

Whither the Crime in Financial Crises? The Thailand Crisis and the NASDAQ Market Collapse Compared

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Abstract

The dominant view of what caused the crises in Thailand and elsewhere holds that local corruption in the form of “crony capitalism” is among the prime culprits. This paper seeks to redirect focus away from the alleged crime of commission as a primary cause of recent crises toward the crime of omission in not interrogating more fully both the instability of finance capitalism and the resulting distributional consequences of that instability. A comparison with the recent American experience suggests crises are an enduring feature of capitalism and not the product of “corrupt” Southeast Asian business practices. This comparison suggests as well that redistribution of income over the course of such episodes may very well be quite regressive. Together this perspective suggests that when western interest groups, exercising their influence through the international financial community, advocate for what is in essence a redirection of entitlements, questions of conflict of interest—arguably lying at the heart of the problem with cronyism—must be redirected as well.

Introduction

Between 1980 and 2002, there were over 80 crises involving bank distress occurring in 64 countries around the world (Demirgüç-Kunt and Detragiache 2005); and these are but a subset of episodes marked by an extreme volatility in financial asset values. Yet, not all such episodes have received the same degree of attention from the international academic and policy communities. Of greatest concern have been the crises in Mexico (1994), Thailand (1997), Korea (1997), Indonesia (1997), Russia (1998) and Brazil (1998). These crises, more than others, have both exposed international lenders to considerable financial risk and are alleged to have impeded economic development in the respective countries.

In each case, the consensus opinion on the prime cause of these crises holds that exceptional circumstances lie at the root of the problems. Indeed, as Grabel (1998:38) critically notes in her assessment of the later crises, “An interesting feature of the *general* crisis of 1997-8 was the ubiquitous claim of *exceptionalism* that was again invoked to explain these events” [Italic original]. The dominant view of what caused these crises holds that local corruption in the form of connected lending or ‘crony capitalism’ is among the prime culprits. Cronyism is synonymous with corruption in this literature and figures prominently among the alleged causes of the crises in

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Thailand, Korea and Indonesia. Non-performing loans traced back to Thai business connections, the Korean chaebols and Suharto's family members are held out, in turn, as evidence of inadequate bank supervision and regulation.

This paper disputes neither the existence nor the extent of the connected lending in these pre-crises economies. It does, however, question the identification of these practices as the primary cause of the crises that followed. The view that cronyism is the prime culprit of recent crises is problematic on at least two counts.¹ One, it implies deceptively that by eliminating cronyism we would reduce the risk of a financial crisis. Two, by circumscribing the debate about causal influences to such "exceptional" practices, the labeling as 'criminal' of what is really public discretion in another form, it distracts attention away from systemic social injustices inherent in the experiences and thus distracts from the need to interrogate in much more detail the distributional consequences of what is a fundamental problem of unconstrained financial capital flowing in pursuit of an unbridled speculation—a problem that caused much greater devastation in the emerging and transition economies than it did when precisely the same phenomenon caused recent havoc in the American equity markets.

The NASDAQ collapse in 2000 is rarely considered a 'crisis' and appears, on the surface, to be a distinctly different event from the recent Southeast Asian experience. The NASDAQ collapse, it is argued, was only the bursting of a speculative bubble in equities. It did not cause widespread macroeconomic havoc, presumably because there was apparently no comparable corruption since western banks are subject to sufficient regulation and oversight. A comparative analysis suggests, however, that surface differences mask core similarities. From a broader evolutionary and institutional perspective, the Thai crisis shares many elements in common with the 2000 NASDAQ market collapse. Both occur in the wake of a structural transition, both are preceded by a substantial speculation that distorts the relationship between financial and underlying real wealth, both redistribute wealth in unintended and regressive ways, and neither stimulates much mainstream debate about how the adverse socio-economic consequences might better and more broadly inform the financial community's approach to market regulation and crisis resolution. Little attention is paid to the differential socio-economic effects of the preceding speculation and subsequent collapse, flying as they do under the radar of aggregated macroeconomic analyses.

