ECONOMIC LESSONS FROM THE ASIAN MELTDOWN

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In late 1997, the United States and European markets were recovering from the first shocks from the Asian meltdown. Uncertainty ruled. Aftershocks still reverberated in global currency markets. Then even as predictions that the loss of Asian markets would hurt company earnings in North America and Europe, the "safe haven" effect began to come to the rescue. By early Spring, the bull market in the United States was roaring again. Asia was discounted—even as the U.S. Administration's efforts to get the $18 billion replenishment for the International Monetary Fund (IMF) stalled in the U.S. Congress.

Certainly, the deflationary effect of the Asian meltdown has not yet been fully felt as I write this in May 1998. Indeed, the American and European stock markets have been pumped up with billions in flight capital seeking safer havens. A fast feedback loop is created by the "herd behavior" of asset managers following asset allocation theory and obliged to buy the big indexes: Dow Jones, Standard and Poor's, and London's FTSE100. This herd behavior effect is reinforced in the United States by the "prudent man rule," which prevents asset managers from straying far beyond such blue chip stocks. I call it "the prudent lemming rule." All this feeds megamergers—usually seen at the top of bull markets—as CEOs with high-flying stock burning holes in their pockets seek new acquisitions.

Indeed, at the turn of the new century, well into the post-Cold War era, the world is still dealing with the unsolved twentieth-century dilemma of nations that collectively aspire to integrate their national markets more deeply. Generations of policymakers—observing the lessons of World War I, the League of Nations, the Great Depression, and World War II, culminating in the Bretton Woods accords of 1945—have drawn attention to three conflicting goals of nations and the various balancing acts they attempted: regulating and coordinating (a) exchange rates, (b) domestic monetary policies, and (c) international capital flows.[1] Economic ideologies have moved beyond the simplistic formulas of "sound money"—the gold standard and attempts to balance national budgets—after witnessing the costs in unemployment and social breakdown of the Great Depression.

But remnants of these earlier economic orthodoxies remain today in calls for unfettered markets, more privatizations, free trade, opening economies to global capital flows,

insulating central banks from "political interference," deregulating domestic economies, and making labor markets more "flexible," while downplaying concerns about human rights, labor, and environmental standards as "trade distorting." All such economic policies, still taught in many universities and business schools, assume efficient markets and full-cost prices—still far from reality. For two decades, I have stressed the need to correct prices to reflect external costs and to retrain all economists in anthopology, ecology, and systems, chaos, and game theory.

Different hypotheses concerning the so-called "new economy" can be seen within today's global context of social system transition. Some hypotheses set local, ethnic, community, and nationalistic backlashes against the backdrop of globalization. The unregulated $1.5-trillion daily global currency markets, the speculative 90 percent of which is unrelated to actual world trade, continues to erode the sovereignty of every nation—more visibly every day. Today's spreading global markets still operate with neo-classical economic-textbook theories of maximizing individual self-interest, efficient markets, privatization, smaller government—generally known as the "Washington Consensus." This one-size-fits-all recipe for economic progress, promoted by American efforts to link democracy with free markets and by the World Bank and IMF, is measured by growth of Gross National Product (GNP). Yet many economists, pressured by environmentalists and grassroots human rights groups and labor unions, now admit that this index is deeply flawed (omitting environmental costs and values as well as the annual $16 trillion of unpaid work in the world's household and informal sectors, estimated by the UNDP's *Human Development Report*, 1995). Meanwhile, useful, broader indicators are proliferating—from the UNDP's Human Development Index, the World Bank's Wealth Index, and many others.

