

# ALTERNATIVE VIEWS ON ASIAN CRISIS AND IMF'S ROLE: NOTES ON FUNDAMENTALS AND EXPECTATIONS

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## 1. Introduction: facts and views on East Asia from miracle to crisis

Starting from July 1997, East Asian long-run development path (see Table 1) was suddenly broken up by a financial storm that switched euphoria for "Asian miracle" into panic, crashed stock exchange and currencies (see Table 2) and put under stress entire economic systems for about two years, till the long awaited beginning of economic rebirth by a stock-led financial markets recovery in 1999.

Thai-born financial crisis was deeper and more far reaching than expected, as it resulted in economic recession and sociopolitical turmoil within Asian worst hit countries; then came further financial contagion and economic deflationary impulses on emerging markets; some effects were felt even on industrialized countries. In fact we can select several stages of Asian crisis as follows:

- a) Thai crisis
- b) first wave on other ASEAN emerging countries like Malaysia, Indonesia and Philippines
- c) second wave on Asian open industrialized economies (Singapore, Hong Kong, South Korea)
- d) sociopolitical deepening impact within Asian worst-hit countries
- e) third global short wave on non-Asian emerging financial markets and global stock markets
- f) fourth global long wave on Russia and Brazil with LTCM-led risk of a new great depression.

After escaping the risk of a new global financial contagion from Brazilian crisis, East Asian countries began at last their recovery as stock and currency markets rose above their pre-crisis level strengthening then their economic perspective at the dawn of 2000 (IMF, 1999b).

We cannot analyze here in details each phase of Asian crisis (for a more detailed analysis of the sequencing of global Asian crisis see Bortot, 1999c, that presents many of Reuters Asia Pacific news, 1997/99). We choose instead to select alternative viewpoints from which Asian crisis and IMF's role are evaluated, trying however to link each view to its underlying facts in order to reach an empirical grounded comparative analysis of various Rashomon-like images of crisis.

The coming of Asian crisis was viewed like an unexpected sound of thunder in a blue sky. Nobody anticipated that crisis. Critics of "the myth of Asian miracle" themselves (Young, 1995 and Krugman, 1994) expected instead a production slowdown

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due to the end of an extensive use of cheap labor, a bit like sovietic kind of planning in its decline and collapse stages (Krugman, 1998). The classical model of balance of payment crisis and speculative attacks to exchange rate (Krugman, 1979 and 1989) does not hold here either.

The risk of a possible Asian financial crisis was not taken into account even after 1995 Mexican financial "tequila" crisis spread toward Argentina and Chile: Asian economic situation was thought to be so widely different from Mexican's, as capital inflows in Asian countries were not used to finance consumption and public sector deficit but to strengthen productive investments for exports in a sound public sector balance or even surplus. Macroeconomic adjustment to portfolio capital inflows troubles seemed easy in East Asian countries under their tight fiscal policy (Corbo/Hernandez, 1996).

Without reviewing here all the stages of "Asian miracle debate" started after World Bank's "East Asian miracle" report in 1993 we can however outline the key elements in Asian growth and the background of the early Thai crisis according to opposite fundamentals and expectations approaches.

We will then address to alternative analyses and evaluations of both Asian crisis evolution and IMF's role noting that key views on Asian crisis underscore internal fundamental gaps in economic policy, external expectations instability in global finance, mixed interdependent approaches and long term perspective analyses.

We will at last assess the IMF bailout strategy of maxi-financial packages for Asian crisis-hit countries, under policy conditionality aimed to obtain austerity and liberalization through high interest rate short-term stabilization, later adapted to social turmoil contexts. Alternative viewpoints about IMF will be so underscored:

- criticism against IMF's short-sightedness, financial giveaway and deflationist therapies
- defense of IMF's fragility and adaptability by learning.

The conclusion will outline the long-run "megatrends" perspectives of Asian recovery after this "momentary lapse of reason" and lack of trust in Asian development potential. Alternative views on policy fundamentals and global finance expectations will allow us to understand why what started as a tiny crisis in faraway Thailand became then a global financial storm.

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## 2. Notes on some "miracle" explanations of Asian development and "crisis" fundamentals in Thai self-fulfilling crash

### 2.1. "Asian miracle" explanations

World Bank's "East Asian miracle" report in 1993 (and its capital flows extension in World Bank, 1996) started a massive debate about the right policy choices between alternative viewpoints on growth factors.

Even avoiding a country-specific analysis about national development patterns it is impossible to review here all the stages on "Asian miracle" debate; we can however remind the key elements in Asian growth:

- stable political and economic policy environment
- state/market cooperation in industrial policies
- economic openness and export-oriented growth
- high savings rates
- Confucian ethic and high education levels
- wide availability of cheap labour from rural areas
- social cohesion and relative equity in income distribution without democracy.

Key elements made possible to underline elements from both neoliberalist (trade openness, macrostability, low cost of labour) and structuralist models (state as policy-maker in education and industrial national development), whose theoretical roots lie in a mix of structural gap approach on conditions to finance industrial growth with financial liberalization approach to create a growth-friendly financial environment.

The consequences of this mixed Asian model – a sort of 'structural liberalism' or 'liberist structuralism', from the opposite viewpoint of international finance and Asian states – was to attract international capital flows and foreign direct investments in East Asia (Lucas, 1992 and Chen, 1993), targeted to finance investments and auto-centric development (Stiglitz, 1996). The most important engine of growth is the typical Asian developmental state with different real situation in Southeast Asia (Crone, 1988) but focused on growth and social welfare with tight control on political liberty (Crone, 1993 and Dahrendorf, 1995). Its key element is embedded autonomy, very different from typical predation African states and semi-corrupted Latin American ones (Evans, 1992 and Baculo, 1995). More key aspects of "Asian values" were highlighted, as in Japan's roots of development between Western technology and Confucian ethic (Dore, 1987, and Sen, 1994); however this does not mean that situations of

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human rights abuse and violation, with social and environmental dumping, can be allowed as "specific cultural traits" of Asia (Scidà, 1996).

The roots of Asian success story were identified also in a flexible microeconomic industrial organization according to the "spirit of Toyota" (Ohno, 1978) with macroeconomic impact (Killick, 1995) otherwise labelled as "factor orgware" (a sort of competitive advantage software provided by organizational framework, see Fodella, 1993). Regional economic integration – even without a formal institution-building approach – was also a key element by growing economic international linkages (Yamazawa / No-hara/Osada, 1986, Oman, 1994) while demographic transition with a slowing population growth was kept as well as an important once-for-all generation factor able to explain "miracle" growth (Bloom/Williamson, 1998).

High savings rates were also considered very important for Asian development (for Korea see Donghyun, 1998), that was sometimes thought as an emerging capitalist model "resistant" to neoliberalist therapies, point underscored in Streeten, 1993 against minimal state after World Bank 1990 Report on the challenges of development, but above all within some French alternative analyses included in economic and geopolitical annual atlas "Etat du Monde", 1993-1995-1997. It can not however be forgotten the important role played by financial liberalization according to a gradual path from the '80s as a source of Asian accelerating growth (Li/Skully, 1991, Thornton, 1994 and from another point of view Stiglitz/Uy, 1996), as compared to the shock path adopted in Latin America's Southern Cone countries in the early '80s, that ended in deep bank crashes (Diaz-Alejandro, 1985). National characters of development models were not lost even in debt crisis years, when Asian countries (except Philippines) weathered that storm without breakdown in growth pattern and large scale socioeconomic disasters in Africa's and Latin America's "lost decade" of the '80s, without recessions or IMF therapies (Streeten, 1988). The very strength and stability of Asian growth, with gradual and piloted economic openness attracted growing capital inflows in search of high-expected returns, after the end of Cold War and the reduction of military conflicts risks in Asia.

At the beginning of the '90s four main events played a key role on capital inflows toward East Asia:

- USA recession (1990/91)
  - European currency crisis of EMS (European Monetary System) after Germany's reunion (1992/93)
  - Japan financial crisis due to speculative bubble's burst in real estate and equity prices (1992/..)
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- Mexican financial "tequila" crisis and its impact on other Latin American countries (1994/95).

Most of those capital inflows were headed toward newly emerging ASEAN-4 countries: Thailand, Malaysia, Indonesia and Philippines, where the mix of endogenous state-led development, trade openness and financial liberalization was at the roots of Asian booming rates of growth (see again Table 1).

## 2.2. "Thai crisis" fundamentals and self-fulfilling expectations

In order to give empirical ground to the debate on Asian crisis it is useful to note some facts about its beginning, at the roots of Thai financial crisis.

Thai economic development (see Table 1) was at first almost stagnant in 1950/75 (3.6 % annual GDP growth, with population growth being about 3%), but then Thailand took-off rising its GDP growth to 7.8% in 1975/90 and to 8.6% in 1990/96 while population growth slowed down to less than 2%. Inflation was always under control (less than 6% after 1980), showing a stable Asian development pattern (Hong Kong and Taiwan style) instead of a more macroeconomic unstable one (Singapore and Korea style, see Pugno, 1995).

