

Economic Liberalism and the Management of the Recent Global Crisis: Lessons for Africa

Enefiok E. Essien, PhD

Faculty of Business Administration, University of Uyo, P. M. B. 1017 Uyo Akwa Ibom State, Nigeria.

* E-mail of the corresponding author: essieneneessien@yahoo.com

Abstract

The efficiency of the free market system in allocating resources and in regulating itself has become a received doctrine in practically all capitalist nations. But the recent global financial crisis and the resultant government interventions to salvage the economies of many nations have generated much debate on the continued relevance of the free market and the wisdom of government 'intrusion'. This paper revisits the free market as propagated by Adam Smith and examines the role of government in present day circumstances. Drawing from the African experience, the paper concludes that the free market system and government involvement in the economy can complement each other provided there is the capacity for determining the appropriate mix that would deliver the maximum good to society.

Keywords: Economy, Management, Crisis, Liberalism, Free Market

1. Introduction

Over two hundred years ago Adam Smith (1776) wrote a book which triggered a discourse that has refused to abate. The main thrust of his work was in defining an efficient system of exchange predicated on the selfish pursuit of personal interest of the participants. The platform for the exchange was the 'market', which served as a clearing house wherein each participant got value that was commensurate with what he opted to part with. The price of any product or service was thus the outcome of a balancing act between those who had what to offer (supply) and those who wanted or needed what was offered, (demand). However, the balance was free to tilt in favour of demand (where there was excess supply) or in favour of supply (where there was excess demand). The direction and structure of these excesses influenced behaviour in consumption, production, and resource allocation generally. Thus, in a free market economy, goods and services were to be allocated in line with the interplay of demand, supply, and purchasing power. Allocation of resources was to be regarded as efficient if no further allocation could improve the lot of any market participant without hurting that of another. And since nobody would want to produce what could not be sold, the content and nature of production, including innovativeness, were influenced by actual or perceived needs and preferences of the consumer. A profitable market situation would, therefore, attract new investment, increased competition, and all things being equal, reduced prices to the benefit of consumers. Where, on the other hand, there was a glut in the market, competition would be stiff, inefficient firms would drop out and prices would fall. In all these, the interaction among market participants was to be devoid of any overt or covert coercion and fraud.

For the market mechanism to function as efficiently as expected, certain conditions were to be met. Central to the conditions was the non-interference of the government in the market. The role of the government was confined to the maintenance of law and order, especially as it pertained to the enforcement of market-based contracts and property rights (that is, the right to own, use, manage, and dispose of property as the owner deems fit). Another condition, albeit implicit, was that market participants were to be more or less equally matched so that no party could take undue advantage of the other.

Government and the free market

According to the proponents of the free market philosophy, the government should not get involved in determining what is to be produced, or how and for whom it should be produced. Market forces should be allowed to do the job, hence the term *laissez- faire*, meaning "leave it alone". Government is, however, expected to enforce such laws as would prevent theft, fraud, collusion, coercion and so on – all targeted at creating and maintaining a fair playing ground for market participants. But the role of government has historically gone beyond those confines, sometimes at the instance of the market participants themselves, an example being the recent invitation of government action in the Nigerian textile industry.

Following the virtual collapse of the textile industry in Nigeria, due mainly to the dumping of cheap foreign-made textiles in the local market, manufacturers in the sector cried out for government intervention. The argument is that free trade should be fair trade and that dumping is inconsistent with the free enterprise philosophy. This has also been the experience even in some of the highly industrialised and pro-free-market countries, including the United States of America. One widely reported instance is the appeal by United States automotive manufacturers for government intervention to save them from stiff competition from foreign car manufacturers, especially from Japan. The appeal resulted in government's imposition of quota on foreign car imports in 1981.

But government does not always wait to be invited before it intervenes in the economy. There are some areas, both economic and social, where government is deemed to out-perform the market. These include defence and justice. Others relate to market structure arising from the emergence of large corporations over time. Because of their size and the resources they control, some large corporations have become so powerful as to defy regulation by market forces. They operate on their own terms. It was the need to curb the excesses of such powerful organisations that informed the promulgation of some of the earliest known market-related legislations in the United States, such as the Sherman Act of 1840 and the Clayton Act of 1914, both of which were meant to regulate conduct and behaviour in the free market economy. But, perhaps, the greatest government intervention in that country was during the Wall Street triggered Great Depression of the 1930's which literally tore the economy apart. Faced with dwindling production, massive unemployment, loss of income, decline in consumption, bank closures, stock market crash, and widespread poverty, President Roosevelt set aside the doctrine of "rugged individualism" of his predecessor, President Hoover, and responded swiftly with a long list of legislations which were later collectively referred to as the *New Deal*. The series of interventions eased the suffering of the masses and helped to restore confidence in the ailing banking sub-sector.

