



Asian Financial Crisis

By Tim Shorrock

In mid-November 1998, President Clinton will travel to Malaysia to attend the annual meeting of the Asia Pacific Economic Cooperation council, a group of Asian and Pacific Rim countries committed to free trade and liberalized capital markets. The gathering will take place as the impact of the Asian financial crisis—which began almost exactly a year ago with the collapse of currencies and stock markets in Thailand, Indonesia, and South Korea—is being felt around the world, triggering fears of a global depression and deepening the plight of workers and the poor everywhere.

The crisis finally came home to Americans last summer, when the stock market took a nosedive as investors began to dump stocks in corporations whose profits had plunged as economic growth in Asia—which buys nearly one-third of all U.S. exports—sank to its lowest rates since the early 1960s. The panic on Wall Street was

also triggered by the stunning collapse of the Japanese banking system, which has sparked a regional capital crunch and created Japan's worst recession since the end of World War II.

President Clinton and his chief economic advisers, Treasury Secretary Robert Rubin and Deputy Secretary Larry Summers, will arrive at the meeting ready to push what has come to be known as the "Washington consensus"—which is the conviction that the expanded liberalization of trade and capital markets, tough policies toward overleveraged corporations and banks, and a blanket rejection of controls on capital flows constitute the only path to economic prosperity.

The United States, as the largest donor to the International Monetary Fund, will also be a staunch defender of the IMF's policies. The IMF administered the multibillion dollar Asia bailout launched last winter but has become the target of fierce criticism at home and abroad for pushing Asia further into recession with its demands for high interest rates and rigid monetary and fiscal policies. Although the fund has recently softened its policies, in many of the APEC discussions,

Clinton, Rubin, and the IMF will find themselves isolated, particularly on the issue of controlling the flows of "hot money." That term refers to the sudden and speculative shifts of investments from country to country that many economists now see as a key factor in the collapse of the so-called Asian "tiger economies."

Economic policy divisions widened in September 1998 after Malaysia, an autocratic state friendly to multinationals, decided to yank its currency from the market and banned foreign investors from withdrawing their capital for one year. The idea of some kind of capital controls has gained support in Japan and other Asian countries. Even some mainstream U.S. and World Bank economists support the concept of capital controls—but not the Clinton administration.

Shortly after Malaysia's announcement, Summers said it would be a "catastrophe" if countries developed "the idea that withdrawing from the global system was right and building a better functioning market economy was wrong." In November 1998, U.S. APEC Ambassador John S. Wolf said: "We think it's important to avoid excessive government interference or rigid controls, which would shrink the pool of capital that is available. That would make the cost of capital prohibitive for emerging markets."

But clearly hot money was one of the factors behind Asia's collapse. In 1997, following a series of corporate bankruptcies and bank failures, foreign investors and bankers began a stampede out of the Asia region, sending the Asian economies into freefall. In just one year, Asian stock markets declined on average between 40% and 60%, while the value of most Asian currencies fell between 35% and 85% against the dollar. That made it difficult for them to buy U.S. products, while lowering prices for their own exports by more than half. As a result, the U.S. trade deficit is projected to hit \$300 billion in 1999 after a record of about \$240 billion this year.

Japan, once the driving force of the Asian economy, has also fallen into decline. Leading Japanese banks began to crumble in November 1997 under the weight of nearly \$1 trillion in bad loans that they had accumulated since Japan's "bubble economy" burst in the early 1990s. Japanese banks are now withdrawing from world markets at a dizzying pace, as the government desperately tries to recapitalize the banking system to revive its ability to lend.

Key Points

- The Clinton administration continues to promote the deeply flawed "Washington consensus" of neoliberal globalization in the APEC countries.
- President Clinton, Treasury Secretary Rubin, and the IMF find themselves isolated in Asia, particularly on the issue of controlling flows of "hot money."
- The Asian crisis, including the end of Japan's "bubble economy," has created economic conditions that make it difficult for Asians to buy U.S. exports and that devalue Asian exports, leading to unprecedented trade deficits in the United States.

In explaining the Asian crisis to the American people, the Clinton administration has focused primarily on the structural problems caused by so-called “crony capitalism.” Under the leadership of Japan, Treasury’s Summers recently said, East Asian countries “favored centralized coordination of activity over decentralized market incentives. Governments targeted particular industries, promoted selected exports, and protected domestic industry. There was a reliance on debt rather than equity, relationship-driven finance not capital markets, and informal rather than formal enforcement mechanisms.” Ultimately, this style of capital formation led to bad business decisions, or, in Summers’ words, “money borrowed in excess and used badly.”

