

The Indian Journal of Quantitative Economics, 1999
(Punjab School of Economics, Amritsar)

**Economic Globalisation and Financial Crises:
Some Lessons from East Asia**

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Abstract: This article suggests that the current wave of economic globalisation has been not only assymetrical but also prone to create world financial instability, to trigger recurrent and contagious currency crises in emerging economies, and to increase the risks of deflation and even recession in the global economy. First, we review the main features and implications of the current economic and financial globalisation. Second, we argue that the recent East Asian crises have been mainly related to premature and indiscriminate financial liberalisations and to herd-like behavior in international capital markets. Third, we suggest that there is a growing questioning of the current model of globalisation. Fourth, we list some lessons for crises-prevention.

JEL Classification: F30, F32, F33, F43, G15.

* The authors are grateful for the constructive and useful comments of two anonymous referees. However, responsibility for the views expressed in the article and for any omission or error remains with the authors.

August 1999

1. Introduction

Economic globalisation is a process which widens and intensifies international linkages in trade and finance. As such, globalisation certainly encompasses world-scale advantages: international trade has clearly become the main engine of growth; new capital and modern technology are increasingly available to developing countries; consumers everywhere have benefited from lower prices and better qualities; and, in more general terms, the international allocation of resources has tended to be more efficient.

However, as international capital movements have been the main catalyst for the accelerating global economic integration in recent times, market failures associated with them have also become more visible. Assymetrical information and the ensuing tendency towards higher risk and volatility are inherent to capital markets and have become more serious as those markets were more and more internationalised. As a result, current globalisation (especially in finance) is prone to provoke world instability, to trigger recurrent currency crises in emerging economies, and also to increase the dangers of world deflation, recession, and even depression. Current financial integration is therefore associated with a greater systemic risk on a global scale.

The recent East Asian financial crises highlighted this risk. They might be described as the more evident proof that the first post-Cold War serious and widespread crisis of globalisation is under way, especially after the Western European and Mexican exchange rate meltdowns. The East Asian episodes call thus for international and national measures to tame global finance. A new financial architecture is certainly needed, but some other more specific and pragmatic lessons should be obtained, especially for development strategies in low- and middle-income economies.

This paper is organised in the following way. First, we deal with the extent and implications of the current economic globalisation, which in fact is not as important and as new as commonly perceived. We argue that globalisation has been assymetrical and that capital flows to developing countries (one of its main features) seem to be unsustainable and prone to very sharp reversals. Second, we list some of the adverse implications of world financial integration, e.g., an increased risk (and volatility) in international capital markets and a deflationary bias in the world economy. Third, we explore the main characteristics and factors of the East Asian financial crises, in order to point out that they have been related, besides to domestic overinvestment and to overindebtedness in short-term foreign liabilities, to ill-advised financial liberalisations and to herding behaviors in global financial markets. Fourth, we suggest that recurrent crises in emerging economies epitomise in fact a deep crisis of the existing model of globalisation. Finally, we obtain from the previous analysis some crises-prevention lessons, which should include at least two main components: a new and more careful approach to financial deregulation and opening in developing economies, and the creation of a new global financial architecture.

2. Extent and Implications of the Current Economic Globalisation

Globalisation might be defined as a process according to which international linkages in trade and finance widen and intensify. International trade of goods and services increased, as a proportion of world output, from 12.1% in 1985 to 16.7% in 1994 and to

18.0% in 1997. Foreign direct investment (FDI) rose from an annual average of US\$ 50 billion in 1980-1985 to US\$ 318 billion in 1995. FDI annual flows represented 2% of world capital formation in 1985, a percentage which rose to 5% in 1995. FDI stock, as a proportion to gross world product, grew from 6% in 1985 to 10% in 1995. A shift of FDI towards service activities also took place. Cross-border transactions in financial assets represented less than 10% of GDP in Japan, the US and Germany in 1980. In the early 1990s, they reached 80% of GDP in Japan, 135% in the US and 170% in Germany. Foreign exchange trading has increased from a daily US\$ 15 billion in 1973 to a staggering US\$ 1.3 trillion in 1995 (Eatwell, 1996) and is estimated to have reached almost US\$ 2 trillion in 1998 (100 times the value of world trade). This trading is moreover mainly short-term: 82% has a maturity of less than seven days while 43% has a maturity of less than two days.

