

1999

Banking and Financial Reform at the Crossroads of the Neoliberal Contagion

Timothy A. Canova

Follow this and additional works at: <http://digitalcommons.wcl.american.edu/auilr>



Part of the [International Law Commons](#)

Recommended Citation

Canova, Timothy A. "Banking and Financial Reform at the Crossroads of the Neoliberal Contagion." American University International Law Review 14, no. 6 (1999): 1571-1645.

This Article is brought to you for free and open access by the Washington College of Law Journals & Law Reviews at Digital Commons @ American University Washington College of Law. It has been accepted for inclusion in American University International Law Review by an authorized administrator of Digital Commons @ American University Washington College of Law. For more information, please contact fbrown@wcl.american.edu.

BANKING AND FINANCIAL REFORM AT THE CROSSROADS OF THE NEOLIBERAL CONTAGION*

TIMOTHY A. CANOVA**

INTRODUCTION	1572
I. THE CONTEXT OF GLOBAL CONTAGION	1578
A. RECENT STRESSES: BANKS, HEDGE FUNDS, AND DERIVATIVES	1578
B. ORIGINS OF CONTAGION: CAPITAL ACCOUNT LIBERALIZATION AND THE HOT MONEY PROBLEM.....	1584
II. NAFTA'S MASK OF NEOLIBERAL DISCOURSES	1586
III. HOT MONEY AND THE "TEQUILA EFFECT"	1597

* This article is based on a paper presented to the Seventh Annual Conference of the United States-Mexico Law Institute in Santa Fe, New Mexico on October 3, 1998, which came on the heels of the most volatile week of the year in United States and global financial markets. The week saw a serious decline in global financial markets, a severe drop in prices in United States stock and bond markets, and a multi-billion dollar private-sector bailout of a suddenly collapsing hedge fund. Those events necessarily provided the context for this article.

My thanks to my editors Jennifer Manvell Jeannot and Matthew Greller, to my research assistants, Mark Lovato and Monica Guardiola, to students in my fall 1998 International Business Transactions class for providing a challenging and constructive workshop, and special thanks to Bill McLeod, Cynthia Lichtenstein, Martin Melkonian, Irwin Stotzky, William Krehm, Robert Desiderio, Fernando Montes-Negret, Barbara Creel, and Paul Smyth for support, suggestions, and encouragement. An excerpted version of this article will be republished as part of the United States-Mexico Law Institute Seventh Annual Conference Proceedings in 7 U.S.-MEX. L.J. (1999). This article is dedicated to the memory of Lynn Turgeon, a great friend and mentor through thick and thin.

** Assistant Professor, University of New Mexico School of Law. J.D., Georgetown University Law Center 1988; B.A., Franklin & Marshall College 1982; M. Dipl., University of Stockholm Faculty of Law 1989; Legislative Assistant to United States Senator Paul E. Tsongas, 1983-84. E-mail: canova@law.unm.edu.

IV. FOUNDATIONS OF THE NEOLIBERAL FINANCIAL REGIME: THE CONTAGION OF NEOLIBERAL REFORM	1610
V. A PATH FOR REFORM	1618
A. EXCHANGE RATE STABILITY.....	1618
B. RESTRICTIONS ON SHORT-TERM CAPITAL INFLOWS	1622
C. PROPOSALS FOR A FINANCIAL TRANSACTIONS TURNOVER TAX.....	1629
D. INCREASING GLOBAL LIQUIDITY WITH SPECIAL DRAWING RIGHTS	1633
E. CHANGING THE BURDENS OF ADJUSTMENT: RECYCLING THE SURPLUSES	1636
F. THE SCARCE CURRENCY CLAUSE AND OTHER TRADE TACTICS	1642
VI. FINDING OPPORTUNITY IN STABILITY	1643

INTRODUCTION

The banking and financial industries in the United States and Mexico are at important crossroads. The paths taken now will have important repercussions for years to come. In the aftermath of the massive devaluation of the peso in early 1995, Mexico's private banking industry virtually collapsed.¹ As reported by the International Monetary Fund ("IMF"), by early 1995, the peso devaluation resulted in dramatic increases in interest rates to levels as high as 80%.² This in turn made it difficult for millions of borrowers to service their debts, thereby undermining the solvency of Mexican

¹ See Roy A. Karaoglan and Mike Lubrano, *Mexico's Banks After the December 1994 Devaluation: A Chronology of the Government's Response*, 16 NW. J. INT'L L. & BUS. 1, 2 (1995) (arguing that the devaluation of the peso in late 1994 resulted in the collapse of the private banking industry soon after).

² See DAVID FOLKERTS-LANDAU AND TAKATOSHI ITO, INTERNATIONAL CAPITAL MARKETS: DEVELOPMENT, PROSPECTS, AND POLICY ISSUES 62-63 (International Monetary Fund, Washington, D.C., Aug. 1995) (analyzing the cause and effect of monetary changes in the capital markets and interest rates).

banks.³ The Mexican government headed by President Zedillo pushed forward with a \$65 billion bank bailout plan, as well as plans to permit foreign ownership of Mexican banking.⁴ The continuing upheaval and bailout of the Mexican financial sector became something of a political lightning-rod, highlighting the extreme schisms between economic classes in Mexico,⁵ particularly between elite creditor groups and the debtor class that makes up a vast proportion of the Mexican population.⁶

In contrast to Mexico's difficulties, banking and finance in the United States bounced back from its earlier setbacks, such as the collapse and bailout of the savings and loan industry, the 1987 stock market decline, and the credit crunch and recession of the early 1990s.⁷ The agenda of the United States banking industry is now a

³ See *id.* (reporting debt-servicing problems of borrowers and resulting decline in asset quality in both "the peso-denominated and foreign currency loan books of Mexican banks").

⁴ See Mike Lubrano, *Foreign Investment in the Financial Sector of Mexico*, 6 U.S.-MEX. L.J. 81, 82 (1988) (describing Mexico's relaxed restrictions to attract foreign investment in its financial sector in the aftermath of the 1994-95 peso crisis); see also Kenneth Bachman et al., *Financial Services Under the North American Free Trade Agreement: An Overview*, 28 INT'L LAW. 291, 305-06 (1994) (discussing the Mexican government plan to permit foreign investment and assist the financial sector in regrowth after the 1994 peso crisis).

⁵ See Lucy Conger, *Mexicans Oppose Rescue Scheme*, FIN. TIMES, Sept. 1, 1998, at 4 (discussing the economic sectors both opposing and supporting the attempted financial rescue plan); see also Julia Preston, *\$62 Billion Bank Bailout Plan in Mexico Incites Outrage as Critics Say It Helps the Rich*, N.Y. TIMES, July 31, 1998, at A6 (analyzing the effects of the bailout plan and the objections of certain sectors of the population).

⁶ See Julia Preston, *Wanted Posters in Mexico Now Feature a White Collar*, N.Y. TIMES, Oct. 28, 1998, at A14 (reporting the filing of formal petitions to the Mexican Congress to begin impeachment proceedings against Guillermo Ortiz Martinez, former Finance Minister and head of the Bank of Mexico for funding the bank bailout program with government debt).

⁷ See Timothy A. Canova, *The Transformation of U.S. Banking and Finance: From Regulated Competition to Free-Market Receivership*, 60 BROOK. L. REV. 1295, 1330-36 (1995) (explaining how the United States banking industry has survived a series of setbacks).

multifaceted strategy of continued financial innovation, diversification, and expansion, often through merger and consolidation.⁸ Some of the largest United States banks expanded by merging with or buying other commercial banks and non-bank financial institutions.⁹ One of the most notable examples is the announcement of the megamerger between Citibank and Travelers Insurance that created Citigroup, estimated to be worth \$70 billion.¹⁰ This merger may spell the end of the Glass-Steagall Act's prohibitions that separated commercial banking from investment banking and insurance.¹¹

⁸ See DEREGULATING FINANCIAL SERVICES: PUBLIC POLICY IN FLUX (G. Kaufman and R. Kormendi, eds., Ballinger Publishing Co. 1986) (analyzing the current United States banking industry and the means by which it facilitates its agendas); see also *Trillion Dollar Banks*, BUS. WK., Apr. 27, 1998, at 32 (discussing the asset value and strategies of major banks within the United States banking industry and their global agendas).

⁹ See *Pretty at Citi?*, ECONOMIST, Apr. 11, 1998, at 11 (describing the merger between Citibank and Travelers Insurance); see also *Trillion Dollar Banks*, *supra* note 8, at 32, 35 (asserting that the new Citigroup will have nearly \$700 billion in assets); Michael Siconolfi, *Citicorp Merger with Travelers Signals New Era*, WALL ST. J., Apr. 7, 1998, at A1 (reporting the merger between Citibank, a commercial bank, and Travelers Insurance, a non-bank financial institution); see generally Richard Brooks, *NationsBank, BankAmerica Holders Vote for \$43.02 Billion Merger Plan*, WALL ST. J., Sept. 25, 1998, at B7 (announcing another merger between two financial giants in the banking industry).

¹⁰ See John Authers, *Travelers, Citicorp merger completes today*, FIN. TIMES, Oct. 8, 1998, at 21 (describing the sharp decline in the price of bank shares in late 1998, which considerably lowered the value of the Citibank-Travelers and the Nations-Bank-BankAmerica mergers).

¹¹ See Jill Dutt & John M. Berry, *Citicorp-Travelers Deal to Test Old Regulator View*, WASH. POST, Apr. 7, 1998, at C1 (discussing the proposed Citicorp-Travelers merger and the effects on the banking and non-bank financial industries); see also J. Robert Brown, Jr., *The Great Fall: The Consequences of Repealing the Glass-Steagall Act*, 2 STAN. J. L. BUS. & FIN. 129, 130-31 (1995) (analyzing the effects of repealing the Glass-Steagall Act and the consequences on mergers between banks and non-bank related financial institutions); see generally Wolfgang H. Reinicke, *Consolidation of Federal Bank Regulation?*, in REFORMING MONEY AND FINANCE 185-86 (R. Guttman ed., M.E. Sharpe 1997) (discussing the merits of reforming the United States banking and finance laws and the potential consequences such reform would have on mergers and acquisitions between finance and money lending institutions).

At first glance, there does not appear to be a relationship between banking and finance in these two neighboring countries. In Mexico, there is financial retrenchment and a banking industry that struggles for solvency and survival.¹² By contrast, there is an incredible inflation in the great United States bull market and the expansion of United States banking and finance into new geographic and product areas.¹³ Mexico, however, opened its banks to foreign ownership at the same time that the agenda of United States banks was to branch out into more diverse types of banking and to continue investing in emerging economies.¹⁴ These trends, therefore, indicate the possibility of a "marriage of convenience,"¹⁵ with United States commercial and investment banking coming to the rescue of the flailing Mexican banking industry.¹⁶ Hoping to preside over this marriage are a host of

¹² See Henry Tricks, *Top Mexico Banks Face Capital Need*, FIN. TIMES, Apr. 21, 1999, at 4 (reporting on the current Mexican banking crisis and the need for an influx of capital to help strengthen and support the failing banks); see also JAVIER GAVITO, AARON SILVA, GUILLERMO ZAMARIPPA, *Mexico's Banking Crisis: Origins, Consequences, and Countermeasures*, in REGULATION AND SUPERVISION OF FINANCIAL INSTITUTIONS IN THE NAFTA COUNTRIES AND BEYOND 228-45 (G.M. von Furstenberg, ed., Kluwer Academic Publishers 1997) (offering an analysis of the causes behind the Mexican banking crisis and the steps that can be taken in the future to avert or prevent such a crisis); *Bancomer of Mexico Braces Itself as It Heads Into Rough Waters*, WALL ST. J., Oct. 2, 1998, at A10 (reporting on the Mexican banking crisis, the reaction of banks like Bancomer, and the steps taken by these banks to survive the crisis).

¹³ See *supra* notes 8-11, and accompanying text.

¹⁴ See *supra* notes 4, 8-9, and accompanying text.

¹⁵ See SIDNEY WEINTRAUB, A MARRIAGE OF CONVENIENCE: RELATIONS BETWEEN MEXICO AND THE UNITED STATES (1990) (likening the relations more as a "mixed marriage" of different cultures); see also Stephen Zamora, *The Americanization of Mexican Law: Non-Trade Issues in the North American Free Trade Agreement*, 24 LAW & POL'Y INT'L BUS. 391, 438 (1993) (discussing the effects of the North American Free Trade Agreement on the domestic laws of Mexico).

¹⁶ See JOHN E. ROGERS & ADRIAN ZUBIKARAI ARRIOLA, *Foreign Banks in Mexico: on the Verge of a New Era?*, 7-12 PROGRAM OF THE SEVENTH ANNUAL CONFERENCE, U.S.-MEXICO LAW INSTITUTE (1998) (analyzing the changes within the Mexican banking system and the possibility of increased foreign investment especially by United States banks).

ministers who seek to broaden the agenda of a particular type of neoliberal globalization, one marked by increased deregulation, financial liberalization and privatization.¹⁷

Such a marriage between United States and Mexican banking and finance would, of course, create significant legal opportunities. Many scholarly writings have focused on the legal details of Mexico's bank bailout and privatization plans,¹⁸ the legal issues involved in the consolidation of United States banking, the erosion of the Glass-Steagall Act,¹⁹ and the minutia of the many private capital market develop-

¹⁷ See BEYOND BRETTON WOODS: ALTERNATIVES TO THE GLOBAL ECONOMIC ORDER (J. Cavanagh et al. eds., Institute for Policy Studies 1994) (contemplating changes to the world economic system which would include increased deregulation, financial liberalization, and privatization); see also FIFTY YEARS IS ENOUGH: THE CASE AGAINST THE WORLD BANK AND THE INTERNATIONAL MONETARY FUND (K. Danaher & M. Yunus eds., South End Press 1994) (discussing the benefits and detriments of the World Bank and the International Monetary Fund over the course of the last fifty years and the effects of their actions on the global economic system); CHERYL PAYER, THE DEBT TRAP: THE INTERNATIONAL MONETARY FUND AND THE THIRD WORLD (1974) (discussing the efforts of poor nations to gain control over their economies, and the role the IMF played in foiling any such attempt); James Wilson, *Latin America's Minnows Scent Privatisation's Rewards*, FIN. TIMES, June 10, 1998, at 7 (reporting on the effects of privatization on Latin American countries and their respective economies).

¹⁸ See ROGERS & ARRIOLA, *supra* note 16, at 10-11 (discussing the economic and financial benefits of foreign investment, especially United States investment in the Mexican banking industry).

¹⁹ See generally Robert G. Rowe III and Kenneth A. Guenther, *The Erosion of the Glass-Steagall Act and the Bank Holding Company Act*, 115 BANKING L.J. 663, 670 (1998) (analyzing the changes to the Glass-Steagall Act as a result of relaxing standards on mergers between banking and non-bank financial institutions); Note, *The New American Universal Bank*, 110 HARV. L. REV. 1310, 1327 (1997) (discussing the rapid increase in mergers between traditional banks and non-bank financial enterprises); Nicole Fradette et al., *Regulatory Reform in Transition: The Dismantling of the Glass-Steagall Act*, 47 ADMIN. L. REV. 545, 552 (1995) (analyzing the effects of continued United States banking sector regulation on the Glass-Steagall Act which prohibits the mergers of banks and non-bank related financial service companies); see also GEORGE J. BENSTON, THE SEPARATION OF COMMERCIAL AND INVESTMENT BANKING: THE GLASS-STEAGALL ACT REVISITED AND RECONSIDERED 179-214 (1990) (arguing that commercial and investment banking should continue to be segregated).

ments and investment opportunities on both sides of the border.²⁰

It is important to step back from the trees and consider the forest; to step back from the details and consider the broader legal and extra-legal developments that often provide the unspoken context for private financial activity. This approach permits an examination of our most fundamental assumptions about the nature of today's globalization of money and finance. This article will consider the context of the global currency contagion, which may threaten the profitability of private financial institutions,²¹ the prospects for a marriage between United States and Mexican banking, and the economic progress upon which so much of the work of United States-Mexican co-operation depends.²²

The currency contagion continues to bring tremendous disloca-

²⁰ See generally RALPH FOLSOM & W. DAVIS FOLSOM, *Understanding NAFTA and its International Business Implications* (1997) (discussing NAFTA in relation to the effects of international business on the banking and other investment opportunities in both the United States and Mexico); see also HAL S. SCOTT & PHILIP A. WELLONS, *INTERNATIONAL FINANCE; TRANSACTIONS, POLICY, AND REGULATION* 768-812 (3d ed., 1996).

²¹ See Joseph Kahn, *Merrill Cites \$1.4 Billion Exposure to Long-Term*, N.Y. TIMES, Oct. 2, 1998, at C1 (discussing the general financial situation of Merrill-Lynch and its profitability); see also Tracy Corrigan and Clay Harris, *Merrill to Cut 3,400 Jobs After Sharp Fall in Profits*, FIN. TIMES, Oct. 14, 1998, at 1 (reporting the layoffs at Merrill-Lynch and the correlation between lower profits and the general welfare of the corporation); Edmund L. Andrews, *Market Place: UBS says it will reduce international lending, as well as risks like investment in distressed loans*, N.Y. TIMES, Jan. 26, 1999, at C12 (discussing the general effects of international lending on financial institutions, which causes some institutions to reduce or to halt such types of investment); John Authers, *BankAmerica in \$1.4 Billion Provision*, FIN. TIMES, Oct. 15, 1998, at 1 (describing BankAmerica's investment strategy and overall profitability).

²² See Sue Major Holmes, *Asian Woes Dragged Down N.M.*, ALBUQUERQUE J., Dec. 29, 1998, at C3 (arguing that the fallout from the Asian contagion has already cost the local economy of New Mexico thousands of jobs); see also Rob Valletta, *East Asia's Impact on Twelfth District Exports*, Federal Reserve Bank of San Francisco, Economic Letter No. 98-35 (Nov. 20, 1998) (stating that the slowdown in United States manufacturing stems from the Asian recession); *Treasury Study Shows Effects of Global Financial Situation*, TREASURY NEWS, (last modified Oct. 6, 1998) <<http://www.treas.gov/press releases/pr2739.html>>.

tions and hardship to Mexican society.²³ For example, very high real interest rates and cutbacks in the government's fiscal programs have harmed a wide segment of the Mexican population.²⁴ Recent financial market developments also brought fears that Wall Street's bull market could itself be threatened by the widening global financial turmoil.²⁵ Instead of congratulating ourselves on the opportunity to exploit this crisis environment, we should focus on the potential benefits of a more stable financial regime. Such a new regime should create opportunities for private profit, while also providing the foundation for renewed prosperity for a wider population, rather than merely the supplicants of high finance.

I. THE CONTEXT OF GLOBAL CONTAGION

A. RECENT STRESSES: BANKS, HEDGE FUNDS, AND DERIVATIVES

The global currency contagion offered a shock to conventional

²³ See Anthony DePalma, *In Mexico, Hunger for Poor and Middle-Class Hardship*, N.Y. TIMES, Jan. 15, 1995, at 1 (reporting on the effects of the peso devaluation on Mexican people and the society); see also Allan H. Meltzer, *Clinton's Bailout Was No Favor to Mexicans*, WALL ST. J., Feb. 2, 1996, at A11 (arguing that the United States' bailout of Mexico's financial crisis did not benefit the financial markets as much as anticipated); Julia Preston, *Mexicans Rise in a Rate Rebellion*, INT'L HERALD TRIB., Apr. 8, 1996, at 10 (reporting that variable interest rates rose above 100%; nearly 20% of the value of all loans was past due).

²⁴ See WILLIAM GREIDER, *ONE WORLD, READY OR NOT* 262-63, 267 (1997) (arguing that imposing interest rates on ordinary Mexicans in the hundreds of percent illustrates that developing countries like Mexico "make a kind of deal with the devil when they open themselves to the animal spirits of global capital").

²⁵ See Paul Beckett, *Banks Latin Exposure Moves to Fore*, WALL ST. J., Sept. 10, 1998, at A3 (analyzing the effects of the Latin American crisis on American financial markets); see also Robert D. Hershey Jr., *The Sell-off in Stocks Deepen as Markets Plunge Worldwide*, N.Y. TIMES, Oct. 2, 1998, at C1 (reporting on the increasing number of market sell-offs in response to the global economic crisis); Paul Volcker, *Boost For Banking*, WASH. POST, Sept. 10, 1998, at A21 (warning against the combination of United States banking with commerce). Volcker writes that recent banking crises in Asia and Russia illustrate "the folly of permitting industrial-financial conglomerates to dominate financial markets and potentially larger areas of the economy." See *id.*

wisdom by striking at United States-based financial institutions with little warning.²⁶ The sudden meltdown and bailout in October 1998 of a large United States-based hedge fund called Long-Term Capital Management, L.P.²⁷ exposed many United States banks for lending millions of dollars to Long-Term Capital, as well as to hundreds of other hedge funds for highly speculative investments in exotic financial instruments known as derivatives.²⁸ Regulators are increasingly concerned that the largest United States banks have significant credit exposure to derivative trading, particularly to exchange rate contracts,²⁹ and the Basle Accord's risk-based capital requirements fail to accurately reflect the risks involved in such derivative trading.³⁰

²⁶ See Peter B. Kenen, *From Halifax to Lyons: What Has Been Done About Crisis Management?*, ESSAYS IN INT'L FIN., No. 200 (1996) (analyzing the sudden effects of the global currency crisis on United States financial institutions and demonstrating that the past Summit meetings of the Group of Seven (G-7) leading industrial countries seems like annual rituals of complacency, where western leaders fail to address the root causes of contagion and focus instead on crisis-management).

²⁷ See Sharon R. King, *After Hedge Fund Bailout, Tighter Restrictions Are Seen*, N.Y. TIMES, Sept. 28, 1998, at C5 (reporting that many hedge funds, like Long-Term Capital Management, are structured as limited partnerships, and are open only to "sophisticated investors" who must have a net worth of more than \$1 million and an annual income of more than \$200,000 in each of the most recent two years).

²⁸ See Robert D. Hershey Jr., *A Warning To Banks: Scrutinize Hedge Funds*, N.Y. TIMES, Dec. 17, 1998, at C4 (reporting on the exposure of United States banks to hedge funds and the detrimental financial and economic effects on the banking industry); see also Daniel P. Cunningham, et. al., *An Introduction to OTC Derivatives*, 848 PLI/CORP 121, 125-27 (1994) (explaining the basic tenets of derivatives and the economic impact of these investments on the global economy).

²⁹ See Stephen Zamora, *Regulating the Global Banking Network: What Role (If Any) For the IMF?*, 62 FORDHAM L. REV. 1953, 1956-57 (1994) (reporting that "by 1992, the aggregate credit exposure of ten United States banks due to derivative trading had reached \$170 billion, or 17.3% of their total assets").

