Currency boards: going back to the methods of British colonial rule

by Richard Freeman

In recent weeks, speculator and economics professor Steve Hanke, representing a group of Thatcherite monetarists led by Sir Alan Walters, has held several discussions with Indonesian President Suharto, in an attempt to pressure him into adopting a currency board. While packaging the scheme as a step toward restoring the stability of the Indonesian currency, the rupiah, in reality, the currency board, true to its British imperial origins, would take away Indonesia's economic sovereignty; impose austerity conditionalities, harsher than those that could be imposed by the International Monetary Fund (IMF); and contribute to the social instability that could break up Indonesia, the fourth most populous nation in the world.

Technically, the currency board reduces a nation's currency to an extension of an international reserve currency—usually the dollar or pound sterling—by limiting the nation's domestic currency issuance to the amount of foreign currency the government holds.

For the moment, it looks as though Hanke's mission of getting Indonesia to adopt the currency board immediately, will not succeed. President Clinton informed President Suharto in a Feb. 13 phone conversation, that he believed that the currency board could cause serious problems, and hinted that the United States would withdraw funding of its portion of the IMF bailout package for Indonesia, if Indonesia went through with the plan. IMF Managing Director Michel Camdessus also expressed disapproval, although qualifying that he does not disagree with the currency board idea as such, just its specific application in Indonesia at this time.

On Feb. 18, German Finance Minister Theo Waigel, who was visiting Indonesia, indicated that the currency board proposal has been shelved for six months. It is not clear whether President Suharto agrees with the idea, or was just flirting with it in order to express his disapproval of IMF conditionalities in Indonesia, which threaten to blow up the country.

However, one thing is certain: The currency board proposal is quite dangerous. Choosing between it and the IMF program, is like selecting between arsenic and cyanide. Further, behind Hanke's huckster appeal that the currency board will "bring currency stability," is a larger agenda: to bust up any possibility of the emergence of a New Bretton Woods monetary system, as conceived by Lyndon LaRouche, which would establish fixed exchange rates—not, as with the currency board, between individual currencies and a fixed dollar supply, but globally among all nations, within the context of a global monetary system that would finance infrastructural and industrial development.

By contrast, the British monarchy's prized monetarists such as Hanke, and his mentor, former Thatcher adviser Alan Walters, are laying the groundwork for what they imagine to be the world after a financial crash, a world whose nation-states have been turned into plantations that produce raw materials, agricultural goods, cheap manufacturing parts, and through which the debt will be collected and the country will be run by an administrative monetary arm, called the currency board.

These currency boards will reduce nations to the colonial status, for which the currency boards were created in the first place.

Most nations will not willingly adopt a currency board. This brings up the second aspect of Hanke's work: running the currency speculation that forces nations, such as Indonesia, to consider currency boards. Hanke and his Toronto, Canada arbitrage/hedge fund group, the Friedberg Group of Companies, were among the principal speculators that drove the Indonesian rupiah from 2,433 to the dollar on July 10 of last year, to 9,425 today, a fall of 74%. Then, like a mafioso, Hanke made Suharto "an offer he couldn't refuse," to stop the fall in the rupiah.

The workings of currency boards

As stated above, a currency board limits a nation's domestic currency issuance to the amount of a specific foreign currency it holds. This destroys a country's economy in several ways. First, it sharply limits the currency in circulation, and thus economic growth. The reason is clear: If the dollar is the currency against which a nation's currency board issues currency, and the amount of dollars that the country holds is small, then the country must cut back the amount of its own domestic currency.

(Normally, the currency board will not hold dollars as such, but rather dollar-denominated interest-earning instruments, such as Treasury bills.)

Second, according to Hanke, the currency board is run by foreign financiers, not the country itself. In a 1993 book, *Russian Currency and Finance,* Hanke makes this explicit: "Since any human institution, no matter how rule-bound, is administered by people and can be changed by people, the model currency board constitution [for Russia] includes a provision that a majority of the board of directors be foreigners. That will help prevent the Russian government from bending the rules. The foreign directors should be appointed by Western commercial banks, or perhaps the IMF if the IMF lends some of the initial foreign reserves of the currency board."

The country is left with no sovereign authority to issue credit for anything, whether financing budget deficits, or for industrial and agricultural growth.

