, and ended-up being just a watchdog for the Washington authorities in relation to developing countries. It lost relevance and credibility not only because its reserves were small in comparison with the debts that certain countries were able to achieve in the international financial market, but also because it proved to be an increasingly mistaken policy, in relation to developing countries, to grow with foreign savings, i.e., with current account deficits. Such strategy appeared for the first time in the 1970s, responding to the possibility and need of recycling the large international reserves accumulated by the oil producing countries after the 1973 first oil shock. In the end of that decade, a second oil shock, coupled with inflation in the US and a huge increase in the international interest rates, led a large number of developing

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populism is essentially the practice of charismatic politicians of speaking directly to the people without the intermediation of political parties.

countries – the ones heavily indebted[3] – to default: a default which was not decided by them, but by the creditor banks that, one by one, suspended the rollover of the debts. This crisis, besides involving enormous costs for the developing countries (they are up to today paying the price of this crisis with decreased rates of growth), represented a threat to the large international banks, and, so, a risk to the developed economies. Given the threat, their finance ministers, led by the US Treasury, and having as agents the IMF and the World Bank, demonstrated an outstanding capacity of coordination. They gave full support to their banks, and imposed to the highly indebted countries not only necessary fiscal and exchange rate adjustments but also practically the full payment of the debt.[4] The 1985 Baker Plan is usually presented as an example of this coordination, but actually it started before, when the debt crisis broke-down, and was informal rather than formal.

The formal coordination of the world economy was, first, assumed by the G-5 and later by the G-7 – informal institutional devices putting together the finance ministers of the rich countries. They had some successes in coordinating the world economy in the 1980s, when they had to face two major financial problems: the developing countries debt crisis, and the overvaluation of the dollar. These two problems were new: since the 1930s the world economy did not face similar challenges. The latter problem was successfully tackled in 1985, with the Plaza Agreement, and involved a coordinated action by the major central banks. Such coordination was relative, but it was sufficient to cause the desired depreciation of dollar, and the elimination of the US current account deficit. The great winner with this agreement was the US that equilibrated its current account, rescued the dollar, and assured the continuance of its role as the world reserve money, without incurring in the rise of inflation; the major looser, Japan – the country that had based its growth on a relatively devaluated exchange rate. The coordination of macroeconomic policies continued with the Louvre Accord, in 1986, but the agreed reference indicators soon collapsed.

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[3] With exception of Colombia, which was not indebted, but had the rollover of its credit suspended.

[4] I participated directly from this crisis as finance minister of Brazil in 1987. For an account of this experience and also of the proposal that I made at that time with the technical support of First Boston and Warburg banks, see "A Turning Point in the Debt Crisis" (Bresser-Pereira, 1999).

It is difficult to deny the success of the Plaza Agreements. Not only because they were effective in achieving the stated objectives, but also for a question of correspondence: if countries are supposed to make macroeconomic policy, there is no reason why the world should not. Yet, immediately after the agreements, the classical argument that the devaluation of the dollar would take place anyway was presented: market forces would correct the situation (Feldstein, 1988: 1 and 5; Frenkel and Rocket, 1988). Feldstein was strong in his opposition to exchange rate and more broadly macroeconomic policy cooperation: "I believe that the pursuit of exchange rate goals is likely to be both futile and economically damaging". Why? Because, given the difficulties in putting together different nation-states, "the attempt to pursue coordination in a wide range of macroeconomic policies is likely to result in disagreements and disappointments", and given the assumption that the dollar would anyway continue to decline "because the future trade deficit implied by the dollar's current level would be too large to finance otherwise", the agreements would be anyway meaningless.

The obvious difficulties involved in international coordination coupled with these critiques probably explain the demise of international macroeconomic policy coordination in the 1990s. A third explanation, however, is less well-known: the theoretical support for large current account deficits in the developing countries. If the US' Treasury, through the IMF and the World Bank, was, since the early 1990s, advising these countries to engage in a growth *cum* foreign savings strategy and opening of the capital accounts, it made little sense to think in coordinate exchange rates: at least the exchange rate of the developing countries which accepted that strategy would necessarily get out of balance (here understood a balanced exchange rate just as the one that assures a current account around zero): they would have to be overvalued for the duration of the strategy.[5] This in fact happened, and, not surprisingly, that decade was marked by huge financial crises. Now, in the first half of the 2000s, another major unbalance threatens international finances: the dollar again appreciated dangerously in relation particularly to East and South-east Asian currencies, and the American current account deficit achieves new records. Given these facts, it is understandable that one can

[5] I know that the concept of what is the equilibrium exchange rate is a theme open to huge academic debate. Here I am just proposing a pragmatic and simple criterion to define what is a 'balanced exchange rate', assuming that this is less demanding than the 'equilibrium exchange rate' concept.

doubt on the existence of global economic governance. Instead, what they suggest is global economic 'disgovernance', or a major global economic unbalance. If this is so, which are the data that support such unbalance? Which are its causes? And which are the tendencies from now on?