This paper seeks to redirect focus away from the alleged crime of commission as a primary cause of recent crises toward the crime of omission in not interrogating more fully both the instability of finance capitalism and the resulting distributional consequences of that instability. It acknowledges that connected lending practices in Southeast Asia privileged a group of asset holders but argues that rearranging allegiances by imposing a western style rule of law will not eliminate the acquisitiveness that caused the crises; rather such western-dictated changes will simply redirect the entitlements to those who, by western norms, are more deserving. Evidence foreshadowing this redirection of entitlements appears in the manner in which the Thai crisis was resolved with domestic interests clearly subordinated to foreign lending interests in the assignment of resolution priority. The questions then are, with a western-style financial system imposed, would the emerging economy be any less prone to crisis? Are there issues of redistribution that might still concern us? The comparison with the recent American experience suggests crises are an enduring feature of capitalism, and not simply the product of 'corrupt' Southeast Asian business practices. And the need to interrogate the distributional consequences of all episodes of financial instability remains. Together this perspective suggests that when western interest groups, exercising their influence through the international financial community, advocate for what is in essence a redirection of entitlements, questions of conflict of interest—arguably lying at the heart of the problems of cronyism—must be redirected as well.

Traditional Perspectives on Crime and Financial Crises

Crony capitalism is usually thought of as “a system in which those close to the political authorities who make and enforce policies receive favors that have large economic value” (Haber 2002:xii). As the (then recently appointed) Deputy Managing Director of the International Monetary Fund described it

Usually, these favors are not outright transfers of wealth (such as forgiving taxes or providing subsidies) but rather take place through provision of economic entitlements. These entitlements can take a variety of forms, but the ones that are most visible in the Asian crisis and the ones under discussion here normally entail ownership of a business or its operation. Ownership may come about when cronies are favored as state-owned enterprises (SOEs) are privatized. More frequently, however, economic entitlements have arisen by enabling the cronies—or, more accurately, the establishments they operate, which I shall call crony operated establishments (COEs)—to receive privileged access to governmental favors that have economic value. (Krueger 2002: 2)

In this way, cronyism is linked directly to public corruption where public corruption has been defined as the “misuse of public office for private gain” (Svensson 2005: 20).

Crony capitalism is inferior to competitive capitalism because, as Haber (2002: xvi), argues, crony capitalism encourages an inefficient allocation of resources, privileges those who do not deserve the benefits and thus distributes income in unjust ways. Wei (2001: 16) captures the prevailing sentiment well: “Crony capitalism is a system in which connection trumps competence, and money supersedes merit”. The ideological biases start to creep in with the label ‘cronyism’ and take solid root when associated directly with ‘corruption’

It is easy to interpret the arrangement of entitlements normalized in this way in ideological terms. When government official uses his discretionary authority to ask a foreign investor to contribute to this or that fund before approving a license to invest, that is corruption. When the investor uses his discretionary authority to authorize investment to force a government to dismantle this or that regulation, that is not corruption. (Kennedy 2003: 25).

A consensus opinion, supported by some case study and micro level evidence suggests that “corruption *severely* retards development” (Svensson 2005: 39) [*Italic added*]. Most broadly, domestic crony capitalism is associated with higher external loan-to-Foreign Direct Investment (FDI) ratio. “Such a composition of capital flows has been identified as being associated with a higher incidence of a currency crisis” (Wei 2001: 15) and prevails allegedly because “corrupt countries” have difficulty attracting relatively stable FDI and are therefore more likely to rely on volatile international bank loans (Wei 2005: 17).

In superior contrast, competitive capitalism allegedly encourages efficient resource allocation, avoids monopoly rents by privileging no one group of asset holders and distributes income in ways that are consistent with entitlements. The belief that competitive capitalism is superior to crony capitalism rests on a number of assumptions that lack empirical support.

Myth 1: Competition otherwise defines international trade and investment

The causal attribution of the crisis to connected lending and the resulting advocacy for legal measures to discourage such behavior are consistent with the belief that competition will emerge as a preferred way of conducting business. Krueger (2002) estimates that the inefficiencies resulting from state monopolies can lead to as much as 2.5 percentage point lower growth rate

under what would have otherwise been obtainable under competitive market conditions. Yet, as Kennedy (2003: 24-25) reminds us

rather few economic transactions are best understood as arms length bargains. It turns out, for example, that the lion's share of international trade is conducted through barter, internal administratively priced transactions, or relational contracts between repeat players. The line between tolerable and intolerable differences in bargaining power—between consent and duress—is famously a site for political contestation.

Myth 2: Connected lending practices are socially and economically inferior to competitive arms length bargaining.

Haber (2002: xvi) notes that the dependence on personal connections of asset holders and government officials are credible so long as the particular officials are in power. Such dependence necessarily implies, he argues, that agents will operate with short-time horizons which in turn “cause cronies to demand higher rates of return for even projects that have short maturities. It may, in fact, completely discourage long-term investing” (2002: xvi). This problem of short time horizons is relative and the question of discouraging longer-term investing is even more critical when examining competitive, highly liquid financial markets.

