Frontier
Vol. 44, No. 6, August 21-27, 2011

REVIEW ARTICLE

NOWHERE TO HIDE

Douglas Porpora

NOWHERE TO HIDE BY Michael Lim Mah Hui and Lim Chin is another *Book on the financial crisis, although with added attention to Asia. In addition to the regional implications of the crisis for Asia, what makes this volume different from so many others is its critical perspective.

The book thus reflects an insider's view of the banking system that is informed by a critical, political-economic perspective. As such, *Nowhere to Hide* makes a good companion to Monthly Review's own *The Great Financial Crisis* by John Bellamy Foster and Fred Magdoff. Indeed, there is a close connection between these works, symbolized by the incorporation of Foster and Magdoff's title into the subtitle of *Nowhere to Hide*.

According to Lim and Lim (the two are unrelated), the failure of two Bear-Stearns hedge funds invested in subprime collateralized debt obligations was the trigger, rather than the cause, of the collapse. Lim and Lim locate the cause instead at three different levels: (1) the theory and methodologies underlying the disciplines of economics, finance, and risk management; (2) poor regulatory practices; and (3) the kinds of structural changes in both the United States and the international economies in relation to which the authors cited Foster and Magdoff's article, "Financial Implosion and Stagnation: Back to the Real Economy," in the December 2008 *Monthly Review* (written as the final chapter of The Great Financial Crisis).

At the first level, the level of neoclassical economic theory and finance, Lim and Lim fault the Efficient Market Hypothesis (EMH), along with its assumption that asset values are always at the correct price. One problem with EMH that Lim and Lim cite in particular is the assumption that risks are normally distributed, when in fact they frequently conform more to t-distributions.

T-distributions, say Lim and Lim, are like normal distributions although with "fatter tails." The effect of fatter tails is to make extreme risks more likely than a normal distribution would predict. Thus, planning according to a normal distribution will not adequately prepare against the eventuality of extreme results. According to Lim and Lin, that theoretically induced miscalculation was part of what befell the banking industry. Against EMH, Lim and Lim, like Foster and Magdoff, go back to Hyman Minsky to propose a Financial Instability Hypothesis, suggesting that financial markets are intrinsically unstable and subject to boom and bust.

One of the more valuable contributions of the book is its explanation of the dizzying array of financial instruments-derivatives, mortgage-backed securities, structured investment vehicles, leveraging, and credit-default swaps-made simple for laypersons to understand. For most of us approaching the disaster from the outside, this excursus from someone who has worked in the banking and financial system is particularly informative.

While the banking system was expanding in all these novel ways, Lim and Lim argue, the federal government was relinquishing control. As did much of the new regime of accumulation, the loosening began under President Ronald Reagan with the passage of the Garn-St. Germain Act, which allowed savings and loan associations to diversify into riskier ventures. The result some years later was the widespread bankruptcies among these organizations.

Undeterred, the commercial banks sought the same release from regulation. That release was granted under President Bill Clinton. Replacing the Glass-Steagall Act, the Graham-Leach-Bliley Act of 1999 henceforth allowed commercial banks to trade and underwrite all kinds of securities. The result was the emergence of an unregulated shadow banking system in highly leveraged debt and securities.

Ultimately, however-and here building explicitly on some of the analysis from the pages of Monthly Review- Lim and Lim blame the crisis on structural changes and macro-economic imbalances. In particular, they cite three structural macro-economic imbalances that contributed to the crisis: the current account imbalance, the imbalance between the financial and real sector (what many term the "financialization" of the economy), and the income and wealth imbalance.

While the current account imbalance among international trading partners is well known and discussed, establishment economists like Alan Greenspan and Ben Bemanke blame the imbalance on the surplus-producing countries. On the contrary, Lim and Lim say, the problem derives from the privileged position the United States enjoys to live beyond its means, a privilege that derives from the dollar's status as the principal international currency of foreign exchange. They say one of the challenges for Asian countries with huge foreign exchange surpluses is to seek alternatives to the US dollar as the dominant international reserve currency.

