

City of London by Stephen Lewis

New ascendancy of BIS central banks

The political goals of the central banks don't match those of discredited investment-bank-dominated finance ministers.

Mr. James Baker's departure from the U.S. Treasury spelt the end of the era initiated at the Group of Seven (G-7) meeting at the Plaza Hotel in New York in September 1985.

This was so, not in the widely understood sense that G-7 unity will now be tested without its instigator, but on a deeper, structural level, Mr. Baker politicized the implementation of economic and financial strategy.

This process of politicization was marked by the emergence of tri-partite blocs, the U.S.A., Japan, and Europe. Consequently, the Group of Seven process has developed into a series of bilateral deals between bloc leaders.

There is, however, another triangle, operating on a different level, which has emerged during the Baker years. This is the triangle of finance ministers, central banks, and markets. For many years, these co-participants in the financial process had observed a recognized system of signals and responses.

In the 1980s, this unity was dissolved—largely under the pressures generated by the so-called conservative revolution. This virtually defied the principle of "free markets."

Governments sought to open direct channels to markets which bypassed the intermediary role of the central banks. In the U.S.A., the investment houses came to supply much of the rationale, not to mention personnel, of the Reagan administration.

In many Western European countries, the drive to de-nationalize major industries rendered governments particularly sensitive to sentiment in fi-

ancial markets.

Everywhere, the watchword in government was "give the markets what they want."

As Mr. Baker leaves the financial scene, the signs are that the direct government-to-markets relationship is being superseded by arrangements in which the central banks, grouped under the Basel-based Bank for International Settlements (BIS), are resurgent.

In retrospect, the 1987 International Monetary Fund conference will be seen as the swan song of the old regime when, to general approval, Mr. Baker voiced support for close political control of foreign exchanges to achieve goals set in the interests of underwriting the capital markets.

In other words, the conference was announcing its intention of fixing things to make the world safe for investment bankers.

The subsequent stock market crash demonstrated the limited ability of governments to support market price levels and undermined the ideological basis for appeasement of the capital markets.

Into the disarray created by the erosion of confidence in financial markets and government circles have stepped the central banks.

This is evidenced by the U.S. Federal Reserve's credit policy tightening, despite this being a U.S. presidential election year.

It would be wrong to suppose that the ascendancy of the central banks will depoliticize economic policy-making.

Nevertheless, the political objec-

tives of the central banks are not expected to coincide with those of the investment-bank-dominated finance ministers who are now discredited.

The key features common to all the major central banks' policy objectives are:

- a) A distaste for financing large government deficits;
- b) A high priority accorded to curbing inflation, even at the cost of economic growth;
- c) Stress on maintaining well-behaved financial markets.

The central banks are likely to launch a major assault on governments to cut their deficits. The attack is expected to be concentrated, after the November U.S. election, on the U.S. budget deficit.

Central bank concern with inflation will probably impart a restrictive bias to credit policies; in other words, a return to the stance, if not the methods, of the early Volcker years at the Federal Reserve.

Finally, the central banks will be unsympathetic to the aggregation of financial power in the hands of the investment banks and the markets. The processes of globalization and deregulation of financial markets in the 1980s have facilitated the objectives of governments; arguably, they have complicated the tasks of central banks.

Already, the shutdown of markets is in progress, as witness the legal assault on Drexel, Burnham, Lambert, the standard-bearer of 1980s securitization, and the share-dealing scandal which is engulfing the Japanese government.

The central banks can be expected to retain only those features of the recent developments in financial markets as will facilitate their own aims. The BIS is now in the driving-seat, as the International Monetary Fund conference Sept. 27 will confirm.