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International Economic Order (NIEO). This aimed to improve the terms of trade for raw materials and build up agricultural and industrial self-sufficiency.

*Global Fracture* shows how the U.S. undermined this progressive initiative and instead pushed for financial dominance over the rest of the world. Today, the NIEO is a forgotten interlude, its optimism replaced by the financial austerity imposed by the IMF and the World Bank.

Exploring how America achieved its economic aims, and tracing the implications this has had through subsequent decades, Michael Hudson covers various topics including trade embargoes, changing U.S. attitudes to foreign aid, the rise of protectionism, government regulation of international investments, the impact on specific industries including the oil industry, the implications of the new economic order and the future of war.

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This new and updated edition of Michael Hudson's classic political economy text explores how and why the U.S. came to achieve world economic hegemony.

Originally published as the sequel to Hudson's best-selling *Super Imperialism*, *Global Fracture* explores American economic strategy during a key period in world history.

In 1973, many of the world's most indebted countries sought to free themselves of trade dependency and the debt trap by creating a New

# Global Fracture

The New International Economic Order

MICHAEL HUDSON

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NEW EDITION



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The New International  
Economic Order

New Edition

Michael Hudson



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## Preface

This book is a successor to *Super Imperialism: The Economic Strategy of American Empire* (1972), which analyzed the evolving methods by which the United States has dominated its Free World allies economically, politically and militarily. As the Cold War pushed America's balance of payments into massive deficit, forced it off gold, and indebted it to foreign governments beyond its willingness to repay, the United States enacted increasingly protectionist trade and investment policies while continuing to inflate the world economy with excess dollars. These tactics finally led other industrial nations and Third World countries to press for a new international economic order. Europe's closing of its foreign exchange markets in 1973, its repudiation of Kissinger's proposed New Atlantic Charter, the Middle East War and the subsequent quadrupling of oil prices, followed by foreign moves to achieve economic self-sufficiency in place of their previous dependency, all represent attempts to break America's hold on the world economy. A North-South conflict has been superimposed on the growing tensions among the leading industrial nations. Europe, Japan and America, each in their own way, are jockeying for position vis-à-vis each other and the newly self-assertive Third World. The resulting diplomacy reflects new values and implies new seats of economic power, characterized by regional alliances that may leave the United States isolated within its own hemisphere.

Whatever the resolution of the forces that have recently been set in motion, they connote an ending of the postwar world order that enabled the United States to tap foreign wealth with almost no constraint. For better or worse America is finding itself thrown back upon its own relatively high-cost resources in the face of inadequate domestic savings and reduced ability to secure from abroad the wealth it is no longer producing at home. The present book describes the principles underlying this global fracture and outlines its most probable economic and political consequences.

## Introduction to the New Edition

*Global Fracture* (1977), the sequel to *Super Imperialism* (1972), describes how debtor countries and raw-materials exporters sought to create a New International Economic Order (NIEO) in the 1970s. A program more of nationalist regimes than of the political left, the NIEO advocated a non-Communist New Deal to improve the terms of trade for raw materials and build up agricultural and industrial self-sufficiency so as to avoid trade dependency and the foreign debt trap.

This program today has become a forgotten interlude. Its optimism has been replaced by the financial austerity and privatizations imposed by the World Bank and International Monetary Fund (IMF) since the 1980s, after Margaret Thatcher was elected Prime Minister of Britain in 1979 and Ronald Reagan won the American presidential election a year later. Over the past two decades foreign countries have been stripped of the public enterprise whose development had been a central plank of the NIEO. Rather than seeking an alternative to the Washington Consensus and its U.S.-centered pattern of global development, even Europe has embraced a monetarist austerity hitherto adopted only by hapless debtor countries.

The term Washington Consensus was coined in 1989 by a World Bank economist, John Williams, to signify America's policy response to the collapse in the prices of Third World bonds and bank loans after Mexico's default in 1982 triggered the Latin American "debt bomb." The hallmark of this neoliberal (that is, pro-creditor and pro-monopoly) program was a monetary drain that has obliged debtor countries to sell off their public domain on credit to insiders (crony capitalism) and foreign buyers, while "freeing capital flows," that is, permitting capital flight without limit. As one economic reporter recently observed in the *Financial Times*: "Mixed with mismanagement and corrupt governance, the Washington Consensus managed to undermine a dozen economies in a decade. Countries like Argentina and Indonesia found that the speed and greed of modern finance was a pipeline for every sort of instability."<sup>1</sup>

Already in the 1970s American diplomats sought to impose a division of labor in which other countries were to import U.S. high-technology, high-

wage and high-profit goods and services in exchange for raw materials and consumer goods made with low-wage labor, and to become dependent on American farm surpluses rather than feeding themselves.

The 1980s saw the World Bank and IMF use their creditor leverage to impose an era of privatization that dismantled and sold off public enterprises and social infrastructure, leaving economies much further indebted and more foreign-owned than anyone imagined in the 1970s. Soviet Communism was vanquished with the accession of Boris Yeltsin in Russia in 1991. Countries not obeying the Washington Consensus faced the prospect of being isolated as international pariahs, subject to sanctions such as those imposed on Cuba, Libya and North Korea. Meanwhile, the United States has retained its agricultural and industrial protectionism but opposed such policies abroad. This double standard has thwarted the drive by other countries to achieve their own national self-determination in industry, agriculture and trade.

No General de Gaulle or comparable European or Third World leader emerged to challenge the U.S.-centered global order. Labour Parties in New Zealand, Australia and Britain (and most recently Brazil under Lula) have imposed neoliberal policies that no non-labor government could have enforced without being thrown out of office. (What are labor parties for in today's world, after all, if not to betray their constituencies?) Even Russia was persuaded to adopt the Washington Consensus by the mid-1990s, dollarizing its economy as its central bank followed IMF dictates and refrained from paying public employees. Only the United States has inflated its economy by running twin government budget deficits and balance-of-payments deficits, obtaining a free ride beyond the expectations of anyone in the 1970s.

