

# THE EUROPEAN AND AFRICAN ALTERNATIVE TO THE INTERNATIONAL MONETARY AND FINANCIAL CRISIS

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## 1. Introduction

In the decade following the oil crisis, the external debt of the third world excluding oil producing countries has increased at an average annual rate of 19%. This trend was due to several causes but the three main factors were: higher prices of petroleum products, the increase in real interest rates and worsening of terms of trade.

The rate of economic development achieved by many third world countries, being higher than the world average, has itself contributed to worsening their trade balances to the extent that it caused imports to rise faster than exports.

The situation began to produce destabilizing and cumulative effects in parallel with the increase in real interest rates and the internationally stagnant economy.

However these international causes are not the only source of the third world's financial difficulties. Frequently external financing has been employed to support consumer spending and not only investments. Financing economic development has created illusions as to the feasibility of loosening the constraints of having to balance a country's trading and payments accounts.

World economic cycles and their own internal problems have affected one another thereby worsening the situation of developing countries. The changes in the international economic climate have in effect lowered the return on the action taken by the third world countries' governments with the support of international lending, which in turn has made it more difficult to produce the flow of income necessary for repayment of such loans.

This is the basis of the widespread debate on the risk of an international financial collapse and on the need for restructuring world financial relationships.

The gravity of the situation does not lie primarily in the order of magnitude of the debt. What is more significant is the context of the problem, the continuing international circumstances which are at the root of the developing countries' situation, the unsolved problems relating to the world financial and monetary order.

The size of the third world's aggregate debt is not large, whatever method of evaluation is used.

If one considers international banking activities alone, following a considerable increase due to the oil crisis, the developing countries' part in borrowing has stabilized at about 30% according to OECD statistics.

A comparison of the present situation with that obtained early this century shows clearly

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that the volume of lending is comparatively small today. International financing was then at a level about three times that of world trade whereas today it amounts to about one tenth only.

Such indications are even more meaningful given the trend of recent years. The exponential trend of the rising US foreign debt, and the increasing deficit of their trading account, is such that it will make the financial problems of the third world inevitably take second place. These conclusions are confirmed by the most recent forecasts of the IMF.

In fact the present international financial order is incapable of managing the international debt problem; in this context we find the real problems of economic development.

## **2. The historical background**

At the beginning of this century the international financial system had the capacity to effect substantial capital transfers, thanks to the stability guaranteed by the sterling exchange standard and the central position of the City of London.

A historical analysis will clarify the circumstances at the root of its success and the causes of the subsequent crisis. In a nutshell, the system enjoyed a period of great stability (late nineteenth and early twentieth centuries) as long as the UK was able to balance its major capital exports with an equivalent surplus in its trading account.

During this period the UK was a steady net exporter of capital for long term investment overseas, thus financing the structural deficits of developing countries through the guaranteed intermediation of the City's efficient and sophisticated structure. This outflow of capital was taking place without risking the stability of the system itself particularly of the pound sterling as the main reserve currency and international settlement means, as it was offset by the British trading account surplus; in other words, loans and investments arranged by City institutions then returned to the UK under the form of demand for goods and services. The stability of the system was also strengthened because, thanks to the City being the main international financial centre, the British economy was able to offset any pressure on the country's gold reserves by importing gold mainly from Europe through raising the Bank of England's discount rate.

At least in general terms, these summary remarks suffice to explain the financial and monetary order which had become established by the end of the nineteenth century.

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By analogy we can say that the system was "marked to the crisis" when the UK lost its economic advantages because the industrial revolution had spread to other countries.

The appearance on the scene of two new economic and political powers, Germany and the US, meant the relative decline of British advantages in trading with open markets overseas. As a consequence the UK found it more and more difficult to balance its capital exports with an equivalent surplus on its trading account.

The situation was worsened by the lack of a central bank in the USA — the Federal Reserve System was founded in December 1913. The Bank of England itself had for many decades been operating, in its relations with the US internal market, with certain functions that were typical of a central bank. And this situation was bound to lead to instability. The US authorities had not only dismissed any responsibility to effectively contribute to a balanced international monetary order: they refused to give the dollar functions similar to the pound sterling, and they even called on the pound sterling to finance their internal economic development.

There is little point in going into further detail in this description which served to emphasize that there is a historical precedent proving the feasibility of financing developing countries' long term structural deficits. The precedent shows that international development financing can be guaranteed by one financial centre (in one country) only under specific circumstances of economic and financial supremacy, which are in due course bound to be eroded.

### **3. The present situation - the role of the USA**

The British historical precedent may be of use in understanding how far the USA can guarantee the financing of international economic development under today's conditions. In the final analysis one has to decide whether the US are in a position to play the same role as the British in the present political and economic scenario.

