

Introduction

The Asian currency crisis and ensuing financial crisis stirred up broad debate among scholars and national leaders over a wide range of questions concerning the financial affairs of developing countries, and this debate provided the opportunity to reexamine a gamut of financial and policy issues ranging from international financial problems transcending individual national economies to macroeconomic policies including exchange rates and the stability of domestic financial systems. Following the outbreak of the Asian currency crisis, this author was among those who became involved in research stimulated by this debate, and the present volume brings together a number of previously published theoretical studies on the crisis which have been revised and updated for this publication.

Chapter 1 reviews the issues that have been at the center of debate over economic development and finance, providing an overview of policy issues ranging from problems concerning the operation of macroeconomic policy to matters of banking policy. The intent of this broad perspective is to give the reader a clearer understanding of the questions that the succeeding chapters in this study will deal with.

Chapter 2 provides a theoretical analysis of the high interest rate policy that was adopted to cope with the Asian currency crisis. The chapter employs a variation of the Dornbusch (1976) overshoot model to inquire into high interest policy. It also shows that exchange rate uncertainty can become a factor increasing risk premium.

High interest rate policy adversely affects the financial sector, especially bank profitability, and carries the danger of causing a financial crisis or worsening an already existing one. In Asian countries, moreover, bank lending plays a central role in corporate finance, so a high interest rate policy has an especially adverse impact. Chapter 3 presents a theoretical analysis of the bank-based financial system that exists in Asian countries (and in developing countries in general). It also points out the adverse impact of a financial crisis on the accuracy and freshness of accumulated information about borrower risk which is needed for the efficient functioning of the bank-based financial system.

Most of the debate to date over the weakness of the financial system has been over the question of “how to prevent a financial crisis.” The latter chapters in this volume take a different perspective. Chapters 4–6 look at dealing with a financial crisis *ex post*, and instead of the above question, they examine “how to deal with a financial crisis after it has occurred.”

Chapter 4 acts as an introduction to chapters 5 and 6. It examines the problem of corporate debt restructuring in Asia as a matter of post-currency crisis policy. It also shows that the many policies stressing the need to improve corporate governance *ex ante* still are meaningful even in the context of *ex post* corporate restructuring.

Chapter 5 focuses on government policy to bail out banks, presenting a model that employs the concept of “time inconsistency” to analyze the problem of moral hazard which is caused by such government policy. It points out that although moral hazard associated with bank bailout policies is a problem difficult to prevent, under certain circumstances such policies become the best among second best choices. The chapter also indicates that the need to deal with moral hazard differs depending on differences in countries’ social safety nets against financial crises and on differences in the size of anticipated macro shocks.

Chapter 6 presents a theoretical analysis of post-currency crisis corporate debt restructuring in Asia based on an agency-cost approach. One of the influential views now is that corporate reluctance to borrow rather than bank reluctance to lend played a major part in the recession that followed the Asian currency crisis. The analysis in Chapter 6 also shows that worsening corporate finances push up agency cost which in turn increases the corporate cost of external funds. This causes a corporate reluctance to borrow. The chapter then shows the policy implications.

The final chapter, Concluding Remarks, sets forth a summation of the analyses and findings presented in the preceding chapters.