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Fed Bashing at the G-20:
A Return to the Gold Standard Anyone?

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A strange thing happened on the way to the G-20 meetings: world elite opinion has turned against the Federal Reserve's "Quantitative Easing" (QE) program, the only significant "Keynesian" macroeconomic policy being implemented anywhere in the face of massive unemployment in much of the developed world; and this criticism is garnering some support from strange places, including among some progressive economists. With all the hubbub, the mercantilist policies of Germany and China and the pre-Keynesian Gold Standard-like stance of the European Central Bank (ECB) are getting a virtual free ride. Meanwhile, the true villain is escaping scrutiny altogether: the elite consensus that there is too much sovereign debt in the world and so there cannot be any more fiscal expansion.

Matías Vernengo's excellent post calling for a global Keynesian response to the global crisis is right on the mark. Vernengo reminds us of the failed global meetings in the 1930s that, instead of bringing about a coordinated expansionary response to the depression, led to squabbling about currency issues. We are witnessing a repeat. The Obama administration is correct to defend Quantitative Easing (QE) by the Federal Reserve, but it should be pushing for more global fiscal expansion. Of course, Obama has undermined his own case at home by failing to press for a second stimulus package and by his self-destructive decision to name a fiscal deficit commission destined to undermine future arguments for fiscal expansion. Meanwhile, Germany calls for belt tightening as it pursues its mercantilist policies, and China just wants the old order to remain as it always was, so it can continue to pursue its model of export-led growth, rather than take on more responsibility for helping to steer the global economy out of the crisis.

Some progressive critics of the Fed's policies have correctly pointed to the problems excessive capital flows are creating for "emerging market" countries such as Brazil, Colombia, South Korea, and South Africa. This has led to the adoption of capital controls by some of these countries to defend themselves from the inflows, and even the IMF has endorsed these controls as useful temporary measures.

It is true that this flood of short-term capital creates problems for these countries but it is also having a positive side benefit: it is leading many countries to reconstruct the institutional mechanisms, such as capital management regimes, that they need to help create the policy space they have been asking for and creates arguments—even
sanctioned by the IMF—against neo-liberal forces inside and outside their countries to be much more pro-active about building up national institutions to manage and help allocate credit flows. So while these inflows are creating short-term problems, they are contributing to longer-run policy investments. And in the meantime, these countries may even learn how to use incredibly cheap capital flows to help finance greatly needed domestic investments.

One of the innovations that should be talked about more as a result of this failure to develop a truly coordinated response to the global crisis is the need for more regional solutions of financial cooperation and investment. As Columbia’s José Antonio Ocampo has argued, regional funds could make use of the cheap credit created at the center and re-cycle it in ways to make it available on regional bases for productive investment.

Of course, the Fed’s policy is not likely to have large enough impacts in the U.S. without some substantial reforms and restructuring of the U.S. financial system: these include a system of creative credit allocation mechanisms to direct credit to more employment generating initiatives, as described, for example, by my colleague Robert Pollin; a massive Federal program of writing down mortgages on the edge of foreclosure, along the lines of the Home Ownership Loan Corporation of the 1930s; and forcing banks, who, apparently, often do not have legal title to the mortgages, to take a very significant haircut along the way.

But, for the time being, the Fed’s QE is the only game in town -- indeed, in the world. So what is it that the Fed bashers at the G-20 are calling for? I hope it is not for the Fed to turn into the ECB. I hope it is not for a return to a gold standard. I hope it is not for the dollar to try to return to an over-valued rate, just as the British tried to return to the pre-war Gold Standard in the 1930s. Focusing on the Fed’s QE is the wrong enemy. The true problem is the return of neo-liberal thought and policy that is dominating debate, and the financial and political elites that are using this return to push their own destructive agendas.