A Review of :

Crisis As Conquest: Learning From East Asia

By

Jayati Ghosh and C.P. Chandrasekhar

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I. Introduction

The first thing to know about this wonderful new book is that it is NOT just another description of the Asian financial crisis of the late 1990's. To be sure, Jayati Ghosh and C.P. Chandrasekhar, both professors at the Centre for Economic Studies and Planning at Jawaharlal Nehru University in New Delhi, discuss in some detail the specifics of the financial crisis, and provide a great deal of useful information about its evolution. But Crisis as Conquest: Learning From East Asia, is much more than that. It is an extraordinarily stimulating attempt to expose the roots of the financial crisis, not only in East Asia, but also in other parts of the world beset by this all too common disease. As Ghosh and Chandrasekhar put it, "The era of globalization is characterized by a combination of slow growth and enhanced volatility, because economies in both the north and the south (have) come to be characterized by *an almost addictive dependence on capital mobility* (emphasis added)." (p. 106)

The book is devoted to helping us understand this "addictive dependence on capital mobility", particularly with respect to the South, and, more specifically, with a focus on East Asia. Crisis as Conquest tells us how the addiction developed, what impact it has had, and suggests what the developing countries of the South can do to kick the habit. As might be expected in such an ambitious agenda for such a short book, not all of these tasks are accomplished equally well. And to be sure, as in the real world of addiction where prescribing and applying cures is the most difficult task, prescribing solutions in the world of capital mobility addiction is not at all easy.

But this very well written book greatly improves our understanding of the deep roots of the mounting international financial crises, often in quite surprising ways. By accomplishing this job, it helps to clear the way so we can make progress on developing alternatives to the destructive structures and policies that have made the Asian Financial Crisis and its progeny possible and even likely.

II. The Roots of the Asian Financial Crisis

Much has been written on the causes of the Asian financial crisis. (See for example, Crotty and Dymski, 1998; Chang, 1998; Wade, 1998; Grabel, 1999; Furman and Stiglitz, 1998; Palma, 1998; Jomo, 2001.). While mainstream economists continue to blame "crony capitalism" and the lack of transparency which characterizes such "far off lands" – with the Enron debacle each and every day demonstrating the hypocrisy of such whining about the *" foreigners' "* "lack of transparency and accountability" -- most "heterodox" economists and analysts have fingered financial liberalization and the international hyper- mobility of capital as the real culprit in the collapse of such miracle economies as South Korea, Thailand, Indonesia, and more recently, Turkey and Argentina.

Ghosh and Chandrasekhar also show how financial liberalization left the Asian countries highly vulnerable to the whims of international investors. They argue that growing and sometimes rather large current account deficits and high foreign debt to export ratios meant that almost any event – from an assassination to a bankruptcy to an off hand pronouncement by a foreign money manager -- could trigger a loss of investor confidence, lead to a currency crisis, and then force a government to implement an austerity program to bring imports plus debt service plus capital flight into line with exports.

But rather than recount numerous details of these debacles, Ghosh and Chandrasekhar cut to what they see as the essence of the problem: in a number of key countries in Asia, financial liberalization meant that individuals and individual businesses were free to borrow foreign exchange without any obligation to be concerned about how they would generate the foreign exchange necessary to repay it. As a result, the process of generating foreign debt was divorced from the process of generating the foreign exchange necessary to service it. In this situation, no one was looking at the big picture to make sure that foreign borrowing wasn't excessive. In the parlance of "modern" economics, this led to a serious "coordination" problem.

Of course, the financial liberalization proselytizers had faith that the market would coordinate these disparate and decentralized acts of borrowing; for example, the cost of borrowing "should" rise as lending got riskier so that, in the end, over-lending would not occur. But as financial markets have shown time and again, they are simply incapable of performing this coordinating function on many occasions. As Charles Kindelberger, one of the greatest students of this cycle has remarked, this periodic over-lending then leads to "revulsion", capital is withdrawn and a crisis ensues.

