Washington's waning way
Alan Beattie

After decades of the US telling developing countries to open up to foreign capital as well as goods and services, the message is being confused by the interventionism that props up Wall Street, writes Alan Beattie. Below, the response in Paris and Berlin

Debating with Al Gore in the presidential election eight years ago, George W. Bush defined a new, humbler attitude towards the rest of the world. "I'm not so sure the role of the United States is to go around the world and say, 'this is the way it has got to be'," he said. "I just don't think it's the role of the United States to walk into a country and say: 'we do it this way, so should you'."

In one area Mr Bush might be about to get his wish, though not perhaps in the way he expected.

The events of the past few weeks on Wall Street have handed ammunition to the opponents of free markets well outside the financial sector and way beyond America's shores, A model of freewheeling finance the US has pushed around the world, which had already undergone some tactical withdrawals over the past decade, appears in headlong retreat.

For some, the retreat of the Washington model risks turning into a rout. David Rothkopf, a senior Commerce department official during the administration of President Bill Clinton, says the world is at a turning point. "This is a watershed," he says. "This is the end of 25 years of Reagan-Thatcherism, 'leave it to the market, less government is better government'. That is over -period."

Some policymakers are confident that, while the pace of liberalisation may slow, it is unlikely to go into sharp reverse. Many economists point out, moreover, that not all liberalisation is the same and that a financial crisis does not justify shunning all free markets. Yet successive US administrations have wrapped the different varieties closely together in a policy package and sold it through a variety of outlets - the International Monetary Fund, the World Bank, the World Trade Organisation and the US's bilateral trade agreements. Disentangling them in the minds of foreign governments and their electorates will be hard.

That package may have started with advocating lower import tariffs on goods, a policy which commands relatively wide support among orthodox economists. But it has expanded to include more controversial strategies: allowing foreign institutions to buy local banks or set up their own subsidiaries, deregulating domestic financial markets and ending controls on cross-border capital movements.

Jagdish Bhagwati of Columbia University, a leading trade economist, has long warned that this is a dangerous confusion of liberalised financial markets, which are subject to repeated bubbles, panics and crashes, and the international movement of goods and services, which is not. Yet in practical terms the two have often been bundled. Washington has sought, for example, to export its own financial model through its trade deals. The template that the US uses in all its negotiations for bilateral trade pacts, and from which it tolerates few departures, includes strict limits on using capital controls to control financial crises.

This, Mr Bhagwati says, is the result of a "Treasury-Wall Street nexus" that has an irrevocable attachment to deregulation. "Wall Street tries to exert pressure on US policy in a big way wherever possible," he says. "It is an ideological commitment. You are made to feel like a socialist freak if you argue against any part of it."

This nexus has been embodied in people as well as vested in ideas, providing conspiracy theorists with copious material. An almost permanently revolving door links investment banks and successive US administrations, Democrat as well as Republican -with a third exit leading off to the IMF. Robert Rubin, one of the most powerful Treasury secretaries in living memory,

came to the Clinton administration from Goldman Sachs and went afterwards to Citigroup. Stanley Fischer, architect of much of the IMF's strategy during the financial turmoil of the 1990s, also left for Citigroup. Hank Paulson, the current Treasury secretary, along with a key group of Treasury advisers, is another Goldman Sachs alumnus.

It was perhaps in the mid-1990s, before the Asian financial crisis of 1997-98, that the financial liberalisation campaign reached its apogee. The US pushed for the liberalisation of countries' capital accounts across the developing world and even cheer-led a move to change the constitution of the IMF to promote it. Former officials say the Fund also rarely saw a kind of domestic financial deregulation that it did not like.

"Until the Asian crisis the IMF, fuelled by the US, urged liberalisation in all directions," says Carmen Reinhart from the University of Maryland and a former IMF official. Countries such as Chile and Malaysia, though relatively successful in economic terms, were castigated for retaining capital controls.

Even before the credit crunch hit last year, the IMF had retreated from that position, particularly on capital accounts. Research by Ken Rogoff, its former chief economist, and others showed that the effects of financial globalisation on poor countries had been mixed.

