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International Financial Crises: Scourge or Blessings in Disguise?

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Abstract

In this article, the authors study the consequences of financial crises in Argentina, Brazil, South Korea, Malaysia, Mexico, Thailand, and Turkey and present an attempt to identify winners and losers during and after the crises. Through empirical analysis, the authors find that financial crises seem to benefit certain segments of international finance capital, and domestic capital, and structural changes imposed on the economy to remedy the situation further the interests and power of capital in general.

JEL classification: *F02, F3, F5*

Keywords: *financial crisis; finance capital; IMF; external debt; precautionary cost*

1. Introduction

The current international financial system is characterized by an increasingly liberalized environment where finance capital is free to roam the world in search of the highest return. Policy reforms around the world tend in that direction, with a focus on price stability, central bank independence, the privatization of state-owned enterprises, the abrogation of trade and capital controls, and so forth. As a result, flows of financial capital from "developed" countries toward "emerging markets" have surged, taking the form of portfolio investments in liquid assets or the acquisition of local productive assets and financial institutions by multinational corporations. Within "developing" countries, significant changes took place in the balance of power between labor and capital, in favor of the latter, giving rise to increasing unemployment, decreasing real wages, and decreasing unionization and labor activity (Duménil and Lévy 2003; Harvey 2003).

Although the capitalist system was thus evolving, there was a concomitant increase in the frequency of financial crises (Eichengreen 2002). This raises questions regarding the effects these crises could have on the system. Financial crises have been variously described as being deleterious for the international financial system or a way whereby its extension and reproduction are affected. However, there does not seem to exist any thorough empirical analysis to support either of these contentions. We

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Table 1
Net FDI as a Percentage of GDP

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Argentina	1.30	1.29	1.94	1.18	1.41	2.17	2.55	3.13	2.44	8.46	3.67	0.81	2.11	1.27	2.67
Brazil	0.21	0.27	0.53	0.29	0.56	0.69	1.45	2.43	4.05	5.33	5.45	4.42	3.60	2.01	3.01
South Korea	0.30	0.38	0.22	0.16	0.19	0.34	0.42	0.55	1.57	2.10	1.81	0.73	0.44	0.53	1.20
Malaysia	5.30	8.14	8.76	7.48	5.83	4.70	5.04	5.13	3.00	4.92	4.19	0.63	3.36	2.38	0.00
Mexico	1.00	1.51	1.21	1.09	2.60	3.32	2.76	3.20	2.66	2.79	2.91	4.46	2.36	1.82	2.43
Thailand	2.86	2.05	1.90	1.44	0.95	1.23	1.29	2.58	6.54	4.99	2.74	3.37	0.75	1.36	0.87
Turkey	0.46	0.52	0.49	0.35	0.43	0.46	0.34	0.29	0.29	0.08	0.06	1.97	0.52	0.52	0.65

Source: United Nations Conference on Trade and Development Balance of Payments Database and World Bank World Development Indicators Database.
Note: FDI = foreign direct investment; GDP = gross domestic product.

propose to bridge that gap by taking a look at different crisis experiences that occurred in recent years. In doing so, we focus on processes related to the movements of financial capital, policy reforms, debt accumulation, and the evolution of the internal balance of power between labor and capital in countries affected by financial crises. In this article, we lay out the preliminary steps of such an analysis for seven countries that have experienced major financial crises in the 1990s and 2000s—namely, Argentina (2000–2001), Brazil (1998–1999), South Korea (1997), Malaysia (1997), Mexico (1994), Thailand (1997), and Turkey (1994 and 2000–2001).

2. Investment

A proximate effect of a financial crisis is to weaken the domestic financial system of the country beset by the crisis in ways that can reverberate in the nonfinancial sector. The resulting general destabilization of the economy can reduce the scope for profitable investment or simply frighten investors away by increasing their perception of risk in that country. This could in turn be expected to lead to a decrease in investment inflows. At the same time, the difficulties experienced by the domestic financial and nonfinancial sectors provide a space for international capital to extend its reach within both sectors. Otherwise viable domestic firms coming under strains could be taken over by international capital or displaced by the affiliates of multinationals, so that an increasing share of the economy comes under the control of international capital. The devaluation of the currency further contributes to making the price of the assets of struggling domestic firms attractive. In this perspective, foreign direct investment (FDI) could flow in during financial crises and their aftermath, which should eventually translate into profit outflows.