As in our precedent, it is clear that for a period of time circumstances enabled the US to balance its considerable export of capital with a trading account surplus. In the immediate postwar period the country was able to achieve this goal without difficulty, suffice it to recall the Marshall plan as the expression of this ability. However there are several factors currently suggesting that such market conditions are bygone. Just as at the beginning of the century the rise of Germany, France and the USA had weaken-

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ed the trading predominance of the UK, since the late 1960s the establishment of the European Customs Union and the rise of Japan have eroded the US unquestionable economic predominance.

Just like the spread of the industrial revolution lost Britain the privilege of being the only industrial power, the success of EEC integration and Japan meteoric growth lost the US the privilege of being the only developed market with a continental size, which is the optimum for modern production technologies.

At the time of Bretton Woods in 1943 the American economy represented about 40% of the world aggregate product; 90% of world gold reserves were then concentrated at Fort Knox; the US industrial system was functioning at full steam while the rest of the world was suffering from the devastations of war. Today the percentage of the world aggregate product represented by US output has fallen to about 20%; the gold reserves have been redistributed; the rest of the world has developed faster than the American economy.

These essential data highlight the insuperable and historical constraints on the role that the USA can play. While the relative strength of the country within the world economy has decreased, there has been a proportionate increase in the demand for international finance and currency to support worldwide economic integration and development.

These two effects add up to disequilibrium which is aggravated by the lack of a European Central Bank. In fact just as the Bank of England was forced to take over the functions of central banking in the USA at the turn of the century, so today the dollar enjoys a similar position both within and outside Europe by filling the gap left by European central banking not yet being in operation.

A further brief analysis of this point indicates that, assuming the above considerations are in their brevity sufficient to make the point regarding constraints, under present circumstances the USA on their own are unable to guarantee sufficient financial support for international economic development.

#### **4. The role of banking**

The central role of the US in supporting the international financial system has continued on the assumption that it was acting as a banking intermediary between foreign creditor and structural debtor countries, but this task has now become more difficult.

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During the years that followed the first oil crisis, a triangular financial system emerged where Opec countries played the role of structural creditors, Third World countries played the debtors, while the industrial countries and especially the American banks played the intermediary recycling the surplus funds.

The capacity of Opec countries to produce financial surpluses is now questioned and it can be foreseen that in the near future these countries will need to sell their accumulated assets in order to meet their current account deficits.

The international banking system is destined to find itself in a difficult situation where the country which used to have a central role is aggravating the disequilibrium by absorbing resources instead of contributing towards financing the rest of the world.

The direct consequence of this situation is the need to find a state of equilibrium by "gearing down", which explains why international banking has forced debtor countries into a deflationary adjustment of their economies in order to reduce or minimize the increase in their indebtedness.

## **5. The deflationary consequences for Third World countries**

In order to define the regressive nature of the solutions adopted under the present international financial order, it is sufficient to measure their deflationary impact especially in developing countries. Lower rates of economic development, falling personal incomes, rising unemployment, sluggish international trade and also a reduced international division of labour have to a varying extent affected the Third World countries. The new industrialized countries of Asia have been the most successful in adjusting to the changing economic climate, whereas some countries in Africa and South America are in the immediate future going to suffer from very serious consequences. And throughout the third world the situation is serious indeed.

The consequences of this situation can be measured 'in the mirror' by considering what level of indebtedness is necessary for them to be able to plan a rate of development sufficient to guarantee a rise in personal incomes, and to overcome their future underdevelopment.

On this point Cepii, the authoritative government economic forecasting organization in France, has calculated as follows: in order to guarantee an annual rise of 2% in personal incomes in the Third World, these countries will have to increase their indebtedness

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by 3 times during the eighties. This forecast should be compared with the increase that took place during 1975-82 of five times.

In order to achieve the minimal objective of maintaining their present level of personal income, according to this forecast it is necessary to allow for an annual increase third world countries' indebtedness of 40 billion dollars.

It should be emphasized that only the prospect of a high increase in Third World debts and the rate of development it is expected to produce will lower the risk for the international financial system; clearly the interests of the industrialized and the Third World call for a solution that may ensure a balanced development of the international economy. Therefore the central problem is the restructuring of the international financial and monetary systems and the present world economic order. This in turn calls for a definition of objectives and of the role of Europe within such a framework.

## **6. The world government**

A first alternative must be recognized in the approach of Keynes during the negotiations at Bretton Woods which led to the foundation of the IMF. This was the world government project based on the strengthening of international organizations, then considered to be the nucleus of such a government which was meant to manage the world economy.

This is the way to reason and in the long term the winning answer as it meets the needs of historical trends. In the short term however some progress is possible in this direction but, for historical and political rather than economic reasons, it is doubtful whether much progress is to be expected here.

The reasons for the validity of the Keynesian project must be fully understood in any case, in order to be able to guide government policies and to define the content of international cooperation.

In Keynes' view the true engine for development is effective demand but it must be added that, while the consumerism has exhausted its potential for development in industrialized countries, economic growth can be supported if potential demand can be made effective in the third world. In the age of the global market a rational management of the reserve of effective demand existing in the third world will be an important factor. Apart from the many political and moral considerations it must be realized that economically speaking a new development cycle can be activated by guaranteeing an

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international financial support to the development of effective demand in these countries. The problem is whether such a design can be promoted today.

