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Article

"Stability breeds instability?" A Minskian analysis of the crisis of the Asian Tigers in the 1990s

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ABSTRACT

The recent disruptions within the global financial system have led to a notable reassessment of heterodox economic theories in hope that their unique insights into the capitalist business cycle can help illuminate the underlying instabilities that may have contributed to recent crises. This paper focuses in particular on the work of noted post-Keynesian economist Hyman P. Minsky and his associated theories of financial fragility and the inherent instability of modern financial capitalism. We emphasize the theoretical foundations of Minsky's work, notably his financial instability hypothesis, and then apply this conceptual framework to the recent Asian financial crisis of 1997-98. Financial instability and overleveraging were important features in the Asian crisis, thus proving the validity of some of Minsky's assertions. The massive increases in speculation and dependence on external capital drove these economies toward a Minsky moment, when the bubble eventually burst.

«¿La estabilidad engendra la inestabilidad?» Análisis minskiano de la crisis de los tigres asiáticos en los años noventa

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RESUMEN

Las recientes perturbaciones en el sistema financiero mundial han conducido a un replanteamiento considerable de las teorías económicas heterodoxas con la esperanza de que sus percepciones singulares acerca del ciclo económico capitalista puedan echar luz sobre las inestabilidades subyacentes que hayan podido contribuir a las últimas crisis. Este documento se centra concretamente en la obra del economista poskeynesiano Hyman P. Minsky y en sus teorías de la fragilidad financiera y la inestabilidad inherente del capitalismo financiero moderno. Hacemos hincapié en los fundamentos teóricos de la obra de Minsky, especialmente en su hipótesis de la inestabilidad financiera, y a continuación aplicamos este marco conceptual a la crisis financiera asiática de 1997-1998. La inestabilidad financiera y el endeudamiento excesivo fueron características importantes en la crisis asiática, lo que otorga validez a algunas de las afirmaciones de Minsky. El aumento masivo de la especulación y de la dependencia del capital externo llevó a estas economías a un momento de Minsky, cuando finalmente la burbuja explotó.

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1. Introduction

The widespread turmoil inflicted upon the global economy over recent years by the convulsions of the financial system has prompted the reappraisal of economic thought previously relegated to the fringes of the academic and financial communities. This paper examines the theories and potential applications of one such economist, Hyman P. Minsky, who argued that economic stability is inherently destabilizing due to its effects on both the level of private investment, leading to overleveraging, and the gradual undermining of associated capital structures. Minsky's work, termed the *financial instability hypothesis*, provides a thought provoking and timely theoretical framework for examining the recent bout of financial crises that have plagued the global economy. Specifically, this paper applies Minsky's financial instability hypothesis to the Asian financial crisis of 1997, and argues that it was largely investment-driven growth, financed through increasingly speculative methods and combined with bad institutions, that led to the accumulated economic fragility that would be the downfall of the high-flying "Asian Tigers."

Hyman Minsky developed his financial instability hypothesis as an adaptation of the investment-driven business cycle put forward by John Maynard Keynes in 1936 within *The General Theory of Employment, Interest, and Money*. Minsky argued that Keynes' theory was fundamentally flawed because it largely ignored the development of the capital structure that supported the associated investment cycle, and therefore could not adequately explain the potentially destabilizing role of finance in the business cycle. To address this weakness Minsky first bolstered the Keynesian business cycle by incorporating Michal Kalecki's profit equation, derived from a heterodox accounting of macroeconomic stocks and flows, and then integrated this more comprehensive theory of the business cycle into the modern financial system. This paper utilizes this comprehensive framework to analyze both the domestic and international sources of economic instability that were building within the seemingly unrelenting expansion of the Asian Tigers during the early-to-mid nineties.

This paper provides a quantitative overview and analysis of both domestic and international economic data to examine the development of financial instability within the Minskian framework. National statistics on asset prices, capital investment, credit expansion, and economic growth are used to illustrate the tenuous nature of growth in corresponding Asian economies during the time period. In addition, we want to look at the role that both private and public credit played in the crisis. Moreover, we will analyze the structural characteristics of these time series. It is also noteworthy that the Asian financial crisis provides an opportunity to study Minsky's theory on an international scale, as a primary source of fragility within many of the Asian economies was their growing dependence on foreign-denominated debt. Therefore, relevant balance of payments data from each nation will also be incorporated into the final analysis.

