

# DEVELOPMENT STRATEGY

Editorial note. *The article by RAS Academician S. Yu. Glazyev headlined “Why in Putin?”, which was published in the previous issue, defines the main conditions under which it is possible to implement the priority development policy in Russia. Aleksandr Nagorny, Deputy Editor-in-chief of the newspaper ZAVTRA (June 2012, No. 3) talks with S. Yu. Glazyev on the issues of global monetary-financial system stabilization and Russia’s participation in this process.*

## Collapse of the global pyramid



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**Aleksandr NAGORNY.** Mr. Glazyev, not long ago, the international economic forum was held in Astana, where the recommendations to the upcoming Mexico G20 summit worked out under your supervision were acknowledged as the best. Could you tell us about the advantages of these recommendations as compared to other approaches already known.

**Sergey GLAZYEV.** The main advantage of the recommendations worked out by our team (S. Bayzakov, M. Yershov, D. Mityayev, G. Fetisov and myself) is their systemic character. In our study, the issue of transition from today’s recessionary and unstable state of global economy to its sustainable development is considered in the unity of macroeconomic, technological and institutional aspects, taking

into account the interrelations between different areas of regulation and patterns of the long-term economic development. In this respect, the ongoing global economic crisis is viewed as resulting from the combination of several factors: monetary and financial imbalance, misalignments in financial markets and institutions, large-scale technological shifts, structural disparities. Thus, overcoming the crisis and beginning the new wave of sustainable economic growth is possible if the following measures: financial stabilization, improving the efficiency of financial market, banking, financial and investment institutions regulation, encouraging the development of the new technological wave and progressive structural changes, formation of new institutions – are implemented simultaneously.

At the same time, the basic causes of the global crisis should be eliminated and the following of them are most important:

- uncontrolled emission of global reserve currencies by some world community members, which leads to the issuers' abuse of their monopolistic position by increasing disparities and destructive trends in the global financial and economic system;
- inability of existing mechanisms, regulating the banking and financial institutions' activities, to ensure protection against excessive risks and emergence of financial bubbles;
- reaching the limit of the dominating technological mode development and the lack of prerequisites for establishing the new one, including the shortage of investments for large-scale introduction of fundamental technologies that form its basis.

Our proposals to reform the global monetary-financial system are linked to the tasks of structural transformation of an economy on the basis of a new technological mode and attraction of the necessary long-term and solid investments. This approach provides a profound insight into the roots of the global financial crisis, explains the modern economy reproduction mechanism, and allows to develop the complex of measures aimed at creating the necessary conditions for its sustainable development.

**A.N. As far as I understand, broadening the context of crisis bailout measures corresponds with the tendency observed at the G20 summits. The subject of "green growth" will become the key issue at the Mexico session. Can this fact be interpreted as the desire of Washington to divert G20 from discussing the reform of the global currency and financial system, an issue which is a sore point for the U.S.?**

**S.G.** It might be, though, in our proposals it is a top priority issue. A broader context of its consideration is needed for creating scenarios of future development.

Overcoming the crisis turbulence and entering the path of sustainable development requires large-scale investments into the new technological mode productions development and modernization of the economy on its basis. When the capital, remaining after the collapse of financial bubbles, flows into the development of new technological patterns, the economy will experience an upswing, and the current volatile situation will change for sustainable economic growth on the basis of a new technological mode.

At the same time, it is essential to understand that this process will affect different countries in different ways. The issuers of the world's reserve currencies tend to restrain the rest countries from attempts to change the existing system of international monetary and financial relations, allowing the former to finance their balance of payments and state budget deficit at the expense of the latter, and also to dominate the world capital market. This inequality of the international monetary and financial exchange enables the world currency issuers to overcome the crisis by the appropriation of other countries' resources and assets.

**A.N. That's exactly what I mean. If at the first G20 meetings the questions concerning the necessity of cardinal reform of the global monetary and financial system were raised, and the speeches of our leaders were of radical nature, at present, peaceful mood prevails there. They speak no more about the inequality of international monetary and financial exchange, injustice of the existing system, necessity of its restructuring on fundamentally different principles...**

**S.G.** This is exactly what was discussed at the Astana forum. Our proposals are aimed at creating stable conditions for the global financial market functioning and investment movements, international monetary and financial exchange on a mutually beneficial basis, development of international industrial cooperation, world trade in goods and technologies.

These conditions should enable national monetary authorities to organize loan services for the development of new technological mode productions and modernization of the economy on its basis, the promotion of innovative and business activity in the promising areas of economic growth. In order to achieve this goal, the issuers of the world's reserve currencies should guarantee their stability by maintaining certain restrictions concerning the amount of public debt and the deficit of payment and trade balances.

