Niyaz Abdulgaleev

What Led to the East Asian Financial Crisis?

Topic and Research Question

This master thesis focuses on the 1997 East Asian financial crisis. This crisis started in the form of a currency shock beginning in Thailand, which quickly spread throughout the entire region (Jomo, 2007). Due to the interplay of various unique factors during the crisis (such as the heavy involvement of international organizations, and the severity of the crisis combined with a quick recovery), the topic has garnered much attention in academia (Carney, 2009). The causes of the crisis can shed light on the dangers of integrated financial markets, while the specific experiences can illustrate the best practices and the pitfalls encountered in transitionary economic periods.

Due to the disagreement amongst many reputable experts (Carney, 2009) this thesis conducts a systemic analysis of the literature which focuses on the causes of this regional crisis, and additionally looks at the particular causes involved in the case of South Korea. The aim is to evaluate the positions of the scholars involved, and answer the following three research questions:

1. *According to the economic research and literature concerning itself with the causes of the financial crisis, what is their ranking in the order of importance.*
2. *According to the economic research and literature on the causes of the Asian financial crisis in South Korea, what is their ranking in the order of importance.*
3. *How do the rankings of causes for the Asian financial crisis for South Korea differ from the ones for the entire East Asian region.*

State of the Art

The classical approaches are divided into *generations* of economic crises models. The *first generation models* used balance of payment models to explain crises (Krugman, 1979; see also Flood and Garber, 1984). The *second generation models* introduced more sophisticated elements including multiple equilibria (Obstfeld, 1994). Nearing the East Asian financial crisis itself, *third-generation models* have become less defined but with a more diverse focus. Examples are studies looking at bandwagoning and herding (Chari and Kehoe, 1997), contagion effects (Eichengreen, Rose and Wyplosz, 1996), sudden stop models (Dornbusch, Werner, Calvo and Fischer, 1994), credit booms and investment booms (Claessens, Igan and Dell'ariccia, 2010), and other models that also became the focus of this thesis.

Finally more general reviews of the literature have been conducted on the East Asian financial crisis in order to review the existing hypotheses such as the study by Pablo Bustelo, review by Corbett and Vines, and the review by Griffith-Jones and Pfaffenzeller (Bustelo, 1998; see also Corbett and Vines, 1998; see also Griffith-Jones and Pfaffenzeller, 1998).

Methodology and Approach

The research was conducted in the form of a literature review with some elements of meta-analysis. By using a combination of several citation-metrics providers and digital libraries the experts responsible for analysis of the causes of the crisis were reviewed. The scope of the study has been narrowed to 1997 to 2007.

Research Papers in Economics (RePEc) was the main backbone of the research, providing the primary sources. The majority of the authors had to be present in this bibliographic system with good results. Exceptions were made for authors who were traced through citation analysis. For South Korea the requirements were lowered as it was harder to find similarly ranked sources. RePEc ranks experts based on a series of bibliographic indicators, including downloads, views and other factors.

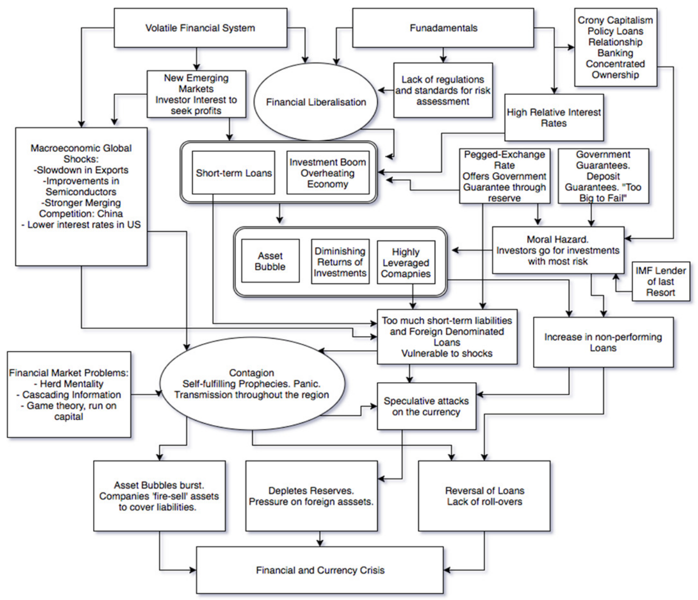
In order to supplement the research, additional bibliographic services such as Thompson Reuter's Web of Science, Google Scholar, CitEc: Citations in Economics were also used.

Eligible works by authors were reviewed and their main arguments summarised and evaluated. The results were further summarised in tables and sorted by each of the different citation metric indicators.

By using a qualitative approach it was possible to use these results to see the elements which were more commonly found amongst the higher ranked works and experts. It was also possible to group many of such elements into common positions regarding the causes of the crisis. A list of causes of the general crisis was compiled in addition to a separate one for the case of South Korea. The two lists were able to provide insight into the differences and similarities in regional versus country specific explanations.

Main Facts

This research has found that the best explanation of the major causes of the crisis is in the form of stacking vulnerabilities. These vulnerabilities have been ranked in importance. Having these vulnerabilities left the countries susceptible to shocks, which could cause the financial crisis.



According to the rankings the most important general cause has been the **(1) underdeveloped states of the affected countries' economies which have went through hasty financial liberalisation** while lacking prudence, experience and supervisory bodies (Wade and Veneroso 1998). There is an agreement that integration into financial markets has introduced a lot of financial pressure which countries were not ready for. The second most important cause has been the **(2) inherently volatile financial system prone to panic-based, self-fulfilling crisis** (e.g. Radelet and Sachs, 1998a). The third reason has been the **(3) macroeconomic mistakes** done by the governments more specifically the combination of high-domestic interest rates, pegged exchange rates, and inadequate reserves which overheated the economies. (e.g. Alba et. al, 1998) **(4) Highly leveraged balance sheets and overexposed banks were susceptible to cash distortions.** (e.g. Corsetti et. al., 1999) **(5) Moral Hazard and Crony Capitalism** have come fifth as they were highly contested topics with a lot of disagreement regarding their full extent and role. Finally **(6) Contagion** and **(7) Supply-side shocks** came at the bottom of the rankings as while they were very common in analysis conducted by the experts, they were not the main structural causes of the crisis itself.

Results

Finally, a similar ranking was compiled for the case of South Korea. The main difference was that **corporate sector vulnerabilities and inefficiencies** topped the ranking. (e.g. Alba et. al., 1998; see also Chang, Park and Yoo, 1998) Experts argued that the government arrangements and preferential loans have developed huge inefficient conglomerates known as *chaebols* which became dangerously leveraged and exposed to shocks and contagion.

Similar to the general causes, financial liberalisation and inherently volatile financial system were the next two causes in terms of importance. Finally, supply-side shocks and moral hazard were at the bottom of the list and were responsible for uncovering the other vulnerabilities. (Baliño and Ubide, 1997)

The conclusions call for more attention and scrutiny aimed at developing strong supervisory bodies, raising the standards of financial markets, especially in risk-assessment and avoiding dangerous macroeconomic policies. Inherent volatility of international markets makes developing countries especially susceptible to shocks, crises and contagion.

References

All references can be found in the full version of the MA thesis available at http://othes.univie.ac.at.

About the Author

Niyaz Abdulgaleev holds a B.A. degree in International Relations with minors in Media Communications and Business Management. This thesis is part of the Master program East Asian Economy and Society at the University of Vienna.

Contact information:

niyaz.ab12@gmail.com

Examination Date: 28 February 2017