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The East Asian Crisis: Implications For Ghana

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INSTITUTE OF ECONOMIC AFFAIRS
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THE EAST ASIAN CRISIS : IMPLICATIONS FOR GHANA

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PREFACE

This paper, the 20th in the IEA's Occasional Papers series, discusses the crisis that gripped a number of East Asian countries — notably Indonesia, South Korea and Thailand — in the late 1990s. Development in these countries had been regarded as models by many other countries, particularly in the underdeveloped world.

An account is given of the factors that precipitated the East Asian crisis; how the crisis impacted on sub-Saharan African countries in general, and Ghana in particular; the failure of national authorities to take prompt action on the crisis before they were compelled to implement remedial measures with the encouragement and financial support of the international community, led by the IMF; and the lessons to be learned from the crisis.

The author draws attention to the relatively embryonic state of the banking system in most African countries, which makes them vulnerable to a banking crisis. And against this background, he suggests caution in emulating the East Asian model. In his view, the lessons drawn from the East Asian crisis provide a framework for formulation of domestic policy. Such a policy should be aimed at lessening the probability of a similar crisis in Ghana, and minimising the impact of such a crisis, should it ever arise.

The paper is a welcome addition to the literature on development, and should find a place in the library of every African economic policy maker.

I am delighted to place on record, the gratitude of the Institute of Economic Affairs to the Danish Government, through the Royal Danish Embassy in Accra and DANIDA, whose generous assistance made this publication possible.

Dr. George A. Apenteng
Executive Director
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Accra, September 1999

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INTRODUCTION

The East Asian crisis represents the most visible and destabilizing shock to the world economy in recent years. Unlike the oil crisis of the seventies which was inflationary, this crisis is, on balance, likely to exert a moderate contractionary and disinflationary effect on the world economy at large. While this reduces the risk of overheating in those countries operating at high levels of resource utilization, it poses a serious challenge to the growth of relatively weak economies. Indeed, the most recent publication of the *World Economic Outlook* describes the East Asian crisis as the main factor responsible for the *downward revision* in projected world economic growth from 4 percent in 1997 to 3 percent in 1998. The OECD half-yearly report predicted even lower world growth rates of 2 percent in 1998 and 2.1 percent in 1999 (*Business and Financial Times*, Nov. 29-Dec. 6, 1998, p. 3).

This paper focuses on the impact of the Asian crisis on developing countries in general, and the policy implications for Ghana in particular. The discussion is organized in the following format. The first section provides a brief background to the crisis, and examines the *main causes* of the crisis. This is followed by an analysis of the *impact* of the crisis on Sub-Saharan Africa in general and on Ghana in particular. The paper then identifies the *lessons* that can be gleaned from the crisis, and their *implications* for policy makers in Ghana.

CAUSES OF EAST ASIAN CRISIS

The countries of East Asia represent some of the most successful emerging market economies in terms of growth and gains in living standards. With generally *prudent fiscal policies and high private saving rates*, these countries had become a model for many others. That this region might become embroiled in one of the worst financial crises in the postwar period, was hardly ever considered—within or outside the region—a realistic possibility. What makes the East Asian crisis unique is that:

* it originated in private sector financial mismanagement rather than undisciplined fiscal spending in the public sector; and
* it combined both a banking and a currency crisis.

The factors precipitating the Asian crisis can be grouped under five categories:

1. Inconsistent macroeconomic policies;
2. Inadequacies of regulation and supervision;
3. Contagion;
4. External factors; and
5. Governance issues or lack of transparency.

- ***Inconsistent Macro-policies***

Following years of export-led economic growth, export earnings declined due to a slowdown in global demand. Meanwhile, to the extent that most East Asian currencies were pegged to the dollar, the 50% appreciation of the dollar relative to the yen (from mid-1995) further undermined the export competitiveness of the East Asian economies, and contributed to the deterioration of their external deficits during the 1996-1997 period. Nonetheless, foreign capital with short-term maturities readily flowed in to finance the external imbalance, due to the impressive growth rates in the region. The banking sector in turn used the loans to finance long-term investment in real estate and other non-exporting sectors.

