

# The Money Lenders in the Temple

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**Contributed by: harrisp**

by Paul Harris

After World War II, an international conference of governments and economists pegged the value of gold at U\$35 per ounce. That artificially established number had the virtue of a fixed target against which the currencies and the productivity of the world's nations could be measured. This allowed for economic equilibrium and for fair and easily understandable international trade and the world enjoyed what is arguably its longest period of sustainable growth and stability for the next 25 years or so.

In one of his most disastrous moves as President of the United States, Richard Nixon abandoned that pegged value and allowed the American dollar to float against everyone else's currency. Because of the huge value of American productivity, the US dollar soon became the de facto standard against which everything else was measured. But it was a moving target and this has led to is 30 or so years of currency speculation that has been a total disaster for all but the strongest players.

In order to value transactions with the rest of the world, the value of a country's currency is related to the value of currencies in other countries by an exchange rate. And exchange rates come in two flavours: floating and fixed. With a 'floating' system of exchange, the value of a country's currency against that of other countries is allowed to change more or less freely according to the supply and demand for the currency. The supply and demand is, in turn, usually a function of the fundamental value of the country's assets, it's productivity rate, political stability, and so on.

Because a floating system has high likelihood of volatility, a large number of countries engage in some sort of 'fixing' of the exchange rate. Using the European Monetary System as an example, rates for the euro can change only within a very narrow margin. This keeps the value of the currency quite stable and it usually only changes because of agreement among the market participants that the present parity is no longer tenable when a supply of the currency is, or is likely to become, greater than the demand for it. Often, the only reason for the change is speculation that it is about to change.

And therein lies the problem. Currency trading dwarfs all other financial transactions. The daily global volume of currency transactions is nearly U\$1.5 trillion. It is estimated that 80-90% of those transactions have nothing to do with the exchange of goods or services or productivity or exploration or development; they are just speculation. Like an international game of craps.

Now some of this trading is at least moderately desirable. Large institutional investors and financial institutions routinely engage in short-term arbitrage transactions where they trade away price differences

for the same currency in different markets. These are not, by nature, speculative transactions and are important for the efficient fixing of prices in financial markets and for securing world-wide liquidity.

But most speculation is something completely different. It is the deliberate taking of a risk by buying or selling an asset in order to take advantage of an anticipated favourable future price change of the underlying asset. The main problem here is such a subjective interpretation of future price changes is based on guessing. For currency, it means buying and selling currency that you don't actually ever get with money you never actually had in hopes that your transaction will pay for itself and leave you with a profit. The trouble arises when it doesn't work out that way.

In principle, large-scale speculation is triggered when the fundamental economic and political indicators of a country change. If those indicators have worsened, the central bank of a 'fixed rate' country will usually try to defend its currency by selling its foreign exchange reserves for local currency, thereby matching the increased supply of local currency with increased demand. They might also increase domestic interest rates to make holding that currency more attractive. But this kind of defence cannot withstand the thrust of the market for very long.

Global financial speculative behaviour has become rampant. Large sums of money are now able to move largely uncontrolled and untaxed around the globe in search of the highest possible return in the shortest possible time. This makes all currencies unstable, particularly those which have been left to float. It makes the financial positions of the smaller or developing countries uncertain and they spend so much of their meagre resources trying to protect themselves that they never have the opportunity to get ahead.

Because this speculation is so rampant and so invisible, the possibility of attacks on a country's currency are very real; control of a country's economy by outside sources who usually have no interest in that country is relatively common; a country can suffer a financial crisis totally outside its ability to manage.

None of this has anything to do with value. If I have corn to trade, by negotiating I can convince my neighbour that my corn is worth a certain volume of his carrots and we can make a deal. But trading in currencies, and particularly the speculative trading of those currencies, has almost nothing to do with how many veggies we have grown. It is not much different than buying a lottery ticket except that you may never actually lay out the cash for the ticket.

There are certainly some moral implications to all of this. Wealth that is earned through work is good and desirable; wealth that arises solely from gambling, as currency speculation surely is, is not. The powerful grip that currency trading and currency speculation exercises over global, regional, and national economies is an indication of how little importance is accorded to the fundamental question of social justice. Essentially, human greed has been institutionalized and legitimized.

It is essential that a effective sanctioning mechanism be developed, through taxation, to eliminate this short-term profit behaviour; current international policies are insufficient. Presently, the preferred control is maintenance of international financial order by a mix of strengthened reporting requirements for financial institutions (not just banks) combined with an officially sanctioned safety net of (mostly) International Monetary Fund (IMF) loans. However, the IMF has already proved itself ineffective in

preventing new currency crises and it does not attack the speculative nature of the money trading. It actually looks more like officially sanctioned speculation that generates private profits and socializes losses that have to be covered by government funding.

One proposal for addressing this trade in currency is known as the Tobin Tax (after economist James Tobin) which would see a small premium collected on each transaction. It is estimated that this tax would produce huge tax revenues for virtually all nations but it is always dismissed by financial bigwigs as being far too complicated. Frankly, all of the transactions moving money around are computerized and those same computers could track the taxes owing. All it takes is the will of government to make the wealthy currency traders, whose activity so disrupts our financial lives, accountable.

Ideally, an instrument that penalizes speculation (such as by taxation) should try to discriminate against and reduce the harmful effects of the system while maintaining its benefits. But however it is done, we have to get our financial futures out of the hands of the crap-shooters.

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Paul Harris is self-employed as a consultant providing businesses with the tools and expertise to reintegrate their sick or injured employees into the workplace. Canadian businesses can reach him at paul@working-solutions.ca. He has traveled extensively in what is usually known as "the Third World" and has an abiding interest in history, social justice, morality and, well, just about everything. Paul is also a freelance writer and can be reached at paul@escritoire.ca. He lives in Canada.

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