Indeed, “crony capitalism” did create serious impediments to sustainable development in Asia, a point often made by Asian unions and social organizations. But it is just one piece of the total picture and ignores the key role played by the United States in developing and sustaining Asian-style capitalism.

By any standard, Asian growth rates since the early 1960s were impressive and raised living standards for millions of people. But the pattern of Asian development since World War II closely followed two growth strategies: the export-led economic agenda promoted by the United States and adopted by South Korea and other U.S. allies during the cold war, and the rapid deregulation of capital markets in the 1990s.

Export-led development followed a simple formula: countries pegged growth to selling manufactured goods, agricultural products, and natural resources overseas. Capital was siphoned into industries chosen by state economic planners and businessmen. In nearly every country where this pattern was followed, the policies were guided by U.S.-backed authoritarian governments that favored certain business groups and maintained low wages by stifling labor unions and independent political organizing. That was the case in South Korea, which was under military dictatorship from 1961 to 1987, and in Indonesia, where General Suharto and a military-dominated government ruled from 1965 to 1998. The first phase of export-led industrialization was primarily financed by Japanese corporations and banks, which began investing heavily in Korea and Southeast Asia during the Vietnam War.

The spread of export-led capitalism was also accompanied by policies, advocated by the U.S. and the IMF, to lift barriers to the flow of private capital around the world. After the Latin American debt crisis of the 1980s, private bond and investment markets replaced international institutions and government development funds as the primary suppliers of capital to foreign countries and corporations. According to the World Bank, private capital flows to the developing world jumped from \$44.4 billion in 1990 to \$243.8 billion in 1996, constituting 85% of total investment in those countries.

To attract investments from other countries, Asian governments raised interest rates and pegged their currencies to the dollar. The policies worked, bringing billions of dollars from foreign investors into the region.

Between 1985 and 1995, GNP growth in Southeast Asia was between 6% and 10% a year. By 1996, Asia was buying more than 30% of all U.S. exports.

The problems that engulfed the region were sparked by the misallocation of these enormous flows of capital. In Thailand and Indonesia, much of the investment was funneled into high-profit projects with quick turnaround time, primarily stocks, consumer financing, and real estate. In South Korea, government-supported banks directed the loans to conglomerates competing with each other to expand capacity in automobiles, semiconductors, and other industries. The crisis developed when banks began to pile up bad debts as a result of a glut in real estate and a slowdown in manufactured exports. That, combined with a wave of currency devaluations, triggered a panic by foreign investors, who quickly sold off their stocks and bonds, sparking the intervention of the IMF. Compounding this hot money crisis was the slowdown of Japanese capital investments in Asia in the 1990s, which was the result of the collapse of a “bubble economy” that was based largely on speculative investments in land and real estate.

Despite the central role played by the United States in fostering export-led growth under state guidance, the Clinton administration is now demanding that Japan and other Asian countries abandon their model in favor of the decentralized, market-driven U.S. model. Summers has been the chief ideologue of this approach. He and his Treasury colleagues want Asia to replicate what he called “the renaissance of American business,” the low-inflation, no-deficit, high-employment boom of the Clinton years. Summers’ description of how

the boom came about offers important clues to Treasury’s vision for the world. Summers said that over the past decade “impatient American capital saw to it that major American companies were among the first companies worldwide to go through painful reengineering and restructuring to reflect competitive realities—and, accordingly, saw to it that these companies emerged first and strongest in their field.”

By urging similar shock treatment for Asia, Treasury has replaced the Pentagon as the U.S. global enforcer, working on the behalf of Wall Street—Summers’ “impatient capitalists”—to force struggling economies to get their act together by shutting down failing banks and putting the screws to manufacturing and service companies that employ too many workers. It should come as no surprise that the financial institutions crafting the restructuring of Asian corporate debt are big Wall Street banks and investment houses, such as Goldman Sachs and Lehman Brothers.

