Nations find free markets a little too free

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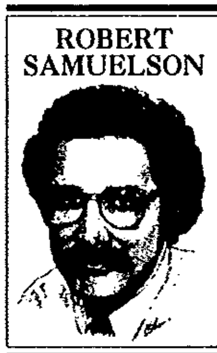

WASHINGTON — Shaky world stock markets contain a large, though muffled, message: Global capitalism — whose triumph once seemed inevitable — is now in full retreat, perhaps for many years. If you doubt that, look at Hong Kong. It's a citadel of free-market thinking. Yet even Hong Kong's overlords have so wearied of global financial turmoil that they have resorted to government intervention to make the market behave. The government has spent immense sums (reportedly $14 billion) to buy stocks and prop up its sagging market. This may or may not succeed; but it surely signals their desperation and disillusion.

Who would have guessed this? After the Cold War, global capitalism offered a powerful vision of world prosperity and, ultimately, democracy. Multinational companies and investors would pour technology and capital into poorer regions, creating a transnational mass market of middle-class consumers who would drive Toyotas, watch CNN, eat Big Macs — and, incidentally, demand more freedom. World trade and investment did indeed surge, but not with the expected consequences. Global capitalism is now destabilizing the economies of poor countries and inflicting large losses on investors in rich countries.

The idea was to open up markets to trade and foreign investment. But now, markets are being shut. Malaysia has imposed exchange controls, preventing foreign investors from reclaiming funds (ringgit could not be changed into dollars). Earlier, Russia had defaulted on some foreign debt and stopped converting rubles into hard currencies (mainly dollars and marks). And then there's Hong Kong's stock-market intervention. Although it doesn't evict foreign capital, the abrupt change of rules could frighten away investors.

What went wrong?

On one level, the answer is simple. Countries became overdependent on foreign capital, which, having entered in huge amounts, is trying to leave the same way. In 1996, South Korea received $42 billion of inflows; a year later, outflows totaled $21 billion. What initially triggered the reversal was the recognition that much foreign money had been squandered through "crony capitalism" or misguided industrial policies. Asia was dotted with empty office buildings and surplus factories. Overseas banks refused to renew their loans; mutual-fund investors sold shares and converted their funds back into dollars.

Now the fear of capital flight is feeding on itself--and spreading to Latin America. If people fear the Mexican peso will be devalued, they may convert pesos into dollars. The frightened include locals, not just foreign investors. But countries need hard currencies to pay for imports; and they can't afford a depositor run on their banks. High interest rates are one way to halt the process by rewarding people for keeping funds in local currencies. Hong Kong's short-term interest rates have risen to about 15 percent, Mexico's to 36 percent. The trouble, of course, is that punitive interest rates also crush local economies.

If a few economies face this squeeze, it's their problem; if many economies do, it's everyone's problem. This is happening. The threat of capital flight has shoved so many countries toward austerity that it's inducing a worldwide slump. And, again, the process feeds on itself. Feeble economic growth has depressed prices of raw-material exports. Between June 1997 and August 1998, oil prices dropped about 30 percent (affecting Russia, Mexico and Venezuela, among others); coffee prices fell 43 percent (Brazil and Colombia); and gold prices sank 17 percent (Russia, South Africa). Earning less abroad, these countries must slow their economies to cut imports. This depresses U.S. exports and the profits of multinational companies operating in these countries.

Thus does the Third World's distress threaten the First World's stock markets and prosperity. But global capitalism's failure demands a deeper explanation. After all, capitalism is supposed to excel at allocating investment funds efficiently. In this case, it didn't. The deeper explanation is that market capitalism is not just an economic system. It is also a set of cultural values that emphasizes the virtue of competition, the legitimacy of profit and the value of freedom. These values are not universally shared.

As a result, spreading capitalism is not simply an exercise in economic engineering. It is an assault on other nations' culture and politics that almost guarantees a collision. Even when countries adopt some trappings of capitalism, they may not embrace the basic values that make the system work. This is what happened.

Led by the United States, global agencies (the World Trade Organization, the International Monetary Fund) sought to persuade poorer countries to become more open to trade and global capital. These countries tried to maximize the benefits of the process while minimizing changes to their politics and commerce.

Mutual deception flourished. Countries like South Korea and Russia pretended that they were changing more than they had. American, European and

Japanese bankers, executives and government officials pretended the claims were true--or might become true. Loans were made on the basis of incomplete or faulty financial statements. Or they were made on the faith that, if a loan went sour, someone (the government, the IMF) would cover the losses.

Global capitalism became a dangerous hybrid. On the one hand, investors committed huge sums and expected high returns. On the other, the money often went--through bank loans, bond issues and stock offerings--to borrowers who were not operating by strict rules of efficiency or profit and loss. "Crony" capitalism often meant corruption: Contracts won with bribes; favoritism for the well-connected. In 1997, a group called Transparency International ranked corruption in 52 countries as judged by global executives and country specialists. Not surprisingly, Russia ranked fourth, Indonesia seventh and Thailand 14th.

But capital flowed freely while optimism and self-deception prevailed. Banks collected interest on loans. "Emerging market" mutual funds rose, because local stocks were buoyed by new investment money. While everyone enjoyed profits, there was a suspension of disbelief. Now comes the reckoning. Capital flight has forced most developing countries to scramble to conserve scarce foreign exchange.

All their choices are bad. Malaysia's exchange controls, by stiffing foreign creditors, risk loss of any future foreign investment. Still, some U.S. economists see currency controls as a temporary way of avoiding high-interest rate austerity. A gentler way to achieve the same result would be debt relief: Global bankers would write down loans, easing the repayment burden. But so far, banks have shown little interest. A third approach is to attract new long-term capital to replace old short-term capital. Some of this is occurring as U.S. and European firms are allowed to buy Korean or Thai companies that were once off-limits. But developing countries are reluctant to sell too much of their economic bases to foreigners at fire-sale prices.

Even if the worst doesn't occur, the world will never be the same. Global capitalism won't soon regain its aura of infallibility. There was nothing wrong with the theory. Free trade and the free movement of capital would, in a world where everyone worshiped efficiency and profits, enrich all nations. The trouble is that we do not live in such a world.

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