³⁰ See George Graham, *Warning on Poor Lending Standards*, FIN. TIMES, Oct. 15, 1998, at 8 (arguing that the poor lending practices and investment practices of banks fail to disclose the risks involved in derivative trading); see also David Barboza & Jeff Gerth, *On Regulating Derivatives*, N.Y. TIMES, Dec. 15, 1998, at C1 (reporting on the proposed increases in regulation for investing in derivatives), Barbara C. Matthews, *Capital Adequacy, Netting, and Derivatives*, 2 STAN. J. L.

Although regulators and legal commentators recognize the role of hedge funds and derivative trading in transmitting financial failure across markets,³¹ discussion of such dynamics is often confined to experts and technocrats.³² Consequently, the failures of private financial actors do not receive much blame when financial contagion strikes.³³ Instead, the focus is on the victim countries, their alleged failures, and on policies that place the burdens of adjustment on those victim countries.³⁴

The drama surrounding Long-Term Capital Management's mismanagement exposed a need for greater humility. For example, in the

BUS. & FIN. 167, 169-70 (1995) (discussing the risks of investing in derivatives and the exposure of United States banks, which was discussed at the Basle Committee meeting in July 1994), Bruce S. Darringer, *Swaps, Banks, and Capital: An Analysis of Swap Risks and a Critical Assessment of the Basle Accord's Treatment of Swaps*, 16 U. PA. INT'L BUS. L. 259 (1995) (offering an analysis of the terms and provisions of the Basle Accord and the risks involved with disclosure requirements of the treaty).

³¹ See Charles A. Samuelson, Note, *The Fall of Barings: Lessons for Legal Oversight of Derivatives Transactions in the United States*, 29 CORNELL INT'L L. J. 767, 768-69 (1996) (discussing the demise of Barings Bank and the lessons learned by American banks regarding the need for legal oversight in derivatives trading); see also J. Christopher Kojima, *Product-Based Solutions to Financial Innovation: The Promise and Danger of Applying Federal Securities Laws to OTC Derivatives*, 33 AM. BUS. L. J. 259, 261 (1995); Nancy Worth, *Harmonizing Capital Adequacy Rules for International Banks and Securities Firms*, 18 N.C.J. INT'L L. & COM. REG. 133, 134-35 (1992) (discussing the need for coordination among international banks and securities firms in developing and administering rules and regulations for hedge funds and derivative markets).

³² See Samuelson, *supra* note 31, at 773-75 (arguing that regulators and legal experts do not analyze the full effects of derivatives, but rather, only a limited number of experts dominate the field).

³³ See Ovidio E. Diaz Espino, *Emerging Markets Derivatives Set To Expand*, 1017 PLI/CORP 669, 671 (1997) (arguing that derivatives are a solution, rather than a problem, for the investment needs of emerging markets).

³⁴ See Jeffrey D. Sachs, *The Wrong Medicine for Asia*, N.Y. TIMES, Nov. 3, 1998, at A19. (stating that "the currency crisis is not the result of Asian government profligacy...[t]his is a crisis made mainly in the private, albeit under-regulated, financial markets").

past several years the United States preached to the rest of the world about the dangers of crony capitalism, the dangers of not moving fast enough to close down insolvent banks, and the need for transparency.³⁵ Suddenly, however, this flagrant wake-up call arose, presenting a reminder that the United States is not immune to such folly and crass self-interest.³⁶

There are several challenging and frightening aspects of the recent turmoil in financial markets. First, is the unpredictability of the onset of financial panic in any particular market. Little more than an unsubstantiated rumor, a disappointing report about earnings or foreign reserves, or even a bearish editorial, triggers a sudden turn in herd mentality to panic selling.³⁷ Second, is the manner in which financial failures in one market are so quickly transmitted around the globe into selling in other financial markets, justly earning the description of "contagion."³⁸

There are many damning facts that should not be forgotten now that a sense of calm has replaced the panic of the fall in 1998. To be-

³⁵ See BRUCE COGGINS, *Does Financial Deregulation Work? A Critique of Free Market Approaches* 11-30 (1998) (describing the deregulationist program and assumptions).

³⁶ See Richard Stevenson, *Fiscal Stones, Glass Houses: Bailout Points Finger Back Toward the U.S.*, N.Y. TIMES, Sept. 26, 1998, at A1 (critiquing the United States for adopting an artificial sense of self-importance prior to falling victim to the effects of the collapse of the Long-Term Capital Management hedge fund and the effects on the United States banking industry).

³⁷ See Soros Urges Russia to Devalue Ruble, FIN. TIMES, Aug. 13, 1998, at 1 (discussing how, for instance, the market turned increasingly against the Russian ruble upon publication of a letter in *The Financial Times* by speculator George Soros predicting the ruble's devaluation); see also *Russian to the Exits: 'A Global Margin Call' Rocks Markets, Banks, and Boris Yeltsin*, WALL ST. J., Aug. 28, 1998, at A1 (reporting the effects of a statement in the global press on the margins of the Russian economy).

³⁸ See Gretchen Morgenson, *Hedge Fund Bailout Rattles Investors and Markets*, N.Y. TIMES, Sept. 25, 1998, at A1 (reporting that hedge funds burned in Russia's meltdown needed to cover open positions by selling United States Treasuries and corporate debt, thereby putting downward pressure on those markets, which undermined the positions of other hedge funds).

gin with, Long-Term Capital Management, a hedge fund with about \$2.3 billion in capitalization, leveraged hundreds of billions of dollars in loans from some of the world's largest private financial institutions, thereby increasing its own exposure to one of systematic proportions.³⁹ Secondly, the fact that Myron Scholes and Robert Merton, two Nobel laureates in economics, who until recently were hailed as financial geniuses, directed this hedge fund.⁴⁰ Thirdly, the fact that the Federal Reserve Bank of New York, rather than permit the meltdown of an obviously insolvent Long-Term Capital Management hedge fund and risk widening the financial crisis, used its offices to broker a \$3.65 billion bailout of that hedge fund.⁴¹

These events suggest that the United States is not immune from the evils and weaknesses that we deplore in others. Such evils and weaknesses include: a frightening lack of financial transparency;⁴²

³⁹ See Floyd Norris, *Risking Everything on One Big Gambler*, N.Y. TIMES, Oct. 1, 1998, at A30 (analyzing the actions of the Long-Term Capital Management hedge fund and the effects of risk exposure on such funds).

⁴⁰ See Peter Truell, *An Alchemist Who Turned Gold Into Lead*, N.Y. TIMES, Sept. 25, 1998, at C1 (reporting on the skills of Myron Scholes and Robert Merton); Jon Krainer, *The 1997 Nobel Prize in Economics*, Federal Reserve Bank of San Francisco Letter, No. 98-05 (Feb. 13, 1998) (discussing the skills of Myron Scholes and Robert Merton and their findings, which earned them the Nobel Prize in Economics); see also JOHN KENNETH GALBRAITH, *THE GREAT CRASH: 1929* 58-61, 120, 129-30, (1954) (warning that financial genius is always before the fall).

⁴¹ See Gretchen Morgenson, *Seeing a Fund as Too Big to Fail, New York Fed Assists Its Bailout*, N.Y. TIMES, Sept. 24, 1998, at A1 (explaining the Federal Reserve-brokered, private sector bailout of the fledgling hedge fund); see also Richard W. Stevenson, *Fed Chief Defends U.S. Role in Saving Giant Hedge Fund*, N.Y. TIMES, Oct. 2, 1998, at A1 (offering alternative insight into the bailout of the Long-Term Capital Management hedge fund); Truell, *supra* note 40, and accompanying text.

⁴² See Melody Petersen, *Trick: Accounting Draws Levitt Criticism*, N.Y. TIMES, Sept. 29, 1998, at C8 (quoting Arthur Levitt, chairman of the United States Securities and Exchange Commission who harshly criticized the use of "accounting hocus-pocus" to manipulate earnings numbers reported to shareholders); see also Melody Petersen, *U.N. Report Faults Big Accountants in Asia Crisis*, N.Y. TIMES, Oct. 24, 1998, at B1 (reporting that the U.N. faulted large accounting firms and accountants in mismanaging finances which led to the current economic crisis in Asia).

hesitation in closing down insolvent financial institutions; failure to know when to maintain these risks from wider financial and economic carnage; and the so-called "crony capitalism" tendency of ostensible public-sector regulatory authorities reaching out to help their "friends" in the private sector.⁴³ The revelation that among Long-Term Capital Management's partners was David W. Mullins, Jr., a former vice chairman of the Federal Reserve Board, is particularly embarrassing.⁴⁴ The class-biased cronyism of the Federal Reserve, however, goes much further.⁴⁵ In mid-October 1998, the Federal Reserve's Open Market Committee convened a special emergency meeting, by conference call, to lower short-term interest rates.⁴⁶ This was motivated in no small part by a desire to assist not just Long-Term Capital Management, but other hedge funds as well to unwind their exposed positions in the government and private sector bond markets.⁴⁷

Long-Term Capital Management should provide a glaring re-

⁴³ See John Plender, *Western Crony Capitalism*, FIN. TIMES, Oct. 3, 1998, at 10 (criticizing the incestuous relationship between government and regulatory officials and their private sector contacts).

⁴⁴ See Stevenson, *supra* note 41, and accompanying text; see also Truell, *supra* note 40, and accompanying text.

⁴⁵ See Canova, *supra* note 7, at 1335 (arguing that the Federal Reserve provided large interest rate spreads as a hidden subsidy to bailout commercial banks).

⁴⁶ See Richard W. Stevenson, *Fed Was Worried About Misinterpretation*, N.Y. TIMES, Nov. 20, 1998, at C5 (reporting that no formal vote was taken of members of the Federal Reserve's Open Market Committee; the interest rate cut was made under Chairman Greenspan's authority). Minutes of the Federal Reserve's October 15th meeting stated that lowering interest rates would more likely help to settle volatile financial markets and cushion the effects of more restrictive financial conditions. See *id.*

⁴⁷ See Bill Barnhart, *Fed Steps In, Stocks Take Off While Many Applaud, Cut is for the Few*, CHI. TRIB., Oct. 16, 1998, at 1 (stating that "the Fed hopes to stimulate enough bidders for risky assets to enable hedge funds and other highly leveraged speculators to sell their positions with the least shock waves possible"); see also Richard W. Stevenson, *Federal Reserve Cuts Rates Again; Wall St. Surges*, N.Y. TIMES, Oct. 16, 1998, at A1 (discussing the correlation between the Federal Reserve's actions regarding interest rates and the effect on the financial markets).

minder that no country, not even the United States, is immune from financial contagion, global market downtrends, or the human proclivity to hide the truth and help one's cronies. It also suggests the need for greater humility when our so-called "experts" at the International Monetary Fund ("IMF") and the United States Treasury Department dispense advice and dictate to others, often as preconditions to badly-needed financial assistance.⁴⁸

For those who remain unconvinced of such insight, pecuniary concerns stemming from the meltdown and bailout of Long-Term Capital Management may prove persuasive. The losses incurred by many leading United States private commercial and investment banks because of their reckless lending to this hedge fund, likely will hamper their willingness and ability to increase or even maintain present levels of investment in emerging market economies, including the Mexican banking and financial sector.⁴⁹ Therefore, Long-Term Capital's mismanagement, and the specter of other financial losses from banking and hedge fund losses in derivative markets, may diminish the likelihood of a United States investor-led rescue of the Mexican banking and finance industries.

B. ORIGINS OF CONTAGION: CAPITAL ACCOUNT LIBERALIZATION AND THE HOT MONEY PROBLEM

The currency contagion once again brought trouble to the Mexican economy. Recently, in the aftermath of the Russian economic collapse, the Mexican peso declined by almost 20% as capital fled from

⁴⁸ See Mark Landler, *U.S. Hedge Fund Bailout Raises Asian Eyebrows*, N.Y. TIMES, Sept. 29, 1998, at C8 (discussing the \$3.65 billion rescue by United States financial institutions of Long-Term Capital Management amidst the economic turmoil in Asia); see also Nicholas D. Kristof, *Japan Sees Itself as Scapegoat of Washington in Asia Crisis*, N.Y. TIMES, Sept. 21, 1998, at A1 (revealing the Japanese view that the United States is partly to blame for the Asian downturn); see generally Joseph Stiglitz, *More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus*, The 1998 WIDER Annual Lecture, Helsinki, Finland, Jan. 7, 1998 (reprinted at <http://www.worldbank.org/html/extdr/extme/js010798/wider.htm>) (the World Bank chief economist criticizing Washington consensus policies, and urging "a greater degree of humility").

⁴⁹ See GREIDER, *supra* note 24 at 262-63, 267 (citing high interest rates in the Mexican economy).

most emerging markets.⁵⁰ As a result, the Mexican government raised interest rates above 40% to appease the international currency markets.⁵¹ These high interest rates, when combined with plunging oil revenues and falling domestic demand,⁵² likely will increase future trade and budget deficits, and continued dependence on foreign capital.

Mexico's recent difficulties should not come as much of a surprise. The very origins of today's currency contagion can be traced to the 1994-95 currency panic that damaged the Mexican peso. By 1994, Mexico had come to rely heavily on short-term portfolio capital inflows, also referred to as "hot money." During this time, foreigners bought approximately 40% of the Mexican treasury notes and held securities accounting for 30% of Mexico's stock market.⁵³ Foreign portfolio investment in Mexico increased from an annual average of about \$5 billion for the period from 1986-1990 to \$67 billion in 1993.⁵⁴ Between 1989 and 1993, Latin America captured nearly 66% of the short-term portfolio investment flows into emerging markets, and the Mexican stock market rose during that same period by 436% in dollar terms.⁵⁵ As the peso crisis subsequently dem-

⁵⁰ See Sam Dillon, *Mexican Prices Feel the Squeeze of World Economic Trouble*, N.Y. TIMES, Sept. 15, 1998, at C4 (evidencing economic difficulties in the Mexican economy).

⁵¹ See *id.*

⁵² See *id.*; see also Paul Solman & Robert Corzine, *Ongoing Slide in Global Oil Prices Pressures Overall Commodity Prices*, FIN. TIMES, Dec. 11, 1998, at 21 (noting that global oil prices hit a twelve-year low, falling below \$10 a barrel).

⁵³ See Enrique R. Carrasco & Randall Thomas, *Encouraging Relational Investment and Controlling Portfolio Investment in Developing Countries in the Aftermath of the Mexican Financial Crisis*, 34 COLUM. J. TRANSNAT'L L. 539, 572-73 (1996) (arguing that Mexico depended on foreign investment more than any other emerging nation in 1994 and, as such, foreigners possessed significant control over economic policy).

⁵⁴ See *id.* at 557 (evidencing the increase in foreign investment in Latin America as a result of economic reforms and high interest rates).

⁵⁵ See *id.* at 557, 560 (arguing that heavy portfolio investment made Mexico dependent on external sources).

onstrated, a country that does not protect itself against short-term hot money inflows is susceptible to market hysteria and thus an economic outflow. After all, what is an outflow problem? It is when everyone starts heading to the door simply because everyone else is heading to the door.⁵⁶ There is not necessarily a rational reason to explain the panic. The Mexican economy seemingly sustained itself on such short-term capital inflows and consequently suffered greatly when those inflows turned suddenly to outflows as a result of changes in mass-market psychology.⁵⁷

II. NAFTA'S MASK OF NEOLIBERAL DISCOURSES

In the aftermath of the 1995 peso collapse, an ongoing debate concerning the relative merits of the North American Free Trade Agreement (NAFTA) and the \$51 billion international bailout package for Mexico persists.⁵⁸ The United States and Mexican governments prefer to characterize both as great success stories. Mexico repaid the emergency bailout loans with interest,⁵⁹ and some studies

⁵⁶ See Walter Russell Mead, *Rule 1: Don't Panic. Rule 2: Panic First*, 130 ESQUIRE, Oct. 1998, at 92, 94-96 (arguing that because economic turmoil has spread throughout Asia and South America so quickly, it may even spread to the United States).

⁵⁷ See Ricardo Ffrench-Davis, *Policy Implications of the Tequila Effect*, CHALLENGE, Mar.-Apr. 1998, at 15 (discussing the history of capital flows to Latin America and lessons to be learned from financial crises).

⁵⁸ See Carrasco & Thomas, *supra* note 53, at 568 (explaining that Mexico also agreed to put the proceeds from its oil sales through an escrow account with the Federal Reserve Bank of New York as collateral for the United States loan); see also SIDNEY WEINTRAUB, NAFTA AT THREE 63 (1997); see generally Russell Dean Covey, Note, *Adventures in the Zone of Twilight: Separation of Powers and National Economic Security in the Mexican Bailout*, 105 YALE L. J. 1311 (1996) (discussing the debate as to whether President Clinton had the authority to extend the aid package to Mexico). The bailout consisted of contributions from the IMF (\$18 billion), the Bank for International Settlements (\$10 billion), foreign commercial banks (\$3 billion), and the United States Treasury's Exchange Stabilization Fund (\$20 billion).

⁵⁹ See David Hale, *Such a Deal: The Much-Maligned Mexico Bailout is Looking Smart, and Not Just for Mexico*, WASH. POST, June 2, 1996, at C4 (arguing that the bailout cushioned foreign investors from the discipline of the market).

suggest that since NAFTA's implementation, a surge in foreign direct investment from the United States to Mexico resulted in the creation of some 600,000 jobs in Mexico.⁶⁰ We should, however, consider a wider range of criteria when assessing the results of the NAFTA regime of free capital mobility and the peso collapse and bailout. For instance, a more convincing narrative holds that NAFTA's liberalization of capital flows and the subsequent peso crash and economic austerity contributed to steep declines in jobs and real incomes for millions of Mexicans,⁶¹ as well as to the recent upsurge of illegal immigration from Mexico to the United States.⁶²

While NAFTA arguably bolstered Mexican exports and job creation in the *maquiladoras* at the border, NAFTA also required that Mexico substantially liberalize its capital accounts by removing all restrictions on the inflow and outflow of capital.⁶³ NAFTA Article 1109 requires that each Member country "permit all transfers relating to an investment."⁶⁴ Contrary to the focus of some commentators,⁶⁵

⁶⁰ See Eusebio Francisco Flores Barraza, *Foreign Exchange Challenges vis-à-vis NAFTA, Five Years After NAFTA Came into Force*, U.S.-Mexico Judicial Exchange Border Conference, Mar. 19, 1999; see also Paul Krugman, *The Uncomfortable Truth about NAFTA*, 72 FOREIGN AFF. 13, 14-16 (1993) (prior to the peso collapse, Krugman did not foresee the substantial depressing effects on Mexican jobs and real income and ensuing economic austerity).

⁶¹ See FOLKERTS-LANDAU & ITO, *supra* note 2, at 125-27; see also WEINTRAUB, *supra* note 58, at 54-68 (acknowledging that NAFTA liberalized capital inflows, yet disclaiming NAFTA responsibility for adverse consequences that followed); FOLSOM & FOLSOM, *supra* note 20, at 307-08.

⁶² See David E. Sanger, *Mexico Crisis Seen Spurring Flow of Aliens*, N.Y. TIMES, Jan. 18, 1995, at A3; see also ROBERT APONTE, *The Effects of NAFTA on Mexico-United States Immigration*, in POLICY CHOICES: FREE TRADE AMONG NAFTA NATIONS 195-216 (Karen Robert & Mark I. Wilson eds., Michigan State University Press 1996) (discussing the jobs and immigration debates); SASKIA SASSEN, *THE MOBILITY OF LABOR AND CAPITAL* 120 (1988).

⁶³ See North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., chs. 11, 14, 32 I.L.M. 296 [hereinafter NAFTA].

⁶⁴ See *id.* at art. 1109 (stating that payment of the investment, profits, dividends, interest, capital gains, and other fees are to be made in a freely usable currency at the market rate of exchange).

NAFTA's capital liberalization provisions are not confined to foreign direct investment ("FDI"), which usually refers to foreign investment in fixed plants and equipment.⁶⁶ Rather, the NAFTA liberalization provisions also apply to many types of so-called hot money investments, such as foreign portfolio investment in stocks and bonds.⁶⁷ Accordingly, this process of financial liberalization left Mexico highly dependent on such hot money inflows.⁶⁸

Finally, Chapter 14 of NAFTA provides for a gradual tolerance for, and liberalization of, foreign ownership of financial institutions and services.⁶⁹ As a result, a significant increase in the operation of

⁶⁵ See, e.g., Gloria L. Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT'L L. 259, 264-65 (1994); see also Jose E. Alvarez, *Critical Theory and the North American Free Trade Agreement's Chapter Eleven*, 28 U. MIAMI INTER-AM. L. REV. 303, 306-07 (1997); Guillermo Emiliano Del Toro, *Foreign Direct Investment in Mexico and the 1994 Crisis: A Legal Perspective*, 20 HOUS. J. INT'L L. 1, 5-7 (1997). These authors were either unaware of the distinction between foreign direct investment ("FDI") and portfolio capital, intended for the term FDI to include portfolio capital flows, or were writing before the significance of such hot money flows was apparent.

⁶⁶ See PETER MOLES & NICHOLAS TERRY, *THE HANDBOOK OF INTERNATIONAL FINANCIAL TERMS* 232, 235 (1997) (asserting that foreign direct investment is usually by multinational corporations involving purchase of physical assets in another country, whereas portfolio investment involves purchase of financial instruments such as common stocks or bonds).

⁶⁷ See NAFTA, *supra* note 63, at art. 1139 (defining investments as including equity securities, interests in an enterprise that entitles owner to share of income or profits, loans to affiliates, and debt securities where the original maturity is at least three years). Even financial instruments that are not considered short-term (such as equities or debt securities with long maturities) can be sold instantly, and are, therefore, vulnerable to shifts in market sentiment. See *Bank for International Settlements: 68th Annual Report*, 1997-98 Ann. Rep. at 129.

⁶⁸ See WEINTRAUB, *supra* note 58, at 55 (noting that while not expressly required by NAFTA, the Mexican government came to rely on capital inflows in the form of foreign investment in *tesobonos* (short-term government debt)). This step was necessary to finance deficits that were made inevitable by NAFTA liberalization of trade in capital goods. See FOLSOM & FOLSOM, *supra* note 20, at 299.

⁶⁹ See NAFTA, *supra* note 63, at ch. 14 (providing for rights of establishment of financial institutions, most-favored-nation, and national treatment; annex VII (B))

foreign financial institutions in Mexico⁷⁰ contributed to the dramatic surge of hot money inflows into Mexico.⁷¹

NAFTA's liberalization provisions, central to the Mexican government's neoliberal agenda, led directly to the eventual run on the peso.⁷² Capital account liberalization set the stage and provided the mechanism for such capital flight.⁷³ Consequently, the peso crisis forced Mexico to adopt economic austerity measures as a condition for IMF financial assistance.⁷⁴ These measures include strict fiscal and monetary austerity policies that have translated into extremely

sets forth Mexico's reservations, commitments, and timetables with respect to establishment and operation of foreign-owned financial institutions in Mexico).

⁷⁰ See ROGERS & ARRIOLA, *supra* note 16, at 6 (noting that Mexico amended its Credit Institutions Law to give effect to Annex VII(B) and by mid-1998 at least seventeen subsidiaries of foreign banks were operating in Mexico).