The 1990s crises and the strategy of growth with foreign savings

I will start by the balance of payment crises that hit middle income developing economies in the 1990s and early 2000s. They began with the Mexico 1994 crisis; followed by the Asian 1997, the Russian early 1998, the Brazilian late 1998, and finally the Argentinean 2002. In this way, these economies, which had just experienced the major 1980s' debt crises, were again facing similar problems. The failure of the international regime established in 1971, and the incapacity of IMF to face it, became evident. Yet, while in the case of the abandonment of the Bretton Woods fixed rates, one can argue that it was inevitable – that the exchange rate regime in a world so integrated commercial and financially would not be either fix, as Keynesians would like, or floating, as neoclassical economists dream, but managed, as they actually are (Bresser-Pereira, 2004) –, in the case of the IMF the failure was evident: actually this organization contributed actively for the 1990s crises.

Although they were loosely called financial crises, they were specifically balance of payment crises, because they involved the suspension by the creditors of the rollover of debts.[6] They were directly related to heavy foreign indebtedness and/or with large current account deficits, increasing loss of credit and credibility, and, in a trigger point, the suspension by foreign creditors of the refinancing of their international debts – public or private. Yet, as the countries also faced fiscal deficits, the current conventional wisdom at IMF and the World Bank attributes the balance of payment crises to fiscal unbalance. This was a convenient approach because it reaffirmed the belief that all problems were originated in the public sector, and coupled with the argument of the twin deficits, because it permitted that international and local authorities did not concern themselves with the increasing current

[6] Financial crises *stricto senso* are banking and financial markets crises. Debt crises are also financial, but I prefer to call them balance of payment crises to indicate its specific nature.

account deficits. On the contrary, they were definitely not concerned, in so far as since the early 1990s, while the Brady Plan was straightening out the debt crisis, a new wave of loans for the now called 'emerging markets' was taking place, and Washington came to what I called 'the Second Washington Consensus': the consensus that legitimated the opening of the financial accounts and the growth *cum* foreign savings strategy.[7]

Table 1 – Asian Crisis: Current Account Balances 1995-1999 (billions of U.S. dollars)

	1995	1996	1997	1998	1999
Indonesia	-6,4	-7,7	-4,9	+4,1	+5,8
Korea	-8,7	-23,2	-8,4	+40,4	+24,5
Malaysia	-8,6	-4,5	-5,9	+9,5	+12,6
Philippines	-2,0	-4,0	-4,4	+1,5	+7,2
Thailand	-13,5	-14,7	-3,0	+14,2	+12,4

Source: World Development Indicators Database

Table 2 – Asian Crisis: Current Account Balances 1995-1999 (% of Exports)

	1995	1996	1997	1998	1999
Indonesia	-12,10	-13,56	-7,75	+7,48	+10,39
Korea	-5,89	-15,12	-5,09	+25,60	+14,25
Malaysia	-10,31	-4,89	-6,32	+11,39	+13,13
Philippines	-7,46	-11,94	-10,89	+4,05	+18,46
Thailand	-19,20	-20,59	-4,14	+21,55	+17,37

Source: World Development Indicators Database.

[7] The first consensus, defined by John Williamson, did not include the opening of the capital accounts, and strategy of growth with foreign savings. This strategy was defined by the US Treasury in the beginning of the Clinton administration (Bresser-Pereira and Varela, 2004).

In the case of the Asian crisis, however, this kind of explanation soon revealed to lack empirical support: while these countries showed reasonably balanced fiscal accounts, foreign indebtedness and large current account deficits were again the main causes. As Joseph Stiglitz (2002: 99) remarks, "the countries in East Asia had no need for additional capital, given their high savings rate, but still capital account liberalization was pushed on theses countries in the late 1980s and early 1990s. I believe that capital account liberalization was the single most important factor leading to the crisis" To this it is necessary to add the fact that banks financed speculative and irresponsible real state investments – a specifically financial aspect of the crises. As in the case of the Latin America crisis, the trigger point was the suspension of international credit, thus configuring a typical balance of payment crisis. Tables 1 and 2 summarize the current account deficits of the countries just before the crisis. They also show the current account surpluses just after the crisis – surpluses that show that these countries learned the lesson fast. As a background note prepared, just after the crisis, by the UNCTAD Secretariat (1998) asserts:

> Although different influences have been at play in different countries in the region, a common feature is that the crisis has its origin in the private sector and has taken the form of a major market failure. One can describe it either as excessive borrowing abroad by the private sector, or as excessive lending by international financial markets. In any case, as pointed out by Alan Greenspan, Chairman of the US Federal Reserve Board, it is clear that more investment monies flowed into these economies than could be profitably employed at modest risk.