This growth-friendly environment of Thai "Asian miracle" growth went however to change at mid '90s, showing some weakness as pointed in an after-shock analysis by IMF, 1997 :

- sharp fall in stock market prices from April 1996 to April 1997 (-40%, see also Batra, 1997);
  - slowing growth (from 8.7% to 6.4%) in 1996/97;
  - strong current account deficit (about 8% of GDP in 1995/96);
  - high interest rates (risen from 6% to 10%) to keep needed capital inflows;
  - change from a superyen age to a new trend of U.S.dollar appreciation (+15% in 1995/96 against yen);
  - rising share of investment ratio to GDP (over 40%) financed by external capital (till 7.7% GDP) well above its however high saving rate (about 33%);
  - increasing external bank net liabilities (20% in 1995/96), with 50% debt/GDP ratio (65% short-term);
  - systemic fall in non-finance bank assets (-19% starting from 1994), by real estate price decline.
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Those early warning signs of concern, peaked with the closing of Bangkok stock exchange on March 3, 1997, were however apparently balanced by other still encouraging signs of stability:

- + inflation still under control (5.9% in 1996), even if rising;
- + structural fiscal surplus (1.6% in 1996), even if declining;
- + more restrictive monetary conditions in M2 growth (12.6%) and domestic credit growth (14%);
- + low levels of debt service/GDP ratio (however increasing over 5%);
- + high level of reserve/import ratio (over 5 months) within an U.S. dollar pegged exchange rate.

At an hindsight however high capital net inflows (7.7% GDP, mainly short term bank loans, declining from their 10% level of 1995) ought to show the increasingly external capital-led development pattern in the '90s, for its very nature much more unstable than the simple export-led growth pattern of the '80s. In this changing environment past history of stability is less important than future expectations on perceived instability, enhanced by stock market bubble burst crisis starting in 1996 (see Krugman, 1991 and Batra, 1997): if some doubts arise on policy capacity or willingness to defend pegged exchange rate, then there is room for a speculative currency attack that becomes rapidly self-fulfilling (Obstfeld, 1986 and 1996 versus Krugman, 1996).

In the first half of 1997 global hedge funds launched new speculative attacks against baht, generating a reaction from Bank of Thailand, with a further rising of interest rates aimed to stop incoming capital outflows, but endangering real economic growth. On July 2, 1997 – after months of resistance – Thailand was forced to let the baht float against U.S. dollar: within few days the effective currency depreciation was about 20% (40% at the end of 1997). Shock waves from news on difficult rescheduling in short term bank loans worsened Thai financial situation, while contagion effects to other ASEAN countries fueled the crisis leading to an economic recession that forced Thailand to request IMF's help on 20 August 1997.

Primary target in IMF's sponsored policy was the reduction of savings/investment gap by reducing external deficit first to 5% of GDP (1997) and then to 3% (1998), reinforcing Thai competition under a new floating exchange rate regime; in the public sector the aim was changing the emerging deficit (-1.6% GDP estimated for 1997) into a new surplus of 1% to support restructuring costs.

IMF first estimates on 1997/98 Thai growth were very optimistic, but reality one year later was indeed very harsh: not an expected slow GDP growth (+2.5%) but a

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deep recession (-0.4% in 1997 and -8% in 1998). Inflation in 1997 was lower than expected due to recession (5.6% instead of 9.5%), but later grew again due to devaluation (8.1% instead of expected 5%). External sector deficit was squeezed to 1.9% GDP by the maxi-devaluation of currency reverting then to a huge surplus in 1998, first sign of coming export-led recovery. Public sector was instead unable to keep its targeted balance, flying to a 6.5% GDP under social concern in 1998. Later IMF reviews of Thai situation went to accept that hard than expected reality, filled with recession/depression impulses, till global Asian recovery in 1999.

Thai financial crisis seems to confirm problems the limits of pegged exchange rates, especially in absence of a potential hyperinflation threat like it happens in Asia: over time the advantages of an anti-inflationary stabilization tend to be offset by the damages of an overvaluation, with volatile capital inflows, declining external competitiveness and surging speculative attacks against pegged currency (see Friedman, 1998 and Tobin, 1999, for once in substantial agreement). In defence of East Asian dollar standard – apart from its yen/U.S. dollar “loose cannon” exchange rate and from lacking banking supervision – the virtues of anchored exchange rates (see De Fontenay, 1995) were reaffirmed after financial crises as a source of stable and sustained growth in East Asia during its 1985/96 “economic miracle” (see McKinnon, 1999). It was however clear that in a “two currency region” like East Asia speculative exchange rates bubbles in dollar/yen relations would have been very dangerous (see Bortot, 1996b on currency volatility between yen/dollar/mark cross rates).

A test on predictability of currency crises (Berg/Patillo, 1999) shows that Thai crisis was “relatively easy to predict” (in contrast with the much less foreseeable Indonesian one), while ex-ante analysis on speculative financial bubbles had already led Batra, 1997 to foresee a global stock market crash in 1998. Other studies show high financial vulnerability of Thailand, due to its 1990/96 lending boom (+58% of ratio between lending growth to GDP growth), leading so to a high debt/GDP ratio of 50% (65% short-term), while M2 to reserve ratio was at high 3,90 level (see Chang/Velasco, 1998 and Corsetti/ Pesenti/Roubini, 1998). So it can be said that Thai crisis was unforeseen from the point of view of fundamentals, but it would be wrong to say it was unforeseeable in terms of self-fulfilling panic expectations after “Asian miracle” euphoria, as shock news on real estate and financial sectors cause a lack of trust by global investors in Thai macropolicy sustainability that leads to further currency speculative attacks deepening in this way the crisis (Bertoldi, 1998).

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### 3. Alternative views on Asian crisis: between fundamentals and self-fulfilling contagion waves

What kind of crisis hit Asia? A "classic" one, rooted in internal and external fundamental disequilibria or an "expectational" one, exploding from some shock news? Which factors are to blame: wrong internal policies or panic behaviour in international finance? Was it a macroeconomic short-term breakdown or a long term structural weakening of the roots of Asian miracle? At first nobody understood the specificity of crisis.

The search for an explanation of such an unexpected crisis focused then on different features of crisis:

- financial mechanics (Krugman, 1998; Chang/Velasco, 1998; Corsetti/ Pesenti/ Roubini, 1998; Bertoldi, 1998)
- stock market bubbles (Batra, 1997)
- exchange rate anchors (Friedman, 1998; McKinnon, 1999; Tobin, 1999)
- structural financial systems elements (Radelet/Sachs, 1998; ADB/OECD, 1999; Tiberi Vipraio, 1999)
- global depression implications (Soros, 1998; Krugman, 1999; Bortot, 1999a; Longueville, 1999).

A specific economic and financial ordering is provided by Bellavita/Dalocchio, 1998, while collected writings on crisis country analyses are included in Borsa, 1998, Borsa/Torri, 1999 and *Politica Internazionale*, 1998. An early review of alternative viewpoints is already included in Sideri, 1998 and *Finance & Development*, 1998.

It is not easy to provide a complete survey of all alternative approaches on Asian crisis. We can try however to explain the main different ones starting from the point of view of the roots of crisis:

- internal view
- external view
- interdependent view
- "longue durée" view.

#### 3.1. Internal view

Since early debate (Sideri, 1998) the analysis of Asian crisis as a liquidity crisis

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stemming from newly emerging *internal fundamental disequilibria* has been shared long different views by both monetarists and keynesians. Typical monetarist free market framework (Friedman, 1998) put the blame on U.S. dollar pegged exchange rates, that made Asian countries competitiveness slow after the devaluation of Chinese yuan renmbimbi (1994) and the creeping devaluation of volatile Japanese yen (about 40% in 1995/97 period). IMF's bail-outs from banking panics are blamed for their inflationary impacts (Radelet/Sachs, 1998) for their moral hazard in saving inefficient lenders and stopping the natural, Darwinian market survival of the fittest.

Within a neokeynesian institutional economic framework the use of exchange rate anchors in Asia was valued as a catastrophic error under condition of Japanese stagnation and yen devaluation (Tobin, 1999); however Asian domestic financial fragility was due to a financial liberalization that went too quick under USA and IMF geoeconomic pressures (see also ADB/OECD, 1999). Asian boom in the early '90s was due mainly to the expectations of huge profits from emerging countries thought to last forever: the end of Cold War in Asia after Tien-An-Men shock effect (1989/90) and the growth slowdown in industrial countries led in fact to a mania-kind behavior often seen in history of financial crises (Kindleberger, 1989). The following systemic under-valuation of risks involved resisted even to a Latin America 1995 "tequila crisis", on the implicit hypothesis that such a financial crisis could not ever happen in strong emerging Asian countries.

This way a new ultraspeculative "Ponzi-kind" financial structure was born (according to Minsky, 1982), thought to be sustainable for its political ties (under "crony capitalism" condition) but financially very fragile and vulnerable to some unexpected shock news that can turn euphoria into panic, as happened in July 1997.

