

TIGERS IN TROUBLE

Financial Governance, Liberalisation and Crises in East Asia

edited by
Jomo K.S.



HONG KONG UNIVERSITY PRESS
Hong Kong



IPSR BOOKS
Cape Town



UNIVERSITY PRESS LTD
Dhaka



WHITE LOTUS
Bangkok



ZED BOOKS LTD
London and New York

TIGERS IN TROUBLE
was first published in 1998 by
Zed Books Ltd
7 Cynthia Street, London N1 9JF, UK

Copyright © Zed Books Ltd 1998

Distributed in the USA exclusively by
St Martin's Press
Room 400, 175 Fifth Avenue, New York, NY 10010, USA

Printed and bound in Malaysia

All rights reserved

A catalogue record for this book is available from the British Library

Library of Congress Cataloging-in-Publication Data

Tigers in trouble : financial governance and the crises in East Asia /
[edited by] Jomo K.S.

p. cm.

A collection of 11 essays by the editor and other authors.

Includes bibliographical references and index.

ISBN 1-85649-661-9 (hc.). — ISBN 1-85649-662-7 (pbk.)

1. Capital market—East Asia. 2. Financial crises—East Asia.

3. Monetary policy—East Asia. 4. International Monetary Fund.

5. International finance. I. Jomo K. S. (Jomo Kwame Sundaram)

HG5770.5.A3T54 1998

332.1'095'09049—dc21

98-27307

CIP

ISBN 1 85649 661 9 Hb

ISBN 1 85649 662 7 Pb

Published in Hong Kong by Hong Kong University Press
14/F Hing Wai Centre, 7 Tin Wan Praya Road, Aberdeen, Hong Kong
ISBN 962-209-475-9

Published in South Africa by IPSR Books
Community House, 41 Salt River Road, Salt River 7925, Cape Town, South Africa
ISBN 0-9584224-4-3 Hb
ISBN 0-9584224-3-5 Pb

Published in Bangladesh by The University Press Ltd
Red Crescent Building, 114 Motijheel C/A, PO Box 2611, Dhaka 1000
ISBN 984-05-1445-8

Published in Burma, Cambodia, Laos and Thailand by White Lotus Company Ltd
GPO Box 1141, Bangkok, 100501, Thailand
ISBN 874-8434-59-1



Institute On
Governance

Institut sur
la gouvernance

Support from the Institute On Governance is gratefully acknowledged.

122, rue Clarence St., Ottawa, Canada K1N 5P6

Tel: (613) 562-0090 Fax: (613) 562-0097

Website: <http://www.igvn.ca>

CONTENTS

<i>Contributors</i>	ii
<i>Tables and Charts</i>	viii
<i>Glossary</i>	ix
<i>Foreword</i>	xi
<i>Acknowledgements</i>	xii
<i>In Lieu of a Preface</i>	xiii
1 Introduction: Financial Governance, Liberalisation and Crises in East Asia	1
<i>Jomo K.S.</i>	
Macroeconomic Concerns	3
Collapse: The Bubble Bursts	5
Lessons	6
Policy Challenges	8
Changed International Financial System	9
Implications of Financial Liberalisation	11
Analytical Catch-up	13
Understanding the Southeast Asian Currency Crisis	16
IMF Intervention	18
This Volume in Brief	21
Roots of the Crisis: Challenges of Governance	23
2 The East Asian Financial Crisis: Back to the Future	33
<i>Yilmaz Akyüz</i>	
The Crisis: Surprising or Predictable?	34
The Policy Response	37
Global Implications	38
Conclusions	42
3 East Asia is not Mexico: The Difference between Balance of Payments Crises and Debt Deflation	44
<i>J.A. Kregel</i>	
An Interpretation of the Asian Crisis	45
A Financial Crisis of International Capital Market Failure	51
Stage Two: The Cure is Worse than the Disease	57

4	Hubris, Hysteria, Hope: The Political Economy of Crisis and Response in Southeast Asia	63
	<i>C.P. Chandrasekhar and Jayati Ghosh</i>	
	Background to the Current Crisis	63
	The Financial Crisis	68
	The IMF Response	74
	Foreign Finance, Governments and People	78
	The Prognosis	80
5	Taming the Tigers: The IMF and the Asian Crisis	85
	<i>Nicola Bullard with Walden Bello and Kamal Malhotra</i>	
	The IMF and Thailand: A Cosy Relationship	85
	The IMF and Indonesia: Under the Volcano	92
	The IMF and South Korea: Teaching the Tiger a Lesson	100
	Social Impact of the Crisis	109
	The Role of the IMF	120
	Conclusions and Recommendations	132
6	Thailand: Causes, Conduct, Consequences	137
	<i>Laurids S. Lauridsen</i>	
	Excessive Short-term Borrowings and Casino Capitalism	138
	Financial Institutions and the Financial Crisis in the 1980s	140
	Financial Liberalisation in the 1990s	142
	Economic Slowdown, Loss of Competitiveness and Currency Crisis	143
	The Politics of the Financial Crises	145
	Financial Crisis and Breakdown of Investor Confidence	147
	The IMF Medicine	149
	The Chuan Government: Financial Clean Up and Sticking by the Terms	151
	From Financial Crisis to Socioeconomic Crises	153
	Concluding Remarks	157
7	Indonesia: Reaping the Market	162
	<i>Manuel F. Montes and Muhammad Ali Abdusalamov</i>	
	Setting the Stage	163
	Asian Crisis Erupts	171
	Conclusions: Understanding the Political Economy	179

8	Malaysia: From Miracle to Debacle	181
	<i>Jomo K.S.</i>	
	Policy Responses: Solution or Problem?	184
	Denial and Distraction	185
	Bail-outs for 'Cronies'	186
	The Changing Budget as a Reflection of Changing Stance	189
	Finally, the Tide Turns	190
	Confidence Restoration	192
	Political Fallout	194
9	The Philippines and the East Asian Economic Turmoil	199
	<i>Joseph Y. Lim</i>	
	Economic Phases in the Last Two Decades	199
	Analysis of the Causes of the Crisis	213
	Prospects for the Future	219
10	South Korea: The Misunderstood Crisis	222
	<i>Chang Ha-Joon</i>	
	Understanding the Crisis	222
	Immediate Causes	223
	Deeper Causes	226
	What Future for Korea?	229
	Afterword: The East Asian and Other Financial Crises – Causes, Responses and Prevention	232
	<i>G.K. Helleiner</i>	
	Causes	232
	Issues in Crisis Management	233
	Crisis Prevention and Damage Control	236
	<i>Bibliography</i>	239
	<i>Index</i>	248

TABLES

P1	Distribution of Loans by Country of Origin	xv
P2	Lending by BIS Reporting Banks by Country and by Sector	xv
P3	Maturity Distribution of Lending of BIS Reporting Banks	xvi
1.1	Selected Indicators for Four Countries in Southeast Asia	31
1.2	International Bank Lending by Banks, as of end-June 1997	32
1.3	Total Exposure of BIS Area Reporting Banks to Non-BIS Borrowers, end-June 1997	32
1.4	Savings Rates in Selected Southeast Asian Countries, 1981-96	32
3.1	External Financing of Korea, Indonesia, Malaysia, Philippines and Thailand	55
3.2	Asian Countries: Investment as Percentage of GDP, 1986-95	55
3.3	Asian Countries: Current Account Balances as a Percentage of GDP, 1989-97	56
3.4	Asian Countries: Fiscal Balances as a Percentage of GDP, 1988-97	56
4.1	East Asia: Export Growth Trends	64
4.2	East Asia: Export Growth Rates in Selected Categories, 1995-96	64
4.3	East Asia: Aggregate Net Resource Flows	84
5.1	Approximate Contributions to IMF Loans	104
5.2	Thailand National Budget, January-December 1998	113
7.1	Indonesia: Inflation and Monetary Aggregates	164
7.2	Indonesia: Ratios of M2 and TAFI* to GDP and to Each Other, 1970-91	168
7.3	Indonesia: Status of Bank Credit, 1993-1995	170
7.4	Indonesia: Monetary and Banking Data, 1990-96	172
7.5	Indonesia: Macroeconomic Fundamentals, 1990-96	173
8.1	Malaysia: Key Macroeconomic Variables, 1989-96	198
9.1	Some Macro Indicators for the Philippines, 1981-97	201
9.2	Philippines: Balance of Payments, 1990-97	206

CHARTS

P1	Southeast Asian Vulnerability	xiii
P2	IMF Prescription/East Asian Dilemma	xiv
7.1	Indonesia: Growth and Type of Banks, 1979-96	167
7.2	Rupiah/US Dollar Movements, 1 July-27 November 1997	176
7.3	Rupiah/US Dollar Movements, 1 December 1997-6 February 1998	177

CONTRIBUTORS

Muhammad Ali Abdusalamov, Tashkent State University of Economics; Visiting Fellow, Institute of Southeast Asian Studies (ISEAS), Singapore (until March 1998).

Yilmaz Akyüz, (PhD, East Anglia), Chief, Macroeconomic and Development Policies, UNCTAD, Geneva.

Walden Bello (PhD, Princeton), Professor, University of the Philippines, Diliman, Quezon City and Co-Director, Focus on the Global South, Bangkok, Thailand.

Nicola Bullard, Senior Associate, Focus on the Global South, Bangkok, Thailand.

C.P. Chandrasekhar (PhD, JNU), Associate Professor, Centre for Economic Studies and Planning, Jawaharlal Nehru University, New Delhi, India.

Chang Ha-Joon (PhD, Cambridge), Assistant Director of Development Studies, Faculty of Economics and Politics, University of Cambridge, Cambridge, England.

Jayati Ghosh (PhD, Cambridge), Associate Professor, Centre for Economic Studies and Planning, Jawaharlal Nehru University, New Delhi, India.

G.K. Helleiner (PhD, Yale), Professor, Economics Department, University of Toronto, Canada; Coordinator, G-22.

Jomo K.S. (PhD, Harvard), Professor, Faculty of Economics and Administration, University of Malaya, Kuala Lumpur, Malaysia.

J.A. Kregel (PhD, Cambridge), Professor, Economics Department, University of Bologna and Professor, Johns Hopkins University, Bologna, Italy.

Laurids S. Lauridsen (PhD, Roskilde), Associate Professor, Roskilde University Centre, Roskilde, Denmark.

Joseph Y. Lim (PhD, Pennsylvania), Associate Professor, School of Economics, University of the Philippines, Diliman, Quezon City, Philippines.

Kamal Malhotra, Co-Director, Focus on the Global South, Bangkok, Thailand.

Manuel F. Montes (PhD, Stanford), Senior Fellow, Institute of Southeast Asian Studies (ISEAS), Singapore and Senior Fellow (on leave), East-West Center, Honolulu, USA.

1

INTRODUCTION: FINANCIAL GOVERNANCE, LIBERALISATION AND CRISES IN EAST ASIA

Jomo K.S.*

Since July 1997, the currencies of all three second-tier Southeast Asian newly industrialised countries (NICs) have fallen precipitously, with the stock markets responding in tandem. The Philippines has also been similarly affected although not as badly. At the end of 1997, despite its rather different economic structure, South Korea too went into free fall, arguably with more disastrous consequences. Most other economies in East Asia have also been under considerable pressure, either directly (e.g. with the attack on the Hong Kong dollar) or indirectly (e.g. due to the desire to maintain comparative cost advantage against the now greatly devalued currencies of Southeast Asian exporters).

Contrary to the impression conveyed by many economic journalists and commentators as well as by the International Monetary Fund (IMF), there is little agreement on how to understand and characterise this crisis. One manifestation of this has been the debate between the IMF and its critics over the appropriateness of its negotiated programmes in Thailand, Indonesia and South Korea. Some critics also point out that the Philippines has not been spared despite being under an IMF programme since the mid-1980s. The Suharto government's plans to establish a currency board in Indonesia have also generated much debate along different lines.

While the policy debates have understandably captured the most attention, especially with the public at large, the East Asian crisis has also challenged economists, especially international economists. Some still see the crisis as essentially a currency crisis, although perhaps of a new type, different from those previously identified with either fiscal profligacy or macroeconomic indiscipline.

* I am grateful to Jan Kregel, Al Alim Ibrahim, Din Merican and Warren Bailey for their useful critical feedback, but implicate none of them.

There continues to be considerable debate over the principal causes and consequences of the recent currency and financial crises in Southeast Asia. This essay is deliberately polemical as there is clearly no shared understanding of the various contentious issues involved. As far as possible, the language is not technical, in order to be accessible to as wide a readership as is feasible. Since events are still unfolding, such reflections should be open to revision with the passage of time, events and trends, and the benefit of hindsight. Hence, criticisms and suggestions are especially appreciated.

Approaching it slightly differently, other economists see it as a balance of payments crisis, emphasising the current account deficits sustained by most of the economies affected. A growing number maintain that the crisis started off as a financial crisis, though most agree that it has already had and is likely to have tremendous consequences for the real economy, either because of its consequences for the financial sector or because of the consequences of official policy and other responses.

There is also considerable debate about the implications of this crisis for economic development, particularly for the debate over whether the East Asian experience of the last three decades offered different lessons and prescriptions for development from those advocated by the 'counter-revolution' against development economics. As is now well known, this neo-liberal reaction has maintained that development economics and its prescriptions were bad economics, based on distortions of neo-classical welfare economics, which exaggerated the extent and implications of 'market failure' and underestimated the likelihood of 'state failure' and its consequences.

Influential economists at the World Bank and elsewhere are already citing the East Asian financial crisis to criticise the Bank's (1993) *East Asian Miracle* volume as flawed. In particular, the critics denounce part of the study's acknowledgement of the success of 'directed credit' and what has come to be known as 'financial restraint' — said to have been authored by the Bank's current senior vice-president and chief economist, Joseph Stiglitz, who has also dissented on the appropriateness of IMF prescriptions for the current financial crisis.

With the mid-1997 crisis starting not long after Paul Krugman's (1994) claims that East Asian growth is not sustainable because it is based primarily on factor accumulation — eventually subject to diminishing returns rather than productivity growth ('perspiration rather than inspiration') — many critics from across the political spectrum have seen the East Asian financial crisis as evidence of Krugman's argument, or of some variation thereof. Often, there is more than a touch of neo-liberal triumphalism in hasty pronouncements of the end of the Asian miracle or in word plays of 'miracle or debacle', 'tigers or fat cats' and the like.

