Bank of England governor tells Jackson Hole conference: Existing financial system will not hold

By Nick Beams
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One of the fictions most assiduously promoted by the ideological representatives of the capitalist economy is that those in charge of monetary and economic policy have a sound knowledge of the system over which they preside and a clear idea of what they are doing. Such operations assume great importance when events, such as the financial crash of 2008, reveal to masses of working people that this is not the case.

The collapse eleven years ago was preceded by assertions as to the "efficiency" of the market. A "great moderation" had been established in which the evils of the past had been finally conquered, with anyone who dared to differ being declared guilty of blasphemy against gods such as Fed chairman Alan Greenspan.

So when it was revealed that the financial system was in reality a snake pit of corruption and conflicts of interest, it was a case of all hands on deck to provide the justification for the trillions of dollars made available to the very banks and financial institutions whose activities had sparked the crisis, while hundreds of millions of workers the world over were made to pay through wage cuts and austerity measures.

The bailouts may have been regrettable, it was argued, but these measures were necessary to prevent something even worse. New regulations were being put in place to prevent a recurrence and after a period of "unconventional" measures—essentially the handout of virtually free money to the "malefactors of great wealth"—things would return to "normal."

This piece of fiction was exposed at the conference of central bankers and financial experts held at Jackson Hole, Wyoming last week.

Reporting on the meeting, the *Financial Times* noted "there was a sense that things would never be the same again." In an interview with the newspaper the president of the St Louis Federal Reserve, James Bullard said there had been a "regime shift" in economic conditions.

Its manifestations are all too apparent. The supply of ultra-cheap money, either through interest rate cuts or the purchases of financial assets by central banks, so-called "quantitative easing," has failed to provide any significant stimulus to the real economy, inflation continues to remain below the target rate set by central banks of 2 percent and interest rates remain at historic lows.

So persistent is this phenomenon that the financial system has entered a kind of Alice in Wonderland world where some $16 trillion worth of bonds are trading at negative yields, meaning that an investor holding them to maturity would suffer a loss.

"Something is going on," Bullard told the *Financial Times*, "and that's causing a total rethink of central banking and all our cherished notions about what we think we're doing. We just have to stop thinking that next year things are going back to normal."

However much they seek to promote the illusion that they are in control, those in charge of the financial system do have to engage in a discussion over the mounting problems they confront and what might be done to alleviate them. And a couple of papers presented at the meeting were significant from that standpoint.

Over the past months, the realisation has begun to grow that trade war is not a passing phase but is now a permanent feature of economic and political life. This is coupled with the recognition that the role of the US dollar as the basis of stability for the financial system is now increasingly being called into question.

Mark Carney, the retiring governor of the Bank of England, told the conference the present international monetary system based on the US "won't hold" and that

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a new international monetary system had to be constructed.

He noted that the US accounted for only 10 percent of global trade and 15 percent of global GDP but the dollar formed the basis for half of world trade invoices and two-thirds of global securities issuances. Movements in the dollar, therefore, were of fundamental importance to other economies even if they had few trade links with the US. They were forced to hoard dollars in order to guard against capital flight.

The dollar was just as important as in 1971 when US President Nixon removed it gold backing and ended the Bretton Woods system of fixed currency relations anchored by gold.

At that time US Treasury Secretary John Connally dismissed the concerns of other countries with the dictum "our dollar, your problem." This had now broadened, Carney said, to "any of our problems is your problem."

For decades the mainstream view had been that countries could achieve price stability and regulate economic growth by targeting inflation and adopting floating exchanges rates. This consensus was now "increasingly untenable." This was because US developments now had "significant spillovers onto both the trade performance and the financial conditions of countries even with relatively limited direct exposure to the US economy."

He said there was little that could be done in the short term and central bankers had to "play the cards they have been dealt as best they can."

However, in the longer term "we need to change the game." The international monetary system could not be reformed overnight but equally "blithe acceptance of the status quo is misguided."

"Risks are building, and they are structural. As [the late economist] Rudi Dornbusch warned, 'In economics, things take longer to happen than you think they will, and then they happen faster than you thought they could.'"

In the medium term he called for the International Monetary Fund to increase its resources and set up a global fund to deal with capital flight. In the longer term there needed to be multipolar global economy and consideration should be given to the establishment of a "synthetic hegemonic currency." possibly through a network of central bank digital currencies, in order to "dampen the domineering influence of the US dollar on global trade" so that US shocks would not reverberate around the world as they do now.

In essence this is a modern-day version of the proposal advanced by the British representative John Maynard Keynes at the Bretton Woods conference in 1944 for the establishment of a global currency, bancor. At that time, the US asserted its power and insisted that the dollar, backed by gold, had to be the international currency. But since the removal of the gold backing in 1971 as a stable anchor, the global financial system has become increasingly impacted by movements in the US dollar.

"The deficiencies of the international monetary and financial system have become increasingly potent," Carney concluded and that "even a passing acquaintance with monetary history suggests that this centre won't hold."

Similar warnings of financial instability were given in another paper presented by Stanford University economists Arvind Krishnamurthy and Hanno Lustig who pointed to the role played by dollar-denominated investments in providing global investors with safe assets.

They recalled the warnings by economist Robert Triffin in 1960 about the essential contradiction at the heart of the Bretton Woods system. Triffin pointed out that the expansion of global trade and finance depended on the continual outflow of US dollars. But this meant that this pool of dollars would outgrow the gold backing that was its anchor, leading to a crisis. That crisis erupted when Nixon ended dollar-gold convertibility.

The authors noted that Triffin's logic could be extended to the current situation. "The supply of safe dollar assets is no longer backed by gold; however, the supply is fueled by increases in public and private leverage. Will dollar leverage be supplied in a manner consistent with financial stability? The events of the last 15 years suggest that policy makers should pay close attention to this question."

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