The End of Super Imperialism?

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With intensifying concerns regarding the soundness and stability of the international monetary and financial system, calls for reforming it have been on the rise. One recent call was made by the Bank of England Governor Mark Harvey, in August 2019, in which he suggested a synthetic hegemonic currency to replace the US dollar as the key reserve currency. Whether such calls will lead to an end of the key reserve currency status of the dollar remains to be seen.

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Oldrich Vasicek is an old friend. When I started my "quant" career in bonds in January 1994 in Walnut Creek, California, Oldrich was there. A recently graduated PhD in mathematics, I received my first real-life finance education from him.

Vasicek (1977), a statistician by trait, is famous for developing the first theory of term structure of default risk-free interests rates in 1977. But, despite this, he had been unfortunate until lately because his theory allowed for negative nominal interest rates. Many modellers considered this as a flaw because negative nominal interest rates were unimaginable then.

And recently, the entire term structures or in non-academic parlance yield curves of Denmark (on 24 July 2019), Switzerland (on 29 July 2019), Germany (on 5 August 2019) and the Netherlands (on 5 August 2019) went below zero. On 15 August 2019, Finland's entire yield curve also went below zero, but the next day, the longest maturity rate was above zero. I presumed it would go below zero again and, as expected, it went below zero on 28 August for another day. Belgium and Sweden seem to appear next in line, although which one will win the competition remains uncertain.

Negative Interest Rates

Let us forget about the theories and look at the history of nominal interest rates starting from about 5,000 years ago (who knows, maybe earlier?) when lending for interest started (Hudson 2018). Although negative interest rates had occurred on some rare occasions in the past, such as on some gold deposits during the gold rush of 1848–55 in California as protection costs, the start of the "formal" history of negative interest rates goes back to the 1970s.

Given that Super Imperialism was kicked off in 1971 (Hudson 2003), it does not come as a surprise that the first "formal" negative interest rates had been imposed on bank deposits of foreigners in Switzerland from 1972 to 1978 to discourage capital inflows to ease the appreciation of the Swiss franc. But, what is Super Imperialism and what happened in 1971?

Super Imperialism

Super Imperialism is a term coined by Michael Hudson (1972, 2003) in his celebrated book, *Super Imperialism*. The Pluto (publisher of the 2003 edition of the book) press release on 25 November 2002 describes the concept as follows:

> Past studies of imperialism have focused on how corporations invest in other countries, extracting profits and interest. This phenomenon occurs largely via private sector investors and exporters. But today's novel form of international financial imperialism occurs among governments themselves, and specifically between the US Government and the central banks of nations running balance-of-payments surpluses.
>
> The larger their surpluses grow, the more dollars they are obliged to put into US Treasury securities. Hence, the book's title, Super Imperialism.

If you agree with this description, then the kick-off date of Super Imperialism was 15 August 1971, although the transition had taken place over about five years through the monetary crisis of 1968–73 and Super Imperialism formally started in 1973.

On the kick-off day, the then United States (US) President Richard Nixon gave his now-famous speech in which he announced his New Economic Policy in an address to the nation on "The Challenge of a Peacetime Economy." He said:

> We must create more and better jobs; we must stop the rise in the cost of living; we must protect the dollar from the attacks of international money speculators.

Among many policy tools to achieve these goals, he suspended the dollar's convertibility into gold.

Bretton Woods System

Although there has been much debate on when exactly the US started to challenge the United Kingdom (UK), there is little doubt that the "official" US takeover of the world hegemony from the UK took place in Bretton Woods, New Hampshire at the Bretton Woods Conference from 1 to 22 July 1944.

At this conference, 700 delegates from 44 countries met to establish a new international monetary system in which they would go back to a gold standard following World War II. At the time, the US held about 75% of the world's gold stock. So, rather than a gold standard, the countries ended up with a dollar standard in which the US would fix the price of gold at $35 per ounce, and the rest of the world would fix their currencies to the dollar, albeit in some adjustable window.

