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Comment Dani Rodrik

Takatoshi Ito suggests in his conclusions that the crises in Thailand, Indonesia, and Korea offer different types of "food for thought," just as the region's ethnic foods differ. While the spices may have been different in each case, it seems to me that these were just condiments on the same old dish that international capital markets have been serving with regularity over the last twenty years.

Whether driven by moral hazard, financial panic, herd behavior, or irrational exuberance, the boom-and-bust pattern of international lending appears to be integral to the operation of international financial markets. When the crisis strikes, it is always easy to find weaknesses in the borrowing economies to justify ex post the reversal of flows: crony capitalism, industrial policies, exchange rates pegged too rigidly to the dollar, weak financial sectors, implicit insurance, and so on. No one can doubt that these were problems of varying degrees of seriousness in the East Asian economies most severely affected. But it takes a large buildup of short-term external liabilities—denominated in a currency other than your own—to metamorphose these weaknesses into the financial and real meltdowns that Thailand, Indonesia, and South Korea have experienced. Figure 8C.1 shows the close correlation between exposure to short-term debt and currency collapse in East Asia.

Asian-style capitalism—with different ethnic spices in each case—did not evolve in the last five years. Furthermore, this is not the first time that many of these countries have experienced external imbalances. South Korea had a mini debt crisis in 1980 that cost it 5 percentage points of gross domestic product (GDP) in one year. But as Ito emphasizes, large capital inflows, particularly of a short-term kind, are a relatively recent phenomenon. We get the real fireworks only when domestic problems meet international financial markets.

There is much useful information in Ito's paper on the patterns of capital inflows to the region. I must say I am less convinced than he is by the evidence on spillovers from direct foreign investment (DFI). Regressions of output growth on lagged DFI do not provide particularly meaningful evidence, in part because investors are forward looking and in part be-

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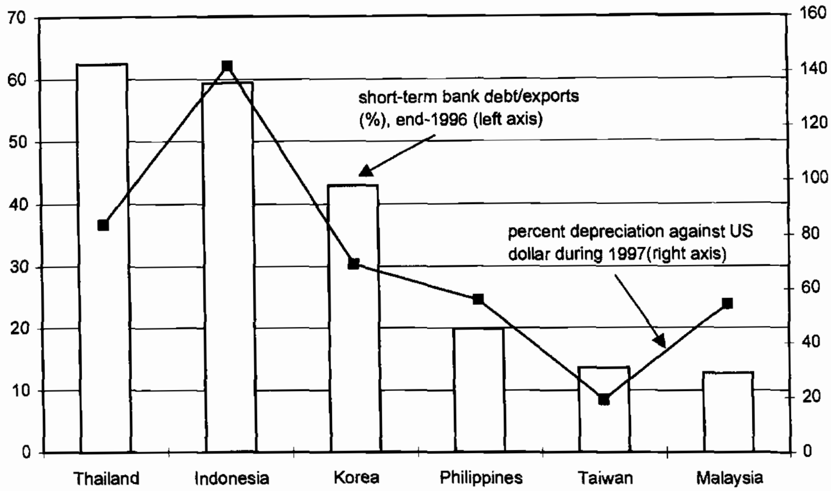

Fig. 8C.1 Short-term debt and currency collapse

cause reverse causality cannot be ruled out when there is persistence in the time series. The more deserved compliment is that DFI moves in rather than out when the short-term investors have bailed out.

It would have been nice if Ito's paper had ended on a more conclusive tone, instead of yielding ground to all the contending theories of the crisis. Nevertheless, it is useful to have a balanced account that does all of them justice.