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Comment Aaron Tornell

Krugman's paper concerns the sale of domestic assets in the aftermath of the Asian crisis. He states that there has been a wave of such sales to foreigners and at much lower prices than in preceding months. Does this constitute a fire sale of productive assets to foreigners that will use them less efficiently? Or does it actually constitute a productivity-enhancing transaction?

The answer depends on one's view regarding the lending mechanism underlying the Asian crisis. If domestic entrepreneurs are more efficient at running such projects, and the crisis simply reflected a run against the country, then the obvious conclusion is that the forced sale of assets to foreigners is inefficient. On the other hand, if domestic agents had access to cheap credit, the creditors did not monitor the quality of the investment projects, and the domestic agents invested in socially inefficient projects, then the sale of assets to foreigners is a good thing.

Krugman connects these two views to alternative crises models. In one model, there are implicit government bailout guarantees and a group of privileged agents that can borrow at the riskless interest rate and invest in very risky projects with low expected returns. As a result, a lending boom accompanied by asset price inflation develops. Once the future arrives and the country defaults on its debt, asset prices collapse and foreigners are able to acquire the assets at fair prices and (maybe) use them more efficiently.

The second view is connected with the celebrated Diamond-Dybvig model of bank runs. In this model the crisis is caused by liquidity problems, not by insolvency. As a result, domestic residents are forced to liquidate their assets at an unfairly low price.

The question then becomes which view is empirically correct? Was the

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crisis a result of a significant amount of inefficient projects that made the economies unable to repay, or was it simply the result of a run? More work would be helpful in this area.

Finally, I would like to note that the fact that asset prices collapsed is consistent with a lending boom explanation in a world where collateral is an important determinant of lending, and where future asset prices are themselves determinants of the value of collateral. Thus a more detailed analysis of the ex ante characteristics of the investment projects in the precrisis years would be very useful in identifying the true causes of the crisis.