

BOOK REVIEWS

***Asia in Crisis: The Implosion of the Banking and Finance Systems.* By Philippe Delhaise. Singapore: John Wiley & Sons, 1998. Pp. 280.**

In contrast to a number of other books on the causes of the Asian economic crisis, the book by Delhaise focuses deliberately and exclusively on the financial aspects of the crash. The book is organized in three parts: the first one (chapters 1 and 2) offers a general analysis of the crisis, the second (chapters 3 to 9) provides an in-depth examination of the banking systems of ten Asian economies,¹ while the last one (chapters 10 and 11) concludes with some policy prescriptions.

In the first two chapters, the author gives his own interpretation of the crisis. He defines it as a crisis of growth and puts the blame for the meltdown on the weaknesses of the banking sector in the fast-growing Asian economies. In his view, the key explanation lies in the inconsistency between the rate of economic growth in most countries in the region and the lack of development — and maturity — of their financial systems. The inability of the financial systems to keep pace with economic growth accounts for the increasing frailties of the banks and finally for the crisis. This leads Delhaise to conclude that each of the four most affected countries had built up the conditions for disaster because of their failure to create the basic conditions for a safe banking system which could assist rapid growth.

A major puzzle in the explosion of the Asian crisis pertains to its timing. There is indeed a wide consensus that the various weaknesses which can be identified as key causes were nothing new and

that the difficulties had been brewing for some time. Delhaise offers an explanation to this puzzle, arguing that the timing of the crisis is due to the existence of another factor: the risk perception of the international financial community, or what he calls the “panic factor”. A shift in perception translated into a liquidity crisis starting in Thailand, with other countries in the region following suit. Delhaise thus distinguishes between the deep-seated roots of the crisis and the panic which accounts for the spread and magnitude of the collapse. In the absence of a panic, the observed weaknesses may simply have led to limited domestic banking crises. The panic factor led to the regional collapse, with the currency markets as transmission belts. In this respect, the book supports the so-called “wake-up call” hypothesis according to which the crash was precipitated by the reassessment of the risks in the wake of the collapse of the Thai baht. While Delhaise considers that the crisis was inevitable and probably beneficial, he views the panic as a negative epiphenomenon that should have been avoided.

The rest of the book is devoted to an analysis of the mechanics of banking in East Asia. A first chapter examines bank accounting practices in the region, while the six following chapters are a collection of individual country studies. The failure of most observers to identify the frailties of the banking systems in the fast-growing Asian economies may come as a surprise, but, argues Delhaise, this can be easily explained through the extent of creative accounting used by various banks to conceal the extent of their problems.

One of the most interesting parts of the book is

probably the chapter on bank accounting in Asia which reveals the extremely imaginative ways of “cooking the books”. Creative accounting is stigmatized as the major reason for the difficulty of getting a clear assessment of banks’ health and thus as a major source of trouble. The detailed country analyses explain further the various ways used by the banks to patch over their problems.

The book concludes with a number of suggestions on how to rehabilitate the banking sectors in the region. Delhaise criticizes the creation of special vehicles to park non-performing loans and calls for more severe punishments, in the form of failures, as the only way to finally eradicate moral hazard. He is also critical of nationalization, which simply helps transfer the loss from depositors and creditors to taxpayers and should thus be restricted to extreme situations. He is also not enthusiastic about foreigners coming in to buy up local banks and is very critical of the 8 per cent BIS capital adequacy ratio, which he considers to be inappropriate to emerging economies (the main problem in this respect pertains to the way ratio calculations and adjustments are applied). One of his major suggestions is that better corporate governance and a better protection for small depositors should rank high on the list of priorities, together with the overhaul of bankruptcy laws for instance. He also insists on the need to develop local capital markets. Although external factors are identified as being key in the spread of the contagion, the book remains surprisingly silent on the possible reform of the international financial system and on the steps that could be taken in order to enhance the discipline in international markets.

In his conclusion, the author is on the whole quite optimistic about the future of Asia which may have ‘to eat plain rice for a while but will come back to prosperity’. In contrast to a few

authors who interpret the crisis as the end of the Asian miracle, Delhaise sees it as merely a pause. He argues further that it can also be seen as the perfect opportunity not only to get rid of excess capacity, to improve bank regulations and corporate governance but to eliminate some dictators and improve the political climate.

The inclusion of a large number of boxes on technical issues or on anecdotes is a further asset to the book which makes it still more enjoyable to read. Of particular interest is the box giving the list of warnings issued by Thomson Bank Watch well before the 1997 crisis, at a time when most other investors and lenders were blind to the emergence of potential problems in Asian banking systems. This shows that the exclusive reliance on so-called fundamentals in country-risk analysis is clearly not enough. The appendices, including a chronology as well as a wide array of figures and ratios by country, further contribute to make this book a very useful reference. By contrast, though, the list of references remains disappointingly short.

Delhaise is unlikely to obtain a literary prize for the quality of his style, but he certainly deserves a special mention for making tricky financial issues quite accessible. He has provided a thorough analysis of how financial systems worked in Asia, and has given interesting suggestions on how to improve them. This book is a valuable contribution to a better understanding of recent events in East Asia as well as to the current debate on post crisis policies.

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NOTE

1. Thailand, Korea, Indonesia, Malaysia, Philippines, China, Taiwan, Singapore, Hong Kong and Japan.