Dancing Ghosts

Now, forty years after being blown up, Bretton Woods' ghosts are popping up at one Central Bank after another. Ephemeral, but as real as ghosts can be. "You don't remember, but we told you so!" they say. "Floating exchange rates will lead to competitive devaluations and misery." "Confidence in money as a store of value will evaporate." "Countries with prudent finances will be penalized with a strong currency, factory closures and job losses."

So here we are, albeit a bit late. The Swiss just showed us how to devalue, much as they did in 1978, the last time there was a speculative rush into the Franc. There is a new team in place in Japan and it's a safe bet Japan Inc will see to it that a lower Yen is in the works. Britain is running on vapours and Canadian economic numbers are worse than popular perception. At least we will be spared further gloating from Ottawa. Lower exchange rates are looking better and better to more and more countries. Especially Greece – let's hear it for a Drachma revival.

But over and above exchange rate chaos, floating rates have done serious damage to industry. Where to build a plant? We know the variables today, but what will they be next year? How to finance? Spot or floating contracts? These discussions may or may not lead to good decisions, but they certainly burn a lot of management time.

Far more important is the impact (good or bad) floating exchange rates can have on business activity, tax revenue and, above all, jobs. Switzerland is classic. It lives on exports of fine watches and jewellery, pharmaceuticals, very sophisticated machinery and even chocolate. A ten percent wage disadvantage with the competition (such as Germany and Japan) may be tolerable, but twenty percent leads to economic suicide. So the Swiss did what they had to do and devalued, linking their healthy currency with a garbage currency. Canada is another classic. Encouraged by policy makers, the loonie has appreciated twenty percent over the past four years and this has led to the near destruction of our industrial base, a savage deterioration of our current account and the transfer of a few hundred thousand jobs to the US – exactly the sort of mess the Swiss chose to avoid.

The global economy now appears to be moving into a period of heavy duty competitive devaluation, much as was the case in the 1920s and 30s after the demise of the gold standard. It was, of course, fear of this sort of behaviour that led the big countries (really the US and, to a lesser degree, Britain) to meet in Bretton Woods in July 1944 (well before the end of WW II) to arrange a (fixed exchange rate) monetary system to kick in after the war. Keynes, part of the British delegation, suggested the key currency, the dollar, be convertible into gold.

That system was pretty successful and lasted twenty-five years before the easy money crowd, the punchbowl people, the masters of the universe, took over. Easy money to fight wars, easy money for bureaucrats, easy money for the financial elite. Now these same people in both Europe and America are simultaneously blaming each other for the current mess and trying to con the public into thinking all will soon return to "normal." Irresponsible is too mild a term for them.

More tragic even than the pending defaults and devaluations is the head-in-the-sand lack of leadership at most levels. It seems bizarre that in 1944 our leaders could hatch a viable monetary system in three weeks whereas today they appear to spend all their time in denial, flying around in luxurious jets and gorging on three-star fare. To the extent that they do make proposals to deal with all the bad paper, the focus is always on generating more bad paper. Let's boost the debt ceiling, the Euro bailout fund, let's create a Eurobond or a super Euro. Somebody even suggested resurrecting the SDR.

Administrations in the US may change, but the unholy alliance between Washington and Wall Street carries on — they too have a communal interest in more and more paper. In Europe for years senior French and German civil servants have gathered in pleasant chateaux to sip dusty claret and set policy for millions. Elected representatives have only faint voices and the people none. The media have generally acted like trained seals.

But polls everywhere are saying people have had enough bureaucratic decision-making on their behalf. First the Icelanders (on two occasions) voted down their leaders' recommendation to accept an IMF proposal. The Finns (and now the Dutch) want pro rata collateral for handouts and a German Court recently said no more bailouts without parliamentary approval. Fat chance. Polls in the US show dissatisfaction with almost everything.

What will really matter, however, will be when people start to vote at polling stations. Or with their pocketbooks. They have already started to shun much of European debt and pretty soon the Euro itself will come into question. Then what? Investors are already well-stuffed with loonies and Sterling. The greenback, almost by default, has been seen as a refuge, and as a consequence has had a Nortel-like surge in popularity. In the fullness of time people will look back on this craze with astonishment.

The greenback is now pretty well without a shred of intrinsic value (nearly all currencies are pretty well without a shred of intrinsic value) and when the exodus from currencies starts some money will of course flow into gold, but most money will flow into stocks. When the exodus picks up steam the ghosts will dance and markets will run wild.

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