Is an Asian crisis imminent?

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It is now more than four years since the onset of the real economy recession in the US. It is also close to five years since the disclosure by investment-banking firm Bear Stearns that two of its subprime mortgage-linked funds were worthless, which signalled the onset of the financial crisis. Yet the global economy has not emerged out of both crises.

In the January 2012 Update of its World Economic Outlook, the IMF has revised downwards by three-fourths of a percentage point (to 1.2 per cent) its global growth forecast for 2012. It also fears that things could be even worse. According to Olivier Blanchard, the IMF's Economic Counsellor "the world recovery, which was weak in the first place, is in danger of stalling. The epicentre of the danger is Europe, but the rest of the world is increasingly affected." The IMF has also noted in a parallel January Update to its Global Financial Stability Report that: "Since the last Global Financial Stability Report (GFSR), risks to stability have increased, despite various policy steps to contain the euro area debt crisis and banking problems."

Even Asian countries, especially China and India, which were not affected by the financial crisis and even remained the fast growing poles in a recession hit, multi-speed global economy, are expected to slow. But this may not be their main problem. Their problem could be that in the geographic shift of the financial crisis from the US to Europe and further they could be the next destination.

The crisis came to the US because finance had, in search of profits, grown too big and diverse for its own good and the good of the rest of the economy. It is true that under developed capitalism some diversification away from material production, including manufacturing, to services, with finance playing an important role, is inevitable. But this was not principal factor contributing to the unsustainable size and ambit of finance capital. It was the "unshackling" of finance.

If we go behind the many proximate causes and explanations of the crisis, there is one fundamental factor that is seen as underlying the phenomenon. That was the inability of capitalism after the crisis of the late 1960s to sustain a regime of stringent control over finance capital. High inflation in the context of a regulated interest rate regime meant that deposits in banks were earning a negative return. So depositors were pulling their savings out of the banks to invest elsewhere, threatening the viability of the banks. In a desperate response the government in the US dismantled controls on interest rates, paving the way for the process of financial liberalization that culminated in the Financial Services Modernisation Act of 1999. This explains finance capital's unbridled growth.

Since an expanding financial sector needs a growing clientele, financial markets must extend their reach beyond their traditional clients such as governments and productive entities, to encompass new markets and a rising share of the

populace at large. The system must make spending today based on expected incomes in the future the norm. Expanding the universe of borrower in this fashion implies the proliferation of risk. To deal with that proliferation the system seeks, through means such as "securitisation" or the bundling of credit assets for subsequent sale, to transfer and share risk. This, in turn, leads to a whole host of new markets and instruments that constitute the world of "financial innovation". These techniques are then embraced in all markets, including for example the market for commodities, resulting in a substantial increase in what is in essence speculative activity aimed at garnering profits from speculation. However, much of profit in this world is merely "nominal" and predicated on the continuance of the speculative tendency. Only so long as that tendency is underway can such "profits" be substituted for purchasing power over goods and commodities.

The framework regulating this world consists of a set of principles and institutions shaped by finance itself, making it more in the nature of self-regulation. At the apex of that framework sits the Basel Committee with its norm and rules such as those relating to capital adequacy. It relies on market institutions like the credit-rating agencies and on models developed by the financial institutions themselves. Regulation by the state gradually withers away making legislation such as the Glass-Steagall Act a relic of the past.

This does not, however, mean that the state withdraws. While state-direction and regulation is diluted, the state gains in importance in three ways. To start with, it ensures access to easy liquidity, which is crucial for sustaining the speculative boom. Secondly, the state is important inasmuch as it steps in to prevent the failure of particular financial entities (such as the Savings & Loans institutions in the 1980s) or specific markets (such as the debt market in Lain America), by resorting to bailouts if necessary, so as to prevent a systemic crisis. Finally, the state sustains financial proliferation by policies, such as reduced taxation of the rich, which put money in the hands of high net worth individuals who can invest in financial assets. In these ways the state supports the expansion of finance through the proliferation of risk.

The crisis of 2008 made clear that self-regulation and state action of the kind noted above cannot in the final analysis prevent a systemic crisis of immense magnitude. What is more, in the aftermath of that crisis, the world has witnessed two peculiar tendencies. One is that while state support has helped financial institutions transit from near-insolvency to profit, households are still trapped in debt and much of the real economy is still in crisis. While finance has been rescued, its clients are still in crisis, and therefore unwilling or unable to take on debt to sustain financial activity.

