THE ASIAN FINANCIAL CRISIS AND THE ARCHITECTURE OF GLOBAL FINANCE

The financial crises across Asia in 1997–98 ignited fierce debate about domestic economic weaknesses and flaws in the international financial system. Some analysts blamed Asian governments for inadequate prudential supervision, widespread failures of corporate governance and even ‘crony capitalism’. Others assailed the inherent instability of global financial markets and what they considered to be hasty and ill-conceived liberalization taken at the behest of Western-dominated international financial institutions. In this volume a distinguished group of political scientists, economists and practitioners examines the political and economic causes and consequences of the crisis. They ask: To what extent were domestic economic factors to blame for the crises? Why were some economies more prone to crisis than others? What are the costs and benefits of international financial liberalization?


John Ravenhill is Chair of Politics at the University of Edinburgh. Previously, he was Professor and Head of the Department of International Relations of the Research School of Pacific and Asian Studies at the Australian National University. His most recent books include The Political Economy of East Asia (1995), Seeking Asian Engagement: Australia in World Affairs 1991–95 (1997); and New Developments in Australian Politics (1997).
CAMBRIDGE ASIA–PACIFIC STUDIES

Cambridge Asia–Pacific Studies aims to provide a focus and forum for scholarly work on the Asia-Pacific region as a whole, and its component sub-regions, namely Northeast Asia, Southeast Asia and the Pacific Islands. The series is produced in association with the Research School of Pacific and Asian Studies at the Australian National University and the Australian Institute of International Affairs.

Editor: John Ravenhill

Editorial Board: James Cotton, Donald Denoon, Mark Elvin, Hal Hill, Ron May, Anthony Milner, Tessa Morris-Suzuki, Anthony Low

R. Gerard Ward and Elizabeth Kingdom (eds) Land, Custom and Practice in the South Pacific 0 521 47289 X hardback
Stephanie Lawson Tradition Versus Democracy in the South Pacific 0 521 49638 1 hardback
Walter Hatch and Kozo Yamamura Asia in Japan’s Embrace 0 521 56176 0 hardback 0 521 56515 4 paperback
Alasdair Bowie and Daniel Unger The Politics of Open Economies: Indonesia, Malaysia, the Philippines and Thailand 0 521 58343 8 hardback 0 521 58683 6 paperback
David Kelly and Anthony Reid (eds) Asian Freedoms 0 521 62035 X hardback 0 521 63757 0 paperback
Danny Unger Building Social Capital in Thailand 0 521 63958 4 hardback 0 521 63931 X paperback
Yongnian Zheng Discovering Chinese Nationalism in China: Modernization, Identity, and International Relations 0 521 64180 2 hardback 0 521 64590 5 paperback
Doh C. Shin Mass Politics and Culture in Democratizing Korea 0 521 65146 8 hardback 0 521 65823 3 paperback
John A. Mathews and Dong-Sung Cho Tiger Technology: The Creation of a Semiconductor Industry in East Asia 0 521 66269 9 hardback
THE ASIAN FINANCIAL
CRISIS AND THE
ARCHITECTURE OF
GLOBAL FINANCE

EDITED BY
GREGORY W. NOBLE
Australian National University

AND
JOHN RAVENHILL
University of Edinburgh
Contents

Abbreviations ix
List of Figures xi
List of Tables xii
List of Contributors xiii
Preface xiv

1 Causes and Consequences of the Asian Financial Crisis 1
   GREGORY W. NOBLE AND JOHN RAVENHILL

2 Capital Flows and Crises 36
   STEPHEN GRENVILLE

3 The Political Economy of the Asian Financial Crisis: Korea and Thailand Compared 57
   STEPHAN HAGGARD AND ANDREW MACINTYRE

