BOOK REVIEW

Financial crisis: Warning of what lies ahead

Title: Nowhere To Hide: The Great Financial Crisis And Challenges For Asia
Authors: Michael Lim Mah-Hui & Lim Chin
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The ongoing problems of Greece and the euro zone provide a timely reminder that the recent global financial crisis is not over. Indeed, increasingly frequent financial crises may now be “the new normal” in the global economy, with attendant implications for Asia.

Dr Michael Lim Mah-Hui, an experienced international banker, and National University of Singapore Business School’s Professor Lim Chin have produced an extraordinarily useful guide to understanding the phenomena at work. The slim volume explains, in language (mostly) intelligible to the layman, what happened, the causes and how we will continue to be affected.

Dr Lim and Prof Lim (no relation to each other or to this reviewer) expertly draw together, and neatly connect, the various explanations that have been given of the crisis, which originated in the United States.

Financial liberalisation and deregulation encouraged and enabled the creation of new financial instruments with which investors (and their financial institution agents) could make ever bigger bets on how particular financial assets (like “packaged” sub-prime mortgages) would move in the marketplace. With the miracle of leverage, if their bets worked out, they could earn 20 to 50 times (or more) what they invested, and if not – well, they could always insulate themselves with another financial institution (say, American International Group) and pass the losses on to someone else.

Needless to say, such “sophisticated” financial innovations led to ever more risky behaviour on the part of financial market actors. A prolonged period of low US interest rates encouraged such risk taking. So did the wall of cheap money flooding into the US (and other developed country markets, including the euro zone) from the ballooning current account surpluses of oil-exporting countries and manufacturing exporters.

This much of Dr Lim and Prof Lim’s analysis is by now conventional wisdom, and the problems thus identified could arguably be solved over time through public policy – specifically, some degree of global financial re-regulation and macroeconomic rebalancing: the US and Europe to save more and cut their budget deficits; Asia and other emerging markets to shift from export- to domestic consumption-led growth.

What is more disturbing, though not necessarily controversial, is their argument that the world economy is in this situation because:

■ the expansion of the financial sector to dominance over the real (goods- and services-producing) sector of the US economy, leading to “regulatory capture” of the political process by financial market actors; and

■ increasing income and wealth inequality in the US and other developed economies, leading to excessive indebtedness (especially housing indebtedness) of the household sector, and excess savings among the ultra-high earners, which then feeds asset-price inflation.

Combined with the globalisation of capital flows, these trends exported debt, bubbles, financial instability and crises around the world, especially to small open economies like Dubai, Iceland, Ireland, Greece and Latvia, whose problems then have the capacity to ricochet around the world.

A major channel of such contagion is the very global financial institutions responsible for the risky financial innovations in the first place. They funded Dubai real estate and bought Greek government bonds. And their highly compensated upper-level employees, rewarded for taking risks with “other people’s money”, contributed to the income and wealth inequality that, Dr Lim and Prof Lim argue, was part of the fabric of this crisis, and will be of future ones.

The challenges for Asia that the authors identify include the limits of export-led growth; the dangers of free capital flows; and foreign exchange reserves now over-invested in the US.

For Singapore – a small and extremely open economy heavily dependent on volatile manufactured exports and international capital flows – this thoughtful book provides a sobering look back that is also a warning about what is still to come, if we, and the world, do not change.

The writer, a Singaporean, is professor of strategy at the Rosen School of Business, University of Michigan.