In all cases, the crises had behind the conventional economics' strategy of growth with foreign savings, i.e., with current account deficits, which caused the overvaluation of the local currencies, and easily developed into balance of payment crises. If the current account deficits had been kept rigorously under control, avoiding the increase of the debt/export ratio, the crises could had been avoided, but the relative appreciation of the local currencies (in relation to an 'equilibrium level' where the current account is zero) and the resulting substitution of foreign for domestic savings would still prevail, causing long term burdens in terms of resource outflows in the form of interests and dividends which were not proportional to the 'net' investment originated from the foreign savings.

Thus, I am suggesting that IMF played an active role in stimulating foreign indebtedness and in not criticizing current account deficits. This is particularly true in the cases of the Mexican 1994, Brazilian 1998, and Argentinean 2002 crises. Contradictorily and

pathetically, the IMF – that was well known for its 'orthodox', 'tough', demanding policies (and often criticized for that reason) – showed a surprising lenience in the case of the current account deficits: actually supported exchange rate populism. The explanation behind is its allegiance to the US' sponsorship of the strategy of growth with foreign savings.[8] It was this strategy that, since the 1970s, replaced the law of comparative advantages in neutralizing possible competition originated in developing countries , or, in other words, in 'kicking away the ladder' that they were using to grow. In the 1970s, with the emergence of the first NICs (newly industrialized countries), the rich world understood that its anti-protectionist strategy had become exhausted (now they needed protection), and concluded that the law of comparative advantage had now little use for them. Given the new conditions, they gradually realized that the growth *cum* foreign savings strategy, coupled with the opening of capital accounts and with the protection of property rights, could play the role of checking the threat represented by the middle income developing economies. Countries were advised to incur in current account deficits and finance them with foreign borrowing or with foreign direct investment. Growth was transformed into a competition among developing countries to obtain more credibility and more foreign savings. Yet, as foreign loans or investments implied evaluation of the exchange rate and the increase in consumption, there was a massive substitution of foreign for domestic savings, and little or no growth in the rates of capital accumulation and in the GDP growth rates. Foreign debt, however, increased and eventually explained the balance of payment crises in the 1990s.

This explanation for the 1990s crises, based on current account deficits and high foreign indebtedness, is different from the conventional 'fiscal deficit explanation' and from its derivatives. Alves Junior, Ferrari Filho and Paula (2004) listed the conventional models explaining exchange rate or balance of payment crises, all based on the hypotheses of 'efficient markets' and on disequilibria in the public sector. The first generation models explain the crises directly with the fiscal deficits; the second generation models add the games

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[8] This strategy was more formally formulated when Laurence Summers was Under-secretary of the Treasury, in the Clinton Administration. I have been working on the critique of such strategy for several years (Bresser-Pereira e Nakano, 2002; Bresser-Pereira e Varela, 2004; Bresser-Pereira e Gala, 2005), because I believe that to reject it is today as important for middle income developing countries as it was to criticize the law of comparative advantages in the beginning of their industrialization.

that economic authorities are engaged in when they face crisis and have to decide if they will maintain the exchange rate fix or float it; the third generation models include the argument classically adopted by Keynesian economics: the unregulated and speculative character of financial institutions. The foreign indebtedness explanation for the 1990s crises is also different from the Post Keynesian, or of the Regulation School explanation, which emphasizes the uncertainty and fragility of financial markets, and rejects the hypothesis of efficient markets.[9] They are correct in rejecting the efficient markets hypothesis, and in emphasizing the speculative character of financial markets. These are well-known characteristics. Yet, in most cases, financial fragility and speculation will not lead to balance of payment crises if the country has an effective policy of limiting current account deficits and foreign indebtedness: not only public but also private indebtedness. In other words, if a country has sound fundamentals (particularly a moderate foreign debt and small or negative current account deficits, a moderate public debt and small budget deficits) it is unlikely that it will get into a balance of payment crisis. There are some famous cases of countries having sound fundamentals and falling in crisis, but they are obviously exceptions. Usually the crises involve fundamentals. They may have a fiscal origin, but, since the 1970s, they are strongly related to foreign indebtedness – a foreign indebtedness perversely stimulated by the Washington authorities and the New York financial markets. Despite historical experience shows that presently developed countries developed used principally domestic savings, developing countries are encouraged to walk in the border of the abysm of high foreign indebtedness, which would be their 'natural' condition, but the wise counselors do not fail to recommend them to be careful and not fall. The worse, in this game, is that there is no advantage in walking in the border of the abysm. Even if the country controls its current account deficits and its total indebtedness, and is not caught into crises, its growth performance will be impaired by that fact that the capital inflows evaluate the domestic currency, cause the increase in real wages and in domestic consumption, and the substitution of foreign for domestic savings.[10]

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[9] For a comprehensive exposition of the Post Keynesian view, see Davidson, 2002; for the Regulation School view, see Aglietta (2002).