⁷¹ See FOLKERTS-LANDAU & ITO, *supra* note 2, at 53-55. The restructuring of Mexico's debt from bank loans to "Brady bonds" may also have contributed to the peso crisis of 1995 by increasing the short-term nature of its exposure. *See id.* at 64 (describing the steep fall in Mexican Brady bonds in the first quarter of 1995); *see also* FOLSOM, ET AL., INTERNATIONAL BUSINESS TRANSACTIONS 947-48 (1995) (detailing the nature of the Brady Bond).

⁷² See FOLKERTS-LANDAU & ITO, *supra* note 2, at 101-102 (noting that even prior to NAFTA's liberalization of capital flows, the Mexican government had started the process by lifting restrictions on inflows in April 1992 and outflows in November 1991). 1990 was the first year of Mexico's surge in inflows and outflows. *See id.*

⁷³ See *supra* notes 52-56, 63-70 and accompanying text (discussing the liberalization process and the subsequent increase in hot money inflows).

⁷⁴ See Carrasco & Thomas, *supra* note 53, at 565-71 (describing Mexico's reform measures, including privatization programs, freezing wages and prices, liberalizing the foreign investment regime, and decreasing spending, and how these measures affected Mexican citizens); *see generally* Letter of Intent from Guillermo Ortiz Martinez, Secretary of Finance and Public Credit of Mexico, and Miguel Mancera Aguayo, Governor of the Bank of Mexico, to Michel Camdessus, Managing Director of the International Monetary Fund (Jan. 26, 1995) (outlining the Mexican plans of action to deal with the financial crisis).

high real interest rates.⁷⁵ When combined with the steep drop in the value of the peso in early 1995, the result has been an escalation in inflation and interest rates and a steep decline in living standards for millions of Mexicans.⁷⁶ The free market model has resulted in the loss of far more jobs within the interior of Mexico than have been gained in the bustling *maquiladoras* along the border.⁷⁷ The dominant narratives of NAFTA, however, focus exclusively on *maquiladora* job gains, to the exclusion of the greater economic austerity job losses.⁷⁸

While the relationship between NAFTA's capital liberalization and Mexico's subsequent economic austerity is widely recognized by policy makers and analysts, Mexican economic reality is largely masked by other more dominant discourses that explain the country's economic and financial problems in terms that serve elite financial interests. These dominant discourses about development and neoliberal economic reform "blame the victim," and promote United States free market cultural values. At the same time, these discourses mask the very real political and structural limitations in transplanting

⁷⁵ See FOLKERTS-LANDAU & ITO, *supra* note 2, at 63; WEINTRAUB, *supra* note 58, at 65. Even after the peso collapse, the Mexican government decided to permit futures trading of the peso on the Chicago Board of Trade. See United States Commodities Futures Trading Commission, *The CFTC: An Active Partner in Global Cooperation Through Bilateral and Multinational Enforcement and Regulatory Memoranda of Understanding* (visited June 12, 1999) <<http://www.cftc.gov/opa/background/mou.html>>.

⁷⁶ See Carrasco & Thomas, *supra* note 53, at 569-71 (noting that Mexico's GDP fell 7% in 1995 and that great social dissatisfaction has since resulted from higher unemployment, reduced benefits, and a heightened foreign presence); see also *The Evolution of Industrial Earnings Inequality in Mexico and Brazil*, University of Texas Inequality Project, Working Paper No. 5, (visited July 6, 1999) <<http://utip.gov.utexas.edu/web/atip.htm>>.

⁷⁷ See U.N. Dept. of Econ. & Soc. Info. & Pol'y Analysis, *World Economic and Social Survey*, 1997, at 34-35, U.N. Doc. St/ESA/256, U.N. Sales No. E/1997/50 (1997) (discussing the persistent high unemployment and poverty rates in Mexico). JAIME SUCHLICKI, MEXICO: FROM MONTEZUMA TO NAFTA, CHIAPAS, AND BEYOND 167, 194 (1996); see also World Employment Report 1998-99, at 21 (International Labour Organization, Geneva, 1998).

⁷⁸ See *supra* note 60 and accompanying text.

United States legal institutions to Mexico and other developing countries.⁷⁹ For instance, there are consistent assertions that Mexico's secured transactions and bankruptcy laws are not just deficient, but pre-modern, archaic, and backward.⁸⁰ These same voices contend that Mexico's economic development will remain retarded as long as the Mexican government fails to adopt protections for creditors modeled after the United States Uniform Commercial Code.⁸¹

This discourse is propagated by elite corporate groups within the United States⁸² that have vested interests in altering particular aspects

⁷⁹ See Elizabeth M. Iglesias, *Human Rights in International Economic Law: Locating Latinas/os in the Linkage Debates*, 28 U. MIAMI INTER-AM. L. REV. 361, 377-85 (1997).

⁸⁰ See Boris Kozolchyk, *What To Do About Mexico's Antiquated Secured Financing Law*, (National Law Center for Inter-American Free Trade, 1998) available in <<http://www.natlaw.com/pubs.htm>>; see also Mike Lubrano, *Practical Difficulties in Mexican Workouts and Bankruptcy*, NORTH AMERICAN CORPORATE LAWYER, Vol. III (1996); Alejandro Garro, *Security Interests in Personal Property in Latin America: A Comparison With Article 9 and a Model For Reform*, 9 HOUS. J. INT'L L. 157 (1987); Franklin Gill, *Remarks to the Commerce and Trade Workshop of the U.S. Mexico Judicial Exchange Border Conference*, Mar. 19-20, 1999.

⁸¹ See Gill, *supra* note 80 and accompanying text; Boris Kozolchyk, *The Basis for Proposed Legislation to Modernize Secured Financing in Mexico*, 5 U.S.-MEX. L.J. 43, 52 (1997) (arguing that the modernization of Mexico's secured transactions laws will attract significant global attention); see also John E. Rogers & Carlos de la Garza-Santos, *General Goods: A Case Involving Security Interests in Inventory and Accounts in the United States, Canada and Mexico*, 5 U.S.-MEX. L.J. 3, 8-9 (1997) (arguing that Mexico's secured transactions laws are more complicated than those of the United States or Canada); see generally John M. Wilson-Molina, *Mexico's Current Secured Financing System: The Law, the Registries and the Need for Reform*, (visited June 13, 1999) <<http://www.natlaw.com/pubs/spmxbk3.htm>> (arguing that the Mexican secured transactions regime is insecure as compared to the United States and Canadian systems).

⁸² For instance, the National Law Center for Inter-American Free Trade is well-funded by elite United States banking, finance, and corporate contributions. At the top of its agenda is reform of Mexico's secured financing and bankruptcy laws. See National Law Center for Inter-American Free Trade, *Secured Financing* (visited June 13, 1999) <<http://www.natlaw.com/secfin.htm>> (providing information about membership, corporate backing, and its secured financing and other

of Mexico's legal system,⁸³ while maintaining other aspects that brought significant damage to Mexico's economic development.⁸⁴ A very ethnocentric mind-set permeates such discourse, which conveniently overlooks the flaws in the United States legal system⁸⁵ and in United States bankruptcy law.⁸⁶ Additionally, there is no empirical support for the dramatic assertion that Mexico's commercial code is the primary and direct cause of the country's economic plight. Moreover, dominant development discourses tend to overstate the deficiencies in Mexican law. Contrary to the dominant narratives, Mexican law provides significant protection for creditors, including provisions for speedy attachment of assets.⁸⁷ Recent Mexican Su-

projects). Noticeably absent from its agenda are any proposals to address Mexico's vulnerability to the hot money problem and its continuing economic austerity. *See id.*; *see also* Todd Nelson, *Secured Financing Project* (visited June 13, 1999) <<http://www.natlaw.com/pubs/sfproj.htm>>.

⁸³ *See supra* notes 80-82 and accompanying text (suggesting that much of the agenda of those propagating the dominant development narratives is to provide additional protections to creditors).

⁸⁴ *See infra* notes 169-183, 187-189 and accompanying text (among the most ignored dynamics has been those relating to capital account liberalization).

⁸⁵ *See generally* George A. Akerlof & Paul M. Romer, *Looting: The Economic Underworld of Bankruptcy for Profit*, in BROOKINGS PAPERS ON ECONOMIC ACTIVITY 1, 1-5 (1993) (describing various financial crises in the United States); *see also* Floyd Norris, *The Rise of Phony Corporate Tax Shelters*, N.Y. TIMES, Feb. 8, 1999, at A26 (explaining the various loopholes in the United States tax regime).

⁸⁶ *See* Douglas G. Baird, *Loss Distribution, Forum Shopping and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, 833-34 (1987) (noting disagreement with the Warren Court's views on bankruptcy protections, which leave many unprotected); *see also* Morris G. Shanker, *The Abuse and Use of Federal Bankruptcy Power*, 26 CASE W. RES. L. REV. 3 (1976); Saul Hansell, *Battle Emerging On How To Revise Bankruptcy Law*, N.Y. TIMES, Oct. 19, 1997, at 1; Katharine Q. Seelye, *Senate Votes to Curb Bankruptcy Abuse by Consumers*, N.Y. TIMES, Sept. 24, 1998, at A1.

⁸⁷ *See* Lic. Guadalupe Von Ontiveros, Lic. Raquel Nieblas German, & Lic. Martin Antonio Lugo Romero, *Remarks to the Commerce and Trade Workshop of the U.S.-Mexico Judicial Exchange Border Conference*, Mar. 19-20, 1999 (reporting comments by three Mexican state court judges); Codigo de Comercio de Mexico,

preme Court decisions reject debtors' defenses and claims that sharply escalating interest rates are unconscionable and constitute usury or excessive enrichment of creditors.⁸⁸ Despite differences between the Mexican civil law system and the United States common law system, there are also significant similarities between United States and Mexican commercial law.⁸⁹ The dominant development discourse, however, continues to ignore both the many deficiencies in the United States legal system and the significant protection for creditors found in Mexican law. For such reasons, combined with the overriding private profit objectives of their proponents, some of these dominant discourses are neocolonial in nature and resemble a type of legal imperialism.

It is particularly distorting to assert with such condescending authority that Mexico's well-developed commercial law impedes economic development⁹⁰ when it is the implementation of neoliberal policy that saddled the Mexican population with crippling interest rates that are as high as 100% or more.⁹¹ In the context of such finan-

Titulo III de los Juicios Ejecutivos, Articulos 1391, 1392, 1394, 1396, 1399 (summary procedures under the Commercial Code of Mexico for attachment and/or seizure of assets based on specific documentary evidence).

⁸⁸ See *supra* note 87; see also Julia Preston, *Mexico Gets Green Light to Charge Interest on Interest*, N.Y. TIMES, Oct. 9, 1998, at C2 (describing a Mexican Supreme Court ruling that allowed ailing Mexican banks to charge interest on interest).

⁸⁹ See *supra* notes 87-88. Likewise, the advent of limited liability in the United States was once criticized as inefficient because it transferred business risks to creditors. See generally Paul Halpern, Michael Trebilcock, & Stuart Turnbull, *An Economic Analysis of Limited Liability Corporation Law*, 30 U. TORONTO L.J. 117 (1980). More recent scholars claim the opposite, namely that limited liability is a necessary precondition to capital accumulation, but the empirical evidence on such a fundamental question regarding the relationship of corporation law and economic growth is inconclusive. See Phillip I. Blumberg, *Limited Liability and Corporate Groups*, 11 J. CORP. L. 573, 575-77 (1986).

⁹⁰ See Transnational Insolvency Project: International Statement of Mexican Bankruptcy Law 14-16 (The American Law Institute ed., 1998) (giving a generally positive assessment of Mexican bankruptcy law).

⁹¹ See GREIDER, *supra* note 24, at 267.

cial conditions, even the most comprehensive legal protections for creditors will not suffice. One cannot draw blood from a stone; and creditors cannot easily stay solvent by trying to collect on debts and attach assets in an economic environment in which jobs are disappearing and real incomes are falling, no matter what the legal protections.⁹²

Most importantly, the dominant discourse that criticizes Mexican commercial culture also tends to subordinate other perspectives that are more critical of the United States neoliberal model.⁹³ The dominant narratives mask and distort more comprehensive descriptions of reality, including narratives that link capital account liberalization to the hot money problem and currency contagion.⁹⁴ Critical perspectives are often marginalized as unrealistic, and dismissed because of the attenuated chain of causation of their analyses.⁹⁵ Liberalized

⁹² See GALBRAITH, *supra* note 40, at 184.

⁹³ See Charles R. P. Pouncy, *Contemporary Financial Innovation: Orthodoxy and Alternatives*, 51 SMU L. REV. 505, 556-74 (1998) (noting that the dominant narratives often serve to marginalize heterodox post-Keynesian theories that are based on more realistic assumptions). Professor Pouncy illustrated how the underlying, but flawed assumptions of neoclassical economic thought prevent legal scholars from generating a complete understanding of the process of financial innovation. See *id.*, Ilene Grabel, *Speculation-led Economic Development: A Post-Keynesian Interpretation of Financial Liberalization Programmes in the Third World*, 9 INT'L REV. APPLIED ECO. 127 (1995); see generally Ilene Grabel, *Marketing the Third World: The Contradictions Of Portfolio Investment in the Global Economy*, 24:11 World Development 1761-76 (Nov. 1996).

⁹⁴ See generally STUART CORBRIDGE, *DEBT AND DEVELOPMENT* (1993) (suggesting dominant narrative interpretations of the third world debt crisis often reflect normative and flawed assumptions about development and global economic structures); see also LARRY ALAN BEAR & RITA MALDONADO-BEAR, *FREE MARKETS, FINANCE, ETHICS, AND LAW* (1994); see generally Ilene Grabel, *Rejecting Exceptionalism: Reinterpreting the Asian Financial Crises*, GLOBAL INSTABILITY AND WORLD ECONOMIC GOVERNANCE 37-67 (1999).

⁹⁵ Similarly, private legal challenges to the Federal Reserve System have been dismissed for lack of standing because the plaintiffs could not convince the courts that the Federal Reserve's open market operations are causally connected to rising interest rates on private loans and to slower economic growth. See *Committee for Monetary Reform v. Bd. of Governors of the Fed. Reserve Sys.*, 766 F.2d 538, 542 (D.C. Cir. 1985) (holding that the plaintiffs lacked standing either on the theory of

capital flows contribute to an overvalued peso, which leads to growing trade deficits. Growing trade deficits, in turn, lead to an eventual sudden outflow of capital and downward pressure on the peso. As a result, the Bank of Mexico engages in foreign exchange market interventions and raises interest rates to stabilize the peso. In the end, the sharply higher interest rates translate into massive job losses, declining incomes, rising bankruptcies, and financial failures.⁹⁶ Such a sophisticated analysis is empirically verifiable. The attenuated causal links in the analysis, however, cannot easily compete with the simplistic appeal of the neoliberal and development discourses that free markets always work best and that submerging economies are to blame for their own plight.⁹⁷

The connections between Mexico's economic austerity and social stresses are apparent. The rich live very well in Mexico City, but they live in gilded cages, often afraid to walk the streets of their own city by day or night. This is not out of fear of mere robbery, but fear of kidnapping. The wave of kidnappings sweeping the Mexican capital is not politically motivated in the strict sense, but economi-

economic harm, or as a challenge on separation-of-powers grounds); *see also* *Bryan v. Fed. Open Market Comm.*, 235 F. Supp. 877, 881-82 (D. Mont. 1964) (holding that the plaintiff did not claim any injury to himself apart from that suffered by all other owners of government obligations, and therefore plaintiff had no standing to sue); Mark F. Bernstein, Note, *The Federal Open Market Committee and the Sharing of Governmental Power With Private Citizens*, 75 VA. L. REV. 111, 131-134 (1989) (examining the issue of standing with regards to the Federal Reserve System).

⁹⁶ *See* Stephen Zamora, *International Debt: How can Developing Countries Regain Creditworthiness?*, 83 AM. SOC'Y INT'L L. PROC. 87, 100-105 (1989) (suggesting that capital flight is believed to have contributed significantly to capital account imbalances). Establishment economists often acknowledge the same events, but reach different conclusions about causation. *See* Michael Mussa & Morris Goldstein, Symposium, *The Integration of World Capital Markets*, in CHANGING CAPITAL MARKETS: IMPLICATIONS FOR MONETARY POLICY 292 (Fed. Reserve Bank of Kan. City, 1993).

⁹⁷ *See generally* ROBERT HEILBRONER & WILLIAM MILBERG, *THE CRISIS OF VISION IN MODERN ECONOMIC THOUGHT* (1995) (providing an overview of classical and modern economic thought); DONALD M. MCCLOSKEY, *KNOWLEDGE AND PERSUASION IN ECONOMICS* (1994); DONALD M. MCCLOSKEY, *THE RHETORIC OF ECONOMICS* (1985).

cally motivated.⁹⁸ Some of the ransoms are as little as \$100 or less. This disturbing social disintegration⁹⁹ is exacerbated by continuing stagnation in real wages and incomes, greater stratification in wealth and income, and persistently high levels of joblessness, underemployment, and poverty.¹⁰⁰

The Mexican government's solutions and the advice of the IMF continue to impose a dismal austerity of fiscal retrenchment, cutbacks in public subsidies, and frighteningly high interest rates that greatly undermine private sector activity.¹⁰¹ This, again, suggests the need for greater humility and a reexamination of whether NAFTA's liberalization of short-term portfolio investment, the Mexican peso bailout, and the IMF austerity program actually represent such great success stories.

⁹⁸ See Mary Sutter, *Crime Wave Continues to Grip Capital of Mexico, Posing Threat to U.S. Business*, J. COMMERCE, Aug. 25, 1998, at A1 (reviewing the crime wave in Mexico); see also Roger Cowe, *Kidnapping: The World's Top Growth Industry*, THE GUARDIAN, Oct. 9, 1998, at 2 (examining the propensities of kidnapping in Mexico).

⁹⁹ See Tim Padgett, *Cop Crisis*, TIME, Aug. 24, 1998, at 14 (reporting on corrupt police officers and brutal crimes in Latin America); see also Sam Dillon, *Murder in Mexico: Reformers Uncover Police Plot*, N.Y. TIMES, Feb. 8, 1999, at A8 (recounting the horrific acts of five Mexican police officers).

¹⁰⁰ See *World Economic and Social Survey 1997*, *supra* note 77, at 34-35 (declaring that the recession in Mexico fueled a sharp increase in open unemployment and poverty rates); see also Hamid Tabatabai, *STATISTICS ON POVERTY AND INCOME DISTRIBUTION* (Int'l Labour Org., Geneva, 1996) (displaying poverty and income distribution information for Mexico); Suchlicki, *supra* note 77, at 167-194 (describing the economic crisis in Mexico); *The Evolution of Industrial Earnings Inequality in Mexico and Brazil*, *supra* note 76.

¹⁰¹ The economic austerity also impacts the country's cultural life in countless ways. See Henry Tricks, *Mexico May End Food Subsidies*, FIN. TIMES, Nov. 6, 1998, at 5 (reporting that Mexico's finance ministry will propose an end to subsidies on food and energy as part of cost-saving efforts to compensate for a drop in oil revenues); Julia Preston, *A Museum In Mexico Suddenly Shuts Down*, N.Y. TIMES, Sept. 23, 1998, at B1 (stating that what critics regarded as Mexico's finest modern art museum was another victim of austerity and recession).

III. HOT MONEY AND THE "TEQUILA EFFECT"

While the peso collapse and the ensuing economic austerity program brought hardship to Mexican society, these events should also be seen as the origin of many of the most serious global financial difficulties.¹⁰² Many utilize the term "Tequila Effect" to describe the adverse impact of the peso collapse on the currencies of other emerging market economies.¹⁰³ According to the IMF's own surveys, this "Tequila Effect" spread throughout Latin America and East Asia as early as mid-1995.¹⁰⁴ Asian financial markets began to decline in January 1995 "when pressures on Mexico began to intensify."¹⁰⁵ The most pronounced market pressures zeroed in on the Thai baht,¹⁰⁶ followed by other foreign currencies.¹⁰⁷

This represented the very beginning of the "Asian Flu," the severe and sudden collapse of a vast portion of the global economy. For many years, Asian developing countries relied less than Latin American developing countries on foreign borrowing from commercial sources, at high or variable interest rates, or in dollar-denominated debt.¹⁰⁸ Asian developing countries, however, began

¹⁰² See generally Ffrench-Davis, *supra* note 57 (discussing impacts of the "Tequila Effect" on various economies).

¹⁰³ See Carrasco & Thomas, *supra* note 53, at 571-72 (comparing the "Tequila Effect" to a "ripple impact" on other Latin American countries).

¹⁰⁴ See FOLKERTS-LANDAU & ITO, *supra* note 2, at 67.

¹⁰⁵ See *id.*

¹⁰⁶ See Philip Shenon, *A Bad Week In the Asian Markets, Too*, N.Y. TIMES, Jan. 16, 1995, at D6 (declaring that aftershocks of Mexico's financial crisis continue to pound emerging markets).

¹⁰⁷ See Ramon Moreno, *What Caused East Asia's Financial Crisis?* Reserve Bank of San Francisco Economic Letter, No. 98-24 (Aug. 7, 1998) (remarking that the collapse of Thai baht in July 1997 set off an unprecedented financial crisis in East Asia); see also Nicholas D. Kristof & Sheryl WuDunn, *Of World Markets, None an Island*, N.Y. TIMES, Feb. 17, 1999, at A1, A8 (noting the global contagion's ability to "infect" other countries).

¹⁰⁸ See Azizali F. Mohammed, *Contrasting External Debt Experience: Asia and Latin America*, in BEYOND ADJUSTMENT: THE ASIAN EXPERIENCE 106-112 (Paul

competing for foreign investment; many of them dismantled controls on short-term capital inflows and became increasingly susceptible to sudden outflows. Generally, East-Asia transformed from a traditionally conservative financial region to one that relied heavily on short-term private borrowing at market interest rates. This transformation accelerated during the 1990s, because of the encouragement of the neoliberal agendas of the Clinton administration¹⁰⁹ and private financial interests.¹¹⁰

When the inevitable sudden outflow of short-term portfolio capital occurred,¹¹¹ currencies fell throughout Asia, including Hong Kong,

Streeten ed. Int'l Monetary Fund 1998) (comparing Asian and Latin American debt statistics). Many IMF analysts did not see the storm approaching over Asia until it actually broke. See Mussa & Goldstein, *supra* note 96, at 309 (dismissing hot money concerns for Asian countries).