The empirical analysis on pre-crisis state of fundamentals – along both the lines of IMF's adjustment approach on exchange rate and economic fundamentals (Clark/Bartolini/Bayoumi/Symanski, 1994) and of structuralist macroeconomic gap theory approach (Taylor, 1994) – focuses on internal and external disequilibria at the roots of currency crisis. In 1996 (see Table 3) in East Asia there were fiscal gaps only in deflationary Japan and booming China, while saving and trade gap were present in worst-hit countries (except Indonesia) and inflationary pressures were stronger in the Philippines and Indonesia, but even here clearly under control (8%). So not all fundamentals were right but Indonesia – that however became the worst-hit country – should have avoided Asian crisis notwithstanding its capital account movement gaps.

Stock markets prices and real estate price crashes in Thailand led in fact to a

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bankruptcy for several finance corporations and banks (see also Caprio/Klingbiel, 1997 for the mechanics of banking crises) put in motion a chain of linked events already known like speculative attacks on anchored exchange rates (Agenor/Bhandari/Flood, 1992) even in absence of the usual deficit budget constraint expected by theory (Savastano, 1992). What did not go analyzed was the mix of an internal financial crisis (well explainable by Irving Fisher, 1933 classical Debt Deflation spiral theory) an external currency crisis (see Krugman, 1979, 1989 and 1992 on balance of payment crises under speculative attacks), when both financial and currency instability are at the same time reinforcing each other in presence of "market failures" by private sector overindebtedment and self-fulfilling market "animal spirits" (see also Krugman, 1998 and 1999, and also Soros, 1998).

Asymmetry information problems worsen the situation by determining an "adverse selection" (that favors more risky projects, allowing for higher expected returns that sometimes fail to realize at all), and a "moral hazard" (covert risky management of borrowed funds for obtaining "at all costs" the strong returns needed to repay capital and sustain the debt service obligations) (see Mishkin, 1997). Under "big bang approach" to financial liberalization the early effect that generates a short-term surplus growth rate than before (Li/Skully, 1991 and Thornton, 1994) or in more gradual openings (Kindleberger, 1987) can easily become a premise for a financial crash as happened in Southern Cone Latin American countries in the early '80s, correctly described as "good-bye financial repression, hello financial crash" (Diaz-Alejandro, 1985) when finance and real economy create a vicious circle under a trust/mistrust situation (Krugman, 1999).

Re-elaborating analytical sequences of Asian crisis under internal view as outlined by Mishkin, 1997 (originally thought after Mexican tequila crisis, see Figure 1), we can display an approach that mix together:

- A) debt deflation due to ultraspeculative behaviour and bubble burst in a one currency economy (Fisher, 1933, Minsky, 1982, Kindleberger, 1989, and also Batra, 1997);
- B) currency crises due to speculative attacks against pegged exchange rates in countries under financial and real estate asset price crisis (Krugman, 1992 and 1998, Tobin, 1999 and Sideri, 1998).

In Asian crisis however currency crash is more a symptom than a cause, as fiscal fundamentals were right and strong growth prevented any macroeconomic temptation by policy-makers to leave the peg (Krugman, 1998).

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The chain sequence of events from Asian miracle to Asian crisis emerges clearly in that mixed Fisher/Krugman/Mishkin approach: the existence of U.S dollar anchored exchange rates – jointly with a yen/dollar devaluation after Japan financial crisis – causes a structural worsening of external competitiveness, with rising trade balance deficit and growing pressures on foreign exchange. The “hard currency policy”, defended by high interest rates level and new external borrowing, feeds strong capital inflows – at first as foreign direct investments (especially in the booming real estate sector) then as portfolio financial flows – that generate stock market euphoria. When (very early) the “overbuilding” effect surpasses reality and perceived housing /administrative building needs, a subsequent overproduction and real estate crisis with price fall emerges. High interest rates under fixed exchange condition lead instead to a growing short term indebtedness in foreign currency at lower rates, as currency risk is perceived as almost null even in a situation of crawling peg (as compared to a floating rate).

The first consequences of speculative currency attacks emerge from stock market and real estate crisis, when both financial and real asset prices deflate, weakening all financial sectors of the economy and spreading uncertainty waves on previously “certain” expectations about the duration of miracle growth.

When forex is under siege, adverse selections and moral hazard problems worsen, making the anchor unsustainable in time and the devaluation unavoidable. The shocking collapse of pegged exchange rate makes external debt service and repayments much heavier, leading several enterprises (of both financial and non financial sectors of the economy) to fail, beginning in this way the debt deflation chain that can lead to a big depression. The bubble burst on overvalued exchange rates and equity prices is amplified by subjective euphoria/panic herding behaviour: banking crisis and external debt crisis cause an already slowed down GDP (by high interest rates) to collapse, showing an emerging fiscal sector cyclical public deficit. The need for adjustment policies force economic crisis to deepen further into a social crisis (sometimes with food side effects) with possible political consequences.

Under this view Asian crisis went from wrong micro-economic policies of unruly financial liberalization and implicit government bailout environment due to “crony capitalism” informal ties coped with a choice of U.S. pegged exchange rates that became inappropriate over time, while macrostability showed by most fundamentals deceived on roots of crisis (Bertoldi, 1998, Krugman, 1999). It can be then concluded that financial liberalization approaches need to be taken cautiously in developing countries,

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where conditions of low contract enforcement, low rule of law and high corruption enhance the probability of an ultraspeculative behaviour (Demirguc-Kunt/Detragiache, 1999).

After Asian crisis it must be noted that in some Asian countries without industrial countries standards of regulation some forms of short term capital can be useful, along with gradual sequencing of capital account liberalization like in China (Mc Kinnon, 1999) or earlier in industrial Europe (Kindleberger, 1987).

### 3.2. External view

The approach of the *external storm over Asian development* is strongly supported by some Asian leaders like Malaysian prime minister Mahathir and Indonesian then president Suharto since 1997. Mahathir attacked currency trade by global funds managers and institutional investors like Soros as "immoral", "neocolonial version worse than original", showing a neodependency kind of approach on Asian crisis, while Suharto more softly noted that financial volatility and fluctuations could waste in few months the socioeconomic progress achieved by developing countries at a price of hard efforts, wise development strategies within several decades. This radical view on external contagion is founded on specific Asian cultural roots, but seems supported by some facts. According to IMF Survey sources financial flows to Asian 5 worst-hit crisis countries, that were at 108,1 billions U.S. dollars in 1996, dried up in 1997 (-0,2) with massive outflows in 1998, the deepest crisis moment (-36,4), before returning toward zero in 1999 and positive in 2000; during crisis the countercyclical role of net official flows was crystal in 1997/98 (29,9 and 26,9 billions), but clearly not enough.

In a more generalized framework it can be showed that global finance (from monetarist world economic center) disgregates regional development models (from fordist peripheral states), as Asian countries could adapt themselves to trade openness but not to financial one. While financial techniques can differ over time, using grant/aids for poorer countries, bilateral loans from industrial states in favour of former colonies or geostrategic allies, multilateral loans for not-aligned countries, bank lending for emerging markets forbidding foreign properties, foreign direct investment for newly industrializing countries and foreign portfolio investment for financial liberalized emerging countries. What happened through debt crisis in East Europe, Africa and Latin America (1979/82), what repeated itself through oil price crash in Middle East

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(1986) happened at last even in Asia, the most flexible and resistant of developing areas.

Under this view Asian crisis is only the latest event of a disintegration of endogenous post-colonial development models: while in the '80s Asian countries (except Philippines) had all won debt crisis threats with endogenous strategies of "adjustment with growth" successfully mixing trade openness within a developmental state (Streeten, 1988) (originating a hybrid form of "developmental liberism"), in the '90s they were caught in the middle of a severe financial and currency crisis.

The increased vulnerability of emerging countries growth to external storms by volatile international finance (see Lipiez, 1984 and Bouchet, 1987 in the debt crisis age) trace back to financial obligations created by economic opening that reshaped economic and financial environment in Asian countries through structural adjustment and liberalization policies, that constrained the range of national policy choices and made "self-fulfilling prophecies" models of behaviour more likely to happen.

A financially stable system can be defined along the lines of a Minski (1982) and Krugman (1991) view.

Under Krugman (1991) analysis the stability of economic systems can be viewed as a weight of past history (objective-rooted stability) in respect to future expectations (subjective-led instability), linked to

- a) high interest rates due to past huge indebtedment
- b) low external economies due to wide public sector and limited place for market economy
- c) low speed of adjustment due to central bank functions as lender of last resort.

After debt crisis in the '80s privatizations and trade openness (stronger interdependence and external economies) in Asian countries that later came to financial openness (high capital speed with low adjustment costs) weakened Asian countries' internal stability, while raising the level of interest rates to support pegged exchange rates was a failed attempt to stop rising instability as globalization weakened the role of central banks as ultimate lenders under pegged exchange rate. Asian growth rates were enhanced by financial globalization – often adopted under external pressures by IMF and USA – that however came to weaken the autonomy of Asian development strategies, linking them more than ever to global financial markets euphoria and panic.