[10] For the formal critique of the strategy of growth with foreign savings see Bresser-Pereira and Gala, 2005.

The US' current account

After the 1997 and 1998 crises, the American Treasury and the IMF probably changed some of their more radical views on the subject, but conserved their main assumptions and goals. On the other hand, no governance or institutional solution was presented to this problem at international level. In its report, the Meltzer Commission (1999), which was created by the US Congress to study the problem, suggested that the IMF should act as a lender of last resort. The countries meeting certain *ex ante* conditions for solvency would be eligible for automatic financing, no additional conditionalities or negotiations being required. Yet, as the UNCTAD's 2001 *World Trade Report* (p. 72) pointed out, "without discretion to create its own liquidity, the Fund would have to rely on major industrial countries to secure the funds needed for such operations. In such circumstances it is highly questionable whether it would really be able to act as an impartial lender of last resort, analogous to a national central bank, since its decisions and resources would depend on the consent of its major shareholders, who are typically creditors". That was all. The idea of restructuring the architecture of global economic governance was discarded.

Like the Asian countries, the Latin American also learned partially the lesson, and, as we can see in Tables 3 and 4, they stopped to incur in huge current account deficits. All the signals, however, are that the US didn't. Contradictorily, if not pathetically, the country that so adamantly persuaded developing countries to engage in the growth *cum* foreign savings strategy – a strategy that did not consult the recipient countries' national interest – got itself prisoner of such disastrous proposal. While the Asian and the Latin American countries were recovering from their crises, the United States has been caught by huge budget deficits and extremely high current account deficits. These deficits are absolute records, and are transforming the United States, the richest and more powerful nation-state in the world, into a 'debtor nation'. According to William R. Cline, who wrote a book with that title (2005: 1), "The [current account] deficit is larger than at any other time in the 135 years for which data are available". The data that he presents show that after a period between 1869 and 1914 that was characterized by deficits being compensated by surpluses, the United States economy experimented a long period of current account surpluses that run up to the early 1980s. From this moment on, we have a first major fall between 1982 and 1987, current account deficits

reaching 3.4% of GDP, a recovery up to 1992, and, since then an increasing deficit which reached 6% of GDP in 2004, and today is around 7% of GDP. As Tables 3 and 4 show, in 2004 the US$ 665.9 billion current account deficit represented 58% of exports.

This is definitely a serious problem. Some authors insist in disregarding the problem, with the argument that despite having become a debtor country, the spread of returns between those earned by US residents on their investments abroad and the average yield of foreign investments in the United States is large.[11] This fact plus the revaluation effects of the 2002-03 depreciation have been neutralizing the financial costs of the negative net international position, but it does no change essentially the picture. If we understand that in the present unbalance of the American economy there is a stock and a flow aspect – the foreign debt and the current account deficit – this argument really reduces the weight of the net debt, but does not reduces the fact that the current account is highly in deficit despite the higher return on US foreign investments. There is another argument, which is mostly shared by governors of the Federal Reserve Bank.[12] According to this argument, which is more explicit and more arrogant in its disregard for the foreign account deficits, the deficit is not US's fault, but the fault of the countries that have depreciated currencies. As *The Economist* reported (April 28th 2005), "lately almost all the governors of America's Federal Reserve have made speeches on the country's current-account deficit, now 6.3% of GDP and rising. Several have sounded remarkably relaxed. Yes, they say, the gap's big, but it's not America's fault; most likely, it will be closed without too much trouble". Thus, adjustment will have to be proceeded by others, not by the US.