¹⁰⁹ Robert E. Rubin, United States Treasury Secretary from 1995 to 1999 and former chairman of Goldman Sachs & Company, an investment bank with a direct interest in capital account liberalization, has been a prime mover of the financial neoliberal agenda. See Nicholas D. Kristof & David E. Sanger, *How U.S. Wooed Asia To Let Cash Flow In*, N.Y. TIMES, Feb. 16, 1999, at A1, A10 (proclaiming that the Clinton Administration pushed hard for financial liberalization and freer capital flows with respect to Asia); see also Gillian Tett, *Japan Plans to Open up Part of Short-term Securities Market*, FIN. TIMES, Aug. 26, 1998, at 1 (explaining that Japan plans to open its short-term government debt market to foreign investment, in response to Rubin demands); Greta Steyn, *Rubin Urges S. Africa to Embrace Globalisation*, FIN. TIMES, July 15, 1998, at 6 (stating that Rubin urged African governments to open goods and financial markets and embrace globalization). One can only imagine the private sector opportunities that await Mr. Rubin now that he has stepped down as Treasury Secretary in reward for his public service in the private interest. See John M. Broder & David E. Sanger, *Rubin Resigning as Treasury Secretary*, N.Y. TIMES, May 13, 1999, A1 (recalling the career of Rubin), Paul Blustein, *Rubin, Placid Before Brickbats and Bouquets*, WASH. POST, July 2, 1999, E1 (reporting that Rubin is joining the New York-based Council on Foreign Relations).

¹¹⁰ See Robert T. Parry, *Development of Financial Services in the Asia Pacific: Issues and Opportunities*, Reserve Bank of San Francisco Economic Letter, No. 96-18 (June 7, 1996). Parry is president and chief executive officer of the privately-owned Federal Reserve Bank of San Francisco.

¹¹¹ See Peter John, *\$51 bn Fall in Bank Lending to Asia is Biggest in Decade*, FIN. TIMES, Nov. 30, 1998, at 1 (citing figures published by the Bank for International Settlements of a \$51.7 billion (or 14%) drop in bank lending to Asia in first half

Indonesia, Malaysia, the Philippines, South Korea, and Thailand. The falling currencies threatened the already weak Japanese yen, and placed pressure on the Chinese yuan.¹¹² Exacerbating the hot money outflows was the dynamic of competitive devaluation of currencies, so destructive during the Great Depression, in which “beggar thy neighbor” currency price wars threw entire regional economies into a downward spiral.¹¹³ As one economist suggested, never before in economic history has such a large part of the world fallen as fast as Asia in the past few years.¹¹⁴

As the Asian Flu spread westward, the Russian ruble collapsed,¹¹⁵

of 1998); see also Martin Meyer, *The Asian Disease: Plausible Diagnoses, Possible Remedies: Regulation of Cross-Border Interbank Lending and Derivatives Trade*, PUB. POL’Y BRIEF NO. 44 (Jerome Levy Economics Institute, Annandale-on Hudson, 1998) (discussing the Asian financial crisis).

¹¹² See Seth Faison, *China’s Economic Boss Resists Pressure to Devalue Currency*, N.Y. TIMES, Dec. 1, 1997, at A6; see also Ramon Moreno, *Lessons from Thailand*, Reserve Bank of San Francisco Economic Letter, No. 97-33 (Nov. 7, 1997) (reporting on depreciation of Asian currencies); Sheryl WuDunn, *As Japan Goes, So Goes the Neighborhood*, N.Y. TIMES, June 16, 1998, at D8 (quoting China’s central bank governor as saying the Yen’s weakness was “having a very negative impact on Chinese imports and exports and the utilization of foreign capital”); Seth Faison, *Beijing on the Brink?*, N.Y. TIMES, Nov. 27, 1997, at A3 (reviewing the various troubles of China’s ailing economy); Terry McCarthy, *Is China Next?*, TIME, Sept. 21, 1998, at 78.

¹¹³ See CHARLES P. KINDLEBERGER, *THE WORLD IN DEPRESSION 1929-1939* (1973); Kenneth Kasa, *Contractionary Effects of Devaluation*, Reserve Bank of San Francisco Economic Letter, No. 98-34 (Nov. 13, 1998) (referring to the decline in Asian economies); see also Kenneth Kasa, *Export Competition and Contagious Currency Crises*, Reserve Bank of San Francisco Economic Letter, No. 98-1 (Jan. 16, 1998) (observing the erosion of Asian currencies).

¹¹⁴ See Paul Krugman, *Saving Asia: It’s Time to Get Radical*, FORTUNE, Sept. 7, 1998, at 75; see also EDDY LEE, *THE ASIAN FINANCIAL CRISIS: THE CHALLENGE FOR SOCIAL POLICY* (1998) (noting the historically devastating economic decline in Asia).

¹¹⁵ See David E. Sanger, *Next Asian Crisis?* N.Y. TIMES, May 28, 1998, at A12 (asserting that the recent panic that struck Russia looks very much like the next phase of the Asian crisis, from the standpoint of Washington); see also Donald G. McNeil Jr., *Fierce Run on the Rand by Speculators Shocks South Africa*, N.Y. TIMES, July 1, 1998, at D1 (discussing the devaluation of the Rand); Avi Machlis

creating the prospect of social unrest and political turmoil in a country of vital geopolitical strategic importance.¹¹⁶ The potential social and political turmoil in other submerging countries should not be underestimated.¹¹⁷

The Russian bear market quickly threatened confidence in Western bull markets and other emerging markets.¹¹⁸ For example, a collapse in Brazil, the new front line in this global battleground,¹¹⁹ would certainly pose a threat to Mexico. Brazil and Argentina are

and Alan Beattie, *Falling Shekel Forces Interest Rate Rise*, FIN. TIMES, Oct. 27, 1998, at 4 (describing the devaluation of the Shekel).

¹¹⁶ See Mead, *supra* note 56, at 162 (stating that "[s]ince the end of the Cold War, Western policy toward Russia has been a textbook case in how to drive a people to fascism"); see also Charles William Maynes, *Squandering Triumph*, 78:1 FOREIGN AFFAIRS 15 (1999) (analyzing economics in a post-Cold War era).

¹¹⁷ See Seth Mydans, *New Violence Puts Indonesia's Military at a Crossroads*, N.Y. TIMES, Nov. 16, 1998, at A1 (noting the dominant role of Indonesia's military).

¹¹⁸ See Diana Jean Schemo, *Possible I.M.F. Bailout Stirs Brazilians' Bitter Memories of 80's*, N.Y. TIMES, Oct. 1, 1998, at A19 (noting a speedy transmission of Russian crisis to hot money outflow from Brazil); see also Peter Fritsch & Michael M. Phillips, *Back to the Brink: Brazil's Devaluation Reignites Global Fears Of Spreading Malaise*, WALL ST. J., Jan. 14, 1999, at A1 (stating that the eighteen-month old global financial crisis, re-emerged as the head of Brazil's central bank allowed the currency to fall in value by 8.3 % against the United States dollar).

¹¹⁹ See Stephen Fidler & Geoff Dyer, *Brazil obtains \$41bn rescue package*, FIN. TIMES, Nov. 14, 1998, at 4 (noting that the IMF eventually pieced together a \$41 billion pre-emptive bailout of Brazil). But see Timothy A. Canova, *Why Brazil Will Fall*, 10:11 ECON. REFORM 16 (1998) (arguing that the assistance package was inherently flawed since it did not address the hot money problem); Jeffrey Sachs & Steven Radelet, *Next Stop: Brazil*, N.Y. TIMES, Oct. 14, 1998, at A23 (asserting that the policies that will likely form the core of the bailout package could condemn Brazil to follow Asia into deep recession); Michael M. Weinstein, *Economic Scene: A Few Billion Dollar Fix that Won't Ultimately Cure Brazil*, N.Y. TIMES, Oct. 29, 1998, at C2 (asserting that neither the austerity plan spelled out by Brazil nor the bailout package will solve its financial crisis).

paying much higher interest rates as a result.¹²⁰ This is rather disturbing since neoliberals had hailed Argentina as the model of a very well-run economy.¹²¹ Argentina brought down its inflation rate to near zero and its fiscal deficit to approximately 1% of its gross domestic product.¹²² Economic and financial fallout could even wash ashore in the United States and Western Europe.¹²³ What is most

¹²⁰ See John Barham, *Brazil Lifts Rates to 35.5% As Real Falls*, FIN. TIMES, Jan. 28, 1999, at 3 (reporting that Brazil raised interest rates to 35.5% to help defend its currency which has lost over one-third of its value since the government terminated controlled exchange rates); see also Geoff Dyer, *Real Keeps Falling as Bank Confirms Decision to Float*, FIN. TIMES, Jan. 19, 1999, at 1 (declaring that the Brazilian Real weakened further against the dollar although the central bank said it would continue to let the market decide the exchange rate); Ken Warn, *Argentine Economy Spending in 1999 to be Held Steady: Buenos Aires Keeps Budget Reins Tight*, FIN. TIMES, Sept. 16, 1998, at 6 (claiming that analysts expected the government to pay high interest rates to handle the debt); Geoff Dyer, *Dollar Outflows Putting Brazil Under Pressure*, FIN. TIMES, Oct 16, 1998, at 8 (declaring that in two months since the Russian crisis Brazil lost about \$25 billion in reserves from capital flight).

¹²¹ See Edward C. Snyder, *The Menem Revolution in Argentina: Progress Toward a Hemispheric Free Trade Area*, 29 TEXAS INT'L L.J. 95 (1994) (reviewing Argentina's dramatic economic improvement); see also Steve H. Hanke, *Don't Cry for Me*, 10 INT'L ECON. 46 (1996) (praising Argentina's economy).

¹²² See Alberto F. Aldes, *Currency Boards and Its Implications for Argentina*, ECON. RESEARCH 21, 22 (Goldman Sachs, Feb. 1995) (listing Argentina's economic statistics). Argentina's currency board model presents particular danger that a slowdown in capital inflows would quickly translate into loss of reserves by the Central Bank, contraction of the money supply, sharply higher interest rates, and economic slowdown. *Id.*

¹²³ See Jonathan Fuerbringer, *Others' Risk of Contagion From Brazil*, N.Y. TIMES, Feb. 11, 1999, at C1 (stating that several countries could face problems, either in raising money or in defending their currencies, due to Brazil's currency plunge); see also Clifford Krauss, *Argentines Suffering From Brazil Crisis*, N.Y. TIMES, Feb. 8, 1999, at A8 (claiming that Brazil's suffering economy will effect the other countries in the Mercosur trade union); Anthony Faiola, *Ecuadorian Economy Near Collapse; Bank Closures, Proposed Austerity Measures Trigger Widespread Protests*, WASH. POST, Mar. 17, 1999, at A22 (stating that like other Latin American countries, Ecuador has been injured by the collapse of the currency in Brazil); Larry Rohter, *Columbia Devalues Peso by 10% in Emergency Decree*, N.Y. TIMES, June 29, 1999, at C4 (describing speculative selling pressure on the Co-

troubling about the dynamics of currency contagion, however, is that the market seems to indiscriminately discipline bad as well as good economic behavior, and the punishment is far too excessive.¹²⁴

This is the new political dynamic of our time, in which sovereign governments have lost their ability to pursue policies of high economic growth and full employment.¹²⁵ Mexico provides a perfect example. It surrendered virtually all controls on hot money capital flows, freed its central bank from democratic accountability, and continued to raise interest rates to keep capital from fleeing.¹²⁶ In early 1999, as Mexico's interbank interest rates rose above 40%, debt burdens also rose. Yet, "faster depreciation of the peso raise[d] foreign debt service payments in peso terms, which also put pressure on the public purse," and necessitated further cutbacks in government

lombian peso and the Government's failed attempts to defend the currency by spending \$275 million of its reserves in the foreign exchange market).

¹²⁴ See Joseph Stiglitz, *An Economic Taint South America Doesn't Deserve*, N.Y. TIMES, Sept. 16, 1998, at A29 (noting that the contagion, which results when investors realign their portfolios, has damaged seemingly unrelated countries and regions); see also Alan Greenspan, *Remarks to annual meeting of the Securities Industry Association*, (last modified Nov. 5, 1998 <<http://www.bog.frb.us/board/docs/speeches/current/19981105.html>> (stating that "market discipline today is clearly far more draconian and less forgiving than twenty or thirty years ago"); Clifford Krauss, *Latin Growth Weakens, With Joblessness Up*, N.Y. TIMES, June 30, 1999, at C1, C6 (describing economic deterioration in Latin America, including sharply rising unemployment as effects of the global currency contagion). Bear Stearns estimated that the purchasing power of Latin America would contract by \$179 billion in 1999. The Bear Stearns report concluded that Latin America is under pressure as it prepares for the Federal Reserve to raise interest rates "in the face of falling prices in much of the world." *Id.*

¹²⁵ See IRWIN P. STOTZKY, *SILENCING THE GUNS IN HAITI: THE PROMISE OF DELIBERATIVE DEMOCRACY* 185 (1997) (offering a representative example of the dilemma often faced by governments of developing countries, when Haitian President Preval had the "arduous task of balancing two constituencies, one of them being his domestic political followers who oppose free-market reforms, and the other being the international donor nations seeking market reforms").

¹²⁶ See generally Gerardo Zuniga Villasenor, *Mexico: Anti-Contagion Defences*, OXFORD ANALYTICA DAILY BRIEF, Jan. 18, 1999 (reporting that the central bank was made independent of political direction in April 1994).

spending for the poor and struggling middle-class.¹²⁷ Tight monetary policy and higher interest rates, however, remain the only politically acceptable solutions to the threat of capital flight, even though such solutions only compound a country's problems.¹²⁸

Capital controls—government restrictions on the flow of capital between countries—represent an alternative solution. Capital controls are dismissed as an option because “monetary authorities are ideologically opposed to non-market instruments,” and because Mexico's long border with the United States “would render them useless.”¹²⁹ These obstacles, however, may merely provide another way of saying that the power of private financial markets and the lack of United States leadership and cooperation stand in the way of using alternative policy instruments.

A country that ignores the hot money threat and the dictates of private financial markets faces the very real danger of capital flight and a sharply falling currency. Scholars and journalists refer to this dilemma as a “dual constituency conundrum,” which pits the interests of voters against foreign currency traders and hedge fund managers “who conduct moment-to-moment referendums” on the economic and financial policies of developing and developed nations alike.¹³⁰

¹²⁷ See *id.* (providing that the measures include a tax on telephone service and a withdrawal of subsidy on tortillas, a food staple, while tax revenues continue to decline since the global contagion and austerity programs have undermined the price of Mexican oil exports.)

¹²⁸ See *id.*; see also Henry Tricks, *Mexican Inflation Setback for Bank*, FIN. TIMES, Jan. 8, 1999, at 3 (reporting that Mexico's central Bank lost credibility with the release of figures showing inflation reached 18.61% last year, a figure above the government's 12% target).

¹²⁹ See Tricks, *supra* note 128, at 3.

¹³⁰ See STOTZKY, *supra* note 125. Presidential candidates, and even coup leaders, of every political stripe now feel compelled to campaign on Wall Street, and to meet with private bankers by video link-ups and at the annual IMF-World Bank meeting. See David J. Rothkopf, *Whistle-Stops on Wall Street*, N.Y. TIMES, Mar. 8, 1999, at A17 (explaining the dual constituency conundrum); see also MILES KAHLER, INTERNATIONAL INSTITUTIONS AND THE POLITICAL INTEGRATION xi, xviii (1995) (elaborating on the erosion of traditional national sovereignty);

How did we get to this kind of world in which markets punish so severely while sovereign governments are rendered impotent? First, we did not learn the lessons from Mexico's collapse.¹³¹ The same causes of Mexico's collapse have continued to occur in submerging countries around the world ever since the Mexican peso collapse.¹³² The dismal chain of events includes: (1) the liberalization of capital accounts; (2) a dependence upon foreign investment; (3) a dependence upon a particular type of foreign investment, short term hot money portfolio investment; (4) the need to maintain high real interest rates and overvalued exchange rates to attract and maintain sufficient levels of foreign investment; (5) the adverse impact of overvalued exchange rates and high interest rates on a country's trade and budget deficits; (6) the inevitable panic and rush to the door; and, finally, (7) the sudden outflow of capital, often triggered by an unforeseen event, but made inevitable by the unsustainable dependence on hot money to finance burgeoning deficits.¹³³

Canova, *supra* note 7, at 1351-52 (discussing the veto-power of international capital markets).

¹³¹ IMF analysts, committed to capital account liberalization, apparently refused to acknowledge the dangers building throughout Asia and other emerging market countries. See Mussa & Goldstein, *supra* note 96, at 309 n.51.

¹³² The global currency contagion has also reduced demand for commodities, further undermining the economic and financial conditions within deficit countries. See Gary Mead, *Commodity price index at 21-year low*, FIN. TIMES, Aug. 28, 1998, at 28; see also David Barboza, *The Brazil Effect On Commodities*, N.Y. TIMES, Jan. 27, 1999, at C1; Henry Tricks, *Mexican budget hit by cut in oil prices*, FIN. TIMES, Dec. 7, 1998, at 4; Jonathan Fuerbringer, *Commodities Price Slide Victimizes Economies of Several Nations*, N.Y. TIMES, Dec. 11, 1998, at C1.

¹³³ See generally Cynthia C. Lichtenstein, *Dealing with Sovereign Liquidity Crises: New International Initiatives for the New World of Volatile Capital Flows to and from Emerging Markets*, 29 MCGEORGE L. REV. 807 (1998) (detailing the "Asian flu" contagion and preventative measures for pre-crisis emerging market economies); see also Gary Weiss, *The Man Who Moves Markets*, BUS. WK., Aug. 23, 1993, at 50, 53 (citing George Soros' view that currency contagion results from overvalued currencies, a tight monetary policy, and high real interest rates); George Soros, *The Capitalist Threat*, ATLANTIC MONTHLY, Feb. 1997, at 45 (asserting that capitalism has replaced communism as the main enemy of an open democratic society).

This neoliberal financial regime is built on a mixture of free market ideology and crass economic self-interest.¹³⁴ For instance, consider the emergence of hedge funds as players in the global financial system. A hedge fund is an unregulated fund of less than one hundred wealthy investors who seek to move their capital around the globe in a nanosecond.¹³⁵ Even Alan Greenspan, the Chairman of the United States Federal Reserve Board, acknowledged that he did not know the number of hedge funds that were presently operating in the United States or offshore during questioning from the House Banking Committee in the fall of 1998.¹³⁶ His ignorance on such a matter may not be entirely unexpected.¹³⁷ Hedge funds are not regulated and

¹³⁴ Keynes may have been overly optimistic when he concluded that "the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas." See JOHN MAYNARD KEYNES, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY* 383 (1964 ed.).

¹³⁵ Hedge funds operate under the Investment Company Act of 1940 exemption for funds of less than 100 private investors; are incorporated offshore; or operate under the 1966 amendment to Federal securities laws that exempts from regulation funds with fewer than 500 "sophisticated" institutions or individuals in which the individuals invest more than \$5 million and institutions invest more than \$25 million. See Leslie Wayne, *Congress to Debate Greater Oversight of Hedge Funds*, N.Y. TIMES, Oct. 1, 1998, at C1 (detailing congressional debate regarding hedge funds); see also Stevenson, *supra* note 41, at B2.

¹³⁶ See *Federal Reserve Board Testimony of Chairman Alan Greenspan* [hereinafter *Greenspan Testimony*] (last modified Oct. 1, 1999) <<http://www.bog.frb.us/boarddocs/testimony/1998/19981001.html>> (reporting that Greenspan warned that any direct United States regulation of hedge funds would drive the funds to offshore jurisdictions); see also Canova, *supra* note 7, at 1306-09 (claiming that a race to the bottom necessitates harmonization of financial regulations of competing jurisdictions); Robert M. Morgenthau, "On the Trial of Global Capital," N.Y. TIMES, Nov. 9, 1998, A29 (essay written by New York County District Attorney and son of Henry Morgenthau, Jr., the great Secretary of the Treasury throughout the New Deal and during the Bretton Woods Conference); John Steele Gordon, *History Repeats in Finance Company Bailouts*, WALL ST. J., Oct. 7, 1998, at A22 (concluding that the financial crisis in Asia and Russia has shown that the jurisdiction of regulators over financial institutions should extend internationally, even at the risk of encroaching upon another States' sovereignty); Reed Abelson, *Survey Shows Big Growth in Hedge Fund Popularity*, N.Y. TIMES, Oct. 1, 1998, at C3.

are not even registered with the Federal Reserve.¹³⁸ Greenspan opined that there could be hundreds of other Long Term Capitals out there ready to fail or in the process of failing,¹³⁹ which explains why the Federal Reserve's Open Market Committee held an emergency meeting in mid-October 1998 to quickly add liquidity to financial markets.¹⁴⁰

It is increasingly clear to a growing number of economists that capital account liberalization is the primary factor within the control of policymakers that is contributing to financial and economic turmoil around the world.¹⁴¹ As countries dismantled their capital controls, a huge expansion in the volume of capital flows occurred. The daily volume of global foreign exchange trading now exceeds \$1.3 trillion.¹⁴² In 1977, global foreign exchange trading represented about

¹³⁷ See MARTIN MAYER, *THE BANKERS: THE NEXT GENERATION* 370, 402-03 (1997); see also ALEXANDER COCKBURN & KEN SILVERSTEIN, *WASHINGTON BABYLON* 276-80 (1996) (commenting on the many victims of Greenspan and upon his involvement in the Savings and Loan debacle).

¹³⁸ See *supra* notes 27-28, 135-136 and accompanying text.

¹³⁹ See *supra* Greenspan Testimony note 136; see also Stephen Fidler, *Greenspan sees signs of an end to "investor fright,"* FIN. TIMES, Nov. 6, 1998, at 20; Jacob M. Schlesinger & Michael Schroeder, *Greenspan's Hedge-Fund Portrait is Stark,* WALL ST. J., Oct 2, 1998, at A3; Joseph Kahn & Peter Truell, *Investors Fear Trouble at Another Hedge Fund,* N.Y. TIMES, Sept. 29, 1998, at C1.

¹⁴⁰ See Barnhart, *supra* note 47 and accompanying text; see also Stevenson, *supra* note 41 and accompanying text; Gretchen Morgenson, *Investors View Fed's Rate Cut as Too Timid,* N.Y. TIMES, Sept. 30, 1998, at C1.

¹⁴¹ See Jagdish Bhagwati, *The Capital Myth: The Difference Between Trade in Widgets and Dollars*, 77 FOREIGN AFF. 7 (1998) (criticizing the ideology that free capital mobility is more desirable than restraints on capital movement); see also KEVIN PHILLIPS, *ARROGANT CAPITAL* (1994); Greider, *supra* note 24 (attributing the exorbitant interest rates in Mexico to the free movement of capital); Martin Wolf, *Wisdom of Free Flows questioned,* FIN. TIMES, Oct. 2, 1998; Nicholas D. Kristof, *As Free-Flowing Capital Sinks Nations, Experts Prepare to 'Rethink System'*, N.Y. TIMES, Sept. 20, 1998, at 6; Robert Kuttner, *Global Financial Crashes are Excesses of Free Markets,* ALBQ. J., Sept. 11, 1998, at A16.

¹⁴² See David Felix, *On Drawing General Policy Lessons From Recent Latin American Currency Crises*, 20 J. POST KEYNESIAN ECON. 191, 198 (1998).

three and one-half half times the volume of annual global exports. By 1995, it grew to about sixty-four times that amount.¹⁴³ In 1977, the ratio of central banks' global official reserves to daily foreign exchange turnover was about fifteen days. Eighteen years later, it is only about one day.¹⁴⁴ Accordingly, the combined total of all central bank reserves equals only about one day's worth of foreign exchange trading. This begs the question, namely what chance does a single central bank have to protect its currency by open market interventions in the face of a sustained market reaction against that currency?