Invariably, the inability of authorities to promptly address the fundamental causes of the current account deficit, and the perception that the exchange rate was unsustainable, further exposed other weaknesses in the economy, including substantial unhedged foreign borrowing by the private sector, an inflated property market, and a weak and over-exposed financial system. The response was a massive reversal of capital flows, spreading from Thailand and then to other East Asian countries as investors began to realize that the problems affecting the Thai economy, including overvalued real estate markets, weak and poorly supervised banking sectors, and substantial private short-term borrowing, persisted in the other East Asian countries.

To protect their currencies and encourage the retention of resources in the economy, the East Asian central banks raised short-term interest rates which, in turn, encouraged further capital inflows and even higher domestic interest rates. As a result of the high cost of borrowing, investments plummeted; unemployment rose; and corporations and financial institutions assumed growing levels of foreign currency risk. These developments significantly increased the vulnerability of the East Asian economies to external disturbances.

- ***Inadequacies of Regulation and Supervision***

The East Asian crisis unmasked inadequacies in the management, regulation and supervision of financial institutions. Banks had accumulated an unexpectedly large amount of risky and impaired assets, against which they held inadequate capital and reserves. In some cases, levels of lending to related parties were very high. Regulatory and supervisory forbearance prevented the exposure of the extent of the financial losses. In addition, standards for public disclosure fell short of what was necessary for economic agents to assess the fragility of financial institutions. Thus, the crisis identified a need to, among other things, improve financial legislation; upgrade the supervision and regulation of financial institutions; review the strategies for dealing with troubled institutions; and set new standards for public disclosure.

- ***Contagion***

Repercussions of the crisis, which originated in Thailand, reverberated through the region, with some economies experiencing capital outflows and declining stock market indices and asset prices because of contagion. Even countries with sound macroeconomic policies and healthy financial sectors were not spared the turbulence, although they were able to avert major financial and exchange rate crises. The process of contagion uncovered economic policy weaknesses that either had previously gone unnoticed or had not prompted reactions. In particular, weaknesses in financial sectors became evident in Indonesia, Thailand and South Korea, as well as in Malaysia and the Philippines. The already fragile condition of the financial sectors (due to maturity mismatches and poor liquidity management) worsened with currency depreciation, which increased the debt service costs of banks and those of their customers who had not hedged their positions. Economic contraction throughout the region curtailed exports, aggravating the general loss of creditworthiness. The repercussions were stronger for countries the weaker their economic performance, the stronger their economic and financial ties to economies already in crisis, and the more similar the structures of their financial systems.

- ***Governance Issues***

The East Asian crisis was compounded by problems of governance and political uncertainties. In particular, there was a lack of transparency about the extent of government and central bank liabilities; about the underlying health of the financial sector; about the extent and structure of indebtedness in the private sector; and about the links between banks, industry, and government, and their possible impact on economic policy. In addition, problems of data availability and lack of transparency hindered market participants from maintaining a realistic view of economic fundamentals, and at the same time added to uncertainty. In the absence of adequate information, markets tended to fear the worst and to doubt the capacity of governments to take timely corrective action.

Furthermore, the imposition of controls on market activity, and the possibility of further controls in the future, not only made investments riskier, but also tended to reinforce the view that governments were addressing the symptoms, rather than the causes, of their problems. This not only sent foreign investors fleeing to safer havens, but propelled a rush by domestic corporations, including those that had borrowed heavily in foreign currencies, to buy foreign exchange.