The United States will probably remain the great economic and political power for many years, but it will be a declining power in so far the dollar will tend increasingly to lose its position as international reserve, probably to the euro. As James Galbraith wrote, "for decades, the Western World tolerated the 'exorbitant privilege' of a dollar-reserve economy

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[11] See, for instance, Hausmann and Sturzenegger (2005). According to these two authors, in 2004 the net foreign income was US$30bn, a number similar to the one in 1980, despite the fact that between 1980 and 1994 the US accumulated a current account deficit of US$4,500bn. We should, however, keep in mind that despite this positive US$30bn net figure, the US current account deficit in 2004 was US$665,9bn, as we can see in Table 3.

because the United States was the indispensable power, providing reliable security against communism and insurrection without intolerable violence or oppression, thus conditions under which many countries on this side of the Iron Curtain grew and prospered. Those rationales evaporated 15 years ago, and the 'Global War on Terror' is not a persuasive replacement. Thus, what was once a grudging bargain with the world's stabilizing hegemon country is now widely seen as a lingering subsidy for a predator state." The assumption that the rest of the world, particularly the Asian dynamic countries, will continue to finance the United States indefinitely, and that what we have now is just a 'new Bretton-Woods' (Dooley, Folkerts-Landau and Garber, 2003) is just not realistic. These countries will be interested in financing the United States and in increasing reserves in so far as this strategy checks the appreciation of their currencies and keeps their export-led economies growing fast.[13] But there are limits for such strategy – limits on the part of these countries, which are seeing the fragility of the American economy, limits on the part of the United States. They are seeing that the debt situation of the country is deteriorating, and that no actions are being taking to correct such trend. As Jarret remarks (2005: 14), "baseline projections of what would happen to the external accounts in the coming years absent any change in the dollar vary significantly, but show a rapid widening of the deficit". Thus, it is becoming increasingly clear that the total 'transition costs' in postponing adjustment are steadily increasing. If the decision to adjust is taken at an early stage, net transition costs will probably be high, but, as a trade-off, the economy will sooner return to stability and growth: total transition costs will be smaller. To try to indefinitely postpone adjustment will normally end up into a major crisis which will impose it.[14]

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[12] Not by Greenspan, but notably by the new president of the Federal Reserve Bank, Ben S. Bernanke (2005).

[13] More recently these three authors Dooley, Folkerts-Landau and Garber, 2005) came with claim that, contrarily to the 'conventional analysis", the US current account deficit is also no cause of concern because the euro is supposed to appreciate in relation to the dollar, and, in a second moment, the euro and the dollar will appreciate relative to renmimbi, but these are just predictions. Eventually this will happen, but probably in a troubling way, not in the smooth way that the authors suppose.

[14] On the concept of net and total transition costs, see Bresser-Pereira and Abud (1997).

Table 3 – Current Account Balance 1999-2004 by regions (billions of U.S. dollars)

	1999	2000	2001	2002	2003	2004
USA	-296,8	-413,4	-385,7	-473,9	-530,7	-665,9
European Union[1]	+21,0	+5,3	+18,9	+62,7	+97,5	+88,5[4]
Latin America[2]	-57,0	-58,4	-53,4	-21,1	-3,5	+4,2[5]
Dynamic Asian[3]	+236,1	+241,1	+186,9	+234,2	+295,6	+386,4[4]
Oil exporters [4]	+15,9	+66,7	+45,8	+48,2	+77,2	+118,6
Other countries	+88,0	+165,0	+188,8	+154,3	+67,2	+71,5

Sources: *World Development Indicators Database* and www.cepal.org. Observations: 1. European 15 plus Switzerland. 2). Excludes Venezuela; 3. Japan, China, India, Korea, Indonesia, Thailand, Malaysia, Singapore, Philippines and Vietnam, and Russia; 4. Venezuela, Norway, Kuwait and Saudi Arabia; 5. Estimates.

Table 4 – Current Account Balance 1999-2004 by regions (% of exports)

	1999	2000	2001	2002	2003	2004
USA	-30,72	-38,60	-38,31	-48,56	-52,00	-58,05
European Union	+0,72	+0,18	+0,63	+1,97	+2,58	+2,08[4]
Latin America	-17,77	-15,63	-14,69	-5,77	-0,88	+0,87[4]
Dynamic Asian	+16,58	+14,20	+11,93	+13,80	+14,67	+15,70[4]
Oil exporters	+10,30	+30,88	+23,36	+24,00	+31,81	+37,72

Sources: *World Development Indicators Database* and www.cepal.org. Observations: See Table 3.

The structural and political economy causes behind

I will not discuss the prospects of this major current account deficit. The literature on the subject is already extensive, authors dividing themselves between pessimists, who believe in a 'hard landing', and optimists, predicting a 'soft landing'. On this subject, it should only be remembered that there is an important difference between the 1985 and the present unbalance. At that time, the supremacy of the dollar was not been questioned, today it is. Additionally, at that time the United States was a net creditor internationally, today it is a net debtor: from a

US$ 298 billions net positive position in 1983, it went to a US$ 2430 billions negative net position in 2003 (Nonnenberg, 2005). Also I will not discuss the remedies for the crises. Although the United States government (Congress and Treasury) insists in attributing the problem to an 'artificially depreciated' Chinese currency, the fact is that the Chinese surplus explains only a small part of the United States deficit. Actually, the required American macroeconomic adjustment will involve fiscal adjustment plus the dollar depreciation. Just fiscal adjustment will probably not be enough: when the Clinton administration reached equilibrium in the fiscal account, the current account was still showing a deficit.