Meanwhile, in recent years, there has been growing recognition of major structural and systemic differences among the eight high performing Asian economies (HPAEs) studied by the World Bank (1993), namely Japan, South Korea, Taiwan, Hong Kong, Singapore, Malaysia, Thailand and Indonesia. The last three have been increasingly grouped as second-tier or second-generation Southeast Asian NICs, with characteristics quite different from the others, and of course, even among themselves. It has been argued that industrial policy or selective state intervention has been of much poorer quality and less effective in these economies for various reasons; instead, there has been much other state intervention motivated by less developmentalist considerations, especially in

Malaysia and Indonesia (Jomo *et al.* 1997). It appears that such interventions bear some of the responsibility for the vulnerability of the second-tier Southeast Asian NICs to the factors which have precipitated the mid-1997 financial crisis in the region.

Macroeconomic Concerns

Rapid economic growth and structural change, mainly associated with industrialisation in the region, are generally traced back to the mid-1980s. Devaluations in all three countries as well as selective deregulation of onerous rules helped create attractive conditions for the relocation of production facilities in these countries and elsewhere in Southeast Asia and China, especially from Japan and the first-tier or first-generation newly industrialising economies (NIEs) of South Korea, Taiwan, Hong Kong and Singapore. This dynamic growth sustained export-oriented industrialisation well into the nineties, but was soon accompanied by the growth of other manufacturing, services as well as construction.

This is not to suggest that the fundamentals were all alright in Southeast Asia. Although high growth was sustained for almost a decade, during most of which fiscal balances were in order, monetary expansion was not excessive and inflation was generally under control, some other indices have been awry. The export-led growth of Southeast Asian economies since the late 1980s has been followed by a construction and property boom, fuelled by financial sectors favouring such 'short-termist' investments — involving loans with collateral which bankers like — over more productive, but often more risky investments in manufacturing and agriculture. The exaggerated expansion of investment in such 'non-tradables' has exacerbated current account trade deficits. Although widespread in East Asia, for various reasons, the property–finance nexus was particularly strong in Thailand, which made it much more vulnerable to the inevitable bursting of the bubble.

Financial liberalisation from the 1980s also saw major ramifications in the region, as foreign savings supplemented the already high domestic savings rates in the region to further accelerate the rate of capital accumulation, albeit in increasingly unproductive activities owing to the foreign domination of most internationally competitive industries in the region. Consequently, several related macroeconomic concerns had emerged from the rapid growth of the last decade by the mid-1990s:

First, the *savings–investment gap*, which was 5 per cent of GNP in 1997, lay behind the *current account deficit*,¹ which has exceeded RM12 (almost US\$5) billion since 1994. The gap had been bridged historically by heavy reliance on foreign direct investment (FDI). But high FDI and foreign debt have, in turn, caused growing investment income outflows abroad.² In recent years, the current account gap has been temporarily bridged by short-term capital inflows, as in 1993 and since 1995, with disastrous consequences later with the subsequent reversal

of such flows. Many recent confidence restoration measures seek to induce such short-term inflows once again, but they cannot be relied upon to address the underlying problem in the medium to long term.³

Although always in the minority, foreign investment institutions 'made' the stock markets in the region, shifting their assets among securities markets as well as among different types of financial investment options all over the world. In the face of limited transparency, the regional nature of their presence, the nature of fund managers' incentives and remuneration and the short-termism of their investment horizons, foreign financial institutions were much more prone to herd behaviour and contributed most to the regional spread of contagion.

Second, there was a *recent explosion of private sector debt, especially from abroad*, not least due to the efforts of 'debt-pushers' associated with greater competition in bank lending.⁴ The ratio of loans to Gross National Product (GNP) has risen rapidly in recent years. Meanwhile, commercial banks' foreign liabilities more than tripled between 1995 and 1997. This is partly why the standard insistence on raising domestic interest rates is quite misleading as much of the recent increase in corporate borrowings has come from abroad. This has exacerbated the impact of the current crisis, with triple pain caused by currency depreciation, stock market collapse and rising interest rates.

Meanwhile, the *over-investment* of investible funds, especially from abroad, in '*non-tradables*' only made things worse, especially for the current account. Only a small proportion of commercial bank and other lending has gone to manufacturing, agriculture, mining and other productive activities; the percentage is likely to be even smaller with foreign borrowings, most of which have been collateralised with assets such as real property and stock.⁵ In other words, much of the inflow of foreign savings actually contributed to an *asset price inflation*, mainly involving real estate and share prices. Insofar as such investments did not contribute to increased production of 'tradables', they actually exacerbated the *current account deficit*,⁶ rather than alleviated it — as they were thought to be doing. This, in turn, worsened the problem of 'currency mismatch', with borrowings in US dollars invested in activities not generating foreign exchange. Insofar as a high proportion of these foreign borrowings were short term in nature and were deployed to finance medium to long-term projects, an additional 'term mismatch' problem also arose.

More generally, the foreign exchange risk of investments generally increased, raising the vulnerability of these economies to the maintenance of the *quasi-pegs* of their currencies to the US dollar,⁷ which had, in turn, encouraged a great deal of *unhedged borrowing* involving an influential constituency with a strong stake in defending the peg regardless of its adverse consequences for the economy. Owing to foreign domination of export-oriented industries in Southeast Asia, unlike Northeast Asia, there was no strong domestic export-oriented industrial community to lobby for floating or depreciation of the Southeast Asian currencies

despite the obvious adverse consequences of the peg for international cost competitiveness. Instead, after virtually pegging their currencies to the US dollar since the advent of flexible exchange rates, from the early 1990s and especially from the mid-1990s, most Southeast Asian central banks resisted downward adjustments in their exchange rates, which would have reduced, if not averted some of the more disruptive consequences of the recent currency collapses.⁸

According to the Bank of International Settlements (BIS) (*Asian Wall Street Journal*, 6 January 1998), well over half of foreign borrowings from commercial banks were short term in nature, i.e. coming due soon: Malaysia 56 per cent, Thailand 66 per cent, Indonesia 59 per cent and South Korea 68 per cent. There is growing evidence of continued lending by continental European and Japanese banks to East Asian customers despite warnings by the BIS and others well before the crisis broke in July 1997 (Raghavan 1998).

Collapse: The Bubble Bursts

Contrary to the claim that 'the market' will exact swift and painful punishment on governments and economies which do not have their macroeconomic house in order, the timing, nature and consequences of the mid-1997 financial crisis in Southeast Asia underline the imperfect nature of financial markets. This has been reflected in the long delay in 'rectification'. For example, current account deficits were more serious in 1995 compared to 1997, but there was no rectification then, let alone punishment of the culprits, i.e. current account deficits in Malaysia and some other neighbouring economies had reached all time highs, without any commensurate adverse effect.⁹

In the wake of the Mexican crisis in early 1995, even the IMF had stepped back momentarily from its advocacy of virtually unfettered financial liberalisation. Unfortunately, the short-termism of financial markets extends to human and institutional memories as well as to related policy-making and advocacy. The recent crisis has also seen a market where the magnitude of 'overshooting' exceeds that of the 'correction' many times over. Further evidence of market-induced anarchy can be found in the 'herd behaviour' underlying the 'contagion' or 'domino' effects. While some governments and economies have been badly affected by the crisis since mid-1997, there is little evidence that the private sector culprits have suffered most as a consequence, i.e. not only is the market neither efficient nor swift, it is also unjust.

Perceiving the Southeast Asian region as much more integrated than it actually is (e.g. in terms of trade links excluding Singapore, the regional entrepôt), the panicky investment decisions of fund managers based outside the region — e.g. in Wall Street or the City of London — have often been 'herd-like',¹⁰ causing a 'contagion' or 'domino' effect throughout the region. The very logic and magnitude of hedge fund operations¹¹ have tended to exacerbate these phenomena,

with disastrous snowballing consequences for the region. Other international, regional and, increasingly, local currency speculators and hedgers have also been responsible, but mainly reacting in their own self-interest to perceived market trends, rather than as part of some grand conspiracy.

Lessons

Obviously, one cannot wish away the present situation by simply claiming that East Asian economic fundamentals are fine, even if that were true. Unfortunately, as East Asia has painfully learnt, the market is driven by sentiments as much as by fundamentals. Hence, although much more serious current account deficits in 1995 did not result in crisis, the authorities have to be careful to minimise vulnerability due to the economy's openness.

One cannot, for example, liberalise the capital account, and then complain when short-term portfolio investors suddenly withdraw due to their whims and fancies. That is why, even Chile, the darling of the Chicago monetarists, makes it very difficult — and costly — to rapidly withdraw capital from its economy, and treats foreign direct investment (FDI) very differently from portfolio investment. Some other authorities may try to go further to distinguish those who are simply short-termist from, say, pension funds with a more medium-term orientation. After all, one cannot expect more birds to fly into rather than out of an open birdcage indefinitely since the basic premise of financial liberalisation is 'easy come, easy go'.¹²

In recent years, many Southeast Asian economies became excessively reliant on such short-term capital inflows to bridge their current account deficits. This was exacerbated by excessive imports to make more non-exportables such as buildings. Ostensibly prudent financial institutions often preferred to lend for real property and stock purchases, and thus secure assets with rising values as collateral, rather than to provide credit for more productive ends.

While foreign banks were happy to lend US dollars at higher interest rates than available elsewhere, Southeast Asian businesses were keen to borrow at lower interest rates than available domestically. The costs of hedging — a hundred basis points or so for ringgit-dollar, a few hundred for baht-dollar or rupiah-dollar — now look cheap in hindsight. The existence of a well-developed swap market allows Southeast Asian companies to tap into foreign capital markets, at a not unreasonable cost, by swapping away the currency risk. The problem was ultimately one of greed: the combination of much lower foreign interest rates and seemingly fixed exchange rates caused borrowers to gamble and not prudently pay the cost for some insurance by hedging.

Hence, most such loans remained unhedged as Southeast Asian currencies seemed pegged to the US dollar in recent years despite the official fictions of exchange rates moving with the basket of currencies of major foreign trading

partners. The boom in bank lending in the region in recent years led to intense competition reminiscent of lending to Third World governments in the late seventies (which built up to the debt crisis of the early eighties). However, the new fiction in international policy-making circles was that such accumulation of private sector debt did not matter as long as public sector debt was reined in.

Meanwhile, portfolio investors moved into the newly emerging stock markets of Southeast Asia with encouragement from the International Finance Corporation, an arm of the World Bank. In Malaysia, for example, they came in a big way in 1993, only to withdraw even more suddenly in early 1994, leaving most retail stockholders in the lurch. But unfortunately, policymakers seem to have short memories and did not learn the lessons from that experience as the new unsustainable build-up from 1995 sent stock prices soaring once again despite declining price-earnings ratios. The rest is history, but as a wise man once said, when history repeats itself, the first time it's tragedy, the second time farce.

Thus, the Southeast Asian currency and financial crises since mid-1997 have been partly due to financial liberalisation and its consequent undermining of monetary and financial governance. The 'quasi-pegs' of the region's currencies to the US dollar and the encouragement of foreign capital inflows — into the recently opened-up stock markets as well as in the form of borrowings, often on a short-term basis¹³ — to close the current account deficit, also ensured that foreign savings supplemented the already high domestic savings rate to raise investment rates in the region, contributing to a spiralling inflationary bubble of share and real property prices. The quasi-peg not only encouraged unhedged borrowing from abroad, but also became a target for currency speculators as regional currencies appreciated with the US dollar despite declining export competitiveness and growth. Meanwhile, financial liberalisation allowed lucrative opportunities for taking advantage of falling currencies, thus accelerating and exacerbating the collapse of regional currency and share markets. All this, together with unjudicious official responses, transformed the inevitable 'correction' of overvalued currencies in the region into a collapse of the currencies and the stock markets of the region as panic set in, exacerbated by herd behaviour and contagion.

Although the financial systems in the region are quite varied and hardly clones of the Japanese 'main bank' system, as often wrongly alleged, they have nevertheless become prone — owing to particular policy conjunctures — to the same financial-property 'bubble' phenomena, albeit for somewhat different reasons. Arguably, the more bank-based systems of Thailand, Korea and Indonesia had a stronger nexus of this sort compared to, say, Malaysia's much more stock market-oriented financial system. Rapid growth, on the basis of export-oriented industrialisation from the late 1980s, gave rise to unregulated financial expansion, which contributed to a property boom and asset price bubbles, both in the more market-oriented or 'Anglo-Saxon' Malaysia as well as the more bank-oriented Thailand.

With the currency collapses, the assets acquired by short-term portfolio and other investors in the region depreciated correspondingly in value, precipitating an even greater sell-out and panic, causing herd behaviour and probably causing contagion to spread across national borders to the rest of the region. In Malaysia and perhaps elsewhere, further property market and stock market collapses seem imminent in view of anarchic over-building and the property–finance nexus. Thus, many will be hit by this ‘triple whammy’ from the currency, stock and property markets.

The higher interest rates being demanded by the financial community will add salt to the wound, and has shown little success so far in increasing short-term capital inflows. But even when higher interest rates succeed in doing so, such flows can only be temporarily sustained and retained, at great and permanent cost to productive investments in the real economy. And if such outflows are eventually reversed in the precipitous manner experienced by Southeast Asia in the second half of 1997, much collateral damage will be experienced again.

Policy Challenges

As a consequence of recent developments, Southeast Asia now faces domestic policy reform challenges relating to four factors, namely *greater exchange rate flexibility*, the *urgency of financial sector reform*, as well as *handling asset price bubbles* and *current account deficits*. Before addressing the challenges on the domestic and international fronts, it is useful to summarise these four dimensions of the current crisis.

Without the advanced economies stabilising exchange rates with regard to one another’s currencies, the *virtual* or *quasi-pegging* of an economy’s foreign exchange rate has become very *dangerous*, as the recent crisis has demonstrated. Short-term capital inflows may temporarily supplement domestic savings, but the reversal of such flows can create severe disturbances. While such flows may be influenced by economic fundamentals in the long term, they are determined by speculative sentiments in the short term. Short-term exchange rate adjustments — with disruptive consequences for domestic prices and wages — are then deemed necessary to stem sudden outflows, but these, in turn, offer an opportunity for currency speculators.