Patterns of foreign investment in the eight crises under examination roughly conform to what we would expect if international financial capital[1] was indeed to seize the occasion offered by financial crises to increase its hold over the economies beset by the crises. Table 1 shows net FDI inflows for the period of 1990–2004. FDI increases both during and after financial crises in Brazil, South Korea,

1. By *international financial capital*, we refer to finance capital and capitalists that operate on a world scale. We also sometimes use the broader term *international capital* to include multinational and transnational firms. By employing such large categories, we do not mean to suggest that all sections of international capital always cooperate, have the same interests, or gain equally from situations of crisis. However, because a detailed breakdown of gains and losses lies mostly beyond the scope of this article, we retain the aggregate categorization in most instances, despite the analytical imprecision it implies.

Table 2
Net Returns From FDI as a Percentage of GDP

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Argentina	0.45	0.42	0.40	0.55	0.61	0.62	0.60	0.64	0.64	0.53	0.74	0.28	–0.23	0.47	1.28
Brazil	0.40	0.25	0.19	0.41	0.36	0.29	0.33	0.64	0.77	0.68	0.54	0.91	1.08	1.01	0.96
South Korea	–0.04	–0.03	–0.01	–0.02	–0.07	–0.03	0.01	0.02	0.39	0.36	0.15	0.24	0.25	0.21	0.17
Malaysia	4.23	4.52	4.84	4.63	5.15	4.57	4.30	4.99	4.01	6.68	8.19	6.82	6.24	5.98	na
Mexico	0.88	0.79	0.64	0.62	1.14	1.49	1.21	0.94	1.25	0.73	1.02	0.83	0.43	0.19	0.30
Thailand	0.36	0.06	na	na	na	na	na	na	na	na	na	na	na	na	na
Turkey	0.11	0.10	0.09	0.14	0.08	0.16	0.10	0.08	0.11	0.09	–0.04	–0.04	0.05	0.17	0.26

Source: United Nations Conference on Trade and Development Balance of Payments Database and World Bank World Development Indicators Database.
Note: FDI = foreign direct investment; GDP = gross domestic product.

Mexico, Thailand, and Turkey. The increases in Brazil, South Korea, and Thailand are both fairly high and short lived, whereas they are more gradual in Mexico and Turkey. It is possible that the effect in these latter cases was more to pry the doors open to international capital, giving rise to a more sustained process of increasing foreign involvement in the country's economy, rather than providing a one-time opportunity to capture part of it. We see a somewhat different outcome in Malaysia, where FDI may have been stemmed or deterred by the array of capital controls put in place at the time of the crisis, though it quickly resumed afterward, as well as in Argentina, where FDI appears mainly linked to the privatization bonanza of the second half of the 1990s.

These FDI inflows following financial crises should, with a little lag, result in an increase in the amount of resources transferred out of the country in the form of returns to FDI. This is indeed what happens in Brazil, South Korea, Malaysia, Mexico, and Turkey, as reported in Table 2.[2] It is interesting that the increases to the returns from FDI are sustained in all these countries, despite the fact that South Korea and Brazil had only experienced short-lived booms; although spurts of FDI inflows might be temporary, there is a certain permanence to the drain on domestic income they impose. Expectedly, the picture differs in Argentina, where FDI flows were not tied to the financial crisis.

Investment can also take the form of portfolio flows, which are somewhat more volatile than FDI. Portfolio flows often contribute to the build-up of a financial bubble before the crisis, only to dry up and reverse direction when troubles start brewing. It might be a sensible assumption that among financial capitalists, the holders of portfolio investments would be hit the hardest, notably those who do not manage to exit in a timely fashion. In Table 3, we observe that not only is portfolio return positive during every crisis we analyze, but in some cases, such as in South Korea, Brazil, and Malaysia, it reaches record heights at those moments. Although the revenue outflow from portfolio investment then decreases in some cases, it stays fairly high in Mexico, Argentina, Brazil, and Turkey for several years after the crisis. Overall, portfolio investment appears to be another channel whereby international capital manages to siphon off resources from countries in the thralls of financial crises.