What I will do is to ask the political economy behind. On the part of the United States, the direct causes of the current account deficit are implied in the remedies: fiscal profligacy and an overvalued dollar. On the part of the rest of the world, the explanation is China's relatively depreciated currency, and the other Asian dynamic countries' still more depreciated currencies (since China has a large trade surplus with the United States, but a deficit with its neighbours). Yet, a new and major factor in explaining the increase of the current account deficit in 2005 (which it is running around US 800 billion) is the sharp increase in oil prices. According to IMF estimates, this year the current account surplus of the oil producers could reach US$ 400 billions against US$ 200 billions two years before[15]. Only Saudi Arabia is expected to have an average surplus of US$ 100 billion, corresponding to 32% of its GDP, against China's surplus that will be just 6% of GDP.[16]

In a conference on the political economy of global governance, the relevant causes of looming crisis are the ones behind theses direct causes. In relation to this, the central question is why the United States, that is facing for several years relatively devalued Asian currencies, and that is now confronting a major oil shock, was not able to act in time to avoid the build up of such huge foreign account unbalance? My argument is that there are two causes internal to the country which, combined, become particularly powerful. The first cause is rather a structural than a political economy cause. In a reference to the 'curse of natural resources', which plague particularly the oil producing countries, I will call this cause the 'curse of

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[15] The difference between this figure and the corresponding 2004 figure in Table 3 is consequence of a smaller number of oil producers in this table.
[16] *The Economist,* November 12th 2005: "Recycling the Petrodollars": 75-77.

having a currency as international reserve'. Usually this is viewed not as a curse but as a blessing. A country that possesses such a valuable currency, first, is able to borrow in its own currency; second, it can borrow at a very low cost. This is certainly true, but, as a trade-off, the incentive to consume too much, to save too little, and to borrow irresponsibly is strong. Not only because the costs involved in foreign borrowing are small, but also because the prestige of the national currency will push it up, will help to appreciate it. If the economic authorities are not vigilant, actively promoting investment instead of consumption, and actively managing the national currency, the tendency will be toward increasing foreign indebtedness. Given, however, the market fundamentalism that dominates the United States administrations since the 1980s, such vigilance and management are improbable.

Combined with this structural cause there is a strictly political economy cause: 'exchange rate populism'. In developing countries this is a well-known practice which was first detected by a distinguished Argentinean economist, Adolfo Canitrot (1975).[17] Can it be applied to a developed country like the United States – a country that, through the IMF, has been consistently criticizing fiscal populism? My answer is yes, for two reasons. First, because fiscal populism is a well-discussed phenomenon, but exchange rate populism is not. Although the concept of exchange rate populism is already present in Canitrot's classical paper, this paper is poorly known in the North. Additionally, the expression 'exchange rate populism' is new: it was probably used for the first time in 2002.[18] If fiscal populism is the state apparatus to expend more than it gets, exchange rate populism is the nation-state to expend more than it gets. Second, because Americans resist the idea that economic populism can be applied to their government. Yet, since the end of World War II, United States is experiencing a worrying political retrocession which makes it prone to both kinds of populism. In relation to exchange rate populism, the objective evidence is that the large current account deficits in the 1980s and the 2000s were associated to two populist administrations: the Reagan and the George W. Bush administrations. Such administrations were not fruit of hazard, however. While the United States continues to grow in economic and

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[17] Besides Canitrot, the classical papers on the subject are O'Donnell's (1978), Dias-Alejandro (1981) and Sachs (1989). All these papers are republished in Bresser-Pereira, ed. (1991).

[18] Bresser-Pereira and Nakano (2002).

technical terms, the political and social retrenchment is becoming increasingly evident. Increasing income concentration is the combined outcome of the technology of information revolution which reduced the demand for unskilled labor while increasing the demand for skilled and managerial labor, of the imports of industrial goods from cheap labor developing countries, and of the immigration coming from the South.[19] The existence of a large number of citizens excluded from the benefits of economic growth remembers developing countries like Brazil. For that reason, the pejorative expression 'Brazilianization' is increasingly applied to the United States. It is also applied to Europe, but the situation there is less disquieting: income is substantially less concentrated, social rights are more universally guaranteed, and elections depend less on money.