When a central bank intervenes in isolation to support its currency against a sustained sell-off, it is in essence handing its foreign reserves over to the speculators. This results in heavy losses for the central bank and huge profits for private speculators,¹⁴⁵ including hedge funds, foreign exchange departments of commercial banks, and other financial institutions.¹⁴⁶ One market observer noted that currency traders have become rich by posturing themselves in the market contrary to the positions of central banks. Moreover, the foreign exchange traders realize enormous gains from central bank interventions which, instead of adding stability to markets, causes increased volatility. The commentator argues further that trader and central banker are often the same, with, at minimum, half a dozen previous governors of the Federal Reserve currently holding high-paying jobs on Wall Street, where they furnish advice to currency and bond traders.¹⁴⁷

¹⁴³ See *id.* at 200.

¹⁴⁴ See *id.*

¹⁴⁵ See Jane D'Arista & Tom Schlesinger, *Reforming the Privatized International Monetary System*, 2 FOMC ALERT 1, 2 (Dec. 22, 1998); Sam Dillon, *Mexico's Central Bank Fails in Attempt to Prop Up peso*, N.Y. TIMES, Sept. 11, 1998, at C4.

¹⁴⁶ See GREIDER, *supra* note 24, at 240-41 (recounting how speculator George Soros had broken the Bank of England's defense of the British pound in September 1992, and made nearly \$1 billion in profit in the process).

¹⁴⁷ See Michael Lewis, *For Love of Money: Why Central Bankers and Speculators Need Each Other*, 74 FOREIGN AFF. 137, 139, 141 (1995) (reviewing GREGORY J. MILLMAN, *THE VANDALS' CROWN: HOW REBEL CURRENCY TRADERS OVERTHREW THE WORLD'S CENTRAL BANKS* (1995)); see also STEVEN

The symbiotic relationship between the regulators and private financial institutions raises important questions about the political process,¹⁴⁸ and the democratic accountability of central banks and finance ministries.¹⁴⁹ It must be comforting for central bankers and their research economists to look forward to promising future career options with private financial institutions. Conveniently, the same private financial institutions also possess an interest in keeping their future employees actively intervening in the currency and bond markets.¹⁵⁰ This symbiotic relationship also casts doubt on the efficacy of central bank interventions in currency and other markets,¹⁵¹ but the

SOLOMON, *THE CONFIDENCE GAME* (1995); DANIEL YERGIN & JOSEPH STANISLAW, *THE COMMANDING HEIGHTS* (1997).

¹⁴⁸ Political scientists have long been concerned with such dynamics of revolving doors, iron triangles, and agency capture by private regulated industries and their interest groups). See D. GRIER STEPHENSON, JR., ET AL., *AMERICAN GOVERNMENT* 258, 522-23 (1992); see also THEODORE LOWI, *THE END OF LIBERALISM* 33-35, 58 (1979).

¹⁴⁹ See Bernstein, *supra* note 95 and accompanying text; see also Timothy A. Canova, *Law School's Blindfold: The Downsizing of the American Dream*, BROOK. L. DIG. 19, 25-29 (1996) (questioning the constitutionality of the autonomy of the Federal Reserve, and criticizing law schools and legal scholars for not discussing the Federal Reserve's independence from the other three branches of government); Harold J. Krent, *Fragmenting the Unitary Executive: Congressional Delegations of Administrative Authority Outside the Federal Government*, 85 NW. U. L. REV. 62, 84-85, n.66 (1990) (criticizing congressional delegation of power to private organizations, which sometimes results in broad power being concentrated in private individuals, such as the Federal Reserve Banks); see generally JOHN HART ELY, *DEMOCRACY AND DISTRUST* 131-134 (1980); DAVID SCHOENBROD, *POWER WITHOUT RESPONSIBILITY* (1993).

¹⁵⁰ See Simon Romero, *Brazilian Central Bank Plans A Currency Insider Inquiry*, N.Y. TIMES, Apr. 1, 1999, at C6; Simon Romero, *As Brazil Devalued, Some Got Rich*, N.Y. TIMES, Mar. 26, 1999, at C4; see also Richard K. Lyons, *Explaining Trading Volume in Foreign Exchange: Lessons from Tokyo*, Reserve Bank of San Francisco Economic Letter No. 97-38 (Dec. 26, 1997) (asserting that dealers who receive advance knowledge of a central bank's currency intervention operations "[have] superior information for forecasting exchange rate movements").

¹⁵¹ See D'Arista & Schlesinger, *supra* note 145 and accompanying text; see also Milton Friedman, *The Case for Overhauling the Fed*, 28 CHALLENGE 4, at 6 (1985) (criticizing the Federal Reserve for "churning" its accounts by unnecessary

IMF's other preferred policy alternative, that of raising interest rates ever higher, also ultimately fails to prop up the currency. Consider the case of Sweden in the early 1990s. The Swedish currency, the krona, came under speculative attack. The Riksbank, Sweden's central bank, tried to defend the currency by raising interest rates. The Riksbank raised the overnight interest rate to over 500% over a two-week period.¹⁵² The Swedish economy and banking system, however, collapsed under the weight of the interest rates, and the strategy failed in its primary objective to support the value of the krona. Trying to defend the value of a currency with high interest rates is a very dangerous course of action. Along the way, those high interest rates compound the financial and economic crisis, contribute to passive government budget deficits,¹⁵³ and deepen a recession. The World Bank acknowledged these dangers in the fall of 1998 when it distanced itself from the IMF. In a rather unprecedented split between these institutions, the World Bank publicly blamed the IMF and the United States Treasury for worsening the global financial crisis, and for increasing the hardship for millions of people as a result of programs of economic austerity, high interest rates, and recession.¹⁵⁴

and excessive buying and selling of government securities to add profits to the bond-dealing operations of its private constituency).

¹⁵² See Timothy A. Canova, *The Swedish Model Betrayed*, 37 CHALLENGE 36 (1994).

¹⁵³ See Timothy A. Canova & Lynn Turgeon, *Fighting the Wrong Deficit*, in MELTDOWN 206-07 (W. Krehm, ed. 1999) (explaining that passive deficits result from slow economic growth, underutilization of resources, declining tax revenues, and/or rising interest costs, whereas active deficits result from the government spending more than it collects in taxes at full employment); see also Gillian Tett, *Japan Warns of \$82.6bn Tax Shortfall*, FIN. TIMES, Nov. 25, 1998, at 1 (stating that Japan's tax shortfall is due to economic slowdown).

¹⁵⁴ See David E. Sanger, *U.S. and I.M.F. Made Asia Crisis Worse, World Bank Finds*, N.Y. TIMES, Dec. 3, 1998, at A1; see also Mark Landler, *Grim Assessment by U.N. of Economic Slide in Asia*, N.Y. TIMES, Dec. 3, 1998, at A8 (reporting that the International Labor Organization ("ILO") reported dramatic worsening in social and economic conditions throughout Asia); James D. Wolfensohn, *The Other Crisis*, (last modified Oct. 6, 1998) <<http://www.worldbank.org/html/extdr/am98/jdw-sp/am98-en.html>>; David E. Sanger, *As Economies Fail, the I.M.F. Is Ripe with Recriminations*, N.Y. TIMES, Oct. 2, 1998, at A1.

IV. FOUNDATIONS OF THE NEOLIBERAL FINANCIAL REGIME: THE CONTAGION OF NEOLIBERAL REFORM

The proliferation of short-term capital flows occurred because of conscious government decisions to liberalize capital accounts, and to abolish any and all kinds of controls on short-term portfolio capital flows.¹⁵⁵ The Articles of Agreement of the International Monetary Fund ("Articles"), otherwise known as the 1944 Bretton Woods Agreement,¹⁵⁶ contain a specific provision, Article VI, which expressly provides member countries with a very important policy tool, namely the right to impose exchange controls and restrictions on capital flows.¹⁵⁷ According to Article VI, "[m]embers may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions."¹⁵⁸

This is an important distinction between capital and current transactions. The Articles define current transactions as including payments due in connection with foreign trade, interest due on loans, and net income from other investments. Payments made for the purpose of transferring capital, however, do not fall under this definition.¹⁵⁹ The Articles consider current transactions, such as payments

¹⁵⁵ History has been repeated with the liberalization of capital flows. Unregulated capital flows contributed to the global financial and economic instability of the Great Depression. See generally JOHN GRAY, *FALSE DAWN: THE DELUSIONS OF GLOBAL CAPITALISM* (1999); KINDLEBERGER, *supra* note 113.

¹⁵⁶ See Articles of Agreement of the International Monetary Fund, Dec. 27, 1945, 60 Stat. 1401, 2 U.N.T.S. 39 [hereinafter Articles].

¹⁵⁷ See *id.* at art. VI, sec. 3; see generally Franhois Gianviti, *The IMF and the Liberalization of Capital Markets*, 19 HOUS. J. INT'L L. 773, 776 (1997) (explaining capital outflows under the IMF).

¹⁵⁸ See Articles, *supra* note 156, at art. VI, sec. 3.

¹⁵⁹ See *id.* at art. XXX(d) (indicating that the payment or liquidation of the principal of an investment, including a short-term portfolio investment, would be considered as a capital transaction).

for goods and repatriation of profits,¹⁶⁰ as essential for the smooth operation of international trade. Accordingly, under Article VIII, member countries are obligated to avoid restrictions on current payments.¹⁶¹ Article VIII requires members to consult with and to obtain the approval of the IMF to impose restrictions on current transactions.¹⁶² Article IV gives the IMF surveillance powers over a wide range of members' economic and financial policies.¹⁶³ In contrast, Article VI's restrictions on capital transactions require no such IMF consultations or surveillance.

The Articles are very explicit in favoring the use of restrictions on capital transactions over restrictions on current transactions.¹⁶⁴ The chief negotiators at Bretton Woods, Harry Dexter White, the assistant United States Treasury Secretary, and John Maynard Keynes, the great British economist, envisioned the Article VI provision as a crucial instrument to control the kind of speculative capital flows that occurred before World War II, and which destabilized the global economy during the Great Depression.¹⁶⁵ Keynes supported Article

¹⁶⁰ See KEITH S. ROSENN, *FOREIGN INVESTMENT IN BRAZIL* (1991) (discussing the difference between the repatriation of profits and capital, and indicating that the payment of interest due on loans and net income from other investments constitutes repatriation of profits).

¹⁶¹ See Articles, *supra* note 156, at art. VIII, sec. 2 (establishing that the only exceptions to the prohibition against current restrictions are found in Article VII, sec. 3 (b), the "scarce currency clause", and Article XIV, sec. 2, which provides for a transitional period until full current account convertibility is completed); see also *infra* notes 288-91 and accompanying text.

¹⁶² See Articles, *supra* note 156, at art. VIII, sec. 2.

¹⁶³ See *id.* at art. IV.

¹⁶⁴ See *id.* at art. VI, sec. 1(a) (providing the IMF with the power to require "a member to exercise such controls [on capital transfers]"); see also Gianviti, *supra* note 157, at 776-77.

¹⁶⁵ See ROBERT W. DIMAND, *Bretton Woods*, in *AN ENCYCLOPEDIA OF KEYNESIAN ECONOMICS* 50-53 (1997) (discussing Bretton Woods, where White chaired the commission on the IMF, Keynes chaired the commission on the World Bank, and Eduardo Suarez of Mexico chaired the commission on other forms of financial cooperation); see also GRAY, *supra* note 155; KINDLEBERGER, *supra* note 113.

VI as: "a permanent arrangement [that] accords to every member government the explicit right to control all capital movements. What used to be heresy is now endorsed as orthodox. . . [i]t follows that our right to control the domestic capital market is secured on [a] firmer foundation than ever before."¹⁶⁶

Article VI was not just a theoretical power; capital controls were widely used throughout Western Europe to shield those countries from speculative capital flows during post-war reconstruction.¹⁶⁷ In fact, for most Western European countries, capital controls remained in place throughout most of the 1950s, and for some countries until the early 1990s.¹⁶⁸ Restrictions on hot money capital flows meant Western European countries could pursue two of the explicit purposes of the Bretton Woods Agreement,¹⁶⁹ namely high growth and full employment, without being overly concerned about the possibility of speculative runs on their currencies.

In recent years, however, the IMF undermined and eroded the Article VI policy tool through the adoption of a program of capital account liberalization.¹⁷⁰ As recently as the spring of 1998, the IMF dis-

¹⁶⁶ Keynes referred to short-term capital movements as "fugitive funds" and attempted to construct a system of national exchange controls between both the sending and receiving countries. See *Cooling Down Hot Money*, 2 ECON. JUST. REP. 4 (June 1994); see also Zamora, *supra* note 96 and accompanying text; see generally LINDA MCQUAIG, THE CULT OF IMPOTENCE: SELLING THE MYTH OF POWERLESSNESS IN THE GLOBAL ECONOMY 223-24 (1998) (reporting that Keynes and White attempted, but failed to achieve provision for "co-operative" controls to require governments to help each other enforce capital controls by tracking down and returning wayward funds).

¹⁶⁷ See Mussa & Goldstein, *supra* note 96, at 252; see also *infra* notes 282-87 and accompanying text.

¹⁶⁸ See *infra* note 287 and accompanying text.

¹⁶⁹ See Articles, *supra* note 156, at Article I (ii) (among the purposes the of IMF were to "facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy").

¹⁷⁰ See Sara Kane, *Seminar Discusses the Orderly Path to Capital Account Liberalization*, 27 IMF SURV. 81, 83 (International Monetary Fund, Mar. 23, 1998)

cussed a possible amendment to the Articles to provide for explicit jurisdiction over the process of capital account liberalization.¹⁷¹ The IMF has focused the burden of adjustment on deficit countries, while virtually ignoring the dynamics of hot money speculative flows that victimize those same countries.¹⁷² Without an explicit mandate and despite the Article VI provision, the IMF effectively pushed capital liberalization through its surveillance, financing, and technical assistance activities.¹⁷³

It is rather perverse and ironic that at the very moment that a country is sinking under the weight of the hot money problem, it must bend once again to permit even further capital account liberalization as a condition for badly-needed IMF financial assistance.¹⁷⁴ The schizophrenic nature of relations is captured in the so-called "Letters of Intent," which are drafted by and yet formally addressed to the IMF.¹⁷⁵ The Letters of Intent, which list the many steps that the submerging country promises to undertake in exchange for IMF aid, include such measures as economic austerity, privatization, and liberalization.¹⁷⁶

(expressing the need to amend the Articles so as to meet the demands of the increasing liberalization of capital movement); *see also Capital Movements Under an Amendment of the IMF's Articles*, ANN. REP. 1998 74 (International Monetary Fund 1998) (questioning the need to strengthen the IMF's control over capital restrictions through a proposed amendment of the IMF Articles).

¹⁷¹ *See Kane supra* note 170 and accompanying text.

¹⁷² *See infra* notes 270-71 and accompanying text (concerning the asymmetrical burden of adjustment on deficit countries).

¹⁷³ *See Kane, supra* note 170 and accompanying text.

¹⁷⁴ *See* Larry Rohter, *New I.M.F. Aid Pact Further Limits Brazil*, N.Y. TIMES, Mar. 9, 1999, at C1; *see also* Geoff Dyer, *Brazil Vows to Continue Privatization*, FIN. TIMES, Nov. 25, 1998, at 7.

¹⁷⁵ *See International Monetary Fund*, (visited June 12, 1999) <<http://www.imf.org/external/np/loi>> (providing copies of some of these Letters of Intent).

¹⁷⁶ Since the United States is the dominant power within the IMF, it is not surprising that this agenda is often closely linked with United States policy. *See* David E. Sanger, *Greenspan Sees Asian Crisis Moving World to Western Capitalism*, N.Y. TIMES, Feb. 13, 1998, at C1; *see also* Nicholas D. Kristof, *Asians*

In pushing capital account liberalization, the IMF has been responding to the demands of capital-exporting nations and their private banking and financial constituencies.¹⁷⁷ Likewise, the World Trade Organization ("WTO"), which is the direct descendant of the General Agreement on Tariffs and Trade ("GATT"), has strongly pushed the same liberalization agenda.¹⁷⁸ The Organization of Economic Cooperation and Development ("OECD"), a group of about twenty-nine of the more developed nations, has actively pushed for free capital mobility among its members through its own Code of Liberalisation of Capital Accounts (the "Code").¹⁷⁹ The Code covers a wide range of capital movements, including hot money flows such

Worry that U.S. Aid is a New Colonialism, N.Y. TIMES, Feb. 17, 1998, at A4; see also photo of South Korean protest march against policies imposed by the IMF in which a protester was holding a sign that read, "I.M.F., I'M Fired." N.Y. TIMES, Sept. 30, 1998, at C1.

¹⁷⁷ The adoption of the General Agreement on Trade in Services ("GATS") at the Uruguay Round of multilateral trade negotiations is expected to open Pacific Basin economies to international banking, even though it could raise problems related to "speculative capital flows." See Ramon Moreno, *GATS and Banking in the Pacific Basin*, Fed. Reserve Bank of San Francisco Economic Letter, No. 94-19 (May 13, 1994).

¹⁷⁸ See *Joint Statement by the Heads of the International Monetary Fund, the World Bank, and the World Trade Organization*, IMF News, No. 98/37 (Oct. 16, 1998) (visited Oct. 20, 1998) <<http://www.imf.org/external/np/sec/nb/1998/NB9837.htm>> (urging further liberalization and integration of financial markets); see also Masamichi Kono & Ludger Schuknecht, *Financial Services Trade, Capital Flows, and Financial Stability*, Staff Working Paper ERAD 98-12 (World Trade Organization, Geneva, Nov. 1998); Guy de Jonquieres, *Liberalization is Good for Stability, Says WTO Study*, FIN. TIMES, Dec. 2, 1998, at 9.

¹⁷⁹ See Cynthia C. Lichtenstein, *The New Financial World of Cross Border Capital Movements: The International Monetary Fund Agreement in light of the 1994 Mexico peso Crash*, in WAHRUNG UND WIRTSCHAFT: DAS FELD IM RECHT, FESTSCHRIFT FÜR PROFESSOR DR. HUGO J. HAHN, NOMOS VERLAGSGESELLSCHAFT 191, 195 (1997) (using the OECD Code as an example of how countries and organizations separate from the IMF embrace the ideology of free capital movement and support the removal of capital barriers); see also Christian Weller, *Global Banking*, 3 FOREIGN POL'Y IN FOCUS (1998) (Interhemispheric Resource Center & Inst. for Pol'y Studies, Albuquerque, N.M.), May 1998, at 1 (opposing recent efforts by the OECD to further liberalize and deregulate the flow of capital).

as operations in securities, money markets, and foreign exchange.¹⁸⁰

Mexico's membership in the OECD merits particular attention,¹⁸¹ because of its significance in terms of the Bank for International Settlement's ("BIS") risk-based capital requirements, also known as the "Basle Accord."¹⁸² The Basel Accord put a zero weighting on credit risk for the central government debt of all OECD countries, which by mid-1994 included Mexico.¹⁸³ Thus, at the time of the Mexican peso crash, banks from around the globe could hold Mexican government debt securities without providing any capital reserves for credit risk. This combined OECD-BIS stamp of approval was certainly a premature inducement to free flows in a particularly volatile form of capital. This type of capital investment, mainly short-term Mexican government debt, resulted in significant losses for United States and other banks, necessitated a multibillion dollar bailout package, and sparked the global currency contagion.¹⁸⁴

The OECD has also pushed negotiations for a Multilateral Agree-

¹⁸⁰ See Code of Liberalisation of Capital Movements (Organization for Economic Co-Operation and Development, 1997) [hereinafter OECD Code] (Art. 1(d) of this Code obligates all OECD members to "endeavour to extend the measures of liberalisation to all members of the International Monetary Fund").

¹⁸¹ See *id.* at 2 (Mexico became a member of the OECD through accession on May 18, 1994).

¹⁸² See generally Hal S. Scott, *The Competitive Implications of the Basle Capital Accord*, 39 ST. LOUIS U. L.J. 885, 886 (1995) (explaining the structure and purposes of the Basel Accord).

¹⁸³ See generally HAL S. SCOTT & PHILIP A. WELLONS, INTERNATIONAL FINANCE 268-69 (1998); MELTDOWN: MONEY, DEBT, AND THE WEALTH OF NATIONS 270, 310 (W. Krehm ed., 1999). For proposed revisions in risk management standards for banks, see also Framework for Supervisory Information About Derivatives and Trading Activities, Joint Report by the BIS Basel Committee on Banking Supervision and the Technical Committee of the International Organization of Securities Commissions (Sept. 1998).

¹⁸⁴ See Louis Uchitelle, *U.S. Losses in Mexico Assessed*, N.Y. TIMES, Dec. 26, 1994, at A6 (noting the loss to American investors caused by the decline in value of the Mexican peso); see also Kenneth N. Gilpin, *Far-Reaching Effects Seen if Mexico Rescue is Halted*, N.Y. TIMES, Jan. 23, 1995, at D1 (discussing the possible impact of the failure of Congress to approve a rescue package for Mexico).

ment on Investment ("MAI") for OECD members and non-members.¹⁸⁵ According to the OECD, the MAI is based on the Code and would "provide legal guarantees" for investments, including the making of portfolio investments.¹⁸⁶ If enacted, the MAI would effectively overturn Article VI of the IMF Articles on a grand multilateral scale. For the time being, however, intense opposition by trade unions and environmental groups forced the suspension of MAI negotiations due to their concerns regarding the broad rights that MAI would grant to corporations to challenge national laws and regulations.¹⁸⁷

While the OECD's multilateral attempt to enshrine capital liberalization in international law has not met immediate success, bilateral efforts have. For the past two decades, developed countries have pressured developing countries to liberalize their capital accounts through hundreds of bilateral investment treaties, such as the U.S. State Department's Bilateral Investment Treaty ("BIT") program.¹⁸⁸

NAFTA's investment provisions are "a direct descendant of the United States model Bilateral Investment Treaty."¹⁸⁹ Not surprisingly,

¹⁸⁵ See *The Multilateral Agreement on Investment*, OECD Pol'y Brief No. 2-1997, reprinted at <<http://www.foe.org/international/trade/mail/mai/html>> (visited June 9, 1999).

¹⁸⁶ See *id.*

¹⁸⁷ See Samer Iskandar, *France quits investment accord talks*, FIN. TIMES, Oct. 15, 1998, at 6 (reporting on the French withdrawal from MAI negotiations); see also Guy de Jonquieres, *Retreat over OECD pact on investment*, FIN. TIMES, Oct. 21, 1998, at 4 (reporting on the withdrawal of several nations from MAI talks); see generally THE MULTILATERAL AGREEMENT ON INVESTMENT, *supra* note 185 and accompanying text.