Today's "new economy" and other hypotheses stem from different paradigms and interpretations, which produce conflicting forecasts of such factors as productivity, inflation, deflation, and effects of the Asian meltdown. Such statistical paradigms underlie GNP/GDP, Purchasing Power Parity, Consumer Price Indexes (CPI), and new approaches to include in national accounts: asset balance sheets, social and environmental capital, unpaid work, and externalities. Some of this statistical work is underway, but still underfunded—from retooling GNP/GDP to account for natural and human capital and subtracting social and environment costs to recalculating the CPIs. CPIs should reflect higher quality in some goods and the shift to services. Macro-economic policies should also account for the valuable public goods and services that add to quality of life but are unpriced (e.g., police and fire services, pollution abatement, the SEC, etc.), without which complex technological economies cannot function. Thus, the U.S. CPI may be overstated by as much as 1.5 percent, as the U.S. Boskin Commission says, or by more than this if the value of unpriced public services are factored in. Or the CPI could be *under*stating inflation if energy and food prices continue to be excluded from the "core" rate—along with depreciation of infrastructure and other national assets. *The Economist* now recommends adding financial and real estate asset inflation to Consumer Price Indexes (May 9, 1998). All this statistical revisioning will end up recalibrating U.S. Federal Reserve policy and the Non-Accelerating Inflation Rate of Unemployment (NAIRU), as well as the budget, Social Security, and the deficits. Meanwhile, GNP/GDP still lacks an asset account (except in New Zealand and Switzerland)—leading budgeteers to continue "expensing" long-term investments in infrastructure in a single year. Try running a corporate balance sheet that way! Thus we should all question traditional economics as we assess the Asian meltdown.

Today, the search for more comprehensive and dynamic models of our economies is made more urgent by recognizing statistical illusions that drove the Asian bubble and also

drive globalization and electronic markets. Forecasters from many disciplines—economics, technology assessment, game theory, ecology, or chaos and complex adaptive system models—now agree that equilibrium models drawn from Cartesian-Newtonian worldviews of a deterministic, "clockwork" universe no longer cut it. In fact, the post-Cartesian scientific principles that I have been urging for twenty years are now almost conventional wisdom. The tightly interactive global economy is increasingly dynamic—creating a world in a hurricane of change. Nations and institutions are restructuring because of such forces. Such a world cannot be understood by conventional macro-economic models assuming equilibrium. Economics textbooks' "Rational Economic Man" with his unchanging preferences still underlies macro-economic models and the statistics that drive most decision-making in our economies.

Contrary to observation, Rational Economic Man never learns or grows or changes his preferences for maximizing his material self-interest in competition with others. Psychologists would say that this model represents humanity's primitive reptilian brain. Robert Lucas won a Nobel Memorial Prize for promoting "Man's" higher forebrain functions and his rational expectations. But if these expectations fully discount all government actions and market information, this leaves us with only nihilism. In the face of new global conditions, from pollution, growing gaps between the rich and poor, spreading deserts, burning rain forests, and ozone depletion, Rational Economic Man waits for the market to act while Pareto Optimality (which assumes that information, wealth, and power are given) still rules its collective decision making. Technology is also assumed to be a parameter in most economic models—rather than as futurists see it, the driving variable of the still-evolving Industrial Revolution—now well into its post-industrial, information-technology-dominated phase. Yet while acknowledging these unrealistic assumptions, economics professors still keep on teaching with them.

Thus, futurists contend that most economic models in the public and private sector are still backing us into the future looking into the rear-view mirror. Human agents are still seen as either the guinea pigs in the computer models of fashionable social simulators or as the golf balls or atoms of traditional Newtonian physics. This "objective" view (which does make the math easier!) assumes that all human actions in society are irrelevant, statistically damped out by the Law of Large Numbers. Even powerful producers in many computer models are assumed to have no impact on the structure of the economy. On the contrary, some economists and most futurists acknowledge that financial markets are influenced by large institutions—from governments to global corporations and institutional investors—in increasingly interwoven global real-time networks, where over-shoots and herd behavior are amplified. Thus, game theory, chaos models, and psychology become sharper tools for examining how markets are affected by the interactions of mutual expectations of players. Unfortunately, the "Artificial Society" models of mathematical economists often program their simulated "human agents" with the same competitive, self-maximizing, economic behavior—and, unsurprisingly, recreate poverty gaps and trade wars. At least, the "quants" and "rocket scientists" whose computer models calculate the prices of derivatives allow a 20-40 percent risk factor due to their own models.

Of course, one or two innovative economists (borrowing models from systems and game theory and from chaos and complex adaptive systems studies) have moved beyond this Industrial Age, Cartesian-Newtonian worldview.