Financial sector reform has to be thought of not only in terms of the liberalisation insisted upon by international financial interests, but also the *new regulation needed* to anticipate and respond to new challenges. While the problems caused by excessive as well as inappropriate regulation are often emphasised by advocates of liberalisation, liberal banking policies can result in a weak domestic banking sector¹⁴ unable to withstand competition from abroad, and even the collapse or costly bail-out of weak banks. For most developing economies, policies of ‘*financial restraint*’ are also *still needed* to ‘direct’ credit¹⁵

to finance productive investments instead of asset purchases or consumption. Greater capital account convertibility, related financial innovation and the proliferation of non-bank finance companies as well as 'private banking' (discreet services for rich clients) also pose new challenges for financial regulation.

Easy credit, partly due to capital inflows, resulted in meteoric rises in real property as well as share prices desired by most of those involved. Banking regulation to minimise such asset price inflation deserves the highest priority, and is always difficult to achieve in 'good times' without precipitating an asset price meltdown. It will be easier to achieve now that the asset price bubble has burst.

Current account deficits have been considered 'natural' in Southeast Asia, as in many other fast growth situations, supposedly reflecting the excess of domestic investment over domestic savings; hence, they were not seen as a source of policy concern in certain policy-making circles. Since the debt crisis of the early and mid-eighties, the cutting of fiscal deficits gained top priority at the behest of the Bretton Woods institutions and others. Developments since the Mexican tequila meltdown of early 1995 suggest that the current account deficit was the Achilles' heel of the Southeast Asian economies, precipitating financial meltdowns beginning with the collapse of their currencies 'quasi-pegged' to the US dollar, inadvertently encouraging massive unhedged private borrowing from abroad.

Changed International Financial System

Malaysian Prime Minister Mahathir Mohamad's criticisms¹⁶ of the role of international currency speculation in precipitating the recent East Asian crisis as well as the IMF policy responses have largely been dismissed outside of Malaysia except for those who recognise his remarks as reflecting confused frustration in the face of a new phenomenon not satisfactorily explained by conventional economic analysis. Hence, dismissing Mahathir would be tantamount to throwing the baby out with the bath water as Mahathir was trying to address a real problem, albeit incorrectly. After all, as many have already pointed out, the international financial system and its further liberalisation have favoured those already dominant and privileged in the world economy, at the expense of the real economy and of development in the South.

Ironically, Mahathir's arch-nemesis, the international financier George Soros has recently argued, quite correctly, that the unregulated expansion of capitalism, especially finance capital, threatens to undermine its own future, i.e. that capitalism has to be saved from itself. While admitting that he himself has profited greatly from financial liberalisation, Soros argued — in Keynesian mode — that excessive liberalisation has been resulting in virtual anarchy, dangerous for the stability so necessary for the orderly capitalist growth and democratic development desired by his liberal vision of a Popperian 'open society'.

The prevailing system of flexible exchange rates was introduced a quarter of a century ago, inaugurating a new international monetary regime with very mixed consequences. Hence, the current regime is relatively new, only beginning after US President Nixon's 1971 unilateral withdrawal from the Bretton Woods' regime of fixed exchange rates — which had pegged the dollar to gold at US\$35 per ounce and other currencies to the US dollar. Under the new regime, the volume of foreign exchange spot transactions had grown to more than 67 times the total value of the international trade in goods by 1995, or more than 40 times the value of all international trade (including 'invisibles' or services).¹⁷ Viewed from a historical perspective then, such currency trading is hardly natural, inevitable or even desirable. For most of human history, including that of capitalism, it has not been 'integral to global trade in goods and services', as claimed by US Treasury Secretary Robert Rubin. In fact, as is well known, various critics have offered various alternatives to the present system such as returning to fixed exchange rates, the gold standard and so on.

In a world economy where foreign exchange spot transactions are now worth more than 70 times the total value of international commodity trade transactions, the financial sector has become increasingly divorced from the real economy. With the recent proliferation of new financial instruments and markets, especially in Malaysia, the financial sector has an even greater potential to inflict damage on the real economy. Ever since Lord Keynes advocated 'throwing sand' into the financial system to check the potentially disastrous consequences of unfettered liberalisation, Keynesians — and others — have been wary of the financial liberalisation advocated by ideological neo-liberals and their often naive allies.

In a telling episode at the beginning of September, IMF deputy head, Stanley Fischer pointed out that although the current account deficits in Southeast Asia had emerged quite some years ago, markets had failed to adjust — contrary to the predictions of conventional economic theory. (In response, instead of recognising the failure of market mechanisms, US Federal Reserve Chair Alan Greenspan gently chided Fischer, expecting the IMF to 'inform' Wall Street.)

Nobel laureate in economics James Tobin has called for a tax on foreign exchange spot transactions to enable more independent national monetary policy, discourage speculative capital movements and increase the relative weight of long-term economic fundamentals against more short-termist and speculative considerations. As a bonus, the tax collected would also more than adequately fund the United Nations system and programmes, not leaving it hostage to the whims of US leadership, as has recently been the case. Another Nobel laureate, Lawrence Klein has mentioned two other options to be considered besides the Tobin tax, namely regional monetary arrangements as well as the introduction of mechanisms analogous to what are popularly known as 'circuit-breakers' into the system — a suggestion also made by the World Bank's senior vice-president and chief economist, Joseph Stiglitz.

But the lobby for financial liberalisation remains much stronger and far more influential, dominating most of the business media and the key financial institutions internationally, especially in the US. Acknowledging that money is not just another commodity, the *Wall Street Journal*, for example, continues to promote currency boards (instead of central banks) and the pegging of other currencies against the US dollar, while attacking most other international monetary alternatives, rarely acknowledging the advantages that dollar pegs have given to the US, such as having the rest of the world finance its huge deficits.

Implications of Financial Liberalisation

An explosion of international financial flows followed the substitution of the Bretton Woods system of fixed exchange rates with a new system of flexible exchange rates. Strong speculative motives are generally ascribable to international capital flows. However, the loosening of fixed exchange rates was also associated with a loosening of capital controls, permitting many investors to diversify to their advantage. In any case, the trend picked up momentum from the 1980s, leading to a US\$1,250 billion daily foreign exchange market by 1997, and the proliferation of new financial instruments. Yet, many of the alleged benefits of financial liberalisation have not been realised, as the following summary of recent findings by Lord Eatwell (1997a) shows.

- First, financial liberalisation was expected to move resources from capital-rich to capital-poor countries,¹⁸ when in fact, *net flows* of finance — and of real resources — have been very *modest*, and mainly towards the capital-rich.¹⁹ Of course, most net flows to the ‘capital-poor’ were mainly to ‘emerging markets’ such as those in East Asia, which arguably contributed to asset price bubbles and, eventually, to financial panic and currency and stock market collapse.
- Second, while liberalisation was expected to enhance opportunities for savers and lower costs to borrowers, savers have benefited most from *higher real interest rates*.²⁰
- Third, the *new financial derivatives* — expected to improve risk management — have actually *generated new systemic risks*, especially vulnerable to sudden changes in sentiment.²¹
- Fourth, improved macroeconomic performance — with greater investment and growth expected from better allocative efficiency — has not been realised; in fact, *overall macroeconomic performance* has been *worse* than before liberalisation.²²
- Fifth, financial liberalisation has introduced a *persistent deflationary bias* on economic policy as governments try to gain credibility to avert destabilising capital flows, instead of the ‘healthy discipline’ on governments expected to improve macroeconomic stability.

Financial markets seem to function in such a way as to impose their own 'expectations' on the real economy, thus defining their own 'fundamentals' and logic, which in turn become self-fulfilling prophecies. In other words, they do not just process information in order to efficiently allocate resources. Since financial markets operate like beauty contests and the real economy has no automatic tendency to converge to full-employment growth, the presumed analytical assumptions of other market participants become imposed on the economy.

The threat of instability in the now massive capital market forces both government and private investors to pursue risk-averse strategies, resulting in low growth and employment creation. A deflationary bias in government policy and the private sector emerges in response to the costly risks of violating the rules of the game. This is exacerbated by the high costs of debt due to high real interest rates owing to efforts to maintain financial stability in a potentially volatile world. Thus, 'long-term price stability' supersedes a 'high and stable level of employment' as the policy priority. Such a monetarily stable system, involving relatively slow growth and high unemployment, can last indefinitely.

A sophisticated liberalised financial system, prioritising flexibility or the possibility of easy exit, is necessarily fragile, as reflected in:

- liquidity crises, *reducing real output*;
- private sector risk aversion, encouraging *short-termism*;²³
- public sector risk aversion, resulting in a *deflationary policy bias*;
- persistent pressure for ever *greater flexibility*, increasing the ease of exit.

The benefits that the reduction of financial controls have brought to 'emerging markets' must be weighed against the increased instability due to *enhanced ease of exit*. While increased flows of (real) FDI generally require agreement to unrestricted profit repatriation, this is quite different from the 'instant exit' conditions demanded by financial markets.²⁴

There is considerable evidence that in the longer term, economic development has been associated with developmentalist states. The post-war Golden Age — which saw high levels of output and employment as well as short-run efficiency — was premised on active macroeconomic management under the Bretton Woods system. Post-war European reconstruction was achieved with tight capital controls. On the other hand, the recent rush to convertibility and capital control deregulation in Eastern Europe has resulted in Russia becoming a significant net capital exporter!²⁵

Some dangers associated with financial liberalisation have now become quite evident, but most are not being sufficiently recognised, let alone debated and addressed. Most initiatives in this regard cannot be undertaken unilaterally without great cost, as market reactions to Malaysian Prime Minister Mahathir's critical remarks have made clear. The very few options available for unilateral initiatives need to be carefully considered, and only implemented, if deemed desirable.

Selectively invoking instances of bad or incompetent policy-making or implementation does not justify leaving things to liberalised markets that render systematic policy-making impossible. Instead, it emphasises the importance of creating an environment and developing the capability for good and competent policy to be effective.

Many need to be actively pursued through multilateral initiatives, for which the governments need the support of neighbours and others. Given the power of the dominant ideology which infuses the prevailing international system, it is virtually impossible to assert control over the financial system without a fundamental change in priorities and thinking by the major governments involved. However, the currencies of a small number of major governments — the US, Japan, Germany and the UK — were involved in over three-quarters of currency transactions in 1995. Hence, acting together, they have the capability to control capital flows, but of course, only if they abandon faith in the alleged superiority of neo-liberalism.

Analytical Catch-up

It seems fair to say that no one fully anticipated the current crisis in East Asia. There were, of course, sceptics who regarded the claims of an East Asian economic miracle as somewhat exaggerated, albeit for different reasons, e.g. because they had not achieved much productivity growth and would eventually run up against diminishing returns (Krugman 1994); others argued that the performances of the Southeast Asian newly industrialising countries (NICs) were significantly inferior compared to Japan and the first-tier NIEs (Jomo *et al.* 1997).

Some had warned, in the aftermath of the Mexican meltdown of early 1995, that current account deficits in Southeast Asia were worryingly high, and that the region was not immune to financial difficulties. But even such pessimists never expected the financial crisis in the region as it has unfolded since mid-1997. They only expected some kind of conventional currency crisis, followed by a temporary slowdown before recovery on a more sustainable basis. Even people like Krugman expected the longer-term slowdown to set in more gradually, with the lead geese affected first.

What happened in East Asia has been far more dramatic than Mexico in early 1995 as well as much more complicated, with asset prices collapsing, banks and other financial institutions failing, many companies going bankrupt, and probably a far more severe and protracted downturn than even the most pessimistic expected. It is now clear that the East Asian crisis differs from conventional currency crisis scenarios in at least several important ways (Krugman 1998):²⁶

- the absence of the usual sources of currency stress, whether fiscal deficits or macroeconomic indiscipline;²⁷

- the governments did not have any incentive to abandon their pegged exchange rates, e.g. to reduce unemployment;
- the pronounced boom-bust cycles in asset prices (real property and stock markets) *preceded* the currency crisis, especially in Thailand, where the crisis began;
- financial intermediaries have been key players in all the economies involved;
- the severity of the crisis in the absence of strong adverse shocks;
- the rapid spread of the initial crisis in Thailand, even to economies with few links or similarities to the first victims.

Very importantly then, the traditional indices of vulnerability did not signal a crisis as the source of the problem was not to be found in the governments *per se* or in national income accounts. The (mainly private) financial intermediaries were 'not part of the governments' visible liabilities until after the fact'. For Krugman (1998) then, one cannot adequately make sense of the crisis in terms of conventional currency crisis models; for him, *the crisis has mainly been about bad banking and its consequences, and only incidentally about currencies.*²⁸

Rejecting the conventional views that blamed either fiscal deficits or macro-economic indiscipline, for Krugman (1998), the East Asian crisis has been brought about by 'financial excess and then financial collapse', involving asset price bubbles and then collapses, 'with the currency crisis more a symptom than a cause of this underlying real malady'. East Asian financial intermediaries 'were perceived as having an *implicit government guarantee*, but were essentially *unregulated* and therefore subject to *moral hazard* problems.²⁹ The excessive and risky lending of these institutions created *inflation* — not of goods, but of *asset prices*. The overpricing of assets was sustained, in part, by a sort of circular process, in which the *proliferation of risky lending drove up the prices of risky assets*, making the financial condition of the intermediaries seem sounder than it was.'

The crisis was thus precipitated by the bursting of the bubble: '*The mechanism of crisis... involved that same circular process in reverse: falling asset prices made the insolvency of intermediaries visible, forcing them to cease operations, leading to further asset deflation.* The circularity, in turn, can explain both the remarkable severity of the crisis and the apparent vulnerability of the Asian economies to self-fulfilling crisis — which in turn helps us understand the phenomenon of contagion between economies with few visible links' (my emphases).

The East Asian vulnerability to crisis contagion was also unanticipated.³⁰ In light of the limited trade and investment relations among Southeast Asian economies (barring Singapore) and the fact that other economies elsewhere producing the same exports have not been similarly affected, popular explanations — invoking regional proximity, linkages and competition — do not stand up to much careful scrutiny. The plight of South Korea, further away and economically quite different, has also undermined such easy explanations, encouraging instead

new hypotheses about East Asia more generally, implying that those affected are mutant flying geese with Japanese-type economies and problems. As the chapters in this volume show, Krugman's suggested sequencing seems more relevant for understanding Thailand, whereas the sequencing in the rest of the region appears to have been different.