4 The Good, the Bad and the Ugly? Korea, Taiwan and the Asian Financial Crisis 80
   GREGORY W. NOBLE AND JOHN RAVENHILL

5 Indonesia: Reforming the Institutions of Financial Governance? 108
   NATASHA HAMILTON-HART

6 Political Impediments to Far-reaching Banking Reforms in Japan: Implications for Asia 132
   JENNIFER A. AMYX

7 Dangers and Opportunities: The Implications of the Asian Financial Crisis for China 152
   HONGYING WANG
## CONTENTS

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Pages</th>
</tr>
</thead>
<tbody>
<tr>
<td>8</td>
<td>The International Monetary Fund in the Wake of the Asian Crisis</td>
<td>170</td>
</tr>
<tr>
<td></td>
<td>BARRY EICHENGREEM</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Taming the Phoenix? Monetary Governance after the Crisis</td>
<td>192</td>
</tr>
<tr>
<td></td>
<td>BENJAMIN J. COHEN</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>The Vagaries of Debt: Indonesia and Korea</td>
<td>213</td>
</tr>
<tr>
<td></td>
<td>THOMAS M. CALLAGHY</td>
<td></td>
</tr>
<tr>
<td></td>
<td>MILES KAHLER</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Notes</td>
<td>261</td>
</tr>
<tr>
<td></td>
<td>Bibliography</td>
<td>278</td>
</tr>
<tr>
<td></td>
<td>Index</td>
<td>299</td>
</tr>
</tbody>
</table>
Abbreviations

ADB  Asian Development Bank
AMC  Asset Management Company
AMF  Asian Monetary Fund
AMU  Asset Management Unit
APEC  Asia–Pacific Economic Cooperation
ASEAN  Association of South-East Asian Nations
BBC  Bangkok Bank of Commerce
BCA  Bank Central Asia
BIBF  Bangkok International Banking Facility
BII  Bank Internasional Indonesia
BIS  Bank for International Settlements
BOK  Bank of Korea
CBC  Central Bank of China (Taiwan)
CCLs  Contingent Credit Lines
CCP  Chinese Communist Party
CSRC  China Securities Regulatory Commission
EFM  emergency financing mechanism (IMF)
EMEAP  Executive Meeting of East Asia and Pacific Central Banks
EMU  Economic and Monetary Union (Europe)
EPA  Economic Planning Agency (Japan)
FDI  foreign direct investment
FRA  Financial Restructuring Authority
FSA  Financial Supervisory Agency (Japan)
G–7  Group of 7
G–10  Group of 10
G–22  Group of 22
GDDS  general data dissemination standard
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>GITIC</td>
<td>Guangdong International Trust and Investment Corporation</td>
</tr>
<tr>
<td>HCl</td>
<td>heavy and chemical industries</td>
</tr>
<tr>
<td>HIID</td>
<td>Harvard Institute for International Development</td>
</tr>
<tr>
<td>HLIs</td>
<td>highly leveraged institutions</td>
</tr>
<tr>
<td>IBRA</td>
<td>Indonesian Bank Restructuring Agency</td>
</tr>
<tr>
<td>IFIs</td>
<td>international financial institutions</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>IOSCO</td>
<td>International Organisation of Securities Commissions</td>
</tr>
<tr>
<td>KAMCO</td>
<td>Korean Asset Management Company</td>
</tr>
<tr>
<td>KMT</td>
<td>Kuomintang</td>
</tr>
<tr>
<td>LDP</td>
<td>Liberal Democratic Party (Japan)</td>
</tr>
<tr>
<td>MITI</td>
<td>Ministry of International Trade and Industry (Japan)</td>
</tr>
<tr>
<td>MOF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>MPT</td>
<td>Ministry of Posts and Telecommunications (Japan)</td>
</tr>
<tr>
<td>NPC</td>
<td>National People’s Congress (PRC)</td>
</tr>
<tr>
<td>ODA</td>
<td>overseas development assistance</td>
</tr>
<tr>
<td>OECD</td>
<td>Organisation for Economic Cooperation and Development</td>
</tr>
<tr>
<td>OEM</td>
<td>original equipment manufacturing</td>
</tr>
<tr>
<td>OFCs</td>
<td>offshore financial centres</td>
</tr>
<tr>
<td>PBC</td>
<td>People’s Bank of China</td>
</tr>
<tr>
<td>PINs</td>
<td>Public Information Notices</td>
</tr>
<tr>
<td>PLA</td>
<td>People’s Liberation Army</td>
</tr>
<tr>
<td>PRC</td>
<td>People’s Republic of China</td>
</tr>
<tr>
<td>RMB</td>
<td>renminbi</td>
</tr>
<tr>
<td>RTC</td>
<td>Resolution Trust Corporation (US)</td>
</tr>
<tr>
<td>SDDS</td>
<td>special data dissemination standard</td>
</tr>
<tr>
<td>SEACEN</td>
<td>South-East Asian Central Banks</td>
</tr>
<tr>
<td>SEANZA</td>
<td>South-East Asia, New Zealand and Australia</td>
</tr>
<tr>
<td>SOEs</td>
<td>state-owned enterprises</td>
</tr>
<tr>
<td>URR</td>
<td>unremunerated reserve requirement</td>
</tr>
</tbody>
</table>
Figures

