Issues surrounding Quantitative Easing in International Law.

"[Money] is in truth demand, which holds all things together… it exists not by nature but by law and it is in our power to change it and make it useless." Aristotle (Nicomachean Ethics Book V).[1]

1 What is Quantitative Easing and why do national central banks utilise it?

Most simply, quantitative easing involves central (or reserve) Banks purchasing financial assets such as government securities from the banking sector, thereby increasing the amount of cash held by banks.[2] The most notable instances of quantitative easing (hereinafter "QE") being utilised has been by Japan, the United Kingdom, the United States, Europe and a number of Scandinavian countries. The money the central banks use to purchase securities is created "out of nothing;" and although it can be printed, in modern times it most often just created electronically.[3] Central banks purchase securities that are issued by governments or financial institutions. Because money is created that has not previously existed, QE results in an additional sum of money being injected into the system that did not previously exist. Thus, QE results in an increase in the amount of currency that is held by banks and circulated in the hands of the public, also called the monetary base.[4]

The intentional increase in the monetary base is a very old concept and has been employed since ancient times.[5] During the fall of the Roman Empire, clippings or shavings from coins were used to make copies of coins, total amount of coins in circulation (or monetary base), which has exactly the same effect as that of QE. Also, one of the alleged reasons for King Edward I's expulsion of the Jews from England in 1290 was for the clipping of coins, which was considered akin to counterfeiting.[6]

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[1] Aristotle "*Nicomachean Ethics*" http://classics.mit.edu//Aristotle/nicomachaen.html (Date of use: 04 June 2015).
[2] M Joyce *et al* "QE and unconventional monetary policy – an introduction" 2012 (122) *The Economic Journal* 271-288 (274).
[3] Positive Money "How Banks Create Money: The Balance Sheets" http://www.positivemoney.org/wp-content/uploads/2012/03/How-Banks-Create-Money.pdf (Date of use: 04 June 2015).
[4] Investopedia "Monetary Base" http://www.investopedia.com/terms/m/monetarybase.asp (Date of use: 04 June 2015).
[5] Investopedia "Debasement" http://www.investopedia.com/terms/d/debasement.asp (Date of use: 04 June 2015). Debasement involves the melting down of coins and mixing it with lower quality metal to create additional coins of the same denomination. The result of debasement is therefore the same as QE, and results in an increase in the monetary base.
[6] ZE Rokéah "Money and the hangman in the late-13th-century England: Jews, Christians and coinages offences alleged and real (Part I)" 1988-1990 (31) *Jewish Historical Studies* 83-109.

According to the Bank of England (the central bank of Great Britain), QE "aims to directly increase private sector spending in the economy and [to] return inflation to target."[7] Because QE increases the amount of money available in a system, it decreases the price of credit, in other words, the amount of interest charged on loans, which is supposed to lead consumers to borrow more and spend more, which in turn, is intended to lead to an increase in prices (or inflation).

The purpose of this paper will be to look at: how QE affects natural and legal persons, whether QE programmes may violate international law, South Africa's capacity to conduct QE and if QE can be considered to be a mechanism whereby neo-colonial powers defend their financial hegemony.

2 The effect of QE on exchange rates and individuals.

In the most basic terms, if there is a fixed amount of goods and services available, and QE results in more money in being in injected into any given system, prices should increase because there is a greater amount of money available in the system, but the amount of goods and services has remained constant. Consider then another hypothetical monetary system, which is similar in all respects, except that it has not conducted QE. If one considers the exchange rate between the currencies of the former and the latter, the former should weaken, whereas the latter should strengthen. This is because the value of a single unit of the former currency has decreased, whereas a single unit of the latter currency has remained the same. One of the major criticisms of QE, is that it leads to an excess of funds in the countries that conduct these type of monetary programmes, which causes sudden capital inflows and outflows in emerging economies, such as the BRICS, which in turn leads to exchange rate volatility and inflationary pressures.[8] Hedge Fund managers and investment bankers, who largely provide services to the richest of society, have admitted that QE largely favours the wealthy by inflating the prices of shares and properties, assets of which the wealthy own the greatest proportion.[9]