During Asian crisis external IMF's requested banking and finance corporation closing down came to accelerate deflation waves, while internal social labour

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protests, government bail-out intervention for small savers and firms with financial mergers and reorganization, along with cyclical budget deficit on social expenditure acted as ways to avoid a full depression wave during the restructuring phase, by taking into account popular social demand that prefer moral hazard risk to social crash certainty. The unexpected consequences of extended external-led financial liberalization (without a proper bank regulation and supervision environment) went undervalued, as imported financial instability ended in a storm that broken Asian development path under switching "market sentiment" from unforeseen "shock news". Asian crisis is therefore also a legacy of financial globalization and market fundamentalism (see Tiberi Vipraio, 1999 for Korea; see also ADB/OECD, 1999 and Soros, 1998).

### 3.3. Interdependent view

IMF analysis of Asian crisis is focused on *interdependent external and internal factors* as it recognized increasingly the global financial crisis element involved beyond internal structural disequilibria by wrong policies, showed at first as the only causes of Asian crisis while much of the same policies had been implemented under IMF's own advise, leading to unintended results. Along Asian financial cycle of international capital flows attraction, management, sustainability and flight IMF chose some key groups of factors as decisive in its explanations (see IMF/WEO, 1997-98-99):

- 1) successful growth
- 2) changes in external factors
- 3) inappropriate policies on macroeconomics and exchange rate
- 4) structural weakness in finance sector.

While strong Asian "miracle" growth was the key element in attracting international capital, macroeconomic policies not coherent with the anchored exchange rate strategy and the low financial sector transparency under the financial/politics mix labelled as "crony capitalism" went to worsen the situation increasingly, so inducing international capital to flight away from Asian emerging countries. It is however to be noted that IMF underlines these key elements in changing international scenario during the '90s:

- low world interest rates (after USA recession) and preference for booming emerging markets;
  - "tequila effect": capital relocation from Latin America to Asia, with booming inflows;
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- yen devaluation against U.S. dollar (and its pegged exchange rates) after superyen age;
  - "Maastricht effect": slowing European imports from Asia due to austerity policies for Monetary Union.

Private capital inflow into Asian countries became a strong element in Asian growth since the early '90s, when conditions of slow growth in industrial countries (USA recession in 1990/91, European recession in 1992/93) led global fund investors to search for newly emerging areas for higher returns, generating an "Asian mania" in equity and security markets. Those inflows increased further after the mid '90s, when external structural favourable conditions weakened: the massive level of private gross financing toward emerging Asia reached its peak in mid 1997, just before Thai currency crash, but then international capital reacted very quickly an unanticipated crisis, at first directing into other emerging regions but then exiting from all troubled submerging markets toward less risky industrial countries.

Another mixed approach can be traced in Longueville (1999) analysis from a country risk point of view: the increased vulnerability of emerging countries rises in the '90s from increasing private short term capital inflows by hedge funds in a contest of a forex liberalization, while banks' loans finance further asset buying in equity/security markets self-fuelling speculative bubbles. Structural disequilibria become so more extended beyond traditional macroeconomic index of inflation, public sector deficit and balance of payment deficit toward private sector short term currency debt and banking fragility indicators due to too fast liberalization. Even Greenwald (1999) analyzes the international adjustment process from the point of view of the imperfect and asymmetric information between external lenders and internal borrowers in the private sector. A different view is exposed in McKinnon (1999), where international currency environment based on U.S dollar pegged exchange rates, the "East Asian dollar standard", crashed under an external condition, (the highly volatile yen/dollar exchange rate), and an internal condition (absence of proper regulation and supervision in newly liberalized Asian banking system). McKinnon thinks however of pegged forex as an important but forgotten key element of Asian miracle that is useful to restore extended to a bilateral yen/dollar anchor: without proper regulation the best course of action is then some controls on capital short term movements in not fully developed countries, as Chile in 1995 successfully avoided this way to suffer contagion effects from tequila crisis. He also underlines the moral hazard element that lies in the euphoric moments, suddenly shifting to risk aversion in panic moments.

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From an Asian crisis hard-hit country it has also been noted that when a domestic bubble burst joins with an external shock by currency anchor crash a special mix of internal and external factor is acting (Korea, 1999). Asian crisis is then the outcome of a cocktail that mixes together external changes to internal key elements once stronger points and now turned weakness.

Another kind of interdependent view is a cross-sectorial one: it is widely recognized even by World Bank (see its vice-president for East Asia view in Marshall/Severino, 1999) that Asian crisis crossed the lines between finance, economy and society jumping then into political and institutional assets with its deflationist effects.

In some countries like Indonesia there were also relevant collateral factors in the ecosystems that worsened the economic crisis into sociopolitical turmoil: droughts driven by El Niño weather phenomenon hit soils made fragile by massive deforestation, causing wooden fires and damaging rice and other food crop production, with a subsequent raising of food prices by scarcity that worsened tolerance for income inequalities and corruption (Bortot, 1998 and 1999b adapting an Hirschman 1973 analysis; see also Borsa, 1998).

#### 3.4. "Longue durée" view

An alternative explanation of Asian crisis – less based on short term fundamental disequilibria or on an external, exogenous one-time storm – can trace back the roots of that crisis under a long run analysis on international capital role in development. The changing interdependence between national strategies of development and international finance's expectation – that happens when once closed economies open to world markets – began to shape ever more the development path by constraining it with limited financial supply resources (see Bouchet, 1987 on international finance operators view; for an Eastern European application see Bortot, 1996a). Under a "longue durée" Braudelian perspective (Braudel, 1969) applied on East Asian development path we can select three different phases according to growth strategy coherent with the classical Akamatsu flying geese model of international growth by linkages between countries (as in classical Hirschman, 1958: for an Indonesian Braudelian application see Bortot, 1998).

Asian postwar development strategies developed neither along the neoclassical line of allocation/accumulation/redistribution ("getting the prices right") nor by putting

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accumulation first (World Bank, 1993) but on a redistribution/accumulation/allocation line of priority in presence of agrarian reforms in rural areas (see Tiberi Vipraio, 1999). We can select three historically different strategies for Asian socioeconomic development (see Table 4):

- investment-led strategy (focused on internal growth, mainly in Japan);
- export-led strategy (focused on external trade growth, extended to Asian tigers);
- finance-led strategy (focused on global financial growth, further widened to Asian little tigers).

Those strategies represented Asian response to new international challenges for development (see also Oman, 1994; Fodella, 1993; Stiglitz, 1996 and the classical World Bank 1993 study).

The role of international capital for economic development (even at risk of debt and financial crises) has been carefully analyzed by World Bank, 1985, that next examines the financial structures more adapt to manage capital inflows, warning against the risk of market errors, financial instability and corruption (World Bank, 1989). International capital arrived in East Asia from different economic and financial subjects with different expectations: we here analyze briefly the main subjects:

- Lending external governments (first USA, later also Japan), focused at first on geopolitical anti-communist aims (Korean and Vietnamese war) but later choosing geoeconomic objectives (populous big ASEAN-4 countries, inclusion of socialist market economies of China and Vietnam into region).
  - IMF: absent at first stage, it later came into regional strategy debate pressing for an adjustment from protectionism to free market economies and then for an Anglo-Saxon model of globalization as a condition for obtaining its financial resources, vital against debt crisis risks and for market credibility.
  - International bankers: lenders for high interest rates returns from miracle countries, they also financed trade opening and labour intensive, low cost exports through their loans.
  - Foreign direct investors: searching for industrial profits from productive decentralization toward low wages areas, they could offer technology transfer from advanced countries.
  - Portfolio institutional investors: they strove for huge short term gains on assets and security markets, through new derivatives futures and options, used to finance corporate sector development projects.
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All different strategies, from agrarian reform and import-substitution industrialization to export orientation and later external capital-led growth, were stopped in time by hurdles requiring their structural transformation in order to maintain state development objectives of focused growth and spread benefits:

- A) little internal market and structural bottlenecks led to economic opening;
- B) fiscal and trade deficit compelled structural adjustment policies of the economy under debt risk;
- C) financial fragility, revealed by Asian crisis, requests a new kind of adjustment to globalization to avoid subsequent boom/burst cycles.

The environment emerging from crisis needs more transparency in economics and more democracy in politics, that probably imply a weakening in typical Asian traditional social cohesion (Dahrendorf, 1995). Korea and Thailand seem to follow this path for recovery, while Malaysia prefers to strengthen back its social cohesion authoritarian Asian model by controlling short term capital flows. Positions are however not ever so clear, as Indonesian transition government tries to mix democratic pressures with traditional military-defended social cohesion as sources of economic recovery, while the opposition prefers a mix between democracy and social cohesion that goes against IMF liberalization therapies.

It is however evident that – under the stress of a deep crisis – East Asia is trying to find new kinds of relations between national states and global markets, needed to overcome the chaotic results of the hybrid “developmental liberist” state born with some trade and financial liberalization measures were mixed to successful developmental state in a way that is now unsustainable for the simple functioning of the Asian model. An interesting experiment in this regard is Korea, 1999.