Other issues also need to be taken into account for an adequate analysis of the East Asian crisis:

- financial *crises* have very severe effects on growth because they *disrupt* the *productive contribution of financial intermediation*;
- the East Asian crises have not only involved excessive investments, but also *unwise investments*;
- the huge real currency *depreciations* are likely to *cause large declines in output*;
- other kinds of market failure, e.g. herd behaviour, need to be taken into account.

While the analysis offered in this volume is not inconsistent with Krugman's emphasis on asset price bubbles, excessive investments and other problems caused by moral hazard due to implicit government guarantees for weakly regulated financial intermediaries, a more adequate analysis must also account for various other phenomena including:

- the implications of the growth in currency trading and speculation in the post-Bretton Woods international monetary system;
- the reasons for the Southeast Asian monetary authorities to defend their quasi-pegs against the strengthening US dollar despite its obvious adverse consequences for export competitiveness and hence for growth;
- the consequences of financial liberalisation, including the creation of conditions which have contributed to the magnitude of the crisis;
- the role of herd behaviour in exacerbating the crisis;
- other factors accounting for the contagion effects.

A number of policy issues also deserve careful consideration, including the nature and implications of IMF 'rescue' programmes and the conditionalities imposed by the Fund, as well as of policies favoured by the international as distinct from the domestic financial communities, and others affected. The adverse consequences of financial disintermediation and grossly undervalued currencies for economic development also deserve special attention, especially as the crisis threatens the future of growth and structural change in the region, not only directly, but also as a consequence of policy responses. The contractionary policies favoured by the IMF, the international financial community as well as others, recently including Malaysia's financial authorities, may well throw out the baby of economic development with the bath water of financial crisis.

Understanding the Southeast Asian Currency Crisis

In late 1997, Manuel Montes (1998) published the most serious attempt to understand the crisis in Southeast Asia. He begins by considering the most oft-cited popular explanations, suggesting that the crisis stemmed from the banking sector due to imprudent expansion and diversification of domestic financial markets, fuelled by short-term private borrowings. Montes (1998: 3) suggests that this was especially true of Thailand, but less so for Indonesia, Malaysia and the Philippines (in order of decreasing relevance), underlining the significance of the contagion effect; 'the differences raise questions about how sensitive the currency knockdown (and the associated divestment from these economies) are to economic fundamentals'.

Despite large current account deficits for the affected countries, more for Malaysia and Thailand compared to Indonesia and the Philippines, he notes that macroeconomic conditions were otherwise sound. He shows high growth and savings rates, and low inflation in the 1990s for the four most affected Southeast Asian economies, with the Philippines a bit of a laggard. By the mid-1990s, all had fiscal surpluses. Instead, Southeast Asian vulnerability was 'as in a classic credit crunch, from an over-extended mismatch in the maturity and currency unit between sources and uses of credit' (Montes 1998: 2).

Montes (1998: 7) sees the Thai crisis as 'the latest in a series of such crises in which a currency attack follows on (or is justified by) an unhealthy domestic banking system, following an episode, of say three to five years, of vigorous external capital inflows'. The currency collapse weakens the domestic banking system by increasing the range of non-viable investments based on the previous exchange rate, thus magnifying the crisis. Such crises have resulted in lower growth, higher unemployment and the deployment of taxpayer funds to salvage the financial system and related asset holdings.

Montes cites Kaminsky and Reinhart's (1996) study of 71 balance of payments crises and 25 banking crises during the period 1970-95. There were only three banking crises associated with the 25 balance of payments crises during 1970-79, but 22 banking crises which coincided with 46 payments crises over 1980-95, which they attribute to financial liberalisation from the 1980s, with a private lending boom culminating in a banking crisis and then a currency crisis. Thus, *Montes attributes the Southeast Asian currency crisis to the 'twin liberalisations' of domestic financial systems and opening of the capital account.*

Montes argues that financial liberalisation induced some new behaviour in the financial system, notably:

- domestic financial institutions had greater flexibility in offering interest rates to secure funds domestically and in bidding for foreign funds;
- they became less reliant on lending to the government;
- regulations, such as credit allocation rules and ceilings, were reduced;

- greater domestic competition has meant that ascendance depends on expanding lending portfolios, often at the expense of prudence.

Meanwhile, liberalising the capital account has essentially guaranteed non-residents ease of exit as well as fewer limitations on nationals holding foreign assets, thus inadvertently facilitating capital flight.

Historically, developing countries in Southeast Asia have successfully induced capital inflows, often by subsidising them through a variety of investment incentive programmes. Montes (1998: 11) argues that 'removing controls on capital inflows effectively subsidises net outflows, a self-defeating stance for a capital-needy economy to take'. Opening the capital account has also provided foreign fund managers with access to domestic bond and stock markets, and given the domestic financial system access to lower cost funds from abroad. Thus, offshore banking operations financed intermediation growth as well as competition among domestic financial groups.

The lending boom increasingly involved asset purchases fuelled by rising property and stock prices. Montes argues that the Thai authorities hesitated to prick the asset price bubble for two reasons. The dominant liberal economic ideology deemed it inappropriate for government authorities to bother about private sector-driven current account deficits. Similarly, it was felt that greater regulation would undermine healthy financial sector development.

To defuse upward pressure on the exchange rate, the Thai authorities engaged in costly sterilisation operations.³¹ Montes emphasises that sterilisation measures put upward pressure on domestic interest rates, increasing the differential with foreign interest rates, thus inducing even more inflows. With the exchange rate peg and sterilisation measures, the interest rate differential widened, especially as international interest rates declined. Montes argues that the Thai authorities failed to protect the long-term viability of their banking system through prudential regulation, which would have required curbs on the massive increase of financial intermediation for asset purchases.

Montes argues that 'three guarantees' exacerbated the problem of moral hazard, contributing to the banking/currency crisis. First is government support for the domestic financial system.³² The commitment to an open capital account and the adoption of a virtually fixed exchange rate or quasi-peg effectively subsidised short-term foreign borrowings, supporting foreign equity investments as well as offshore banking facilities. With these three guarantees, and arguably the expectation of IMF protection of their interests in the event of a crisis, international lenders are encouraged to lend more while not having much incentive to effectively monitor the deployment of their loans. The quasi-pegging of Southeast Asian currencies to a strengthening US dollar since the mid-1990s gave non-US dollar lenders to the region unrealised exchange rate gains as well.

In a useful chapter (Chapter 4) on fundamentals and sentiments, Montes points out that international financial analysts and macroeconomists mean different things

when they speak of fundamentals. Private asset managers seem to refer to 'factors that support the one-year to year-and-a-half stability of key asset prices, especially exchange rates' whereas economists and public officials usually think of the medium term in terms of three years and consider fundamentals 'in terms of the impact of asset prices on real economic variables, such as output growth, exports, and employment' (Montes 1998: 29).

Montes goes on to identify the following as key fundamentals of the affected Southeast Asian economies:

- viability of domestic financial systems;³³
- domestic output and export responsiveness to nominal devaluations;³⁴
- sustainability of current account deficits;³⁵
- high savings rates and robust public finances.

Despite the sound fiscal situation before the crisis, the Southeast Asian economies are now expected to have even larger fiscal surpluses despite the need for greater public financing of physical infrastructure and social services. To restore confidence in their currencies, they are being asked to cut their current account deficits besides government spending, with ominous implications for economic recovery and sustainability.

Recognising a limited but still significant scope for monetary independence in the Southeast Asian economies, Montes maintains that economic liberalisation should not be allowed to frustrate the sound development of the financial system and improvements in the productivity of investment. He warns that sound macro-economic fundamentals do not guarantee immunity from contagion and crisis. The scope for monetary independence partly depends on the soundness of macro-economic management as well as political will. Favouring flexible exchange rates, he warns that capital controls and other efforts to prop up a currency under attack are ineffective and actually subsidise further speculative actions. International co-operation and co-ordination have often been the best response during such episodes, but are also important for effective prudential and regulatory initiatives as well as to reduce 'policy arbitrage'. He also advocates measures to insulate the domestic banking system from short-term volatility through regulatory measures and capital controls as well as stricter prudential regulation for the region.

IMF Intervention

The challenge at the international level is formidable, especially with the vested interests underlying American as well as European positions on systemic reform. Yet, there have been many misgivings elsewhere too about the nature and volatility of the international financial system, with renewed attention to particular aspects with each new crisis. Southeast Asians need to work with others who are like-minded and to draw upon the rich critiques which have developed over the

years in developing reform proposals which are likely to gain broad international support.

That is why it is distressing that at the September 1997 Hong Kong annual meetings of the IMF and World Bank, the IMF's policy-making Interim Committee — which represents all 181 IMF member countries via 24 ministers — gave the IMF a mandate to alter its Articles of Association so that it would have additional 'jurisdiction' over the capital account as well as over the current account of members' balance of payments, which it has had for many decades.³⁶

In December 1997, the World Trade Organisation also concluded its financial services agreement which basically commits member countries to scheduled accelerated liberalisation of the trade in financial services. The *Wall Street Journal* noted that the agreement would primarily benefit the US and Europe since it is most unlikely that the South is in a position to export financial services to the North. It is therefore likely that countries of the South will face even greater problems with their balance of payments as their services, and hence current account deficits worsen. Many of the nascent financial services which have emerged under protection in these countries are unlikely to survive international competition from transnational giants enjoying economies of scale and other advantages.

As recent press discussion of the IMF's record and capability suggests, there is growing international scepticism about the IMF's role in and prescriptions for the ongoing East Asian crisis. Perhaps partly out of force of habit in dealing with situations in Latin America, Africa, Eastern Europe and elsewhere, where fiscal deficits have been part of the problem, the same prescription ('one size fits all') seems to underlie the recent IMF interventions in East Asia.

Many of its programmes are effectively contractionary in consequence, with little regard for the social and other adverse consequences of swallowing its medicine. Thus, what starts off as a currency or financial crisis leads, partly due to IMF-recommended policy responses, to economic slowdown, if not recession. For example, although all the affected East Asian economies have been running fiscal surpluses in recent years (except Indonesia which had a small deficit in 1996), the IMF has forced all the governments to slash public expenditure and increase their budgetary surpluses.

There has been considerable doubt as to whether the IMF actually recognised the novel elements of the crisis and their implications ('old medicines for a new disease'), especially at the outset. The apparent failures of the IMF — to anticipate the current crisis in its generally glowing recent reports on the region, and also to stem, let alone reverse the situation despite interventions in Thailand, Indonesia and Korea — have certainly not inspired much confidence. Nor has the fact that though the Philippines had long been under an IMF programme, it was not spared the contagion.³⁷

The Fund does not seem to be sufficiently cognisant of the subjective elements contributing to the crisis, and seems to approach the crisis as if it were solely due

to macroeconomic or other weaknesses. For instance, by closing down banks in Indonesia, the IMF undermined the remaining shreds of confidence there, inducing wholesale panic in the process. Also, while the IMF insists on greater transparency by the affected host government and those under its jurisdiction, it continues to operate under a shroud of secrecy itself.

The IMF's double standards, as reflected by its apparent priority for protecting the interests of foreign banks and governments, has also compromised its ostensible role as an impartial party working in the interests of the host economy. The burden of IMF programmes invariably falls on the domestic financial sector and, eventually, on the public at large — through the social costs of the public policy response, usually involving bail-outs of much of the financial sector if not the corporate sector more generally — who thus bear most of the costs of adjustment and reform, while commitments to foreign banks are invariably met, even though both foreign and domestic banks may have been equally irresponsible or imprudent in their lending practices.

As the BIS noted in its latest *Report on the Maturity and Nationality of International Bank Lending* (Raghavan 1998, Vadarajan 1998), 'In spite of growing strains in Southeast Asia, overall bank lending to Asian developing countries showed no evidence of abating in the first half of 1997.' In the year from mid-1996 to mid-1997, South Korea received US\$15 billion in new loans, while Indonesia received US\$9 billion. Short-term lending continued to dominate, with 70 per cent of lending due within a year, while the share of lending to private non-bank borrowers rose to 45 per cent at the end of June 1997. The banks were also actively acquiring 'non-traditional assets' in the region, e.g. in higher yielding local money markets and other debt securities. Most of this lending was by Japanese and continental European banks.

Thus, Western banks will emerge from the crisis not only relatively unscathed, but also relatively stronger. Some merchant banks and other financial institutions will also be able to make lucrative commissions from marketing sovereign debt as the short-term private borrowings — which precipitated the crisis — are converted into longer-term government-guaranteed bonds under the terms of the IMF programmes. Thus, the bail-out programmes are primarily for the foreign banks rather than the East Asian economies or people.

The limited willingness of the US to contribute to the IMF bail-out packages to Thailand, Indonesia and South Korea — now exceeding a hundred billion US dollars — has also reflected new US priorities in the post-Cold War context. Despite its own unwillingness to commit more, the US administration also blocked Japanese and other regional initiatives to develop a regional facility for fear that it might enhance the Japanese role and leadership in the region and diminish the US's standing. However, since the end-October 1997 global stock market panic, the US administration seems to have taken a leading role despite the limited

exposure of US banks to the region. US concerns about a possible global financial meltdown, the US dollar's role as the leading reserve currency and the opportunities for US banks and other investors to take advantage of the situation seem to have influenced this change of stance.

Almost in tandem with financial liberalisation, IMF intervention is generally recognised to undermine and limit national economic sovereignty.³⁸ Particularly damning is the clear abuse of imposed IMF conditionalities in the Korean aid package to resolve outstanding bilateral issues in favour of the US and Japanese interests (Chossudovsky 1998). Legislation and other new regulations enabling greater foreign ownership of as well as increased market access to the Korean economy — which have little to do with the crisis or its immediate causes — have been forced upon the Korean government. Even more damaging has been the further dismantling of many key institutional features which have made possible the Korean economic miracle since the 1960s. Meanwhile, Japanese banks have insisted that the Korean government guarantee repayment as a condition for rolling over Korean short-term debt.

More generally, throughout the region, there is a 'fire-sale' going on at bargain basement prices, with foreign investments taking up the best assets available for a song. If one accepts that the currency as well as more general financial crisis means that these assets are grossly under-priced by international standards, one cannot claim any welfare improvement (Krugman 1998), given the likelihood that the new foreign owners need not be more efficient to be able to buy up these assets.

