Globalization may be built on increased world trade, but the movement of money has accelerated faster yet in the last 10 years, propelled by financial market reforms and enabled by information technology.

Is the free movement of money inseparable from that of goods? Can a sustained globalization separate the two, with different principles for each? Is advocacy of open financial markets an act of faith or the lesson of experience?

Laura Tyson

Chair of the U.S. National Economic Council, 1993-1995

A former senior economic advisor to U.S. President Clinton, Laura Tyson observed that the push for free trade may have bled into too forceful a push for open capital markets.

The Perils of Short-term Foreign Capital Investment

INTERVIEWER: What do you say to people who argue that in the first term you all moved too fast with trade equalization? Is that because it happened so quickly that the architecture wasn't in place?

LAURA TYSON: I wouldn't say trade equalization. I think the distinction people debate is about capital-market liberalization, and I think that's a fair point. The point is that you can engage countries in breaking down barriers through trade, so you buy and sell products, but you can still choose to limit the amount foreigners who can invest in your financial instruments. Take the case of China, which is a good case here. China has had a dramatic growth in its international trade. If you look at China as a developing country and you look at the share of trade in its GDP, you would say it's quite an open economy. It also has allowed a lot of foreign direct investment into China to build facilities and run operations. What it has kept out of China is a sort of financial capital. It doesn't sell its short-term government debt to foreigners. It doesn't allow foreigners to hold large amounts of Chinese currency. Therefore, it's not indebted in a short-term way to global private capital markets. And it doesn't have the possibility that global private capital markets can start selling and buying their securities. And what the countries that were most affected by the financial crises of '97-98 had done is they had opened their capital markets. They were bringing in huge amounts of foreign short-term money, and they were doing it by selling debt instruments to them—corporate debt and government debt. Selling equities to them was a great way to bring in a lot of money. The problem was the money was very volatile. It's money that could easily be pulled back, and [when there was] any sort of uncertainty about returns, you could see the money just turning over. And unfortunately, that danger turned out to be a real phenomenon in '97-98. It really was the movement of short-term capital when the markets liberalized on the capital side, allowing such money to come in, and then the very quick exit of such money when foreign investors got concerned.

INTERVIEWER: So how do you prevent that from happening?

LAURA TYSON: You can do it, first of all, for countries that haven't yet liberalized like China. You just don't sell those kinds of [debt] instruments; you don't make them available to foreigners. You simply don't, in that sense, allow foreigners to deposit money in your domestic institutions or buy your government debt. And in a way, it's easier to prevent it from happening if you haven't gone down that path. Once you've gone down that path, it's really hard. This, of course, is what Malaysia did. What you have to do is basically say to people that are holding these kind of assets that they have to hold it for a certain amount of time before they can sell. You can do it by saying, "If you sell before that time, you have to pay a very big tax penalty." So you can put a restriction on holding—how long, if you buy an instrument, you must hold it to avoid a very big penalty on selling. It's almost like a savings account with a penalty for early withdrawal. So you can do things like that. If you've gone down the path of not doing that, and then all of a sudden you try to do that, you run the risk that a lot of money is going to leave even faster in order to get around your new restraints. That's why it's more difficult as soon as foreign investors think you're about to do that. They're going to pull their money out as fast as they possibly can, and that depresses your currency, it robs you of finance, and it drives up your cost of borrowing so it just gets harder to do.

I think that what has become our conventional wisdom is oftentimes wrong, that many of these countries may in fact have opened up their short-term capital markets too soon. What does that mean? It means that there weren't enough regulations in place to control whether assets being sold were creditworthy accounting for how much of this was actually going on. No one was keeping track of how much the banks were becoming indebted in the short term. No one was keeping track of how much the companies were becoming indebted in the short term. The governments knew how much they were becoming indebted in the short term, but you just didn't have the data, the accounting structure, or the regulatory structure to prevent what, in retrospect, is clearly much too much dependence on this very flighty and expensive foreign capital.

