Neo-liberalism and the Asian Financial Crisis
Today’s Agenda

• Review the “families” of Political Economy theories
• Back to Taiwan: Did Economic development lead to political changes?
• The Asian Financial Crisis
  – The story
  – Explanations
  – Lessons for today?
“FAMILIES” OF MODERN THEORIES OF POLITICAL ECONOMY
Liberalism

Neo Liberalism

Comparative Advantage

Rational Choice Theory

Property Rights

Free Market

Collective action problems

Indifidualismn

Neo Liberlaism

FREEDOM

Embedded Liberalism

Hegemonic Stability Theory

Keynesianism

Modernization Theory

Stag Hunt

Prisoners Dilemma

Dependent Development

Development

Modified Liberalism

Staples Theory

Product Cycle

© 2002 Grant L. Misbach
www.Misbach.org
Political Economy of Freedom: The Liberal Family

• Liberalism
  – Neo-liberalism
  – Comparative Advantage
  – Rational choice theory

• Repaired of modified Liberalism
  – Embedded liberalism
  – Keynesianism
  – Hegemonic Stability Theory
More “relatives” in the Liberal Family

• Focused on Economic Development
  – Modernization theory
  – Staples Theory
  – Product-cycle theory
  – Dependent development
Liberal language: some terms

• Transaction costs
• Strategic interaction
• Stages of economic growth
• Property rights
• Laissez-faire
• Business cycle
Some Liberal Policies to ensure freedom

• Minimal state intervention in markets
• Structural adjustment
• Multilateralism
• Gold Standard......
The Family Tree

Equality

Distributive Justice

Exploitation

Class conflict (production)

Surplus Value

Marxism

Unequal Exchange

Unequal Terms of Trade (exchange)

Underdevelopment

Core-Periphery Relation

Imperialism

Welfare State (diminishes salience of class)

Norm of equal citizenship

Social Democracy

Market Socialism

Redistribution of Wealth

NIEO
Political Economy of Equality: The Family

- Marxism
- Socialism
- Distributive Justice
- Keynesianism
- Dependency Theory
Equality Language

• Language criticizing liberalism
  – Exploitation
  – Surplus value

• And with regard to development
  – Unequal exchange
  – Imperialism
  – Unequal terms of trade
  – Core
  – Periphery
Policies to bring about equality

• The welfare state
• Keynesianism—deficit spending
• NIEO
The COMMUNITY

Community and Nation

Communal Sharing
Gift Economy
Collective action
Communal Ownership
Equality as basis of Community
Fairness
Mutual Obligation

General Will
Cooperation
Communal identity

Commutarianism

Economic Nationalism
Development

Retaliation
Currency Manipulation
Capital Controls
Market Control
Trade Protection

Infant Industry
Import Substitution
Late Development--planning
State-led Development
Strategic trade
Export-led growth
The Political Economy of Community: The Family

- Communitarianism
- Communal Sharing
- Nationalism
- Economic Nationalism
  - For developing countries:
    - ISI and Infant Industry protection
    - State-Led Development
Policies to preserve community

• Protectionism
  – Trade protection
    • Tariffs
    • Non-tariff barriers to trade
    • Subsidies to domestic industry
    • bilateralism
  – Currency manipulation (example: competitive devaluation
  – Capital controls
Theories and the Business Cycle in 20th century History

19th Cent.
Britain Provides
“Hegemonic Stability”
Classical Liberalism

Great Depression: Keynes and the “Liberal” welfare state

Post War
Embedded Liberalism, Hegemonic Stability

1970s Recession

Rise of “Neo-liberalism” And developmental states

Asian Financial Crisis

Level of real output

Peak
Recession
Growth
Recovery
Trough

Time
Have strong markets led to Democracy and have the NIEs reached the stage of a mass-consumption society?

STATE-LED DEVELOPMENT, THE OPENING OF MARKETS, AND DEMOCRACY
In East Asia, what has economic development done to repressive governments?

• Can new information technologies lead to more freedom?
• Will a growing middle class demand more political participation and competition?
Political Liberalization in Taiwan
Approved Taiwan Investment in China
(cumulative, US$ billion)

* Up to Mar 2000
Source: Taiwan’s Ministry of Economic Affairs
Interdependence

**Approved Investments in China by Sector Between 1991 and 2001**

- Electronics and Electrical Products: 30.43%
- Metal Products: 8.13%
- Plastic Products: 7.52%
- Food and Beverages: 6.73%
- Chemicals: 6.44%
- Others: 40.75%

*Source: Ministry of Economic Affairs*

**Approved Outward Investments in 2001**

- China: 38.80%
- British Territories in Central America: 23.60%
- USA: 15.23%
- Singapore: 5.27%
- Japan: 2.36%
- Hong Kong: 1.32%
- Other Areas: 13.42%