Nobody had speculated on what it would mean for other countries not to promote a more equitable and symmetrical alternative to the American-centered order, or what it would mean specifically for economies to recycle their foreign-exchange earnings to finance the U.S. Government's federal budget deficit, as much of Asia and Europe have done. The natural expectation is that a nation cannot get something for nothing, as the exploited parties will soon catch onto the game. But as the modern science of advertising has demonstrated, people can be convinced that what is bad for them actually is good. It is all a question of how to frame their decision-making process.

In Japan, the nation that at one point loomed as the major potential economic rival to the United States, politicians sandbagged their economy by agreeing to the Plaza and Louvre Accords of 1985 and 1986. These agreements committed Japan and Germany to lower their interest rates

and create financial bubbles, for no better reason than to facilitate low interest rates so as to promote U.S. financial expansion that followed the 1981 tax cuts that made real-estate speculation and junk-bond takeovers effectively exempt from income taxation. The takeover movement helped inflate a financial bubble, coupled with an unprecedented credit creation to finance asset-price inflation in the 1990s.

The dollar standard had arisen without much forethought. American diplomats insisted on veto power in any international organization they joined, so as to protect their nation against policies that might impinge on its interests. After the gold-exchange standard ended in 1971, the United States used this go-it-alone power to turn its balance-of-payments deficit into a tax on the rest of the world, obtaining its imports for paper promises to pay at some future date, at low rates of interest.

Chapter 2 of *Global Fracture* describes the dilemma with which America confronted the central banks of Europe to Japan and China. Whereas America was the world's major creditor nation in 1945, it is now the world's largest debtor. Yet unlike other debtors, it has not had to forfeit its autonomy. Rather, other countries have had to adjust their economies to the U.S. payments deficit. If they refuse to lend their trade surpluses to the U.S. Government, their currencies will rise and the dollar will fall, threatening to price their exports out of world markets. Powerless to use their economic strength for anything more than to become the major buyers of Treasury bonds to finance the U.S. federal budget deficit, foreign central banks have enabled America to cut its own tax rates (at least for the wealthy), freeing savings to be invested in the stock market and property boom.

### **How the world's economic philosophy has been inverted since 1945**

On the deepest economic plane the U.S. Government has come to represent the interests of finance capital. Its economic dominance can be traced to its emergence during World War I as the world's major creditor. The government subsequently has used its influence—and veto power in any international organization it joins—to move the heady ideals voiced in the aftermath of World War II away from a regime of currency stability to sinking exchange rates for debtor countries (including in recent decades the United States itself); from full-employment objectives to financial austerity; from using budget deficits to fuel economic expansion to fiscal surpluses, at least for countries outside the United States; from a symmetrical spirit of international law and trade agreements

to a double standard favoring the United States; from currency values being determined mainly by foreign trade and investment to currency speculation creating sharp and rapid fluctuations in exchange rates; from government regulation to creditor planning and control over economies; from the Cold War isolation of Russia to co-opting its leaders through neoliberalism; and ultimately from the Cold War into an international class war waged by industrialists against labor, and even more by creditors against debtors.

Probably it was inevitable that finance would have come to rule the modern world, regardless of what nation was in the lead. Although the early power of finance was nurtured by government, the financial sector's growing strength has led it to unseat its parent. The primary mode of accumulation has become financial, enabling investment bankers to replace government planners and wrest control from landed property and industrial capital.

This shift has been accompanied by a neoliberal ethic that opposes traditional social values, above all the long-held hope that governments would lead the way toward more egalitarian societies via public regulation, progressive taxation and infrastructure spending. As President Reagan expressed neoliberal philosophy: "Government is not the solution to our problems; government is the problem." Although this philosophy portrays itself as resting on the Enlightenment values of individualism and equality of opportunity, it places unprecedented power in the hands of a financial class whose philosophy is anything but democratic and progressive. This helps explain why it was first introduced by the Chicago Boys in Chile under General Pinochet after 1974.

For centuries the idea of economic progress depicted rising productivity as enhancing living standards. Economic theory focused on how profits made on producing consumer goods would be spent on capital goods to produce yet more output. But today's austerity programs imposed by the IMF and World Bank have shrunk domestic markets and dislodged exchange rates. Debtor countries have been forced to relinquish control over their fiscal and financial policy, permitting foreign investors to rush in like vultures to appropriate their assets at distress prices as their currencies collapse.

The Achilles' heel of proposals to create a better economic order was the inability to cope with the twists that modern finance has taken. Rather than funding new productive powers, bankers lend mainly against property and public monopolies already in place, headed by real estate and corporate stocks and bonds. The richest lode of new assets since 1980 has been the public domain, whose privatization has turned government

enterprises into financial vehicles to generate interest, dividends and capital gains.

What is remarkable is that while the United States has acted as a creditor nation toward the Third World, it has used quite a different economic diplomacy toward Europe and Asia. Having become the world's largest debtor nation, America itself refuses to follow what the Washington Consensus dictates to other debtor countries. It supports its own employment and growth, by running federal budget deficits, inflating its capital markets, reducing its interest rates and trying to lower its exchange rate to make its producers more competitive.

When the dollar's value fell against the euro, sterling and the yen after the 1985 Plaza Accords, European and Asian central banks holding these dollars suffered a twofold loss. In addition to a lower value of the U.S. Treasury's dollar bonds in terms of their own currencies, these securities yielded only about 4 or 5 percent—a far cry from the 45 percent rate that deficit countries such as Argentina and Brazil had to pay by the end of the decade.

These losses suffered by foreign central banks on their dollar holdings serve as a measure of modern international financial exploitation. It is the cost of the failure of creditor nations and others to develop an alternative to the Treasury-bill standard. Meanwhile, freed from having to finance their own government deficit, U.S. investors put their money into the bubbling stock and real estate markets.

If economic models and geopolitical game theory accurately described countries as acting in their own self-interest, a New International Economic Order would have emerged in one form or another as a system of negotiated checks and balances in the 1970s. There was widespread hope that low-income countries might catch up with the world's industrial creditor nations. A parallel belief was that world trade and finance should be symmetrical, enabling all countries to pursue similar policies rather than suffering from a double standard. All countries could provide their own credit, for instance, rather than leaving this as the monopoly of a single nation at the expense of others.

