CHAPTER 1

AN OVERVIEW OF THE FINANCIAL CRISIS IN EAST ASIA

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1. INTRODUCTION

Some two years after the financial crisis first broke out in Thailand, all of the East Asian countries, with the exception of Indonesia, have managed to stage a recovery and are now demonstrating gradual growth. This seems, therefore, an appropriate time to take a retrospective look at the financial crisis and to undertake a comprehensive analysis of the underlying causes and impacts, upon financial systems in particular, and on the economic climate in general. Throughout the past two years, there have been many books, and many thousands of articles, dealing with the crisis from various points of view, but none of these has made any attempt at providing a systematic and satisfactory explanation covering the entire period from

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economic downturn to recovery. This is a situation that requires rectifying since, naturally, in all of the countries affected by the financial crisis in East Asia, for both governments and citizens alike, this is not only a true story that we have experienced, but also an invaluable lesson for us to bear in mind for the future.

In the introductory chapter of this volume, first of all, we examine the importance of the issue of the East Asian financial crisis from an historical perspective. From the very first signs of the financial crisis, there have been many arguments regarding the causes; we go on to review the various explanations provided, presenting a model used to explore the root causes of the crisis. We also talk about the role of the government in facing the challenge of the financial crisis and the function of the IMF's rescue program. Since many signs indicate that East Asia is gradually recovering from crisis, we would like to explore its reasons. Finally, we explain the purpose and the structure of this volume.

2. THE IMPORTANCE OF THE ISSUE: THE FINANCIAL CRISIS IN EAST ASIA

During the twentieth century, there have been two major financial crises that have struck on an international scale. The first of these occurred during the period 1929–30, mainly affecting the developed nations on both sides of the North Atlantic, while the second crisis, which struck in 1997 and persisted until 1999, was experienced mainly by the newly emerging economies in East Asia. The important lesson learned from the first financial crisis was the need to construct much more sound financial systems within these developed countries and recognition of the requirement for separation of the business of banks, from dealings in stocks and insurance. The banking system was considered a key financial institution, which, above all, must maintain its independence and soundness so as to protect depositors. It was therefore imperative that the banking system was in a position to be able to avoid the impact of the inherent risks involved in stock market and insurance transactions. The by-product of the 'great depression', which resulted from