*Source: Investment Commission, Ministry of Economic Affairs*
Political Interdependence?
From export-led growth to Domestic Demand and Mass-Consumption Society: Convenience-store culture
From Mass Consumption Society to relative decline?
The Asian Financial Crisis
Neo-liberalism and Global financial liberalization

• FDI is a small part part of financial flows
• Cross border bank lending has grown 10% annually in last two decades
• Currency trading has grown even faster.
• And so has cross border securities trading
Hot Money
The Asian “Tigers” and financial Liberalization

• 1990s US and IMF asked Asian countries to open their financial markets
• They began to be called “emerging markets”
• Short-term bank loans were main form of capital inflow leading to
• Domestic booms
1985-1997 high growth countries used less foreign capital.
Booms turned to bubbles

- Booms busted and money flowed out
- BoP surpluses turned to deficits
- Speculative attacks on currency....
- Leading to currency devaluation
- Investors pulled out their money
- Inability to roll over loans because foreign banks demanded immediate repayment
- So domestic banking sector froze up
In sum: the causes of the crisis

• Evaporation of Asian economic “miracle”
• Asian “Tigers” became source of danger
• The problem was the strategy to attract foreign capital
• Perils of “fast track” capitalism…….
Perils of “fast track” Capitalism

• Foreign capital entered in the form of short term loans to banks and firms
• But never found its way into the real economy
• Used for “betting” not for economic growth
• Everyone was overinvest in high yield risk sector....
• And banks had made bad loans
• Debts could not be repaid.....so
• Many investors and speculators jumped ship and took their money out, leading to.....
• devaluation
Currency devaluation

Figure 2
Depreciation of Asian Currencies
Against the U.S. S$ Since July 1997

Data Source: J.P. Morgan & Co.
It began in Korea.....
Spread to Thailand.....
Enter the IMF.....

- Provided huge loans
- For balance of payments
- But required conditions (structural adjustment, austerity programs)
- This was to calm markets
IMF bailed out private banks

• States gave IMF funds to firms so that they could repay private loans
• Lenders did not have to face full consequences of their bad loans
Example

- Speculator borrows 24 billion bhat from Thai bank
- At exchange rate of 24:1,
- sells it for $1 billion
- Value of bhat falls
- Now it is 40:1
- Now it only takes $600 to pay back the loan
- He makes a $400 million profit
- Sends it to a Swiss bank
IMF Structural adjustment

• Developmental states had to step aside
• IMF demanded cutback in govt. spending, increases in taxes
• But the program failed to halt exchange rate fall
• Unemployment soared
• GDP plummeted
• Banks closed
• Poverty grew
The Contagion

• Korea, Thailand, Malaysia, Indonesia to Philippines......
• To Brazil to Argentina....
• And led to the rethinking of the global financial system
Stopping the crisis....

• Korean government bought bad loans from private banks
• Banks were nationalized
• Thailand closed 42 banks
• Indonesia closed banks
• Separating the wheat from the chaff
Economic Recovery After the Setback

Source: World Bank, World Development Indicators Online, at go.worldbank.org/B53SONGPA0 (July 12, 2007; subscription required).
THE LIBERAL EXPLANATION
Liberals blame “Traditional” society

- Non-transparency
- Personal ties govern economic advancement
- Family dominance
- Unhealthy relationship between government and business
- Lack of democracy
Which was characterized by Relational banking and crony capitalism
That led to Moral Hazard
Liberals also blame Strategic Trade

• Supporting “national champions” in international trade
• Betting on the wrong export industries
• Big decisions can be big mistakes
• Can you have a stable global economy without a hegemon?
• Are international financial institutions like the IMF enough?

THE ABSENCE OF A HEGEMON AND THE RISE OF NEO-LIBERALISM?
A MARXIST INTERPRETATION

• Capitalism is Marked by Crisis
Dependency Theory explanations

Core (North)       East Asia post-Crisis

Core

Periphery

IMF FUNDS

Benefits go to Western investors
IFIs aid private firms
A “late or state-led development” perspective: Financial Liberalization was too fast

- Traditional society
- Wrong speed and wrong sequencing
- Those countries that did not open up too fast did not suffer much
Are there lessons for the current crisis?

• Some Conditions were different
  – Real crisis was contained
  – IMF and World bank organized bailout packages then; not now
  – The US Federal Reserve is intervening internationally
  – Now the “Tigers” have big reserves of currency
And some conditions are similar

- Crony Capitalism?
- Is government a Committee to manage the affairs of the ruling class?
- Lack of transparency
Unregulated Capital flows
Most important lesson was not learned in the last 10 years: Hot money
Need for a new Bretton Woods?
Figure 3.2
Gross Domestic Product (Current prices, converted into dollars)

Source: OECD.
The Role of American hegemony
Japanese participation in the Taiwanese economy
With the Fastest growth rate in the world......

Figure 1. GDP Growth
(Percent change)

Source: IMF staff estimates.