Key Problems

- Crony capitalism has created serious impediments to sustainable development in Asia, but it’s just one piece of a total picture that includes the key role played by the U.S. in developing Asian-style capitalism.
 - Despite the role played by the U.S. in fostering export-led growth under state guidance, the Clinton administration now demands that Asian countries abandon their model in favor of the decentralized, market-driven U.S. model.
 - By urging a shock treatment of economic restructuring in Asia, the Treasury Department has replaced the Pentagon as the U.S. global enforcer.
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A year after the financial crisis hit, there were some signs of economic stabilization in the region. Governments in South Korea, Thailand, and Japan have begun the long process of recapitalizing their banks so businesses—particularly small and medium-sized companies—can start borrowing again. The Korean government of Kim Dae Jung is pressuring its largest *chaebol*, or conglomerates, to restructure and put an end to the overcapacity in automobiles, semiconductors, and steel. With the exception of Indonesia, foreign investors are beginning

Key Recommendations

- A new global economic policy toward Asia should encompass thorough reform of the IMF.
- Protectionist trade policies that fail to address the U.S. role in promoting exports from abroad should be opposed.
- Among proposals that should be considered: a small tax on capital flows overseas that would create emergency funds for future crises, requirements that foreign capital remain in a country for at least a year, and a credit insurance corporation that would force banks to finance a private bailout fund.

to return. Indonesia is facing an uncertain future under President Habibie, who retains many ties to business, like his predecessor, Suharto.

But all of this has come at a tremendous human cost. According to a recent report by Oxfam International, more than 15 million Indonesians will be out of work by the end of the year, while poverty in Thailand is expected to rise by one-third. In South Korea, local governments have been forced to open orphanages to cope with the thousands of children abandoned by parents with no jobs and no income.

At the same time, the forced restructuring of Asian corporations has sparked severe labor tensions. Despite the more democratic nature of the Kim Dae Jung government, hundreds of trade unionists opposed to layoffs have been jailed. Earlier this year, for example, workers at Korea's Mando Machinery, part of the Halla Group and one of the world's largest auto parts makers, went on strike to protest mass layoffs. When executives with the Wall Street firm of Rothschild Group, which is administering Halla's restructuring, told Mando that they would be unable to sell the plant if the strike continued, the police were sent in the next day to break up the protest.

Rothschild is not alone. Major Wall Street investment banks, from Goldman Sachs to Lehman Brothers, are swooping down on the region to buy up its bankrupt assets and advise governments and central banks on the intricacies of U.S.-style finance.

For American industrial workers, the situation in Asia is dangerous. Already, hundreds of jobs in U.S. export industries, from aircraft to wood pulp, have been lost as Asian countries have cut back on imports from the

U.S., which have doubled or more in price since Asian currencies plummeted in late 1997. The rising trade deficit with Asia has also sparked a strong protectionist backlash. In recent weeks, U.S. steelmakers and unions, along with the U.S. semiconductor and shipbuilding industries, have sought government assistance to slow the flood of low-priced Asian imports.

A new global economic policy toward Asia should encompass a thorough reform of the IMF and develop a new architecture for capital markets so that economic development reflects the needs of entire societies, not just the wealthy elite. The U.S. priority should be refocusing the discussion on how capital markets can meet the long-term needs of workers both at home and abroad. At the same time, the Clinton administration should reevaluate the rapid opening of capital markets abroad until better global controls are in place and economic recovery is under way in Asia. Protectionist trade policies that fail to address global labor standards, global wealth disparity, and the U.S. role in promoting exports from abroad should be opposed.

Long-term Architecture: To prevent future havoc to the global economy, policymakers and citizen groups should strive for a global system that will alleviate problems in financial markets such as sudden, destabilizing flights of capital. Among the proposals currently floating in labor and progressive circles are the so-called Tobin transaction tax, a small tax on capital flows overseas that would create emergency funds for future crises; requirements that foreign capital remain in a country for at least one year; and investor George Soros' proposal for an International Credit Insurance Corporation that would force banks to finance a private bailout fund instead of relying on the government.

Alternatives: The traditional IMF prescription for growth in developing countries—export-led development fueled by foreign capital and based on low wages—is deeply flawed. In Asia, it has supported a tiny elite that has integrated portions of their economies with the world market while keeping a tight lid on political activities and labor unions. Progressives should develop a global economic model based on sustainable, domestic-led growth that recognizes the benefits of open trade but is not solely dependent on access to the U.S. market. A key element of such a model would be the support of labor rights and higher wages in developing countries—and opposition to efforts by corporations like Nike to keep them low—so workers overseas can start buying the goods they produce.

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[Excellent resource; everything you ever wanted to know about the Asian financial crisis, compiled by Nouriel Roubini, Associate Professor of Economics and International Business at the Stern School of Business, New York University.]

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