All this underlies today's pop debate in the financial press about the nature of the "new economy" and the explosive rise of the U.S. stock market and whether U.S. Federal Reserve Board Chairman Alan Greenspan's new view of the statistical lag in measuring productivity

is correct. *Business Week* has frequently editorialized that globalization and the increasing competition it brings does discipline even the biggest firm's pricing—just as it does wages—echoing calls for dumping the Phillips Curve, as I have urged since 1978. Even Phillips didn't believe in the Phillips Curve. All this has shifted the NAIRU into lower territory so that interest rates can be reduced and sustainable economic growth can proceed in a new virtuous cycle. All this sounds great and it is half right, as a market "flow model" (i.e., the conventional monetarist "bathtub" model of the national economy as a hydraulic system). In the UK, Roger Bootle makes a similar case in his *The Death of Inflation* (1996, 1997) but with a longer time scale interpretation beyond simple monetarism and a more radical conclusion: that OECD economies face a future of deflation. Asia will be another deflationary factor.

Beyond these expanded economic models, the less-examined other half of the story relates to assets (stocks of built, natural, and human capital) as well as liabilities, debt, and other aspects of restructuring outside much market data and models. Here, the gloomier view of our $1.5-trillion daily global casino emerges, and the $50 trillion in outstanding derivatives positions in which individuals hedge their own risks by adding to systemic risks. Today's tidal waves of "hot money" and speculation can simultaneously devalue currencies and hammer economies on one side of the world while feeding asset bubbles somewhere else. Today's central bankers are charged with the now-impossible job of managing national economies and currencies. They still foolishly play at the same casino table with highly leveraged, profit-maximizing currency traders, who arbitrage interest rates and national government policies alike. The central bankers, under pressure from banks and financial interests, have stripped themselves of other macro-economic tools: adjusting bank reserve ratios and stock brokers' margin requirements, as well as capital controls. They now must rely on interest rates alone to cool inflation and financial bubbles. Central bankers' new Catch 22 is that they are now afraid to use interest rates to cool economies—not only because this throws the real economies of Main Street into recession and unemployment, but also because it pricks asset bubbles too drastically. Thus, central bankers today are left with "jaw-boning" stock markets about "irrational exuberance." Canada's Finance Minister Paul Martin's recent call for a "global supervisor" of national financial supervisory bodies was endorsed by other G-7 ministers.

Even for its own players, the global financial system needs regulatory harmonization of rules on accounting, disclosure, insider trading, money laundering, and so on, as even George Soros has emphasized. Asia proved a minefield for many investment bankers. Lehman Brothers and Schroeders are cutting back—as Peregrine's bankruptcy continues to chill Asian markets, down an average of 50 percent since early 1995.[2] Beyond all this, global financial markets need better settlement systems, custodial reserve requirements—indeed a "Global Securities and Exchange Commission" to deal with future Mexican and Asian-type crises, as the G-7 and U.S. Treasury Secretary Robert Rubin have acknowledged.

How all these issues, global trends, and the Asian crisis unfold will be profoundly affected by business decision-makers and institutional investors as well, as they interact with governments of nation states, now weakened by the forces of globalization and electronic commerce. Thus, more demands than ever should and will be placed upon business and investors by the public. Business executives and their associations are helping change some of the archaic statistics and text-book conventions of the current marketplace to fit new global realities.

Business leaders have joined in calls for repeal of the estimated $750 billion to $1 trillion of subsides to obsolescent polluting, resource-intensive corporations of the Industrial

Age—which could at last allow a level playing field for the emerging industries of the Solar Age. Insurers could join with Swiss Reinsurance in their efforts to get fossil fuel industries to assume some of the risks they create by their atmospheric CO_2 emissions and to shift their own investment portfolios to less risky renewable resource and energy efficiency sectors. Banks could better assess borrowers from environmental and social risk standpoints. Oil companies could follow British Petroleum and take climate change seriously by investing in solar energy.