Third, a currency board enforces severe austerity and obliges a nation to deregulate and globalize its economy, including privatizing its patrimony of state-owned electricity and water utilities, port authorities, industries, and mining companies which the state uses to foster economic growth. In a Dec. 12, 1995 speech before the monetarist Heritage Foundation, Hanke praised the currency board in Argentina, one of the few countries to have one, because it produced "a coherent program to cut public spending and to privatize and deregulate its economy."

Fourth, the policy of the nation imprisoned with a currency board currency is reduced to fulfilling the whims of the private bankers, who control all available credit. Since a country must have dollar reserves against which it pegs its own currency, it does everything to attract dollars into the country and prevent their fleeing. The objective of the country becomes one of a cheap goods exporter, which avoids essential capital goods imports—because they are too costly and use up valuable dollar reserves—while pliantly developing stock and real estate markets, which attract hot foreign capital, while sucking out wealth from the physical economy.

Finally, under a currency board, a currency is always kept, according to free market strictures, "fully convertible," meaning that it is always subject to the threat of currency warfare. This keeps the country with a currency board in line.

British imperial origins

The currency boards today bear the fine imprint of their origin, as instruments of British colonial control of subject territories' credit and finances.

The principle of the currency board was provided by the British Bank Charter Act of 1844. The first currency board was established in the British African colony of Mauritius. The oldest continuously running currency board is on the Falkland Islands (Malvinas), which was established in 1899. Of the 70 or so territories that have had currency boards at one time or another, more than 85% are former British or former French colonies.

In an essay on the formation of currency boards in the *New Palgrave: A Dictionary of Economics,* Sir Alan Walters wrote happily about the good old days of colonialism: "Once ubiquitous in the [British] colonial regimes of Africa, Asia and the Caribbean, currency boards now survive only in such small countries as Singapore, Brunei and Hong Kong." These were the golden times, as the local currency board's currency "served as a stable means of exchange and as a store of value in those largely inflation-free days of colonial occupation." Walters laments that, "As colonies became independent states in the 1950s and 1960s, they generally eschewed the currency board system and formed Central Banks to manage their currencies, ostensibly for 'development purposes.' "

Case study: Argentina

Less than a dozen nations, most of them very small, have currency boards today. The biggest nation of this group, which is therefore held up as a model, is Argentina. During the late 1980s, as a result of speculation, Argentina's financial system was reeling: In 1990, its inflation rate grew by 2,314%, its M3 money supply grew by 719%. This created a condition of ungovernability, in which the Mont Pelerin Society circles around Walters pulled a political coup, and installed a currency board. The Argentina peso was pegged to the U.S. dollar, eventually on close to a one-to-one ratio. The economy was "dollarized." In Argentina, the leader of this currency reform, with a modified currency board, was then-Finance Minister Domingo Cavallo. During 1995-96, Hanke was an official adviser to Cavallo.

It is true that the country held to a fixed dollar-peso exchange rate, but the method—destroying the physical economy—should make anyone think twice when they hear about the "model success of Argentina" since 1991. A few examples give a flavor of what really happened.

- Between 1981 and 1993, expressed on a per-household basis, Argentina's steel production fell by 7%; grain production by 27%; cement by 33%; and meat by 35%. The trend since 1993 has been much worse, although it has not been quantified yet.
- In late 1994, the Mexican peso was devalued, spreading what became known as the "tequila effect." In the first quarter of 1995, dollar flight capital started to leave Argentina. Because the currency board stipulated that the Argentine peso supply was unalterably pegged to the dollar supply, this required a sharp contraction of the domestic money supply. Between January and March 1995, Argentina's currency supply, M3, contracted by 12%. Yields on peso-denominated bonds shot up to 39.2%. To raise revenues, Argentina increased its value-added tax from 18% to 21%. Only a $7 billion rescue package, with $5 billion pledged by the IMF and World Bank, and an acceleration of the privatization program to bring in dollars, restored financial, although not economic, stability.
- Over the last five years, to raise dollars, in large part to provide money to its currency board, Argentina sold off much of its state-owned patrimony, in particular in oil, telecommunications, and sanitation companies, to financier sharks for $20 billion, a fraction of their true value. Argentina also sold portions of its banking system, and today, British Common-

wealth banks control 54% of the assets of Argentina's banking system.

- Between 1993 and 1996, Argentina's combined foreign and internal dollar-denominated debt shot up from $101 billion to $159.1 billion. Even some monetarists are alarmed by this product of the "Argentina miracle."
- The official poverty rate is 18%, one out of every five workers; unofficially, it is much larger.