This decentralization of borrowing and lending, is destroying more centralized and state directed lending processes that had characterized industrial policy in South Korea and other countries at earlier points in time (Crotty and Lee, 2001). Had these types of more centralized and regulated financial systems stayed in place, the likelihood of these financial crises would have been much reduced, according to Ghosh and Chandrasekhar.

But -- and this is where their story really gets interesting -- they go to the next step, which most analysts of the financial problems failed to do. They ask: why did financial liberalization occur in these countries? As they so perceptively ask: "Why did these countries, which had remarkably high domestic savings and investment rates, choose to invite foreign capital flows of this magnitude?" (p. 29.) It is the asking and answering of this question that constitutes the key contribution Crisis as Conquest makes to our understanding of the problem of economic development in the time of globalization.

III. Why Financial Liberalization in Asia?

Ghosh and Chandrasekhar's answer to this question is extremely paradoxical: they argue that the success these countries had in creating manufacturing export regimes, in some cases under state-guided policies of controlled and directed finance, often with a heavy dose of multinational investment, almost inevitably led to a policy of financial liberalization and financial openness. To see how strange an outcome this is, at least on the surface, one needs to imagine domestic manufacturing elites and huge foreign multinational corporations that are mostly engaging in manufacturing, voluntarily turning over these economies to financiers, who then proceeded to run these economies into the ground. Why, on earth, would they do this?

The answer Ghosh and Chandrasekhar give to this question is multi-faceted and interesting. The starting point is based on the limits of the export-led growth strategy that fueled the East Asian economic miracles. Ghosh and Chandrasekhar argue that this strategy was running out of steam in the late ‘80s early ‘90s and that

the countries of Thailand, Malaysia, Singapore and South Korea were looking for another "leading sector" to keep the miracle alive. In addition, MNC's, affected by their global competitive strategies, began looking for other pastures, notably in China. The previous miracle economies of Asia thus hit upon the financial sector as the answer to their problems.

By liberalizing finance these countries would kill a number of birds with one stone. They would: create jobs; create a new profit center for domestic capitalists; attract foreign exchange and credit; and by giving the northern financial services industry access to the East Asian domestic markets, they would be able to argue for more access to northern markets for their manufacturing products. So, they acceded to the pressure from Northern finance to liberalize their financial markets at least partly because it fit in with their plans to overcome the limits of their export-led growth strategies.

In combination with the increased pressure from Northern financial institutions to find markets for their loans and services, this produced a rapid expansion of foreign capital into East Asia in the 1990's.

While extremely interesting, this argument may not apply equally to all of the East Asian countries. In South Korea, there seems to be relatively little evidence that financial liberalization was pursued as a result of internal pressures of the kind described by Ghosh and Chandrasekhar. (eg. Crotty and Lee, 2001.). On the other hand, the cases of Malaysia and Thailand might fit better.

In any case, what is impressive about their story is that, they are trying to answer the important questions and looking in the right places: it is not enough to say that these countries faced pressure from the northern banks and governments to liberalize. The key question is, what domestic political and economic coalitions ultimately supported the liberalization process and why? Future research is needed to elaborate on the answer.

IV. Imperialism by a Different Name?

Ghosh and Chandrasekhar also confront the sticky question of what is left of the theory of imperialism, in light of the great success stories of East Asian economic development. They concede that some simplistic theories, which claim that developing countries cannot industrialize if they integrate into the world economy, are wrong. However, they do argue that the Asian financial crises calls into question whether large numbers of developing can generate sustained economic development by relying on foreign capital, and in particular, foreign direct investment (FDI) which has been hailed as the "good kind" of foreign capital, usually as part of an export-led growth scheme.