- ***External Factors***

Developments in global financial markets and in advanced economies since the early 1990s, also contributed to the crisis. Weak growth in Europe and Japan contributed to low interest rates in those economies. In response, large capital flows headed toward emerging economies, particularly those in Asia. These flows eventually served to finance increasing domestic and external imbalances. During the pre-crisis period, the volume of inflows, especially short term, exerted upward pressure on domestic prices, caused the real exchange rate to appreciate, and thus eroded the export competitiveness of some countries. However, the inflows continued despite evidence of inflated asset prices, especially those of real estate. In retrospect, it is clear that most of these inflows did not show sufficient concern for the potential risks. When exchange rate regimes prevailing in the region were deemed to have become unsustainable, capital outflows set in. As a result, exchange rates fell steeply in the most affected countries (as well as in most other countries in the region), and domestic residents rushed to hedge their liabilities (i.e., they bought foreign currency), making currencies fall well below what was required to correct the initial overvaluations.

To contain the economic damage caused by the crisis, the countries directly affected have been compelled to implement corrective measures, and the international community led by the IMF has provided financial support for policy programs in the countries worst hit—Indonesia, South Korea, and Thailand.

EFFECTS OF EAST ASIAN CRISIS ON SUB-SAHARAN AFRICA

The crisis in East Asia has led to a downward revision of the projected real GDP growth rate for Sub-Saharan Africa, of nearly one half of one percent to about 4 percent in 1998. It is also responsible for the 2 percentage point increase in the projected external accounts deficit (excluding grants) for 1998, which is estimated at 6 percent of GDP. Invariably, the crisis will tend to impact Sub-Saharan Africa in terms of lower commodity prices, higher cost of borrowing, and diminished access to foreign aid and investment (*Finance and Development*, September 1998).

- ***Decline in Commodity Prices***

The decline in world commodity prices has been compounded by weakened demand in East Asia and the consequent reduction in the demand for metals, fuels and agricultural raw materials which constitute important exports from Sub-Saharan Africa. Meanwhile, in recent years, trade links between Africa and East Asia have been on an upward trend. Consequently, lower Asian imports are likely to have a measurable impact on African exports. For instance, between 1980 and 1994, African exports of agricultural materials to Asia grew by an average of 13.8 percent, while exports of ores and metals grew by 16 percent. This is higher than Africa's export growth of these commodities (2.1% and –3.1%, respectively). By 1997, 20% of Africa's total agricultural exports, and 13% of mining products were going to Asia (*Daily Graphic*, Wednesday, October 28, 1998, p. 23 "*Asian Financial Crisis: From Boom to Bust.*").

Indeed, the prices of industrial commodities are at their lowest in real terms since the 1930's. This has invariably hurt commodity producers not only in Africa, but in Latin America, Australia and Canada as well. In particular, the drop in gold prices has hurt Ghana, Mali, S. Africa and Zimbabwe. The sharp decline in the price of copper has seriously affected Zambia, while the fall in the demand for diamonds has had a major impact on Botswana, Namibia and South Africa. Moreover, fears that Russia might try to boost export revenues by dumping commodities on the world markets, have exacerbated the decline. The *Economist All-Items Commodity Price Index* has fallen by 30% since mid-1997 to its lowest in real terms in over 25 years.

Producers of agricultural raw materials in Sub-Saharan countries have also been adversely affected. In December 1997, Cameroon's state-owned timber exporting company which sells approximately 60% of its logs to Asia, began confronting a slowdown in sales and by mid-1998 as unsold stocks mounted, it ceased purchasing more timber from domestic logging companies, leading to widespread layoffs of both loggers and transporters. Again, Swaziland's Usutu Pulp Company, one of the largest in the country, shut down due to large declines in Asian sales. Given the global nature of the problem, even countries that do not export directly to Asia, have faced shrinking markets. However, *the impact varies by country due to the varied composition of each country's exports.*

Countries whose commodity basket is dominated by copper, gold, diamonds, fuels and cotton, generally bore the brunt of the crisis since such products have been adversely affected by the crisis. In particular, oil-producing African countries have been hit heavily by falling prices, while oil-importing countries such as Ghana, have benefited from reductions in their import bills. Likewise, exporters of cocoa, coffee and other beverages have been doing very well due, in part, to civil unrest in Indonesia, a major producer of cocoa and coffee.