The problem with this ideal was a growing recognition that symmetrical development along the lines pioneered first by Europe and then by America would involve rising raw-materials prices, and that countries would aim at achieving economic self-sufficiency by producing their own food and manufactures rather than remaining dependent on imports. Also, if Europe had an alternative to the dollar, Americans would have to finance their own government's budget deficit. U.S. interest rates would rise, while foreign treasuries could create their own credit rather



depending on U.S. consumer demand, investment outflows and foreign military spending as the "engine of growth."

These perceptions prompted the Washington Consensus to be imposed, an economic order whose objectives, principles and policy precepts are in opposition to a NIEO and indeed, antithetical to those held almost universally a generation ago.

*From currency stability to sinking exchange rates for debtor countries*

In 1945 the United States opposed currency depreciation. The argument over the British Loan that year aimed at preventing Britain from establishing a competitive postwar exchange rate. The fear was that the Sterling Area and other countries might protect their economies against America's industrial and agricultural superiority by returning to the beggar-my-neighbor tactics of the 1930s. Devaluation of sterling had to be postponed until 1949, and currency stability was built into IMF prescriptions. The United States ran a heavy payments surplus but was not obliged to adjust, any more than other countries were allowed to devalue.

The U.S. balance of payments moved into deficit starting with the Korean War in 1950. By 1971 overseas military spending had forced America off gold and the dollar was devalued by 10 percent. Meanwhile, U.S. officials no longer feared the downward drift of sterling, given Britain's badly managed economy. They also saw that the Southern Hemisphere's social backwardness was locking it into the status of a raw-materials exporter and supplier of low-wage consumer goods. Latin America had dismantled its nascent industry, while its ex-colonial agriculture was based on absentee-owned plantations producing export crops rather than family farming producing grain and other food for the region's growing population. Its economies have become so export-oriented that devaluation alone would not suffice to change its trade patterns. It would merely reduce dollar prices for exports, along with the international price of domestic real estate, stocks and bonds—and for the public domain being sold off.

In recent years the IMF routinely has imposed devaluation on debtor countries in an attempt to reduce domestic purchasing power. This is supposed to leave more output available to export to pay foreign creditors. What is devalued in practice is mainly the price of labor, because prices for raw materials and capital goods are dollarized, as are foreign debts. The effect is to make exports cheaper and imports (especially of food) more costly, as each dollar of exports buys fewer and fewer imports. IMF

planners claim that this will shift resources from domestic production to the export sector.

Debtor countries must provide more and more exports for each unit of foreign debt,<sup>2</sup> as devaluation impairs the Third World's terms of trade while increasing the debt burden in terms of domestic currency. The effect is to prevent debtors from working their way out of debt. Their unpaid balances are rolled over to grow exponentially, throwing them even further into dependency on the IMF and World Bank.

The NIEO sought to improve the terms of trade, but did not tackle the problems of land reform and backward economic institutions called for more progressive systems of taxation and income distribution. Proposals for a NIEO also never tackled the problem of debts that had mounted up beyond the ability of countries to pay. Such shortcomings reflect the degree to which the NIEO aimed at merely marginal amelioration within the context of the existing institutions rather than recognizing the need for more far-reaching structural transformation.

Regional economic groupings that did emerge, most notably the European Community, have been organized under monetarist principles. The European Central Bank is committed not to finance more than marginal budget deficits, regardless of employment conditions.

*From full-employment objectives to financial and fiscal austerity*

Roosevelt's New Deal was followed by postwar Keynesian fiscal policy endorsing budget deficits to promote full employment. This also was the objective of Keynes's proposed Clearing Union and of the International Trade Organization (ITO) proposed at Havana in 1948. Since the 1980s, however, the IMF and World Bank have demanded fiscal austerity and heavy taxation (of labor and industry, not finance and land), while dismantling protective tariffs and subsidies such as those the U.S. Government routinely has given to American farmers since 1933.

As noted above, austerity plans deliberately create unemployment that blocks wage levels from rising. The hope is that this will squeeze out more exports to pay foreign creditors. There is little thought of developing domestic markets and modernizing economies. Under monetarist direction neither Third World countries nor Europe were to achieve full employment. They are supposed to rely on American consumers rather than their own citizens to supply "demand." Full employment is to be ensured only for the United States.

In this respect the advice that the IMF and World Bank give to debtor countries is like that of a parasite telling the host to give the intrusive *rentier* all the revenue it demands for its own growth, neglecting that

of the host. To make debtor countries "good investment markets," the IMF demands that taxes be raised—not on finance, real estate or other business, but on labor.

Devaluation holds down the price of labor regardless of union agreements in domestic currency, while privatization enables the traditionally unionized public-sector labor force to be replaced with non-union workers. High domestic taxation, coupled with low employment and purchasing power, shrinks the domestic market and reduces investment, making even less output available for export. And policies to hold down wage levels slow the growth of labor productivity, which requires rising educational, health and dietary standards. On a national scale the effect of mean-spirited austerity programs is to increase trade dependency and hence the balance-of-payments deficit, pushing countries even more deeply into debt and dependency.

These destructive effects may seem strange for ostensibly free-market philosophy to promote. The explanation is that the term "free-market" has become almost synonymous with dismantling government and replacing it with planning by global financial managers, whose business involves loading down economies with debt while "solving" the problem by dismantling and selling off public enterprises.

Few national leaders pressing for a NIEO showed an interest in improving labor's remuneration. Most plans were nationalistic rather than social-democratic, and no alternative economic theory yet has been put forth to counter the Chicago School monetarism that has spread throughout the world since the 1980s. It has taken the abject failure of the Washington Consensus reformers in Russia in recent years to spur thoughts of shifting the tax burden off labor and onto land and finance capital.

*From budget deficits to fiscal surpluses (outside of the United States)*

Worried that the cessation of military demand would lead to unemployment after World War II, governments were persuaded to inject purchasing power into economies by running budget deficits. But today the IMF directs economies to run budget surpluses so as to "absorb" local purchasing power and divert output to export markets. (So much for Say's Law, which posits that on an economy-wide basis, payments to employees are spent on buying the output they produce.)