A concluding remark on Asian crisis’ alternative theories requires some further reflections. While the internal view about Asian crisis fails to see the changing global scenario before and after some wrong fundamentals led to currencies crashes and self-fulfilling vicious circles, the external view is unable to search for the reasons of internal inability to stop the growing destabilizing of Asian growth model. IMF’s interdependent view tries to avoid the usual unilateral blame on internal country and recognizes the global dimension reached by Asian financial crisis, but its short term stabilization approach fails to see the deep interlinkages that lie over time between Asian national strategies and global financial expectations, more analyzed in World Bank post-crisis analyses.

Global finance indeed came to develop and destabilize Asian countries, but Asian

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governments were not able to respond to that challenge as it were during debt crisis in the '80s. It happened this way partly for more environmental instability, partly for the fact that past successful policy choices went wrong when government power in economics was reduced, and this was not fully recognized in time by strengthening supervision and prudential regulation in a hybrid financial system of "developmental liberalism".

#### **4. IMF's role in Asian crisis: short-sighted, giveaway, deflationist, fragile or adaptive? From orthodox adjustment therapy to social budget deficit**

The several waves generated by Asian financial storm put serious doubts on IMF's chosen strategy, and renewed an old debate on its role in a globalized financial world. As a "safekeeper" of international monetary system, IMF failed for months to contain spreading effects of financial crisis from Thailand to East Asia and emerging markets. So it went under criticism about two different aspects:

- A) failed forecasting of Asian crisis by a short-sighted IMF;
- B) inappropriate and ineffective therapies by an ineffective IMF.

##### **4.1. Short-sighted IMF**

As it already happened in 1995 Mexican "tequila" crisis – anticipated by renowned economist Rudiger Dornbusch, but not by IMF – the Fund too was surprised by events in Asian crisis, and it systematically misjudged its gravity in early stages. The continuous worsening in revised estimates about 1998 GDP growth in Asian countries (see IMF/WEO, 1997/98/99) shows that in December 1997 (after 5 months from the beginning of Asian crisis) a consistent even if slowed growth was still expected, except in zero growth Thailand. Japan, ravaged since 1991 by a bubble burst financial crisis and several cracks on derivative products, had to face three main financial crashes in November 1997 (Sanyo Securities, Yamaichi Securities and Hokkaido Takushoku Bank) but it was still credited of a 1998 1.1% growth. Hard crisis events let only China and Taiwan growth rate little affected, while all other East Asian countries drowned into a deep recession (except zero growth stagnant Singapore and Philippines). Summing up, the estimate change in IMF/WEO projections about Asian countries' 1998 GDP from May 1997 to April 1999 was very huge for every countries

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involved into crisis (except the almost untouched Taiwan and China): for the other 8 East Asian countries the change was enormous for Indonesia (-21,2% in percentage point, ranging from +7,5% to -13,7% GDP change in 1998), but it was very deep even for Thailand, Malaysia, Korea and Hong Kong (above 10% in percentage points) and not irrelevant for Philippines, Singapore and Japan (above 5%).

As already seen for transition countries (Bortot, 1996c), IMF figures about Asian countries have three original flaws that makes IMF short-sighted in crisis forecasting:

- A) low statistical transparency in emerging countries;
- B) IMF's conflict of interest between information and policy purposes, with structural tendency to exhibit "less hard" crisis estimates, in order to avoid panicked herding behaviour in global finance;
- C) "horse wishes" for analysts, with self-fulfilling rosy expectations about believed international financial system stability and IMF's decisive role.

This mix between objective and subjective factors in crisis monitoring at the time of Thai baht crash was stricter only in Philippines, that were following an IMF's Extended Financial Facility program since 1994. In early stages of Asian waves the "pure economics" approach within IMF's macromodels, excluding any analysis of sociopolitical stability of country systems, prevented it to observe quickly the emerging signs of sociopolitical crash (especially in Indonesia).

#### 4.2. Uneffective IMF

While a "forecast criticism" labelled IMF as a *short-sighted* research center for its inability to see beyond standard trendy situations and to anticipate crises at early warning alarms, further criticism was focused on IMF's Asian strategy, that can be synthesized as follows:

- A) IMF as a *giveaway* bureaucracy, for it depleted resources from taxpayers in failed bail-out favouring corrupted and inefficient financial systems, ending to save speculative creditors;
  - B) IMF as a *deflationist* policy-maker, for its austerity and price liberalizing therapies worsen already existing recession and cause declining standard of life and exploding social turmoil.
- IMF defence lies along those lines:

- C) IMF as a *fragile* financial subject compared to worldwide volatile financial capi-
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tal movements: its correct strategy can do very little in panicking herding behaviour markets, and was often delayed and stopped by internal sociopolitical crises in Asian countries;

- D) IMF as an *adaptive* institution, for it learned from its early errors on crisis analysis and is often able to review and improve its own therapies.

#### 4.2.1. IMF's criticism: against a giveaway and deflationist bureaucracy

Financial criticism of a *giveaway* IMF underlines the moral hazard element involved in the uncontrolled bail-out aspect of maxi-financial packages, that ends to help ultraspeculative operators by impeding the market punishment of their errors (losses, failures and bankruptcies), along the lines of a Darwinian "survival of the fittest" contest. According to Friedman, 1998 IMF represents a global destabilizing factor since Mexican "tequila" bail-out, by allowing expectations of generalized bail-out to strengthen, fuelling so hazardous behaviours by international investors: in a world without IMF there has been no Asian crisis at all, but only internal financial crises (like Japan in the '90s), without contagion effects. Friedman put under fire even the adaptive element in IMF behaviour, seeing it as an attempt by an old international bureaucracy to save itself by searching a new role after the crash of fixed exchange Bretton Woods system, along the lines of the worst keynesism.

Supporters of this view focus on the huge cost of IMF maxi-packages (however unable to stop the crisis contagion), noting that the full sequence follows the shock waves of Asian crisis:

- Thailand: 17.2 billions USD (of which 4.0 directly from IMF),
- Indonesia: 42.3 billions USD (of which 11.2 directly from IMF),
- Korea: 58.2 billions USD (of which 20.9 directly from IMF).

In order to save the three Asian – worst-hit countries IMF so committed in 1997 directly 36.1 billions USD, for a collective resource mobilization of 117.7 billions USD in 1997. In 1998 moreover IMF had to stop the global effect of Asian crisis on Russia and Brazil as follows:

- Russia: 22.6 billions USD (of which 11.2 directly from IMF)
- Brazil: 41.5 billions USD (of which 18.0 directly from IMF).

So IMF had to commit another 29.2 billions USD: from the beginning of Asian crisis IMF put 65.3 billions of its own resources to save the world financial stability with-

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in 181.8 billions USD of cumulative maxi-packages against the threat of a global depression. The results were however discomfoting: while in 1995 "tequila" crisis IMF avoided major contagion (except for Argentina) with only 17.8 billions USD of 50 billions total amount, in 1997/98 Asian crisis 36.1 billions USD were substantially ineffective. Too much taxpayer money wasted for ill growth results in 1997/98.

The criticism against a *deflationist* IMF can be done from a macroeconomic or from a social point of view. It is well known that IMF's models of structural adjustment are a mix of monetary approach to balance of payments and a real sector neoclassical growth theory, with later inclusion of structural bottlenecks in developing countries and rational expectations in finance forward looking sector (for a systemic analysis of models see Khan/Montiel/UI Haque,1991). In the 90's, along with a free capital movement additional conditionality for financing crisis countries, IMF accepted an exchange rate anchor (with easy daily monitoring) instead of a monetary anchor against high cronic inflation, sometimes coped with a social pact anti-indexation policy to avoid recession from traditional monetarist shock therapies and achieve a growth-oriented adjustment (see Kiguel/Liviatan,1992 and De Fontenay,1995).

When Asian pegged currencies crashed, the return to a free floating exchange rate included a typical IMF sponsored adjustment program whose key elements are as follows:

- 1) strong restrictive monetary policy, with high interest rates to stop uncontrolled devaluation;
- 2) financial sector regulation reform to monitor short term bank exposure in foreign currencies;
- 3) bank restructuring by recapitalizations, mergers and closures, with creditors/debtors burden sharing;
- 4) corporate governance rule in private sector with accounting and transparency against crony capitalism;
- 5) tight fiscal policies to reduce recession-born fiscal deficit.

It is worth to be noted that after Indonesian sociopolitical catastrophe (may 1998, see Bortot,1998) IMF changed its Asian view by allowing for some anti-cyclical fiscal deficit for social expenditures on human capital (education, health and food subsidies).

In his structural macroeconomic criticism, Sachs (1998) affirms that IMF Asian therapies made things worse rather than better by underrating the fact that overvalued exchange rates and high interest rates deepened corporate bankruptcies and internal banking crises damaging both export and consumption and unleashing reces-

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sionary impulses that slowed Asian growth and later put Brazil into recession. That criticism went out by Stiglitz (chief economist of World Bank) and was reprised at Seoul seminar "One year after IMF" (December 1998), evidencing a rare disagreement between twin Bretton Woods institutions: it was emphasized the need for a careful country analysis before suggesting standard therapies causing a deep credit crunch when interest rates soared above 30% in the failed attempt to slow capital flight (see also Sideri, 1998). From its specific point of view even Soros (1998) criticizes IMF for being part of the problem and not of the solution in Global Asian crisis, while Krugman (1999) simply put in perspective the return of depression economics. Evidence of deflation effects in Asian crisis from IMF/WEO sources shows a price level gap: prices were in fact at a lesser level than expectations in 1997/98 in all countries except in over-devaluing Indonesia (+49%); while in Korea and Philippines consumer prices were a little higher than expected (+3%), there were elsewhere signs of relative disinflation (compared to expectations), with peaks of absolute deflation phenomenon in Singapore and China as explained in Krugman, 1999.