Two important institutions came out of the conference: The International Monetary Fund (IMF) or the Fund, and the International Bank for Reconstruction and Development (IBRD) or the Bank, which soon came to be called the World Bank. The task of the Fund was to assist for the countries to fix their currencies to the dollar by providing short-term loans during temporary balance-of-payment deficits. The task of the Bank, on the other hand, was to provide financial assistance for the reconstruction of the countries devastated by World War II and for others so that they can "develop", although its purpose has eventually become lending to emerging and developing market countries only.

The US Department of State website states that these institutions were created with the following in mind:[1]

> The lessons taken by US policymakers from the interwar period informed the institutions created at the conference. Officials such as President Franklin D Roosevelt and Secretary of State Cordell Hull were adherents of the Wilsonian belief that free trade not only promoted international prosperity, but also international peace. The experience of the 1930s certainly suggested as much. The policies adopted by governments to combat the Great Depression—high tariff barriers, competitive currency devaluations, discriminatory trading blocs—had contributed to creating an unstable international environment without improving the economic situation. This experience led international leaders to conclude that economic cooperation was the only way to achieve both peace and prosperity, at home and abroad.

So, according to the US Department of State, this conference was more about free trade than an international monetary system. The monetary system was to ensure that high tariff barriers, competitive currency devaluations, discriminatory trading blocs and the like did not occur.

Collapse of the Bretton Woods

While the US had been a debtor country for most of the pre-war period, World War I changed that. The US emerged from World War I as the world's largest creditor and largest holder of gold, mostly running balance-of-payments surpluses. At the time of the Bretton Woods Conference, this was still the case. And this was the main reason why other countries eventually agreed to hold dollars as the gold equivalent in their central bank reserves. But, there was a problem in this arrangement.

The central banks held the reserve currencies mostly in the form of government bonds and less often, other financial assets of the reserve currency-issuing country, at least, back then. Hence, the US had to pump more dollars into the world financial system by borrowing more from the rest of the world.

I must add that in the US most real assets, especially those the US government deems strategic, are not up for sale to the foreigners. So foreigners do not have many options. What the US Department of State calls free trade on its website means that the US can freely trade whatever it wants. But, the others cannot.

Let me also add that since 1986, the US has been in a perennial balance-of-payments deficit and the world's largest debtor country. As the US hardly ever pays its Treasury bonds because it keeps them rolling, this means that the US gets others to pay for its foreign expenditures, including its military adventures. In a nutshell, this is what Hudson (1972) defined as Super Imperialism, the seeds of which were planted at the Bretton Woods Conference. Whether the US negotiators knew what they were doing at the time is, of course, open for debate.

The system operated reasonably well until the 1960s as there had been little doubt that the US was fully capable of redeeming these dollars with its enormous gold stock. However, when an attack on the dollar and run on gold pushed the price of gold temporarily up to $40 per ounce in the autumn of 1960, the eyebrows began to raise. Fears that the US was approaching the point at which its debts soon would exceed the value of its gold stock began to spread.

Attacks on the dollar and runs on the gold had continued, and finally, on Thursday, 14 March 1968, a major run on gold on the London Gold Exchange ensued, forcing the US to request the UK to suspend the London Gold Exchange. On Friday, 15 March 1968, the London Gold Exchange was closed temporarily. On Sunday, 17 March 1968 in Washington DC, an informal agreement was reached with the central banks of Belgium, Germany, Italy, the Netherlands and the UK that they would stop converting their dollar reserves into gold. And on Monday, 18 March 1968, the US Congress repealed the requirement for a gold reserve to back the US dollar.

This was actually how the Bretton Woods system ended. What Nixon did on 15 August 1971 was just making it official. Since the US dollar was not backed by gold after 15 August 1971, it was made a floating currency. And by March 1973, all currencies were made floating and from a form of gold standard, the world moved to a form of US Treasury bond standard.

Finally, on 19 October 1976, the then President of the US Gerald Ford signed an act to put in law what was already true as a matter of formality.