Besides, they should observe the appropriate requirements of providing the transparency of their mechanisms ensuring the issue of their currency, granting the opportunity of their easy exchange for all the assets traded on their territory, including new technologies, as well as providing the national regime of refinancing to foreign non-government banks, complying with the criteria of reliability and transparency. Observance of the rules of fair competition and non-discriminatory access to their financial markets should become an important requirement for the issuers of the world's reserve currencies. At the same time, the rest of the countries bound by the similar restrictions should be granted the opportunities of using their national currencies as a tool of foreign trade and monetary exchange including their use as reserve currencies by other partner countries.

**A.N. But these issues are not included into the G20 present agenda...**

**S.G.** So, it means they should be, as they remain unsettled. The U.S., EU and Japan that emit world currencies have imposed on the other G20 members the mutual obligations aimed at abandoning protectionist measures and maintaining the open foreign economic regime, all this is necessary for preserving the existing system. All G20 statements declare protectionism to be unacceptable and contain the idea of ensuring freedom of action of market forces in the international currency, capital and commodity markets. The talks about the unequal impact of these forces and

unjust distribution of outcoming profit and losses have almost stopped. Though, in these circumstances, our economy annually loses tens of billions of dollars due to the illegal outflow of capital, and suffers even greater losses from legalized financial speculations. The talks on reforming international financial institutions, without which we can't make progress in changing the global financial architecture, have also receded into the background.

**A.N. Even those cosmetic measures aimed at minor changes of the national shares in the International Monetary Fund and the World Bank, that Washington accepted, are postponed to the mid-decade. What are your proposals in this area?**

**S.G.** It is essential to carry out a profound reform of international financial institutions including IMF, the World Bank, and the Basel Committee in order to ensure equitable representation of the member states according to the objective criterion based on a number of characteristics like a country's share in global production, trade, finances, environmental assets and population. The same criterion can be used to form a currency basket for creating SDR, in relation to which the rates of all national currencies including global reserve ones can be determined. At the initial stage, this basket can comprise the currencies of those G20 states which will agree to comply with the above-mentioned requirements. The reform of the international financial institutions on the principles of fair representation and consensus-based decision-making by the countries willing to promote the implementation of the global monetary-financial system alteration projects will give these institutions a number of powers on fulfilling the supranational functions of a global regulator. In particular, IMF could be entrusted with the following functions: monitoring of complying with the requirements to the issuers of world currencies and their attribution to a certain category, establishing standards of financial risks assessment and activity of world rating agencies and audit companies.

**A.N. Is it possible in the framework of the existing system of international law? In fact, what you propose is the creation of supranational global regulators. Will the sovereign states agree to compromise on their national sovereignty in this area?**

**S.G.** Objectively speaking, they have already agreed by recognizing a number of foreign currencies as reserve ones and take them into account while issuing their own money in accordance with the foreign agencies' ratings and foreign audit companies' estimates. The problem is that the functions of global regulators and emission centres have been de-facto appropriated by private entities controlled by the international financial oligarchy and regulated by the national law of the United States.

After deciding to open our economy a couple of decades ago, we became a part of the global market which is regulated in the private interests of large international capital on the basis of foreign legal norms upon which we have no influence at all. We function as the U.S. and, partly, the EU donor by providing them with cheap capital and raw materials in exchange for the currencies emitted by these states in the conditions of increasing inflation. We are forced to dance their dance, and this role is completely unprofitable for us as well as for other countries which are not members of the Freely Convertible Currency club.

Due to this non-equivalent exchange, we annually lose 20 up to 100 billion dollars, transferring abroad more than a trillion dollars of the capital after the collapse of the Soviet Union. At the same time, leading Western countries that gain multi-billion dollar profit from the emission of world currencies (e.g. the European Central Bank has printed twice as much money as Russia received from oil export for the period of 10 years) are limiting access to their own markets of assets, technology and labour, introducing more and more restrictions.

We suggest linking the right to emit the world trade and reserve currencies with observing the issuers' obligations to ensure the transparency of their commodity, services, labour and capital markets, free regime of technology and capital transfer. In order to increase the reserve currencies issuers' responsibility, the rest G20 issuers should be given the right to carry out currency swap transactions with them. This will allow the issuers of the rest of the currencies to gain access to the necessary volume of "cheap liquidity", aligning the cost of capital and eliminating the negative impact of the credit dumping on the part of the issuers, who retained negative real interest rates for a long time.

The implementation of such large-scale reforms requires an appropriate legal and institutional support. This can be done if the G20 decisions will be given the status of international obligations of the countries interested in their implementing, as well as the support from the UN institutions and other international organizations. Simultaneously, the new opportunities for stabilization of the world monetary-financial system and solution of global problems will open up. In particular, in order to reduce turbulence in the global financial market, it is expedient to impose restrictions on financial transactions with offshore companies, as well as the tax on foreign exchange transactions and financial speculation. The tax revenues could be allocated for solving problems of poverty and illiteracy, preventing epidemics of socially dangerous diseases, overcoming the consequences of natural and technological disasters. In the context of structural reorganization of global economy on the basis of the new technological mode, of special importance for the employment is the creation of international education network source consisting of the world leading universities for the purpose of educating the citizens from developing and underdeveloped countries as well as implementing the programs of retraining the unemployed in developed countries.