Social criticism to IMF focus on a "human hazard" approach: recessionist policies and food price liberalization, by reducing financial resources and raising the cost of living worsened daily life conditions in the short term, fuelled social protests and political pressures that generated stop/go unsuccessful adjustment and delayed stabilizations (as shown by Alesina/Drazen, 1991), especially in the case of Indonesia (see Bortot, 1998). Traditional criticism to social impact of IMF's austerity policies emerged since debt crisis years from UNICEF and various NGOs (see the classical study by Cornia/Jolly/Stewart, 1987) and have some points in common with food riots against IMF as analyzed by Walton/Seddon, 1994, transforming a financial shock into economic recession and then a sociopolitical crash (see also a FAER 1998 alarm).

#### *4.2.2. IMF's defence: support to a fragile and adaptive institution*

IMF's role and strategy during Asian crisis was however defended along two different points of views.

It has been affirmed that IMF's therapies against Asian speculative bubble were appropriate (Grilli, 1997) while its means were limited as IMF is *fragile* in a stormy international finance environment (Alesina, 1998), in a world where over 90% of capital flows transactions have no trade counterpart, but are made by pure financial specula-

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tions. On the other side IMF's Deputy Managing Director Stanley Fischer, recognizing the need for a global finance reform, underscored the *adaptive* IMF's nature, always able to learn from crisis itself by institutional innovations: at first IMF used Emergency Financial Facility (created after the "tequila" crisis), then forged a new Supplementary Reserve Facility against sudden forex reserve outflows to help countries like Korea, hit by a sudden swing in "market sentiment" from euphoria to panic. In 1998 then IMF reactivated the General Agreement on Borrow to prevent further contagion by giving a pre-crisis lending package to save Russia and then Brazil, trying to anticipate capital flight and avoid the crisis, but obtaining only a deferment of exchange rate collapse, gaining however some time to face the crisis in a better way (Fischer, 1998; Lane, 1999; for changed IMF social aspects approach see IMF Staff, 1998).

Fischer underscored the recent changes in IMF's later Asian therapies in respect to earlier ones, taking into account the emerging deflationary environment and trying to stop the deepening of Asian crisis, allowing for non-liberist semi-keynesian socio-economic policies on

- anti-cyclical budget deficit to counteract recession;
- vital social expenditure (education, health and emergency rice and food subsidies);
- temporary controls on short - term capital movements (as in Chilean 1995 experience).

High interest rates are however defended as an instrument to avoid further devaluations and external debt crisis bankruptcies. IMF had to recognize ever more the role played by global finance environment in worsening Asian crisis through contagion effects and financial turbulence (IMF/WEO, 1997- 1998-1999).

For example, Japan recession stopped a rapid Mexican-style recovery in Asia as it could not act as an engine of growth by absorbing cheap exports from devalued countries, while United States could do it with Mexican cheap exports after the "tequila" crisis. It is worth noting however that the mild Japan recovery of 1996/97 was crashed not only by its own financial crisis but even by spillover effects of Asian crisis on the fragile Japanese financial structure.

Fischer affirms furthermore that the IMF's suggested closure of 16 ailing banks (November 1997) was not the "shock news" that triggered Indonesian crisis, that is instead to be charged on social turmoil at the sunset of a political age: those protests however materialized after economic crisis, fuelled by banking failures, touched everyday life on IMF dictated price liberalization even in the food sector. (Bor-

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tot, 1998). The inability of IMF to take into account sociopolitical instability linkages with economic recession is so confirmed, while IMF's field invasion in typical World Bank activities as microeconomics finance sector restructuring shows that in times of growing interdependence and global crisis contagion the usual distinction between the Fund and the Bank seems blurred. The possibility of a "World Development Fund" by merging together the "Bretton Woods twins" as proposed by Brandt Report already in 1980 is controversial, as market fundamentalist prefers a simple abolition of IMF. A major integration between financial elements (including more supervision and systemic stability) and basic human needs (education, health, food) seems however needed especially in times of crisis to cut its deep social costs.

Alan Greenspan, president of Federal Reserve and world's lender of last resort by cutting U.S. interest rates in the middle of global turmoil (September/October 1998) sustained that a limited IMF is better than no IMF, supporting the "IMF fragility" view against the "IMF giveaway" view and so contributing to a difficult Congress approval of USA quota in IMF recapitalization of 18 billions USD against strong "market fundamentalists" supporters of simple IMF uselessness (November 1998).

What is clear is that the IMF started with monetarist anti-inflation therapies that deepened recession pressures, but after Indonesian crash preferred a more keynesian-type anti-depression strategy founded on allowed anti-cyclical budget deficit to strengthen social safety net and levels of education, health and food obtained in "miracle" growth years by Asian countries.

IMF consensus among international financial economists and strategists did not disappear at all: a Reuters instant survey showed on August 28, 1998 the following economic evaluation of IMF strategy during global financial crisis: sufficient about Asia (score 6 out of 10), almost good about Latin America (7 out of 10, but that was before Brazilian's January 1999 devaluation), very bad about Russia (4 out of 10).

IMF's role in global Asian crisis was at first short-sighted and deflationary in its therapies on a "conjunctural" crisis; later it tried to adapt itself to the structural aspects of a stormy environment, tempting to finance socioeconomic adjustment to globalization even at cost of some giveaway bail-out intervention, but its strategy was anyway limited by its own resource fragility. The inappropriate suggested use of exchange rate anchors in a semi-dual currency area (U.S. dollar and Japanese yen) without chronic inflation seemed to have played a significant part in IMF's Asian errors. It is however worth noting that IMF in the end changed its approach according to some of more marked social criticism to its early action.

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## 5. Conclusion: beyond Asian instability: expectations as opportunity and threats to historical development paths

The debate on Asian crisis has been rooted in classic "fundamental" facts in macroeconomic policy and "self-fulfilling prophecies" in global finance herding behaviour along different stages on Asian crisis: Thai crisis, South East Asian crisis, East Asian crisis, global Asian crisis (see Bortot, 1999c).

Thai crisis exploded with most of fundamentals right and only current account balance large deficit, but later estimates put it as sustainable over time by increasing foreign investment - led exports: overinvestment would have obtained future productive results, differing from overconsumption in Mexican crisis (Dornbush, 1997). Even if this crisis was predictable (Berg/Pattillo, 1998) by taking into account financial and real estate sectors, the evolution of Thai situation shows however a typical self-reinforcing speculative behaviour under uncertainty and shock news. Contagion effects on East Asia were much more of the self-fulfilling type, linked to herding behaviour of hedge funds (Bertoldi, 1998 and Soros, 1998), putting at risk the entire financial world (Euromoney, 1997).

Asian crisis has been analyzed from alternative viewpoints: internal fundamental gaps by wrong policies, external global financial expectations, interdependent changing environment and "longue durée" structural links between Asian development strategies and international finance expectations. Each view has some points, but the last one seems more promising by putting Asian miracle, crisis and recovery in perspective: Thai crisis was brought neither by fiscal deficit (as in "classical" currency crisis models) nor by macroeconomic temptations due to weak growth and high unemployment (as in "self-fulfilling" models like in EMS 1992 crisis). It went from the bust of a real estate and asset price bubble under a "longue durée" process of increasing economic vulnerability to global finance (Batra, 1997; Krugman, 1998 and Bortot, 1999c). Later "self-fulfilling" contagion played an important role by emerging shock waves on other even dissimilar Asian economies (Bertoldi, 1998).

Asian crisis teaches us a lesson about the powerful mix in which self-fulfilling expectation shocks impact on historical structural development fundamental trends within a global market-led international monetary system. Under condition of unruly financial liberalization, financial instability and deflationist pressures triggered by speculative attacks against pegged exchange rates can make development paths very fragile facing international finance, that amplifies perceived shock news (Krug-

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man, 1991; Minsky, 1982; Krugman, 1999). This may be a short-term occasional self-fulfilling phenomenon (Obstfeld, 1996) but it has "longue durée" fundamental roots as development paths tend to shift over time from history to expectations. Self-fulfilling expectations are then not only a powerful opportunity of self-reinforcing growth by stock market push but even an enormous risk of financial crash led by debt-deflation mechanics enhanced with pegged exchange rates mismanagements.

IMF was unable to stop this crisis immediately, for two main reasons: myopic behaviour and deflationist therapies that worsened the crisis wasting taxpayers' money. It is however to be noted that the Fund was a very fragile tool within global finance turmoil, and then it adapted somehow to cushion the socioeconomic crash by allowing a counter-cyclical budget deficit on social expenditure like education, health and food subsidies (Bortot, 1999c).