Financial Crises

With the abandonment of capital controls after the start of Super Imperialism, capital started to flow across borders freely, and thus began a new era of financial crises. If I list only those crises I have personally experienced since I started my "quant" career in bonds in January 1994, I may run out of space. So rather than giving the full list, let me turn my attention to the last of the crises—the ongoing global financial crisis (GFC) that started in the summer of 2007. I have tried to chronicle the GFC in many articles in *EPW* and elsewhere, and my *EPW* readers would recall that I have always argued that the GFC has never ended (see, for example, Öncü 2015b). As my readers would know, I have been waiting for the end of the GFC like *Waiting for Godot* (Beckett 2011) and although, I am sure Godot will arrive one day, I still do not know when. And since the start of August 2019, I have started waiting for the end of Super Imperialism. I will explain why, but first, let me discuss some of the events of August 2019.

A Volatile Month: August 2019

The month began on Thursday, 1 August with a tweet of President Donald Trump announcing an additional 10% tariff on $300 billion in Chinese imports as of 1 September, and the world stocks and government bond yields started to fall. It must be that Trump is not one of those US policymakers who took lessons from the interwar period in which government policies, such as high tariff barriers, had contributed to creating an unstable international environment without improving the economic situation as the State Department had claimed.

Friday, 2 August was calm. The mayhem began on Monday, 5 August when China allowed its currency, the renminbi to fall to its lowest level against the dollar in more than a decade. The onshore renminbi traded at around 7.05 renminbi per dollar, and the world stocks and government bond yields fell even worse than they did on 1 August. Indeed, 5 August was the day when the entire yield curves of Germany and the Netherlands went below zero. Before further progress, let me go back to the history of the negative interest rates.

Although some ultra-short Japanese interest rates in the derivatives market had entered the negative territory for ultra-short periods in the 1990s, the second phase of the "formal" history of the negative interest rates started about seven months after the GFC reached its climax with the Lehman collapse of 15 September 2008 in Sweden in 2009.

Shortly after the US central bank, the Federal Reserve (Fed) started its first quantitative easing programme and the zero interest rate policy, the central bank of Sweden, the Riksbank, announced on 2 July 2009 that it lowered its repo rate (the rate at which it lends reserves to banks against collateral overnight) to 0.25%, pushing the deposit rate (the interest banks get for depositing reserves with the Riksbank overnight) down to -0.25%. Then in 2010, the European Debt Crisis started in Greece (Öncü 2015a). In response, Switzerland's central bank, the Swiss National Bank, announced on 3 August 2011 that it was narrowing the target range for the three-month LIBOR from 0.00–0.75% to 0.00–0.25%. This pushed interest rates on the Swiss two-and three-year government bonds into negative territory and the rest is history.

Therefore, the fact that some more interest rates went negative on 5 August 2019 was not that novel. One novelty that occurred on 9 August 2019 that might have gone unnoticed was that Chase Bank, part of the New York-based JP Morgan Chase & Co, made the following announcement:[2]

> Chase made the decision to exit the Canadian credit card market. As part of that exit, all credit card accounts were closed on or before March 2018. A further business decision has been made to forgive all outstanding balances in order to complete the exit.

One takeaway from this is that debt cancellation is not religious fiction or ideal as some think it is (Öncü 2017). If so chosen, it can happen even today, as the Chase Bank demonstrated in Canada. Indeed, negative interest rates also are a form of debt cancellation. You lend someone some money today to get less in the future. According to Hudson, rates will quickly go as negative as 25% and thus erase some of the debt burdens.[3] However, I am less optimistic than him.

Then came Wednesday, 14 August. For no obvious reason, the 30 Year US Treasury bond yield dropped to its historical low below 2%. If you looked for a novelty, this was a novelty for sure. What was not novel was that on the same day, the spread between the 10-year and 2-year US Treasury yields went below zero. This spread is another measure of the US yield curve inversion (Öncü 2019). It has happened many times before, but the last time it happened was in the summer of 2007. When this inversion happens, many commentators start screaming, "recession." Whether such an inversion signals recession or not is immaterial. If the market believes it does, it becomes a self-fulfilling prophecy.