The fact is that, in the aftermath of World War II, the United States was the example of democracy for the world, and President Roosevelt, with the New Deal, had put the United States ahead of all other countries in the protection of the poor. Today, this is over. Why? To answer this question is still more difficult, but probably a large part is related to the aggressive individualism which took hold of the American society since the war. For some time, in the 1960s, not only the utopian but principally the republican values that were behind the Founding Fathers of the American republic, seemed to hold. But already at that time an individualist and neo-liberal (or ultra-liberal, the opposite of what Americans call 'liberal') ideological wave was taking hold of hearts and minds. Sophisticated economists and philosophers like Buchanan, Olson, Friedman, Nozick, proposing 'public choice', 'the impossibility of collective action in large organizations', the 'freedom to choose', or 'the minimum state', were not just defending market fundamentalism, but preaching radical individualism and denying the existence and relevance of the public interest as an effective motivation for public action. This was a serious thing. When they were rejecting the public interest, they were automatically rejecting democratic politics which can only survive when politicians and public officials have as one of their motivating forces the fight for the public

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[19] A recent study by the Bureau of the Budget of the US Congress shows that, in the US, the income of Latin American immigrants working in construction, textiles, maintenance operations, catering and restaurants are 50% smaller than the ones paid to Americans for the same jobs. Only in the last decade, the number of immigrant workers increased from 13 to 21 millions. Such growth represented half of the growth of the labor force in that period. (*Valor* [*Financial Times*] November 15, 2005).

interest. Only based on considerations of the public interest politicians were able to lead the liberal social contract of the nineteenth century which limited the abuses of the authoritarian state, and the democratic contract of the twentieth century which established some limits to robber barons' capitalism. The moral consequences of this denial over secular capitalist societies as ours are catastrophic. In the religious societies of the past, salvation and revelation offered moral criteria to subjects. In modern secular societies, however, when the public interest or the common good is discarded of political life, citizens immediately cease to have a public and moral criterion to follow. The only things that are valued are the private interests, and the only rule to follow is the one of the market: to compete while simultaneously searching for monopolistic advantages. In this framework, public and social life is reduced to the market. The brute forces of capitalism – injustice, greed, corruption, and disregard for the natural environment – take hold of everything. This danger was present since capitalism became dominant in Great Britain, and since then men and women are trying to keep it under control using as tool the republican concept of public interest. In the seventeenth century, within the realm of the absolute state, was rising a new and noble activity, politics – republican and democratic politics – whose role would be to limit the excesses either of the absolute state or of the greedy market. The political history of the liberal state of the nineteenth century, and of the democratic state of the twentieth century is the history of the endeavor of republican individuals fighting to curb the absolutism of the state and the excesses of the market. In the second part of the twentieth century, however, such republican conviction grew weaker and weaker in the United States, what opened room was for all types of individualist if not cynical behaviors and theories. The disorganizing and demoralizing consequences of this type of individualism are powerful and, probably help to explain the political and social retrocession in the United States, and the fact that governments are again recurring to populist practices without being punished in the elections.

The logic behind globalization

Summing up, the huge current account deficit of the United States and the current account deficits of the middle income developing countries in the 1970s and again in the 1990s have exchange rate populism behind. But, in the times of globalization, the later ones respond also

to a strategy of domination: the growth *cum* foreign savings strategy. While, within the United States, economic populism is just a demand of society that self-interested politicians supply, in the case of developing countries' current account deficits and balance of payment crises, beside self-interested and populist local politicians, we have another cause: a hegemonic power giving counsels, making recommendations and imposing conditionalities through international financial institutions.[20] Yet, such imperial strategy involved a non-predicted boomerang effect. Since the Breton-Woods agreements, the United States believed that it could exert almost alone the leadership of financial international system. After the dollar floated, and the agreements were buried, the United States continued to believe that it would be able to keep untouched its control of the system. The market – the supposed self-regulating market – would facilitate the job. Thus, the United States always rejected any attempt to create a more organized and structured international financial system, where a vigilance on the exchange rates could be exerted. Instead, their different administrations preferred, first, to assume that the United States itself, with its sound macroeconomic policies, would be a source of rationality; second, that they would count with the support of the other developed countries, whose problems were similar to the ones they face; third, that IMF and the World Bank, with their present mandates, and duly controlled by the U.S. Treasury, would be sufficient to keep the whole system under control – particularly the populist developing economies. But the problem that United States and the other rich countries faced in relation to these economies was not only their 'populism' or their 'nationalism': it was also the economic threat that they represented since the instant that they began to export manufactured goods. To neutralize such threat, they proposed that these countries adopted the growth *cum* foreign savings strategy and opening of capital accounts, and that they accepted globalization not as a fact but as an ideology – the ideology that nation states had become irrelevant in the 'borderless society'.