The recent movement towards globalisation has two distinct features.

First, it is not as important and new as commonly perceived. As suggested by the aforementioned figures, world trade amounts to only one-sixth of gross production. Despite the growth of foreign capital flows, the bulk of world investment is still domestically financed. Moreover, international movements of capital and labor were surely more intense in the pre-1914 period than presently. For instance, by 1914 capital outflows amounted to 9% of United Kingdom's GDP and around 5% of GDP of all capital-exporting countries (Bairoch and Bozul-Wright, 1996: 11). Estimates of current capital outflows from Japan or Germany do not even reach 4% of their respective GDPs. However, the ratio between international trade and world output surpassed its pre-1914 level already in the late 1970s. Moreover, technological changes, improvements in transport and telecommunications, and the surge of quickly-moving capital, along with the rise of Third World's exporters of manufactures and of China's and Eastern Europe's markets, are new phenomena indicating an acceleration in global economic integration.

Second, globalisation has been asymmetrical, as it has tended to skew its benefits towards rich countries and privileged social sectors (UNCTAD, 1997). The unprecedented unleashing of market forces was combined with a lopsided trade and capital liberalisation. Trade liberalisation in products where developing countries are more competitive has been slow, while capital movements, where advanced countries have an advantage, have obtained a much increased mobility. As a result, divergence of per capita income between developed and developing economies has increased since 1980, with the only exception of East Asia. Growth has been insufficient to create enough jobs on a world scale and to reverse the tendency towards more poverty. Financial activities have gained preeminence over productive industrial activities, while returns from capital have increased their share in total income in virtually all countries. A growing inequality between qualified and non qualified workers has been accompanied by a hollowing out of middle social classes and by a greater job and income insecurity.

Notwithstanding, globalisation certainly has advantages. It has consolidated foreign trade as the main engine of growth in both developing and developed economies. Firms have now more opportunities than ever for export to the world market. Globalisation has also permitted a growing availability of external funds and imported technology in developing countries. Consumers on a world scale have benefited from lower prices due to increased

international trade. There is also more awareness among ordinary people of the domestic implications of the state and trends of the world economy.

However, the current wave of globalisation has also several important drawbacks for developed and developing countries.

According to Rodrik (1997 and 1998), globalisation has three main disadvantages for advanced industrial economies. First, it alters the balance of power away from workers and towards employers. Second, it undermines established social norms, such as workers' rights. Third, it makes more difficult for governments to raise taxes in order to finance social spending, due to the larger mobility of capital and skilled labour. However, globalisation should not be blamed for the increase in unemployment, inequality and deindustrialisation in advanced economies. "Low-cost" imports from developing countries, even combined with the relocation of manufacturing activities towards low-wage economies, have still a too small importance, at least to explain the bulk of the increase in unemployment. The adverse tendency in inequality is related to the growing gap between wages of qualified and non-qualified workers, which has been mainly a result of technological changes. Deindustrialisation is mainly due to productivity gains, which have outpaced production growth in manufacturing activities, exactly the opposite of what happened in the service sector.

For developing economies, globalisation has, in general, intensified inequality, increased relative (and, in some cases, also absolute) poverty and been used by governments in the industrial economies as an alibi to close their markets to developing countries' exports and to facilitate the structural adjustment programmes in the latter.

Net private capital flows to developing countries deserve special attention (Lopez-Mejia, 1999). They have grown from an annual average of US\$ 18.2 billion in 1978-1982 to US\$ 130.4 billion in 1990-1997. But, as the recent experience in East Asia clearly demonstrated, those flows are not sustainable in nature and are instead prone to very sharp reversals. Moreover, the composition and destination of those flows have changed substantially since the late-1970s. First, bank lending has been replaced, as the major source of finance, by direct and portfolio investments (mainly in bonds, equities, certificates of deposit, and commercial paper, in the latter case). However, this was not the case, in 1990-1996, of East Asia, where bank lending was the major source of external funds (in contrast, by the way, with the situation in pre-1994 Mexico, where portfolio investments dominated). Second, the public sector of developing countries received around 60% of those flows in the late-1970s and the 1980s, while now private agents receive more than 70%. All this has created more instability in capital flows to developing countries, while official development assistance has been declining in real terms.

