G20 summit dominated by specter of currency, trade wars

By Barry Grey
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The G20 summit of leading economies opens today in Seoul, South Korea under conditions of mounting international currency and trade conflicts exacerbated by Washington's drive to gain a competitive trade advantage over its rivals by devaluing the dollar.

The fundamental and systemic character of the world economic crisis that erupted two years ago is reflected in the fate of the G20 itself. In November of 2008, only weeks after the collapse of the Wall Street investment bank Lehman Brothers triggered a meltdown on global financial markets, the first post-crisis summit of G20 government leaders was held in Washington. It was hailed as a triumph of international cooperation.

The participants proclaimed their unanimous agreement that no nation would seek to extricate itself from its crisis at the expense of other nations. The competitive currency devaluations, protectionism and trade war that had dominated the 1930s and led to World War II would not be repeated in the more enlightened 21st century, it was said.

French President Nicolas Sarkozy enthused at the time: "The G20 foreshadows the planetary governance of the 21st century."

Two years and four G20 summits later, today's meeting of government heads has been preceded by mutual recriminations and a series of hostile thrusts and counter-thrusts by the United States and its main trade competitors. There is a growing sense that the entire post-war system of global economic relations is breaking down.

Anemic and slowing growth in the US, Europe and Japan and the turn by governments, most savagely those of Europe, to drastic austerity policies in the wake of the European sovereign debt crisis, as well as mounting signs of a possible breakup of the euro, are fueling a resurgence of protectionism and economic nationalism.

At the center of the crisis is the vast decline in the global economic position of the United States, which has shattered the foundation for the restabilization and expansion of capitalism that followed the Depression and World War II. This is reflected starkly in collapsing confidence in the dollar and the currency system anchored by the US currency.

On Monday, World Bank President Robert Zoellick stunned governments and central bankers by proposing that the G20 consider a radical revamping of the world currency system. He suggested that the role of the dollar as the supreme reserve and trading currency be ended and that it be supplanted by a new system involving the dollar, the euro, the yen and the Chinese renminbi. He further proposed that the new structure use gold as an indicator of currency values.

This was a tacit acknowledgement that the system that has prevailed for the past 65 years is no longer viable and that there is no national currency that can replace the dollar as a world reserve currency.

The near-zero interest rate policy of the US Federal Reserve has flooded financial markets with cheap dollars, resulting in a staggering decline in the value of the dollar on world currency markets. The dollar has fallen by 13 percent against the Japanese yen so far this year. Just since last June, it has dropped 18 percent versus the euro. Weighed against a basket of currencies, the dollar is down 8 percent since late August.

The starkest expression of the erosion of confidence in the dollar and the existing currency system is the explosive rise in the price of gold. This week, gold futures hit an all-time high of over $1,420 an ounce. The precious metal has risen 28 percent this year.

The precipitous fall in the dollar is fueling a general surge in commodity prices, including copper, oil, corn and other foodstuffs.

On Wednesday, Zoellick warned that the G20 had to take seriously the soaring price of gold as a warning of a deepening crisis in global economic relations. "I do think there are tensions in the system," he said, "and if not properly managed those tensions risk an increase in protectionism."

The Obama administration had hoped to forge an alliance of European and Asian nations at the summit behind its demand that China allow its currency, the renminbi (also called the yuan), to appreciate more rapidly.

The US has sought to cast China as the chief obstacle to a rebalancing of the global economy between surplus and deficit nations, accusing it of manipulating its currency to keep its exchange rate low and its exports cheap. But this ploy has been undermined by Washington's ultra-loose monetary policy, which is seen internationally as a means for the US to manipulate its currency—cheapening the dollar so as to make US exports more competitive and foreign imports more expensive.

America's major trade rivals—China, Germany, Japan—as well as a host of so-called emerging economies—India, South Korea, Brazil, Indonesia, South Africa, Thailand, Taiwan, Singapore—have been particularly jolted by the Fed's decision a week before the summit to launch a second round of "quantitative easing," i.e., the printing of $600 billion to drive down long-term interest rates in the US, fuel the stock market and further devalue the dollar.

This is correctly understood by the major exporting nations as a protectionist measure to increase US exports at their expense. For the emerging economies, the Fed's policy heralds a flood of speculative dollars driving up their exchange rates and stoking asset bubbles and inflation.