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[20] Americans prefer to call their country the 'benevolent hegemon', but we know well that all countries that achieve economic and military dominance tend to act in imperial forms in relation to others, i.e., they tend to protect their interests at the costs of the others' interests using their greater power. The forms under which this power is exerted change. In the past, the use of force and direct exploitation was the norm, in present days it is essentially ideological, and is conveyed through recommendations and pressures for weaker countries to adopt policies that do not consult their national interests.

Such strategy, however, had a first disastrous consequence for the developing countries while it represented a threat for the rich ones. The 1980s foreign debt crisis constrained the United States to organize a quasi-cartel of creditors to defend their commercial banks. In the 1990s, when the growth *cum* foreign savings strategy was repeated, the first major crisis – the Mexican 1994 crisis – represented a threat to the American economy, and constrained the United States government to intervene with huge sums which the IMF did not have. As Paul Davidson (2002: 200) remarks, "the Mexican crisis spilled over into the dollar problem… the dollar was initially dragged down by the peso". The other crises were also disastrous for the developing countries which endured them, and threatening for the rich ones. The present crisis or threat of crisis represented by the American current-account deficit and the increasing foreign debt is a consequence of exchange rate populism combined with arrogant belief that the United States has become so powerful after the collapse of communism that it could permit itself everything.

What we really have behind the present global economic disgovernance is a combination of lax exchange rate policies, economic populism, and a mistaken strategy in relation to medium income developing countries. Such combination presents six major problems. First, the crises provoked by the growth *cum* foreign savings strategy, in the countries which obediently adopted it, were greater than it was expected: the idea was to limit their exports and increase the dollar income of the profits made by multinational enterprises in those countries, not to cause crises. Second, the dynamic Asian countries did not believe in that strategy, and profited the opportunity to devise an opposite strategy of growth *cum* negative foreign savings. In this way, they were able to maintain their exchange rates relatively depreciated, and kept going their export-led strategies even if productivity gains did not legitimate it. Third, the current account surplus achieved by the Asian countries turned viable the maintenance of high levels of domestic consumption and increasing current deficits in the United States. Fourth, the sharp 2005 increase in oil prices and the enormous trade surpluses that the oil producers are experiencing are accentuating the current account disequilibria. Fifth, the market efficiency assumption, the idea that markets are self-regulating is proving once again just ideological. Sixth, practice did not corroborate the assumed rationality on the part of the macroeconomic policies adopted by the US Treasury and the Federal Reserve. Mr. Greenspan ended his eighteen years as chairman of the Federal Reserve

Bank widely acclaimed by the competence and flexibility that he employed in managing the institution – and I subscribe such prize, particularly in relation to his management of the interest rate – but it was above his powers to prevent the policy mistakes which led to the dangerous situation which the American and the world economies are today.

Proposals? I share with many the belief that a better architecture of the international financial system is required. The United States must recover control over its budget deficit, and depreciate the dollar. The IMF must stop being governed by stock holders and start being a real multilateral organization, and must have the necessary resources to act as a real lender of last resource. Exchange rates and current account deficits must be more closely followed; their equilibrium must be seen not as depending of the market forces alone, but of a combination of such forces with competent macroeconomic management. Developing countries must recover control over their capital accounts, keep control of their fiscal accounts, and limit foreign borrowing. There is no heterodoxy here. Heterodox or unusual is my attribution of the developing countries crises to the growth *cum* foreign savings strategy, not the recommendation of prudence. Competent economists such as John Williamson (2005) and Barry Eichengreen (2003), for instance, are saying similar things. While the more general policies are not adopted, however, what developing countries should learn is that growth is made essentially with domestic resources – that capital is made at home, with domestic savings; that foreign savings are desirable only in special occasions, when the domestic investment opportunities, expressed in high expected profit rates, hamper the natural tendency of economic agents to increase consumption when their real income is increased; that the alternative reason for desiring foreign savings – the scarcity of the domestic ones – is the typical common sense idea that scientific reasoning is supposed to reject. I believe that it is more realistic, in the moment, to denounce exchange rate populism and the strategy of growth with foreign savings than to put all our bets in the reform of international financial architecture. Sooner or later such reform will take place, but, while it does not, the economic authorities in each nation-state, developed or developing, should remember that the exchange rate is the more strategic macroeconomic price, and that the alternative 'fix or float' is false: the only sensible policy is: 'manage it'. After all, developed countries do that: why should not developing ones?

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