20/20 Hindsight: Opening the Asian Capital Markets

INTERVIEWER: Let's go back to the Asian crisis. You said that some of the countries maybe opened up their capital markets a bit too quickly. Some people say that the administration actually bears a responsibility for that, for pushing them.

LAURA TYSON: ... There may be some truth to that. I was not deeply involved in that part of the administration's agenda for the following reason. If you go back to [Clinton's] first term, a lot of the international approach of the administration on economic issues was to break down barriers to U.S. firms. It really was this idea of free and fair trade. So we were taking the position that "We're Democrats, and we believe in fair trade. We're not protectionists, though. We're not going to build barriers around ourselves. We are going to engage our trading partners and encourage, cajole, convince them to bring down their barriers." One of the areas in which we were doing this was financial services, and this came out of a tradition of working with Japan on liberalization of their financial services industry in the 1980s.

The Agriculture Department, for example, would lead on the issue of liberalization of trade in agriculture. And the Treasury would lead on liberalization in trade in financial services. And we were saying to countries like Korea: "Gee, you want to be part of the Organization of Economic Cooperation and Development [OECD], and you want to be treated like an industrialized nation. In order to do that, we want you to open up your capital markets to flows of U.S. dollars. For investors who want to invest in Korean assets, we want you to liberalize your equity markets." So yes, I think we did do that.

You know, I guess what I would say is, we did it for the right reasons. I think with the benefit of hindsight, there is concern that my profession overestimated the benefits to the country of doing that, or maybe we underestimated the risk to the country. There were some benefits. I think we got the benefits right, but we didn't pay enough attention to the risks. And so I would put more of the blame at my profession's doorstep. The Treasury ended up being the lead negotiator on those kinds of issues, probably being most engaged in those. I was never involved in them. I don't want to claim that I would not have done it. So I think it's a fair issue. It's an issue that I think one only sort of understands with the benefit of hindsight.

The Unpredictable Role of Information Technology

INTERVIEWER: You mentioned also that you didn't quite anticipate the role of technology in all this. I wonder whether those two went hand in hand. In other words, the risks were much greater because of technology.

LAURA TYSON: The risks were greater because the speed—the magnitude and speed of change—were so much. The amounts of money involved were much larger than would have been the case had you not had the ability to move money around the globe by hitting a button. The same thing with the speed, and I would say related to that is the volatility. If you'd asked people at the beginning of the 1990s, "Do you think that very sophisticated trading technologies and very sophisticated management technologies would make financial markets dramatically more volatile?," I don't think there would have been a resounding "yes" to that. There might have been a "maybe." There might have been a "Gee, well, you know, on the one hand it could make it more volatile because there's more money moving and it can move faster; but on the other hand, more information might actually lead to a more stable financial market because the information is widely available to people at a moment in time and you get fewer mistakes." You know, I think that the technology clearly did play a role, but I think the role it played would not have been easy to predict.

Stanley Fischer

First Deputy Managing Director, International Monetary Fund, 1994-2001

Closely involved in crisis management as the second-ranking official of the IMF from 1994 to 2001, Stanley Fischer looked back on right and wrong ways to open capital markets.

Short-term Foreign Investment: Welcome Only When System Is Sound

INTERVIEWER: [Some believe that the Asian financial crisis] happened because the U.S. pushed the [Asian] countries to lift capital controls in the early '90s. Was that significant?

STANLEY FISCHER: Part of what happened is because ... capital controls were removed incorrectly. Thailand opened up to short-term capital flows. You could invest for a week in Thailand or three weeks in Thailand, but you couldn't invest in equity. That's the exact opposite of what to do. Korea—exactly the same. Koreans didn't want foreigners owning their companies, but they would borrow one-week money. That's exactly backwards. ... I don't think that was what the international community was pushing on them, opening up the short end. As we say, it had a role to play, and one of the important lessons is if you are going to open up the capital account, bring in the long-term money first, let equity investment come in, let long-term borrowing come in, let foreign direct investment, buying companies, selling companies come in. Only open up at the short end when your financial system is sound. That's a lesson we learned. I wouldn't blame the United States. I'm sure that it and others were pushing for a capital account opening. I think the IMF has also been accused of that. Probably there was more pressure and less recognition of the need to differentiate what you were opening up than we would have now.