One of the most interesting and novel parts of the book is Lim and Lim's exposition of the relationship between inequality and financial crisis-an imbalance that the authors say is neglected in most mainstream discussions of the crisis. The authors marshal an array of data to show the increasing inequality in the United States since the mid-1970s, the most interesting being the divergence between productivity and labor compensation. Wage stagnation necessarily results in "under-consumption" for the majority of working class, but this was "resolved" through household debt accumulation, leading to a debt bubble that eventually burst. Higher up the socioeconomic ladder, extreme concentration of income and wealth in a tiny minority created an asset bubble, as people with massive wealth placed their savings in the hands of bankers and financiers who invented a dazzling array of financial instruments with high leverage and gigantic gains. This asset bubble also eventually exploded.

Interestingly, this thesis is gaining more momentum, even in establishment circles. A very recent IMF working paper in November 2010 comes to conclusions similar to what Lim and Lim advanced.

In their last chapter, Lim and Lim maintain that the future rests on outcomes in three contested terrains. Internationally, there will be a growing contest over the dollar's primacy and the global dominance of the United States. In the economy, there will be continued contention over balance between the financial and nonfinancial sectors, a battle in which the role of regulation will be key. And in the academy, Lim and Lim argue, there will be growing contestation between the followers of Keynes and Minsky on the one hand and the neoliberal market fundamentalists on the other.

The so-called Asian Financial Crisis (AFC) of 1997, they say, was not the bust of a normal business cycle but the product of an external shock-the great influx of foreign capital chasing higher yields in emerging markets. Much of this inflow inevitably went into speculative ventures in stock or property markets. The results "were asset bubbles and over-leveraged corporations with foreign currency loans that imploded when sudden massive reversal of capital flows caused huge depreciation in the borrowers' currencies". In contrast with the United States, Asian countries seem to have learned something from the AFC. They reined in speculation and leveraging, nationalized nonperforming banks, and instituted extensive reforms in their financial and legal sectors.

One extremely important factor, Lim and Lim note, was the reduction of corporate debt to equity ratios, which, between 1996 and 2007, declined from 41 percent to 13 percent in the Philippines and from 119 percent to 46 percent in Indonesia. Along with a healthier global environment for exports, the Asian economies managed eventually to turn current account balances from deficits to surpluses. Thus, by 2007, the various Asian countries, particularly China, had accumulated strong foreign currency reserves.

Still, owing to the export-led nature of their economies, when the Western financial crisis hit, the Asian countries suffered a great loss of demand. The result was an even greater contraction of GDP in Asia than among the Western countries, where the crisis had originated. Whereas between 2007 and 2009, the Dow Jones Index had dropped by 34 percent and the UK FTSE by 30 percent, the Japanese Nikkei fell by 42 percent and the Shanghai Composite by 64 percent. During the same period as well, the Asian currencies depreciated, particularly the Korean *won*, which was hardest hit because of its greater exposure to foreign portfolio investments.

The Asian response to the crisis was primarily a large fiscal stimulus. The Chinese stimulus package represented 12 percent of GDP, followed by Malaysia's stimulus package amounting to 9 percent of GDP, Singapore's 8 percent, and Korea's 7 percent. In all cases, the stimulus packages exceeded those extended by the United States as a percentage of the GDP.

Evidently, the strategy worked. If the economies of the Asian countries have since bounced back, it has been partly because of the resurgence within them of regional and domestic demand. The intriguing question that Lim and Lim raise is whether the Asian countries are managing to decouple their economies from those of the G-2 countries. For that to happen, however, Lim and Lim say that the Asian economies will need to reduce their own domestic inequalities in wealth and income, which, as in the West, place limits on aggregate demand. In a fascinating chapter on this topic, Lim and Lim assess the likely course ahead.

Clearly written and addressed to a mainstream, popular audience, what makes *Nowhere to Hide* most noteworthy is its crossover nature. Penned from within the establishment, it nevertheless contains the crux of a more radical critique. □□□

---

*NOWHERE TO HIDE : *The Great Financial Crisis and Challenges for Asia*
by Michael Lim Mah Hui and Lim Chin
Singapore : Institute of Southeast Asian Studies, 2010, 200 pages, $39.90, Paperback.