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Book review : The Asian financial crisis and the ordeal of Hong Kong

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The Asian Financial Crisis and the Ordeal of Hong Kong. By Y. C. Jao.

Lok Sang Ho

BOOK REVIEWS

The Asian Financial Crisis and the Ordeal of Hong Kong. By Y. C. JAO. [Westport: Quorum Books, 2001. 227 pp. £54.50. ISBN 1-56720- 447-3.]

This well-narrated book consists of five parts: the Asian financial crisis; the impact on Hong Kong; "Two puzzles;" the role of China; and an epilogue entitled "Lessons and reflections." The author is a veteran scholar on banking in Hong Kong. The first part documents the genesis of the Asian financial crisis through its propagation from Thailand to the rest of East Asia. The second part is really the main body of the book, comprising five chapters out of a total of 12. The book is rich in details, with plenty of tables and illustrative figures.

This carefully researched book is no doubt a handy reference if one wants to know how the contagion of mismanagement of the financial and monetary affairs in one country spread to other countries. In comparison, the book is not as successful in providing a convincing explanation of why things happened the way they did.

Jao systematically categorizes the various prevailing theories that attempted to explain why the Asian financial crisis (AFC) took place. The approaches are called, respectively, "self-fulfilling financial panic theory," "crony capitalism theory," "financial mismanagement and financial sector fragility," and the "eclectic view." He explains, convincingly, why the third view "is the most satisfying," and goes on to draw up a very interesting schema of the AFC. Indeed "crony capitalism" cannot explain the financial panic. Surely "self-fulfilling financial panic" could not occur if the financial sector were not fragile and if there was no mismanagement in the first place. Mismanagement is no doubt very much at the centre of the explanation behind the genesis and the turn of events throughout the crisis. The reader is tempted, upon reading the book, to ask further: "what exactly is the nature of this mismanagement?"

Related to this are two equally intriguing questions: why was Hong Kong hit so badly by the AFC, and why did Hong Kong recover so slowly in its aftermath? These two questions are addressed in the section that is titled "Two puzzles." According to the author, "there was no pervasive financial mismanagement, no reckless borrowing internally or externally. Hong Kong's banking system was one of the best supervised in the world." Yet what hit Hong Kong in 1998 was more like a depression than a recession, using the author's own words. The author's key explanation is that a

sudden reversal in market psychology caused a serious credit crunch, with borrowers cutting back their borrowing while lenders cut back their lending. The puzzle remains, however, as to why the economic outlook suddenly grew so dim that it even surpassed what happened during the Cultural Revolution of the 1960s and the oil price shocks of the 1970s. High real interest rates and real exchange rates cannot be the only explanation, as really high real interest rates caused by deflation did not set in until the latter part of 1998, while the real exchange rate appreciation from 1997 to 1998 was relatively modest.

Overall, the book must be credited with faithfully documenting the background to and the course of the crisis, how the SAR Government dealt with the crisis, and particularly how mainland China was characterized by “an extraordinary mixture of external strengths and domestic weaknesses” (cited from the Fitch IBCA Report on p. 198). The detailed discussion of China’s response to the crisis and its ability to weather the storm are all of great interest. To Jao, “China had avoided the trap of overhasty exchange liberalization that caused massive capital inflows, which in turn fuelled domestic credit expansion and asset bubbles in many Asian countries just before the AFC” (p. 184). One wonders, after reading Jao’s book, if the “financial mismanagement” was the “overhasty exchange liberalization” that characterized many of the countries hit by the crisis.