The spread of huge global contagion waves from Asia to world financial markets shows the Harrodian truth that financial capitalism is on a knife edge kind of instability: herding behaviour can then reinforce euphoria or panic by self-fulfilling expectation when speculative attacks clash against the pegged exchange rate under doubts on policy behaviour: short-term turmoil is linked to long-term weakening of structural economic stability. Some "sand in the wheel" controls on short term capital flows may be required to stop self-fulfilling panic (Tobin).

After 1999 Asian recovery lead some euphoric observers began to talk about a "new Asian miracle"; on that matter we can note that the Asian crisis is really over for all countries except Indonesia: dynamics trends show an improving financial and economic situation, while the stock market has regained its pre-crisis level at the Beginning of 2000. Real sector recovery in worst-hit crisis countries however brought GDP level over 1997 only in Korea (1999) and next in Malaysia and Thailand (2000) while Hong Kong and Thailand seem to have to wait one year more (2001) and there is a much longer way for Indonesia to return on growth path (see also Marshall/Severino, 1999 for a World Bank cautious view on Asian recovery).

Much harder is Asian everyday life as crisis social effects of "lost wealth" in foreign currency terms sum up to "lost income" due to lower real wages and rising unemployment that worsen income distribution threatening social equity. It is worth noting that the strong East Asian recovery in Korea happened after the beginning of a restructuring process within a "social pact" by the Trilateral Committee of labour, business and government, able to overcome the worst protest of a month-long strike at Hyundai reaching an agreement.

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The panicking night in which all the dragons are the same is now gone: flying geese are starting to fly again in quiet after the financial storm, each one at its own speed, even if other reasons for concern arise from the political risk involved in China/Taiwan unsettled relations.

While Asian tigers are recovering every expectation of a quick reprise even in the socioeconomic field by simply repairing the broken "miracle" development model does not seem reasonable as the root factors of miracle growth are increasingly eroded (see Krugman, 1994 and Young, 1995) by newly emerging Asian megatrends (Naisbitt, 1996 and Filippini, 1998) that threaten to break up socioeconomic cohesion, "orgware factor" of Asian development (see Fodella, 1993 and Dahrendorf, 1995). Here is a simple key-question list.

- A) Political and economic stability are threatened by the transition from nation states, engines of Asian development, to regional network, as crisis showed the inefficiency of ASEAN cooperation between crisis-hit countries, worsening instead disintegration risks in multiethnic states (for example, Indonesia has to face different separatisms from East Timor, Aceh, Ambon, Irian Jaya).
  - B) Traditional Confucian ethic explaining with agrarian reforms the almost social equity in income distribution comes to be eroded by cultural modernization and emerging values of an individualist way of life (as a recent World Bank report on social crisis in Thailand shows, citing rising criminality and anomic behaviour that arise from Asian socioeconomic quakes).
  - C) Economic openness founded on exports and capital inflows can be substituted with domestic consumption as crisis fades and recovery helps to regain the average pre-crisis standard of life.
  - D) State/market cooperation (sometimes sources of political and financial corruption in the "crony capitalism" model) is undermined by global capital inflows, evidencing the limits of trade strategies "country-system" based in emerging countries.
  - E) Rural saving behaviour (for development aims) is to be slowed by the urbanization process and by the diffusion of a standard cultural model of consumerism in a "Mc Donalds world".
  - F) Education growth, with an emerging high-skilled labour (even if it is stopped for now by crisis induced reported declines in secondary education enrolment rates), undermines the "cheap low skilled labour-intensive" model of export toward its demise.
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- G) Authoritarian developing power is undermined by the emergence of a democratic movement that risks to unleash social redistributive conflicts (especially in times of crisis) from newly reorganized trade unions (see Korean and Indonesian strikes).

Summing up, current "Asian miracle" fundamental trends were weakening already before crisis (Krugman, 1994 and Young, 1995) even if Asian crisis seems now fading as a spectacular contingency crash as recovery gains strength. Different Asian Mega-trends will emerge gradually in the next years in a country-specific fashion according to their own cultural response strategies, while Asian crisis impact will be more absorbed by society in its everyday life, showing the need for Asian countries to find a new development model focused on the "new technological economy" by restructuring old key elements of growth now turned weakness. Under this view the Korean model of socioeconomic recovery beyond Asian financial crisis (Korea, 1999) is fundamental.

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**Abstract**

*After many years of strong and increasing economic growth and social progress (the so-called "Asian miracle"), in 1997 East Asian countries came under an unexpected crisis that later spread on emerging countries and on global financial markets and deepened into East Asian societies. Recovery began only in 1999. This paper tries to analyze the changing key elements from miracle growth and Thai fundamentals situation at the beginning of Asian crisis, along with the expectations' role on self-fulfilling panic behaviour.*

*We will then reflect on alternative views on Asian crisis (internal financial disequilibria, external financial storm, an interdependent mix of both) on a short-term perspective as well as on a Braudelian "longue durée" perspective in which structural relations between international capital expectations and Asian development strategies are also examined under a Krugman-type process of development dynamics from history to expectations due to a mix of internal debt deflation theory (Fisher and Minsky) with external currency crash (Krugman).*

*We also present various kinds of criticism on IMF's maxi-package strategy during the crisis, under attack as a short-sighted, money giveaway or deflationist institution notwithstanding its fragile adaptive strategy from early bankruptcy-leading shock therapy to later social expenditure protection strategy.*

*Our conclusion is two-ways: on Asian development and on its global finance environment. A renewed growth in Asia must be based on new social foundations as Asian megatrends show the fading of conditions required for extensive growth "miracle".*

*Global financial instability tends to undermine economic development, as expectation swing can change euphoria into panic without "sand in the wheel" controls on short-term capital flows (Tobin): it is therefore crucial to avoid simultaneous crisis shocks in the "longue durée" path that leads from historical national roots to expected global futures along a globalization process.*

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**POINTS DE VUE ALTERNATIFS SUR LA CRISE ASIATIQUE ET LE RÔLE DU FMI.  
NOTES SUR LES FONDAMENTAUX ET LES ATTENTES****Résumé**

*Après beaucoup d'années de haute et augmentante croissance économique avec progrès social (le soi-disant "miracle asiatique"), en 1997 les pays de l'Asie Orientale tombèrent dans une crise inattendue, avec une diffusion sur les pays émergentes et les marchés globales, et une approfondissement en racines des sociétés de l'Asie Orientale. La reprise commença en 1999 seulement.*

*Cet article cherche à analyser les éléments clefs qui changent des années du miracle et les indices fondamentaux en Thaïlande aux racines de la crise.*

*Nous réfléchissons sur les points de vue alternatifs sur la crise asiatique (déséquilibres financiers intérieurs, tempête financière extérieure, interdépendance mixte des deux vues) entre une perspective de brève durée (événementielle). Puis nous analysons une perspective Braudelienne de "longue durée" où les relations structurelles entre les attentes du capital international et les stratégies du développement asiatique sont aussi examinées avec un procédé à-la-Krugman. Ce model conduit la dynamique du développement de l'histoire vers l'attentes, en joignant une intérieure deflation par dettes (à-la-Fisher/Minsky) avec un extérieur crac de la devise (à-la-Krugman).*

*Nous examinons aussi différentes critiques de la stratégie du Fonds Monétaire International fondée sur les paquets financiers géants; le FMI a été attaqué comme institution myope, dépensière ou deflationiste, même si sa stratégie fragile et adaptable change de faillites bancaires à la sauvegarde de la dépense sociale.*

*Notre conclusion est double face: sur le développement asiatique et sur l'environnement de la finance globale.*

*La reprise de la croissance en Asie doit être fondée sur nouveaux reseaux sociaux puisque l'analyse des grandes tendances asiatiques montre que les conditions du "miracle asiatique" de la croissance extensive s'évanouiront.*

*L'instabilité financière globale tend à déstabiliser le développement économique, puisque le virage en attentes peut changer euphorie en panique sans contrôles sur le capital à bref terme comme "sable en rouage" (Tobin). Le point crucial est d'éviter simultanés chocs de la crise en processus de la "longue durée" des racines historiques nationales vers les attentes globales du future, en cours de la mondialisation.*

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## Appendix

**Table 1:** Long run development in East Asia: rise, fall and rebirth of an economic miracle (real GDP, annual percent change)

	1950/75	1975/90	1990/96	1997	1998	1999	2000
Japan	7.6%	4.3%	2.3%	1.4%	- 2.8%	1.0%	1.5%
Korea	5.1%	8.7%	7.7%	5.5%	- 5.8%	6.5%	5.5%
Taiwan	5.3%	8.6%	6.3%	6.8%	4.9%	5.0%	5.1%
Hong Kong	5.0%	8.6%	5.0%	5.3%	- 5.1%	1.2%	3.6%
Singapore	7.0%	7.6%	8.5%	8.0%	0.3%	4.5%	5.0%
Thailand	3.6%	7.8%	8.6%	- 0.4%	- 9.4%	4.0%	4.0%
Malaysia	2.6%	6.4%	8.8%	7.7%	- 6.7%	2.4%	6.5%
Indonesia	2.0%	5.9%	8.0%	4.6%	- 13.7%	- 0.8%	2.6%
Philippines	2.8%	3.2%	2.8%	5.2%	- 0.5%	2.2%	3.5%
China	4.2%	7.8%	10.4%	8.8%	7.8%	6.6%	6.0%

Sources: \* 1950/75 data: World Bank, *Twenty-five years of economic development*, Washington, 1977.