¹⁸⁸ It was during the time of another neoliberal Democrat, the Carter administration, that the BIT program was first launched. See Kenneth J. Vandeveld, *U.S. Bilateral Investment Treaties: The Second Wave*, 14 MICH. J. INT'L L. 621, 622 (1993).

¹⁸⁹ See Alvarez, *supra* note 65, at 303-04. The United States has negotiated more than 40 BITs with foreign countries. See *List of U.S. Bilateral Investment Treaties* (visited June 10, 1999) <<http://www.state.gov/www/issues/economic/6proto.html>> (listing and providing the text of many actual United States BITs).

BITs typically define "investment" to include private debt and equity securities, the raw material of hot money flows.¹⁹⁰ By granting United States investors the right to freely transfer such investments,¹⁹¹ the BIT program has undermined the ability of developing countries to adopt Article VI restrictions on capital transfers.

The primary objective of developing countries in negotiating a BIT with the United States or some other developed country is to attract foreign investment.¹⁹² As Dean Salacuse argues, while the BIT program "purports to create a symmetrical legal relationship between the two [contracting] states," in reality an asymmetry exists since the developing country is in need of, and dependent upon, United States sources for scarce capital investment.¹⁹³ According to Dean Vandevelde, "[f]or many developing countries, the BIT represents a tangible way of signaling their receptivity to foreign investment, and thus may seem to assist in attracting capital from the United States and other developed countries."¹⁹⁴

Consequently, the United States is in a stronger bargaining position to condition other official benefits for the developing country on

¹⁹⁰ See Joseph E. Pattison, *The United States-Egypt Bilateral Investment Treaty: A Prototype For Future Negotiation*, 16 CORNELL INT'L L.J. 305, 316 (1983) (noting that one United States BIT defines "investment" as all "equity, debt, service and investment contracts"); see also Wayne Sachs, *The New U.S. Bilateral Investment Treaties*, 2 INT'L TAX & BUS. LAW. 192, 203-08 (1984) (discussing definitional aspects of investments and investors in various BITs).

¹⁹¹ See Mark S. Bergman, *Bilateral Investment Protection Treaties: An Examination of the Evolution and Significance of the U.S. Prototype Treaty*, 16 N.Y.U. J. INT'L L. & POL. 1, 19-20 (1983) (enumerating the rights to purchase and transfer investments under the United States prototype BIT).

¹⁹² See Jeswald W. Salacuse, *BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24:3 INT'L LAW. 655, 661 (1990).

¹⁹³ See *id.* at 663.

¹⁹⁴ See Vandevelde, *supra* note 188, at 638.

that country's agreement to the BIT.¹⁹⁵ Moreover, the BIT is a "confidence-building" measure that sends a green light to the private investment community.¹⁹⁶

Developed and developing nations have signed over three hundred BITs.¹⁹⁷ As Salcuse notes, "in thirty years, the nations of the world fashioned an instrument of public international law to create rules for private foreign investments. . . ."¹⁹⁸ By requiring bilateral liberalization of capital flows, the BIT program significantly undermined the important policy instrument of capital controls, a policy option expressly permitted under the IMF Articles of Agreement.¹⁹⁹ Therefore, a multilateral framework for dealing with capital account liberalization and restrictions has been largely supplanted by bilateral arrangements that reflect and reproduce the power disparities among capital-exporting countries, private financial institutions, and the developing world.²⁰⁰

V. A PATH FOR REFORM

A. EXCHANGE RATE STABILITY

The liberalization of global capital flows has contributed to the

¹⁹⁵ See Salacuse, *supra* note 192 at 661-63 (noting that "those benefits may include participation in the United States foreign investment insurance program, and United States political support and economic assistance").

¹⁹⁶ See *id.* at 674.

¹⁹⁷ See *id.* at 655.

¹⁹⁸ See *id.*

¹⁹⁹ See *id.*

²⁰⁰ The bilateral approach of the BIT program is contrary to the multilateral principle of the Bretton Woods and GATT post-war trading system. See BETH V. YARBROUGH & ROBERT M. YARBROUGH, COOPERATION AND GOVERNANCE IN INTERNATIONAL TRADE 5 (1992).

extreme volatility in exchange rates.²⁰¹ Countries have lost their autonomy to pursue expansionary economic policies as they have been forced to compete for foreign investment. This has led to the neutralization of fiscal policy and the ascendancy of monetary policy as the one and only policy tool to deal with every policy problem, from inflation to unemployment and exchange rate stability.²⁰² This over-reliance on monetary policy has, in turn, contributed to extremely high real interest rates, slower economic growth, and the general retreat from policies of full employment.²⁰³

In 1994, former Federal Reserve chairman Paul Volcker chaired a commission known as the Bretton Woods Commission. Its work coincided with the fiftieth anniversary of the Bretton Woods Conference. The Bretton Woods Commission concluded:

Since the early 1970s, long-term growth in the major industrialized countries has been cut in half, from about 5 percent a year to about 2.5 percent a year. Although many factors contributed to this decline in different countries at different times, low growth has been an international problem, and the loss of

²⁰¹ See MAXWELL WATSON, ET AL., *INTERNATIONAL CAPITAL MARKETS: DEVELOPMENTS AND PROSPECTS* 15 (International Monetary Fund, Jan. 1988); FELIX, *supra* note 142, at 191.

²⁰² See generally Timothy A. Canova, *The Macroeconomics of William Vickrey*, 40:2 CHALLENGE 95 (1997). The first Nobel laureate in economics, the late Dutch economist Jan Tinbergen, often said that we should have at least as many policy tools as there are policy objectives. Tinbergen recognized the futility of attempting to achieve multiple objectives (i.e., full employment, price stability, and equilibrium in the balance of payments) with only one policy instrument (i.e., monetary policy). See JAN TINBERGEN, *ECONOMIC POLICY: PRINCIPLES AND DESIGN* 53-56 (1956). This suggests that we should consider capital controls to complement other policy instruments designed to achieve multiple objectives. See MCQUAIG, *supra* note 166, at 254-55 (according to the Mundell-Fleming thesis, nations can achieve only two of the following three policy objectives: stable exchange rates, free capital mobility, and policy autonomy, such as full employment).

²⁰³ See JAMES MEDOFF & ANDREW HARLESS, *THE INDEBTED SOCIETY* (1996); see also SIDNEY HOMER & RICHARD SYLLA, *A HISTORY OF INTEREST RATES* 386, 430 (1991) (examining the fluctuation of interest rates in Europe and North America).

exchange rate discipline has played a part.²⁰⁴

The Commission was surprisingly critical of liberalized exchange rates, and recommended a return to some kind of regime of semi-fixed exchange rates in order to encourage increased global trade and economic growth.²⁰⁵

If countries regained some measure of control over hot money speculative capital flows, there is a good chance for a return to exchange rate stability. With such stability, there is also a good chance that countries would be empowered to once again pursue full employment and a host of other progressive social policy objectives. Political leaders in Western Europe, particularly in France and Germany, have recognized the need for exchange rate stability,²⁰⁶ but

²⁰⁴ See Bretton Woods Commission, *Bretton Woods: Looking to the Future*, Commission Report (1994); see also Greider, *supra* note 24, at 250.

²⁰⁵ See Raymond F. Mikesell, *Revisiting Bretton Woods: Proposals for Reforming the International Monetary Institutions*, PUB. POL'Y BRIEF NO. 24, (Jerome Levy Economics Institute, 1996); THE BRETTON WOODS-GATT SYSTEM: RETROSPECT AND PROSPECT AFTER FIFTY YEARS (O. Kirshner ed., 1996); see also Elizabeth Olson, *World Trade Study Says Export Growth May Slow Further*, N.Y. TIMES, Apr. 23, 1999, C1 (noting the decline in growth of world merchandise exports, which resulted from the Asian economic crisis).

²⁰⁶ See Ralph Atkins, *Schroder favours plan for currency targets*, FIN. TIMES, Sept. 29, 1998, at 1 (reporting that Germany's chancellor-designate called for stronger international co-operation to avert global recession); see also David E. Sanger, *Chirac, in U.S., Offers Alternative Approach to Economic Crisis*, N.Y. TIMES, Feb. 19, 1999, A1 (reporting on Chirac's urging that the United States, Japan, and Europe manage the exchange rates of their currencies, keeping them within specific zones agreed upon by the major nations), Michiyo Nakamoto, *Obuchi to Call for New Currency Era*, FIN. TIMES, Jan. 6, 1999, at 2 (reporting on the Japanese prime minister's plans for currency stabilization), John Grieve Smith, *Managing Exchange Rates*, FIN. TIMES, Oct. 7, 1998, at 18 (arguing for specific remedies to currency instability), Craig R. Whitney, *Germany's New Leader Gives France Reassurances About Ties*, N.Y. TIMES, Oct. 1, 1998, at A17 (reporting on the German-French agreement regarding the need for regulation of global capital flows).

have had little success with the Clinton administration,²⁰⁷ and elicited the outright hostility of central bankers.²⁰⁸

In order to reform the global financial system to restore stability in exchange rates, a return to some kind of regime of limited use of controls or restrictions on short-term capital inflows is needed. This would entail a reorientation of IMF policy, one that may already be in its infancy. During some of the worst months of the global currency contagion, many internationalists came to appreciate the kinds of prudential controls on short-term capital inflows that Chile adopted several years ago.²⁰⁹ For instance, a foreign investor who wanted to invest or lend within Chile, was required to deposit 30% of such investment or loan into a non-interest bearing account with the central bank for a full year or pay a 3% tax to recover that deposit.²¹⁰ These prudential limits, known locally as the *encaje*, had the effect of cutting down the incentive for short-term borrowing from abroad, and thereby reduced Chile's reliance on short-term capital inflows.²¹¹

²⁰⁷ It is uncertain whether the Bush administration was moving in the direction of more stability in exchange rates. See *Bush: Overhaul Currency Valuation*, NEWSDAY, Sept. 21, 1992, at 21.

²⁰⁸ See Wolfgang Munchau & Tony Barber, *Central Bank Chiefs Dismiss Calls For Exchange Rate Targets*, FIN. TIMES, Nov. 22, 1998, at 1.

²⁰⁹ See Felix *supra* note 142 and accompanying text.

²¹⁰ In the summer of 1998, Chile relaxed its capital restrictions under strong political pressure from foreign investors. See Craig Torres, *Chilean Bid to Boost Confidence Lauded: Stocks Climb on Plan to Ease Curbs on Foreign Investors*, WALL ST. J., June 29, 1998, at A14; see also Imogen Mark, *Chile may ease capital inflow rule to lift peso*, FIN. TIMES, June 26, 1998, at 8; Greider, *supra* note 24, at 319, 490. Not surprisingly, within a year of lifting its capital restrictions, Chile experienced a weakening currency, economic recession, and a sharply rising unemployment rate. See Clifford Krauss, *Chile: Cabinet Quits*, N.Y. TIMES, June 22, 1999, at A8; see also Clifford Krauss, *Chile Leader Moves to Aid His Economy, And Prestige*, N.Y. TIMES, June 23, 1999, at A5 (reporting that in the past year, Chile's unemployment rate rose from 5% to 8.2%, as 140,000 workers lost their jobs).

²¹¹ See Ricardo Ffrench-Davis et al., *Capital Movements, Export Strategy, and Macroeconomic Stability in Chile*, in *COPING WITH CAPITAL SURGES: THE RETURN OF FINANCE TO LATIN AMERICA* 99, 136-37 (Ffrench-Davis and S. Griffith-Jones eds., 1995) (examining the short-term flow of capital in Chile); see

In mid-1998, a high-level defection shook the established economic orthodoxy when MIT economist and free-trader Paul Krugman suddenly came out in favor of capital and exchange controls. Krugman did not just publicly support controls on capital inflows, but rather he advocated the more pervasive and intrusive controls that Malaysia had recently adopted to control exchange operations, current transactions and capital outflows.²¹² The highly visible and respected Krugman is now supporting currency and capital controls that are much more pervasive than many critics of the neoliberal contagion previously dared to advocate.²¹³

B. RESTRICTIONS ON SHORT-TERM CAPITAL INFLOWS

Throughout much of the past year, a covert discussion has taken place in financial circles about capital controls. Joseph Stiglitz, the chief economist of The World Bank, has consistently endorsed "speed bumps" to slow down the pace of global financial speculation, and has expressed his sympathy for the Chilean program.²¹⁴ Sti-

also Carlos Massad, *The Liberalization of the Capital Account: Chile in the 1990's*, in *SHOULD THE IMF PURSUE CAPITAL-ACCOUNT CONTROVERTIBILITY?*, *ESSAYS IN INTERNATIONAL FINANCE* (R. Cooper ed., 1998) (presenting arguments for and against capital controls in Chile and evaluating their successes and failures); *Chile's Experience with Capital Controls*, in *ANNUAL REPORT 1998*, 176 (International Monetary Fund, 1998).

²¹² See Krugman, *supra* note 114, at 78-80; see also Paul Krugman, *An Open Letter to Prime Minister Mahathir* (last modified Sept. 1, 1998) <<http://web.mit.edu/krugman/www/mahathir.html>> (arguing in favor of capital and exchange controls to promote "a recovery of the real economy").

²¹³ In light of Krugman's sudden about-face on capital and exchange controls and his late recognition of the Asian glut, one might expect him to issue an apology for his earlier criticisms of Greider. See PAUL KRUGMAN, *THE ACCIDENTAL THEORIST* 32, 74, 76 (1998).

²¹⁴ See *Comment and Analysis*, *FIN. TIMES*, Apr. 17, 1998, at 17; Joseph E. Stiglitz, *Using Tax Policy To Curb Speculative Short-Term Trading*, 3 *J. FIN. SERVICES RES.* 3 (1989) (arguing in favor of the use of tax policy to increase economic efficiency); see also Paul Krugman, *Curfews on Capital Flight: What Are the Options?* (visited June 12, 1999) <<http://www.web.mit.edu/krugman/www/curfews.html>> (discussing "cooling-off" periods for capital flight).

glitz pointed to a study showing no correlation between capital account liberalization and economic growth, and suggested that mild restraints on capital flows might help economic growth.²¹⁵ In early February 1998, Stanley Fischer, the IMF's first deputy managing director, recognized the need to find ways to deal with the problem of surges of short-term capital across borders.²¹⁶ Fischer suggested that the Chilean scheme was one that needed to be considered.²¹⁷ More recently, in September 1998, the IMF's Asia-Pacific Director, Hubert Neiss, indicated that short-term capital controls may be needed to curb the spread of the currency contagion.²¹⁸ Later that same month, the IMF declared that controls on inward movements of capital could provide a useful tool for some countries, and that opening economies prematurely to free flows of capital constituted "an accident waiting to happen."²¹⁹

²¹⁵ See Joseph Stiglitz, *The Role of the Financial System in Development*, Presentation at the Fourth Annual Bank Conference on Development in Latin America and the Caribbean, San Salvador, El Salvador, (visited June 29, 1998) <<http://www.worldbank.org/html/extdr/extme/jssp062998.htm>>; see also Joseph Stiglitz, *Road to Recovery: Restoring growth in a region could be a long and difficult process*, ASIaweek, July 17, 1998 reprinted at <<http://www.worldbank.org/html/extdr/extme/jsart-w071798.html>> (visited June 12, 1999); James Wilson, *Delegates agree the state has a role to play in the financial sector-but what is it?*: FIN. TIMES, July 1, 1998, at 6.

²¹⁶ See Louis Uchitelle, *I.M.F. May Be Closer To Lending-Curb Idea*, N.Y. TIMES, Feb. 3, 1998, at D1.

²¹⁷ See *id.* at D1.

²¹⁸ See Bill Tarrant, *I.M.F. sees short-term capital controls in Asia*, REUTERS, Sept. 14, 1998; see also *IMF Moots Capital Controls For Asia*, BUS. DAY (S. AFRICA), Sept. 15, 1998, at 14.

²¹⁹ See Stephen Fidler, *IMF admits drawbacks to free flow of capital*, FIN. TIMES, Sept. 22, 1998, at 9. Former Treasury Secretary Rubin criticized Chilean-style taxes on short-term capital inflows as difficult to administer over time. Rubin demonstrated a preference for capital account liberalization and IMF-sanctioned austerity for deficit countries when he warned that the Chilean-type program must not be a substitute for "fundamental reform to strengthen and liberalize financial systems." See Robert E. Rubin, *Remarks on Reform of the International Financial Architecture to the School of Advance International Studies*, TREASURY NEWS, Apr. 21, 1999, reprinted at <<http://www.ustreas.gov/press/releases/pr3093.htm>> (visited June 12, 1999).

Yet, it seems that each time a crack appears in the official orthodoxy, the transgressors or their allies at the IMF, Treasury, or elsewhere quickly backpedal or even retract their earlier expressions of misgivings about the dangerous direction of today's neoliberal policies.²²⁰ One is tempted to conclude that the prior confessions were made in unguarded moments, under the weight of conscience, only to be retracted when, once again, one imagines the dangers of expressing the truth and the potential loss of "credibility" in the eyes of the established powers that profit by today's hot money regime.²²¹ The accepted orthodoxy, it seems, must be maintained at all costs, even if an urgently needed debate is delayed, and therefore denied, and poorly conceived policies continue to impose suffering around the world.²²²

There is, however, a very real and growing split within the world of finance concerning the pace and degree of financial liberalization and the use of temporary controls and prudential restrictions on the

²²⁰ See Michel Camdessus, *Capital Account Liberalization and the Role of the Fund*, Remarks at the IMF Seminar (Mar. 9, 1998), reprinted at <<http://www.imf.org/external/np/speeches/1998/030998.htm>> (visited June 12, 1999) (restating the IMF's views on capital account liberalization); see also Nancy Dunne, *Summers Sees IMF Dealing With Global Crisis*, FIN. TIMES, Oct. 23, 1998, at 6. Lawrence Summers, United States Treasury Secretary, has become one of the Clinton administration's chief cheerleaders of capital account liberalization, despite the fact that he supported taxes on financial transactions prior to his tenure in government. See generally Lawrence H. Summers & Victoria P. Summers, *When Financial Markets Work Too Well: A Cautious Case for a Securities Transactions Tax*, 3 J. FIN. SERVICES RES. 163 (1989).

²²¹ For an example of such "strategic positioning," see Enrique R. Carrasco, *Opposition, Justice, Structuralism, and Particularity: Intersections Between LatCrit Theory and Law and Development Studies*, 28 U. MIAMI INTER-AM. L. REV. 313, 328-29 (1996-97) (arguing that LatCrits should cautiously support the neoliberal policies of the IMF and World Bank if those LatCrits want policymakers to take their work seriously).

²²² See JOHN KENNETH GALBRAITH, *THE AFFLUENT SOCIETY* 11 (1958) (stating that "the hallmark of the conventional wisdom is acceptability"); see also Stiglitz, *supra* note 48 (remarking "all too often the dogma of liberalization became an end in itself, not a means of achieving a better financial system").

flow of short-term hot money.²²³ This split is increasingly pushed underground at a time when resurrection of serious discussion is most needed. This covert debate is currently being played out around the globe in the context of the global contagion and increasingly desperate economic and financial conditions.

In the fall of 1998, Mexican President Zedillo publicly rejected the option of capital controls.²²⁴ Although that option is taboo in the present political environment, such proposals will probably resurface if the currency contagion continues to deepen and spread to Mexico.²²⁵ This raises the question of NAFTA's compatibility with controls on capital flows between Mexico and the United States. NAFTA's Article 2104 would permit restrictions on capital transactions if Mexico experienced serious balance of payment problems. According to Article 2104(5), however, Mexico could impose such restrictions "only in conjunction with measures imposed on current international transactions."²²⁶ The practical effect of this wording is that Mexico must submit to the IMF's surveillance under Article VIII of the IMF's Articles.²²⁷ That, of course, is only a prescription for continued economic austerity.

²²³ See Michael M. Weinstein, *The Markets: Economic Scene; Twisting Controls on Currency and Capital*, N.Y. TIMES, Sept. 10, 1998, at C1; see also John Plender, *Taming wild money: Risk-taking banks have intensified economic cycles*, FIN. TIMES, Oct. 20, 1998, at 21.

²²⁴ See Richard Lapper, *Zedillo warns against protectionist pressures*, FIN. TIMES, Oct. 15, 1998, at 6 (reporting that Zedillo claimed that capital controls were doomed to fail). That was not the first time that Yale-educated Zedillo has rejected controls on speculative capital flows. See GREIDER, *supra* note 24, at 263.

²²⁵ Mexico has suffered financial crises during each presidential transition since 1976. The IMF hopes to prevent such a recurrence during the 2000 presidential election by adding a \$4.2 billion credit to Mexico's reserves. See Rick Wills, *World Business Briefing: Americas; I.M.F. Loan Approved*, N.Y. TIMES, July 8, 1999, at C3.

²²⁶ See NAFTA, *supra* note 63, at art. 2104(5).

²²⁷ See *id.* at art. 2104(5) (referring to Article 2104(2)(a), which requires IMF Article VIII review and, therefore, approval of any currency account exchange restrictions).

In the alternative, Mexico could invoke NAFTA Article 1410, which permits reasonable measures for prudential reasons such as the maintenance of safety, soundness, and integrity of the financial institutions, and the integrity of the financial system.²²⁸ Therefore, it seems clear that under NAFTA, Mexico could legally impose Chilean-style prudential reserve requirements on short-term capital inflows without swallowing the bitter IMF austerity pill.

In recent years, quite a number of countries have experimented with various programs of capital restrictions with varying degrees of success.²²⁹ In fact, Chile's *encaje* program by no means represented the most restrictive. The Chilean program probably received a great deal of enthusiastic attention because of its relatively modest approach of using the tax system to decrease the financial incentive for short-term portfolio inflows. Other countries such as China and India have remained somewhat sheltered from the currency contagion because of their more restrictive programs of exchange controls on capital (both inflows and outflows) and currency transactions.²³⁰ Yet, the IMF still ignores the lessons of such success stories.²³¹

Also in the fall of 1998, Brazil imposed some restrictions on short-term capital inflows in response to an increase in capital outflows

²²⁸ See *id.*, at art. 1410(1).

²²⁹ See FOLKERTS-LANDAU & ITO, *supra* note 2, at 83, 97, 100-103 (describing various programs of capital controls, prudential restrictions, and alterations in reserve requirements in six countries, including Chile).

²³⁰ See Peter Passell, *China's stable currency is protecting it for now*, N.Y. TIMES, June 25, 1998, at D2 (asserting that China seems like an "island of stability" in the Asian financial turmoil because of its exchange controls); see also GREIDER, *supra* note 24, at 319, Craig S. Smith, *China Can Spur Growth Without a Devaluation*, WALL ST. J., June 22, 1998, at A1 (controls permit China to limit trading in its currency, the yuan, to a "narrow, tightly controlled range").

