Forum Mundial Social, Porto Alegre, Jan 2005

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Theses for discussion of the panel on capital controls

1 Financial markets during the decades after the break down of the Bretton Woods System in 1973 displayed the highest growth rates of all global markets. More important than this quantitative aspect are profound qualitative changes, some of them with a heavy impact on the peoples of the world. The most often heard sermon instead is about the beneficial working of free markets for the people. However, the reality of financial markets is characterized by deep crises (in Latin America, Asia, Africa, Eastern and Central Europe, but also in Western Europe and North America).

2 The collapse of the Bretton Woods System is the most serious aspect of the transformation which took place during the 1970s:

- oil crisis,
- crisis of the US-hegemony after the defeat in Vietnam and the deprecation of the US$
- return of mass unemployment and the growth of the informal sector
- victory of neoliberalism over Keynesianism
- "great transformation from fordism to "post-fordism"

The most widespread response to these crisis tendencies was deregulation of political rules and constraints and liberalisation and opening of markets enforced by global institutions, such as the IMF and the World Bank.

3 One of the consequences of deregulation was the intensification of global competition. Whereas competition on markets for goods and services to some degree exerts a downward pressure on prices this is quite different on financial markets. In order to avoid capital flight and speculation against the currency (since exchange rates are not fixed but freely floating) interest rates must be kept competitively high and stability in time (struggle against inflation) and in space (struggle against a depreciation of the currency) must be secured. Therefore the prevalence of stability policy vis-à-vis employment policy or environmental policy in all parts of the world turns out to become the dominant economic policy concept.

4 Financial stability is understood as a "global public good". This position however is at best one-sided. For, financial stability has an expensive trade-off, namely growing unemployment and cuts of social expenses in the state budgets. Therefore one can say that financial markets exert repression on the real economy and on the society as a whole. Neo-liberal ideologues, however, reserve the concept of "financial repression" to monetary and fiscal policy which introduces certain limits to "free" capital movements. Some institutional economist or "monetary Keynesians" also follow this interpretation by stressing the importance of a "hard budget constraint" for "rational" decision making.

5 Financial stability has become a hallmark of economic policy, imposed by the Bretton Woods institutions and other international organisations on national governments by means of structural adjustment plans or stability criteria such as the Maastricht criteria in the EU. His is so because under the rule of the "Mundell-trilemma" only two out of three policy goals can be realised: stabilisation of the exchange rate, liberal capital markets, and an independent monetary and fiscal policy. Since capital markets are free and exchange rates must be stable in global competition on financial markets, economic policy has to give up its independence. Policy makers must follow the signals of the financial markets. The consequences can be studied from Euro-Europe to Brasil under Lula, or from South Africa to the Asian countries.

6 Those countries with capital controls have more space of manoeuvre for economic policy. China is an example as well as Malaysia. Argentina after the crisis of 2001 stopped servicing the debt and by doing so regained some room for economic reforms. These cases show the importance of political autonomy of governments vis-à-vis global financial markets. The introduction of the principle of precaution into monetary and fiscal policy requires the possibility of falling back to capital controls.

7 After the Asian crisis and continuing financial turmoil the Financial Stability Forum has been set up in order to formulate rules for financial markets. The main concern however one can read in every handbook on good governance: better surveillance, more prudential behaviour by actors on financial markets, precaution where necessary without violating the free market-principle. The proposals of the FSF have a different reach. With regard to short term capital flows and their inherent instability and volatility the FSF is reluctant to plea for control by governments. With regard to the destabilizing power of hedge funds and off-shore-financial centres the FSF is much more outspoken. The borderline between surveillance and control is not strictly drawn.

8 With regard to the control of currency markets two options are possible: *separation* of currency-areas or their *integration*. The latter has been the project of the EU with the creation of the Euro. Its success is rather attractive so that also other regional integration areas are considering a similar development trajectory towards a currency union.

9 One has however to make a distinction between a multilateral currency union and a bilateral one. The first in principle is realised in the euro-zone with eleven more or less equal participants. The second is the case of "dollarization", i.e. to give up the national currency for the US$ (or for the €). The experiences made in countries concerned (e.g. Ecuador) are not convincing. The dependency on the politics of the USA due to the dollarization considerably reduces the range of political choices of the dollarized country.

10 The segmentation of currency areas is the concern of Tobin's proposal to establish a tax on capital movements. The Tobin tax is a vehicle to increase the costs of capital movements, especially of short-term and thus speculative roundtrips. The expectation is directed towards a reduction of short-term capital movements and thus a calming down of speculation on financial markets. However, the expectations may be false, especially in cases of wild speculation against a given currency. The Tobin tax cannot be as high as the gains of speculators with a currency depreciation of, say, 20% and more. Nevertheless, a tax on capital movements at least has the following positive (three times C)-effects (dependent on the design of the tax, which is a controversial issue):

- *calming down* of speculative bubbles and thus prevention of speculative overheating of financial markets
- *correction* of a tax system which is becoming more and more unjust. The most immobile factors of production, i.e. workers, are bearing the lion's share of the tax burden whereas the most mobile factors of production, i.e. investors on global financial markets, have all possibilities to avoid paying taxes by using the facilities of tax evasion, particularly OFCs and other tax heavens.
- *collection* of funds to be distributed for development assistance. The need for global taxes is not everywhere, but broadly acknowledged. It has been underlined in the preparations of the UN-summit "Financing for Development", march 2002, and it is a central issue in the recent debates on the provision of global public goods. One of the taxes to be established for that aim is a tax on capital movements.

11 Political deregulation and market liberalization also has widened the spaces for illegal and criminal profit- and rent-seeking. Money laundering is a big industry, reaching at 5% of world GNP or up to 1500 Bn US$. The sources of this money laundering industry are

corruption, economic frauds, trafficking of drogues and of human beings, smuggle of weapons, of by extinction threatened species, terrorist networks or secret services of self-defined non-rogue-states. Liberalized financial markets therefore not only undermine financial stability but also the integrity of financial institutions and actors. However, it is blatantly impossible to only control illegal transactions without establishing devices for the control of capital flows in general.