The main reasons explaining the intrinsic instability of international portfolio flows may be listed as follows. First, investors, in order to contain their individual risk, prefer high liquidity and rapid exits, so they tend to invest in quoted securities and to roll over short-term positions. Second, they choose, on risk-containment grounds, diversification instead of more information and control. Third, as competition between funds and clients is intense, investors tend to offer the latter high-yield and high-risk placements (FitzGerald, 1998 and 1999).

3. The Adverse Effects of the Current Financial Liberalisation

In this section, we will try to analyse two main adverse consequences of the current financial liberalisation. In the first place, we will briefly study the risk and volatility problem provoked by asymmetric information and weak enforcement of contracts, growing use of derivatives, and leveraged operations by institutional investors. Secondly, we will analyse the deflationary bias problem imposed on real economies by the expectations of financial agents.

As regards to the risk and volatility problem, there are two opposite views. On the one hand, conventional theory argues that liberalisation and internationalisation of capital movements lead to a decrease in risk and volatility. As risk is measured by the risk premium (points over LIBOR), this means that there should also be a fall in effective international interest rates (that is, in the cost of capital) following liberalisation of capital markets (Stulz, 1999). The reason is that through liberalisation, capital suppliers have access to a larger number of possible investments and that, by means of diversifying the latter, they can reduce the risk of each one of their projects and the overall volatility. On the other hand, there is a second strand of thought (see, for instance, Hermalin and Rose, 1999) which maintains that internationalisation of capital flows leads to higher risk and volatility. This argument is supported by the fact that any financial market has intrinsic distortions which are exacerbated when the financial market becomes global. According to Hermalin and Rose (1999), those distortions are mainly two, related firstly to asymmetric information and secondly to enforcement of contracts. The asymmetry of information simply highlights the fact that information in financial markets is not perfect; that is to say, it is unevenly distributed among agents. For instance, in any lending contract, the borrower will always have better information about the expected returns of the project he wants to borrow for than the lender. This lack of information implies a cost for the lender. The other problem is related to the enforcement of contracts and refers to the institutional and legal environment in which the financial contract is signed. The cost associated to this kind of problem will be higher the weaker the institutional and legal framework. In both cases, the lender has two options: either he can spend an additional amount of money in order to acquire further information about the expected returns of the borrower's project and the institutional and legal framework in which he operates; or he can simply run on a higher risk (although the credit ratings system, together with portfolio diversification, may be used on risk-containment grounds). In both cases, the result will be a higher interest rate. This increase will be greater the wider the asymmetry of information and the weaker the institutional framework.

As we said before, those two problems are exacerbated when the domestic financial market becomes international. The asymmetry of information widens when the lender and the borrower belong to two very different economies. The lender then has less information about the borrower than he would have if the borrower belonged to the local market. Something similar happens with the enforcement of contracts, as the transaction cost related to it increases when the lender has to collect information about a different legal framework than the one he is used to operate in. From this point of view, the result is that risk and volatility associated to financial operations are higher in global markets than in domestic financial markets.

We believe that the mechanism described by conventional theory, that is, the reduction of risk through portfolio diversification, only applies *ceteris paribus*. In other words, risk diminishes only if a certain amount of resources is spent in order to keep the asymmetry of information at the same level as it was before (in a domestic market). But in a global market, the amount of resources needed to maintain the same level of asymmetry is much higher: there are many more unknown borrowers operating in many more unknown institutional and legal contexts. So, investors prefer to invest small amounts of resources in additional information and choose instead short-term placements so that they will be able to retire their funds in case of trouble. The net result will probably be a stable or reduced average volatility when the funds are invested in non-national but “known” markets, that is, intra-American, intra-European or intra-Asian investments. On the contrary, volatility will be higher in inter-zones operations, for instance, US or Western European placements in East Asia.

There is some but little empirical evidence on the evolution of volatility both in developed and emerging economies. According to Eatwell (1996) and as regards to industrialised countries, volatility in exchange rate, bond yields and stock markets seems to have featured little change since the collapse of the Bretton Woods system, excluding the 1992-93 period. However, the same author observes a much higher volatility in stock prices in emerging markets than the one that is observed for the same period in developed countries.

