Foreword

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Immediately following a financial crisis such as the one experienced in East Asia in 1997–1998, a flurry of activity takes place in the media, in academia, and among international organizations. They provide diagnoses of what caused the crisis and propose the economic remedies that might mitigate, or even avoid, future crises. However, once the crisis is no longer in the headlines, the hard work of actually implementing corrective measures receives far too little attention. And when the initial recommendations for institutional changes are further analyzed, social, economic, and political constraints often make the proposals far less palatable to domestic policymakers.

To a large extent, economics is the study of getting incentives right: How can we construct the rules of the game to use our limited resources in the most productive way possible? Policies intended to create substantial economic benefits frequently create large social and economic costs, because incentives were not correctly aligned. The law of unintended consequences appears particularly often when institutional arrangements from one country are grafted onto other countries with very different social and business norms.

Difficulty in implementing major changes in business infrastructure has plenty of historical precedent. After World War II, significant efforts were made to change the close-knit business infrastructure in Japan. Despite this, and likely reflecting the Japanese culture, the business infrastructure changed far less than was intended, and still is evolving. If the wartime situation was not a sufficient impetus, how successful are international organizations likely to be now in emerging economies, with far less power to make meaningful changes in the business infrastructure? Unless we understand the social and political constraints in emerging markets, the incentives may not be aligned correctly and the changes may be superficial, rather than fundamental. Faced with difficulties in implementation, policymakers frequently can be tempted to adopt measures that placate critics from international organizations or international investors, without creating meaningful change.

One major difference between implementing infrastructure changes in Japan in the 1940s and making changes in emerging economies in this century is the role of the private sector. Increasingly, the enforcement mechanism is dictated by the market. Countries unwilling or unable to guarantee fundamental property rights, provide financial statements that accurately convey the underlying condition of firms, ensure safe and sound financial sectors, or develop deep and liquid securities markets will be increasingly shunned by international investors. As capital becomes ever more mobile, countries that fail to innovate are likely to find it increasingly difficult to attract international capital or to retain their own domestic saving. Thus, the revolution in information technology that is the engine behind globalization will force countries to reexamine their business infrastructure and will penalize those countries that fail to satisfy international norms.

Understanding the impediments to fundamental change are particularly important, because superficial changes can lull both investors and policymakers into a false sense of security. During boom times, infrastructure problems are frequently overlooked, as has been the case many times in Latin America. While, in the short run, rampant optimism can fuel an economy that has failed to make necessary improvements to its financial infrastructure, such failures are quickly exposed during a downturn. Furthermore, the adjustment periods have been dramatically shortened, as international investors can quickly rebalance their international holdings and flee those countries where financial irregularities or banking system failures are revealed.

Have we been successful in making changes that will prevent future financial crises, or are we condemned to repeat our mistakes? What can we learn by comparing those countries that have successfully implemented reforms with those that have not yet made fundamental changes? What are the practical impediments to change? What serious social, economic, and political constraints have been overlooked as our best economic minds have suggested policies that have not been widely accepted? My hope is that future crises can be avoided, or at least their severity mitigated, by creating the appropriate incentives and inducing countries to adopt measures that will not only help stabilize their domestic economies, but also prevent future spillovers into the world economy.

This conference brought together representatives from many of the institutions and countries that are directly involved in reorganizing the international financial infrastructure. They have reexamined what has happened since the East Asian crisis and reflected on the progress that has been made implementing policy recommendations and on the reasons why some of the policies advocated in 1997 and 1998 have not been accepted. Their findings should encourage further research and policy discussions and lead to pragmatic policies that will make financial crises, so prevalent in emerging economies in the 1980s and 1990s, much less likely in the future.

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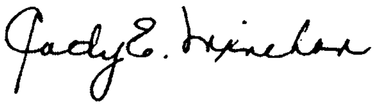

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