3. External Debt

Financial crises are expensive, very expensive, and governments often bear the brunt of the costs, be it in their efforts to provide resources for the overhaul of the domestic financial system or the

2. Data for FDI returns and portfolio returns are not reported separately for Thailand for the period we examined.

Table 3
Net Returns From Portfolio and Other Investment as a Percentage of GDP

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Argentina	2.66	1.82	0.69	0.72	0.83	1.19	1.43	1.47	1.83	2.10	1.91	2.41	7.55	5.67	4.51
Brazil	2.11	2.12	1.86	1.92	1.28	1.26	1.23	1.38	1.74	2.86	2.45	2.99	2.89	2.68	2.47
South Korea	0.27	0.26	0.30	0.32	0.35	0.41	0.43	0.61	1.35	0.91	0.43	0.11	–0.23	–0.21	–0.19
Malaysia	0.03	0.46	0.42	0.12	–0.30	0.07	0.29	0.20	1.22	0.06	–0.05	0.54	0.36	–0.52	na
Mexico	2.52	2.03	2.07	2.27	1.92	3.18	3.06	2.24	2.01	1.89	1.49	1.39	1.41	1.46	1.37
Thailand	1.54	2.02	1.93	2.01	2.08	2.27	2.86	3.41	4.46	3.64	2.51	4.50	3.70	na	na
Turkey	0.00	0.00	0.02	–0.15	0.42	0.44	0.29	0.03	–0.01	–0.05	0.22	0.48	0.45	0.50	0.39

Source: United Nations Conference on Trade and Development Balance of Payments Database and World Bank World Development Indicators Database.
Note: GDP = gross domestic product.

Table 4
External Debt as a Percentage of GDP

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Argentina	44.03	34.48	29.87	27.23	29.07	38.17	40.82	43.76	47.30	51.37	51.87	57.33	146.89	128.16	110.61
Brazil	25.97	29.71	33.04	32.88	27.91	22.79	23.40	24.52	30.68	45.69	40.45	45.45	50.59	46.78	36.76
South Korea	na	na	na	na	na	na	na	na	na	na	na	na	na	na	na
Malaysia	34.82	34.76	33.84	39.09	40.73	38.66	39.34	47.15	58.76	52.94	46.36	51.24	50.67	46.69	44.07
Mexico	39.76	36.27	30.88	32.37	32.85	57.68	46.94	36.77	37.74	34.59	25.85	23.42	21.59	22.16	20.29
Thailand	32.92	38.38	37.49	42.11	45.34	59.58	62.11	72.70	93.79	79.10	64.95	58.15	46.79	36.23	31.73
Turkey	32.81	33.74	35.59	38.24	51.07	43.58	44.09	44.82	48.66	55.62	58.88	78.04	71.34	60.49	53.37

Source: United Nations Conference on Trade and Development Balance of Payments Database and World Bank World Development Indicators Database.
Note: GDP = gross domestic product.

takeover of nonfinancial enterprises whose failure is deemed undesirable. This is in addition to the fact that currencies must be supported and reserves reacquired. Given their suddenness, governments have to borrow a large portion of the funds needed to meet these obligations, not to mention that fiscal revenues are hurt by the havoc created in the wake of the crisis. Because the domestic financial system is in shambles and many of the government outlays require a disbursement of foreign currency, governments may end up borrowing large amounts abroad.

Accordingly, the external debt of the government of the countries under study jumps up quite spectacularly around the time of the crisis. Table 4 shows the change in the total external debt of the country as a ratio of their gross domestic product (GDP). The rise is most dramatic in Argentina, where it more than doubles as a percentage of GDP and reaches 146 percent in 2001, but important in Brazil, Mexico, and Turkey as well, where the increase ranges from 15 percent to 25 percent of GDP.

A large part of the funds borrowed appears to be sent back to international financial capital, either directly through capital gains opportunities for international financial capital following the change in the value of the currency or indirectly through the nationalization of a portion of private foreign debt. In the case of Turkey, for example, the Central Bank sold US $5 billion in one day alone, on the eve of the devaluation. As the currency lost about 30 percent of its value in the next few days, large capital gains could be made by purchasing back the Turkish currency (Dufour and Orhangazi 2006). These loans also do not come for free. Governments have to expend a large amount of resources to

Table 5
Debt Service as a Percentage of Exports of Goods and Services

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Argentina	37	34	27	31	25	30	39	50	57	75	70	43	16	38	30
Brazil	22	23	20	24	30	37	42	63	79	118	94	76	70	66	47
Malaysia	13	7	9	9	9	7	9	7	7	5	6	6	7	8	6
Mexico	21	24	34	36	26	27	35	32	21	22	30	25	23	22	22
Thailand	17	13	14	13	13	12	13	16	18	22	16	25	23	16	11
Turkey	29	32	32	29	31	28	22	21	24	36	36	41	47	39	36

Source: United Nations Conference on Trade and Development Balance of Payments Database and World Bank World Development Indicators Database.

service that debt, as can be seen in Table 5. However large this servicing obligation may be, though, there could also be an important nonmonetary cost.

