Crony capitalism and the East Asian currency and financial 'crises'

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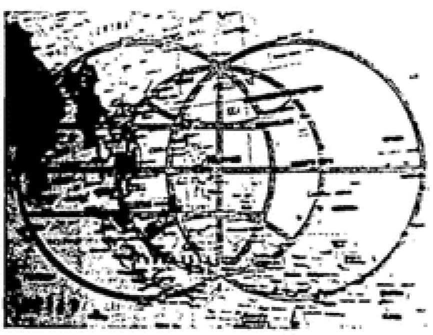
The East Asian 'crisis' has been marked by a plethora of bad debts, including the, as yet, uncounted debts to Japanese banks. The figures quoted are running into billions. They suggest that a large proportion of the private flows of capital to East Asia in the 1990s were egregiously risky. They were not supported by project and sovereign risk analysis that shareholders and depositors have a right to expect from financial institutions. Much of the investment undertaken within East Asia in recent years was channeled into unproductive enterprises and projects. Much was stolen. It is deeply mystifying that these flows were not perceived as contributing to the weakness of the East Asian economies by the International Monetary Fund (IMF), the World Bank and the Asian Development Bank, all of which had responsibility for monitoring East Asian countries. In 1993, the World Bank (1993: v–vi), ignoring the extensive literature on monopoly and oligopoly, concluded that the East Asian countries were '... better able than most to allocate physical and human resources to highly productive investment and to acquire and master technology.'



A few perceptive observers (eg. Lingle 1997) provided clearly argued early warnings, but these were ignored by most observers and the multilateral institutions that had surveillance responsibilities for East Asian countries. They were not undertaking appropriate analytical work and they were unwilling to embarrass their member governments by pointing out the cost of cronyism. Following the IMF's half-century of persistently bailing out any country that ran into balance of payments difficulties, some private lenders suspended risk assessment, making 'moral hazard' a serious consequence of IMF operations.

Most analysts have focussed on the collapses of financial institutions and devaluations of exchange rates that became necessary once the hollowness of much of the unproductive investment and financial cronyism was exposed (Arndt and Hill 1999; McLeod and Garnaut 1998; Montes and Popov 1999; Radelet and Sachs 1998). They have not explained why countries known for their prudent macroeconomic policies for some 30 years abandoned them in the mid-1990s. A more perceptive analysis indicates that 'the root cause of the crisis...' was that 'financial intermediaries were not always free to use business criteria in allocating credit...' and 'well connected borrowers could not be refused credit...' that '...was created by implicit or explicit government guarantees against failure' (Moreno, Pasadilla, and Remolona 1998). That is, corporatist policies led to crony capitalism and hence to the 1997 collapse.

Leading East Asian market economies avoided following the Prebisch-Singer 'development economics' inward oriented model that was widely accepted by developing countries in the 1960s and 1970s (Lal 1983), recognising that an open market economy was more likely to bring progress than a *dirigiste* one. Liberalisation made considerable progress. Competition in international markets encouraged further reforms. Except in Hong Kong, Singapore and later in Taiwan, however, privileged local entrepreneurs originating in protected domestic industries were able to prevent the

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