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[7] Bank of England "What is Quantitative Easing?" http://www.bankofengland.co.uk/monetarypolicy/Pages/qe/default.aspx (Date of use: 05 June 2015).
[8] Al Bawaba "Quantitative Easing – Impact On Emerging and Developing Economies" http://search.proquest.com/docview/1365288350?accountid=14648 (Date of use: 05 June 2015).
[9] Wall Street Journal "How the Fed Favours the 1%" http://www.wsj.com/articles/SB10001424052702304356604577343430113336486 (Date of use: 05 June 2015); ZeroHedge "QE Benefits Mostly The Wealthy" JPMorgan Admits, And Lists 8 Ways ECB's QE Will Hurt Everyone Else" http://www.zerohedge.com/news/2015-01-24/qe-benefits-mostly-wealthy-jpmorgan-admits-and-lists-8-ways-ecbs-qe-will-hurt-everyo (Date of use: 05 June 2015).

The thinking behind QE and its effect in practice differs greatly. The result of devaluing a currency by means of QE is not always achieved, and at times, the exact opposite occurs.[10] From November 2008, the time when the US started conducting QE, to April 2011, the dollar was devalued against the rand by a more than 30%, but from that period onward, until October 2014, when the American Federal Reserve halted its QE programme, the dollar strengthened against the rand by over 60%.[11] Daniel Mminele, the Deputy Governor of the South African Reserve Bank pointed out that the weakening of the South African rand, in light of QE policies by developed countries will result in higher food prices, more wage disputes and higher inflation, which will in turn, result in higher inflation, lower output growth and export volumes and may also lead to an increase in unemployment.[12]

Large local companies often take out loans denominated in foreign currencies, and in the event of volatile exchange rates, the interest payments these companies have to bear may become intolerable. One example is African Bank, which would have failed had it not been for the intervention of the South African Reserve Bank.[13] When looking at African Bank's financial statements for the year ending 2013,[14] the company had loans denominated in, and interest payments due in Swiss francs and US dollars, with an average rate of 4.4% for the former and 7% for the latter. Between 2013 and 2014, both the Swiss franc and the US dollar appreciated in value against the rand by 8%,[15] which had the result of effectively increasing the interest payments due to be paid by African Bank by 2.45% in US dollars and by 1.4% in Swiss Francs. This means that the effective rate of interest payable by the company increased by 35% in the case of the former and by 32% in the case of the latter.

When one looks to history, one can find similar examples volatile exchange rates leading to increases in debt obligations, economic instability and political turmoil. In 600BC Greece, there was a particular exchange rate of the silver coins of Athens and the Island of Aegina, and due to speculation by the Aeginians and their cornering of the silver market; an increase

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[10] XE "USD/ZAR Chart" http://www.xe.com/currencycharts/?from=USD&to=ZAR&view=10Y (Date of use: 05 June 2015).
[11] BBC "US Federal Reserve end QE stimulus programme" http://www.bbc.com/news/business-29823798 (Date of use: 05 June 2015).
[12] Mminele D "South African monetary policy in the context of central banking developments abroad" http://www.bis.org/review/r121203i.pdf (Date of use: 05 June 2015).
[13] Bonorchis R and Janse van Vuuren A "African Bank splits to isolate loans in Reserve Bank rescue" http://mg.co.za/article/2014-08-11-african-bank-splits-to-isolate-loans-in-reserve-bank-rescue (Date of use: 05 June 2015).
[14] African Bank "Annual Financial Statements 30 September 2013" http://africanbank.investoreports.com/wp-content/uploads/2013/12/African-Bank-Limited-2013-Final.pdfj (Date of use: 05 June 2015).
[15] XE "CHF/ZAR Chart" http://www.xe.com/currencycharts/?from=CHF&to=ZAR&view=5Y (Date of use: 05 June 2015), *Supra.*

of the rate of interest on loans taken out by the Athenian farmers by something like 50% resulted.[16] To combat this injustice, Solon, a Greek lawmaker and reformer, cancelled existing debts, gave back land that had been seized in foreclosure, set floor prices for agricultural products and favoured smaller farmers by setting a maximum size on land holdings.[17] These reforms encouraged foreign trade by stabilising the local currency, thus protecting the Athenian farmers against foreign moneylenders exploiting fluctuating exchange rates.[18]