The second channel through which volatility in financial markets is widened when they become international is through the increased use of derivatives (options and futures). The notional principal outstanding in financial derivatives rose to US\$ 56.5 trillion in 1995 from US\$ 1 trillion in 1986 (Eatwell, 1996). When the Bretton Woods system collapsed in 1973, the management of exchange rate risk was privatised: under fixed exchange rates, this risk was carried by the governments. But with flexible exchange rate regimes, the private sector had to create new tools to handle with it. That is precisely how the derivatives market was developed. Although the main target of such a market was to reduce risk (mainly exchange rate risk) in financial or trade operations, the use of this kind of products quickly became speculative, leading to higher volatility through a wider asymmetry of information.

Finally, the third mechanism through which risk increases volatility in global financial markets is through the role played by institutional investors (hedge funds, pension funds, mutual funds, insurance companies...). Some big institutional investors display highly leveraged operations (Das, 1998; Reisen, 1999). Leveraged operations are highly risky, adding higher volatility to the financial system.

There are other adverse consequences of the globalisation of the financial markets, apart from greater volatility. One of the most important is the so-called deflationary bias that financial movements can impose on real economies. According to Eatwell (1996), international financial agents can set a certain behaviour on a government. For instance, suppose an economy is benefiting from higher activity, financial agents may expect then a future rise in interest rates. They will react selling their bonds in the market, provoking a rise in long-term government interest rates (this is a typical case of self-fulfillment process). The consequences will be a rise in fiscal deficit and a currency appreciation, both leading to a decrease in economic activity.

4. The East Asian Financial Crises

The recent East Asian crises were in many aspects related to the aforementioned implications of global financial integration. The following discussion updates previous work by one of the authors (Bustelo, 1999).

The East Asian financial crises (note the use of plural) in 1997-1999 were, to an extent which is difficult to understand today, unanimously unpredicted. Academic specialists on currency crises, debt-rating agencies, and even the Asian Development Bank (ADB) and the International Monetary Fund (IMF), failed to predict not only the crises but also any kind of major economic or financial disturbance in the region. In fact, the background in 1990-1996 of the later troubled Asian economies featured generally sound macroeconomic fundamentals: high savings and investment rates, robust growth, moderate inflation, fiscal surpluses or balances, limited public debts, substantial foreign exchange reserves and high and apparently sustainable net capital inflows. The international economic and financial environment was also benign: low interest rates in developed countries, reasonable growth of international trade and of GDP in the US and the EU, and stability in world commodity markets. The crises came then as a surprise, despite some signs of fragility and vulnerability (see below). Also unanticipated were their deep impact and their prolonged duration.

The East Asian financial turmoils have also been heterogeneous. Southeast Asia has suffered from a balance-of-payments crisis, although with distinctive features compared with similar past episodes, such as the European Exchange Rate Mechanism's crisis in 1992-1993 (Southeast Asia had higher GDP growth and lower unemployment rates) and the Mexican crisis in 1994-1995 (Southeast Asia had lower public deficits and inflation rates, higher savings and investment rates, and more abundant foreign exchange reserves). Southeast Asia's crises featured also several important distinctions between each of the countries concerned. On the contrary, South Korea only suffered initially from liquidity problems of domestic banks and companies (and not from severe currency overvaluation and/or a high current account deficit), which were associated with overinvestment and excessive external debt accumulation, but finally had to face also sharp international solvency difficulties.

Besides, the East Asian crises have been tremendously controversial, both as respect to the explanations offered by analysts and specialists and as regards to the solutions implemented by the IMF in Thailand, Indonesia and South Korea.

Moreover, due to the importance of East Asia in the world economy, the global impact of its crises has been very significant. For instance, the world was on the brink of a global recession in mid-1998, while several other developing and transitional regions (Latin America – especially Brazil - and Russia) were infected and most of the developed economies are still suffering from the trade impact of the Asian crises.

Although there are several schools of thought on the issue, a combined explanation of the main factors of the crises is surely appropriate (Bustelo, 1998). An analytical distinction between common and specific factors is outlined below.

Among the former, all East Asian economies (except Japan and, partially, China and Taiwan) were subjected in 1996-1997 to four main weaknesses (Glick, 1998; Corsetti, Pesenti and Roubini, 1998).