The other development of significance is that, having borrowed to finance massive bailouts, governments in the developed countries have seen a burgeoning in the volume of their indebtedness. The result has been a revival of conservatism in the fiscal policies in the developed counties. Though the real economy crisis persists, there is a call to replace stimulus packages with austerity measures in the budgets of governments. This limits the space for

expansion of finance based on public debt and private corporate investment in the developed countries.

In sum households, corporations and governments in the developed world are no more serving as the principal clients of global finance. What this implies is that a revived finance capital must depend on alternative sites for generating profits from speculation and even seek new frontiers for finance. This is not a new exercise. Looking back to the initial years of financial proliferation after the Great Depression, which were in the 1980s, the new non-developed country frontier for finance was Latin America in the 1980s and then, till the S.E. Asian crisis, East Asia. After the latter crisis Asia had, partly perforce, to reduce its exposure to international finance. But this reduced exposure has over the last decade made it a potential hunting ground for finance capital seeking to diversify to new markets. This together with the region's better growth performance has made Asia once again a "new frontier" for finance.

There was substantial evidence of this before the 2008 crisis. Between June 2003 and June 2007, total foreign claims of reporting banks increased by 112 per cent with in the developed countries, 102 per cent in offshore tax havens and a much higher 163 per cent in the developing countries. There was also a high degree of concentration of flows to developing countries in Europe and the Asia-Pacific. These inflows reflected the accumulation of speculative positions by many investors. While the outstanding values of all kinds of international assets held by banks doubled during the surge, derivative contracts, especially over-the-counter derivative contracts had increased by much more.

The surge points to a supply-side push of capital into the stock, credit and real estate markets in the so-called "emerging economies". That tendency was strengthened by voluntary financial liberalization in many of these countries. The return of financial capital to Asian markets after the 1997 crisis was facilitated by processes of internal liberalization in the countries that were adversely affected by the 1997 crisis. In return for negotiating a "solution" to the crisis finance capital demanded and won policy changes that gave them not just access to these markets but a playing field similar to what they were accustomed to in liberalized markets at home. Soon, the competition among countries to attract foreign finance meant that these policies were adopted even in countries that were not so adversely affected by the 1997 crisis.

Those policies not merely facilitated the cross-border flow of finance but also sought to attract the financial institutions from the developed countries that were the carriers of capital. This required the creation of an environment in which these institutions could replicate their financial policies and trading practices in the developing countries. Not surprisingly Asia has witnessed the accelerated adoption of Anglo-Saxon financial policies and standardized global regulatory frameworks like the Basel norms.

What is surprising is that despite the 2008 crisis, which starkly revealed the dangers associated with unshackled finance, this process of financial liberalization in Asia is continuing. Tendencies that could be termed "structural contagion" or "policy contagion" are clearly visible today. In India, for example, the government has in in recent months removed controls on interest rates on

savings deposits and permitted individual foreign investors or "qualified foreign investors" to enter domestic markets.

This is having its effect on capital flows. It is true that immediately after the 2008 crisis it appeared that finance capital was exiting emerging markets because profits had to be booked and investments liquidated there in order to meet commitments or cover losses in developed country locations. This affected Asia too. But what has surprised many is that this reverse flow was quickly reversed. In fact, a significant part of the cheap liquidity that was pumped into the system after the crisis to bailout banks and stimulate the economy in the developed countries has found its way to emerging markets, especially in Asia, resulting in an appreciation of their currencies and a boom in their financial markets. Asia is once again a new frontier for finance.

It is in this context that we have to turn to the lessons of the 2008 crisis, which showed that tendencies of this kind create the environment not just for microeconomic failures of individual institutions but systemic failure. As noted, such tendencies have not been reined in but strengthened in Asia after the 2008 crisis, in order to attract institutions and their capital from the developed financial world. In the developed counties too there has been no effort to restore elements of the regulatory framework dismantled since the 1980s, when the shift from structural to market-mediated regulation occurred. If finance capital in the developed world has not been reined in after the crisis and emerging Asia has not been deterred from adopting deregulation and financial innovation that characterized pre-crisis America, then the surge of capital to Asia is likely to continue. In that case risk is likely to proliferate and Asia could become the venue for the next crisis precipitated by speculative finance.