Today, see-saw struggles—*human* employees, citizens, voters, consumers, and investors versus faceless mega-corporations, banks, and financial institutions—are playing out on a changing global stage. The Multilateral Agreement on Investment (MAI) should regulate investments and create a "Global Securities and Exchange Commission" to hold investors, traders, brokers, and all market players to the highest ethical principles and enforceable standards for human rights, labor, and environmental protection. In countries where voters, unions, and civic organizations win local and national standards to protect their health, safety, well-being, and "safety-nets" that their taxes support, corporations move offshore to find less democratic but more "economically liberal" and "business-friendly" nations, in search of politicians willing to further deregulate. *This is the way that real national sovereignty is being eroded*—our elected political leaders and business lobbies are deregulating this sovereignty away to global corporations and finance. In the United States, corruption of politicians has reached epidemic levels. Many other scandal-ridden governments put their taxpayers' funds on the global auction block, along with their workforces and their natural and environmental resources in the new global bidding war to lure (bribe) corporations, banks, and financial institutions to locate in their countries. [3]

The continuing woes of Asian economies—particularly the tragic loss of life in the process of ousting Indonesia's Suharto regime—taught the world a lesson about what's wrong with conventional economic prescriptions. Headlong globalizing of financial markets and privatizing of state enterprises and services to woo private investors, crank up exports, and go for GNP-measured growth all proved unsustainable. Of course, such dirty dashes to GNP-growth can show spectacular numbers—no trick when they are based on slave wages, social repression of dissent, and environmental destruction. The uncalculated cost of social disruption and environmental damage are still assumed to be ameliorated in the future, for example, by traditional economists' eccentric models of a supposed Environmental Kuznets Curve.[4] Over the past ten years, grass-roots activists, global citizens, and alarmed scientists from many disciplines have documented the appalling, often irreversible, social and environmental consequences in Asia and other developing countries of this narrowly focused, short-term GNP growth. As global direct investment and portfolio flows quadrupled between 1990 and 1997, now estimated at $8.3 trillion, the World Bank, the International Monetary Fund (IMF), central bankers, and their private banking colleagues all hailed the Asian growth miracle—promising further rising living standards trickling down to lift millions still in poverty. Ironically, China with its own brand of market-socialism so far has been insulated from Asia's worst problems.[5] In my view, this is largely due to its insistence on limited convertibility of the *yuan* and its resistance to following the Washington Consensus path.

Today, we learn that bankers knew all along about the "crony capitalism" of insider-dealing, lack of transparency, lax regulatory supervision, and imprudent borrowing and lending, as well as rising excess capacity in many manufacturing sectors. Their advice is still to further deregulate, privatize, and open markets. During these heady years, little warning was given to the public of the growing fragility of these financial markets—even after the

Japanese asset bubble burst in the early 1990s. Few bankers or their economic experts admit that the widespread banking and financial deregulation they encouraged in the 1980s helped create today's daily trillion-dollar global electronic markets. Today, electronic commerce in our newest global commons of cyberspace is exacerbating nations' tax-collection problems, budget deficits, and adding to money supplies.

How could these bankers not know that removing all the "firewalls" between the world's economies—via deregulation, privatization, and free-trade agreements, like NAFTA, the GATT and the WTO—would inevitably increase such interactive financial flows and exacerbate volatility in floating currency exchange rates, as the history of this century has shown?[6] How could these experts not have known that these tidal waves of hot money sloshing around the planet every day would lead to rising uncertainty, continual industrial sector restructuring, mega-mergers, corporate downsizing, the rise of "contingency employment" (part-time and temporary jobs) and their adverse impacts? Surely they expected today's massive use of hedging such new financial risks via the growth of derivatives now standing at over $50 trillion.[8] Why did central bankers not warn the public sooner about the worldwide asset bubble inflating ominously in Asia and on Wall Street since the early 1990s? Instead, they focused on beating inflation in wages and Consumer Price Indexes relying on high real interest rates—whatever the social costs in recessions and unemployment. Today's dangers lurk in central bankers' decades-long push toward political independence and "zero-inflation." Now deflation in consumer prices and company earnings are fed by the Asian implosion. Japan's weakening economy could well spread deflation worldwide.

Most Asian governments today are sadder and wiser—saddled with massive debts and IMF-bailout conditionalities, which may spare elites while causing further suffering for the most vulnerable citizens. Meanwhile, citizens in Japan wonder why they should bail out their reckless banks after recently coughing up for a costly rescue of their *jusen* (savings and loans). It has been well known for several years that if Japan's Nikkei stock index fell below 15,000, many Japanese banks would be technically bankrupt. The Hashimoto government's much-bandied multi-trillion yen "stimulus packages" have failed to "talk up the Nikkei index."[8]

