

Accordingly, excessive investment is considered to be the basic cause of the financial crisis in East Asia, with speculator activities being nothing but a fuse. The most important factor is that if the internal excess investment had not been financed with external excess savings, it would not have been possible for these countries to make so much unnecessary investment in real estate and stock markets and to create such a serious financial crisis. On the other hand, if their financial sectors had been sound, the financial crisis would have been diluted to some extent, even if the financial crisis could not have been completely avoided.

As for the contagion of the financial crisis, when it broke out in Thailand, it immediately and quickly swept across Northeastern Asia and all the ASEAN countries. Theoretically, capital and trade flows should have been the channels of contagion; but actually, psychological factors played the most important part in this respect, since the pessimistic psychology caused by the financial crisis occurring in Thailand was reflected in foreign exchange and stock markets creating rapid currency depreciations and dramatic falls in stock prices.

To sum up, it may be reasonable to argue that the outbreak of the financial crisis in many East Asian countries can be considered a marriage of internal excess investment and external excess savings.

8. THE ROLE OF THE GOVERNMENT

When a financial crisis occurs in the exchange market and stock market, what kind of reaction and attitude should be expected from the government? This issue has caused many debates. One school argues that the government should leave the market alone, and allow the “invisible hand” to automatically adjust the markets accordingly, in other words, government intervention is unnecessary. The alternative argument is that the government should intervene in the markets because they were only destroyed as a result of international speculation and they had subsequently failed to adjust themselves.

An infamous case took place in August 1998, when international speculators made use of enormous amounts of capital to penetrate the Hong Kong stock market. First of all, the speculators bought successively large

amounts of stock, pushing up the stock prices until they reached a high level, whereupon they withdrew their capital from the market, offloading all the stocks they held, so that the stock prices dropped sharply. This illustrates the case earlier described, that where the stock market is not sufficiently large, it is easily attacked and destroyed by powerful speculators. And once the market has collapsed, no small investors are able to survive. In order to maintain a free market, in which no one single buyer or seller can dominate prices, it is necessary to have international laws or regulations, which to a large extent are able to eliminate the influence of these speculative activities.

Foreign exchange systems are also an important factor in speculative activities. If a country adopts a fixed exchange rate system, it is very easy for international speculators to take advantage of the system to make huge gains without any foreign exchange loss. If the country were to adopt a floating exchange rate system, the speculators must then run the risk of currency depreciation.⁷

9. THE FUNCTION OF THE IMF

Following its establishment, many developing countries have benefited greatly from the implementation of programs offered by the IMF. As the financial crisis has affected so many East Asian economies, the IMF has played the role of firefighter. However, these countries including Indonesia, Thailand and Korea, which have each received the support of the IMF, must meet some specific requirements: the receiver should agree to a program of restructuring, which includes macroeconomic, structural adjustment and social policies. The macroeconomic policy includes suggestions on economic policies including contraction of monetary and fiscal policies, and liberalization policy, all of which have been criticized by western economists

⁷ Before the financial crisis, most Southeast Asian countries had adopted fixed foreign exchange rate systems, which had provided speculators with an opportunity to take advantage of the system to make speculative gains. Since then, they have all adopted managed floating foreign exchange rate systems.