One might think that the postwar epoch would have learned the lesson that governments should denominate debts in their own currency. But the Washington Consensus promotes dollar borrowing with central-bank guarantees. In post-Soviet Russia even domestic deficit spending was

supposed to be backed with dollar reserves. This policy denies indebted economies of using the traditional means of eroding the national debt burden by gradually inflating away their purchasing power. The value of dollarized debt is out of their control, becoming heavier (in domestic-currency terms) as their inflation rates rise and their currencies fall in value.

It is deemed to be inflationary to create domestic credit but not to borrow abroad in hard currency, on the specious logic that foreign bankers will not lend for risky or bad purposes. The reality is that it is no more inflationary for governments to create their own credit than to leave this to private-sector bankers. In fact, public credit tends (if not corrupt) to be created for more social, long-term purposes aimed at raising living standards and promoting employment.

The financial sector claims that it is good for central banks to be "independent" and not answerable to elected governments and hence to voters. In practice, central bank independence turns out to be a euphemism for dependence on the Washington Consensus, whose control over fiscal and monetary affairs prescribes self-defeating policies that reward creditors at the expense of debtors, while permitting only the United States to run large and chronic budget deficits.

*From neo-protectionism to neoliberal economics*

The world seemed to be moving beyond laissez faire in 1945, and the NIEO seemed poised to usher in a neo-protectionist era (as described in Chapter 12, "The Ending of Laissez Faire"). By the 1970s hardly anyone expected to see the backlash of neoconservative "market fundamentalism" that was about to occur in the 1980s. Instead of promoting government power, today's fine print of the WTO aims at elevating finance capital over governments. In political terms, checking the government's regulatory power, public enterprise and taxation has turned the planning process over to financial managers.

The World Bank and IMF originally were empowered to lend only to governments, and hence were obliged to work with them. This caused complaints in the 1950s from economists advocating land reform. Nearly all the World Bank reports urged family-based food production, which required land reform in oligarchic former colonies. But the Bank claimed that it was powerless to impose reforms on client countries, and most of its agricultural loans were for large plantation projects to produce export crops.

Since 1980, however, the World Bank has not been at all shy at demanding privatization, deflation and other oligarchic policies. Today

the Bank devotes its efforts to "nation building," a euphemism for the monetarist philosophy that blocks governments from raising living standards and breaking free of foreign finance capital. What began on the far-right periphery in Chile under General Pinochet in 1974 has now become mainstream policy.

It is a starkly creditor-oriented policy. Debtors throughout history have forfeited their property to foreclosing creditors, but today entire economies are told to begin selling off their land and mineral rights, along with government monopolies in railroads and airlines, power, water, gas, telephones and broadcasting in the public domain, capped by the privatization of Social Security. Given the financial austerity dictated by the IMF and World Bank, such sell-offs must be made primarily to foreigners, who cause a chronic balance-of-payments drain by "repatriating" their subsequent earnings.

Although the United States remained highly protectionist, its diplomats sought to block foreign governments from supplying credit to agriculture and industry on concessionary terms. Its own government had been doing this for a generation, but U.S. officials realized that financial charges are the largest cost of modern production, funded as it is by interest-bearing debt. The fact that socialist economies did not charge interest or rent was viewed as giving them a cost advantage. They alone could conduct planning along purely engineering lines using subsidized prices and virtually free credit and land use instead of having to give priority to financial pay-offs and other payments to *rentiers*.

American fears that such governments might "interfere with markets" led it to scuttle proposals to create an ITO and to exclude the Soviet Union and other centrally-planned economies from membership in the World Bank and IMF. Foreign countries that set out to emulate U.S. policies by subsidizing their production and trade were isolated (Cuba and China), destabilized or overthrown (Iran, Guatemala and Chile).

*From symmetrical international law to a double standard favoring the United States*

Trade negotiations have foundered on America's agricultural subsidies and quotas that block Third World economies from developing their own food production. U.S. refusal to relinquish the farm protectionism that has been "grandfathered" into trade agreements has left little to negotiate, as the remaining trade issues seem marginal by comparison. U.S. support of "free markets" rests on U.S. Government manipulation and support of its own domestic market.

There is a further fear that America's go-it-alone policy will lead it to ignore the international agreements it signs. Steel is a notorious

example, most recently in 2002 when Pres. Bush sought to attract voters in Pennsylvania and other steel-producing states by imposing illegal import quotas (*viz.* Chapter 11, "America's Steel Quotas Herald a New Protectionism").

A similar double standard emerged in the sphere of foreign investment. Despite the rising U.S. balance-of-payments deficit, America blocked foreigners from buying control of its banks, airlines, military and technology companies. OPEC governments were told in the 1970s that they could use their dollars only to buy small marginal shares of major U.S. companies. In the 1980s Japan was permitted to invest only in overpriced real estate, movie studios or troubled companies, while the United States demanded that foreign economies sell their own commanding heights.

The most striking double standard since the 1970s has been America's ability to pursue a debtor and a creditor strategy simultaneously. The United States is a debtor vis-à-vis Europe and Asia, but remains a creditor vis-à-vis "developing nations," that is, economies fallen into the debt trap and food dependency rather than really developing. As described in *Global Fracture* (p. 257):

America's strategy in the face of the New International Economic Order is to render it no more than a tentative scenario, and to reestablish the pre-1973 state of affairs wherever possible. The Treasury-bill standard is to be reinstated while gold, sterling or a Eurocurrency are rejected as viable alternatives. . . . American export prices are to be supported as foreign countries continue to depend on U.S. grain, arms and aircraft, in payment for which Third World countries are to compete among themselves once again to export their raw materials at falling terms of trade. . . . U.S. economic strategy is to continue drawing upon foreign resources in order to sustain growth in its living standards and government spending.

A major U.S. fear is that foreign countries might expand their own monetary and credit systems through Keynesian budget-deficit policies of the sort that the United States has been running all along. Domestic money and credit creation would free foreign countries from dollar dependency on foreign capital, while land reform and subsidies to promote self-dependency in food would reduce U.S. grain exports.

This is precisely what the Washington Consensus opposes. The double standard, after all, provides a free ride for the U.S. economy, as well as for creditors in client oligarchies.