An interesting observation came on 19 August 2019.[4] The observation is this:

> A 4-sigma event would be expected to happen once or twice in a trading lifetime—according to the most popular VaR-based risk models. We've seen 10 of those this month in Treasuries. What we should have learned from the GFC has been all but forgotten. What the market had considered to be impossibilities (or at least highly unlikely…) is quickly becoming the norm.

This may sound too technical. The author essentially is saying that if daily yield changes were distributed normally (assuming 252 trading days a year), the observed jumps in the US Treasury yields in the first half of August 2019 would have had an approximate daily frequency of once every 63 years. No one can claim the normal distribution of daily yield changes. But, if these many jumps happen in about 15 days, it is not normal. The last time something like this happened was in 2008. First, around the Bear Stearns collapse of 14 March 2008, and then, around the Lehman collapse of 15 September 2008.

But, the most important event of August 2019 was Mark Carney's, the current governor of the Bank of England, speech at the Fed Jackson Hole Symposium on 23 August 2019.

> When change comes, it shouldn't be to swap one currency hegemon for another. Any unipolar system is unsuited to a multi-polar world. We would do well to think through every opportunity, including those presented by new technologies, to create a more balanced and effective system. (excerpt from Carney's speech)[5]

Here is a second excerpt:

> Even if the initial variants of the idea prove wanting, the concept is intriguing. It is worth considering how an SHC in the IMFS could support better global outcomes, given the

scale of the challenges of the current IMFS and the risks in transition to a new hegemonic reserve currency like the Renminbi.[6]

Conclusions

Carney's synthetic hegemonic currency (SHC) proposal at the Fed Jackson Hole 2019 Symposium is reminiscent of Keynes's bancor proposal at the Bretton Woods Conference of 1944 (Keynes 1943):

> The proposal is to establish a Currency Union, here designated an International Clearing Union, based on international bank-money, called (let us say) bancor, fixed (but not unalterably) in terms of gold and accepted as the equivalent of gold by the British Commonwealth and the United States and all members of the Union for the purpose of settling international balances.

Of course, neither Carney is Keynes, nor is the Fed Jackson Hole Symposium 2019 the Bretton Woods Conference 1944. Further, Carney is not the first major central bank governor who made such a proposal. Others have also made similar proposals and one of the first ones was Zhou Xiaochuan, the Governor of the People's Bank of China. Shortly after the Lehman collapse of 15 September 2008, on 23 March 2009 in the Bank of International Settlements (BIS) journal *BIS Review*, Governor Xiaochuan wrote:[7]

> The desirable goal of reforming the international monetary system, therefore, is to create an international reserve currency that is disconnected from individual nations and is able to remain stable in the long run, thus removing the inherent deficiencies caused by using credit-based national currencies.

As Carney said on 23 August 2019 and Zhou appears to have agreed on 23 March 2009, "we need to improve the structure of the current IMFS." Of course, Carney could not have said the following at the Jackson Hole Symposium, but I can write it here:

Our international monetary and financial system is broken. Indeed, it was this conclusion and the observations I have made in this and other articles that led me to ask the question in the title of this article: Are we approaching the end of Super Imperialism?

NOTES

1 https://2001-2009.state.gov/r/pa/ho/time/wwii/98681.htm.

2 https://www.usatoday.com/story/money/2019/08/09/chase-bank-canada-forgives-all-credit-card-debt-customers/1964419001/.

3 https://michael-hudson.com/2019/08/negative-interest-debt-jubilee/.

4 https://monday-morning-macro.com/.

5 https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/the-growing-challenges-for-monetary-policy-speech-by-mark-carney.pdf.

6 SHC is the abbreviation for synthetic hegemonic currency, and IMFS is the abbreviation for international monetary and financial system.

7 https://www.bis.org/review/r090402c.pdf.

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