The findings of this paper bolster Hyman Minsky's argument that modern capitalist economies, i.e. those that developed in the post-Second War period and matured by the 1970s, trend toward instability due to the confluence of the aforementioned factors that Minsky laid out in his financial instability hypothesis. Beneath the veneer of unparalleled economic growth the Asian economies were becoming increasingly unstable. They exploited artificially cheap foreign debt and government subsidized domestic lending to fuel increasingly speculative investments that were only deemed rational either through outright cronyism and bad institutions and/or the rose-colored glasses that have adorned financial bubbles throughout history.

2. Histories and Theories of Financial Crises and Business Cycles

Financial crises are as topical as ever, given the recent worldwide financial crisis. There is a plethora of new research on the history and causes of bubbles and busts. Often those perspectives are linked to the debate as to why the so-called Great Moderation, i.e. the period from at least the 1980s when economic volatility decreased substantially, has come to an end. Macroeconomics as a whole is a state of turbulence, since the old maxims of Keynesianism or the tenets of Neoclassical economics no longer seem to offer such obvious solutions to modern economic problems.[1]

The causes of the current lingering financial and economic crisis are hotly debated among academic and policy circles. Some, like Carmen Reinhart and Kenneth Rogoff, have sounded the alarm about public sector's indebtedness in the aftermath (or on the road to) of financial crisis. They have argued that a public debt-to-GDP ratio of over 0.9 pose a risk for long-run economic growth, an argument that sounds quite reasonable given recent debt problems and defaults by countries like Greece. While they do not seem as concerned about private (or foreign) debt, they do recognize that often governments have had to absorb lots of private debt in the form of toxic assets. Crises can come in various shapes and forms, including sovereign debt crises, inflationary crises (often related to wars or bad policies), banking crises (such as in the 1930s), and currency crises.[2]

There have been a number of critiques of Reinhart and Rogoff's focus, primarily, on public debt levels.[3] One clear distinction in particular that should be made concerns whether public debt is from domestic or foreign sources.[4] As Niall Ferguson and others have pointed out, domestic sources of public debt, primarily a result of wars and crises, have led to the creation of financial markets and more democratic forms of government in the last centuries.[5]

A more internationalist approach to financial crises that has grown in popularity in recent years centers on the concept of global imbalances.[6] Ben Bernanke most famously advocated this theory in a 2005 speech where the future Fed Chairman coined the term "global savings glut" (GSG).[7] The Fed Governor argued that excessive net savings in emerging markets (mainly China and oil exporting nations) were flowing into the United States bond market, distorting interest rates and consequently helping to fuel asset prices through the expansion of cheap credit (mainly in the form of "safe" mortgage-backed securities).[8] With this framework Bernanke tied together global capital flows, the rise of structured finance, and the resulting asset price speculation in the US housing market. The aforementioned economic historian Niall Ferguson further popularized this model in his 2008 book *The Ascent of Money* with his introduction of "Chimerica" into the academic vernacular. Ferguson presented American debt-fueled consumption and the Chinese desire to accumulate foreign exchange reserves as a kind

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1 See Kates (2010), on the critique of neoclassical theory and institutional alternatives; see North (1997), Greif (1997), and Greif and Laitin (2004).
2 See Reinhart and Rogoff (2009), and Krugman and Wells (2010). See also Reinhart and Rogoff (2011).
3 See Wray and Nersisyan (2010).
4 One of the earliest to make this distinction, in theoretical terms, was Buchanan (1957).
5 See Ferguson (2001), Macdonald (2003), and Graeber (2011).
6 For an example of the widespread adoption of the "global savings glut" see "The great thrift shift" (2005), in *The Economist*.
7 For details of the original speech see Bernanke (2005).
8 After becoming Fed Chairman Bernanke further developed his theory in Bernanke et al. (2011).

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