One could perhaps argue that the rise of the Economic Freedom Fighters (EFF) and the unconventional measures proposed by the political party, which in some respects are similar to those adopted by Solon, are a consequence of the effect of the current system of administration in international finance on the normal working-class persons, not just in South Africa, but all over the world. Oxfam, an organisation which seeks to find solutions to poverty has published some statistics that are relevant with regards to the unconventional monetary policies adopted by developed countries.[19] The organisation has pointed out, since the US has adopted QE, the wealthiest one percent has captured 95% of the financial growth the country has experienced, whereas the bottom 90% of persons in the country became poorer. Shockingly, the richest 85 persons in world now own the same amount of assets as the bottom half of the world's population of 3.65 billion and the richest one percent, between 1980 and 2012 have increased their share of total global income in 24 out of 26 countries meaning that relatively speaking, the poor have become even poorer. When one considers the Bank of England's purpose for QE, which is to "increase private sector spending in the economy and [to] return inflation to target," and that the fact that QE may contribute toward worsening wealth inequality, it seems morally unacceptable and logically inconsistent for the solution to stagnant spending and slow growth or deflation to also make the rich, richer and the poor, poorer.

3 QE, International bodies and law.

3 1 The International Monetary Fund (IMF)

[16] Milne JG "The Monetary Reform of Solon" 1930 (2) *Journal of Hellenic Studies* 179-185 (181-183).
[17] Zarlenga S *The Lost Science of Money* (American Monetary Institute 2002) 30-31.
[18] Milne *Journal of Hellenic Studies* 179-185 (184-185).
[19] Oxfam "Working for the few – Political capture and economic inequality" https://www.oxfam.org/sites/www.oxfam.org/files/bp-working-for-few-political-capture-economic-inequality-200114-summ-en.pdf (Date of use: 05 June 2015).

Some of the most important rules of international law concerning exchange rate policies are contained in the Articles of Agreement of the International Monetary Fund.[20]The Articles state that, each of its 188 members shall:

- "Seek to promote stability by fostering orderly underlying economic and financial conditions and a monetary system that does not tend to produce erratic disruptions."[21]
- "Avoid manipulating exchange rates… in order to… gain an unfair competitive advantage over other members."[22]

Finally, the Articles state that the IMF "shall oversee the international monetary system in order to ensure its effective operation, and shall oversee the compliance of each member with its obligations,"[23] and that the IMF "shall exercise firm surveillance over the exchange rate policies of members."[24]

Kishore and Mohanty[25] point out that if a country is not in a borrowing relationship with the IMF there is no reason why the country should heed the Fund's advice, in other words, countries that contribute funds to the IMF, such as the USA, the UK, France, Germany or Japan, can in the event of a breach of their obligations under the IMF Articles concerning their exchange rate policies, just ignore the IMF, while many poorer African countries that are beneficiaries of the Fund, have to observe the rules of the Fund more strictly for fear of being refused future funding. When considering that it is possible that developed nations might ignore their obligations in terms of the Fund, it is even more poignant that even establishing a breach requires an almost impossible measure of proof. In terms of the Fund's rules clear *mala fide* intention would need to be established in respect of "policies directed at affecting the level of exchange rates." This means that policies that indirectly affect exchange rates, even if they do so dramatically, such as QE, is most likely not prohibited in terms of the IMF Articles, and even if it were prohibited, establishing *mala fide* intention on the part of a country's policymakers in an international forum would be a very difficult task.

3 2 The World Trade Organisation (WTO).