First, a salient feature was **overindebtedness in foreign liabilities** (mainly private, denominated in foreign currencies, short-term, and unhedged). Total foreign debt (relative to GDP) amounted in 1997 to 218% in Indonesia, 75% in the Philippines, 74% in Thailand, 62% in Malaysia, and 51% in South Korea, a higher proportion than the respective figures for Argentina, Brazil and Mexico in 1982, when the Latin American debt crises unfolded (UNCTAD, 1998). Bank lending, financed to a great extent by foreign borrowings (as borrowing abroad at low rates to relend domestically at high rates was profitable), to the private sector increased, from 1990 to 1996, more than 30 points of GDP in Thailand and the Philippines and more than 20 points in Malaysia, and reached sizeable levels in Thailand and Malaysia (102% and 93% of GDP in 1996). The debt structure displayed a high proportion of liabilities in Japanese yen and US dollars, as borrowing in Japan and the US, at low interest rates, to lend in developing East Asia, with substantially higher rates, was obviously a very lucrative operation. Moreover, short-term foreign debt, as a percentage of total foreign liabilities, reached in mid-1997 high levels in South Korea (67.8%), Thailand (65.5%) and the Philippines (65.6%). Furthermore, most of the debt exposures were unhedged, as a result of the underdevelopment of domestic hedging products, because purchasing them offshore would have increased the cost of borrowing abroad, and as pegged currencies were perceived as eliminating the exchange-rate risk. Therefore, the East Asian economies featured an increased vulnerability to solvency problems and balance of payments crises: short-term foreign debt was higher (considerably so in South Korea, Indonesia and Thailand) than official foreign exchange reserves and the ratio of narrow money (M2) to reserves surpassed 400% in the region, similar to the level attained in Mexico in 1994.

Second, another weakness was **overinvestment**, especially in excessively extended manufacturing sectors, inflated real estate and booming stock markets. Investment rates surpassed in the mid-1990s 40% of GDP in Thailand and Malaysia and 35% in Indonesia and South Korea. The incremental capital-output ratio (ICOR) in manufacturing activities displayed an upward tendency in the early 1990s in South Korea, Thailand and Malaysia, indicating a process of declining efficiency and falling profitability. An increased share of bank lending was directed to speculative investment in real estate, equities, and other financial assets. For instance, real estate exposure of domestic banks was very high (30-40% of total bank lending) in Malaysia and Thailand.

Third, all East Asian economies pursued, in different degrees, **premature and indiscriminate financial liberalisations** in the 1990s, involving both domestic deregulation and external opening (Singh, 1998). Liberalisation proceeded in a context of a very weak prudential supervision and regulation of financial activities. Moreover, governments abandoned policy coordination of investments and borrowings. Therefore, the crises in the East Asian economies might be well characterized as “crises of under-regulation”. According to Singh (1998: 18), “the fundamental reason for the crisis is to be found not in too much, but rather in too little government control over the financial liberalisation process which these countries implemented in the recent period”.

Financial liberalisation included measures directed to increase the number of financial institutions and the scope of their activities, to raise foreign competence to domestic banks, and to authorize greater access of banks and non-bank financial institutions to international capital markets. Interest rate controls and restrictions on corporate debt financing and cross-border borrowing were lifted. Under-regulation allowed banks to present a higher maturity mismatch between assets and liabilities, and to evade restrictions on investments in risky activities.

Fourth, **herd behavior in the global financial markets** (financial panics) prompted massive currency depreciations and a tremendous fall in stock indexes. According to the Institute of International Finance, net private capital inflows to the five troubled East Asian economies (Indonesia, Malaysia, the Philippines, South Korea, and Thailand) increased from US\$ 37.9 billion in 1994 to US\$ 102.3 billion in 1996 (of which US\$ 62.7 billion of bank lending), but registered a figure of *minus* US\$ 0.2 billion in 1997 and *minus* US\$ 27.6 billion in 1998 (IIF, 1999). The bulk of this reversal (which amounted to 15% of their combined GDP in 1997-1998) was related to swings in commercial bank lending and portfolio investments. The ensuing liquidity squeeze, as foreign creditors were less willing to roll over their loans, was intensified by domestic residents' reluctance to hold deposits in domestic currencies. Meanwhile, manufacturing companies presented a high financial leverage (high ratios of bank borrowing to investments and of debt to equity). Financial institutions (both banks and non-bank institutions) had few liquid assets and a high level of collateralized lending. In a context of persistent speculative attacks, a vicious circle appeared, as hikes in interest rates, in order to defend the currency, created corporate defaults and credit crunches and as falling asset prices reduced collateralized lending, prompting companies to sell land and other assets, which further depressed their prices.