The devaluation of East Asian currencies has also enhanced their export competitiveness relative to Africa, and consequently threatens the continent's share of world trade. For example, the competitiveness of textile exports from several African countries including Ghana, Mauritius and Zimbabwe, has been undermined by the currency depreciations in East Asia. On the other hand, the decline in the price of rice has benefited Ghana and several other West African countries.

- ***High Risk Premia Due to Decline in Investor Confidence***

The impact will also depend on the extent to which African countries are exposed to developments in foreign exchange and financial markets, and the extent to which financial flows have been redirected following the crisis. Bruised by losses in Asia and Russia, investors are fleeing from risky assets to safe havens such as American Treasury Bonds. As a result, the yield on emerging market bonds has risen 15 percentage points above the yield on American Treasuries. This is in stark contrast to a mere 3 percentage points difference in the fall of 1997. Higher bond yields have in effect raised the costs of borrowing, dampened growth in the emerging world, and inflated government debt servicing. Total net capital flows to emerging markets are estimated to slump to $119 billion in 1999, down from $186 billion in 1998, and $247 billion in 1997. Higher costs of borrowing coupled with diminishing capital flows could undermine growth in several African countries. Furthermore, to the extent that foreign capital funds become more expensive, it can have dire consequences for the debt service burden of African countries.

On the other hand, the impact of the crisis on foreign exchange and equity markets in Sub-Saharan Africa will invariably be marginal because of the nascent stage of development of these markets.

- ***Increased Competition for Aid***

A principal concern here is that Overseas Development Assistance (ODA) will be diverted for the purpose of bailing out some of the troubled Asian economies. Indeed, there is some evidence that this is under way. The IMF expects net external financing and net external borrowings from official sources to Africa to decline significantly in 1998.

Developments in East Asia also suggest that Africa can no longer count on aid flows from crisis-stricken Japan, the top donor country in the early 1990's. Furthermore, the crisis seriously undermines the potential of Asian countries as an important source of foreign direct investment in Africa.

In recent years, Malaysia, for instance, has been a source of funds and expertise to Ghana in the areas of film, television stations, postal services, and dry dock and shipbuilding management. Finally, budgetary restraint in other main donor countries could potentially compromise aid flows to Africa.

IMPACT OF EAST ASIAN CRISIS ON GHANAIAN ECONOMY

The impact of the crisis in Ghana has been muted at best. A key component of strategy in dealing with the crisis has been the maintenance of an appropriate macro-economic environment characterized by tight monetary and fiscal policy to slow the rate of inflation, reduce interest rates, and stabilize the nominal exchange rate. The fallout from the East Asian crisis was manifested in relatively low commodity prices, particularly for gold and timber. The average spot price of gold in the first half of 1998 ($296.94) was 14.5 percent lower than in the corresponding period of 1997 ($347.24). However, lower gold prices were largely offset by increased export volumes, resulting in only a marginal (2.0 percent) decline in export values between the first halves of 1997 and 1998. Export receipts from timber (mainly lumber) also declined 36.8 percent between the first halves of 1997 and 1998 as prices tumbled 37 percent, from US$210.7 per cubic meter in December 1997 to US$132.9 per cubic meter in June 1998.

On the other hand, the decline in gold and timber prices was largely offset by relatively low oil import bills. The growth in oil imports declined from a high of 49 percent between the first halves of 1996 and 1997 to a mere 11.6 percent over the corresponding periods in 1997 and 1998.

Furthermore, commodity prices for cocoa were higher in the first half of 1998 than in the corresponding period of 1997. The average three-month futures price for cocoa increased 9.4 percent (from $978 to $1070.5) between the first halves of 1997 and 1998. This development may have been tied to developments in Asia.