The lessons of the Great Depression and the New Deal are clear: a responsible government has no choice but to intervene in the free market whenever the 'invisible hand' proves too feeble to sustain the health of the economy or component(s) thereof. Ordinarily, governments seek to steer the affairs of the macro economy for purposes of checking inflation, stabilizing the interest rate, generating employment, and promoting sustainable growth, among other goals. They achieve these through the deployment of fiscal and monetary instruments and, also, by direct manipulation (increase or reduction) of regulations. In a relatively stable environment, the measures tend to achieve the purposes for which they were designed. However, when there are large scale systemic disruptions in the market - when traditional instruments, especially regulations, are either too little or too late - and when there is a real threat of an imminent collapse of the economy, government intervention assumes a more robust and non-routine posture. Such was the case with the U.S. financial crisis of 2007 and beyond.

Protecting public interest: The bailout option

What has come to be variously described as economic meltdown or global financial crisis typifies major distortions in the operation of the market mechanism in directing the economy. Commentators have traced the roots to "liquidity shortfall in the United States banking system caused by the overvaluation of assets" (Wikipedia, 2010, p.1). Wikipedia (2010) explains the problem further as follows:-

The immediate cause or trigger of the crisis was the bursting of the United States housing bubble which peaked in approximately 2005–2006. Already-rising default rates on "subprime" and adjustable rate mortgages (ARM) began to increase quickly thereafter….. Defaults and foreclosure activity increased dramatically as easy initial terms expired, home prices failed to go up as anticipated, and ARM interest rates reset higher. (p.5)

The United States swiftly reacted to the situation in order to avert what seemed an iminent collapse of the economy. Interestingly, that was not done by further liberalizing the market, but rather, by regulating it, in spite of the ideological stance of the country. Affected European countries responded to the problem the way the Americans did. Anderson, Cavanagh and Redman (2008) reported that United States spent $1.3 trillion while European countries spent $2.8 trillion as at November 13, 2008 to bail out their ailing financial sectors. Tables 1 and 2 give a breakdown of the bailout in United States and Europe respectively.

Apart from the financial sector, manufacturing also benefited from the bailout. As at January 2009 the auto industry in the United States, for instance, had received a total of $24.9 billion from the $700 billion bailout fund. And, in addition to the financial stimulus, the industry agreed to embark on some government induced reforms such as:

- reduction in financial and non-financial benefits of Chief Executives,
- issuance of warrants to government for stocks in their organisations,
- speeding up the development of more efficient vehicles, and
- generally repositioning the industry for greater efficiency and competitiveness

These steps served to forestall a systemic economic collapse in the affected countries, and prompted Dionne (2010:4) to ponder if "practical minded business people (would) now admit that there are occasions when government intervention can be good for capitalism by saving it from some of the very forces it unleashes". Clearly, 'government intrusion into the private sector' is not only useful but could be the most potent option in certain circumstances. And, this is mindful of the fact that "when it comes to almost anything the government does, ideology trumps facts, slogans trump reality, and loaded words ("socialism") trump data" (Dionne, 2010:3). Governments in the developed world confronted the financial crisis unapologetically because the wellbeing of their citizens was at risk. But can the same be said of developing countries, especially in Africa?

Protecting public interest: The African experience

The financial crisis had its collateral effects in the developing world. Research has shown that the growth rate of many developing countries reduced considerably due to the impact of the financial crisis on commodity prices, trade, remittances, and investment, and that the situation resulted in a sharp increase in the number of persons living below the poverty line in those countries (Velde, 2009). But that notwithstanding, not much is said about the management of the problem by the developing nations, especially in Africa where for the most part, the weight of free market mentality is still holding sway.

Admittedly, some African governments crafted some sort of intervention measures in response to the problems generated by the global financial crisis. But whereas the United States and the European governments intervened in their economies with the "largest liquidity injection into the credit market and the largest monetary policy action in world history", African countries that intervened at all did so less robustly. In Nigeria, for example, the Central Bank injected a total of N620 billion (about $4.2 billion) into the financial sector to salvage those banks considered to be in a 'grave situation' from imminent collapse. As a further action, the Chief Executive Officers of the worst affected banks lost their jobs. Though limited, the intervention still had a positive effect on the economy. The Central Bank explained the position as follows:

In Nigeria, the economy faltered and the banking system experienced a crisis in 2009, triggered by global events. The stock market collapsed by 70% in 2008–2009 and many Nigerian banks had to be rescued. In order to stabilize the system and return confidence to the markets and investors, the CBN injected N620billion of liquidity into the banking sector and replaced the leadership at 8 Nigerian banks. Since then, the sector has considerably stabilised (Sanusi, 2010, p.1).

In addition to bailing out the ailing banks, the Nigerian government took other initiatives including the setting up of Asset Management Corporation (AMCON) with the prime function of buying toxic assets from banks, and the establishment of a N500 billion intervention fund for use in strengthening the real sector of the economy. However, these interventions seem to be crisis-led. Also, they show no serious questioning of, or desire to modify the country's version of the free market philosophy. The end result is the frequently encountered inconsistency in policy direction, the best example being the fiscal policy measures announced about the close of 2010. After providing funds to the Bank of Industry (BOI) for onward lending on easy terms to manufacturers, including firms in the dying textile industry, the government announced the lifting of the ban on importation of textiles, apparently in the spirit of economic liberalism. That was without regard to the uncompetitive position of local manufacturers brought about by dumping and the crippling shortage of necessary basic infrastructure.