As I have argued elsewhere (Spotton Visano 2004), increased access to international capital markets encouraged by earlier liberalization initiatives, increased access to financing and yielded capital inflows equal to as much as 10 percent of GDP. But the dramatic increase in the inflow of foreign capital was into debt instruments of shorter maturities, denominated in hard currencies. International borrowing at the shorter end of the maturity spectrum increased significantly the risk exposure of the domestic economy to external shocks such as fluctuations in foreign interest rates, exchange rate changes, and shifts in investor sentiment. The liberalization initiatives did attract foreign funds, but most of it as large private inflows of ‘hot money’ seeking quick speculative gains. For the individual investor, the liquid nature of the short-term funds reduced total risk; but what was true for the individual could not hold true for the collective, as these crises proved yet again (also see Corsetti, Pesenti, and Roubini 1999).

The ease with which financial asset ownership may be transferred compounds the loss of control created by a partitioning of asset ownership with a relinquishment of ownership control. Liquidity, as the means to sell quickly an asset at close to current market price, shifts the temporal horizon of the owners of capital to a much shorter term. Although the enterprise is itself a longer-term venture, there are, in a system of financial capitalism, fewer longer-term individual stakeholders in its success. Asset holders dissatisfied with the operation and direction of the firm or market are less likely to exert pressure to change and more likely to abandon the enterprise altogether by dumping their holdings. The telescoping of investor horizons places a greater emphasis on current profits and current capital gains than would otherwise be placed. The result is a greater impatience and shiftability of capital of the type stressed by John Maynard Keynes (1973 [1936]).

Contrariwise, many elements of “cronyism” are identical to the relationship banking practices that define the universal banking systems of Japan and Germany. Relationship banking has long been recognized for its benefits in mitigating the asymmetric information and moral hazard problems that affect credit institutions (for example see Hoshi, Kashyap, and Scharfstein 1991). Rather than shorten the investing horizon, personal relationships between lenders and borrowers may very well offer *better* information, provide *more* opportunities and *longer*-time horizons for side-payments and reciprocity, reduce monitoring costs, and make enforcement easier, (see Kang 2003).

Myth 3: Cronyism distorts prices

The notion that corruption distorts prices and is thus inefficient suggests corruption imposes transactions costs that do not properly (in the sense defined by allocative efficiency) reflect opportunity costs of the transaction itself. Prices in a corrupt regime are then allegedly higher than they would otherwise be by virtue of a concentration of power in the hands of government officials. There is, however, no *a priori* basis on which to base such a conclusion. The argument assumes that differentiating between 'normal' and 'distorted' prices is a matter of observable, uncontested fact. But as Kennedy (2003: 24) asks, "when is the state supporting a transaction by formalising it and when is the state burdening the transaction by adding unnecessary steps or costs?" "And, just as sometimes what look like market distorting interventions can also be seen to compensate for one or another market failure, so what looks like corrupt local preferences can turn out to be efficient forms of price discrimination" (Kennedy 2003: 25). The evidence is sparse, ambiguous and altogether incapable of supporting the allegation.

Myth 4: Rents are unproductive incomes

If, however, prices are in fact distorted then those receiving the income from such transactions are receiving monopoly rents extracted by virtue of their power to dispense preferential treatments. Are these monopoly rents any less productive than those that will be extracted by foreign financial and business interests? As Kennedy (2003: 24) asks, are these public figures "more or less likely to place their gains unproductively in foreign bank accounts than foreign investors?" Kennedy (2003: 25) continues on to note

Corruption becomes a code word for 'rent-seeking'—for using power to extract a higher price than that which would be possible in an arms length or freely competitive bargain—and for practices which privilege locals. At this point, the anti-corruption campaign gets all mixed up with a broader programme of privatisation, deregulation, and free trade...and with background assumptions about the distortive nature of costs exacted by public as opposed to private actors. ...there is no *a priori* reason for identifying public impositions on the transaction as distortions—costs of the transaction—and private impositions as costs of the good or service acquired. But the effort to treat corruption reduction as a development strategy substitutes a vague sense of the technical necessity and moral imperative for a "normal" arrangement of entitlements.

The view that connected lending practices are 'corrupt,' which in turn causes crises, and that the crises impeded economic development together implies that by imposing the rule of law as a development strategy designed to eliminate corruption, crises would be avoided and economic development would be encouraged. Proponents of this view are relying heavily on the rule of law to solve economic development problems most generally and to prevent crises more specifically. If cronyism is not the root cause of crises, however, measures designed to prevent it will fail to deliver the desired stability.