The recent currency and financial crises in Southeast Asia suggest that the Southeast Asian economic miracle has been built on some shaky and unsustainable foundations. Recent growth in both Malaysia and Thailand has been increasingly heavily reliant on foreign resources, both capital and labour. Limited investments and inappropriate biases in human resource development have held back the development of greater industrial and technological capabilities throughout the region.³⁹ Southeast Asia's resource wealth and relatively cheap labour sustained production enclaves for export of agricultural, forest, mineral and, more recently, manufactured products, but much of the retained wealth generated was captured by business cronies of those in power, who contributed to growth by also re-investing captured resource and other rents in the 'protected' domestic economy in import-substituting industries, commerce, services, and privatised utilities and infrastructure.

This Volume in Brief

This volume essentially makes three closely related arguments involving liberalisation and governance. First, financial liberalisation has undermined previously

existing governance institutions and mechanisms without creating adequate alternatives in their place. Second, domestic governance arrangements, including those involving the financial system, have been shaped or abused by those with influence for their own advantage. Third, in some instances, especially in Thailand, Malaysia and Indonesia, in the absence of adequate crisis response arrangements, official responses have been unduly influenced and compromised by vested interests as well as other considerations.

After critically examining the nature of the East Asian financial crisis as well as the policy responses, Yilmaz Akyüz considers various likely implications of both. He highlights the gross inadequacy of existing arrangements for global financial governance in order to avoid the recurrence of similar crises. Although capital is more mobile than other factors of production and financial markets are far more integrated than product markets, global governance of international financial transactions is woefully inadequate and tends to discipline borrowers rather than to regulate lenders. Existing arrangements seek to manage rather than to avoid crises, often at considerable cost to human welfare and economic development, and do not provide for either dispute settlement or adequate checks against 'beggar thy neighbour' policies. He also highlights the absence of effective, orderly and adequate arrangements for liquidity provision by an international lender of last resort as well as for orderly workouts of international debtor-creditor relations.

As Jan Kregel's chapter shows, many aspects of the East Asian financial crisis were neither completely unprecedented nor unanticipated. But referring to historical precedent can not only be misleading, but even dangerous, as has been the tendency to see the East Asian crisis as analogous to the 1994-95 Mexican 'tequila' crisis. To emphasise the differences, Kregel reviews recent developments in East Asia in a global context and from a historical perspective, highlighting its novel features, relevant antecedents as well as systemic elements contributing to it.

C.P. Chandrasekhar and Jayati Ghosh consider the political economy of recent growth in Southeast Asia. They locate Southeast Asia's vulnerability prior to the crisis in the decline of export growth, exacerbated by the appreciation of currencies in the region, particularly against the Chinese renminbi devalued in 1994. They also address the questions of why international banks were so heavily exposed in Southeast Asia, and why the affected Southeast Asian economies — with among the highest domestic savings rates in the world — needed the huge capital inflows in the first place. The latter part of their chapter is devoted to the nature and likely implications of IMF intervention in response to the crises in East Asia.

Nicola Bullard, with Walden Bello and Kamal Malhotra, critically assess the IMF's role and performance in the East Asian financial crisis. They show that the Fund has prescribed wrong and socially disastrous medicine for the region's ills, grossly exceeded its mandate in its Articles of Agreement, conducted itself

arrogantly and reflected the interests of the US. The result of the Fund's failures has been to exacerbate the human and macroeconomic impact of the crisis. Drawing upon the variety of criticisms of the Fund which have emerged in the last half-year from across the political spectrum, they argue that the IMF should serve as the lender of last resort during balance of payments crises, while opposing any changes to the Fund's Articles of Agreement, such as extending its jurisdiction to include capital account liberalisation, as well as the variety of conditionalities recently associated with IMF funding. They also call for new mechanisms for the effective and just resolution of private sector debt crises and the regulation of international capital flows, especially of short-term speculative capital, to reduce their capacity for economic destabilisation.

The remaining chapters in this volume are country studies which identify the origins and circumstances of the financial collapses as well as their economic and other implications in the four Southeast Asian economies of Thailand (Laurids Lauridsen), Indonesia (Manuel Montes) Malaysia (Jomo K.S.) and Philippines (Joseph Lim), as well as South Korea (Chang Ha-Joon). There is some inevitable unevenness as well as redundancy in coverage, but also a striking unanimity about the international and systemic origins and sources of the recent currency and financial crises in the region.

Roots of the Crisis: Challenges of Governance

The roots of the crisis can usefully be summed up in terms of various challenges of governance, at both international and national levels. At the international level, governance issues have been raised by the transformations of financial, especially capital markets. Flexible exchange rates and other related developments have increased the scope for and activity in currency speculation. Increased international flows of investment funds have also contributed to currency volatility. Most of these funds are of a portfolio nature, and hence more liable to enhance volatility, while the share of direct investments continues to decline.

Financial liberalisation has also reduced monitoring and supervision of financial, including banking operations and transactions, including those of a prudential nature. There has also been a significant increase in 'private banking' as well as increased banking transactions across borders with the proliferation of 'international offshore financial centres' and other international banking facilities. The growing dollarisation of the world economy, including international finance, has also skewed the nature of these developments in important ways.

Liberalisation of financial services as well as of investment regulations, including liberalisation of the capital account, have otherwise also reduced national oversight and management of financial flows, which created the conditions conducive to the recent Southeast Asian and South Korean crises. The scope for national macroeconomic — including monetary — management has been

considerably reduced by various dimensions of financial liberalisation. Options for developmentalist as well as rentier initiatives have been significantly reduced as a consequence.

The variety of regimes in East Asia do not allow easy generalisations for the entire region. It has been tempting for observers to contrast the economies and regimes which have experienced major crises since the second half of 1997, i.e. Thailand, the Philippines, Indonesia, Malaysia and South Korea, with the other high performing East Asian economies which have not, namely Japan, Taiwan, Hong Kong and Singapore, as well as China. There is no systematic evidence that the difference lies primarily in the extent of corruption, rent-seeking, government intervention, industrial policy, export-orientation, productivity growth, FDI or democracy. Although all the economies affected have liberalised their capital accounts, this may only be a necessary, but certainly not a sufficient condition for the crisis. The big difference seems to have been that the former have not had much foreign exchange in reserve unlike the latter, which have the highest reserves in the world, and hence were not vulnerable to currency attack.

The extent to which macroeconomic fundamentals were awry among the affected economies varied considerably and, by themselves, cannot explain the financial collapses, although they suggest their greater vulnerability to currency attack and the greater likelihood of panic. This crisis has underlined the significance of sentiments, and there is no convincing explanation for what happened, especially herd behaviour, which does not take account of market psychology. Hence, confidence restoration must necessarily be at the top of the agenda for any recovery programme, but this, in turn, raises the dilemma posed by the temptation of reviving confidence in a potentially volatile set of arrangements, which can easily turn against the national economies concerned and their regimes' ambitions — as the recent crises have shown.

Previously hegemonic neo-liberal explanations of the East Asian miracle were effectively challenged from the late 1980s (White 1988, Amsden 1989, Wade 1990) and developed in sophistication (e.g. see Chang 1994) and nuance (Jomo *et al.* 1997) in the mid-1990s. The World Bank's (1993) influential response suggested that the political, bureaucratic, cultural and institutional circumstances of the rise of Japan and the first-generation or first-tier East Asian NIEs of South Korea, Taiwan, Hong Kong and Singapore were so exceptional as to be beyond emulation. Instead, it was suggested that other developing countries should seek to emulate the second-tier Southeast Asian NICs of Malaysia, Thailand and Indonesia, which had, according to the World Bank, achieved rapid growth and industrialisation after liberalising in the mid-1980s.

In response, Jomo *et al.* (1997) argued that the Southeast Asian NICs achievement has been much more modest than that of the first-tier East Asian NIEs in several important respects, and that the sustainability of their growth, industrial-

isation and structural change was much more suspect as a consequence. Their volume also suggested that the former's rapid export-oriented industrialisation from the mid-1980s was partly due to a favourable conjuncture — involving Southeast Asian currency depreciation coinciding with Japanese and first-tier East Asian NIE currency appreciation and rising production, especially labour costs — as well as liberalisation of some existing regulations inimical to attracting such investments and their replacement with a new investment regime much more conducive to promoting export-oriented industrialisation.

Many other features of the old regime have been retained, while 'rentrepreneurs' creatively utilised features of the new regulatory environment to advance and pursue their own interests. These features have all contributed to industrial organisation and structure in these economies. Thus, while some regulations have undoubtedly enhanced growth and structural change, often by offering rents and incentives to encourage desired investments, others have also strengthened rentier abuse. While much of this may be analytically distinguishable, with the latter relatively easily isolated and checked through policy intervention, others may be much more difficult to unravel from developmentalist rents.

Simplistic perspectives and gross generalisations do not recognise and distinguish between developmentalist rents and rentier abuse. Policy reforms which fail to do so will encourage throwing out the developmentalist baby with the bathwater of abuse, with disastrous consequences for developmentalist ambitions and projects. Of course, the willingness to check rentier abuses is ultimately determined by the regime's independence of such rentier interests, its consequent 'political will' and its capacity to bring about the necessary reforms.

Finally, as economic and business historians remind us, there have been important precursors to the recent crises in East Asia, even within the region. Unfortunately, the market — which is increasingly being left to its own devices — has neither an institutional memory nor a capacity to develop natural immunity. It is therefore left to policymakers to build the necessary institutions and to design and redesign the needed institutional features of governance to ensure that tragedy does not become farce.

Notes

1. Meanwhile, the 'financial analysts' have become so fixated with the current account deficit that this indicator, almost alone, has become the fetish of financial analysts, especially since the Mexican meltdown of early 1995. In earlier, different times, some economies sustained similar deficits for much longer, without comparable consequences. As noted in the immediate aftermath of the Mexican crisis of 1995, several Southeast Asian economies already had comparable current account deficits then despite, or rather because of rapid economic growth. Yet, as IMF deputy head, Stanley Fischer observed, the currency markets failed to adjust earlier in Southeast Asia.

2. Of course, the availability of cheap foreign funds — e.g. due to a low real interest rate — can help to temporarily close both domestic savings-investment as well as foreign exchange gaps, especially if well invested or deployed.
3. In this connection, it is interesting to note that the Chicago school-influenced Chilean government has maintained strict controls on the capital account. Portfolio investments in Chilean stock are permitted in the New York Stock Exchange, rather than in the Santiago stock market, while unlike FDI, portfolio capital inflows into Chile are subjected to conditions which inhibit easy exit.
4. In some countries, government-owned non-financial public enterprises (NFPEs) have been very much part of this private sector debt growth phenomenon.
5. There is also no evidence that the stock market boom in recent years has more effectively raised funds for productive investment; in fact, the converse seems more likely as financial intermediation has switched from commercial banks to the stock market in the last decade.
6. While the Southeast Asian economies have been running current account deficits, so has the US, especially with the region, except that it has different consequences given the actual and 'quasi' dollar pegs prevailing in much of the world today.
7. While the US economy has been strengthening, the Southeast Asian economies were growing even faster.
8. In the mid-1990s, as the US dollar strengthened with the US economy, both the Japanese and the Germans allowed their currencies to depreciate against the US dollar, with relatively little disruption, in an effort to regain international competitiveness.
9. For example, the Malaysian current account deficit as a share of GDP was lower in 1996 and 1997 than in 1995.
10. In the face of limited information and a novel, rapidly changing situation, such behaviour is often considered rational by market players, even if unfortunate.
11. Hedge funds may, however, go in different directions, for instance, when one fund's currency sell-off provokes another fund to snap up bargain equities, e.g. foreigners were often persistent net buyers of Japanese stocks throughout the bursting of the bubble there in the 1990s.
12. Financial liberalisation means investors have a choice as to when they 'come and go', and, of course, the very existence of that choice may encourage them to stick around in certain circumstances.
13. Short-termism — encouraged by financial liberalisation — has also accentuated the bias against longer-term productive investments.
14. As in Chile in the early 1980s.
15. These can involve savers being encouraged with tax policies that do not punish them for putting money away. While banks should still make lending decisions based on economic criteria alone, systemic biases towards short-termism need to be mitigated. The government can prioritise and favour certain types of investments by subsidising them through taxes or loan guarantees for those sectors or activities it deems important.
16. It has been very difficult for Malaysia to credibly take the high moral ground on currency and other types of speculation because of the well-known behaviour of Bank Negara in the 1980s. The Malaysian central bank was known to take very aggressive, short-term speculative positions in the major currencies with a view to making a profit. This went on for several years until the Bank lost several tens of billions of ringgit in 1992 while betting on sterling and then withdrew to tamer activities. There is a similar sense about the tin cartel in the early 1980s (Jomo 1990). Mahathir's comments are hence seen as insincere abroad in that he is seen to have directed the government to undertake speculative activities in the

past and was able to do so because the international currency and commodity markets are so open. It has been difficult to gain sympathy about non-Malaysian speculators after having approved of such activities before.

17. Since trade-related currency trading is greatly exceeded by investment-related currency trading, it is not surprising that the volume of currency trading is so large. One key question is how much of those investment-related trades are 'healthy', 'appropriate' or 'desirable'. International investors want to hedge their personal income and wealth by spreading their investments across many countries and adjusting them quite frequently as conditions change, thus contributing to market volatility.
18. Recent results show that national savings tend to equate national investment, suggesting that flows of capital to 'the best possible use' are far from universal and much smaller than simple theories predict. Lack of information or other risks and uncertainties tend to reduce cross-border capital flows.
19. Eatwell suggests a negative correlation between dependence on 'foreign savings' and economic performance. This is true if we do not break down the nature of foreign savings. The numbers are strongly biased by the inclusion of short-term money market flows, which may include efforts by governments to prop up their currencies with high interest rates which temporarily suck in money from overseas. Mexico, Brazil and especially Venezuela typified this a few years ago. If only long-term direct investment or equity investment was considered, a lot of poorly performing Latin American economies would be screened out. Southeast Asian countries, especially Singapore and Malaysia, would then rank high on both foreign savings (measured 'appropriately') and economic performance.
20. Currently, high interest rates represent a very unhappy situation for the region. They are intended, in part, to prop the currency up to maintain confidence but, perhaps more importantly, to allow local companies to pay off their foreign debts. The cost of this is slower growth. With lower interest rates and lower exchange rates, which help the economy grow and help consumers, mismanaged local companies would have to reorganise themselves, or otherwise lose their equity (which they deserve, in many cases, to forfeit). Foreign creditors who were stupid enough to lend dollars to mismanaged companies should see their bank loans and bonds defaulted on. Bankrupt local companies could be bailed out and re-capitalised, with 100 per cent equity ownership then going into mutual funds or pension funds distributed equally to the masses of ordinary citizens.