First, they point out the FDI flows are very concentrated among a handful of developing countries. Second, they argue that FDI is not more stable than portfolio capital flows, emphasizing the argument that they are highly sensitive to exchange rate changes. Third, they argue that foreign capital, including FDI has a "homing pigeon" instinct (p. 90) so that, at the first sight of trouble, it returns home leaving the developing country high and dry.

Finally, and most interestingly, they argue that FDI is best seen as part of a strategy of inter-capitalist rivalry by nations and corporations based in the northern

countries. As such, companies are highly mobile and move around in response to changes in the imperatives or this rivalry, and will contribute to long run development goals only by accident, and in the relatively short term. The fears of large movements of MNC's out of East Asia into China in response to China's entry into the WTO is a case in point.

Hence, according to Ghosh and Chandrasekhar, it is a dangerous and ultimately self-defeating strategy for developing countries to focus on attracting foreign capital, *including foreign direct investment* – as the basis for their development strategy.

One question not seriously dealt with in this context is the following: if FDI is part of an inter-capitalist competitive rivalry among mostly northern based companies, why can't developing countries use that rivalry and competition to their own advantage: why can't they play one company off against the other, much like MNC's try to play one country off against another? The answer must surely lie both in the relative scarcity of foreign capital in a world in which attracting it has become an ideological obsession in the developing world; and the second must have to do with the structure of the international financial and trading system, which makes it difficult for developing countries to join forces to manage and control the more destructive practices of these MNC's.

Is the upshot of this argument that countries should eschew foreign capital entirely?

V. Kicking the Habit: An Alternative to Foreign Capital Addiction

In the last chapter of the book, the authors develop an alternative to export-led growth and the associated dependency on financial liberalization and foreign finance. In doing so, they do not follow many of the formulaic approaches which are often proposed. In particular, they do not argue for autarky, or even for a return to the import substitution policies of the 1950's and 1960's. Nor do they argue for foregoing all foreign finance. Instead, they propose a policy which emphasizes developing the home market and domestic sources of supply and demand, while arguing for foreign trade and finance as supplemental or secondary aspects of the development policy. The chapter in which this policy is proposed suggests that this is a policy for India, but presumably it has broader significance. (Chapter 10).

The discussion in this chapter shows a valuable awareness of the need for a broad set of institutions and policies necessary to support real development. It does not promise a silver bullet, such as the neo-liberals often propose: "free markets", "export-led growth", "financial liberalization" are examples of the simple medicine often peddled by neo-liberal economists and policy makers. Rather, tax reform to cut budget deficits, land reform, some liberalization combined with regulation are all aspects of a sensible policy. In some ways this is at first dissatisfying because it feels so vague. But at the level of analysis adopted by the book, and given its length, in a sense one could not reasonably expect anything more specific. Sensible policies must be tailored to the particular institutional structures of each country and cannot rely on cliché's.

Still, there are some odd aspects of the suggested policy responses. For example, the authors argue that the international financial system needs a hegemonic country to organize it, ala Kindelberger's discussion of the great

depression. (p. 116) This is proposed with little discussion. And while it was a popular argument to make in the 70's and 80's (indeed, I believe I made this argument in print at the time) it seems a little odd in the early part of the 21st century in light of the fact that there is a hegemonic country once again: namely, the U.S. And it hasn't done much with its hegemony to prevent financial crises. In fact, quite the contrary. Moreover, true cooperation among a large number of countries could provide real financial stability. In short, I suspect that hegemony is neither necessary nor sufficient for financial stability.

Some lapses notwithstanding, the discussion on policy, though brief, is nonetheless worth taking seriously. (Also, see Grabel, forthcoming) It implicitly proposes a challenge to those of us working on alternatives to neo-liberalism: develop country specific, and concrete alternatives to the one size fits all policies of the IMF. Thankfully, many progressives are taking up the challenge and their ideas can be found, among other places, on the web site developed by the authors: (www.networkideas.org). Consult this site, and having had your appetite whetted by Crisis as Conquest, try to wait for Ghosh and Chandrasekhar's next book. I know I will.

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