Dr. Mahathir bin Mohamad

Prime Minister of Malaysia

Malaysia's long-serving prime minister Mahathir saw the risk that financial globalization could rapidly undo the benefits of trade-based globalization.

Perils Inherent in Globalization

INTERVIEWER: We were talking about the Washington consensus and the American desire for Asia to open her markets. Was the head of the IMF coming to you and saying, "What you should do is open your capital markets. It'll make you prosperous"? Was there other talk of American free marketeers as evangelists, who were like missionaries going out to Asia and spreading the gospel of the free market? When did you sense this, and was anyone talking to you about this?

DR. MAHATHIR BIN MOHAMAD: I think it was very early on, long before globalization was being implemented or becoming a very common household word. Various delegations came from America, one of which was headed by [former Secretary of State Alexander] Haig, and they were insisting that we allow American banks to operate as national banks in this country. We pointed out that if they come in, their size would smother the Malaysian banks. But [we were told] this is good for you because they are going to bring in their expertise [and] efficiency, and things would be stimulated by their participation. We have a responsibility to protect our local banks. We told them that "We are not ready yet for that; wait until we are big enough, and then you can come in." So very early on there has been this pressure to give national status to foreign companies. National status is what we use to protect our weak businesses, banks, and industries so that they have a chance to survive. But if you allow at that early stage for foreign companies to attain national status, then there's no way we can protect our own businesses.

Of course, when globalization became a formal idea which everybody seemed to espouse, it is the same thing: the desire [to] give foreign companies national status in your country. We felt if we do that, then all our own businesses will be just swallowed up. All will just perish, so that is why we fear that globalization, as defined by the Western countries, is not going to be good for us, and we had a foretaste of that during the currency crisis.

INTERVIEWER: You said that Malaysia and developing countries must stand up; they must not bow down to the globalization extremists. Who are the globalization extremists, or the theologians of globalization?

DR. MAHATHIR BIN MOHAMAD: The globalization extremists means other people coming from the very rich countries who see in the form of globalization that they propose opportunities for making huge sums of money for themselves. They are not doing this for charity. Although they say this will benefit the developing countries, really they don't care. Since currency trading is part of globalization, we have seen them destroy 100 times the amount of money that they make. In the case of Malaysia, we lost US$250 billion, and I think the currency traders could not have made more than $5 billion out of destroying $250 billion. We cannot be convinced that this is good for us, losing $250 billion, so that somebody can make $5 billion for themselves. It is destructive of wealth, wealth we have taken a lot of trouble to accumulate over decades. Because of this, we don't see why we should open our arms and embrace globalization.

Regulated Globalization

INTERVIEWER: But you've also said that you support free markets. I think you said you supported globalization. You realize that capitalism, free markets have a potential of doing tremendous good in the world. Do you think that's still true? Does capitalism and the free market still exist and still have the potential to do tremendous good?

DR. MAHATHIR BIN MOHAMAD: Yes, if we have proper regulation and proper structure, it is possible. We welcomed foreign capital a long time ago, and they came in, they built factories, and they exported goods from our country, creating jobs for our people, improving our economy. Yes, that is the kind of globalization that we want. At the same time, respect our laws and our policies and allow our own companies to be protected until such time when they are able to compete with the foreign countries. That kind of globalization, yes. But the sudden inflow and outflow of currency is too destabilizing. That we cannot accept as a part of globalization.

If, on the other hand, you say that there must be freedom of movement across borders, it should be a borderless world. Whereas the capital in the rich countries is in the form of

money, our capital is in the form of people. Are you willing to allow our people to migrate to your countries in great numbers? Say 300 million Chinese, 200 million Indians should migrate to Europe. Immediately you are going to say, "No, that is not what is meant by globalization." But you talk about a borderless world, about free movement of capital and not anything else. Why should there be such a difference? Since you would like to regulate the migration of people into your own country, we should be allowed to regulate the inflow of capital and the outflow of capital from our country.