2.1 Capital inflows and current account deficits 37
2.2 Asian private capital flows prior to the crisis 43
2.3 Capital flow reversals 44
2.4 Output, credit and equity capitalisation, 1996 45
2.5 EMBI spread to US treasuries 47
2.6 Asian credit ratings, 1986–98 48
2.7 Asian share markets, 1980–98 49
10.1 Structure of external debt by class of borrower, 1997 216
### Tables

1.1 Key economic variables of East Asian economies 7  
1.2 Crisis and recovery in East Asian banking 19  
2.1 Capital flows to emerging markets (annual averages, $US billion) 38  
2.2 Assets of institutional investors, 1980–95 41  
2.3 International bank and bond finance for five Asian countries ($US billion) 42  
2.4 Average real interest rates 50  
4.1 Economic profiles of Korea and Taiwan on the eve of the crisis 81  
4.2 International comparison of average debt/equity ratios in manufacturing 85  
4.3 International comparison of interest costs to sales ratio in manufacturing 86  
4.4 Comparative rates of profitability 91  
5.1 Change in financial indicators 122  
10.1 Consultative Group on Indonesia commitments 226
Contributors

JENNIFER A. AMYX, Department of Political and Social Change, Research School of Pacific and Asian Studies, Australian National University, Canberra

THOMAS M. CALLAGHY, Department of Political Science and the Lauder Institute, Wharton School, University of Pennsylvania, Philadelphia

BENJAMIN J. COHEN, Department of Political Science, University of California, Santa Barbara

BARRY EICHENGREEN, University of California, Berkeley

STEPHEN GRENVILLE, Deputy Governor, Reserve Bank of Australia

STEPHAN HAGGARD, University of California, San Diego

NATALSHA HAMILTON-HART, Department of International Relations, Research School of Pacific and Asian Studies, Australian National University, Canberra

MILES KAHLER, University of California, San Diego

ANDREW MACINTYRE, University of California, San Diego

GREGORY W. NOBLE, Department of International Relations, Research School of Pacific and Asian Studies, Australian National University, Canberra

JOHN RAVENHILL, Department of Politics, University of Edinburgh

HONGYING WANG, Syracuse University, Syracuse
Preface

The financial crisis that erupted in Thailand in 1997 and quickly spread to the rest of Asia has exerted a dramatic impact on the global political economy. The magnitude of the crisis was striking. It brought Indonesia to its knees, pushed Korea and other countries suddenly and deeply into recession and threatened the financial system of China. However, the sheer size of its impact on affected economies is only one aspect, and perhaps not the dimension that distinguishes it from other debt crises in recent decades. After all, the Latin American debt crisis of the early 1980s led to a ‘lost decade’ of economic retrenchment in an entire continent, and posed a greater threat at the time to the financial integrity of overexposed Western banks. The African debt crisis, while of only minor significance to the international financial system as a whole, has left already poor countries in desperate straits from which there is no easy exit.