**A.N. Washington will hardly agree to this...**

**S.G.** Then we will have to be prepared for a scenario of the global financial system's self-destruction. Today, the U.S., EU and Japanese financial authorities choose the simplest way of handling the insolvency problem (accumulated public and private debts) by pumping cash liquidity. Thus, the balance of the U.S. Federal Reserve System, have almost tripled since 2008, the balance of the European Central Bank has grown more than 2.5-fold, the balance of the Bank of Japan almost doubled over the past two years only. Consequently, the exponential growth of the financial pyramid of the G7 public debt is maintained, masking their inability to solve the structural problems (including the urgent technological restructuring of the economy). This policy is accompanied by the export of inflation to the rest of the world which is expressed in a sharp rise in prices on energy carriers, raw materials and foodstuffs, in the preservation and growth of the global disproportions of payment and trade balances.

Due to a policy of constant delay of the global financial system reform and its infinite "restoration" according to the old rules, a consistent increase of the system-wide risk is taking place, which can be measured in the ratio of off-balance sheet liabilities of the largest, first of all, American banks to the size of their balance sheets, that increased from 30-fold up to 50-fold as compared to the beginning of the crisis.

Consequently, the strategic instability (latent system-wide risks) of the global financial system is just increasing, a number of the leading state financial systems (USA, Japan, PIIGS countries in Europe) function mainly at the expense of emission. In fact, the issuers of the world's reserve currencies act according to the "pyramidal" principle of increasing public debt, which dooms the whole global financial system as well as national systems of state finances, social, medical and pension provision of the developed countries to self-destruction already in the foreseeable future.

**A.N. Do you think that the measures that you propose will be sufficient for the stabilization of the global financial and economic system?**

**S.G.** So far we were talking only about the monetary policy of the world currencies issuers. Our proposals also include measures of global and national financial regulation that have countercyclical features. The main condition of stabilization is the limitation of financial leverage. In the present two-sector financial and economic system, only the banking sector is regulated by the state. Other business entities may have a leverage amounting to a few hundred (the problem of "shadow financial system"). In these circumstances, debts are increasing immensely. What we need is the elaboration of uniform principles of financial accounting (on the basis of International Financial Reporting Standards and Basel) and auditing for all participants of economic activity and not only for banks; to fulfill this task it is necessary to adopt the appropriate G20 recommendations for national regulators. Currency risks should also be reduced – like banks, all economic entities should commit themselves to maintaining an open currency position and limit it on a percentage basis to the amount of equity capital.

An important part of our proposals concerns the national macroeconomic policy. They should have a system of safety mechanisms ("moderators") for financial transactions and movement of capital flows, in case of the necessity to protect the monetary and financial systems against speculative attacks and suppress the related turbulence. In particular, a) reservation institute for currency transactions of capital flows; b) income tax on the sales of assets by non-residents, the rate of which depends on the asset ownership period; c) the above mentioned Tobin tax (on transactions with foreign currencies) can serve as such "moderators". The rates (ratios) of all these instruments can be temporarily reduced to a minimum in a favourable situation, and raised in case of increasing

financial turbulence, in order to slow down the capital inflow (or outflow). Central banks should be assigned the task of promoting economic growth and employment, which can be achieved by using modern mechanisms aimed at refinancing the requirements for the development of national economies.

**A.N. Although your proposals sound most convincingly, I still can't imagine that the U.S. oligarchy will accept them. What can you suggest in this case?**

**S.G.** We suggest a comprehensive expansion and deepening of the regional integration structures that could become supportive pillars of foreign economic exchange in case of self-destruction of the global monetary-financial system. We speak, first of all, about expanding the sphere of national currencies usage in mutual trade and development of regional financial institutions.

Actually, the most far-sighted countries have already entered this path and create their own "islands of stability". Recently, Japan and China declared their switching to transactions in national currencies. In recent years, the latter has established a large-scale international network of transactions effected in yuan through currency swaps. We have successfully completed the formation of the Customs

Union of Russia, Belarus and Kazakhstan, now we are creating the single economic space within the Eurasian Economic Community and moving towards establishing the Eurasian Economic Union. There has been a speed up in regional economic integration processes in South America – within the framework of MERCOSUR the plans for transition to the economic and monetary union are being discussed.

These are the right steps that we should undertake in any case. Even if we consolidate our efforts and manage to avoid the collapse of existing American-centric monetary-financial system, it will inevitably evolve in the direction of a more balanced and fair multi-currency system regulated on the basis of international law. This will cause competition among various international and intergovernmental emission centres for a share in world seigniorage. In this connection, we possess serious competitive advantages: low debt, substantial foreign exchange reserves, significant production, natural resources, scientific-technical and intellectual potential. They can be considerably increased with the formation of the common position of BRICS states and the global financial-economic system reorganisation in the common interest, on the basis of efficiency and justice.