Spreading the currency board

During the past year, the Thatcherites launched their war of speculation against currencies and stock markets in Southeast Asia.

In this, Steve Hanke played a leading role. In 1991, Hanke joined the board of directors of the Friedberg Group of Companies (FGOC); in 1996, he became vice chairman. The FGOC is a high-risk fund, with currency arbitrage and hedge fund divisions. It was founded in 1971 and has a total of $800 million in assets under management. As with most high-risk investment funds, it can borrow—i.e., use leverage—at a ratio of 10:1 to 15:1, meaning it can deploy, at any one time, up to $8-12 billion. The Hollinger-owned *Toronto Globe and Mail* wrote that "Friedberg invented the futures industry" in Canada.

In its fourth-quarter 1997 report, the company's Currency Trading Division wrote: "It was a far better quarter than we had ever imagined it would be. . . . The rapidly depreciating Malaysian ringgit provided almost 50% of our total gross profits, with another 25% attributable to bear strategies (selling calls and outright forwards) in the Japanese yen. The remaining profits came from . . . short positions in the Thai baht, the *Indonesian rupiah* and the Czech koruna" (emphasis added).

Also during the fourth quarter of 1997, the Friedberg Global Opportunities Fund, Ltd. "maintain[ed] the aggressive short [selling] position in Japanese banks [stocks] established [during the third] quarter." In particular, it shorted the stocks of medium-size Japanese banks. In a Sept. 22, 1997 conference call, FGOC founder Albert Friedberg, talking about the very large problem of Japan's medium-size banks, cooed, "Nothing has been done to resolve this problem. And when the problem comes to the floor and you start seeing more and more of these banks fail, you might get a situation similar to a bank run."

After having wrought this havoc in Indonesia and throughout Asia, the duplicitous Hanke told the Dec. 29, 1997 *Forbes* magazine, "Don't blame the bankers. Don't blame the market system. The governments are the villains." Then Hanke approached Suharto, offering to sell him "protection" through the currency board.

On March 6, 1997, Hanke was made an adviser to the President of Bulgaria, Petar Stoyanov, to set up a currency board in that country. The board was imposed when many Bulgarians were at the point of starvation.

On Jan. 30, 1998, Hanke told the U.S. House Banking Committee: "On Oct. 6, 1992, the U.S. Congress passed legislation that directed the IMF to use U.S. quota contributions to establish currency boards, if appropriate (Public Law 102-391, U.S. Statutes at Large, Vol. 106, p. 1636). Although this legislation was a step in the right direction and motivated the IMF to become more 'currency-board-friendly,' it did not go far enough. The U.S. Congress should not advance further replenishment funding to the IMF unless the Congress imposes conditionality on that funding. Specifically, the Congress should not provide replenishment funding to the IMF, unless the IMF mandates currency boards for developing countries that receive IMF credits. This would require the IMF to do what it did with Bulgaria in 1997: a currency board or no IMF credits."

At the moment, the plans of Hanke, Walters, et al. are on hold in Indonesia. But the British financier oligarchy which runs this crew, still has their plan on the agenda for several other countries.

Who is Sir Alan Walters?

It is lawful that Alan Walters would be at the center of the currency board movement. He is one of the most rabid monetarist opponents of the American System of economics, which is based upon the concept of developing the cognitive power of the human mind and the dirigistic powers of the state to promote economic development.

Born in 1926, Walters graduated from Oxford, and in 1981, he was one of the chief architects of British Prime Minister Margaret Thatcher's economic revolution. *The Iron Lady,* a favorable biography of Thatcher by Hugo Young, reports: "Early in January [1981], Mrs. Thatcher took on an economic adviser, Alan Walters, who secured more influence in less time at the heart of the government than anyone in a comparable position before him. . . . He became her trusty guru."

In 1981, Walters pushed through £3.5 billion of budget cuts, and an increase in personal, gasoline, and other taxes. Interest rates soared; unemployment leapt above 15%. The British oligarchy sacrificed what remained of its own physical economy as an international example. Britain became strictly a post-industrial economy. The City of London, which had always been the world's dominant financial center, took off to spread speculation around the world. For his work, on Thatcher's recommendation, Walters was knighted by Queen Elizabeth II.