

### 3. GLOBALIZATION AND RECENT FINANCIAL CRISES IN DEVELOPING COUNTRIES

***“For 40 years, all these (emerging) countries have been trying to build up their economies and a moron like George Soros comes with huge sums of money to speculate and destroys everything.” Malaysian Prime Minister Mahatir*** <sup>38</sup>

Globalization has been blamed as the main reason for the severe effects of recent financial crisis in a number of developing countries. It is argued that the size and speed of capital flows' movements in international financial markets have led to “devastating” consequences for these countries. For many politicians and journalists, these events have been a crisis of globalization and even the IMF labeled the 1994-95 Mexican crisis as the “first financial crisis of the 21<sup>st</sup> century”.

However, globalization neither causes financial crises nor makes them more severe and, as a matter of fact, they are not at all new events. As, Professor Kindleberger has demonstrated, these crises are thoroughly unoriginal, even though during the past 300 years in each crisis politicians and the media have made hyperbolic statements about every event<sup>39</sup>.

It is worthwhile to have a closer look at what actually happened in the Southeast Asian crisis in 1997-1998. During the decade prior to this crisis, the bulk of capital inflows (75%) to these countries came not from portfolio investment but from commercial banks. These loans proved to be the true “hot money” for once currencies began to collapse, the banks pulled out rather than portfolio investment. Even though portfolio investment diminished, it continued to be positive while commercial banks outflows amounted to US\$29.9

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<sup>38</sup> Malaysia's Prime Minister Mahatir, quoted in the Jakarta Post, January 24, 1998.

<sup>39</sup> Kindleberger, C. (1978).

billion. The same phenomenon happened during the Russian crisis a year later<sup>40</sup>.

The main lesson from these crises is that despite the financial liberalization in many emerging economies during the 1990s, their institutional and regulatory infrastructure remained seriously underdeveloped. Rather than an excessive confidence on international capital markets, it has been the lack of confidence that has led to financial crises around the world. In earlier crises as today, it was often the flow of “hot money” (short term and portfolio investors) that triggered events, but in none of these cases have they been the underlying cause of the crises. Financial crisis can be always located at the peak of business cycles with particularly high growth and/or expectations. High expectations lead to speculative excess, and a change in expectations then leads to a stampede out<sup>41</sup>.

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<sup>40</sup> Baily-Farrel-Lund. (2000)

<sup>41</sup> Oberhänsli, H. (2000)