Liberalisation is generally associated with higher interest rates. However, lower interest rates could have been due to a combination of pegged exchange rates, capital controls and the deployment of funds inside such economies. Pegged exchange rates are enforced by capital controls which 'trap' a pool of savings inside an economy. The trapped savings are typically exploited by governments or banking cartels which may keep interest rates too low, even below inflation rates. The capital controls may thus force savers to accept low interest rates and stop them from getting a fairer return elsewhere. The cheap savings may get loaned to undeserving corporations or for other purposes, possibly at the direction of the government.

21. One could argue that some of this is the result of greed, stupidity, and lack of education or regulation. If used carefully, derivatives are ultimately insurance contracts.
22. There is, however, evidence of a strong positive correlation between financial openness, foreign investment, GDP growth and per capita income for the East Asian countries, though the region seems to be exceptional.
23. Due to the separation of ownership and management of portfolio investments, though it may be in the interest of investors to 'buy and hold', it is difficult to write contracts to motivate pension managers, mutual funds and other intermediaries to stay put.

24. Of course, liquidity is one of the features which induces otherwise risk averse investors to buy into a situation. Furthermore, in any transaction, there is a buyer for every seller.
25. Of course, capital flight is not an inevitable consequence of financial liberalisation, but may reflect the fears and consequent hedging behaviour of locals.
26. Paul Krugman's (1998) attempt at theoretical catch-up is particularly worthy of consideration in light of his own previous attempts at understanding related international economic phenomena as well as East Asian economic growth. As the crisis is still unfolding, such an attempt can hardly be definitive, especially since we do not even have the advantage of complete hindsight. Yet, as policy is very much being made on the hoof, his attempt to highlight certain relationships may well be illuminating. Hence, Krugman argues that:

it is necessary to adopt an approach quite different from that of traditional currency crisis theory. Of course Asian economies did experience currency crises, and the usual channels of speculation were operative here as always. However, the currency crises were only part of a broader financial crisis, which had very little to do with currencies or even monetary issues *per se*. Nor did the crisis have much to do with traditional fiscal issues. Instead, to make sense of what went wrong we need to focus on two issues normally neglected in currency crisis analysis: the role of financial intermediaries (and of the moral hazard associated with such intermediaries when they are poorly regulated), and the prices of real assets such as capital and land.

27. None of the fundamentals usually emphasised seem to have been important in the affected economies: all the governments had fiscal surpluses and none were involved in excessive monetary expansion, while inflation rates were generally low.
28. Krugman (1998) argues:

The boom-bust cycle created by financial excess preceded the currency crises because the financial crisis was the real driver of the whole process, with the currency fluctuations more a symptom than a cause. And the ability of the crisis to spread without big exogenous shocks or strong economic linkages can be explained by the fact that the afflicted Asian economies were... highly vulnerable to self-fulfilling pessimism, which could and did generate a downward spiral of asset deflation and disintermediation.

29. According to Krugman, East Asian financial intermediaries 'were able to raise money at safe interest rates but lend at premium rates to finance speculative investments.' He shows that they had 'an incentive not merely to undertake excessively risky investments, but (even) to pursue investments with low expected returns'. Krugman argues that the moral hazard problem involving over-guaranteed, but under-regulated financial intermediaries not only distorted investments, but also led to overinvestment at the aggregate level as well as overpricing of assets. He also suggests why East Asian businesses became extremely leveraged by Western standards as well as their tendency to be over-optimistic about their investments. Access to world capital markets allowed moral hazard in the financial sector to translate into excessive real capital accumulation.

He then concludes that such a moral hazard regime with overpriced assets was vulnerable to financial crisis as disintermediation set in. For Krugman, 'the days of cheerful implicit guarantees and easy lending for risky investment are clearly over for some time to come' as 'financial intermediaries have been curtailed *precisely because they were seen to have lost a lot of money*' (Krugman's italics). The problem is exacerbated by a magnification effect caused 'by the circular logic of disintermediation: the prospective end to intermediation, driven by the losses of the existing institutions, reduces asset prices and therefore magnifies those losses.' His analysis offers 'a story of self-fulfilling financial

crises, in which plunging asset prices undermine banks, and the collapse of the banks in turn ratifies the drop in asset prices.'

However, Krugman's model assumes that the financial intermediaries do not invest capital of their own, thus leading to the prediction that they will almost always need financial bailouts; in fact, if they invest their own capital, financial intermediaries will have something to lose as well, which would presumably check their conduct.

30. Krugman's model focuses on domestic financial intermediaries, whereas foreign institutions have played a major role in the East Asian crises.
31. In contrast to portfolio investment to buy domestic financial assets, FDI flows for new plant, equipment and intermediate inputs have different macroeconomic implications, with a limited impact on reserves, money supply and domestic interest rates (Montes 1998: 22). FDI is also less easily withdrawn.
32. Montes (1998: 27) points out that incentives in international markets tend to intensify, rather than moderate, over-optimism or over-pessimism due to herd behaviour and other factors.
33. Montes emphasises that sentiments can either favourably or unfavourably influence fundamentals and the health of financial systems; in particular, the collapse of the Southeast Asian currencies due to sentiments would adversely affect the viability of investments made in different exchange rate conditions, which could in turn further exacerbate the domestic banking crisis.
34. Montes argues that the rural-based economies of Southeast Asia have been better able to carry out real devaluations from nominal changes in currency value, while their export sectors have not been too tied down by supply side inflexibilities to respond to real devaluations. After asserting that stock markets have served to share risks among asset owners rather than raise financing, he argues that except for financial system weaknesses, Southeast Asian real sectors have been relatively immune from the recent asset market frenzy.
35. Montes points out that equity and portfolio investments have overtaken direct investment, loans and trade credit in providing external financing in the 1990s. He cites Reisen's warning (Montes 1998: 34) that offers of foreign financing should be resisted if they would 'cause unsustainable currency appreciation, excessive risk-taking in the banking system, and a sharp drop in private savings.' Hence, in a market-sentiment driven world, currencies become too strong with offers of strong external financing and too weak when capital withdraws.
36. I am grateful to Anthony Rowley for confirming these details with Kunio Saito, director of the IMF's new Tokyo regional representative office on 17 December 1997.

The executive board of the Fund is currently holding a series of meetings to discuss the detailed implementation of this mandate and will report again to the Interim Committee on the *modus operandi* at the spring meeting. Thereafter, individual member governments have to ratify the change, but a simple majority will be sufficient. In other words, a unanimous vote is not needed to approve the change in the Fund's Articles.

However, other colleagues — including Professor Gerald Helleiner of the University of Toronto and Dr. Yilmaz Akyüz of UNCTAD — suggest that the situation is not as dire as the above account suggests because the approval process is much more complicated.

37. Arguably, the Philippines currency has not taken quite as hard a hit, in part because their (colonial-inherited) banking and accounting standards are considered relatively better, but also because short-term capital inflows have been relatively less, given the recentness of its economic recovery.

38. However, invoking 'national economic sovereignty' may become very dubious when it is clearly hijacked by special interests.
39. While the low productivity growth critique popularised by Krugman (1994) may be theoretically and methodologically faulted, there is little doubt that East Asian growth has generally been boosted by high savings and investment rates. While this might give the impression of 'all perspiration, no inspiration', as suggested by TFP critics, the dominance of FDI in the internationally competitive export-oriented industries suggests the transfer or import of 'inspiration' embodied in new plant and equipment as well as the necessary technological learning to get the jobs done.

INDEX

- ABN-AMRO, 92
accountability, 133, 134
Aquino, 200, 202, 204
Agosin, Manuel R., 175
Ahn Mi-Young, 118
Ahuja, Vinod, 100
Akyuz, Yilmaz, 22, 36, 38, 69, 102
Alien Business Law, 91, 127
Altbach, Eric, 124
American Express International, 126
Amnuay Veeravan, 145
Amsden, A., 226
Anand Panyarachun, 86, 140, 142
Andrews, Edmunds S., 67
Anwar Ibrahim, 185, 186, 188, 190, 191, 195
Argentina, 36, 224
Asia 1997 Economic Yearbook, 144
Asia Pacific Economic Cooperation (APEC), 123
Asiaweek, 144
Asian Development Bank (ADB), 94, 103, 117, 149, 158, 162
Asian Monetary Fund (AMF), 123, 124, 134, 194
Asian Wall Street Journal (AWSJ), 5, 88, 98, 99, 128, 129, 131, 183, 188
asset markets, 37, 59, 60, 162, 232
asset prices, 7, 9, 11, 14, 15, 17, 18, 38, 58, 76, 77, 152, 211, 220, 232
Asset Management Corporation (AMC), 151, 152
Associated Press, 117
Association of South East Asian Nations (ASEAN), 47, 94, 95, 205, 220
Australia, 94
Aziz Taha, 183
- baht-dollar, 6, 37, 51, 70, 85, 86, 88, 90, 93, 112, 113, 127, 137, 138, 139, 140, 142, 147, 149, 153, 154, 155, 157, 158
bail-out, 21, 135, 139, 152, 153, 185-9, 229
- Bakun Dam project, 187
balance of payments (BoP), 2, 16, 19, 23, 34, 45, 51, 52, 57, 59, 63, 73, 75, 122, 126, 142, 149, 165, 200, 202, 203, 204, 210
Bangkok, 86, 87, 110, 111, 112, 139, 145, 156
Bangkok Bank of Commerce (BBC), 146, 152
Bangkok Bank, 140, 156, 158
Bangkok International Banking Facility (BIBF), 51, 87, 138, 139, 142
Bangkok Metropolitan Bank, 152
Bangkok Post Year-end 96 Economic Review, 144
Bangkok Post, 91, 110, 126, 127, 144, 149, 150, 151, 153, 155, 156
Bangna-trat Highway, 111
Banharn Silpa-Archa, 143, 145, 146, 147, 157, 158
Bank Bumiputra, 188
Bank Negara Malaysia (BNM), 183
Bank of Asia, 92
Bank of Ayudhya, 140
Bank of Commerce, 188
Bank of International Settlements (BIS), 5, 35, 48, 58-9, 106, 131, 149, 229, 237
Bank of Japan, 51
Bank of Korea, 107, 223
Bank of Thailand, 50, 51, 87, 89, 137-52, 157, 217
Banuri, T., 230
Barshefsky, Charlene, 123, 127, 130
Bello, Walden, 23, 157
BIBF, *see* Bangkok International Banking Facility
Blum, George, 69, 165, 169, 180, 181, 183, 193
boom-bust cycle, 14, 39, 180, 214
Brady Plan, 205
Brazil, 202, 224

- Bretton Woods, 9, 10, 11, 12, 15, 33, 42,
 45, 52, 133, 134, 141
 budget surplus, 77, 157
 Budnevich, C., 35
 Bullard, Nicola, 23
 Burma, 111
 Burton, John, 106, 108
- Camdessus, Michel, 96, 103, 158, 191
 capital
 account, 6, 9, 17, 18, 19, 23, 24, 66, 69,
 70, 71, 76, 87, 105, 121, 124, 132,
 133, 134, 142, 157, 163, 235
 flight, 17, 68, 98, 99
 flows, 23, 41, 47, 57, 66, 67, 75, 76, 83,
 86, 109, 121, 157, 199, 215, 220
 inflows, 6, 9, 11, 12, 13, 16, 17, 22, 34,
 35, 39, 41, 45, 48, 50, 51, 57, 60, 68,
 69, 85, 86, 94, 102, 123, 143, 157,
 165, 171, 175, 214, 220
 liberalisation, 211, 215, 218, 219
 market, 12, 23, 36, 50, 51, 66, 68, 69, 75,
 76, 78, 107, 132, 137, 149, 163
 outflows, 75, 126, 153, 165
 regulation, 218
chaebol, 53, 68, 71, 79, 100, 101, 102, 105,
 107, 108, 118, 119, 130, 131, 224, 225,
 228
 Chalongphob Sussangkarn, 156, 157
 Chandrasekar, C.P., 22, 86
 Chang Ha-Joon, 24, 72, 188, 226, 227,
 230
 Chart Thai Party, 146
 Chart Pattana, 145, 147, 151
 Chavalit Yongchaiyudh, 89 - 92, 114, 125,
 143, 147, 151, 157, 158
 Chicago, 6, 120
 Chile, 6, 36, 52, 162, 175, 185, 218
 Chin Kok Fay, 183
 China, 3, 24, 39, 41, 53, 66, 112, 143, 149,
 165, 213, 218
 Clinton, Bill, 96, 99
 Cohen, William, 96
 Cole, David C., 163, 168, 169
 commercial banks, 4, 5, 70, 72, 108, 138-
 42, 149, 153, 154, 158, 166, 168, 182,
 183, 212, 217, 218
 commercial borrowing, 70, 72
 Commonwealth Games, 192
 consociationalist regime, 195
 conspiracy, 6, 185, 186, 216
 contagion, 4-8, 10, 15, 18, 37, 41, 68, 74,
 93, 82, 185, 192, 225
 Cook Islands, 168
 corruption, 24, 162, 163, 169, 199, 219,
 224
 counter-cyclical policy, 199
 crony, 137, 186, 187, 191, 194, 195, 199,
 200, 214, 228, 229, 230
 currency board, 1, 11, 53, 78, 79, 80, 98,
 99, 127, 129, 179
 currency speculation, 6-9, 68, 90, 145, 190
 currency trading, 10, 13, 15, 145, 147
 current account, 2-9, 10, 13, 16-9, 34, 46,
 51, 54, 63, 66-7, 70, 81-2, 86, 94, 97,
 106, 137-8, 142-6, 150, 153, 157, 171,
 181-4, 189, 200-11, 215, 217, 223-6
- Daewoo, 107
 Daim Zainuddin, 188, 191, 195
 Davis, Bob, 91
 debt GNP ratio, 223
 debt servicing, 7, 40, 200, 224
 Deen, Thalida, 100
 deflation, 12, 36, 37, 41, 42, 53, 58, 80, 88
 depreciation, 4, 25, 53, 60, 75, 79, 96, 106,
 153, 155, 184, 202, 212, 217, 219, 220,
 227
 depression, 200
 deregulation, 3, 13, 38, 72, 93, 100, 123,
 127, 141, 165, 219
 Dertouzos, M., 230
 devaluation, 3, 18, 39, 42, 53, 57, 58, 59,
 81, 82, 85, 87, 99, 140, 142, 145, 147,
 155, 158, 162, 193, 200, 204, 227, 212,
 219
 developmentalist, 3, 12, 24, 25
 Diaz-Alejandro, Carlos, 36
 direct foreign investment, 70, 171
 discount rate, 51, 52
 dollarisation, 36
 domestic, 4, 9, 17, 35, 40, 45, 58, 60, 71,
 72, 75, 78, 79, 106, 163, 165, 216
 domestic savings, 3, 7, 8, 9, 23, 68, 70, 71,
 76, 100, 142, 204, 210, 214
 domino, 5, 10
 Doner, Richard, 141, 142
 Dresdner Bank, 67