The governments' desperate need for funds could push them into a certain degree of subservience with respect to the lenders, notably international financial institutions (IFIs), a power relation that the sheer size of the debt load would then help to keep in place. Some scholars claim that the infamous conditionalities imposed by the International Monetary Fund (IMF) are evidence of a relationship of debt peonage between IFIs and debtor countries (Harvey 2003; Stiglitz 2002; Wade 1998, 2000). The IMF typically asks for policy concessions both before it hands over the funds, at a moment when the government of the country under financial pressure has virtually no bargaining power, and afterward, as repayment conditions are negotiated, often in areas that have nothing to do with its mandate or the problem at hand whatsoever (Stiglitz 2002). This pressure from the IMF might explain the haste with which some countries, such as Argentina and Brazil, recently repaid their outstanding debt—before its maturity. The 2000–2001 crisis in Turkey offers a striking illustration.

As troubles had started to brew at the end of 2000 and the government of Turkey had already had recourse to a loan by the IMF, the Turkish government proceeded to provide a full guarantee to all creditors. After the crisis, the government stepped up the pace of privatization in key financial sectors and gave the Central Bank its formal independence and set inflation targeting as its main objective. Finally, banking laws were changed both before and after the crisis in line with the demands of finance capital (Dufour and Orhangazi 2006).[3]

4. The Cost of Precaution

Financial crises create disorder in countries they affect, disrupting the functioning of the economy in ways that are less than palatable to a large portion of the population. After they experience the dire consequences of a financial crisis, governments often strive to make sure it does not happen again. As regulatory interventions in the management of the capital account get a stern look under the new neoliberal orthodoxy, there is virtually only one way left for governments whereby they can protect their countries from the vagaries of international capital markets: pay tribute to industrialized countries, a.k.a. the emitters of hard currency. In Table 6, we present the total reserves held by these countries, excluding gold. The increase in foreign exchange reserves in Argentina, South Korea, Mexico, and Turkey following the financial crises that occurred in these countries are nothing short

3. See Crotty and Lee (2001) for an analysis of IMF conditionalities in the case of South Korea and Duménil and Lévy (2006) for Argentina.

Table 6
Total Reserves (Excluding Gold) as a Percentage of GDP

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Argentina	3.25	3.16	4.37	5.83	5.57	5.54	6.65	7.62	8.28	9.26	8.85	5.42	10.28	10.92	12.34
Brazil	1.61	1.97	5.77	6.98	6.79	7.06	7.53	6.29	5.41	6.48	5.40	7.03	8.18	9.71	8.73
South Korea	5.61	4.45	5.19	5.59	6.06	6.32	6.10	3.95	15.05	16.61	18.79	21.32	22.19	25.53	29.28
Malaysia	22.16	22.15	29.12	40.73	34.13	26.76	26.78	20.75	35.41	38.65	32.69	34.63	35.92	42.82	56.11
Mexico	3.75	5.64	5.21	6.23	1.49	5.88	5.84	7.17	7.55	6.60	6.11	7.19	7.79	9.22	9.38
Thailand	15.59	17.83	18.27	19.58	20.30	21.43	20.77	17.35	25.77	27.84	26.09	28.00	29.99	28.74	30.10
Turkey	4.02	3.41	3.88	3.50	5.53	7.35	9.08	9.86	9.76	12.70	11.29	13.00	14.72	14.14	11.78

Source: United Nations Conference on Trade and Development Balance of Payments Database and World Bank World Development Indicators Database.
Note: GDP = gross domestic product.

of spectacular. The Turkish case is especially telling, as each crisis leads to an immediate multiplication in reserves. The pattern is similar in Brazil and Thailand, although the rate of increase is lower in these countries and the evolution of the level of foreign reserves seems to be more affected by the passage of time than financial crises. Malaysia also presents a different picture: the level of reserves stays more or less put after the crisis before it increases dramatically in 2003 and 2004. We conjecture that the capital controls put in place right after the crisis may have decreased the need for reserves.

Traumas stemming from financial crises aside, the wave of capital account liberalization in "developing" countries has forced their governments to pad themselves against the possibility of undesired gyrations in the value of their currency. This is yet another cost of financial crisis, albeit a precautionary cost in that it is simply a fee paid for peace of mind. Resources are drained from these countries and lent to the governments of industrialized countries at rates of interest that are much lower than what these countries pay to service their own foreign debt. What is more, in none of the countries we study does there seem to be a bound on the amount of resources that need to be set aside for this precautionary purpose.