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[20] Articles of Agreement of the International Monetary Fund (Res 63-3 2011)
[21] Article IV, Section 1(i) of the Articles of Agreement of the International Monetary Fund.
[22] Article IV, Section 1(ii) of the Articles of Agreement of the International Monetary Fund.
[23] Article IV, Section 3(a) of the Articles of Agreement of the International Monetary Fund.
[24] Article IV, Section 3(b) of the Articles of Agreement of the International Monetary Fund.
[25] Kishore A and Mohanty D "How Effective Will the IMF's New Surveillance Framework Be?" 2008 (43) *Economic and Political Weekly* 31-36 (34, 36).

When it comes to the World Trade Organisation (WTO), members are required to accept as a condition of WTO membership, the existing trade rules embodied in the General Agreement on Tariffs and Trade (GATT).[26] The WTO's rules prohibit countries providing subsidies to help promote their national exports.[27] It may be possible that QE policies might constitute subsidies under the terms of the WTO. The WTO's Agreement on Subsidies and Countervailing Measures, defines a subsidy as:[28] "a financial contribution by a government or any public body within the territory of a Member," involving "a direct transfer of funds," "government revenue that is otherwise due that is foregone or not collected," or "a government provid[ing] goods or services." The Agreement further holds that "no Member should cause, through the use of any subsidy… adverse effects to the interests of other Members, i.e.: "injury to the domestic industry of another Member," or "serious prejudice to the interests of another Member."[29] One could perhaps argue that QE, which involves a public body (a Central Bank) increasing a country's monetary base, thereby lowering the cost of credit to companies in a particular country, constitutes the "provision of a service" by a government, that lowers costs of production and helps to encourage exports, which could comply with the definition of a subsidy. Further, it may be possible that QE in developing nations, as argued above, could "cause adverse effects to the domestic industry of other Members." In contrast with the IMF, the WTO has a working mechanism for enforcing its rules.[30] Any WTO Member that alleges a violation by another country may refer a matter to a Dispute Settlement Body (DSB).[31] Hypothetically speaking, should a DSB find that QE by a particular country constitutes a subsidy in violation of the GATT, it will make a ruling, which if not abided by, will lead it to authorise the complaining party to impose retaliatory measures against the offending country.[32]

In practice, however, any action by an emerging economy against developing nations seems unlikely, because developed countries would most probably retaliate by retracting aid and scientific support and ceasing joint projects and attempting to politically isolate a potential belligerent. More likely to succeed would be joint action undertaken, say for example by a

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[26] Sanford JE "Currency Manipulation: The IMF and WTO" 2011 *Congressional Research Service* 2.
[27] Agreement on subsidies and countervailing measures of the World Trade Organisation https://www.wto.org/english/docs_e/legal_e/24-scm.pdf (Date of use: 05 June 2015).
[28] Article 1 1.1(a)(1)(i)-(iv) of the Agreement on subsidies and countervailing measures of the World Trade Organisation.
[29] Article 5(a)-(c) of the Agreement on subsidies and countervailing measures of the World Trade Organisation.
[30] Sanford *Congressional Research Service* 2.
[31] Article 4 4.4 of the Agreement on subsidies and countervailing measures of the World Trade Organisation.
[32] Sanford *Congressional Research Service* 2-3.

union of BRICS and other developing nations, but the possibility of such an occurrence is also low.

3 3 The International Court of Justice (ICJ).

The ICJ has the jurisdiction to hear any alleged breach of an international obligation under treaties, international law or international customs between UN member states.[33] Theoretically speaking, any UN member state would therefore be able to raise a complaint concerning QE, as conducted by developed nations, as a breach of international law. However, say a judgment were made in favour of a complainant in a case where it is alleged that QE constitutes a breach of international obligations, there is already a precedent whereby a UN Security Council Member was able to block the enforcement of an ICJ judgement.[34] This case unfortunately set a precedent, which any of the five UN Security Council Members (China, France, Russia, the United Kingdom and the United States), could rely on in future to ignore and block ICJ judgments.