The extent to which the world's banks have mismanaged the global economy is only now becoming visible. Short-sighted, imprudent, badly supervised banking systems, as well as deregulated and virtually unregulated financial markets, changing technology, and globalization have been at the heart of these problems.[9] The Bank for International Settlements (BIS) rule on 8 percent reserve capital requirements, promulgated in 1988, has also proved inadequate. All this costs the world's taxpayers, employees, small businesses, and investors dearly. The world's poorest citizens remain the most tragic victims of maldesigned, malfunctioning financial systems and the debacles caused by the false promises of a generation of economists. Added to all this, formidable technical and political challenges are posed by the start of the European Monetary Union and the launching of the *euro* on January 1, 1999, and the simultaneous effects on banks of the multi-billion dollar costs of upgrading their computer programs to handle the "Year 2000 Problem." In Europe and the United States, it is probably already too late for some 30 percent of small banks to prevent their computers from crashing and may have to close their doors on January 1, 2000. We hope that it will not take such catastrophic learning experiences for current decision makers to rethink and reshape the global economy into the win-win game that it can become.

The principles articulated at Bretton Woods, on which the IMF was founded, that nation states' domestic economic policies *do* affect each other and *do* need surveillance and coordination is as important as ever. The global financial system will continue affecting

nations as its ever more interlinked web of information technology and electronic commerce advances. Thus, international regulation of corporations and markets as well as coordination of national policies and standards are vitally needed. If not, global financial crises will continue to erupt and the current wave of global mergers of corporations and banks will continue—ad hoc efforts to control roiling markets in the fruitless game of global economic warfare. "Globalization" at last has become a household word.

Surely it is also time for a fundamental rethinking of the role of banks and the way central bankers create money and oversee monetary policy and credit, and to reveal the politics underlying economic theories, such as the Washington Consensus. If bankers do not shape up, we can go around them with today's "info-currencies": direct electronic exchange, high-tech barter, local scrip, swaps, and global countertrade—now estimated to comprise up to 25 percent of all world trade. The World Bank, the IMF, private bankers, and global financial players should join the call for a "Global Securities and Exchange Commission," currency exchange fees, circuit breakers, and many other needed regulations and/or capital controls to tame today's global casino.

Beyond Asia, as more markets and businesses move into cyberspace, what are some key and broader implications? Let's start with electronic commerce. Most companies assume that money-based transactions will monopolize cyberspace through better security, encryption systems, credit card handling, and e-cash systems. However, electronic commerce does not *require* money-based transactions, but could lead to pure information-based transactions, that is, high-tech barter. Money and information are now equivalent—we are already off the money and gold standard and on the information standard worldwide. Banks thrive on money-based scarcity and, understandably, are trying to reintroduce scarcity into cyberspace transactions via their debit and credit cards. Yet today, billions of dollars of services and goods are bartered each year in the United States by corporations and individuals on personal computer-based electronic trading networks. The implications for the world's central bankers are clear: If they don't improve their currency issuance and monetary management and control operations—through overhauling the Bretton Woods institutions and making credit widely available, not just to their cronies in governments and corporations—then they will be bypassed by pure info-based transactions. Today's state-of-the-art computer-based markets in cyberspace can make such info-based, high-tech bartering efficient with minimal transaction costs. Developing countries will no longer need to earn foreign exchange but can trade all their commodities among themselves—doing three-, four-, five- and six-way trades with the computers keeping the audit trails as to settlement agreements (which is what money is and does). I have spelled out the implications of all this, including the need for three different kinds of currency: a global reserve currency; national currencies and monetary unions of them, where appropriate; and local currencies to clear purely local markets.[10]

Nations will need to regain some of their lost sovereignty in order to maintain their political legitimacy and manage their domestic economies democratically for the benefit of the majority of their citizens. All this will now require international agreements to set up new Bretton Woods-type global mechanisms to protect human citizens, employees, and investors—not only paper financial institutions. The Global Securities and Exchange Commission can harmonize securities markets and their regulations—full disclosure, accounting protocols, safeguards against money-laundering, insider-trading, bear raids, and the kind of speculations that helped threaten even the Hong Kong dollar and other well-managed currencies like Brazil's *real.* I expect a further shift to "safe haven," high-tech barter transactions both locally and globally. Local currencies and personal computer-based trading systems are flourishing in the United States, Canada, Europe, Australia, and New

Zealand.