The problem in the Nigerian case, and in similar cases in Africa, is clearly that of inadequate capacity of the architects of government intervention. Akpakpan (2004) highlighted this problem as follows:

It is inadequate capacity that makes our governments and government agencies unable to deliver the services they are expected to deliver, it is inadequate capacity that makes our government officials to accept inappropriate pieces of advice from ill-informed external experts, and it is inadequate capacity that makes potentially sound policies not to work in this country. Relevant capacity is crucial in all we do (p.32).

The policy failures and dismal performances of African economies, therefore, have a lot to do with the capacity of African governments – the capacity to discern and the capacity to sift through prescribed policy directions introspectively. An example is the unbridled acceptance of the so-called Washington consensus about which the following comments had been made:

The liberal economic policies packaged under the Washington consensus which aimed at opening up national economies of those countries, and reducing the role of the state, with privatization, deregulation and support for property rights (Williamson, 1990) is widely believed among scholars and practitioners to have generated policy learning among nations….Consequently, many of these governments almost copy blindly, and in the process end up deteriorating their economies and worsening the plight of many of their citizens (Aikins, 2009:36)

The experiences of the more successful less-developed countries (LCDs) show that the market mechanism is not inherently incompatible with government intervention or regulation. Indeed, it is the role of government to ensure that the market works for the general good of society. And it does so by checking actual or potential abuses of economic liberalism and self regulation – abuses that are capable of hurting the wellbeing of citizens. This is what governments in the successful Asian countries, especially Taiwan, South Korea, and Japan did, an approach which Robert Wade (1990) described as 'governing the market' and suggested that 'other countries would be wise to learn' (p.7). The challenging experiences of many African countries in their struggle to improve the lot of their societies are, therefore, not attributable to the market mechanism *per se,* but to the inability of the governments to use the market in ways that are best suited to their circumstances.

Conclusion

The global financial crisis has generated a lot of debate on the merit and adequacy of economic liberalism. Alongside, the role of government has come under intensive scrutiny. But, drawing from the African experience and, indeed, the experiences of other nations, it is clear that government intervention and the market mechanism are not mutually exclusive policy options. They could, and usually do, complement each other. The problem then lies in determining the appropriate mix that each situation uniquely demands. The capacity to identify what is good in the market and in government with a view to harnessing them for the wellbeing of citizens is what African societies really need, and should focus on in the struggle to improve economic and social conditions in the continent.

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Table 1: US Commitment to Financial Sector Bailout as at November 13, 2008. ($Billions unless otherwise stated)

Programme	Amount	Description
Troubled Asset Relief Programme (TARP)	700.00	Original plan was to use the funds primarily to purchase troubled mortgage related assets. The Treasury Secretary has since decided to use the funds for cash injections for banks.
Commercial Paper Funding Facility	243.00	Through this facility, the Fed buys commercial paper (short-term debts) from banks to help finance day-to-day business operations.
Fannie Mae/Freddie Mac	200.00	Federal officials assumed control of the mortgage firms and are providing cash injections to keep them afloat
AIG	112.50	Does not include $40 billion drawn from the 700 billion $ bailout fund. After an initial bailout in October, AIG negotiated a larger rescue package with easier terms.
Bear Stearns	29.00	Special lending facility to guarantee losses on the investment bank's portfolio; facilitated buyout by JP Morgan.
FDIC Bank Takeovers	13.20	The Federal Deposit Insurance Corporation has put up to cover deposits on failed banks.
Total	**U.S. $1.3 trillion**	

Source: Anderson, Cavanagh and Redman (2008) as presented in Aikins (2009)

Table 2: Western European Commitment to Financial Sector Bailout as at November 13, 2008. ($ Billions Unless Otherwise Stated)

Country	Amount	Description
United Kingdom	743.0	The UK bailout was the first announced and largely served as the model for other European rescues. Half of the package is for guaranteeing inter-bank lending, 40% for short-term loans and 10% for recapitalization.
Germany	636.5	The bulk is to guarantee medium-term bank lending, with 20% for recapitalization
France	458.3	The bulk is to guarantee bank debt, with about $50 billion for recapitalization
Netherlands	346.0	To guarantee inter-bank loans
Sweden	200.0	For credit guarantees
Austria	127.3	For bank buyouts, interbank lending, and bank bond issuance guarantees
Spain	127.3	For bank buyouts, interbank lending, and bank bond issuance guarantees.
Italy	51.0	To purchase bank debts
Other European Countries	110.6	
Total European	**$2.8trillion**	

Source: Anderson, Cavanagh and Redman (2008) as presented ln Aikins(2009)