*From foreign trade and investment to currency speculation*

Trade and financial dependency were deemed to be part of an economically efficient global specialization of labor and credit. But Mexico's insolvency in 1982 interrupted lending and investment until 1990, by which time Argentina and Brazil were obliged to pay 45 percent interest on dollar-denominated debts. This exorbitant rate reflected their failure to develop along lines leading to economic and financial self sufficiency.

Investors nonetheless started to lend again, having discovered a new source of foreign exchange. Debtor-country governments might pay their creditors by selling off public enterprises. These privatization programs were voluntary pre-bankruptcy forfeitures, as if governments were not sovereign debtors able to retain the public domain under their own control by obliging bankers and bondholders to absorb the losses resulting from their bad loans.

A quantum leap occurred. Whereas creditors in times past appropriated the property of individual debtors piece by piece, they now have taken aim at the entire public domain of national economies. Appropriation of public enterprises is passing into the hands of financial managers.

A byproduct of the resulting "free capital movement" (that is, capital flight and "repatriation") is that foreign trade no longer plays the major role in determining exchange rates. The frenetic currency speculation now being conducted minute by minute each trading day far exceeds the entire annual volume of trade and direct investment.

*From government monetary control to creditor control*

Ending of the Cold War has given way to a reversion to the classical conflict between creditors and debtors. Today's characteristic mode of exploitation is not to seek industrial profits by employing wage labor, but to get governments to promote (and un-tax) *rentier* economies yielding interest and rent. This is achieved by bringing financial leverage to bear over indebted countries, and in the creditor nations as well.

The post-1980 order thus has been primarily financial in character. Instead of enabling Third World debtors to monetize their own credit, the IMF's role has been to make them dependent on credit creation by foreign banks, in a way that reflects specifically U.S. national interests.<sup>3</sup>

Acquiescence in this state of affairs could not have developed without a distracting array of euphemisms and ideological blinders. Less developed countries (called "backward" in 1945 because of the property ownership patterns and financial dependency put in place under colonial rule) were indoctrinated to believe that the path to wealth lay in developing as export-oriented raw-materials monocultures. Meanwhile, the

assumption that credit relationships should be controlled abroad—and in "hard currency"—deterred countries from becoming self-reliant by implementing what G. F. Knapp called the State Theory of Money.

*From Cold War isolation of Russia to neoliberal buyout*

In the 1970s the Cold War metamorphosed into détente as America and Russia formed trade ties, capped by U.S. grain sales. Russia's opening to the West led to *glasnost* and *perestroika* in 1986, and five years later the USSR was dissolved. In one of the greatest economic about-faces in history, Russia was persuaded to assign its mineral wealth, land and enterprises to insiders drawn mainly from the ranks of the old Soviet *nomenklatura* and *mafia*. When the dust had cleared, Russia discovered that its industrial, agricultural and military production had been dismantled. America had ringed it with military bases from Central Asia to outer space, and was using the flight capital of its kleptocrats to buy out what remained of the nation's natural resources and other assets.

During the past decade the Washington Consensus has shown itself to be anything but a policy that promotes growth. Given a freer hand in Russia than anywhere else, neoliberal "reformers" managed to destroy Russia as a potential rival of the United States.

Neoliberals claimed that the new proprietors would respond to the logic of market incentives as described in economics textbooks and build up production by recycling their income into new investment. But the appropriators realized the political risks inherent in grabbing assets in which they were seen not to have had any role in creating. The safest way to preserve their gains was to move as much as they could out of the country as quickly as possible, away from the tax collector and criminal authorities. The oligarchs moved their takings abroad at the rate of \$25 billion annually for a decade—and then followed their bank accounts by obtaining citizenship in Israel, Britain and other countries.

By 2001, ten years after Yeltsin's attack on Russia's Parliament, a quarter-trillion dollars had been siphoned off and spirited out of the country through embezzlement, false invoicing of exports and flipping ownership rights to foreign buyers. Over and above this capital flight was the brain drain of Russian scientists and skilled workers. Life spans shortened, disease spread (headed by AIDS) and suicide rates rose as Russian society fell into depression psychologically as well as economically.

The Soviet Union thus was conquered financially rather than militarily, broken into a set of Third World countries that relinquished policy control to the U.S. AID, World Bank and IMF. By 1994 the government and many private companies had stopped paying salaries



to labor, and no domestic credit was made even to finance government deficits. The "reformers" had wiped out domestic rouble savings through hyperinflation, prompting people to keep their savings mainly in the form of the \$100 bills, accumulating more U.S. currency than was circulating in America itself.

Farm machinery rusted, factories rotted and investment plunged without finance, causing a deepening import dependency. Neoliberals insisted that government payments be backed by U.S. dollars, as if employees would spend all their money on imports. (The neoliberal showcase of Argentina followed dollarization even more stringently, crashing in 2002 and leaving a decade's worth of unpaid debt in its wake.)

Yet rather than being perceived as an object lesson illustrating the failure of such policies as a program of economic growth, the dismantling of Russia by neoliberal financial policies is being lauded as a victory of market efficiency over the inherently inefficient role of government planning and investment. The private fortunes created by these reforms were made by carving up the public enterprises that the government had built up, not by enterprise in the classical sense of increasing productive capacity.

Meanwhile, the era of world peace envisioned in 1945 is giving way to a global network of U.S. military bases and even the militarization of outer space. Still, the main mode of conquest remains financial, by dismantling government regulatory and taxing power outside of the United States. Toward this end the World Trade Organization (WTO), IMF and World Bank oppose government economic intervention, thereby promoting just the opposite program from what originally was envisioned for postwar development.

#### *From Cold War to class war*

Collapse of the Soviet Union in 1991 ended the Cold War, leaving the United States as the world's undisputed military and economic power. No longer checked by a Communist threat, it sought to make its gains irreversible by depicting its victory as evidence that government planning, price subsidies, taxation, income redistribution and public credit all were wasteful *ipso facto*. Public regulation and an active social role for government appeared to be discredited even in Social Democratic countries, including proposals to create a more equitable economic order in the sphere of foreign trade, financing and government planning to modernize agriculture, industry and social welfare.