Lopsided Distribution

INTERVIEWER: Globalization, deregulation is supposed to enrich the world, but at the moment, is it one-sided? Are most of the riches going to the rich countries? What will happen if this divide is not closed?

DR. MAHATHIR BIN MOHAMAD: In the first place, what we see is that globalization is only benefiting the rich. A good example of that is currency trading. It mainly enriches the rich at the expense of the poor. So that is something we cannot accept, but if it is going to be beneficial, then there must be some regulation. You cannot suddenly be free. Any sudden change would be disruptive. Even if it is a change for the good, it would be disruptive. Now, the whole process should be slowed down in order to allow for countries to adjust to globalization and the effects of globalization. If that is done, and if the views of the poorer countries are given serious consideration, then we can have globalization without the disruption. It may take a little bit longer, but it will not involve the destruction of so many economies as has happened now.

INTERVIEWER: In this globalized world, is it possible for a country, especially a developing country, to opt out?

DR. MAHATHIR BIN MOHAMAD: No, there's no question of opting out. The fact that you don't accept certain ideas doesn't mean that you step off the world. You are still there. In our case, we rejected ideas which have been accepted by the whole world because we think our ideas could solve our problems, not other people's problems. But without damaging our economy, because we are so dependent upon the rest of the world. Our trade is 140 percent of our GDP, so we need the world. We cannot step off the world.

Lee Kuan Yew

Senior Minister of Singapore

In the push to liberalize capital markets worldwide, Singapore's senior minister Lee Kuan Yew saw a collision between faith and inexperience.

The Abrupt Departure of Capital Demolishes Developing Economies

INTERVIEWER: I want to ask you about your sense of the evolution of the Clinton administration's global economic policy in the '90s. We interviewed [Robert] Rubin, Clinton, and [Lawrence] Summers, and they talked about their push to open markets, particularly in Asia, the emerging markets. I'm wondering whether you think that perhaps they pushed too hard to encourage countries to open themselves up, particularly to capital.

LEE KUAN YEW: Yes. It was an article of faith that these countries would thrive and prosper if they opened themselves up and allowed free flows of trade, investments, currencies, people, ideas, machines, everything. But it assumes that you have the administrative machinery or the system in place which can prevent yourself from being demolished when you have a withdrawal of capital. I support the view that free trade in goods and services is a win-win situation. I'm not so convinced that free flows of capital without restriction is a win-win situation. Theoretically, it is the most effective way to allocate capital. And there are trillions of dollars' worth of pension funds and insurance company funds waiting to go into the best markets, highest returns. But if they had not persuaded the Thais and the Indonesians to lift their exchange controls, this enormous inflow of funds from Europe, some from America, some from Japan, would not have gone into this economies. They were booming, and the finance ministers thought this was the way to join the boom.

These countries did not need extra money; they had huge savings of their own. But when Western bankers set up businesses, they said "Here you are" at lower interest than their own currencies, because their currencies were pegged to the dollar, in order to sustain the value of the peg at high interest rates, so they borrowed in dollars with low interest rates. When the trade balance moved against them, because the Chinese had devalued their own currency and were capturing American markets, replacing Indonesia, Thailand, and several other countries, the fund managers immediately noticed that this money won't be repaid. First, they can't sustain that rate of exchange. Secondly, where's the foreign exchange going to come from?

So they pulled out, and when they pulled out, as all fund managers do, they acted in rapid unison just in case they were the last one out. And no small economy can withstand a withdrawal of... I think within a few months they had $200 or $300 million worth pulled out. Currencies were devalued; stock markets plummeted, because they were sold to get the currency to move out; property prices collapsed; companies collapsed. And in the case of Indonesia the social fabric collapsed; the social fabric was torn apart. From an economic [standpoint] it became a national unity problem. And you had ethnic groups fighting each other; you have Muslims versus Christians. Was it necessary? Could it have been different? Yes, I think so. They should not have persuaded them to do something which they were not capable of doing, to monitor the inflow of funds to make sure that it was allowed in at a rate that they could repay. They didn't have the machinery to monitor what was being transacted by their private corporations with the foreign banks.