In the remaining sections, I review and compare key features of the Thai and NASDAQ episodes and illustrate how at a higher level of abstraction these two episodes share many elements in common with the cause of crises in finance capitalist systems and in this way challenge the exceptional explanation of the Southeast Asian crises. This alternative view of the cause of crises suggests that not only is it doubtful that cronyism is the root cause of the Southeast Asian disaster but that in the absence of such behavior it is even more doubtful that the crises would have been averted.

The Financial Crisis in Thailand²

From the mid-1980s onward, the rapid industrialisation and commercialisation of the Thai economy propelled Thailand forward in manner unmatched by that of the European, Japanese, or American economies at the time. In 1990-1993, Thailand undertook a host of financial reforms designed to encourage foreign lending and portfolio investment. Thai authorities removed restrictions on currency convertibility, created an offshore banking facility, and removed stock market rules prohibiting foreign purchases of Thai equity. Japanese and Western financial firms attracted to the relatively high rates of returns in Thailand, and repelled by relatively low rates of return at home, 'generated a faddish enthusiasm' for Thailand as an 'emerging market' and 'Asian miracle.' With the Thai currency pegged to the U.S. dollar and, more often, loans negotiated in foreign currencies, the currency risk of such investment was minimal. The surge in financial inflows headed principally for the banks and arrived in the form of short-term bank loans.

The economy quickly overheated with foreign debt reaching dangerous heights. Capital inflows fed inflation, the Thai baht became overvalued, Thai products lost their international competitiveness, and Thailand's balance of payments deficit increased to nearly half of its gross domestic product. Over-investment in domestic infrastructure, heavy upstream industries and real estate generated overcapacity and falling returns. By 1995, returns on real estate were falling and the debt default of the property firms threatened the solvency of the finance industry. International speculation turned from lending on Thai development projects to undercutting the currency (Phongpaichit and Baker 2000: 2-3). Unable to defend the attack, the baht was floated on 2 July 1997. In less than twelve months, the currency had lost half its value, wiping out Thai financial equity denominated in foreign currency. Net private capital outflows were equivalent to nearly one-fifth of Thailand's GDP, credit contracted, liquidity evaporated, production dropped, unemployment rose and economic conditions deteriorated unabated for eighteen months.

Prior to the mid-1980s, a cartel of four to five major banks dominated Thailand's major sectors. As centres of 'sprawling business conglomerates,' the banks dominated first agri-business, then import-substituting consumer industries and basic process industries, and finally urban services. In addition to Japanese foreign direct investment, these banks supplied the bulk of funds to support capital formation. Close links between the business leaders and the politicians ensured the protection of the bank cartel until the 1980s energy crisis forced Thailand to adopt the World Bank's export-oriented development strategy in exchange for temporary financial assistance. With this external intervention came a 'transfer of power over economic policy making into the hands of technocrats' and, in the 1990s, a push to liberalize the financial system. In 1990, restrictions on convertibility were removed; in 1993, an offshore banking facility was established to enable foreign lenders to lend in the Thai market. In the same period, stock market rules changed to attract foreign investors, and encouraging Thailand's direct access to foreign funds diminished the bank cartel's influence. Capital inflows surged. While portfolio investments increased, the vast majority of the new funds arrived in the form of loans. Private-sector foreign debt increased tenfold. By 1996, Thailand's foreign debt was equal to approximately 70 percent of the Thai GDP, with over 60 percent of the total held in the private sector.

Over this period, investment in agriculture declined, rural population migrated to the urban centres, and the export mix shifted from cheap labour industries, such as textiles, to technology-based industries including computer parts, auto parts, and electrical goods. Multi-national companies controlled the technology and focused on development for export, while domestic conglomerates focused on property development, services (finance, retail, and media), and infrastructure (roads, telecommunications, and power generation). From 1993 onwards, foreign loans financed the domestic expansion, particularly in property development and telecommunications.

With a pegged currency and a newly liberalized capital account, the government soon lost control of the macro-economy. To prevent overheating, the monetary authorities raised interest

rates with every intention of restricting liquidity and slowing the rapid growth. In the era of free flowing 'hot money,' however, the higher rates served only to attract more financial inflows in form of short-term, liquid loans denominated in foreign currencies—at the peak, more than 60 percent of the foreign loans held a maturity of less than one year. The percent of short-term foreign debt to foreign exchange reserves was well over 100 for the two years prior to the crisis in Thailand (see Ghosh 2001: 82).