\* 1975/96 data: International Monetary Fund, *World Economic Outlook*, selected years.

\* 1997/98 data: 1999 estimates and 2000 projection: International Monetary Fund, *World Economic Outlook*, 1999, October, Washington.

**Table 2: The twin faces of Asian financial crisis: stock market and exchange rate crises (changes from 1 July 1997)**

	Stock Market Changes from 1 July 1997				Exchange Rate Changes from 1 July 1997			
	Jan. 98	Sept. 98	Jan. 99	July 99	Jan. 98	Sept. 98	Jan. 99	July 99
Japan	- 14%	- 26%	- 28%	- 8%	- 8%	- 21%	+ 1%	- 6%
Korea	- 32%	- 57%	- 31%	+ 24%	- 50%	- 38%	- 28%	- 29%
Taiwan	- 5%	- 23%	- 32%	- 12%	- 15%	- 20%	- 14%	- 14%
Hong Kong	- 25%	- 48%	- 37%	- 10%	Ø	Ø	Ø	Ø
Singapore	- 20%	- 55%	- 27%	+ 13%	- 14%	- 17%	- 15%	- 16%
Thailand <sup>(1)</sup>	+ 5%	- 63%	- 36%	- 14%	- 42%	- 36%	- 29%	- 30%
Malaysia	- 31%	- 69%	- 50%	- 30%	- 33%	- 34%	- 34%	- 34%
Indonesia	- 30%	- 56%	- 46%	- 9%	- 71%	- 79%	- 73%	- 64%
Philippines	- 26%	- 59%	- 30%	- 9%	- 33%	- 39%	- 31%	- 31%

Sources: our computing from Reuters, "Asia Markets", selected days:

- A) Jan. 98 = data on 2 January 1998 (after Korean crisis)
- B) Sept. 98 = data on 9 September 1998 (after Russian crisis)
- C) Jan. 99 = data on 26 January 1999 (after Brazilian crisis)
- D) July 99 = data on 14 July 1999.

\* All exchange rate data are valued as changes in bilateral exchange rate of national currency versus U.S. dollar, referred to its 1 July 1997 level.

\* All stock market data are valued as changes in stock market own index, referred to its 1 July 1997 level.

<sup>(1)</sup> In Thailand the beginning and build-up of Asian crisis in the first half of 1997 took place under a still pegged exchange rate regime but with a sharp fall in stock market prices (-33%) worth to be mentioned.

**Table 3: Asian crisis and fundamentals' disequilibria in 1996 according to the gap theory (as % of GDP, except inflation)**

	Inflation (annual %)	Current Account Balance	Capital Account Movements	Trade Balance (goods & services)	Net (*) Domestic Savings	General Government Balance
	inflation gap			trade gap	saving gap	fiscal gap
Japan	0.1%	+ 1.4%	+ 3.9%	- 2.5%	+ 1.6%	- 4.1%
Korea	4.9%	- 4.9%	- 1.4%	- 3.5%	- 3.5%	Ø
Taiwan	3.1%	+ 5.2%	- 2.0%	+ 7.2%	+ 7.0%	+ 0.2%
Hong Kong	6.0%	- 1.3%	- 2.8%	+ 1.5%	- 0.7%	+ 2.2%
Singapore	1.4%	+ 15.0%	- 7.0%	+ 22.0%	+ 13.6%	+ 8.4%
Thailand	5.9%	- 7.9%	- 1.8%	- 6.1%	- 7.7%	+ 1.6%
Malaysia	3.5%	- 4.9%	- 3.6%	- 1.3%	- 5.5%	+ 4.2%
Indonesia	7.9%	- 3.3%	- 5.4%	+ 2.1%	+ 0.7%	+ 1.4%
Philippines	8.4%	- 4.7%	- 0.8%	- 3.9%	- 3.5%	- 0.4%
China	6.1%	+ 0.9%	- 4.9%	+ 5.8%	+ 7.3%	- 1.5%

Sources: \* For economic data: our computing on IMF "World Economic Outlook, Interim assessment, December 1997", Washington.

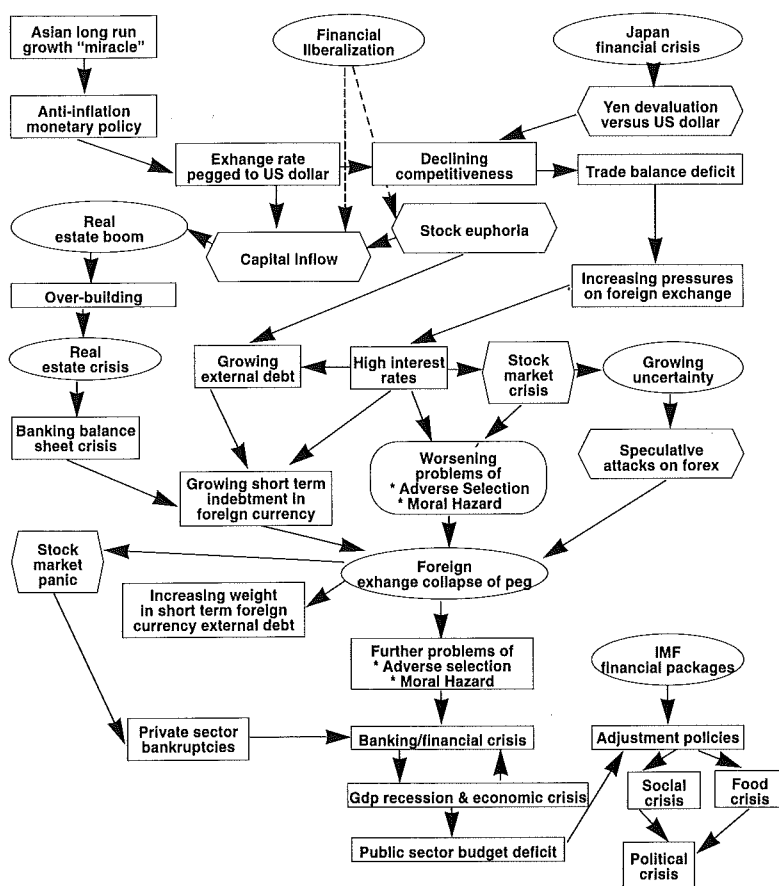
\* For choice and definition of fundamentals and gaps, see:

A) P. Clark, L. Bartolini, T. Bayoumi and S. Symansky "Exchange rate and economic fundamentals. A framework for analysis", IMF Occasional Papers n. 115, 1994.

B) L. Taylor, "Gap models", Journal of Development Economics, 1994, n. 1

(\*) Definition: Net Domestic Savings = Gross domestic savings less Fixed Capital Formation

**Figure 1: A stylized framework of Asian crisis (from Thailand to Indonesia)**



Sources: our restyling from F.S. Mishkin, "Understanding financial crises: a Developing Country perspective", Annual World Bank Conference on Development Economics, Washington, The World Bank, 1997.  
On similar lines see also P. Krugman, "What happened to Asia?", 1998.



**Table 4:** *International financial expectations and Asian economic strategies from growth to crisis in a long run perspective: our elaborations from Akamatsu's flying geese model*

Asian Development Strategies			
	Investment-led Strategy (1950/65)	Export-led Strategy (1965/83)	Finance-led Strategy (1983/97)
Flying geese development pattern countries	1) Japan	1) Japan 2) Korea, Taiwan, Singapore, Hong Kong	1) Japan 2) Korea, Taiwan, Singapore, Hong Kong 3) Thailand, Malaysia, Indonesia, (Philippines)
International Financial Expectation			
Lending Governments	exp) anti-communists USA loans str) agrarian reforms, import substitution industrial growth	exp) anti-communists USA loans str) export-led industrial growth	exp) geostrategic USA loans, geoeconomic Japan loans & direct investments str) external finance-led industrialization
International Monetary Fund		exp) adjustment from state to market oriented growth str) financing against risks of debt crisis	exp) adjustment to anglosaxon-style globalization str) financing for foreign currency reserves & government's market credibility
International Bankers		exp) lending to high return emerging countries str) financing labour intensive, low cost exports	exp) lending to "miracle" newly industrializing countries str) financing export with technological upgrade & low labour cost
Foreign Direct Investors			exp) industrial investments in cheap labour areas str) technology transfer from advanced countries
Portfolio Institutional Investors			exp) financial capital for high return countries str) financing in corporate development projects
International Environment	* fixed currencies * fordist/taylorist industrial pattern * decolonization * rise of communist China * Korean war	* floating currencies * toyotist industrial pattern * national development * birth of ASEAN * Vietnamese war	* new anchored currencies * derivatives financial production pattern * regional development * post Tien-An-Men context * China/Taiwan tensions
End-Results	* inward oriented growth * structural internal bottlenecks	* outward oriented growth * external debt adjustment	* financial boom * financial crash