²³¹ See Kenneth Kasa, *Could Russia Have Learned from China?*, Fed. Reserve Bank of San Francisco Economic Letter, No. 98-26 (Sept. 4, 1998). The IMF shows no recognition that the most important lesson that Russia should have learned from China's success is to go slower on capital account liberalization. See Zuliu Hu & Mohsin S. Khan, *Why Is China Growing So Fast?*, ECON. ISSUES (International Monetary Fund, 1997) at 8.

stemming from the global currency contagion.²³² This presented a sharp reversal from Brazil's prior policy. In November 1997, at the peak of the Asian currency crisis, and in keeping with the IMF and United States agenda for capital account liberalization, Brazil opened loopholes to attract capital inflows into short-term debt instruments.²³³ As a result, Brazil's inflows of hot money soared, leaving the country "vulnerable to investor mood swings."²³⁴ The horse was apparently already out of the barn, and Brazil was already too addicted to short-term capital inflows for prudential restrictions on such inflows to be of much help.²³⁵

This is the danger of waiting until the wolf is already at the door.²³⁶ The cost of delay may be the kind of full-blown financial crises that we have seen in Russia and throughout parts of East Asia. For example, Malaysia adopted exchange restrictions on capital inflows, capital outflows, and current transactions that persuasively surpassed any of the prudential restrictions that Chile ever imposed.²³⁷ Yet, Malay-

²³² See Geogg Dyer, *Brazil to curb short-term capital inflows*, FIN. TIMES, Sept. 30, 1998, at 3 (quoting Francisco Lopes, director for monetary policy of Brazil's central bank, as saying, "One important lesson of the crisis is that you take a lot of risks with large short-term capital inflows").

²³³ See *id.*

²³⁴ See *id.*

²³⁵ See Geoff Dryer, *Capital Controls for Brazil Rejected*, FIN. TIMES, Jan. 27, 1999, at 3; see also Larry Rohter, *Brazil Devalues Its Currency 8%, Roiling Markets: Wider Effect Seen*, N.Y. TIMES, Jan. 14, 1998, at A1.

²³⁶ Japan's recent attempt to protect its currency with increased controls elicited strong political opposition from the international investment community. See Paul Abrahams & Gillian Tett, *Tokyo to curb short selling to counter market decline*, FIN. TIMES, Oct. 2, 1998, at 1; see also Gillian Tett & Michiyo Nakamoto, *Japan's politicians step on stage with hedge funds in their sights*, FIN. TIMES, Oct. 28, 1998, at 4; Jane Martinson, *Hedge funds unnerved by short-selling rules*, FIN. TIMES, Oct. 23, 1998, at 6; Gillian Tett, *Anger over Japan's new curbs on short selling*, FIN. TIMES, Oct. 23, 1998, at 18.

²³⁷ See *Malaysia Imposes Controls On Trading in Its Currency*, N.Y. TIMES, Sept. 2, 1998, at C2; see also Bank Negara Malaysia Press Release: *Details on Changes in Exchange Control Mechanism* (visited June 5, 1999) <http://www.jaring.my/star/Wednesday/ecmnotic.html> (describing dealings with

sia appears to be using the breathing space provided by its exchange controls to boost domestic demand and slowly bring back foreign investors.²³⁸ Proponents of capital account liberalization fear that Malaysia may succeed in its program, at least relative to other Asian countries, and might then present a viable alternative to the IMF model.²³⁹

The situation is even more severe in Russia where the government, on the brink of default, was forced to call a temporary halt in trading of its currency in the foreign exchange markets and a moratorium on debt repayments.²⁴⁰ The Russian financial meltdown severely impacted its economy, and threatens the country's political reforms.²⁴¹ It

gold and foreign currency); *see generally* Mahathir Mohamad, *Call Me a Heretic If You Like*, TIME, Sept. 21, 1998, at 80 (Malaysian Prime Minister's express and open defiance of the financial orthodoxy).

²³⁸ *See* Charles Chan, *Trade Surpluses Strong Signs of an Improving Economy*, MALAYSIAN STAR, Feb. 11, 1999 (noting that Malaysia's economy is improving); *see also* Wang Sulang, *November 1998 Trade Figures Bring More Good News*, MALAYSIAN STAR, Jan. 6, 1999; Edward Luce, *Tokyo Backs Malaysian Bond Issue*, FIN. TIMES, Dec. 11, 1998, at 8; T.J. Tan, *Malaysia to Borrow from Consortium of Foreign Banks*, FIN. TIMES, Dec. 30, 1998, at 4; Sheila McNutty, *Malaysia bank chiefs face sack unless they lend*, FIN. TIMES, Nov. 14-15, 1998, at 4.

²³⁹ *See* G. Pierre Goad, *Acceptance of Capital Controls is Spreading*, ASIAN WALL ST. J., Sept. 2, 1998, at 1 (noting that Malaysia's decision to impose controls violates economic orthodoxy); David E. Sanger, *Malaysia Pushes Economic Grouping of Asian Nations*, MPLS.-ST. PAUL STAR TRIB., Apr. 7, 1991, at 3J (reporting that Malaysia is trying to organize Asian nations into economic group); *see generally* Alan Cowell, *U.N. Seeks Social Compact with Big Business*, SAN DIEGO UNION & TRIB., Feb. 1, 1999, at A8; David E. Sanger, *Asia's Economic Tigers Growl at World Monetary Conference: Say Opening of Markets Hands Wall Street too much Power*, N.Y. TIMES, Sept. 22, 1997, at A1.

²⁴⁰ *See* Michael Gordon, *Russians Say Loan By I.M.F. May Fall Short of the Need*, N.Y. TIMES, July 8, 1998, at A1; *see also* Celestine Bohlen, "Ruble Rescue Redux," N.Y. TIMES, Aug. 14, 1998, at A6; Celestine Bohlen, "Russia Warns it Might Default if Western Aid is Withheld," N.Y. TIMES, Sept. 25, 1998, at A10; "Russia: Currency Controls Tightened," N.Y. TIMES, Jan. 12, 1999, at A6.

²⁴¹ *See* Timothy L. O'Brien, *Horrific Debt, Devastated Economy*, N.Y. TIMES, Sept. 15, 1998, at A12; *see also* Grigory Yavlinsky, *Russia's Phony Capitalism*, 77 FOREIGN AFF. 67 (1998); Michael Wines, *Russia's New Leaders Plan to Pay Debt by Printing Money*, N.Y. TIMES, Sept. 18, 1998, at A3.

is particularly tragic that at least some of these dire consequences could have been avoided had there been greater use of prudential restrictions on short-term capital inflows.

Such restrictions on hot money capital flows, however, should be seen as necessary, but not sufficient to accomplish the objectives of sustainable economic development. Even if less vulnerable to the dangers of hot money flight, developing countries would still be confronted with the challenge of obtaining long-term assistance to finance their development efforts.²⁴² In addition, the leading industrial countries would still need to end the deflationary biases and tendencies of the global economy.²⁴³

C. PROPOSALS FOR A FINANCIAL TRANSACTIONS TURNOVER TAX

Among the compelling reform proposals that have been raised is the so-called Tobin Tax, first proposed by the Nobel-laureate economist, James Tobin.²⁴⁴ It would impose a turnover tax on foreign exchange transactions, an entry-and-exit toll that would be a very small percentage of the transaction, but enough to deter over-

²⁴² Proposals to meet the requirements of long-term development assistance include increasing allocations of Special Drawing Rights, using revenues from a global financial transactions tax, and low-interest or no interest recycling of reserves from surplus to deficit countries. See *infra* notes 249-272, 282-87 and accompanying text.

²⁴³ Proposals to correct the global economy's deflationary biases and tendencies include relaxing the IMF's severe conditionality requirements, redistributing the burdens of adjustment from deficit to surplus countries, and reducing reliance on monetary policy to maintain domestic price stability and currency stability. See *supra* notes 203-204 and accompanying text; see also *infra* 273-296 and accompanying text.

²⁴⁴ For Tobin's original proposal, see JAMES TOBIN, *THE NEW ECONOMICS ONE DECADE OLDER, THE JANEWAY LECTURES ON HISTORICAL ECONOMICS* (Princeton Univ. Press 1974) (setting forth the original proposal); see also John Maynard Keynes, *THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY* 159-160 (1964 ed.). "The introduction of a substantial Government transfer tax on all [financial] transactions might prove the most serviceable reform available, with a view to mitigating the predominance of speculation over enterprise." see *id.*

speculation.²⁴⁵ As Tobin said, such a tax would "throw sand in the gears of the speculators."²⁴⁶

Unfortunately, policymakers have largely overlooked Tobin's proposal while accepting more recent Nobel-laureates whose work has concentrated on undermining financial market stability and the economic planning capabilities of governments by developing increasingly intricate financial derivative instruments.²⁴⁷ Many critics of the Tobin Tax proposal claim that such a tax is unenforceable because of the ever-present incentives to try to evade taxes.²⁴⁸ If the objectives are compelling enough, however, there is no reason that such a program should not elicit wide international support and cooperation, and be effectively implemented, as was the Basle Accord on international

²⁴⁵ See James Tobin, *A Proposal for International Monetary Reform*, Presidential Address before the Eastern Economic Association, 1978 EASTERN ECON. J. 153; see also Robert E. Prash, THE TOBIN TAX: COPING WITH FINANCIAL VOLATILITY (Mahbub Ul Haq ed., 1996) (stating that Tobin was awarded the Nobel Prize in Economics in 1981); AN ENCYCLOPEDIA OF KEYNESIAN ECONOMICS 605 (T. Cate ed., 1997).

²⁴⁶ See Barry Eichengreen et al., *Two Cases for Sand in the Wheels of International Finance*, 105 ECON. JOURNAL 162-72 (1995). But see Paul Davidson, *Are Grains of Sand in the Wheels of International Finance Sufficient to do the Job When Boulders are often Required?*, 107 ECON. J. 671-86 (1997); Jacob A. Frenkel, Symposium, *Overview*, CHANGING CAPITAL MARKETS: IMPLICATIONS FOR MONETARY POLICY 394 (Fed. Reserve Bank of Kansas City, 1993). A well-designed financial transaction tax could achieve several objectives, including reducing speculative capital flows and raising significant revenue. See Simon Romero, *Brazil Ousts Bank Board That Opposed Tax*, N.Y. TIMES, June 24, 1999 at C4. Brazilian President Fernando Henrique Cardoso dismissed the board of one of the largest government controlled banks after it sought a court order to free itself from paying a 0.38% tax on financial transactions that is expected to raise about \$3.9 billion, and is considered essential in containing the nation's budget deficit. See *id.*

²⁴⁷ Two such Nobel-laureates that helped drive Long-Term Capital Management hedge fund into the ground are Myron Scholes and Robert Merton; see Truell, *supra* note 40; see also Timothy L. O'Brien & Laura M. Holson, *Hedge Fund's Star Power Lulled Big Financiers Into Complacency*, N.Y. TIMES, Oct. 23, 1998, at A1.

²⁴⁸ See FOLKERTS-LANDAU & ITO, *supra* note 2, at 98-99.

capital standards among the ten leading central banks.²⁴⁹ Most of the world's foreign exchange transactions take place in only five countries.²⁵⁰ Effective implementation would require the support of those five major players and a commitment to keep "off-shore," unregulated jurisdictions from using the international financial payments system to undermine the tax program. In addition, the same technology that speculators would use to try to evade a Tobin Tax could also be used to enforce such a tax program.²⁵¹

The Tobin Tax is another issue where European leaders are far ahead of United States political leaders.²⁵² In March 1999, the Canadian Parliament voted to endorse an international tax on financial transactions as part of a program to control currency speculation,

²⁴⁹ See SOLOMON, *supra* note 147, at 414-35; see also Philip Arestis & Malcolm Sawyer, *How Many Cheers for the Tobin Transactions Tax?*, 21 CAMBRIDGE J. ECON. 753-68 (1997); MCQUAIG, *supra* note 166, at 267-71.

²⁵⁰ See GREIDER, *supra* note 24, at 234, 319 (stating that the most important foreign exchange markets in the world are London, New York, Frankfurt, Tokyo, and Hong Kong).

²⁵¹ See David Bollier, Reporter, *The Global Advance of Electronic Commerce: Reinventing Markets, Management, and National Sovereignty* 46-47 (The Aspen Institute, Washington, D.C., 1998); see also Rodney Schmidt, *A Feasible Foreign Exchange Transactions Tax*, Ottawa: North-South Institute (March, 1999) (explaining that all international financial transfers are transacted through Fedwire, CHIPS, or SWIFT, three United States-based clearing systems); Gerard Wyrsh, *Treasury Regulation of International Wire Transfer and Money Laundering: A Case for a Permanent Moratorium*, 20 DENV. J. INT'L L. & POL'Y 515, 517-21 (1992); Stephen Zamora, *Remarks*, 86 AM. SOC'Y INT'L L. PROC. 188, 201-04 (1992) (stating that "[i]f the world community adopts a closed-circuit system, it will be essential to enter that system in order to take part in the western financial system"). Every computer message or connection linked to the Internet can be identified and traced through a unique code called the Internet protocol address. Such computerized coding should be applied to transnational financial transactions. See William M. Bulkeley, *Arrests Made in Internet Hoax*, WALL ST. J., Apr. 16, 1999, at C1; Edward Wyatt, *Fake Web Posting Leads to Fraud Charge*, N.Y. TIMES, Apr. 16, 1999, at C1 (reporting that swift tracing of securities fraud suspect in fake posting on Internet demonstrates how difficult it is to venture into cyberspace without leaving footprints).

²⁵² See Barbara Crossette, *As World Leaders Confer on Poverty, Mitterand Urges New Tax*, N.Y. TIMES, Mar. 12, 1995, at 4.

making Canada the first G-7 government to endorse formally, though largely symbolically, such a currency transaction tax.²⁵³

There are also reasons related to distributional equity to impose such a tax on financial transactions. Presently, in the United States there is a sizable tax on labor, the Social Security tax, which levies a combined tax of 12.4% on employers and employees.²⁵⁴ There is, however, no comparable tax on capital flows. In its most recent tri-annual Survey of Consumer Finance, the Federal Reserve concluded that the top 1% of United States households now controls more wealth than the bottom 90%.²⁵⁵ It is time for investors who have done quite well earning double digit returns in the global financial marketplace to get out of the wagon and push their own weight.²⁵⁶

Many of today's free-market cheerleaders criticize the Tobin Tax and other prudential restrictions on short-term portfolio capital flows by claiming that such solutions would prevent countries like Mexico and other emerging markets from getting the capital that they need

²⁵³ See Donna Green, *A Money Grab*, CANADIAN BUS., Apr. 30, 1999, at 20 (noting Canada's endorsement of the Tobin Tax); see also Shawn McCarthy, *Liberals Vote in Favour of Currency Transaction Tax*, GLOBE & MAIL, Mar. 25, 1999, at B5.

²⁵⁴ See Henning Bonh, *Social Security Reform and Financial Markets*, in SOCIAL SECURITY REFORM: CONFERENCE PROCEEDINGS 197 (S. Sass, R. Triest, eds., June 1997) (stating that the combined employer and employee contributions to Social Security's Old Age, Survivors Insurance, and Disability Insurance Funds amounts to 12.4% of covered payroll).

²⁵⁵ See Arthur B. Kennickell et al., *Family Finances in the U.S.: Recent Evidence from the Survey of Consumer Finances*, 83 FED. RESERVE BULL. 21, at tbl. 14 (Jan. 1997); Arthur B. Kennickell & R. Louise Woodburn, *Consistent Weight Design for the 1989, 1992, and 1995 SCFs, and the Distribution of Wealth*, 30, at tbl. 9 (unpublished Fed. Reserve technical paper, revised Aug. 1997); DOUG HENWOOD, WALL STREET 66-67 (1997) (stating that "[w]ealth is now the most concentrated it's been since the 1920s").

²⁵⁶ Senator Phil Gramm is usually credited with popularizing the metaphor of the welfare wagon, but by welfare he refers to entitlements for the poor, not legal rules that benefit those with wealth. See Robert L. Borasage, *Take From The Poor, Give to the Rich*, L.A. TIMES, June 26, 1997, at B9.

for development.²⁵⁷ However, it has been estimated that a Tobin Tax of only 1% on foreign exchange transactions could raise more than \$700 billion annually, even after accounting for reduced trading volume and exemptions to finance the actual sale of real goods and services.²⁵⁸ Many things could be done with the significant sums of money that would be raised with a financial turnover tax, including a healthy increase in long-term development assistance to developing countries.

D. INCREASING GLOBAL LIQUIDITY WITH SPECIAL DRAWING RIGHTS

Back in 1994, before the Mexican peso meltdown and the start of the global currency contagion, the Managing Director of the International Monetary Fund, Michel Camdessus, proposed increasing "Special Drawing Rights," by \$52 billion.²⁵⁹ The Special Drawing Right ("SDR"), also known as "paper gold," is a global currency that was created by the IMF, first issued in 1970, and used as a reserve asset.²⁶⁰

Supporters of the Camdessus proposal recognized that the formerly communist and other poor countries never received any initial allocation of SDRs.²⁶¹ It should be no surprise that many of those

²⁵⁷ See *The Case for Global Finance*, ECONOMIST, Sept. 12, 1998, at 19-20 (warning that controls would encourage capital flight); see also David R. Henderson, *Let Capital Flow Freely*, WALL ST. J., Sept. 10, 1998, at A22 (asserting that capital controls drastically reduce the incentive for private foreign investment).

²⁵⁸ See David Felix, *The Tobin Tax Proposal: Background, Issues and Prospects* 13 (United Nations Development Programme (UNDP) Social Development Policy Paper, Mar. 1995).

²⁵⁹ See Paul Lewis, *Rich and Poor Nations Split on Aid Plan*, N.Y. TIMES, Oct. 3, 1994, at D1, D2.

²⁶⁰ See DETLEV F. VAGTS, TRANSNATIONAL BUSINESS PROBLEMS 98 (1998) (explaining that SDRs were first established by an amendment to the IMF Articles of Agreement that went into effect in 1970, but only about \$28 billion in SDRs have ever been created).

²⁶¹ See Lewis, *supra* note 259.

countries now lack the reserves with which to fend off speculative attacks against their currencies. Unfortunately, the Camdessus proposal was rejected, and Camdessus was reportedly "roundly criticized by the United States, Germany and Britain, which accused him of empire-building."²⁶²

It may, however, be more accurate to describe the Camdessus proposal as a failed attempt at empire-breaking, or at least to undermine the dominance of the United States dollar and several other major currencies. There is reason to conclude that the global monetary system favors First World surplus and creditor countries, as well as the United States, a chronic deficit country²⁶³ that does not operate under the same constraints as most other deficit countries since its own currency,²⁶⁴ the United States dollar, is the major reserve currency in the world.

According to a 1991 report by the BIS, capital flows tend to exaggerate trade imbalances.²⁶⁵ The United States and other major indus-

²⁶² See Jeff Gerth & Elaine Sciolino, *I.M.F. Head: He Speaks, and Money Talks*, N.Y. TIMES, Apr. 4, 1996, at A1; see also Peter Passell, *Economic Scene: An Old Idea is Dusted Off to Aid Russia: Special Drawing Rights*, N.Y. TIMES, July 7, 1994, at D2 (reporting that Camdessus wanted to create SDRs to cover 10% of the total growth in demand for financial liquidity).

²⁶³ See Sylvia Nasar, *Trade Deficit Rises, Setting Record Early*, N.Y. TIMES, Jan. 22, 1999, at C1 (explaining that the United States trade deficit widened sharply in November); see also Mark Suzman, *Imports Push U.S. Trade Gap to Record \$19.4bn*, FIN. TIMES, Apr. 21, 1999, at 1 (stating that United States monthly trade deficit hit a new high).

²⁶⁴ Even huge and growing United States trade and current account deficits are not able to undermine the high value of the United States dollar, which remains a safe haven during global financial and/or economic turmoil. See Paul Lewis, *U.S. Said to Face Brunt of Economic Crisis*, N.Y. TIMES, Oct. 9, 1998, at A8.

²⁶⁵ See Philip Turner, *Capital Flows in the 1980s: A Survey of Major Trends*, (BIS Economic Papers, No. 30, Apr. 1991). Many theoretical and empirical economic studies suggest that trade and economic liberalization actually undermines the terms of trade of developing countries. But the IMF and World Bank solution to the resulting balance-of-payments difficulties is another dose of bad medicine, i.e., more liberalization is demanded through the IMF and World Bank's Structural Adjustment Lending Programs. See Michael Bleaney, *Liberalisation and the Terms of Trade of Developing Countries: A Cause For Concern?* 16:4 WORLD ECON. 453, 464 (July 1993). "If this analysis is correct then structural

trialized countries may perversely benefit as safe havens for capital fleeing from other countries that are experiencing extreme and acute financial and economic hardship. In contrast, deficit countries typically face capital outflows, as capital tries to beat, and thereby contributes to, a coming devaluation.²⁶⁶ Attempts by developing countries to defend the value of their currencies with higher interest rates also contribute to larger trade and budget deficits,²⁶⁷ thereby leaving those developing countries more dependent on hot money inflows.

The Camdessus proposal did not represent the first time that the IMF attempted to increase the allocation of SDR's. In the 1970s, Mr. J. de Larosiere, the IMF's previous managing director, supported such proposals.²⁶⁸ Developing nations also called for increased SDR allocations as part of their demands for a New International Economic Order ("NIEO") in the context of the so-called North-South dialogue.²⁶⁹

Nevertheless, there has been no increase in the allocation of SDRs for nearly eighteen years.²⁷⁰ Many of the countries that never received

changes in the trade policy of developed countries will do little to solve the problem, and help would have to take the form of a direct alleviation of balance of payments constraints through flows of aid." *Id.*

²⁶⁶ United States interest rates may be lower than rates elsewhere because of such inflows of frightened capital. See Turner, *supra* note 265 and accompanying text; see also HENWOOD, *supra* note 255, at 108; ROBERT SOLOMON, MONEY ON THE MOVE 93 (1999).

²⁶⁷ See Sachs & Radelet, *supra* note 119, at A25; see generally Canova & Turgeon, *supra* note 153 and accompanying text.

²⁶⁸ See MARGARET GARRITSEN DE VRIES, BALANCE OF PAYMENTS ADJUSTMENT, 1945 TO 1986: THE IMF EXPERIENCE 146, 175, 288-89 (1987) (discussing IMF policy).

²⁶⁹ See *North-South: A Programme For Survival*, Report of the Independent Commission on International Development Issues (1980) at 211-212; see also ROBERT L. ROTHSTEIN, GLOBAL BARGAINING: UNCTAD AND THE QUEST FOR A NEW INTERNATIONAL ECONOMIC ORDER 162 (1979); see generally John Williamson, A NEW SDR ALLOCATION? 34 (1984).