The substantial drop in the external value of the Thai currency combined with the distress that had spread to all sectors of the economy created a fire-sale opportunity. Foreign direct investment again rose to dominate capital inflows through 1998 and 1999, but this time it was not for new investment but to acquire cheap assets. At the beginning of 1997, Thailand had fifteen commercial banks and ninety-two finance companies; three years later, twenty-three finance companies remained in operation and all but the largest five banks had been closed, whose assets were transferred to the government's Krung Thai Bank or sold to foreign financial interests.

The crisis hit every sector of the Thai economy, and from the summer of 1997 through to the fourth quarter of 1998, real GDP fell 12 percentage points from its peak in 1996. The non-agricultural sectors were hit hardest; the construction industry did not begin to recover until the third quarter of 1999, and the finance industry was still contracting by the end of that same year. All indicators of employment problems showed a marked deterioration. Unemployment rose from 2.2 percent in 1997 to 5.2 percent in 1999, real average monthly wage rates fell 4.6 percent and average number of days seeking employment increased 22-50 percent in the same period, (Paitoonpong 2001: 7). The number of people living below the poverty line increased by 8.3 percent by one measure and 16 percent by another (Paitoonpong 2001:9). While all suffered—with the incomes of a large number of people dropping below the poverty line—hardest hit were those at the top and bottom of the income scale, the poorly educated, and those in the rural northeast (the major source of city migrants) (Phongpaichit and Baker 2000: 95; see also Paitoonpong 2001). Studies of changes in *national* income distribution suggest an improvement since the crises generated the greatest losses for those at the top of the income scale; but to date the international transfers of income remain unmapped and so the question did the crises redistribute income from poorer eastern nations to richer western nations goes unanswered.

The strategy adopted to manage the crisis specifically and intentionally sacrificed domestic economic stabilization in favour of international financial concerns. John McHale (1999) reports on the deliberations of Thailand experts, IMF officials, and academic researchers at a conference held under the auspices of the high-profile National Bureau for Economic Research

The crisis management strategy was dictated by the belief that exchange rate stabilization should be the primary objective. It was also believed that in an economy as open as the Thai economy, stabilization and the stimulation of real activity were not compatible in the midst of a crisis of confidence. *This meant that a liquidity squeeze and a contraction of real activity were unavoidable until the exchange rate stabilized.* As the exchange rate stabilized in early 1998, a more expansionary policy stance began to be pursued. The move to economic stimulation was also aided by the good inflation performance and rapid turnaround in the current account, combined with the (not unrelated) greater than expected drop in real GDP growth. [Italic added]

In addressing the question of whether or not a larger assistance package would have stabilized the economy sooner, the ensuing discussion (McHale 1999) clearly indicates the manner in which domestic concerns were further subordinated to foreign financial interests

[A larger package] might also have bought more time to fix the financial sector. He also stressed that when talking about bailouts it is important to distinguish the domestic and foreign investors. *He argued that the foreign creditors got bailed out anyway. A larger*

package of reserves might have allowed more time to fix—but not necessarily bail out—the domestic institutions. [Italic added]

Not only were Thai interests subordinated in all key respects to international financial interests in the immediate resolution of the crisis, the conditions then imposed saw to it that this subordination would become structurally entrenched. The foreign take-over in other industries, notably export, retail, and telecommunications industries, saw Thai ownership lost to Japanese, American, and continental European business interests. Financial liberalisation destroyed the Asian form of entrepreneurial banking with potentially serious consequences for future national development. As Phongpaichit and Baker (2000: 228-9) argue

The international banks are likely to favour international firms because the systems and relationships are already in place. They will concentrate on consumer banking and risk management, where they have clear advantages through technology and experience. They are much less likely to take over the Thai banks' old role of funding ambitious entrepreneurship on the basis of personal relationships and personal market knowledge.

The NASDAQ Market Collapse

In the 1980s, technological advance was radically altering the manner in which people communicated and managed information. By the early 1990s, the personal computer was fast becoming required equipment for businesses and, later on, for households. By 1997, the Internet—as a means of accessing a large and ever-increasing amount of information—was familiar to many. From 1995 through to 1999, American real gross domestic product rose at a rate of 4 percent annually, driven by a total fourfold increase in business investment in computers and related equipment. Companies at the heart of the advance as listed on the NASDAQ saw the index of their stock prices climb from a low of 600 in 1996 to a peak of more than 5000 in March of 2000. Nine months later, the index had dropped to under 2300, wiping out nearly \$5 trillion of paper wealth before sinking to a low of 800 in the late summer of 2002. By comparison, the Wilshire 5000 Price Index—the broadest index of American share prices—declined by 26 percent over the same period.