Reserves are not the only buffer in case of financial trouble. When the pressure starts mounting, the IMF can be—and is often—called on to provide emergency funding. All the countries whose crises we analyze did have recourse to the IMF in the midst of the turmoil, except Malaysia, which avoided this relationship. Table 7 shows that the typical pattern is that of a major disbursement around the time of the financial crisis and maybe also in the years immediately following it, while the country is reeling under the impact of the crisis, followed by a reimbursement process lasting several years. As we mentioned in the previous section, however, the lines of credit of the IMF come with unpleasant strings attached to them.

5. The Domestic Scene

The discussion has so far revolved around the interface between the international financial system and countries affected by crises. Financial crises could also have an important impact on the relations of production within a country and on the distribution of the social product, as well as constitute an occasion whereby the balance of power between labor and capital is modified. Although more work clearly needs to be done in this area, there seems to be evidence to suggest that financial crises hurt labor to a much greater extent than capital and that the distribution of income shifts in favor of the latter (Diwan 2000, 2001; Lee and Jayadev 2005). Crotty and Lee (2001) show how the power of labor was eroded by postcrisis policies. Moreover, Dufour and Orhangazi (2006) present evidence

Table 7
Relations With the IMF (in Millions of SDRs)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Argentina																
(1)	322	293	585	1,155	612	1,559	548	321	0	0	1,588	8,168	0	4,005	2,341	0
(2)	514	724	638	275	290	319	297	348	484	602	970	928	574	4,106	3,714	2,417
(3)	204	174	127	147	142	181	186	201	195	144	148	327	523	466	374	346
Brazil																
(1)	0	0	128	0	0	0	0	0	3,419	4,450	0	5,277	12,274	12,635	0	0
(2)	564	415	411	360	94	32	48	24	16	1,446	5,074	0	3,588	8,899	2,940	16,117
(3)	170	110	64	28	10	7	3	2	1	339	255	104	361	780	815	730
South Korea																
(1)								8,200	5,850	363	0	0				
(2)								0	2,050	7,900	0	4,463				
(3)								0	666	528	227	106				
Mexico																
(1)	1,608	932	233	0	0	8,758	0	0	0	1,034	905					
(2)	877	807	636	842	841	754	1,414	2,499	784	3,727	4,164					
(3)	384	395	357	305	163	359	448	351	312	202	116					
Thailand																
(1)	1,800	0	0	0	0	0	110	335	0	0	0					
(2)	0	1	207	285	193	189	257	235	61	0	0					
(3)	11	0	13	37	43	52	65	71	45	0	0					
Turkey																
(1)	0				236	225	0	0	0	583	2,622	8,895	9,929	1,191	794	1,666
(2)	36				0	0	0	20	165	210	66	868	4,916	1,224	3,158	5,267
(3)	3				3	16	20	21	18	8	40	339	628	639	647	644

Source: IMF.
Note: IMF = International Monetary Fund; SDRs = special drawing rights; (1) = total disbursements; (2) = total repayments; (3) = total charges and interest paid.

for Turkey that supports the view that workers were driven into subservience after the 2000–2001 crisis. Not only did the labor share of income and real wages decline, but labor unions lost membership and organized labor became much more quiescent, as evidenced by the fact that the number of days lost to strike dropped to historical lows.

6. Where Does This Take Us?

Our results thus far support the contention that financial crises are in fact beneficial for the international financial system and the fringe of finance capital that occupy its commanding heights. At the same time, there is some evidence that financial crises can lead to a strengthening of the position of capital within the countries beset by them. Pulling together the different strands of our analysis, there emerges a framework wherein these two tendencies can be investigated through a study of (a) the evolution of the balance of power between different groups in the system, and (b) the distribution of the social product among these groups.

Although our preliminary results reveal a change in distribution and power in favor of capital, financial crises also open opportunities for changes in the opposite direction. The Argentinean crisis of 2000–2001 stands as a case in point. After a decade of reforms that had made the country into a poster child for IMF liberalization cum privatization policy recommendations culminated in this dire financial crisis, several groups in society mobilized in an attempt to halt and reverse the thrust of these policies. The chaos created by the crisis and the loss in credibility of the policy package implemented in the 1990s created a space for alternative models to emerge. Financial crises can therefore have contradictory effects on the economic system.

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