Could so great an inversion of the social and economic philosophy reasonably have been forecast in the decades when free-marketers were

isolated on the right-wing fringe? Certainly the final paragraph of *Global Fracture* (p. 267) was off the mark in concluding that "whether led by socialist governments or monarchies, countries are regulating market forces to serve their own national or regional self-interest." Financial interests are now doing most of the world's economic planning, and Chicago School monetarism has become so dominant since the 1980s that by the 1990s even China's leadership had developed an eclectic tendency, prompting Deng Xiaching to remark that "black cat or white cat, it doesn't matter as long as it catches mice."

The question is, why hasn't a more symmetrical and equitable mode of international development emerged? If the strategizing of the 1970s has failed, what then is the most likely path to a more workable post-neoliberal order to replace the Washington Consensus? It is easy enough to understand America's desire to act in its own self-interest. But why have Europe, Asia and Third World countries acquiesced in this American-centered world instead of promoting their own distinct interests? They are not "playing the game" that economic textbooks and those of international power politics assign to sovereign nations.

This poses the question of what America will do with its unprecedented power. The logic of empires is to promote growth of the imperial center, not of the periphery and hence the empire as a whole. Rome's experience affords a lesson. As Tacitus described Roman policy, *solitudinem faciunt pacem appellant*: "They have made a wilderness and call it peace." The *rentier* oligarchy used its control to shift the tax burden onto the shoulders of agricultural and handicraft producers, leading to debt foreclosures, demographic shrinkage and a deepening dependency that settled into serfdom.

Ending of the Cold War bears many similarities to the conflict between creditors and debtors in times past. By the 1980s this conflict took on a political dimension as right-wing governments came to power in the United States, Britain and other countries. Mexico is an example of how Latin American regimes served financial interests. Its 1988 presidential election was stolen by the PRI, blocking the populist leader Cuauhtémoc Cárdenas. In 1991 the authoritarian PRI allied itself with the right-wing National Action Party (PAN) to maintain the crony capitalism that led to financial collapse of the Mexican stock exchange in 1994, headed by the telephone company and other enterprises that insiders had privatized.

#### *From empirical economics to free-market sloganeering*

For decades, IMF financial managers have stripped debtor countries of the credit and revenue needed to grow. It is as if a parasite has taken over

host economies and their guiding brain, bleeding away their nourishment to feed its own body. Its takings have been mistaken for growth in the host countries rather than destroying the host's own investment needs. Most biological parasites have learned to establish a symbiosis with their hosts and even to help them thrive, but empires never have succeeded in regulating themselves so rationally.

The financial sector's dominance over governments today is illustrated most nakedly in the Russian reforms that culminated in "grabitization" and subsequent sell-offs, and refusal by the European Community's central bankers to permit budget deficits to provide the credit needed to reflate its economies.

Orwellian double-think has given such reform the meaning of regressive taxation, insider privatizations, flight capital ("free capital transfers"), and a dismantling of government regulation. For its victims, "reform" along these neoliberal lines has become a bad word, diametrically opposed to the principles of the NIEO and progressive reforms prior to the 1980s—Social Democratic policies to build up the home market, and budget deficits to spur full employment at rising educational, health and living standards.

Yet quite apart from American arm-twisting, the lack of an alternative logic to today's trickle-down ideology of wealth creation has left a *tabula rasa* to be filled in to explain how governments best might act independently along such lines.

### The Path to a Post-Rentier Economic Order

It is not hard to see what is needed to counter the polarizing effects of today's neoliberal reforms. A better world order would provide government credit to finance budget deficits to spur investment and employment; denominate international debts in domestic currency and make debt service subject to the capacity to pay, as the Dawes and Young Plans did for German reparations in the 1920s; and shift the tax burden away from labor and industry onto land, subsoil resources and monopolies.

To bring about such a world order, it is necessary to create new international institutions whose development philosophy would replace that of the IMF, World Bank and ITO; negotiate an alternative to the U.S. Treasury-bill standard; enact U.S.-style tariffs and subsidies to complement land reform; constrain U.S. military expansionism; and develop a post-neoliberal theory to restore the classical distinction between earned and unearned income.

### *Government credit to finance budget deficits aimed at spurring investment and employment*

Economies do not require foreign exchange and savings to pay labor and other domestic factors of production. There is no reason for governments not to do what the United States has been doing all along—running budget deficits to support domestic market demand at a rate that keeps labor fully employed. Although monetarists claim that government credit is inherently inflationary, there is no reason why government credit should be any more inflationary than private credit. In fact, public credit under democratic regimes tends to be spent in ways that are conducive to the long-term raising of living standards, while banks prefer to finance property bubbles and the acquisition of real estate or other assets already in place.

### *Denomination of international debts in domestic currency*

Most countries may benefit from importing technology and capital goods, but the past half-century's experience with debt dependency (euphemized as "resource flows") has shown that such borrowing should be made only in their domestic currency, as only its value remains under their control. If self-determination is desirable and indeed, part of the political definition of sovereign states, it follows that currency and debt control is a *sine qua non*. This requires that dollarization be replaced with debts denominated in domestic currency.

The objective is to create a form of economic balance that promotes development rather than being merely redistributive in character. Today's economic orthodoxy defines "equilibrium" as the rate at which debtors need to sell off their assets to pay creditors (*viz.* the demands of Argentina's bondholders since 2002). American diplomats define financial equilibrium as the amount of U.S. Treasury debt that foreign central banks must buy in order to finance the U.S. budget deficit as it cuts taxes, while trade equilibrium seems to be the volume of products that foreign countries need to supply America to enable its citizens to maintain their living standards even as their economy deindustrializes and the population is turned into *rentiers*.

The problem is that today's trade and payments system aims at rewarding *rentiers* rather than helping countries develop. The disastrous effect of neoliberal logic has been demonstrated most notably in Russia's deflation of the domestic market in the mid-1990s, and in the European Community's fiscal austerity. Future generations no doubt will find it remarkable that this doctrinaire monetarist consensus was self-imposed

voluntarily without a General Pinochet being in place to enforce it at gunpoint.

