



Asian Financial Crisis

by Tim Shorrock

A series of bank failures and corporate bankruptcies in 1997 sent Asian currency markets tumbling, sparking a sudden flight of foreign capital that sent the economies of four East Asian nations into a free-fall. To contain the damage, the International Monetary Fund (IMF) and the U.S. Treasury quickly crafted the largest financial rescue plan in history.

Over \$120 billion from the IMF, the World Bank, the U.S. government, and other institutions went to South Korea, Thailand, Indonesia, and the Philippines to help their governments pay billions of dollars owed to U.S., European, and Japanese banks, to reestablish business confidence, and to persuade foreign investors to return to their markets. In exchange, the four countries agreed to restructure their economies by shutting down insolvent enterprises and banks, ending monopolies, phasing out government restrictions on investment, and opening their markets even further to foreign capital. Those

moves have paved the way for a massive sell-off of Asian assets to foreign companies.

The "Asian crisis," as these events have been dubbed by the U.S. press, is having a dramatic impact on workers in Asia, and its ripple effects are being felt throughout North America. Already, hundreds of thousands of Asian workers—10,000 a day in South Korea alone—have lost their jobs as factories close down. Families are suffering as state controls on food prices, transportation, and other commodities are phased out.

By the end of 1998, job losses are expected to be in the millions. In Indonesia, an authoritarian country ruled by the powerful Suharto family, food riots and antigovernment

demonstrations are spreading across the country as Suharto and his generals intensify their political control.

In the United States, the Economic Policy Institute (EPI) has estimated that over one million industrial jobs are threatened as Asian countries export their way out of

the crisis, adding to the huge U.S. trade deficit. U.S. jobs will also be lost as Asian goods, which are suddenly less expensive because of currency depreciations, replace U.S. exports to Asia and other emerging markets. Those job losses, according to the EPI, will be concentrated in key manufacturing industries, including steel, electronics, apparel, and automobiles.

In Washington, the Asian crisis and the Clinton administration's request for \$18 billion in additional funds for the IMF have sparked a lively political debate about the IMF and future U.S. economic policy. Groups on both the left and right challenged the IMF's programs in Asia as a waste of U.S. taxpayer money to bail out international banks that poured capital into questionable Asian projects. But the Clinton administration, led by Treasury Secretary Robert Rubin, mounted a strong counterattack, arguing that the IMF bailout is necessary to restore economic stability in Asia and to prevent a broader crisis that could cause serious damage to the U.S. economy and an even greater loss of jobs. The administration also linked the Asian crisis to U.S. national security interests, saying that serious social unrest in Indonesia and other Asian countries could somehow lead to involvement by the U.S. military and could threaten the use of the Indonesian sea lanes, through which about 30% of global shipping passes.

The U.S. Senate, with strong support from the business community (and with organized labor largely on the sidelines), passed the bailout legislation by a vote of 84-16 in March 1998. In the House, most of the opposition came from Republican conservatives who believe the IMF is violating free market principles. Democrats who opposed fast-track trade legislation, such as Rep. David Bonior, D-MI, and Rep. Barney Frank, D-MA, agreed to support the IMF replenishment on two conditions: that the IMF pay more attention to labor and environmental issues, and that Treasury establish an advisory panel from U.S. business and labor to review IMF programs. Meanwhile, U.S. steel, shipbuilding, and semiconductor companies secured an amendment that will: 1) impose penalties on Asian countries that dump their goods in the U.S. market by selling them at below-market prices, and 2) prohibit the IMF money from being used to increase capacity in certain industries.

Key Points

- The \$120 billion bailout for four troubled Asian economies, crafted by the IMF and the U.S. Treasury, is the largest financial rescue plan in history.
- In Asia, hundreds of thousands of people have lost their jobs as insolvent factories close; total job losses could be in the millions. In the U.S., one study predicts that one million industrial workers could be laid off as Asian countries export their way out of the crisis and cut into U.S. markets.
- The IMF bailout has sparked a lively debate in Washington about economic policy, but opposition to IMF policies is coming mainly from the right.