The NASDAQ market crash devastated the 'new economy' sector, venture capital dried up, banks experienced a sharp rise in loan losses, and the rate of business investment declined, turning negative a year later. GDP growth dropped from an inflation-adjusted rate of 3.7 percent in the first half of 2000 to 0.9 percent in the second half. Employment slumped with a severe and sustained decline occurring in manufacturing. The economy entered a brief but severe recession in March of 2001 that ended 9 months later, leaving the real GDP growth at a mere 0.3 percent for that year.

Speculation in the clusters of advances that mark the revolution in information and communications was itself affected by the innovations. The innovations that defined the focus of the speculation and the advances altered the manner in which people speculated. Trading directly in the stocks of Internet, computer hardware, and software companies was itself mediated by the computer. The enhanced processing of data and the greater ease of access to that data fuelled an enthusiasm that propelled the NASDAQ index upwards, gathering an ever-greater number of investors. At its peak, it is estimated that nearly 50 percent of Americans were participating in the stock market, up 10 percentage points from just three years earlier (see Hong, Kubik, and Stein 2004).

While the collapse of the 'dot-com bubble' resulted in a slowdown in the economy, the slowdown was short-lived and nowhere near as devastating as the Thai experience. In its effort to counter the contractionary effects of the crash, the American central bank cut short-term interest rates by almost five percentage points in 2001. The action successfully offset the balance sheet effects of loan losses on the banks' portfolios and "spurred a rapid increase in core deposits, which

provided banks with plentiful, low-interest rate funding” (Bassett and Carlson 2002: 259). The Fed-driven combination of lower interest rates and additional liquidity ensured that despite the economic slowdown, the U.S. commercial banking industry remained solvent and profits remained high in 2001. This action combined with a smaller portion of the commercial economy relying on the banking system for credit helped to contain the depressing effects of the crash largely to the industries related to the initial advance.

In the absence of widespread economic devastation of the type experienced in Thailand and elsewhere, the combined issues of price distortion and adverse income redistribution appear less severe. The significant jump in participation combined with recent evidence of the skewed distribution of stock performance suggests, however, that the income redistribution inherent in the run-up and subsequent collapse of the NASDAQ market was regressive and prices were, at least by *ex post* criteria, distorted. Recent research by Barber, Odean, and Zhu (2004, 2005) suggests that herding by individual investors distorted equity prices from that which would have prevailed if institutional investors alone had dominated trading and that stocks “heavily bought by individuals subsequently underperform stocks heavily sold by 4.4 percentage point annually.” This result supports previous evidence that individual investors lose money by trading in markets with large institutional investors.

Comparisons

The US NASDAQ market collapse, which occurred in a developed equity market, did not result in wide scale bank failures and so had (fortunately) only minimal drag on the macroeconomy; it appears on the surface completely different from the earlier Thai disaster. Appearances are, however, deceiving. Significant innovation spurring large-scale restructuring, an enthusiastic speculation in the assets related to the source of the restructuring, and emerging imbalances between the real and financial sectors that ended in a sharp, unexpected reversal of fortune characterized both episodes. Moreover, both crises may well have involved significant regressive income redistribution that to date remains largely unmapped.

In the late twentieth century, the American economy was in the midst of a transition to what some have called the information age. An increasing number of businesses in all industries were becoming dependent on the computer as a means of storing, processing, and delivering information. By the end of the century, personal computers, together with the Internet, were fast becoming a household necessity. The technology was altering (and continues to alter) all manner of economic and social interaction. Speculation in NASDAQ-listed stocks was speculation focused on the assets directly related to these advances.

Similarly, transitional restructuring marked the 1990s Asian ‘miracle’ economies, only here it appeared in the conversion from a centralized political structure, with industrial development and financing directed by the nation-state, to an increasingly diffuse market-oriented system. Innovation as it affected these societies appeared less in the form of internally induced technological change leading to industrial development and more in the form of economic and political restructuring. An outward looking development policy focused not on importing cheap raw materials but rather on attracting relatively cheap funds for internal development and adoption of foreign technologies. The need for foreign exchange to service the foreign debt drove the search for external markets in which to sell final goods and services produced.

