Asian crisis

Some of the issues raised in "The Asian Crisis: Causes and Cures" (*Finance & Development*, June 1998) need greater emphasis. On both a macro and a micro (corporate) basis, there were currency and maturity mismatches between borrowings and loans. Because of the availability of cheap capital and overly optimistic estimates of growth prospects, East Asian banks borrowed large sums in foreign currency and liberally made loans in domestic currency largely for speculative investments. While the banks' foreign borrowings tended to be short term, their loans were largely for long-term investment.

Between 1993 and June 1997, Thailand's external debt escalated from $20 billion to $69 billion, and almost three-fourths of the debt had a maturity of one year. The volume of foreign bank debt amounted to about 45 percent of GDP. Banks made a large number of long-term loans to the property and real estate sectors. When real estate and share values plunged, banks were left with a large volume of nonperforming assets. Financial disasters, bank failures, and bankruptcies occurred. As it became obvious that loans might not be repaid, foreign banks ceased to make fresh credits available and recalled old loans, aggravating the crisis.

Developing countries may learn a number of lessons from the East Asian debacle. The magnitude of external borrowing must be limited to a country's capacity to use the loans productively and generate surpluses to repay and service them in foreign currency. Mismatches between short-term borrowing and long-term lending must be avoided. The financial and banking sector must be properly regulated, and capital-adequacy standards and prudential lending norms observed by banks and other financial institutions. Foreign portfolio investment should be monitored and excessive inflows checked. Such investments are the first to be withdrawn, and sudden capital outflows can destabilize a currency. IMF packages incorporating structural reforms and stabilization measures are often tough to implement and may result in recession and unemployment. Prevention is therefore better than a cure, and developing countries would do well to avoid currency crises.

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"The Asian Crisis: Causes and Cures" (*Finance & Development*, June 1998) provides an analytic overview of the financial turmoil that has engulfed several Asian countries since July 1997.

The article recognizes only indirectly and in very subdued terms the two basic factors contributing to the crisis: the political corruption of semi-authoritarian regimes and unsound financial systems. The two are linked—especially in Indonesia and South Korea—with rampant bribery among business groups, as pointed out by Frank Vogl of Transparency International in his article, "The Supply Side of Global Bribery," in the same issue.

The article raises another serious issue in connection with the prospects for recovery in 1999–2000—the current ailments of the Japanese economy. The continuing decline of the yen in terms of the dollar reflects the unsoundness of the financial sector in Japan, whose banks have an estimated bad debt totaling about $650 billion.

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Criteria for financial aid

In their article, "Aid Spurs Growth in a Sound Policy Environment," (*Finance & Development*, December 1997), Craig Burnside and David Dollar quote Nicholas Eberstadt of the American Enterprise Institute as saying, in his testimony before the U.S. Senate Foreign Relations Committee, that financial aid to Third World governments for development is "positively destructive." I disagree. The fact that countries such as Zambia maintain poor policies despite the aid they receive does not indicate that aid is in itself destructive.

In the 1980s, Ghana's economic situation was bad. As a result, Ghanaians began to seek refuge in neighboring countries. Following several years of economic hardship, the country started to recover economically after receiving financial aid from foreign donors. Subsequently, during the 1990s, Ghana adopted sound economic policies, which eventually led to economic improvement and reduction of poverty. Bolivia and Honduras are other examples of countries that improved their policies after receiving aid.

Donors should establish criteria for providing financial aid to developing countries. These criteria should include sound economic policies and good national leadership to ensure that aid is put to productive uses. Countries that cannot implement good reform programs should not receive help, including technical assistance.

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Corrections

In the September 1998 issue, a conference panelist in the photograph on page 8 was incorrectly identified as Nieves R. Confesor. That panelist was Siow Yue Chia.

In the same issue, in the review of Isher Judge Ahluwalia and I.M.D. Little's book, *India's Economic Reforms and Development: Essays for Manmohan Singh*, one of the papers cited on page 51 was incorrectly attributed, owing to an editorial error, to Mrs. Ahluwalia; the author is Montek Ahluwalia.

Credits
Photographs: cover, contents page, and pages 32, 36 and 38, Padraic Hughes; book photos, Pedro Marquez; authors' photos, IMF Photo Unit. **Illustrations:** page 8, Mark Robinson; contents page and pages 16, 20, 24, and 40, Massoud Etemadi.