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PACIFIC CHAOS AND THE DEBTOR NATION, 1990S STYLE

The panel was convened at 10:30 a.m., Saturday, March 27, by its Chair, Chantal Thomas, who introduced the panelists, Robert A. Blecker, American University, and Robert Wai, Osgoode Hall Law School, and the commentator, Spencer Weber Waller, Brooklyn Law School.

COMPARING THE "1990S-STYLE" AND "1980S-STYLE" DEBT CRISES

by Chantal Thomas[*]

A decade ago, the newly industrializing countries of Southeast Asia—the "1990s-style" debtor nations around which this panel is organized—were identified by the Bretton Woods institutions as models of export-led growth for the developing world. The typical 1980s debtor nation had maintained an import-substitution industrialization (ISI) policy and a fixed exchange rate that tended to be overvalued. Many developing nations had pursued ISI in defiance of the Bretton Woods institutions' counsel. When the "1980s-style" debt crisis—excessive government-held loans from foreign banks—hit the ISI countries, the Bretton Woods Institutions attributed the crisis to ISI-encouraged market inefficiency and government corruption.

In 1997, the 1990s-style debt crisis came into its own in Thailand (having been foreshadowed by the Mexican peso crisis of the mid-1990s). The foreign and domestic investment glut in Thailand overextended banks and increased imports of capital goods associated with increased investment; these increased imports led to a trade deficit. Bank failures precipitated the devaluation of the Thai baht; ensuing investor panic caused the value of the baht to plummet; and the free-falling baht together with the trade deficit caused a severe balance-of-payments crisis coupled with a crisis in privately held debt. The panic created pressure on the other Southeast Asian currencies, leading to the ignobly titled "Asian contagion."

For the Bretton Woods institutions, the 1990s-style debt crisis has generated a corresponding crisis in development policy. The 1990s debtor nation had done everything "right," from the perspective of orthodox development policy makers, in modeling its trade and investment regimes—that is, it had pursued export-oriented growth and opened up foreign investment. How does the Asian crisis bode for development policy, and for the international financial order? I will let the panelists address these issues in more detail, but will point out that fixed exchange rates have been one immediate cause of both crises. In the 1980s-style debt crisis, the Bretton Woods institutions could agree that ISI was the problem. In the 1990s, ISI is much less of an issue, but fixed exchange rates continue to be widespread. Both 1980s and 1990s debtor nations maintained fixed exchange rates that tended to be overvalued. Exchange rate policy presents developing country governments with a catch-22 of sorts: A fixed rate promotes investor confidence, but often makes economies vulnerable to balance-of-payments crises in trade markets.

From the orthodox perspective, the 1980s crisis was precipitated by the debtors' trade and investment regimes, whereas the 1990s crisis was precipitated by inadequate finance and monetary policies. In the aftermath of the Asian crisis, the Bretton Woods institutions have accordingly focused on improving "transparency" and "accountability" among financial regulators in the debtor nations. The difficulty, however, is probably more fundamental than that. In particular, there is no coherent Bretton Woods response to the exchange rate

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conundrum described above. The "Pacific chaos" seems to have forced dominant actors in the international financial order to confront their failures to prevent or manage such crises. To sound an optimistic note, however, this chaos has also created a moment of unusual candor in which the need for change has been openly and widely acknowledged, and has yielded an opportunity for real dialogue on what has and has not worked in the Bretton Woods vision.

COMPETING EXPLANATIONS FOR THE ASIAN CRISIS AND CONSEQUENCES OF THE CRISIS FOR THE ASIAN DEVELOPMENT MODEL

by Robert A. Blecker[*]

Economic analyses of the Asian crisis have generally been divided into two main camps. One group emphasizes internal problems in the Asian crisis countries, especially the lack of adequate regulation and supervision of financial institutions, the lack of transparency in domestic banking and business accounting, and so-called crony capitalist relationships between lenders and borrowers. The other group emphasizes the problems created by the liberalization of capital markets in the Asian countries and blames the crisis on volatile flows of speculative "hot money" that destabilized domestic financial and economic systems. These two positions have sometimes been referred to as, respectively, one that emphasizes countries' "fundamentals" and another that emphasizes financial speculation.

These different views lead to different positions on what kind of "new architecture" is needed to reform the global financial system and prevent future crises. Those who stress fundamentals—especially policy makers at the U.S. Treasury and the International Monetary Fund (IMF)—emphasize the need for debtor countries to reform their internal practices through such measures as improving transparency and surveillance, introducing Western accounting practices and bankruptcy laws and cleaning up the balance sheets of weak banks. This approach presumes that capital markets should remain liberalized, and that the goal is to make national financial systems better prepared to manage liberalized capital inflows and outflows.

Economists in the other camp—those focusing on speculation—argue that greater transparency and other domestic financial reforms are at best not enough, and at worst are a smokescreen for covering up the inherent flaws of liberalized capital markets. These economists advocate renewed capital controls and exchange restrictions, possibly along the lines of those used by Malaysia, in order to discourage volatile inflows and outflows of short-term capital and to prevent destabilizing currency speculation. With capital controls in place, it is argued, countries can pursue appropriate (i.e., more expansionary) fiscal, monetary and exchange rate policies in service to the objective of reviving domestic growth.

In evaluating these arguments, it is important to start from the premise that crises as deep and widespread as those that occurred in Asia over the past two years are unlikely to have just a single cause. Undoubtedly, there were weaknesses in the domestic financial systems of Thailand, South Korea, Indonesia and the other countries that suffered bouts of the Asian flu. However, these domestic weaknesses would not have led to such severe crises on their own, and the domestic weaknesses were themselves exaggerated by the hot money inflows, asset market bubbles, overborrowing from international banks and other consequences of liberalized capital flows. Thus, it makes sense that countries that are not prepared to manage large capital inflows would be better off reintroducing capital controls and restoring some measure of domestic policy autonomy, and that capital market liberalization should not be pressed on countries that lack the institutions and regulatory capabilities to handle it.

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