### **7. The European and African alternative**

The establishment of a new world economic order has since Bretton Woods been a far-sighted though abstract ideal, but under present conditions it is acquiring the validity of a realistic and necessary answer to current problems. The project is feasible because it can be supported by the joint initiatives of Europe and Africa, in fact this is the only strategy which can ensure the development of both Europe and Africa and in the final analysis of the whole world.

The proper answer to the problem is to launch a European sort of new Marshall plan for African development. This is also the only strategy which could support the modernization of the European economy, a process which can only be conceived as part of an overall design supporting the development of international cooperation. A Europe falling back on itself would fatally be forced into protecting its manufacturing capacity and the effects would then be a return to protectionism, the progressive obsolescence of its industries, economic stagnation and second league status for Europe.

The problem is reaching agreement on the conditions necessary to bring this alternative into effect. Strengthening the process of economic & monetary unification in both Europe and Africa is of a decisive importance here.

The matters under discussion are the development of the international economic system and its financing; setting up a new monetary order is essential if international finance is to achieve balanced development and have a progressive role.

The economic and monetary unification of Europe would enable it to have a currency with the dollar's functions which could therefore be used for international reserve and payments purposes. This is also an indispensable condition for uniting Europe's capital markets. Only thus can Europe hope to have a leading role at a world level like the role the City of London played in the past.

The creation of a European Monetary Union is crucial because, in order to ensure adequate financial support to a solidarity programme for the Third World, Europe must increase its own weight in the world economy. Likewise the strengthening of existing African monetary unions and the beginning of a process of monetary and economic unifica-

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tion, on an African scale, are indispensable for guaranteeing the continent's balanced development. Internationally the African Union would be capable of ensuring equal partnership in its relations with Europe and the other industrialized areas, whereas a divided Africa would be condemned to submit to the dominance of the more advanced states, in the form of a new colonialism. The unification of Africa is also necessary to ensure the optimum allocation of resources within the continent.

We should recall the historical precedent of postwar Europe, as its reconstruction took place on the basis of a unification project; this ensured the best possible utilization of assistance from the USA under the Marshall Plan and laid the basis for a relationship of equal partnership between Europe and the US, although this could not be achieved immediately.

Africa has therefore to follow the example of the European Monetary System and to set to work for the foundation and development of an African Monetary System.

The experience of the EEC is important. The monetary problem was not considered at the time of its foundation because, in the first stages, the EEC was able to use the dollar as its European currency. Nowadays the EEC is unable to function without a common currency because the dollar crisis is the cause of dramatic fluctuations: in order to fulfil its functions a market needs stable prices of raw materials and manufactured goods which is impossible without monetary stability.

For Africa, developing a process of monetary unification is even more indispensable. In Europe the problem was how to lower the customs barriers holding down economic development, in order to allow a better division of labour, whereas in Africa the problem is how to create the agricultural and manufacturing capacity which cannot develop spontaneously.

This is why it is necessary to achieve an optimum allocation of resources throughout the continent, distributed in accordance with a common and consistent credit policy.

Currency is a decisive element in economic sovereignty. Proposing this monetary unification means posing the problems of both European & African autonomy. The greater the autonomy of the two continents, freeing them to follow their natural vocation and to obtain the means necessary to control their own destiny, the more will cooperation between Europe & Africa be able to develop.



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## L'ALTERNATIVE EUROPÉENNE ET AFRICAINE À LA CRISE MONÉTAIRE ET FINANCIÈRE INTERNATIONALE

### RESUME

*La gravité de la situation financière du Tiers Monde dépend non tellement de l'ampleur de sa dette extérieure mais plutôt des limites de l'ordre financier international. Cet article analyse et compare la situation actuelle (Dollar Standard) avec celle du début du siècle (Sterling Exchange Standard). Les deux systèmes monétaires ont enregistré en bien des aspects un développement analogue. L'analyse du système monétaire du début du siècle permet de nous éclairer pour mieux comprendre les causes de la crise actuelle et pour proposer les meilleures alternatives.*

*La solution idéale au problème a déjà été indiquée par J.M. Keynes: il s'agit de mettre en action une réponse au niveau international se basant sur la création d'une banque centrale mondiale. De cette façon il serait possible de rendre effective la demande potentielle de biens et services du Tiers Monde et de soutenir ainsi un développement équilibré au niveau mondial.*

*Dans les conditions actuelles, une solution réaliste serait la naissance d'un nouvel ordre monétaire et financier multipolaire, basé sur le dollar USA, le yen et l'E.C.U.*

*L'Afrique pourrait s'insérer dans cette réforme mondiale cherchant, comme l'a fait l'Europe, sa propre identité et unité monétaire. Cela rendrait plus facile la coopération entre les deux continents sur la base des principes de réciprocité et d'égalité.*