Specific factors in Southeast Asia, on the one hand, and in South Korea, on the other, may be outlined in the following way.

First, **sharp currency real appreciation** and/or **high current account deficits** in Southeast Asia. Capital inflows, pegged nominal exchange rates to the US dollar (which provoked an important swing following the sharp appreciation of the US dollar since mid-1995), and the shift of trade advantages towards China, led to currency real overvaluation. Between December 1993 and December 1996, currency real appreciation amounted to 25% in Indonesia, 24% in the Philippines, 8% in Thailand, 6% in South Korea and 3% in Malaysia. On the other side, slowing exports, due to overproduction in semiconductors and the stagnation of Japan, led to high current account deficits (an average of 8% of GDP in Thailand and Malaysia, 5% in the Philippines and 3% in Indonesia, in 1995-1996). Therefore, only Thailand and the Philippines featured both weaknesses, while Indonesia did not present a high external deficit and Malaysia did not experience a severe overvaluation.

Second, a **high proportion of portfolio investments** in total foreign capital inflows in South Korea (54% versus 41% in Thailand and 18% in Indonesia in 1996), which did not have problems related to a sharp currency appreciation nor associated to a high current account deficit. Between December 1990 and March 1997, currency real appreciation amounted to 11% in South Korea (while it surpassed 25% in Indonesia, Malaysia and Thailand, and 45% in the Philippines). The Korean current account deficit was in 1996

and 1997 low and declining (4.7% and 2.0% of GDP, respectively). However, as we said before, Korea accumulated a very large amount of short-term foreign debt, which represented in the second quarter of 1997 more than two times its foreign-exchange reserves (1.45 times in Thailand).

5. Recurrent Financial Crises: A Crisis of Globalisation

As a result of the East Asian crises, there is a growing questioning of the current model of globalisation, of the benefits associated with premature and indiscriminate trade and financial liberalisation in developing countries, and of the wisdom of unregulated global financial markets. We are therefore witnessing the first serious and widespread post-Cold War crisis of globalisation.

Contrary to many mainstream assertions, the East Asian crises did not represent the demise of the East Asian model of developmental and state-led capitalism. For instance, Alan Greenspan, chairman of the US Federal Reserve, has argued that the Asian crises will have the (allegedly) beneficial effect of moving East Asian economic practices closer to those associated with the Anglosaxon model. Michel Camdessus, managing director of the IMF, has seen in the crises a “blessing in disguise”. In fact, the crises have not been due to a specifically Asian “crony capitalism”, but rather to the opposite. Conventional approaches contend that the East Asian political economy certainly rendered in the past higher growth and fewer social ills than the Anglosaxon liberal political economy. But, the argument goes on, East Asia was also plagued with “cronism” (collusive state-private sector relations), limited political competition, and a staunch anti-Western nationalism. The time should be now, it is argued, to completely overhaul these state-led models, the “Asian values” theories and the exclusively Asian regionalist tendencies.

In stark contrast with this view, we argue that the East Asian recent experience represents in fact a crisis of Western low-growth and market-led (or liberal) model of capitalism (and also of globalisation). The post-crises intellectual environment is exhibiting two distinct, although related, tendencies: on a general level, what we are witnessing is the first post-Cold War serious and widespread questioning of the current model of globalisation and, more specifically, of the wisdom of unregulated global financial markets (Higgott and Phillips, 1999); in East Asia, a renewed skepticism on the Anglosaxon model of capitalist development is under way. The latter is surely related to a growing dissatisfaction with mainstream Western explanations of the Asian crises (as epitomised in most IMF publications, from *Finance & Development* to the *World Economic Outlook*), whose central tenet has been blaming excessive state interferences. Most Asian (and a growing number of Western) specialists would instead emphasize (correctly, in our view) premature and imprudent financial liberalisations and the abandonment of the traditional institutional structure of collaboration between governments, banks, and firms, and, more precisely, of borrowing and investment coordination by the state (Wade, 1998). Moreover, there is also a growing resentment in East Asia over the IMF’s handling of the crises. The treatment has been perceived, in a simplistic but not totally incorrect manner, as having aggravated the recession, and as having been designed to allow more Western banking investments and trade inroads and to protect foreign creditors at local expense. Although governmental practices will surely (and they should), as a result of the crises, become leaner, more transparent, and less

receptive to rent-seeking behavior, “it is unlikely that all the elements of the ‘developmentalist’ statist model will be torn up in the interests of a purer Anglo-American neo-liberalism” (Higgott, 1998: 17). Rather, the East Asian turmoils may reinforce the attractiveness of the traditional style of regulated capitalism (as it existed in the 1970s and 1980s). They might also put into question the global economic environment which contributed, to a great extent, to shifting this style towards a more liberal path.