- Dutch disease, 163
- East Asia, 1, 3, 11, 13, 14, 15, 19, 22, 23, 24, 25, 34, 36, 37, 38, 39, 40, 41, 67, 74, 154, 181, 199, 211, 216
- East Germany, 60
- Eastern Europe, 13, 19, 41
- Eatwell, John, 11
- Econit, 117
- economic development, 2, 16, 22, 147, 158, 199, 220
- Economic Planning Board, 227
- economic policy, 12, 134
- economic strategy, 194
- EIU country report, 145, 147-51, 154, 156
- Ekamol Khirawat, 146
- Ekran, 187
- El Nino, 112, 116
- Employees Provident Fund, 186, 187, 189
- employment, 12, 18, 230
- equity markets, 36, 44, 53, 54
- ersatz capitalism, 194
- ESCAP, 114
- Euh, Y., 226
- Eurobond market, 139
- Europe, 19, 38, 39, 40, 41, 42, 44, 45, 101, 107
- European banks, 41, 216
- European currencies, 41
- European Union (EU), 41, 81, 124, 133, 134, 155
- exchange rate, 5, 8, 10, 75
- export growth, 22, 63, 66, 67, 70, 71, 81, 101, 143, 152
- export-oriented, 3, 4, 7, 18, 25, 34, 49, 67, 82, 132,
- external account, 35, 37, 39, 40, 41, 42, 46, 47, 50, 57, 70, 75, 86, 105, 142, 178, 200, 211, 214, 215, 216, 217
- external finance, 36, 40, 70, 75, 94, 138, 171, 179, 182, 193, 214, 233, 235
- Far Eastern Economic Review (FEER)*, 124, 144, 145, 148, 149, 150, 151, 155, 156
- Federal Reserve, 50
- Feldstein, Martin, 40, 120, 121
- Ffrench-Davis, Ricardo, 175
- FIDF, *see* Financial Institutions Development Fund
- finance capital, 9
- Finance One, 50, 88, 147, 148
- financial
- borrowings, 200
 - collapse, 77
 - capital, 7, 8, 9, 16, 190
 - companies, 110, 141, 142, 144, 147-155, 157
 - disintermediation, 16
 - flows, 11, 24, 36, 66, 121, 226
 - governance, 7, 9, 12, 16, 22, 87, 90, 102, 103, 133, 216, 226
 - institutions, 6, 11, 14, 20, 37, 38, 47, 51, 52, 69, 71, 72, 77, 86, 88, 90, 93, 97, 105, 106, 121, 126, 127, 131, 132, 140, 149, 150, 152, 157, 168, 189, 225, 226, 236
 - instruments, 11, 165
 - intermediaries, 14, 17, 69, 72
 - intermediation, 15, 17, 157
 - investments, 4, 52
 - liberalisation, 3, 5, 6, 7, 10, 11, 12, 13, 47, 106, 108, 132, 138, 157, 168, 171, 175, 184 185, 191, 193, 203, 210, 211, 212, 216, 219, 235-6
 - markets, 5, 10, 12, 16, 22, 36, 40, 42, 44, 45, 68, 70, 71, 72, 73, 76, 86, 87, 94, 120, 127, 225, 229, 232
 - reform, 88, 125, 150, 166
 - restructuring, 38, 90, 126, 151
 - sector, 2, 3, 8, 10, 17, 19, 20, 35, 40, 49, 50, 71, 73, 76, 77, 78, 81, 88, 93, 94, 96, 98, 99, 105, 121, 126, 128, 130, 142, 144, 145, 148, 149, 150, 151, 154, 156, 165, 181, 185, 190, 202, 210, 211, 213, 217, 226
 - speculators, 71, 75, 186
 - system, 7, 10, 13, 16, 17, 18, 19, 22, 38, 42, 48, 59, 71, 72, 73, 76, 86, 88, 137, 139, 140, 146, 155, 162, 163, 165, 168, 169, 175, 182, 184, 235-8
 - turmoil, 216
- Financial Institutions Development Fund (FIDF), 88, 147, 149, 150, 152, 154, 157
- Financial Restructuring Agency (FRA), 90, 150, 152, 154
- Financial Times*, 106, 108, 120, 150, 151, 155, 156, 158, 193, 215
- Finland, 162

- First Bangkok City Bank, 92, 152
 first-tier, 3, 13, 25, 33
 fiscal, 1, 3, 9, 14, 16, 18, 19, 38, 39, 52, 57,
 73, 75, 76, 89, 106, 153, 202, 203, 204,
 210, 234
 Fischer, Stanley, 10, 51, 123
 Fisher, Irving, 58
 fixed exchange rates, 6, 10, 153
 floating currency system, 178
 flying geese, 13, 39, 44, 45
 Ford Motors, 154
 foreign
 acquisitions, 36, 80
 banks, 4, 6, 20, 21, 70, 73, 80, 87, 89,
 90, 92, 97, 98, 102, 105, 106, 131,
 132, 139, 151, 154, 169, 182, 210,
 214, 218, 224, 229
 borrowings, 4, 5, 40, 45, 52, 54, 58, 59,
 60, 68, 77, 89, 100, 108, 121, 132,
 142, 193, 202, 212, 213, 218, 219,
 223, 226
 capital, 6, 7, 35, 57, 71, 74, 78, 80, 86,
 88, 92, 100, 101, 102, 108, 125, 126,
 142, 157, 158, 211
 companies, 79, 191
 currency, 46, 50, 52, 87, 98, 98, 103,
 142, 150, 166, 210
 debt, 3, 50, 68, 78, 98, 99, 103, 104, 126,
 141, 168, 175, 181, 186, 199, 202,
 205, 210, 214, 219, 224
 direct investment (FDI), 3, 6, 12, 24, 34,
 41, 63, 66, 67, 75, 120, 149, 181, 182,
 218, 220
 exchange, 4, 10, 24, 40, 45, 46, 48, 50,
 51, 53, 54, 59, 70, 71, 73, 74, 78, 79,
 86, 87, 99, 122, 138, 139, 142, 145,
 149, 153, 155, 157, 163, 165, 166,
 168, 180, 185, 189, 205, 215, 217,
 220,
 funds, 17, 71, 73, 117, 182, 183, 193
 inflows, 214, 219, 220
 interest rates, 6, 8
 investment, 4, 21, 67, 79, 87, 93, 94, 97,
 122, 143, 205, 210, 211
 investor, 53, 67, 71, 77, 79, 83, 107, 121,
 126, 128, 138, 144, 151, 154
 ownership, 17, 21, 79, 97, 121, 130
 reserves, 51, 54, 68, 73, 83, 105, 138,
 148, 149
 savings, 3, 4, 7
 take-over, 105, 108, 131
 trade, 94
 workers, 194
 Forum of the Poor, 114
 Foundation for Children's Development,
 112
 FRA, *see* Financial Restructuring Agency
 France, 41
 Friedman, Milton, 120
 fund managers, 4, 5, 105, 182, 186
 fundamentals, 3, 6, 8, 11, 12, 16, 18, 24, 37,
 162, 175, 179, 219

 G7 governments, 133
 GATT, 67, 82
 GDP, 52, 66, 72, 73, 76, 77, 90, 91, 94,
 100, 105, 106, 115, 125, 138, 143, 144,
 145, 153, 154, 157, 171, 202, 203, 204,
 205, 210, 213, 214, 223, 226
 Genting-Camerons, 190
 Germany, 13, 104
 Ghosh, Jayati, 22, 86
 global, 10, 21, 33, 38, 39, 40, 41, 42, 43,
 44, 46, 47, 49, 54, 57, 60, 132, 134,
 globalisation, 34, 44, 45, 49, 68, 102, 215,
 218
 GM (General Motors), 154
 GNP, 3, 4, 181, 182, 204, 210, 212, 213,
 214, 219, 223, 226
 Goldman Sachs, 99
 Golub, Stephen S., 48
 governance, 22, 23, 25, 42, 43, 105, 134
 government, 20, 114, 120
 Great Depression, 53
 Green, Duncan, 115, 116, 117, 129
 Greenspan, Alan, 10, 36, 44, 51
 gross domestic product, *see* GDP

 Habibie, B.J., 99, 97, 129
 Halim Saad, 187, 188
 Hanbo, 50, 224, 225, 229
 Hanlon, Joseph, 121, 123, 133
 Harvard Institute for International
 Development (HIID), 120
 Harvard University, 12
 Hashimoto Ryutaro, 96
 hedge, 5, 6, 145, 157, 213
 Helleiner, Gerald, 35, 232

- Helsinki, 121
 herd, 4, 5, 7, 8, 10, 15, 24, 36, 67, 75, 182, 192, 215
 high performing Asian economies (HPAEs), 2
 Hong Kong, 1, 2, 3, 19, 24, 25, 33, 41, 47, 48, 53, 54, 78, 98, 185
 House Ways and Means Subcommittee, 123, 130
 Howard, John, 96
 Human Rights Watch, 116
 Hungary, 78
 Hyundai, 107, 224
- ICMI, 115
 Iman Taufik, 128
 immigrant labour, 194
 impact, 18, 33, 35, 162, 191, 202
 implications, 2, 15, 18, 20, 22, 23, 178
 import, 22, 66, 194, 203
 India, 86
 Indonesia, 1, 2, 3, 5, 7, 16, 19, 20, 21, 22, 23, 24, 25, 33, 35, 37, 47, 48, 50, 52, 54, 63, 66, 67, 70, 71, 75-80, 82, 85, 89, 92-6, 98, 99, 101, 103, 104, 109, 112, 115-7, 120-4, 127-9, 132, 133, 162-80, 182, 184, 191-2, 194, 202, 204, 217, 224
 Indonesian Banking Law, 168
 Indonesian rupiah, 6, 37, 77, 78, 79, 80, 93, 94, 96, 98, 99, 162, 163, 165, 169, 171, 178, 202
 industrial policy, 2, 227, 228
 industrialisation, 3, 39
 inflation, 3, 4, 16, 40, 42, 45, 46, 57, 76, 77, 81, 96, 97, 105, 106, 109, 115, 119, 131, 142, 150, 156, 193, 200, 202, 203, 204, 211, 213, 214
 control, 137, 227
 rate, 163, 179, 193, 195
 Information Technology Agreement, 81
 Institute of International Finance (IIF), 67, 69
 institutional reform, 230
 interest rates, 4, 6, 8, 11, 14, 35, 37-41, 43, 45, 46, 47, 49-53, 57-60, 69, 71, 76, 80, 82, 86, 88, 89, 91, 93, 94, 100, 105, 106, 108, 120, 125, 130, 131, 138, 140, 142, 143-5, 157, 158, 171, 178, 184, 189, 200, 203, 205, 212-4, 216, 217, 220
 Internal Security Act (ISA), 189
- international
 banks, 23, 34, 35, 67, 69, 126, 158
 capital markets, 162, 228
 community, 111
 confidence, 225
 corporations, 79
 credit markets, 70
 creditors, 126
 debtor-creditor, 22, 43
 economy, 72
 finance, 8, 9, 68, 69, 70, 73, 78, 85, 134, 162, 186, 226
 institutions, 123, 132
 investors, 74, 75, 78
 lenders, 18
 markets, 68, 73, 81, 100, 101
 monetary systems, 184
 offshore financial centre, 193
 private banks, 126
 reserves, 200, 204, 210
 speculators, 185
 system, 13, 73,
 trade, 10, 101
- International Finance Corporation (IFC), 7, 182
International Herald Tribune, 146, 152
 International Monetary Fund (IMF), 1, 2, 5, 9, 10, 15, 16, 18, 19-21, 23, 37, 47-9, 52, 54, 57-60, 69, 74-80, 82, 85-135, 137, 144, 147-50, 154, 155, 158, 178-80, 186, 191-5, 200, 202, 212, 222, 229-30, 237-8
 Articles of Agreement, 23, 121, 122, 133, 134
 Articles of Association, 19
 conditionality, 15, 21, 23, 37, 193, 196, 229, 234-5
 intervention, 19, 21, 191, 192, 194, 237-8
 Korea bailout, 21
 packages, 121, 123, 125, 234-5
 policy-making interim committee, 19
 intervention, 20, 23, 24, 25, 33, 37, 141, 175, 192, 217, 219, 228
- intra-regional
 investment, 39
 trade, 39, 81
- investment, 3, 7, 8, 9, 12, 15, 17, 18, 21, 23-5, 34, 35, 37, 42, 71, 122, 134, 138, 139, 144, 151, 153, 156-8, 165, 181-4, 190, 193, 194, 200, 202, 204, 210, 211, 215, 216, 227, 228