Capitalist Evangelism and Social Turmoil

INTERVIEWER: I read that you wrote that after the end of the Cold War that the U.S. became as evangelical as the Communists.

LEE KUAN YEW: Yes, it's an article of faith. I mean, democracy, human rights, free flows of capital—it does not brook a counter-argument. They believe this is right, and therefore let's do it.

INTERVIEWER: This article of faith that you've mentioned—what is the faith?

LEE KUAN YEW: The faith is this way: If you have a better world, everybody would be prosperous; everybody will maximize his capabilities and his benefits. But is it true? I don't think so. Within limits, it may be true for countries like Singapore, because we have learned to build up the institutions, but even then we suffered, because when you have people selling shares and currency, when they're pulled out... They don't say that "When the crisis broke in '97..." The fund managers didn't know the difference between Indonesia and Malaysia, Thailand, Singapore; they just say, "I want out." So they just sold, brought our currency down, brought our stock market down. Then, after a while, they discovered [that] no, we were slightly different. We were not so bad; we were not in debt. And then we recovered. But we

lost a lot of money, and our banks lost a lot of money in Indonesia and Malaysia, and Thailand where we had that money.

INTERVIEWER: So did American arrogance help cause this crisis?

LEE KUAN YEW: No, I wouldn't call it arrogance. I think there's a certain overwhelming belief that what's worked for America will work worldwide and that this way the world will be a better place. I'm not saying they came here to do harm. All missionaries want to do good. But if you don't understand the local culture and customs, and you don't understand that change has got to take place at a pace that their people can take, then you can do that people some discomfort and sometimes harm, as was done in the case of Indonesia. Now who is going to rescue them? How can you put Humpty Dumpty together again? The genie is out of the bottle, and enter ethnic hostility. Churches have been burnt; mosques have been attacked; they have killed each other. Dyaks [indigenous people of Borneo] have beheaded Muslim Madurese. Chinese have been massacred in different parts of Jakarta and other parts of Java. And you're going to live happily ever after? This will take years to heal. It's all the fallout of an economic collapse. If the economic collapse had not happened, the stresses would not have been so severe. I'm not saying they had a perfect infrastructure of institutions and law and administration, but it need not have got into this terrible spiraling violence.

INTERVIEWER: But they say that "We told the countries they had to have proper systems in place."

LEE KUAN YEW: They need decades to build up even now. You mean to tell me that at a flick of a switch you've got central bankers? You can't, if you had told they were being persuaded not just by Rubin, but also by all the European finance ministers who are very keen to spread this global capital market. But are you sure that they can build up the institutions, the banking practices, corporate governance that can withstand the sudden withdrawal of funds? Even the best of countries with the highest banking standards... Britain in the 1970s got into trouble. You remember John Major in the 1990s? He tried to defend his pound, and George Soros milked the British pound for over a billion dollars. But that's fair game, and that's part of the rules of the game. These are toddlers in the banking world. Yes, they have a few who have been to the IMF and the World Bank for training, but have they the experience? Were they

supported by people with experience at every level? We are still learning. The Swiss used to tell us that we ought to allow our Singapore dollar to be internationalized. In other words, people can borrow our dollars and spend it any way they like. He said, "We do that." I looked at the Swiss gentleman, the banker who told me that. I said: "But we are not Swiss. We are new in this. You've been international bankers for generations. You know how to hedge. Even then you got into trouble when you had to have negative income tax, negative interest rates, to protect your own economy." I haven't got those skills. Those are highly honed skills. Finally it comes to people running a good system, and good people running good systems. So you have Alan Greenspan, and he's not alone. He has eight or nine other Federal Reserve Bank governors. He's got a whole staff of people, every one of them with decades of experience in the banking business and regulators. Why do they produce this? So I think it was unintended, but nevertheless a grievous harm.