6. Lessons for Crises-prevention

A clear implication of the precedent analysis is that the emphasis should be now on measures to protect developing (and especially emerging) economies from the volatility of international capital (Dieter, 1999: 17).

First, financial liberalisation in developing countries should be undertaken more slowly, carefully and gradually than in the past. It is now clear that financial liberalisation, including both domestic deregulation and external opening, should be attempted only after achieving macroeconomic stability, a reasonable trade openness, and the establishment of a solid and well-regulated financial sector. One of the main lessons of the East Asian crises is that deregulation should proceed in a framework of adequate governmental oversight and prudential supervision. Capital-account opening before having a sound and solid financial system is a recipe for large vulnerabilities.

Second, a radical reform of the international financial architecture is also needed, in order to prevent, as far as possible, the recurrence of financial crises (and also, if they occur, to manage them better). Several proposals have been made in recent times by specialists.

1. The IMF should be revamped, in order to increase its transparency, its control by national governments, and its regionalisation. Moreover, the IMF should, in the event of a crisis, intervene with a bailout or rescue operation featuring attached conditions both appropriate to the national development strategy and reasonably standard across countries.

2. The international community should be more receptive and permissive to the need, in developing countries, for maintaining or imposing capital controls. Taxes or reserve requirements (usually deposited in the central bank) on foreign borrowings, ceilings on short-term external debt by local banks or firms, restrictions in the use of foreign loans, controls over foreign-exchange deposits and loans made by private or corporate foreigners or residents have been already used in several countries. The evidence (in Chile, for instance) tends to suggest that, if capital controls are used in a proper way, they may increase the proportion of long-term foreign investment in total capital inflows without decreasing the latter, and also the autonomy of domestic monetary policy, while they may help in avoiding adverse currency appreciations.

3. Standards for international financial regulation should be improved, through the establishment of a far-reaching Financial Stability Forum (which was created by the G7 in March 1999, but it remains to be seen if it will be effective), or even a World Financial

Organisation (WFO), and also through changes in the Basle Committee's standards concerning private banks' capital adequacy requirements and risk weightings.

4. A real international lender of last resort should be perhaps created, either through new credit lines or contingency funds in the IMF, through establishing new regional institutions with this aim, or through a brand new international organisation.

Furthermore, if crisis-management is to be improved, the private sector should be involved in the bailouts, while key insolvency principles (debt standstills and debtor-in-possession financing) should be accepted in dealing with debt-rescheduling in financially-distressed developing economies (UNCTAD, 1998: 91).

7. Conclusions

The current economic globalisation is not only asymmetrical but it also tends to create world financial instability, to trigger recurrent and contagious currency crises in emerging economies, and even to increase the risk of deflation and even recession in the world economy.

The preceding pages have tried to suggest that, in order to reduce such adverse effects, several measures should be adopted at international and national levels. However, most of the international initiatives might appear to be utopian: for instance, a complete overhaul of the IMF, or the creation of a World Financial Organisation. Notwithstanding, it seems necessary, certainly on a national basis and, if possible, also internationally, to strengthen the institutional financial framework and to discourage short-term and easily reversible capital flows to developing countries. The use of capital controls by developing countries, as a device aimed towards this end, has gained increased support in recent times. Capital controls are in fact a practical way to contain the pace of international financial integration (especially for potentially vulnerable developing countries), given that the realistic alternative of improving international regulation and supervision of financial flows might be completely insufficient.

Individual developing economies should therefore be allowed to maintain their national sovereignty in financial matters. However, it has to be borne in mind that current proposals by rich countries (for instance in the G7) tend, in a paradoxical way, to be more directed at restructuring emerging economies in order to facilitate a larger international mobility of capital rather than at protecting them from the dangers associated with capital flows.

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