Specifically, the civil unrest in Indonesia, a major producer of cocoa and coffee, may have contributed to higher commodity prices through disruptions in world supply.

Developments in the non-traditional export sector were also promising. Earnings from this sector are estimated to have increased 47.6 percent (from US$92.8 million to US$137.0 million) since the first half of 1997, in spite of the real appreciation of the exchange rate. As a result, the non-traditional export sector increased its contribution to gross export receipts by 3.5 percentage points, from 12.5 percent in 1997 to 16.5 percent in 1998.

As a result of the above-mentioned developments, total exports grew at a faster rate (12 percent) than imports (9.8 percent) between mid-1997 and mid - 1998 (CEPA: *Mid-Year Report*). Furthermore, the mid-1998 trade deficit improved relative to previous years. Even though it deteriorated by 4.6 percent relative to mid-1997, the mid-1997 deficit was over 300 percent larger than the corresponding deficit for mid-1996 (CEPA: *Ghana Mid-Year Macro-economic Review*, 1998). Hence, deficits notwithstanding, the 1998 figures represent an improvement over time.

Furthermore, the East Asian crisis appears to have had no sustained adverse impact on domestic currency and equity markets. With the exception of S. Africa, equity markets in Africa have been largely insulated from the global upheaval, chiefly because they do not have large amounts of foreign portfolio investment. In fact, Africa receives only around 2-3 percent of total world foreign direct investment. However, there are some indications that the Ghana Stock Exchange may have benefited from the crisis in the form of capital inflows. The Ghana Stock Exchange was described as the world's best-performing stock exchange in 1998 by London-based financial analysts (*The Daily Graphic*, Thursday November 5, 1998, p.1). The GSE All-Share Index, the indicator of market performance, was up about 90 percent, from 511.74 points in December 1997 to 970.18 points in June 1998. An all-time high index of 1,201.08 points was recorded in May 1998 (CEPA: *Ghana Mid-Year Macro-economic Review,* 1998).

Overall, the above-mentioned events have conspired to bring about a modest decline in the growth of domestic and external deficits, lower interest rates, and a decline in the inflation rate which is currently estimated at about 17 percent. However, the appreciation of the real effective exchange rate raises concerns about the implications for export competitiveness, and consequently, the external balance of the economy.

LESSONS FROM EAST ASIAN CRISIS

- ***Adopt Sustainable Macro-policies***

The East Asian crisis points to the need for authorities to respond swiftly to macro-economic imbalances. In the East Asian case, the mounting external deficits in the face of an appreciating nominal exchange rate should have been addressed before investor sentiment regarding the sustainability of government policy turned sour. In the short run, the current account deficit could have been addressed through currency depreciation to boost exports and raise the domestic currency price of imports. Contractionary fiscal policy could also have curbed imports by reducing domestic demand. In retrospect, pegging the domestic currency to the dollar in the face of mounting external deficits, limited the policy options of the government, and merely postponed the inevitable devaluation of the currency. A more prompt response would have averted the drastic loss of foreign reserves experienced by East Asian central banks in their unsuccessful effort to rescue their domestic currencies and restore investor confidence in the economy.

- ***Create Desirable Conditions for Liberalization***

The prudential and supervisory framework in the East Asian countries facing crises was clearly inadequate to ensure an efficient and cautious management of the risks of lending and other contracts by financial institutions. Hence, the East Asian experience emphasizes the need to support financial sector liberalization with the establishment of an adequate framework for prudential regulation and supervision of financial institutions. Countries that seek to liberalize their financial systems must create banking systems that adequately protect the savings of small depositors. Banking systems must also be freed from government intervention in the allocation of credit, so that funds are channeled not just to a favored few, but to those who will use it productively. Ultimately, the crisis raises the issue of the pace of liberalization and the importance of putting in place the institutional mechanisms that are necessary for successful financial liberalization.