- investor confidence, 68, 76-8, 81, 120, 124, 130, 149, 158, 180
- investors, 21, 142, 143, 145, 158, 182, 183, 185, 189, 213, 215
- Iraq-Kuwait crisis, 204
- Isthmus of Kra, 190
- Jakarta, 77, 96, 115, 116, 163
- Jakarta Post*, 97, 117
- Japan, 2, 3, 13, 24, 25, 38, 40, 42, 44-6, 51, 57, 80, 94, 101, 103, 123, 131, 140, 157, 180, 220
- Japan Economic Institute, 104, 116, 149
- Japanese banks, 225
- Japanese yen, 40, 51, 54, 81, 184, 227
- Jomo K.S., 3, 24, 25, 80, 183
- Kaminsky, 16, 163
- Kang Kyung Shik, 225
- Kansai, 190
- KCTU, 107, 118, 119, 120
- Keynes, Maynard, 9, 10
- Khazanah, 187, 189
- Kia Motors, 225
- Kim Dae Jung, 107, 108, 127, 131, 229
- Kim Young Sam, 224-230
- Klein, Lawrence, 11
- Koener, P., 224
- Kohl, Helmut, 96
- Koperasi Usaha Bersatu (KUB), 188
- Korea, 7, 48, 49, 50, 54, 59, 60, 178, 222
- Korean won, 37, 54, 69, 79, 102, 107, 130, 222
- Kregel, Jan, 22
- Krissana Parnsoonthorn, 139
- Krugman, Paul, 13, 14, 15, 21, 69, 143
- Krung Thai Bank, 140, 152
- Kuala Lumpur, 95
- Kuala Lumpur Composite Index (KLCI), 181, 189, 193
- Kuala Lumpur Stock Exchange (KLSE), 182, 185
- labour market, 107, 108, 118, 129
- Labuan, 183
- Latin America, 19, 33, 40, 41, 47, 67, 74, 75
- Lauridsen, Laurids, 68
- Le Fort, G., 35
- lender of last resort, 43, 57, 73, 148
- letter of intent, 151, 153, 154
- liberalisation, 8-11, 17, 19, 22-5, 34, 35, 60, 68-70, 72, 73, 76, 87, 97, 102, 121, 123, 124, 127, 132, 137, 163, 178-80, 193, 194, 205, 222
- LIBOR, 69, 108, 131, 226
- Liem Sioe Liong, 98
- liquidity, 35, 43, 141, 145, 153, 154, 155, 165, 178, 185, 190, 212, 217, 232-4
- Lissakers, Karin, 91
- London, 5, 124
- Lucky-Goldstar (LG), 101
- Maastricht Treaty, 124
- macroeconomic, 12, 14, 16, 18, 24, 40, 42, 157, 162, 175, 234
- Mahathir Mohamad, 9, 13, 184-8, 190-2, 194, 195
- Malacca Straits, 190
- Malayan Banking, 188
- Malaysia, 2, 3, 5, 7-10, 12, 16, 21, 22, 24, 25, 33-5, 37, 48, 49, 52, 54, 59, 63, 66, 70, 71, 82, 104, 112, 182, 184, 186, 187, 190, 192, 193-5, 204
- Malaysia Inc, 195
- Malaysian International Shipping Corporation (MISC), 188
- Malaysian Mining Corporation (MMC), 188
- Malaysian ringgit, 10, 6, 184, 190, 193
- Malhotra, Kamal, 23
- Mar'ie Muhammad, 169
- Marcos, Ferdinand, 200
- Marks & Spencer, 156
- maturity structures, 226
- McKinnon, Ronald, 218
- merchant banks, 20, 105, 131, 226
- Mexican crisis, 5, 9, 10, 13, 22, 47, 57-8, 144, 145, 149, 157, 162, 214, 223, 224
- Mexican peso, 44, 45
- Mexico, 14, 35, 45, 46, 49, 52, 74, 103, 104
- Ministry of Finance and Economy (MOFE) (South Korea), 227
- Ministry of Finance, 137, 142, 144, 157, 227
- Ministry of Labour, 110
- Ministry of Social Welfare, 110
- Minsky, Hyman, 35, 58
- Mirzan Mahathir, 182, 188

- Mohamad 'Bob' Hassan, 129
 monetary, 3, 10, 15, 38, 40, 45, 57, 94, 105,
 142, 143, 144, 150, 165, 183, 203, 204,
 205, 210, 234
 money markets, 20, 54, 145
 monopolies, 178
 Montes, Manuel, 16, 18, 163, 175
 Montgomery, John, 49, 50
 Moody, 144
 moral hazard, 15, 69, 108, 120, 126, 131,
 132, 179, 218
 multinationals, 34
 Muslim ulama, 195
 Myanmar, 111, 156
- Nan (Thai province), 110
 NAP, 147
 Naris Chaiyasoot, 138, 141
 Narongchai Akrasanee, 147
 Nasution, Anwar, 168, 171
Nation, 106, 108, 131, 156
 National Assembly, 118, 119, 129
 National Bureau of Economic Research
 (NBER), 121
 National Economic Action Council
 (NEAC), 188, 191, 195
 national income accounts, 14
 National Law, 94, 97
 National Steel Corporation (NSC), 188
 NBFIs (non-bank financial institutions),
 166, 168
 Neiss, Herbert, 91, 92, 153
 neo-liberal, 2, 10, 13, 24, 120, 124, 218,
 228
 nepotism, 189
 net open positions (NOPs), 168
 New Economic Policy (NEP), 192, 194,
 196
 New Port Project, 119
 New York, 53, 74, 108
New York Times, 94
 newly industrialising countries (NICs), 1, 2,
 3, 13, 67, 217
 newly industrialising economies (NIEs), 3,
 13, 25, 33, 40, 44, 45, 53
 nexus, 3, 8, 181
 Nikhom Chandravithun, 111
 Nixon, Richard, 10
 Nolan, P., 230
- non-deliverable forward (NDF) cover, 217
 non-exportables, 6
 non-financial public enterprise (NFPE), 182
 non-governmental organisation (NGO), 110,
 128
 non-OPEC developing countries, 224
 non-performing loans, 223
 non-tradables, 3, 4, 181, 184, 211, 220
 Northern Regional International Airport,
 190
 Norway, 162
 NU (Nadhatul Ulama'), 117
- OECD, 34, 49, 66, 82, 100, 101, 223, 228
 offshore 17, 24, 48, 138, 142, 144
 Ostrey, Sylvia, 46
- Pacific Chemicals, 187
 PAKTO-27, 166
 payment deficit, 45
 Peerawat Jariyasombat, 155
 pension funds, 6, 68
 peso, 52, 74, 203, 205, 210-3, 215-7, 219,
 220
 Petronas, 188
 Philippines, 1, 16, 23, 24, 37, 48, 52, 63,
 67, 71, 93, 100, 104, 193, 199-221
 Pichit (Thai province), 110
 Pill, H., 218
 Plaza accord, 42, 102, 157, 204
 policy 5, 7, 9, 13, 37, 149, 180, 227, 228
 political participation, 85, 133
 portfolio, 6, 7, 8, 17, 75, 86, 143, 165, 205,
 212, 214, 215, 217, 218, 220
 Prangtip Daorueng, 110
 Prem (former Thai Prime Minister), 142,
 145
 private debt, 4, 7, 12, 17, 34-6, 39, 93, 114,
 154, 229, 233
 private sector, 12, 36, 132, 137-9, 149, 157,
 158, 165, 166, 179, 182, 214, 228
 privatisation, 88, 94, 122, 127, 151, 154,
 182, 196, 202, 203
 productivity, 2, 13, 18, 39, 139
 profit repatriation, 12
 property, 6, 8, 36, 154, 158, 211, 213, 216,
 217
 Property Loan Management Organisation
 (PLMO), 147, 148

- protectionism, 42, 67, 82
PT Bank Duta, 179
- Quantum Fund, 186
- Radhanasin Bank, 152
Raghavan, 5, 20
Ramos, Fidel, 188
Rangsit University, 110
Reagan, Ronald, 120, 121
real economy, 162, 222
real estate, 7, 14, 139, 141, 156, 183, 192, 211
recession, 19, 40, 92, 139, 142, 199, 204, 211, 214
recovery, 13, 18, 24, 37, 38, 145, 153, 192, 193, 199, 202, 214
Reinhart, Carmen M., 16, 163
Reisen, Helmut, 171
renminbi, 227
Renong, 185, 187, 188
rentier, 24, 25, 196
Rizal Ramli, 117
Robinson, David, 141
Rubin, Robert, 10, 124, 186
Russia, 13
- Sachs, Jeffrey, 87, 89, 106, 107, 120, 122
Saito, Kunio
Samsung, 107, 225, 228, 229
San Francisco, 139
Sanger, 94, 127
Sanwa Bank, 92
Sap Poo Pan (Thai village), 110
Satya Sivaraman, 111, 112
savings investment gap, 3, 181
SBI (Sertifikat Bank Indonesia), 166
SBPU (Surat Berharga Pasar Uang), 166
second-tier, 1, 2, 3, 24, 33, 34, 44, 82
Securities and Exchange Commission (SEC), 146
Securities Commission, 182
securities market, 4, 36, 38
Sen, Abhijit, 86
Seoul, 101, 103, 130
Seoul-Pusan High Speed Railway, 119
short-run foreign borrowing, 220-1
short-term, 3-6, 8, 10, 11, 158, 181
 capital, 3, 8, 134, 157, 182, 192, 236
 debt, 16, 18, 20, 21, 34, 38, 70, 108, 126, 138-40, 143, 175, 184, 211, 220, 224, 226
Siam Cement Company, 155,
Siam City Bank, 140
Siam Commercial Bank, 92, 140
Sime Bank, 188, 189, 192
Singapore, 2, 3, 5, 15, 24, 25, 33, 48, 94, 98, 129, 163, 193
Singapore Business Times, 187
Singh, A., 230
Siti Hardijanti ('Tutut') Rukmana, 128
Slade, Betty F., 168, 169
small and medium-sized enterprises (SMEs), 155
social costs, 20
social investment fund, 114
socialisation, 36,
Somprasong Land, 139, 147
Soros, George, 9, 185, 186, 216
South America, 44
South China Morning Post, 185
South Korea, 1, 2, 5, 15, 20, 21, 24, 25, 33-5, 38, 63, 66-9, 71-3, 75, 76, 79, 82, 85, 89, 100-9, 111, 118-20, 122, 123, 127, 130-3, 140, 157, 158, 171, 191, 199, 214, 217, 222-4
Southern Cone crisis, 36
sovereignty, 21
speculation, 15, 23, 132, 145, 149, 212, 213, 215-7
stability, 18, 42, 137, 142, 166, 179, 211, 212
state banks, 166, 169
state-business relationship, 228
state-directed economic system, 222
state intervention, 2
state-led economic system, 222
state-owned banks, 169
sterilisation, 17, 216
Stiglitz, Joseph, 2, 11, 121, 133
stock exchange, 168
Stock Exchange of Singapore (SES), 182
stock market collapse, 11, 36, 187, 193
stock markets, 1, 4, 7, 8, 14, 17, 21, 35, 37, 39, 53, 59, 66, 68, 74, 77-9, 93, 101, 103, 108, 130, 139, 141, 143, 145, 157, 166, 182-4, 188, 189, 192, 205, 211-3, 215

- structural adjustment, 87, 199, 202, 203
 structural change, 3, 16, 25
 structural reform, 88, 105, 123, 143, 180, 222, 235
 Suehiro Akira, 140
 Suharto, 1, 77-9, 92, 94-9, 109, 124, 127-9, 132, 178, 190, 194
 Sumarlin shocks, 169
 Summers, Lawrence, 96, 123, 158
 Supachai Panitchpakdi, 151, 153
 sustainability, 18, 25
 swap market, 6
 Sweden, 59, 162
 Swiss Bank Corporation, 69
- TAFI, 168, 169
 Taiwan, 2, 3, 24, 25, 33, 53, 54, 140, 157
 Tarrin Nimmanahaeminda, 153
 tax reforms, 203
 Taylor, L., 230
 Techapaibul family, 153
 Telephone Organisation of Thailand, 91
 tequila crisis, *see* Mexican crisis
 Thai Airways, 91
 Thai Bankers Association, 140
 Thai Danu Bank, 154
 Thai Farmers Bank, 140
 Thai Military Bank, 140, 148
 Thai petrochemical industry (TPI), 155
 Thailand, 1-3, 5, 7, 14-6, 21, 22, 24, 25, 33-5, 37, 38, 44, 47, 48, 50-2, 54, 59, 63, 68, 70, 71, 76, 83, 85-7, 89, 90, 92, 93, 99, 103, 104, 109, 111-4, 119-27, 131-3, 137-61, 180-2, 186, 194, 204, 212, 214, 217, 223, 224
 Thailand Development Research Institute (TDRI), 138
 Thammavit Terdudomtham, 139
 Thanong Bidaya, 89, 90, 110, 148
The Economist, 95, 120
Third World Resurgence, 21
 Thurow, Lester, 139
Times of India, 20
 Ting Pek Khiing, 187
 Tobin, James, 10, 11
 trade balance, 46, 47, 50, 59, 75, 141
 trade deficit, 40, 42, 46, 210, 211
 trade liberalisation, 105, 123, 124
 trade policy, 155
 trade surpluses, 40, 53
 transparency, 4, 20, 57, 122, 132-4, 182, 189, 217, 237-8
 Turner, Anthony G., 48
- UEM-Renong, 187-9
 UMNO, 187, 188, 191, 195
 unemployment, 14, 16, 38, 41, 42, 156, 230
 Unger, Roberto Mangabeira, 134, 141, 142
 United Engineers Malaysia (UEM), 185, 187, 188
 United Kingdom (UK), 13, 44
 United Nations (UN), 11, 114
 United Nations Conference on Trade and Development (UNCTAD), 34, 232
 United States (US), 10, 11, 13, 19, 21, 23, 35-9, 41, 42, 44-7, 59, 74, 79, 80-2, 94, 96, 101-8, 120, 123, 124, 126, 127, 130, 131, 133, 149, 154, 156-8, 180, 194, 216, 228, 237
 University of the Philippines, 216
 Uruguay, 36
- Vadarajan, S., 20
 value-added tax (VAT), 88, 149
 Vatchara Charoonsantikul, 89, 90
 Voravidh Charoenlert, 112
- Wade, R., 24
 Wall Street, 5, 10, 11, 19, 186
 Wardhanna, Ali, 168
 Warr, Peter, 140
 Washington, 74, 101, 133
 Washington consensus, 123
 welfare economics, 2, 33
 White, G., 24
 Wing Tiek Holdings, 188
 Wolf, Martin, 108, 223
 Wolfensohn, James, 117
 World Bank, 2, 7, 11, 19, 24, 86, 92-4, 109, 110, 114, 115, 117, 121, 123, 128, 133, 134, 137, 150, 156, 158, 179, 182, 223, 224, 237-8
 World Trade Organisation (WTO), 19, 43, 48, 67, 81, 82, 94, 236-7
- Yamin, Kafil, 117, 128