The run-up to the summit has seen a chorus of complaints and denunciations of the US by G20 members. The most bellicose reaction was that of German Finance Minister Wolfgang Schäuble, who told *Der Spiegel* magazine last Saturday that the Fed's decision was "undermining the credibility of US financial policy."

He declared the US "growth model"—which he said was based on "borrowed money," "inflating its financial sector and neglecting its small and mid-sized industrial companies"—to be in "deep crisis."

Accusing the US of hypocrisy, he said, "It's inconsistent for the Americans to accuse the Chinese of manipulating exchange rates and then to artificially depress the dollar exchange rate by printing money."

German Chancellor Angela Merkel spoke along similar lines, although in a more moderated tone, in an interview with the *Financial Times*. She dismissed Washington's proposal that the G20 set quantified targets for current account surpluses and deficits, saying, "I don't think much of quantified balance of payments targets."

She went on to criticize countries whose "growth was built on debt and bubbles"—by implication including the US—and added, "The greatest danger that threatens us is protectionism."

Jean-Claude Juncker, the prime minister of Luxembourg and chairman of the group of euro-zone finance ministers, told a European parliament committee: "I don't think [the Fed's resumption of quantitative easing] is a good decision. You're fighting debt with debt. There is great criticism of the Chinese policy, but in a different way they are pursuing exactly the same policy."

The top economic aide to Russian President Dmitry Medvedev, Arkady Dvorkovich, said Russia will insist at the G20 summit that the Fed consult with other countries before making any major policy decisions.

Brazilian Trade Minister Weiber Barral denounced the Fed action as a "beggar-thy-neighbor policy."

A number of Chinese officials denounced the US move and called for the G20 to monitor US monetary policy. The state-run Xinhua News Agency published a commentary Tuesday saying the G20 should "set up a new mechanism that effectively monitors the issuer of the international reserve currency, especially when it is not able to carry out responsible currency policies."

Chinese Vice-Finance Minister Zhu Guangyao at a briefing Monday said, "As a major reserve currency issuer, for the United States to launch a second round of quantitative easing at this time, we feel that it did not recognize its responsibility to stabilize global markets and did not think about the impact of excessive liquidity on emerging markets."

A leading Chinese newspaper warned that the US actions were a form of currency manipulation that could lead to a new round of currency wars and even global economic collapse.

In an unvarnished act of retaliation against the Fed's action, China's leading state-endorsed rating agency on Tuesday downgraded the US credit rating. The agency cited the Federal Reserve's decision and warned of Washington's "deteriorating debt repayment capability" and "the serious defects in the United States economic development and management model," which it predicted would lead to "fundamentally lowering the national solvency."

Japanese Prime Minister Naoto Kan told the *Wall Street Journal* in an interview Saturday: "First and foremost, one of the biggest reasons for the yen's rise is the dollar's weakness, a reflection of America's economic policy. We need for there to be a clear understanding of that background."

He made clear that Japan reserves the right to intervene in currency markets again, as it did massively in September. "If we face another rapid surge in the yen, such a step may become necessary," he said.

For his part, President Obama, on a ten-day, four-nation Asian tour that includes the G20 summit, defended the Fed's action and reiterated the US demand that export-led nations with large balance of payments surpluses such as China and Germany accept a reduction in their exports and an increase in America's share of global markets. This is what Washington means when it speaks of a "rebalancing" of the global economy.

At a joint press conference with Indian Prime Minister Manmohan Singh, Obama said, "I will say that the Fed's mandate, my mandate, is to grow our economy. And that's not just good for the United States, that's good for the world as a whole."

He continued, implicitly targeting Germany and China: "We can't continue to sustain a situation in which some countries are maintaining massive (trade) surpluses, others massive deficits, and there never is the kind of adjustments with respect to currency that would lead to a more balanced growth pattern."

Speaking at his next stop in Indonesia, Obama more directly hit out at China, declaring, "You are seeing some countries run up very big surpluses and intervening significantly in the currency markets to maintain their advantage when it comes to their currency."

There is virtually no prospect that the intensifying conflicts will be resolved at the G20 summit or that any serious agreement will be reached to moderate them. South Korean President Lee Myung-bak, the summit host, all but acknowledged as much, saying in an interview Wednesday, "We were not able to come up with the specifics. That will be left to a working group. It will take some time."

The best that the participants can hope for is a vague communiqué that will paper over the differences and avert an open breach.