4 South Africa's capacity to conduct QE.

The South African Reserve Bank cannot conduct a fully-fledged QE programme similar to that of developed nations because the Bank is prohibited from buying, discounting or re-discounting securities which have longer maturities,[35] and the amount of government securities that the Reserve Bank may hold is statutorily limited to the "sum [of] its paid-up capital and reserve fund plus one-third of its liabilities to the public in the Republic."[36] Looking at the most recent Reserve Bank Statement of Assets and Liabilities,[37] it is possible to calculate the maximum amount of government securities that the Bank may hold, which is just over R40.3 billion. To appreciate the significance of this limitation, one must compare the maximum amount of government securities that may be held by the South African Reserve Bank in relation to country's Gross Domestic Product (GDP), with the amount of government securities accumulated by the US Federal Reserve during its QE programmes in

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[33] Article 36 1-6 of the Statute of the International Court of Justice http://legal.un.org/avl/pdf/ha/sicj/icj_statute_e.pdf (Date of use: 06 June 2015).
[34] *Military and Paramilitary Activities in and against Nicaragua (Nicarague v United States of America), Jurisdiction and Admissibility, Judgment, I.C.J Reports 1984,* p.392; United Nations Security Council "Document S/18428" http://www.un.org/ga/search/view_doc.asp?symbol=S/18428 (Date of use: 06 June 2015).
[35] Section 13(d)-(e) of the South African Reserve Bank Act 90 of 1989.
[36] Section 13(f) of the South African Reserve Bank.
[37] South African Reserve Bank "Statement of Assets and Liabilities as at 31 May 2015" https://www.resbank.co.za/Lists/News%20and%20Publications/Attachments/6754/May%202015.pdf (Date of use: 05 June 2015).

relation to that country's GDP.[38] The Federal Reserve government securities held as a percentage of GDP, amounts to 15.5%, whereas the amount of government securities that the South African Reserve Bank is permitted to hold amounts to less than 1%. This means that in an environment of competitive devaluations by developed nations, South Africa is at a disadvantage regarding its potential to expand its monetary base.

4 Neo-colonialism: a monopoly of power in international organisations and financial war.

One of the major criticisms of the IMF and WTO are that they act as propagators of neo-colonialism by preventing development in international relations, and by "chaining Africa to continued dependence on Western economies for mere subsistence, by preventing self-help to the continent's economic problems" under a mask of economic support.[39] Furthermore, the policies enforced on African countries seem to favour a trade imbalance to already wealthy Western economies.[40]

Dr Rajan, the incumbent Governor of the Reserve Bank of India, stated that "[QE] and sustained exchange intervention are in an economic equivalence class, though the channels they work through may be somewhat different."[41] Dr Rajan mentions that competitive QE conducted by a number of countries simultaneously, causes distortions in global demand, increases financial risks and therefore necessitates a reform of international law regarding such types of monetary operations.[42]

In conclusion a statement by the notable British Economist, John Maynard Keynes, whose work still forms the basis of modern macroeconomics, seems apt: "the difficulty lies, not so much in developing new ideas, as in escaping from old ones."

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[38] Trading Economics "South Africa Economic Indicators" http://www.tradingeconomics.com/south-africa/indicators; Trading Economics "United States Economic Indicators" http://www.tradingeconomics.com/united-states/indicators; Federal Reserve Bank "The Federal Reserve Banks Combined Financial Statements" http://www.federalreserve.gov/monetarypolicy/files/BSTcombinedfinstmt2014.pdf (Date of use: 05 June 2015).
[39] Nyikal H "Neo-Colonialism In Africa: The Economic Crisis In Africa And the Propagation Of the Status Quo By the World Bank/IMF and WTO" 2005 *Ethics of Development in A Global Environment (Poverty & Prejudice)* 1-19 (1).
[40] *Ibid.*
[41] Rajan R "Competitive monetary easing – is it yesterday once more?" http://www.bis.org/review/r140414b.htm (Date of use: 04 June 2015).
[42] *Ibid.*