

# *Discussion*

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## **1. General Discussion**

Most of the discussion revolved around the nature and extent of implicit guarantees in the east Asian economies, and whether they had exercised an important influence on capital inflows to the region.

It was pointed out that implicit official guarantees exist in virtually all financial systems, since no government can credibly commit itself to remaining passive in the face of a crisis. The question then is not whether there were any implicit guarantees in east Asian financial systems, but whether or not those guarantees were abnormally comprehensive. Some participants argued that they were not and that the analysis by Corbett, Irwin and Vines had exaggerated their importance.

For instance, there was disagreement about the extent to which the fixed exchange rate regimes in east Asia provided an official guarantee of exchange rate stability to international investors. Some argued that governments which are expected to defend a fixed exchange rate socialise at least some of the costs of hedging exchange rate risks. To that extent, they reduce the private costs of hedging and so provide an implicit, if partial, guarantee of the foreign currency value of capital inflow. Others argued that the implicit guarantee was so weak as to be almost non-existent. Fixed exchange rates were maintained on a 'best endeavours' basis only: there was always the possibility that they would be adjusted. Well-informed investors in Indonesia, for example, would have been aware of the sizeable discrete devaluations that had occurred on a number of occasions in the past.

In a different register, one participant reasoned that capital flows to east Asia had the hallmarks of an asset-market mania, and that such manias often occur without official guarantees, implicit or otherwise. Indeed, it is very difficult to distinguish between the 'excessive' investment that occurs as a result of implicit guarantees and that which arises as a consequence of a market-driven euphoria.

Another participant suggested that the language of moral hazard and implicit guarantees is unhelpful when trying to understand the policy-setting process in east Asia. Many of Thailand's problems, for example, were identified as simple policy mistakes rather than deliberate, or even unconscious, efforts by policy-makers to underwrite foreign investment.

Against this, it was argued that investors could have expected support from official international institutions in the event of a crisis. Specifically, the international bailout of Mexico may have set a precedent and generated a perception that the IMF would support foreign investors in the event of a systemic east Asian crisis. If so, there may have been a rationale for the unhedged, and seemingly excessive, flows of capital into east Asia in the mid 1990s.

Not all were convinced that the IMF had been a source of moral hazard. For example, it was claimed that an IMF bailout of South Korea had been unforeseeable

prior to the crisis. Nevertheless, there was considerable debate about the role of the IMF in assisting economies suffering from acute capital flight, and it was argued by some that a diminished role for the Fund as lender of last resort would contribute to an easing of moral hazard and perhaps reduce the need for conditionality in its lending. The contrary view was also put: that the promise of Fund assistance eases the burden which national governments face in having to hold high levels of reserves in order to defend their financial systems against volatile capital flows.

It was also noted that the extent of official financial support varied considerably across countries: it was much smaller in east Asia than it had been in the 1994/95 Mexican crisis. This led some participants to the view that the moral hazards associated with bailouts were diluted by the fact that investors did not know the extent of their guarantees.