²⁷⁰ See *Special Drawing Rights, Survey Supplement on the Fund 1996*, (visited June 11, 1999) <<http://www.imf.org/external/pubs/ft/survey/sup0996/>>

an SDR allocation now find themselves without sufficient reserves to fend off financial speculation.²⁷¹ Other developing countries that received SDR allocations many years ago have been harmed by the way the global financial system unfairly punishes developing countries that are experiencing trade and/or budget deficits.²⁷²

E. CHANGING THE BURDENS OF ADJUSTMENT: RECYCLING THE SURPLUSES

When trade between nations remains chronically unbalanced, deficit and/or surplus nations must make adjustments.²⁷³ Another approach to the problem of providing sufficient long-term development capital would attempt to place the burden of adjustment on surplus countries by requiring them to recycle their reserves at low or no interest to deficit countries.²⁷⁴

10sdr.html.> (reporting that the last allocation was on January 1, 1981, when only SDR 4.1 billion was allocated).

²⁷¹ In a particularly shortsighted stance, the United States Treasury Department opposes offering Russia any new IMF resources. See David E. Sanger, *I.M.F. Relents on Aid to Russia, but U.S. Talks Tougher*, N.Y. TIMES, Mar. 30, 1999, at A6.

²⁷² While each member country was originally allocated SDRs in proportion to its IMF quota (i.e., contribution), the IMF has discretionary power to expand the size of SDR allocations. See VAGTS, *supra* note 260, at 98, Francis Stewart, *Back to Keynesianism: Reforming the IMF*, IV WORLD POL'Y J. 465, 477 (1987).

²⁷³ See Geoffrey Gilbert, *International Clearing Union*, in AN ENCYCLOPEDIA OF KEYNESIAN ECONOMICS 256, 257 (T. Cate ed., 1997).

²⁷⁴ See Robert Chote, *G7 Urged to Find Extra Cash for Debt Relief*, FIN. TIMES, Apr. 29, 1999, at 7 (explaining that debt relief could be part of a strategy to recycle surpluses and relieve some of the burden of adjustment from deficit countries). Unfortunately, debt relief plans usually apply only to the poorest of countries and even then the levels of relief are insufficient to alter the direction of adjustment burdens. See Paul Lewis, *I.M.F. and World Bank Clear Debt Relief*, N.Y. TIMES, Sept. 30, 1996, at C2; see also Jeffrey D. Sachs, *A Millennial Gift to Developing Nations*, N.Y. TIMES, June 11, 1999, at A31 (endorsing Jubilee 2000, an international movement calling for the cancellation of the unpayable debt of the poorest nations); see generally Jubilee 2000 Convention (visited July 6, 1999) <<http://www.jubilee2000uk.org/main.html>>; Leviticus 25:8-12, 25-55; Deuteron-

In the months leading up to the 1944 Bretton Woods conference, Keynes offered a proposal for an International Clearing Union that would assess an interest charge on excess reserves above a country's quota.²⁷⁵ This, he believed, would remedy the defects in the pre-war adjustment mechanism that put an unequal burden of adjustment on deficit countries, thereby undermining economic activity and world commerce.²⁷⁶ Keynes claimed that the International Clearing Union plan would pressure adjustment on "any country whose balance of payments with the rest of the world is departing from equilibrium in either direction."²⁷⁷

The Bretton Woods Conference rejected Keynes's proposal in favor of the United States' plan for the IMF, which lacked an explicit mechanism for assessing charges against chronic surplus countries.²⁷⁸ While the Articles do contain a "scarce currency clause" to shift some burden of adjustment on surplus countries, the IMF has largely ignored that provision.²⁷⁹

Throughout its existence, the IMF has consistently demonstrated a bias that places the complete burden of adjustment on deficit countries.²⁸⁰ When a country's balance of payments is chronically in defi-

omy 15:1-12 on the biblical origins of the concept of sabbatical and jubilee years to prevent the growth of economic classes and forgive debts after specified time periods.

²⁷⁵ See Gilbert, *supra* note 273, at 257; see also James Crotty, *On Keynes and Capital Flight*, 21 J. ECON. LITERATURE 59, 62-63 (1983).

²⁷⁶ See Robert Skidelsky, *Keynes's New Order: The Genesis of the Clearing Union*, Paper Presented at Post-Keynesian Workshop Conference, Tennessee, June 26 - July 1, 1998, at 20-26 (draft on file with author).

²⁷⁷ See Gilbert, *supra* note 273, at 258.

²⁷⁸ See *id.* (stating that it was not surprising that the American plan prevailed or that it favored surplus countries, given the fact that the United States was a surplus country at the time, and enjoyed a "commanding political and economic position").

²⁷⁹ See *infra* notes 298-301 and accompanying text.

²⁸⁰ See *North-South*, *supra* note 269, at 213-14.

cit and its reserves are declining, IMF consultations result in a classic austerity program under which the deficit country deflates its economy by raising interest rates, constraining the growth of the money supply, cutting back on government spending, and raising taxes. As the deficit country falls into recession, its citizens simply lose the means to continue to demand imports from the rest of the world. If the burdens of adjustment were distributed in a more equitable manner, then chronic surplus countries would be compelled to inflate their economies, import more goods and services from the deficit world, and/or recycle their surpluses through long-term foreign investment and grants. Not surprisingly, developing countries also urged a more equitable distribution of the burdens of adjustment as part of their calls for a New International Economic Order in the 1970s.²⁸¹

Japan is the classic example of a surplus country that had not recycled its surplus. Japan has out-traded the rest of the world, but it is sitting on a mountain of foreign reserves, and it is now choking on those surpluses.²⁸² In contrast, after World War II, the United States created the European Recovery Program, which lasted from 1947 to 1951. Also known as the Marshall Plan, this effort by the United States government gave \$13 billion (more than \$150 billion in today's dollars) in foreign aid in just a four year period to rebuild the economies of Western Europe.²⁸³

²⁸¹ See *id.* (arguing that the IMF or others should devise a means to encourage countries in current account surpluses to make "long-term loans to deficit countries that are undertaking needed adjustment").

²⁸² See Paul Abrahams, *Japanese Trade Surplus Climbs To Record \$122bn*, FIN. TIMES, Jan. 26, 1999, 16; Wayne Angell, *How To Save Japan From Oversaving*, WALL ST. J., June 22, 1998, A22. For an early recognition and explanation of Japan's economic weakness, see LYNN TURGEON, *STATE AND DISCRIMINATION: THE OTHER SIDE OF THE COLD WAR* 98 (1989).

²⁸³ See LYNN TURGEON, *BASTARD KEYNESIANISM: THE EVOLUTION OF ECONOMIC THINKING AND POLICYMAKING SINCE WORLD WAR II* 7, 10, 59 (1996) (examining the beneficial effect of the Marshall Plan on the United States economy); DIMAND, *supra* note 165, at 53 (discussing comparable United States aid to Japan and the Anglo-American Financial Agreement, in which the United States extended a \$3.75 billion line of credit to Britain); JOSEPH M. JONES, *THE FIFTEEN WEEKS* 239-56 (1955) (describing the role of the Marshall Plan in the larger context of the reorganization of the world economy following World War

The Marshall Plan stimulus was highly successful; by 1951, the Marshall Plan countries had raised their industrial output by 40%.²⁸⁴ We often forget how much Western European and United States prosperity owes to public-sector investment in long-term infrastructure and technologies, rather than short-term private hot money flows.²⁸⁵ Moreover, post-war reconstruction of Western Europe occurred behind the protection of capital and currency controls.²⁸⁶ Most of Western Europe did not achieve currency convertibility until the end of 1958,²⁸⁷ and capital controls were not lifted until later. In fact, some larger Western European countries did not fully remove capital controls until the 1990s, obviously well after achieving significant economic development.²⁸⁸ Yet, today the IMF expects developing countries to reach economic take-off without restricting hot money capital flows.

In omitting the history and success of the Marshall Plan, today's dominant narratives about development serve to misinform public discussion about global capital markets. For instance, in editorializing that capital controls would scare off foreign capital, the Econo-

II); Paul Davidson, *Reforming the World's Money*, 15 J. POST-KEYNESIAN ECON. 153, 156 (1993) (enumerating the benefits of the Marshall Plan).

²⁸⁴ See JOHN BLUM, ET. AL., *THE NATIONAL EXPERIENCE* 720 (1977).

²⁸⁵ See TURGEON, *supra* note 282, at 9-11 (explaining that United States post-war prosperity depended in significant part upon military expenditures). The groundwork for increased military spending was laid in early 1950, when President Truman signed a secret National Security Council memorandum NSC-68. See *id.* NSC-68 was drafted by Leon Keyseling, the chair of the Council of Economic Advisers, who was also instrumental in drafting the Employment Act of 1946. See *id.* During the Kennedy administration economic growth was once again spurred by renewed military spending, space expenditures, and foreign aid. See *id.* at 17.

²⁸⁶ See FRED L. BLOCK, *THE ORIGINS OF INTERNATIONAL ECONOMIC DISORDER* 109 (1977) (noting that at the beginning of the 1950s "no major European currency was convertible"); GARRITSEN DE VRIES, *supra* note 268, at 30-32.

²⁸⁷ See GARRITSEN DE VRIES, *supra* note 268, at 30-32.

²⁸⁸ See Mussa & Goldstein, *supra* note 96, at 52.

mist offered a photo of a construction site above the caption: "The benefit of foreign capital,"²⁸⁹ by which the Economist meant *private* foreign capital. This view conveniently ignores the fact that much of Western Europe's post-war construction sites stemmed from the Marshall Plan, which provided a public-sector transfer of capital during a time of widespread currency and capital controls.

More revealing is how the dominant neoliberal view reflects the ethics of a hard core drug dealer. The euphoria of the short-term inflow somehow justifies the addiction,²⁹⁰ no matter how ephemeral and illusory the prosperity appears after the crash, no matter the inevitable outcome of lost jobs and broken dreams. But the free market pushers of hot money flows do not expect to be the ones waking up with hangovers after the party is over. They will not even imagine such a fate. Their calls for more austerity for deficit countries that fall victim to the hot money addiction show that they refuse to accept any degree of responsibility for the results of their actions.²⁹¹

Finally, once again, it is instructive to compare the United States recycling of its surplus through the Marshall Plan with what Japan has done with its own surplus.²⁹² By recycling its post-war surplus, the United States essentially accepted its share of the burden of ad-

²⁸⁹ See *Time to turn off the tap?*, ECONOMIST, Sept. 12, 1998, at 83, 85.

²⁹⁰ See Stanley Fischer, *Capital Account Liberalization and the Role of the IMF, Paper Prepared for the IMF Seminar "Asia and the IMF," Sept. 19, 1997*, (visited June 8, 1999) <<http://www.imf.org/external/np/speeches/1997/091997.htm>> (describing in laudatory terms the benefits that private capital inflows brought to Asian countries and arguing that capital account liberalization should be a priority worldwide); see also Robert E. Rubin, *Remarks to the Dow Jones/ Wall Street Journal Annual Conference on the Americas, Oct. 1, 1998*, (visited June 8, 1999) <<http://www.ustreas.gov/press/release/pr2729.html>> (reaffirming support for the free flow of capital and greater adherence to "market discipline").

²⁹¹ According to Franhois Gianviti, the General Counsel of the IMF, a basic tenet of the IMF is "that the resolution of external debt problems due to a major capital outflow was not the responsibility of the [International Monetary] Fund, but was the responsibility of the country facing this outflow...[i]n an age of liberalization of capital markets, these principles may seem antiquated, but they are still in force and must be observed." See Gianviti, *supra* note 157, at 775

²⁹² See *North-South supra* note 280.

justment. Western Europe used those Marshall Plan funds to purchase United States products and to pay United States construction companies, and in that way, the Marshall Plan helped to sustain demand in the United States economy as well.²⁹³ Japan, on the other hand, sat on its vast surplus of reserves, and instead of recycling through massive foreign aid,²⁹⁴ Japan sunk those funds into speculation in stock and real estate markets and created financial bubbles that inevitably burst.²⁹⁵ This resulted in a dangerous price deflation and recession in the world's second largest economy.²⁹⁶ The major industrialized countries, including the United States, have also refused to recycle their reserves to ease Russia's transition from communism to market capitalism. It is not surprising that, in the aftermath of the Russian ruble collapse, many Russians now feel betrayed

²⁹³ See TURGEON, *supra* note 283, at 10, 59.

²⁹⁴ Japan has only lately started to focus on recycling its surplus as part of a rescue package for Asia. See Frances Williams, *UNCTAD Backs Japan's \$100bn Asia Aid Plan*, FIN. TIMES, Oct. 21, 1998, at 9 (noting that the aid program would have a greater impact on Japanese GDP than a similar-sized domestic fiscal stimulus); see also Stephen Fidler & Gillian Tett, *Japan joins World Bank to back Asia bonds*, FIN. TIMES, Nov. 2, 1998, at 1 (describing a plan to help reflate Asian economies). Japan's efforts, however, have not found support in the United States. See Robert Wade & Frank Venerose, *The Resources Lie Within*, ECONOMIST, Nov. 7, 1998, at 19-21 (stating that in August of 1997, the United States Treasury Department effectively blocked a \$100 billion Japanese proposal for an Asian Monetary Fund to deal with Asian financial crisis); Edward A. Gargan, *Asian Nations Affirm I.M.F. As Primary Provider of Aid*, N.Y. TIMES, Nov. 20, 1997, at C2 (describing how the United States rejected the Japanese plan to create an Asian-only fund to supplement IMF assistance).

²⁹⁵ See David P. Hamilton, *So, How Far Has Japan Fallen? Take a Look at These Numbers*, WALL ST. J., July 2, 1998, at A19.

²⁹⁶ As a sign of the deflationary dangers in Japan, market interest rates fell below zero, an almost unheard-of phenomenon, prompting the Japanese central bank to purchase massive amounts of corporate debt in an attempt to stave off a liquidity squeeze. See Gillian Tett & Edward Luce, *Yen Deposit Rates Fall to Below Zero*, FIN. TIMES, Nov. 6, 1998, at 1 (describing how depositors were willing to accept sub-zero interest rates because of lack of other destinations for Yen assets); see also Gillian Tett & Edward Luce, *Man and Machine Mystified by Negative Interest Rates*, FIN. TIMES, Nov. 10, 1998, at 6; Gillian Tett, *Bank of Japan Steps in to Buy More Corporate Debt*, FIN. TIMES, Oct. 30, 1998, at 22.

by the West.²⁹⁷

F. THE SCARCE CURRENCY CLAUSE AND OTHER TRADE TACTICS

Pressure could also be brought to bear on surplus countries to recycle their surpluses through the IMF Articles. Article VII is the so-called "scarce currency clause" which permits the IMF to identify a chronic surplus country, declare its currency as a scarce currency, and allow the rest of the world to discriminate against that country's imports.²⁹⁸ Unfortunately, the scarce currency clause has never been invoked.²⁹⁹ Consequently, the IMF took a "highly asymmetrical" approach to adjustment by placing the major burden of policy change and adjustment on deficit countries.³⁰⁰ But a credible threat to effectively use the scarce currency clause might pressure a surplus country to recycle its reserves to deficit countries.³⁰¹

Even international trade law supports the use of trade restrictions

²⁹⁷ See Michael Wines, *Hostility to U.S. is Now Popular with Russians*, N.Y. TIMES, Apr. 12, 1999, at A5; see also *supra* notes 242-243 and accompanying text.

²⁹⁸ See Articles, *supra* note 156, art. VII, sec. 3(a) (providing for the authority to declare a general scarcity of a particular currency); see *id.* sec. 3(b) (authorizing any member, after consultation with the Fund, to temporarily impose limitations on the freedom of exchange operations in the scarce currency); see also BLOCK, *supra* note 286, at 52.

²⁹⁹ Indeed, the IMF's General Counsel does not even mention the scarce currency clause as an exception to the Articles' prohibition against restrictions on current transactions. See Gianviti, *supra* note 157, at 775-76.

³⁰⁰ See Stewart, *supra* note 272, at 472. According to Sir Roy Harrod, Article VII, sec. 3(b) may violate the multilateral principle at the base of the IMF, thereby making the operation of the scarce currency clause "a purely bilateral matter between each separate member and the scarce currency country". See ROY F. HARROD, *THE DOLLAR* 110 (1954) (arguing that multilateral application would permit more effective operation of the scarce currency clause).

³⁰¹ During the 1970's, the managing director of the IMF, Mr. de Larosiere, advocated such recycling by urging surplus countries to increase their official development financing to help deficit countries develop their infrastructure, their resource base, and sustain their living standards. See GARRITSEN DE VRIES, *supra* note 268, at 174, 228.

to maintain a balance of payments equilibrium if the restrictions comply with principles of non-selectivity and nondiscrimination. Article XII of the GATT, as adopted by the WTO, permits the use of import controls if the achievement and maintenance of full employment generates a high level of demand for imports that threaten a country's monetary reserves.³⁰² In order to safeguard its external financial position and achieve full employment, a contracting party "may restrict the quantity or value of merchandise permitted to be imported."³⁰³ If properly interpreted and applied, international trade law could encourage chronic surplus countries to bear more of the burdens of adjustment.³⁰⁴

VI. FINDING OPPORTUNITY IN STABILITY

The full implications of the range of these proposed reforms are compelling. First and foremost, countries would be free to pursue and maintain economic growth and full employment without excessive fear of currency contagion and economic collapse. Most elected governments are presently caught between a rock and a hard place, trying to respond to the needs of their citizens, but also attempting to placate the demands of industrialized countries, multilateral lending institutions, and private financial markets.³⁰⁵

³⁰² See Wynne Godley, *A Critical Imbalance in U.S. Trade: The U.S. Balance of Payments, International Indebtedness, and Economic Policy*, PUB. POL'Y BRIEF NO. 23 (Jerome Levy Economics Institute, Annandale-on-Hudson) 1995, at 25 (noting that the WTO modifications to GATT Article XII express a preference for "price-based" measures over quantitative controls).

³⁰³ See *id.*

³⁰⁴ One way for surplus countries to bear adjustment burdens would be encouraging them to import more from deficit countries. See Guy de Jonquieres, *US asks EU to Ease Import Curbs to Aid World Economy*, FIN. TIMES, Oct. 19, 1998, at 1; Peter Montagnon & Sheila McNutty, *Attempts at APEC Deal Fail as Japan Resists Tariff Cuts*, FIN. TIMES, Nov. 16, 1998, at 18.

³⁰⁵ See Paul Lewis, *World Bank Says Poverty Is Increasing*, N.Y. Times, June 3, 1999, at C7; see also *Latest World Bank Poverty Update Shows Urgent Need to Better Shield Poor in Crises*, NEWS RELEASE NO. 99/2214/S, June 2, 1999 <<http://www.worldbank.org/html/extdr/extme/2214.htm>> (reporting that, as a result of the global currency contagion and misguided adjustment policies and austerity responses, the number of people living on less than \$1 per day rose from 1.2

Today's so-called "Wall Street-Washington" consensus that is supported and advanced by the IMF and the United States Treasury Department assumes that one size fits all. Such a view holds that there is only one path for development, and only one way for a government to organize its economy and society.³⁰⁶ This approach is ethnocentric and undermines other non-financial values. As a result, there have been profound dislocations around the world, as governments dismantle universal entitlements and social safety nets to fit the IMF's very narrow conception of sound finance.³⁰⁷

A reformed and truly progressive global financial architecture that permits full employment would present a return to the original purposes of the Bretton Woods agreement.³⁰⁸ It would begin to reverse the destructive trends towards high real interest rates, widespread underemployment, slow or declining economic growth, high poverty levels, and stagnant incomes that beset submerging market countries in recent months and years.³⁰⁹ These reforms would enable central

billion to 1.5 billion from 1987 to 1999).

³⁰⁶ See Bhagwati, *supra* note 141, at 10 (referring to the confluence of interests supporting neo-liberalized hot money capital flows as "the Wall Street-Treasury complex").

³⁰⁷ For instance, Latin American countries have been under pressure to cut back on social services to placate the IMF and private investment community. See Diana Jean Schemo, *Brazil Congress Votes to Scale Down Social Security Benefits*, N.Y. TIMES, Feb. 13, 1998, at A5 (describing moves to restrict social security eligibility and benefits and to water down an environmental crimes law, intended to "lift the confidence of international investors"); see also Frederico Grayeb, *Argentina's Values*, N.Y. TIMES, Feb. 13, 1998, at A26 (finding Argentina's state-provided universal health care, free public universities, legal protections from layoffs, and six-month maternity leave threatened by the Americanization of its economic culture).

³⁰⁸ See Articles *supra* note 169 and accompanying text; Ilene Grabel, *Crossing Borders: A Case for Cooperation in International Financial Markets*, CREATING A NEW WORLD ECONOMY: FORCES OF CHANGE AND PLANS OF ACTION 64 (Gerald Epstein, Julie Graham, Jessica Nembhard, eds., Temple University Press, 1993).

³⁰⁹ See *Global Financial Crisis Will Trigger Jump in World Unemployment*, Press Release on the ILO World Employment Report, 1998-99, Sept. 24, 1998, (visited June 8, 1999) <<http://www.ilo.org/public/english/235press/pr/1998/33.html>> (estimating that more than one billion people, or one-third of the world's labor force,

banks to deliver much lower interest rates and elected governments to use fiscal policy for a broad range of economic and social purposes, without fear that capital would flee a country's currency.³¹⁰ While owners of financial capital may not cherish such lower real interest rates, these rates would certainly prove very beneficial for the health of industrial capital and social enterprise.

A more stable regime would present different opportunities for social progress and private profit. While there might not be the shotgun marriage of United States investment and Mexican banking, greater opportunities for prosperity and profit in the trade of real goods and services, and increased commerce and tourism may result from stability between these neighbors.³¹¹ Hopefully some of these broader questions will be introduced in discussions by considering the mechanisms by which today's financial regime has actually impeded progress in Mexico, the United States and around the globe, and by considering the challenges that confront our efforts to reform today's speculative regime into a more stable system of relations.

are unemployed or underemployed).

³¹⁰ For recent examples of IMF-imposed hardship, see Clifford Krauss, *Argentina: Students Protest Cuts*, N.Y. TIMES, May 7, 1999, at A6 (describing nationwide student protests over government plans to cut \$280 million from the Education Ministry as part of agreement with the IMF to cut \$1.4 billion in overall spending); see also Richard Chacon, *Tuition Hike Sparks Fight Over Mexico University's Mission*, BOSTON GLOBE, Apr. 25, 1999, at A3 (describing a student strike that shut down Mexico's largest public university to protest a proposed tuition increase from twenty cents to \$120 per semester as part of the government's IMF-backed austerity measures); Julia Preston, *Student Strike in Capital Jarring All of Mexico*, N.Y. TIMES, June 25, 1999, at A8 (student strike has closed down classrooms for more than three months for 270,000 students at Mexico's largest university, the National Autonomous University of Mexico; after the university's governing council voted to cancel obligatory tuition payments, protests have expanded to oppose the role of private enterprise in Mexican society).

³¹¹ As part of a program to restore monetary sovereignty and full employment, Keynes sympathized with calls to minimize economic and particularly financial entanglements. See John Maynard Keynes, *National Self Sufficiency*, in THE COLLECTED WRITINGS OF JOHN MAYNARD KEYNES 233, 236 (D. Moggridge ed., 1982) (asserting that "[i]deas, knowledge, art, hospitality, travel - these are the things which should of their nature be international...[b]ut . . . above all, let finance be primarily national").