The Asian crisis was particularly notable in other aspects. First, it occurred after a huge upsurge in the mobility of international capital. Foreign money swept into Asia in the early 1990s then, beginning in 1997, swept out again – taking a great deal of local capital with it. The crisis posed new questions about how to manage risk in an increasingly globalised financial system, the appropriate sequencing of financial liberalisation and, more fundamentally, the very desirability of capital account liberalisation in countries with little bureaucratic or political capacity to implement effective systems of prudential regulation. Second, the crisis threatened countries such as Korea, Thailand and Indonesia that had been hailed as models of development for their success in sustaining rapid growth that drastically reduced the rate of poverty. Moreover, the affected economies in Asia displayed few of the classic warning signs that had preceded financial crises in the past, such
as ballooning government budget deficits and high rates of inflation. Thailand manifested a few of the other traditional symptoms, such as an overvalued currency and large and growing deficits in its current account, but Korea and Indonesia seemed less susceptible by those conventional measures. The inability of the international community to predict the crisis and prevent it from causing catastrophic damage to some economies led to moves at the global, regional and national levels to improve the monitoring and governance of financial markets, and to provide additional resources to multilateral institutions to enable them to reduce the risks of contagion. Thus, the Asian crisis raises two sets of urgent questions: what went wrong? And what can be done to prevent similar problems from arising in the future?

To address these problems, the Department of International Relations of the Research School of Pacific and Asian Studies at the Australian National University, in conjunction with the Monash Asia Institute, organised an international conference in Melbourne at the end of 1998, to which leading practitioners and top-flight analysts were invited. The conference was fortunate to receive penetrating papers from two of the leading players in the Asian drama. One was Barry Eichengreen, professor of economics and political science at the University of California at Berkeley, who served as the chief research economist at the International Monetary Fund (IMF) at the height of the crisis. The other was Dr Stephen Grenville, Deputy Governor of the Reserve Bank of Australia, which has taken an active role in the rescue process and the surrounding debates on reforms to the global financial architecture. Participants in the conference, and this book that has resulted from it, included a balance of economists and political scientists, all of whom have written extensively on the crisis economies and/or on the political economy of the global financial system.

The Asian Financial Crisis and the Architecture of Global Finance covers four broad topics. Chapters 1 and 2 introduce the evolving debate on the causes and consequences of the crisis. Next, the book looks at a number of comparisons within the region. Why did Korea prove so much more vulnerable to financial instability than Taiwan, its geographic neighbour and developmental twin? How did different types of political institutions create uncertainty in the minds of foreign and domestic investors? How do recent efforts at financial reform in regional countries such as Indonesia compare to earlier episodes? Third, the book examines the roles played by the regional giants in contributing to the crisis – and how they might possibly help its resolution. Japan is especially important in the short-to-medium term because it comprises over two-thirds of the regional economy, but in the long run the crisis
may have an equally profound impact on the economic and even political development of China.

The second half of the book (chapters 8 to 11) examines efforts to reform the global architecture of finance. A central and highly controversial question is how the IMF should evolve. Should it continue to ‘bail out’ distressed economies? If so, what kind of conditions should it impose and how should its own performance be monitored? A related question involves the nature of the international monetary regime and the preferences of the leading economies that exert the greatest influence upon it. Private-sector actors such as international banks are also crucial players. The Asian financial crisis has revealed major difficulties in negotiating arrangements to work out debts, particularly in the private sector. Although there is a good deal of consensus on the need for many technical improvements, including increasing the availability of financial information, the transparency of the IMF’s operations and the quality of domestic prudential supervision, the larger policy issues remain contested.

Underlying these debates is the unifying concern on how best to handle the risks created by the increasing international mobility of capital. How great are the risks? To what extent can local or international regulations ameliorate them? Who bears the risks—and the costs of any measures taken to reduce them? This broader concern for risk management embeds study of the Asian financial crisis in some of the classic debates in political economy: governments versus markets; mobile factors of production, such as capital (now including not only the Rothschilds and the Rockefellers, but grandma and grandpa’s pension fund) versus relatively immobile factors such as labour; and the relative merits of freedom and flexibility versus security and community. More than is usually recognised, the Asian crisis has opened a wedge on these issues between the IMF, the United States and the United Kingdom, which insist on upholding and accelerating liberalisation, and the governments of the affected countries – Japan and Europe – which call for significant modifications of the international financial system. Whether or not the crisis becomes a defining moment in the political economy of Asian development, it has certainly ignited a series of debates on the architecture of global finance and Asia’s place in it.