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”—the incestuous relationship in Asia between governments, banks, and corporations. Although those structures have created serious impediments to sustainable development in Asia—a point often made by Asian unions and social organizations—they are just one piece of the total picture.

Until very recently, the Asian economies were praised by the IMF, the World Bank, and the U.S. business elite as miracles of growth. But though Asian growth rates were impressive by any standard, the pattern of development in Asia closely followed two historical developments: the export-led economic agenda advocated by the United States and adopted by South Korea and other U.S. allies during the cold war, and the rapid opening and deregulation of capital markets in the developing world in the 1990s.

Export-led development follows a rather simple formula: countries peg their growth to producing and selling manufactured goods, agricultural products, and natural resources overseas. This is accomplished by attracting foreign investment and loans and then siphoning it into industries designated by economic planners and businessmen as competitive on the world market. In nearly every country where this pattern has been followed, the policies have been guided by authoritarian governments who 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 is still the case in Indonesia, where General Suharto and a military-dominated government has ruled since 1965. All four countries receiving the IMF bailout are key U.S. military allies and major recipients of U.S. military aid.

The spread of export-led capitalism has also been accompanied by policies, championed by the U.S. government and its allies in the IMF and the World Bank, to deregulate the flow of capital around the world. After the Latin American debt crisis of the 1980s, private bond and investment markets replaced the IMF, the World Bank, and government development funds as the primary suppliers of capital to foreign countries and corporations. By 1996, according to the World Bank, private capital flows to the developing world had jumped from \$44.4 billion in 1990 to \$243.8 billion, constituting 85% of total investment in those countries. This figure included \$109.5 billion in foreign direct investment, \$88.6 billion in bonds (long-term loans purchased by foreign investors), and \$45.7 billion in portfolio investment in the stock market.

Over 75% of private foreign investment has gone to 10 developing countries, led by China, Indonesia, Mexico, South Korea, and Brazil. This money is not just from rich investors; U.S. workers have a big stake in Asian capital markets through their pension plans and mutual funds. The *Wall Street Journal* has estimated that over 11% of the total assets of pension funds are invested overseas.

In Asia, the first phase of export-led industrialization was financed by Japanese corporations and banks, which invested heavily in manufacturing. The surge in Japanese capital began during the Vietnam War and was encouraged by the United States after its defeat in Indochina as part of a cold war strategy to encourage market capitalism and discourage the spread of planned socialist economies. But the flow of Japanese capital to the region began to wane in the early 1990s, partly the result of Japanese banks taking heavy losses from speculative investments in real estate—a mistake that was later repeated in Thailand and other Southeast Asian countries.

To attract foreign investments from other countries, governments in the region raised domestic interest rates and pegged their currencies to the dollar. The IMF, the World Bank, and the Clinton administration strongly backed these policies, which brought billions of dollars from private investors in the United States and Europe. Between 1985 and 1995, GNP in Southeast Asia grew 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 the enormous flows of capital. In Thailand and Indonesia, much of the investment was funneled into high-profit ventures with a 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.

But a crisis developed in mid-1997 when Asian banks began to topple 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 massive panic by foreign investors, who quickly sold off their stocks and bonds, sparking the intervention of the IMF. Now, transnational corporations (TNCs) from the United States, Europe, and Japan are taking advantage of the crisis—and the big drop in prices—to buy Asian companies and integrate them into their global operations. Many Asians fear that these purchases will lead to a loss of their national sovereignty and a surrender of key economic assets to global capital. By buying up bankrupt Asian companies, U.S. TNCs might expand U.S. markets. But they will more likely use their low-cost Asian operations to export goods to the United States, as so many U.S. corporations do today.

