

Financial Market Reform: Beyond the Roller-Coaster Economy

By Wayne Visser

Over the month or so, financial markets around the world, including the Johannesburg Stock Exchange, crashed! The weeks to follow were a rollercoaster ride in the all-share indexes of the major trading countries. Coincidentally, this was around the 10th anniversary of the infamous crash of October 1987. This is a timely reminder of the need to regain control over financial speculators.

Effects of the Casino Economy

Each day, over \$1 trillion pass through the world's financial markets, a 14-fold increase since 1980 which is mostly accounted for by the explosive growth in derivatives trading since it first began on the Philadelphia Stock Exchange in 1971. Of this, only between 2% and 5% is related to international trade in real goods, a phenomenon which US critic David Korten calls "de-linking money from value". The effects of speculative activity of these proportions on real trade, however, can be significant and potentially harmful.

One of the criticisms of speculative financial markets is that they divert capital away from long-term productive investment in the "real economy" in favour of short-term speculative investment in the "virtual economy". Another is that these markets are becoming increasingly depersonalised and automated - "high tech and high speed" - operating without regard for the human or ecological consequences of their actions but simply chasing the highest profits to be made.

The worrying increase in the volatility and instability of the financial markets has numerous claimed effects, from destroying the livelihoods of small traders and growers and the cultural fabric of indigenous or rural communities, to increasing the uncertainties and risks of bankruptcy for businesses, and disrupting the plans of governments and the economies of small nations. All of these effects amount to a decrease in self-reliance, at both national, community and individual levels.

Taming the Beast

There is now widespread consensus for the need to control and regulate trans-national financial markets, by various regulating bodies, including the Basle Committee on Banking and Supervision (BCBS), the International Organisation of Securities Commissions (IOSCO), the US Commodity Futures Trading Commission (CFTC), and the Commission for Global Governance Committee on Global Financial Markets (GCFUN).

However, there is growing criticism that these conservative institutions are proving ineffective in their efforts.

One such critic is economist James Tobin, who has suggested two possible routes for reform of the international monetary system:

1. Making currency transactions more costly to reduce capital mobility and speculative exchange rate pressures (derived from Keynes' ideas); or
2. Greater world economic integration, implying eventual monetary union and a World Central Bank.

Proposed Alternatives

The former approach, which has become known as the "Tobin tax", was favoured by Tobin and has also become most popular among many new economists. Tobin described his proposal as "an internationally uniform tax on all spot conversions of one currency into another, proportional to the size of the transaction", suggesting a charge range of between 0.5% to 1%. Economist Rudi Dornbusch goes further, suggesting a cross-border tax on all financial transactions instead of just currency trades, which could be collected by national governments.

Subsequently, the United Nations Development Programme (UNDP) commissioned a report by a group of influential economists which concluded in support of a Tobin fee of between 0.05 and 0.25%. This was later endorsed at the UN World Summit on Social Development in Copenhagen in March 1995 by France's then-President Mitterand, Norway's Prime Minister Brundtland, and Denmark's Poul Nyup Rasmussen, and later that year at the G-7 Summit in Halifax by Canadian Human Resources Minister Lloyd Axworthy and UN High Commissioner for Human Rights Jose Ayala Lasso, but rejected by other leaders.

US policy analysts Makhijani and Brown favour Tobin's second reform route, proposing an International Currency Unit, to be administered by a World Central Bank and based on an equivalent "basket" of goods in each country. The value of these "baskets" in domestic currency would determine relative exchange rates, which would therefore depend on real domestic economic conditions rather than short-term currency movements.

All of these proposals and others need to be brought onto political and financial agendas and given more serious consideration for their potential role in reducing the systemic risk of financial markets and restoring self-reliance to countries and communities who are adversely affected by present financial market shocks, crises, capital flight and general volatility.

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