The continued growth of electronic commerce into today's autonomous global casino will continue to erode the power of governments while also denying them the tax revenues they formerly received from domestic bricks-and-mortar commerce. On the national and micro-level, the tax issue will involve a fight for equitable tax treatment between traditional bricks-and-mortar businesses and those in cyberspace.[11]

Global financial markets are now in a new domain of volatility on which traders thrive. U.S. Federal Reserve Chairman Alan Greenspan has pointed to the preponderance of market players who now benefit from this volatility. This continued volatility will bring acceleration of the efforts of G-8 leaders to cobble together a rudimentary Global Securities and Exchange Commission. After the UN Kyoto Climate Conference in December 1997, a new Bretton Woods-type institution, the International Bank for Environmental Settlements,[12] emerged from the deliberations, and will be discussed further in Buenos Aires in late 1998. This new bank would be governed by all signatory nations, would allocate carbon credits and debits between nations (hopefully, on an equitable, per-capita basis), and eventually oversee an electronic derivatives exchange for environmental commodities, including water and biodiversity. So far, such emissions trading in the United States has been unfair, since the government gave *only polluters* these rights to trade their sulphur dioxide emissions—thus penalizing everyone else, including "greener" companies. I also expect central bankers will wise up and stop sitting around the same table in the global casino with profit-maximizing currency traders speculating on large margins. The central banks may decide that their role as protectors of their nations' currency demands that they set up their own FXE with the United Nations and the Bretton Woods institutions as a "public utility"—with specifically designed state-of-the-art electronic trading systems and audit trails. These could be designed to capture information on money-laundering and speculative movements while offering systems for user-fees and circuit-breakers.[13] Instead of reliance on now ineffective open-market buying operations, interest rate hikes, and the domestic recessions they engender, central banks can use such new tools. There is no reason central banks cannot manage their currencies and financial markets as closely as they manage their sovereign bonds. Chile and China have shown how some restrictions on "hot money" work well.

Lastly, new global systems of political risk-management are now possible, which can reduce the world's military budgets—by employing insurance instead of weapons. For example, the Global Commission to Fund the United Nations has proposed the creation of a United Nations Security Insurance Agency (UNSIA), a public-private-civic partnership between the UN Security Council, the insurance industry, and the hundreds of civic humanitarian organizations worldwide that engage in conflict resolution and peace-building.[14] Any nation wanting to cut its military budget and redeploy its investments into its civilian sectors could apply to UNSIA for a peace-keeping "insurance policy." The insurance industry would supply the political-risk assessors and write the policies. The "premiums" would be pooled to fund both properly trained peace-keepers and a rapid-deployment, on-line network of existing civic, humanitarian organizations "on the ground" to build trust and confidence. The UNSIA proposal is now backed by several Nobel Prize winners, including Oscar Arias and other leaders, and is taught at the London School of Economics and other major institutions. UNSIA was debated in the UN Security Council in April 1996, the first time that body had considered the need to bring civic humanitarian organizations into peace-keeping operations. In May 1996, the Security Council called on the Secretary General to investigate the feasibility of "a rapid-deployment humanitarian force," and in October 1996, the Norwegian government pledged $1 million to this project.

Companies and countries are shifting slowly from obsolete textbook economics, focusing on competitive, money-based individual, self-maximizing behavior as that of "rational actors" while ignoring (and thereby punishing) altruism, volunteering, cooperation, sharing, and caring (that estimated $16 trillion worth of production of goods and services simply missing from annual global GDP statistics). In all other social sciences, including psychology, sociology, anthropology, game theory, and systems and decision sciences, the full repertoire of human behavior from competition to cooperation is acknowledged and studied. Only in market economics, which is the predominant driving theory underlying GNP growth and the globalization of markets, finance, and trade, is the focus only on competition—win-lose strategies. Expanding to a multidisciplinary focus for both domestic and globalization policies can reveal all the positive-sum, win-win games, the new public/private/civic partnerships, and new strategies that can help all actors imagine, develop, and build toward a win-win world in the next century. Humans must now acknowledge their responsibility for their active roles in the evolution of societies.

Today, in a world we have made increasingly interdependent, we are learning the differences between money and wealth and finding that, in a planetary context, all our self-interests are identical. Ethical investing and socially responsible business have simply become pragmatic.

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