The degree of uncertainty about the eventual material outcomes of each transition was profound. When the outcome of an innovation is unknown and unknowable, collective influence in defining the anticipations of advance intrudes. Shared opinion of the potential for advance influences the degree of actual speculation and thus the extent to which funds are available to finance the innovation. If the extent to which the promise of an innovation may be realized is dependent on the available funding, the increased funding will ensure initial advance and further

feed the speculative enthusiasm. Without any objective future information on which to base anticipations of speculative advance, speculators can only have extrapolated from recent past events, reinforced by the observation that others were of the same mind and shared the same opinions. Observing that others share the same optimistic opinion reinforces the speculator, further encouraging the speculative optimism and resulting activity. In a roundabout manner, then, uncertainty with respect to the innovation's future material outcome opens the door to collective influence through the individual's reliance on the shared opinion of others. Where the speculative activity itself materially affects the innovation's potential, the material outcome becomes dependent on the collective assessment of the potential outcome.

In this environment, interpretations of what is economically justified and what is 'excessive' become extremely vague, disputable and disputed. The American debate between Congress and then Federal Reserve Board Chairman Alan Greenspan over the combined question of financial imbalances and the Fed's obligation to address them are now legendary (see Greenspan 1996; Hayford and Malliaris 2005). In the wake of the NASDAQ collapse, it is now widely acceptable to describe the preceding run-up of stock prices as a 'bubble.' Such consensus was, however, conspicuously absent prior to March of 2000.

Speculative bubbles occur when "competitive bidding, motivated by repetitive and self-fulfilling expectations of capital gains, drives up asset prices in excess of any reasonable value for the asset" (Spotton and O'Hara 1999:1079-1080). Upon bursting, distress selling replaces the bidding excesses such that "price fluctuations are greater than they would have been in the absence of a speculative bubble, and such bubbles are evidence of destabilizing speculation" (Spotton and O'Hara 1999: 1080).

Before the collapse, the nature of the innovations and the widespread restructuring that resulted made it unclear whether there was in fact a bubble. Could not, instead, the run up in asset prices be reflecting "a profound and fundamental alteration in the way our economy works that creates discontinuity from the past and promises a significantly higher path of growth than we have experienced in recent decades" (Greenspan 1998)? Only in hindsight, once states of confidence and investment potential are fixed are we able to look back and clearly identify excesses.

Similarly, only in retrospect were the critical vulnerabilities of the Thai banking system apparent. As late as the summer of 1997, multilateral institutions and international investors were equally bullish on Southeast Asian prospects despite the fact that banks were borrowing in foreign currency denominated, short-term debt, but lending in domestic currency for long-term, illiquid infrastructure projects (see Allen *et al.* 2002). Indeed, had the currency not fallen as much as it did, had interest rates risen by less, the banking sector would not have been weakened so.

Finally, while income in Thailand appeared to become more equally distributed in the wake of the crisis, the embedded transfer of wealth from national to foreign interests remains unmapped and ill defined but potentially significant. To date, we have little more than ideologically based arguments that allegedly confirm the rightfulness of that transfer. Where the stock market wins and losses of the type generated with the NASDAQ run-up and subsequent collapse is, some would argue, a zero-sum game taken together, it is the potential for a significantly regressive redistribution of that income that to date escapes critical inquiry.

Conclusion

As I describe elsewhere (Spotton Visano 2006), the essence of capitalism as an economic process lies in its continual adaptation to innovation and its perpetual reconfiguring of the matrix of the inputs of land, labour, and physical capital and the outputs in the production of services and material goods. Driven by the socially constructed need to accumulate wealth, innovation and its associated investment become the engines of economic growth.

Finance capitalism is a form and dimension of capitalism characterized by the impersonal transfer of contracts, evidencing claims to wealth and defining the particular means by which the individual speculates on that growth. The formal financial institutions that characterize finance capitalism are those institutions that provide the means of transferring wealth and purchasing power from suppliers to users of funds. Formal financial institutions include the contractual claims on wealth, the markets in which to trade these claims, and the legal entities, such as banks, whose primary business is defined—in both function and by a portfolio of assets—by the process of creating and transferring credit.

These institutions of finance capitalism, by offering the speculator a means of lowering the perceived risk of loss from investment and speculation, encourage, in turn, innovations in non-financial capital. In the partitioning of an asset's value in the manner afforded by joint stocks, for example, funding innovation becomes easier. With only part ownership of an innovative asset, the required financial commitment of the individual speculator is lower. Where the claims to part ownership are tradable, the ability to extract that commitment becomes potentially easier. By creating an easier means by which to speculate in the tangible innovations, financial institutions have encouraged the speculative supply of funds available to support non-financial innovation and have thus promoted investment in the non-financial innovation itself. Increased accessibility, together with increased liquidity, may not only increase efficiency by ensuring that for a given exchange fewer resources are expended to transact it, but may also encourage even greater savings, investment, and accumulation and thus an even greater expansion of the capitalist system. The institutions of finance capitalism can therefore be growth inducing.