Key Problems

- Ignoring other factors, the Clinton administration has blamed “crony capitalism”—close links between Asian governments, banks, and industries—for the Asian financial collapse.
 - Asian growth, although very high by world standards, has largely been based on export-led development strategies crafted by authoritarian governments that repress labor unions and political freedoms.
 - In the 1990s, private capital markets replaced public funding as the primary engine of growth in the developing countries of Asia. Under this deregulated system, private capital flows to developing countries reached \$243.8 billion, constituting 85% of total investment in those countries.
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Despite the IMF bailout, the crisis is far from over. Indonesia, the world's fourth-most-populous country, has been resisting change, particularly IMF demands that members of Suharto's family divest themselves of control of key industries. Governments in Thailand and South Korea, in contrast, have adopted many IMF reforms—such as policing how corporations allocate capital—and have attracted new investment from foreign mutual funds and bond buyers. But they are continually looking over their shoulders to see if China, which has lost export markets to its Asian rivals, devalues its currency to maintain its own competitiveness. Japan, meanwhile, continues to resist calls from its neighbors and from the United States to expand its domestic economy and slow its export growth so it can absorb exports from the troubled Asian economies.

For U.S. 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 that have doubled in price since their currencies plummeted in

late 1997. If Indonesia crumbles, the crisis could worsen, particularly in South Korea, where banks have over \$5 billion in outstanding loans to Jakarta. A further weakening in Korea, the fifth-largest overseas U.S. market, would be another blow to U.S. exports. The threat of deeper job losses if the Asian situation doesn't stabilize was a key factor in the AFL-CIO's decision not to oppose the administration's request for new money for the IMF.

Policymakers and administration officials should acknowledge that the deregulation of financial markets in developing countries is part of the problem, not the solution. The Clinton administration

should suspend the rapid opening of capital markets abroad until better global controls are in place and economic recovery is under way in Asia. For similar reasons, the U.S. government should lobby against the Multilateral Agreement on Investment, which would make it much harder for any country (including the

U.S.) to impose labor or environmental conditions on capital. Protectionist trade policies that don't address key issues—such as the U.S. role in promoting exports from abroad and wide disparities in wealth and labor standards—should be opposed.

To alleviate problems in financial markets—such as sudden, destabilizing flights of capital—the global financial system and multilateral institutions like the IMF need to be substantially reformed. Among the proposals currently floating in labor and progressive circles are the following: the Tobin transaction tax (a small tax on capital flows overseas that would create emergency funds for future crises); Chile's requirement that foreign capital remain for at least one year; and investor George Soros's proposal for an International Credit Insurance Corporation that would force banks to finance a private bailout fund instead of relying on governments.

Short of calling for its abolition, the U.S. should use its clout in the IMF (18% of voting power) to press for sweeping reforms in this highly secretive institution. Policymakers should oppose the IMF charter change that would give the institution more authority to demand that countries eliminate capital controls. With the IMF deeply engaged in economic restructuring in Asia, any legislation to bankroll the fund should stipulate that IMF procedures become more transparent and that the fund condition future lending programs on strong political as well as economic reforms.

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 group of elites who have integrated portions of their countries' economies with the world market while keeping a tight lid on political activities and labor unions. Policymakers and citizen groups should work to develop an 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 support for labor rights and higher wages in developing countries—and opposition to efforts by corporations like Nike to keep wages low—so workers overseas can start buying the products they produce. At the same time, the Pentagon must stop supporting governments (like Suharto's in Indonesia) that repress their people.

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Key Recommendations

- A new policy on Asia should press for a thorough reform of the IMF and should develop a new framework for capital markets so that economic development reflects the needs of entire societies, not just the wealthy elite.
- The U.S. should suspend the rapid opening of capital markets abroad until better global controls are in place and economic recovery is under way in Asia.
- The U.S. should support an economic model based on sustainable, domestic-led growth that recognizes the benefits of open trade but is not solely dependent on access to U.S. markets.

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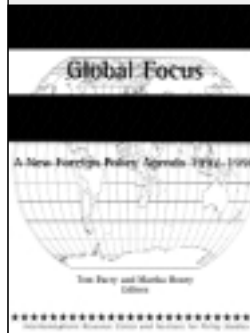
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