Today (2004), Argentina is trying to establish conditions under which dollar debts must be converted into its own national currency. This need was learned the hard way, following the country's 2002 default after a decade of hyper-dollarization that required each issue of domestic currency to be backed by a parallel loan to the U.S. Treasury, as if Argentina were part of the U.S. fiscal system rather than a sovereign country. Although international bondholders and bank lenders have protested, the precedent for Argentina's negotiating stance was created by none other than Franklin Roosevelt himself when he unilaterally negated the "gold clause" in pre-1933 financial contracts. (The clause made all debts payable in gold valued at the price prior to dollar devaluation.)

*A rent and resource tax on land, subsoil endowments and monopolies*

Today's global financial grab seeks above all to obtain resource rents (including monopoly profits) by acquiring public monopolies, raw materials and real estate, not by investing in new capital formation to earn industrial profits. The extraction of property rents has been maximized by blocking governments from collecting them as taxes. As financiers know, what the tax collector gives up is available to be paid out as interest, dividends and management fees.

It is fairly easy for governments to counter this kind of resource grab. All they need do is to tax the land, subsoil mineral wealth and natural monopolies that have been privatized. The virtue of such a tax is that it reduces the fiscal burden levied on industry and labor. This shifts the tax system away from wages and industrial profits onto the "free ride" of rental revenue produced by nature (favorable land sites or natural resources) or monopoly power. It would enable governments to recover the revenue that *rentier* asset-grabbers hope to siphon off.

Rent and property taxation is legal under international law as long as it is applied evenly to domestic and foreign owners alike. It has a long pedigree, having been the focal point of classical political economy culminating in John Stuart Mill and subsequently was espoused by the 19<sup>th</sup> century's major economic reformers ranging from the German socialists Ferdinand Lasalle and Karl Marx to Henry George and Thorstein Veblen in the United States, Alfred Wallace, George Bernard Shaw and Winston Churchill in Britain, Sun-Yat Sen in China, Jose Marti in Cuba, and Leo Tolstoy and Alexander Kerensky in Russia.

A rent tax does not involve nationalization of property, which would require compensation under international law, recalling the arguments

over "just compensation" that became such a thorn in relations with Cuba and other Communist nations after their revolutions. Every government is permitted to tax its property and income in any way it chooses.

Even Milton Friedman and other neoliberals have acknowledged that a rent tax is the fairest and most equitable form of taxation. Rather than pressing this perception, however, they realize that the political appeal of their monetarist doctrines is mainly to property owners. They tend to conflate profit with rent, as if land and other property and monopoly rights belonged in the same category as manmade capital that requires labor for its creation rather than merely the act of appropriation. This confusion between land and capital is politically motivated in failing to distinguish between profits earned from tangible capital investment and the "free lunch" of economic rent—the free lunch that Milton Friedman and other neoliberals publicly claim does not exist, despite their preference for a rent tax over all other forms of taxation.

Squeezing out a surplus that has no counterpart in direct production costs is not "profit" in the classical sense of the term. It is economic rent, or what John Stuart Mill's generation of reformers called the "unearned increment." Vladimir Putin's counter-liberal reformation in Russia in support of resource-rent taxation is based on the perception that globalism has become mainly an exercise in appropriating property and rent.

Western countries, by contrast, have seen a steady reduction in the proportion of taxes levied on property since the end of World War II. The tax burden has been shifted onto labor and fixed capital formation. This trend needs to be reversed under an economic order that aims at growth and development rather than rewarding *rentiers* for using borrowed credit to gain control of property and monopoly rights whose prices are being inflated.

*New international institutions to replace the IMF, World Bank and ITO*

The IMF and World Bank hardly can be expected to support proposals that would loosen their control over debtor economies. Although their original aim was to support stable exchange rates and finance economic modernization, their economic doctrines now support *rentier* resource grabs and debt dependency. These two institutions need to be replaced because they are not reformable.

There is no need for countries to remain members of these two institutions, or of the ITO with its opposition to government enterprise and regulatory activity. Member countries simply need ask that their gold subscriptions to be returned, thereby rejecting the Washington



Consensus and its opposition to rent taxation, deficit financing and public credit creation.

#### *U.S.-style protective tariffs and subsidies*

As late as the 1950s, United Nations economists saw land reform as essential to the policies needed to enable food-deficit countries to supply their own grain rather than remaining dependent on imports. This policy requires a break from the ITO's imposition of free-trade principles on countries outside of the United States and Europe. The alternative is for food-dependent regions to import whatever the United States produces in crop surpluses, and to supply the tropical plantation plants that America does not produce in sufficient quantities to satisfy its home market.

Grain-deficit countries need to feed themselves in order to break free of the food weapon wielded by highly protected U.S. and European agriculture. Self-sufficiency requires a shift away from foreign-owned plantation production for export markets. To modernize agriculture and industry in the face of the heavily subsidized investment that has characterized Europe and the United States during their industrial and agricultural revolution, countries need to do what they did: provide protective tariffs to subsidize the capital investment needed. In other words, they should do what America actually has done, not what its diplomats say to do.

#### *An alternative to the U.S. Treasury-bill standard*

Foreign countries that run balance-of-payments surpluses presently are obliged to keep their central bank reserves in the form of loans to the U.S. Treasury *ad infinitum*. These savings become part of the U.S. financial system rather than building up their own productive capacity. There is no hard-currency guarantee for the value of these loans as the dollar falls against the euro, yen and other currencies of economies running trade and payments surpluses. In domestic-currency terms, the value of dollars held in central bank reserves declines.

The problem is how to constrain the United States from running a payments deficit without limit, and how to compensate countries for their foreign-exchange losses resulting from a buildup of dollar reserves in their central banks. Prior to 1971 a constraint was imposed by countries holding their foreign-exchange reserves in gold and using this metal to settle international balances. In the absence of a shift to some such asset today, or into currencies issued by European and Asian economies, the problem can be solved only by spending dollar surpluses as they accumulate.

The most natural and symmetrical option would be to impose on the United States the same demand that it imposes on other countries: let dollar holders buy control of industry and high technology, forests and other natural resources. A related alternative would be to use surplus foreign-owned dollars to buy out U.S. corporate investments abroad.

