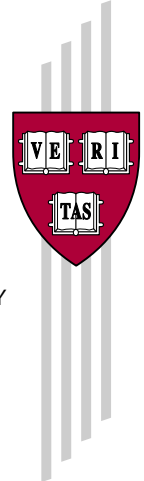


UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT



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G-24 Discussion Paper Series

Reform of the International Financial System and Institutions in Light of the Asian Financial Crisis

Yung Chul Park and Yunjong Wang

No. 12, July 2001

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**Research papers for the Intergovernmental Group of Twenty-Four
on International Monetary Affairs**



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PREFACE

The *G-24 Discussion Paper Series* is a collection of research papers prepared under the UNCTAD Project of Technical Support to the Intergovernmental Group of Twenty-Four on International Monetary Affairs (G-24). The G-24 was established in 1971 with a view to increasing the analytical capacity and the negotiating strength of the developing countries in discussions and negotiations in the international financial institutions. The G-24 is the only formal developing-country grouping within the IMF and the World Bank. Its meetings are open to all developing countries.

The G-24 Project, which is administered by UNCTAD's Macroeconomic and Development Policies Branch, aims at enhancing the understanding of policy makers in developing countries of the complex issues in the international monetary and financial system, and at raising awareness outside developing countries of the need to introduce a development dimension into the discussion of international financial and institutional reform.

The research carried out under the project is coordinated by Professor Dani Rodrik, John F. Kennedy School of Government, Harvard University. The research papers are discussed among experts and policy makers at the meetings of the G-24 Technical Group, and provide inputs to the meetings of the G-24 Ministers and Deputies in their preparations for negotiations and discussions in the framework of the IMF's International Monetary and Financial Committee (formerly Interim Committee) and the Joint IMF/IBRD Development Committee, as well as in other forums. Previously, the research papers for the G-24 were published by UNCTAD in the collection *International Monetary and Financial Issues for the 1990s*. Between 1992 and 1999 more than 80 papers were published in 11 volumes of this collection, covering a wide range of monetary and financial issues of major interest to developing countries. Since the beginning of 2000 the studies are published jointly by UNCTAD and the Center for International Development at Harvard University in the *G-24 Discussion Paper Series*.

The Project of Technical Support to the G-24 receives generous financial support from the International Development Research Centre of Canada and the Governments of Denmark and the Netherlands, as well as contributions from the countries participating in the meetings of the G-24.

**REFORM OF THE INTERNATIONAL FINANCIAL
SYSTEM AND INSTITUTIONS IN LIGHT OF THE
ASIAN FINANCIAL CRISIS**

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Abstract

When East Asian countries came under speculative attacks in 1997, some of them were not able to defend themselves, and subsequently had to seek the financial assistance of IMF and accept its stabilization programmes. These crisis-hit countries were criticized for not having restructured their financial, corporate, and public sectors along the lines suggested by the Washington consensus. This failure was singled out as the main cause of the crisis and, understandably, these crisis-hit countries were subject to heavy doses of structural reforms. The East Asian crisis became contagious, even threatening the stability of major international financial centres. The severity and contagiousness of the East Asian crisis underscored the importance of, and renewed interest in, reforming the international financial system. Numerous proposals have been put forward. The G-7-led reform, however, has concentrated its efforts on reforming the financial and corporate sectors of developing economies, while by and large ignoring the problems of the supply side of international finance.

As was the case in the Mexican crisis of 1994/95, the appetite for radical reform of the international financial system has receded considerably in the wake of global recovery. The ongoing debate on the future direction of the international financial reform in fact suggests that most of the problems that beset the international financial system are likely to remain unchanged. This pessimistic outlook arouses deep concern in developing countries lest they remain vulnerable to future financial crises, even if they faithfully carry out the kinds of reform recommended by IMF and the World Bank. Given this reality, developing countries may have to develop a defence mechanism of their own by instituting a system of capital control and adopting an exchange rate system that lies somewhere between the two corner solutions.

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REFORM OF THE INTERNATIONAL FINANCIAL SYSTEM AND INSTITUTIONS IN LIGHT OF THE ASIAN FINANCIAL CRISIS*

Yung Chul Park and Yunjong Wang

I. Introduction

Following the collapse of the Thai baht on 2 July 1997, the financial markets in other East Asian countries suffered similar and disastrous consequences up until mid-1998. The simultaneous financial meltdown in the East Asian countries has led to the widespread use of terms such as the Asian “flu”, with the implication that this was a real case of contagion, where one country’s crisis spread to other vulnerable countries. Many academic researchers and pundits have argued that the domino effects among the East Asian currencies were mainly attributable to deep-seated regional structural weakness. Blame has been heaped on “the Asian way”.¹ One

Contrary to the popular opinion in most creditor countries, however, the economic crisis in East Asia was not an “East Asian” one. The conditions that precipitated the crisis were by no means unique to the region. They had their roots in the liberalization of the financial sector prior to establishing an efficient framework of regulation and supervision, excessive borrowing and lending by private agents, and the inability and unwillingness of key players – including governments – to accurately assess risks. The resulting collapse of domestic financial and currency markets is a phenomenon already observed in the 1990s in Europe, Latin America, and then in East Asia. Furthermore, the continued spillover effects of the East Asian crisis hit the Russian Federation and reached Latin America.

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