The World Bank has also embraced a more nuanced set of prescriptions. Its ability to press deregulation on developing countries has in any case diminished as China has emerged as an alternative source of finance, particularly in Africa. Beijing builds roads and doles out cash with fewer strings attached and sometimes portrays itself as a model of how to get rich without wholesale liberalisation of product and capital markets.

Yet such liberalization often still forms an important part of Washington's international economic diplomacy, embedded as it is in its trade policy.

US financial services companies have traditionally been among the more enthusiastic lobbyists for trade deals. They were widely credited for getting the so-called Uruguay round of global trade talks concluded in 1994 and have pushed for more concessions in the current Doha round.

Washington will find itself selling a distinctly tarnished brand if, after the dust settles, it continues to advocate financial sophistication and more freedom for those of its investment banks that still exist. Raghuram Rajan at the University of Chicago, a former IMF chief economist, recently presented a report on financial liberalisation to the Indian government. He found opposition in India to the whole idea had spread. "It is not just the traditional left jumping up and down and saying, I told you so," he says. "Even people who had been willing to countenance reform are becoming a lot more cautious."

Nor, he says, does the public debate in India make much distinction between different forms of financial reform. Selling off government stakes in commercial banks, developing interest rate and currency futures markets, even setting up a new bankruptcy system - all have been tainted by the events in the US. "There is a sense that all these things are interconnected - Wall Street, hedge funds, private equity, futures markets - and that we want no part of it," Mr Rajan says. As if to underline its suspicion of speculators, India's government recently suspended trading in commodity futures in response to the global food crisis.

Reactions elsewhere in the developing world have been more mixed. In China, market regulators have postponed approval to begin trading equity futures, even though most of the 'technical groundwork has been done. But Chinese officials stress that the crisis in the US has not persuaded them to abandon a policy of gradual liberalisation. According to a finance official in Shanghai, the credit crunch could actually accelerate some reforms.

"The lesson is not that there were too many innovations in the US and so we should not innovate at all... It is wrong to say that all these sophisticated products are just bad things," says Fang Xinghai, director general of Shanghai's Financial Services Office. "If we learn the

lessons [of the crisis] we may even speed up financial reforms because we will know the kind of precautions we will need."

In Latin America, a region with plenty of experience of financial crises, one policymaker says: "It is important the debate doesn't get so polarised that we simply wipe the slate clean and everything related to securitisation gets thrown out of the window."

At the least, advocates of freer markets will have to moderate and target their messages - and given its own interventionist response to the crisis, including the ban on short selling stocks, the US will struggle to maintain its previous line in international forums. As well as its dealings with emerging markets, the US is likely to have an awkward time turning up to meetings such as the Group of Seven rich countries and holding forth with its customary lectures on the benefits of deregulation.

True, the likes of Germany and France, which spent much of the past two decades being berated by Washington for insufficient flexibility in product, labour and capital markets, have been restrained about displaying public schadenfreude. But a line of advance has been opened up. Angela Merkel, the German chancellor, said this month that Berlin would push harder within the G7 for higher capital requirements for banks and transparency requirements for financial markets. French President Nicolas Sarkozy called for a world summit to rebuild what he called "regulated capitalism".

Many economists remain optimistic that the collateral damage to open markets and financial innovation can be contained. Mr Bhagwati points out that in the aftermath of the Asian crisis, east Asian governments, while becoming much more suspicious of capital account openness, remained wedded to free trade in goods. Mr Rajan thinks that, in time, the logic of financial sector reform - and particularly innovations such as a bankruptcy system that will enhance economic stability, not undermine it - will prevail. India has opened up capital movements without much opposition, he says.

Mr Rogoff says that even if the US gives up leading the charge towards more financial sophistication, others such as Singapore, Hong Kong, even Brazil can come in to take its place. "There is a lot of creativity in the financial services industry and it has created a lot of growth and stability," he says. "At some point, some countries are going to look back and say: 'there was a lot of good in what the US was doing and we can do it better'."

But what seems highly likely is that free markets and complex financial engineering will need new cheerleaders. Reluctant liberalisers around the world now have a great deal more ammunition when faced with American visitors saying: "We're from Wall Street and we're here to help."

Fonte: Financial Times, London, September 29 2008, Primeiro Caderno, p. 10.