

Financial Markets and Economic Growth

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Abstract

The current economic problems in Southeast Asia can be attributed not to too *much* reliance on financial markets, but to too *little*. Like the U.S. economy a century ago, the emerging Asian economies do not have welldeveloped capital markets and so remain heavily dependent on their banking systems to finance growth.

For all its benefits, banking is “not only basically 19th-century technology, but disaster-prone technology.” The extreme maturity (and, in some cases, currency) mismatch on banks' balance sheets plus the first-come, first-served nature of the deposit obligations mean that banks are inherently vulnerable to massive runs by depositors—and that their economies are subjected to periodic credit crunches. And, as the author says, “in the summer of 1997 a banking-driven disaster struck in East Asia, just as it had struck so many times before in U.S. history.”

In this century, the U.S. economy has steadily reduced its dependence on banks by developing “dispersed and decentralized” financial markets. In so doing, it has increased the efficiency of the U.S. capital allocation process and reduced its susceptibility to the credit crunches that have occurred throughout U.S. history. By contrast, Japan has not reduced its economy's dependence on banks, and its efforts to deal with its banking problems have served only to destabilize itself as well as its neighbors. Developing countries in Southeast Asia and elsewhere are urged not to follow the Japanese example, but to take measures aimed at developing financial markets and institutions that will either substitute for or complement bank products and services.

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