Yet another alternative would be to do what America did in 1921 when the German mark and other European currencies were plunging in value. The United States applied tariff duties according to the American Selling Price (ASP) rather than to the nominal import price. This resulted in a floating tariff, rising to reflect currency depreciation and hence preventing financial fluctuations from disrupting existing production-cost patterns.

A logical extension of this practice would be to use tariff revenues and other foreign-exchange proceeds to provide a subsidy to exports made to countries whose currencies were depreciating in value. The objective here would be to normalize costs and achieve in practice the assumption of "pure cost values" that underlies traditional trade theory.

#### *Isolation of offshore flight-capital and tax-avoidance centers, and regulation of transfer pricing*

National tax laws and regulations have been countered in recent years by dummy corporations registered in tax-avoidance havens as vehicles to enable companies to use intra-corporate transfer pricing to evade taxes and other laws.<sup>4</sup>

The counter-strategy is simple. National financial systems and tax collectors can refuse to acknowledge such centers, much as the United States and its allies isolated China, Russia, Cuba, Libya and Iraq for many years. It is to be expected, however, that attempts to create a better economic order along these lines will be confronted by U.S. pressure to prevent its emergence. This requires regional agreements to achieve strength in numbers.

#### *Constraints on U.S. military expansionism*

As Chalmers Johnson recently has observed in *The Sorrows of Empire*: "According to the Pentagon's annual inventory of real estate—its so-called Base Structure Report—we have over 725 military bases in some 132 countries around the world. This vast network of American bases constitutes a new form of empire—an empire of military enclaves rather than of colonies as in older forms of imperialism. . . . To dominate the oceans and seas of the world, we maintain some thirteen carrier task-forces, which constitute floating bases." Most recently, the United States has started to militarize outer space with satellite-based weaponry.



All this spending increases the deficits in the U.S. balance-of-payments and domestic budget, which the central banks of Europe and Asia are subsidizing on a much vaster scale today than in the Vietnam War years prior to 1971, when the gold-exchange standard imposed a limit on overseas military spending. It has long been an axiom of world geopolitics that imperial ambitions can be sustained only by falling into a debtor status and hence sacrificing financial power, as Britain and the rest of Europe discovered after World War I. Since America went off gold, however, this check on foreign military spending no longer operates.

The key to limiting imperial ambitions in the modern world lies in re-establishing the link between the costs of empire and the dissipation of economic position. No nation can afford to pay these costs by itself, given the expense of modern military technology. Yet the costs of empire have broken every imperial design in modern history, as exemplified most dramatically by the British Empire's dissipation after World Wars I and II. Its maintenance costs drove sterling into a financial dependence on the U.S. dollar—a dependency that America deftly turned into a political and diplomatic dependency that remains in place even today, even as it maintains its global military power by shifting the costs onto Europe and Asia.

If the key to military strength lies in shifting the costs of empire onto the periphery (as Rome did, bleeding its colonies dry in the process), the key to dissolving empire must lie in resisting this shift. To paraphrase the slogan that inspired the American Revolution in 1776, "No taxation without representation." The United States taxes the world by running a balance-of-payments deficit, thanks to its ability to negotiate credit without limit from foreign central banks while enjoying a free ride as *rentier-in-chief*.

*A post-neoliberal theory to restore the classical distinction between earned and unearned income*

It seems absurd to call the present system's high taxes and public guarantees to foreign bondholders "free enterprise." Under these conditions "market fundamentalism" becomes a euphemism for financial dominance over governments. It is merely another form of centralized planning, not the absence of planning. It is planning to impose dependency, not self-reliance.

A more equitable and peaceful world order would reverse today's trend of turning planning power over to financial institutions. Economies need to produce output rather than be turned into vehicles to generate interest,

dividends and capital gains. The role hitherto assigned to government has been taken over by creditors and foreign investors.

Neither foreign loans nor prior savings are needed to fund capital investment and employment. National credit can be produced by any country, and indeed is a prerogative of sovereignty. What need to be developed are internal markets rather than reliance on U.S. consumers and military spending to act as the world's "engine of growth."

The emerging oligarchy is euphemized by the term "managed democracy," which is antithetical to democracy in the traditional meaning of the term. It goes together with "post-industrial," as if modern finance is promoting progress rather than retrogression.

The solution must be as much political as economic. American imperial designs have produced a doctrine of financial austerity rather than one designed to modernize economies by moving them along the lines that the United States itself pursued to achieve its position of world leadership.

On the other hand, China has followed a path that may be emulated by India and perhaps Venezuela, Argentina and Brazil, while Russia under Putin's resource-rent tax may revive its industrial base along lines that go far beyond those contemplated in the 1970s when *Global Fracture* first was published. The alternative is for the U.S.-centered world to crash into a financially imposed austerity, Roman Empire style, leading to neo-feudalism.

## Notes

1. Joshua Cooper Ramo, "China has discovered its own economic consensus," *Financial Times* (London), May 7, 2004, summarizing his report on *The Beijing Consensus*, published by the Foreign Policy Centre in London.
2. *My Trade, Development and Foreign Debt* (Pluto Press, 1972, Chapter 6 and especially Chapter 15) provides a historical analysis of how capital transfers depress the terms of trade.
3. I have discussed these North-South issues in a series of UNITAR reports published by Pergamon Press: "The United States and the NIEO," in Erwin Laszlo and Joel Kurtzman, eds., *The United States, Canada and the New International Economic Order* (1979); "The Structure of the World Economy: A Northern Perspective," in Laszlo and Kurtzman, eds., *The Structure of the World Economy and Prospects for a New International Economic Order* (1980); and "The Logic of Regionalism in History and Today," "The Objectives of Regionalism in the 1980s," and "A Regional Strategy to Finance the New International Economic Order," in Davidson Nicol, Luis Excheverria and Aurelio Peccei, eds., *Regionalism and the New International Economic Order* (1981).
4. I describe this phenomenon in detail in my introduction to a new 2004 edition of Prof. Tom Naylor's *Hot Money* (McGill-Queens University Press).