If this indeed best describes a pre-crisis Thai economy that might have prevailed in the absence of cronyism, then conclusions about corruption and the resulting retardation of development might well be justified. Arguably, however, this was not the case. Thailand was undergoing a massive economic restructuring in the transition to a more market-oriented economy with a wider industrial base. Comparable to the American restructuring spurred on by innovations in the information and communications technologies, the material outcomes and economic potential were unknown and unknowable, consequently dependent on collective opinion, and thus indeterminate. In such a circumstance, speculation proceeds solely based on extrapolated expectations, which we know to be destabilizing (see Frankel 1996).

Although the institutions of finance capitalism exist generally to reduce uncertainty and do so insofar as they structure in predictable manner the means by which the system creates and transfers credit, these same institutions will at times encourage the unbridled, self-reinforcing, and ultimately destabilizing speculation in revolutionary innovations. The speculation will ultimately distort prices (in the sense captured by the common notion of a speculative bubble) by driving a wedge between financial and real wealth. When supported by credit flowing through the banking system, as was the case in Thailand, the subsequent collapse can be devastating. The problem however for policy makers seeking to intervene is that *ex ante* we have no way of knowing even vaguely that point in the prior enthusiasm when the speculation becomes unsustainable. The interdependency of speculation and outcomes means that any combination of speculation and outcomes could be sustainable under different states of confidence. Not until after the destabilizing speculative enthusiasm has subsided are we able to look back and identify that point in time when financial asset prices outpaced underlying real values and thus identify when the supporting debt became unsustainable.

Endogenously, therefore, speculation via financial claims on underlying real wealth creates its own fragility in a manner akin to the instability discussed by Minsky (1982). This endogenous fragility implies that an economy in the early stages of a speculation may be able to withstand a shock of a given magnitude, but that same shock could eventually fracture the system. The crisis is then not in terms of "excess" speculation. Neither is it necessarily or strictly in terms 'excess' lending. Instead, the crisis is simply—but importantly—the inability of the capitalist system to withstand periodically economic shocks. The speculative inclinations of investors and the ability

of the financial system to accommodate and support the speculation with credit creation are both common features of capitalism. Crises, then, are the outcome of precisely the same behaviour that capitalism rewards and encourages and by which we define the culture of capitalism. The Thai crisis differed from the NASDAQ experience by only a matter of degree.

To date, efforts to minimize, if not prevent, crises of the type occurring in Thailand have focused on strengthening bank regulation and oversight, by which is meant imposing western-style portfolio regulation. The belief is that such laws will prevent the cronyism that allegedly caused the 1997 crisis. This paper has argued that not only is it questionable that cronyism caused the crisis but suggests that eliminating it will not avert further such episodes. With comparative reference to the recent American experience, core similarities provide evidence of the fact that periodic crises are an inherent element of finance capitalism. While the form and degree of crises differ from episode to episode, key elements of a fundamental instability prevail in finance capitalist systems. The facile reference to law as a panacea overlooks the fundamental properties of capitalism and the ontological foundations of law which are both imbricated and implicated therein.

Crises and their resolution appear to entail significant adverse redistributions of income but these effects remain as yet incompletely mapped and here we have a crime of omission. With very few exceptions, consideration of the systemic injustices inherent in the crises and the speculation that precedes them, have been absent. In default of any imminent wholesale replacement of the prevailing socio-economic structures, the onus is on analysts to critically examine the evolving income redistribution over the course of such episodes. Critically examining who wins and who loses—as shaped by both the crisis and range of possible crisis management strategies, explicitly informed by notions of distributive justice, in full view of all potential conflicts of interest—is among the most pressing of challenges still facing us.

Endnotes

¹ A third concern, but one that lies beyond the scope of this paper, is the fact that identifying connected lending with corruption demonizes key persons and practices and in so doing simplifies detrimentally the complex phenomenon of institutional transition. Elsewhere I (Spotton Visano 2006) have argued that kinship networks in non-market economies are functionally similar and comparably effective to the business networks in market-based systems. As economies shift from the informal to the more formal market based system, we see trust and loyalty embedded in kinship ties replaced by exchanges between unknown principals. In Thailand, the rapid externally stimulated economic transition was not matched by a comparable transition in internal customs. Juxtaposed against the alleged objectivity of foreign financial transactions, the kinship ties defining the informal Thai networks appeared subjective and corrupt.

² The summaries of Thai and NASDAQ experience draw heavily on those offered in Spotton Visano (2006).

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