- ***Managing Capital Inflows***

The crisis in East Asia also points to the necessity of managing the destabilizing effects of foreign capital inflows. While capital inflows can finance the external deficit, provide cheap access to capital and facilitate higher investment and growth, in the absence of appropriate macro-economic policies, they can also fuel inflation, support unsustainable consumer levels, cause the real exchange rate to appreciate, and consequently widen the current account deficit. Thus, inflows must be accommodated within the framework of sound macro-policies involving a combination of currency depreciation and tight fiscal policies to improve international competitiveness, and reduce pressure on the current account.

- ***Capital Flows and Integration***

The integration of domestic economies through globalization, facilitates the swift transmission of both economic benefits and losses across national boundaries. The contagion that the East Asian crisis brought in its wake suggests that no country can isolate itself from the effects of a currency crisis. This makes it even more imperative that countries put in place, monitoring mechanisms that promptly detect and identify domestic regulatory lapses, especially within the banking system.

In this context, the findings of a recent study aimed at identifying possible warning signals or leading indicators of banking system distress are instructive. The study examined 43 episodes of bank crises in 38 countries from late 1970's through 1988. A distinction was made between banking *crises* and banking *distress*. Banking crises were determined to be associated with *big credit expansions* funded mainly by *capital inflows* and *fluctuations* in *real effective exchange rates*. By contrast, periods of bank *distress* were more likely to be linked to *domestic phenomena*, such as a largely contemporaneous fall in real GDP growth, boom bust cycles in inflation (i.e., big increases followed by big decreases in inflation and credit growth), credit expansion and capital inflows, rising real interest rates, a sharp decline in the real exchange rate, and an adverse trade shock.

Countries with deep and more sophisticated banking systems are more likely to experience periods of distress, rather than full-blown crises. The finding for Africa is unique in the sense that, unlike other regions, the biggest source of bank distress came from terms of trade shocks and less from inflation fluctuations. For Asia, there was a very strong correlation between banking sector distress and credit growth, increased capital inflows, real appreciation of the domestic currency on the one hand, and excessive investment on the other hand (IMF Working Paper, *Leading Indicators of Banking Crises: Was Asia Different?*). A disturbing conclusion of the paper is that in general, bank crises are difficult to predict or forecast a year in advance.

In short, the findings clearly indicate that to the extent that the banking system in most African countries are relatively embryonic, the probability of banking crises in this region is quite high. Furthermore, unlike other regions, such a crisis is most likely to be triggered or associated with a terms of trade shock.

IMPLICATIONS FOR DOMESTIC POLICY

The lessons drawn from the East Asian crisis provide a framework for domestic policy formulation, aimed at minimizing the impact of the crisis on the local economy and lessening the probability of a similar crisis in Ghana. Using these lessons as a backdrop, the last section examines policy recommendations under two broad categories: macro-economic policy; central bank reform and transparency.

- ***Macro-economic Policy***

Sound economic policy must rest on macro-economic stability. While the Ghanaian economy has made good strides in stabilizing the nominal exchange rate and reducing the rate of inflation and interest rates through tight fiscal and monetary policy, more needs to be achieved in this area if financial liberalization is to be successfully implemented:

1. The current account has been in deficit for several years in a row, and has been sustained by foreign capital inflows. By 1997, the external debt was 92 percent of the GDP. In a flexible exchange rate regime, rising external deficits tend to exert a downward pressure on the domestic currency. Since both the interest and the principal must be repaid in foreign currency, thereby inducing further demand for foreign exchange. This can in turn increase currency volatility and investor uncertainty as individuals buy foreign currency as a hedge against currency depreciation. Hence, there is a need to reduce the external deficit through increased export revenues, particularly in non-traditional exports;

2. It appears that nominal exchange rate stability in Ghana has been associated with a corresponding appreciation of the real exchange rate. While a stable rate encourages investment by reducing risk and uncertainty associated with currency fluctuations, currency stability must be consistent with the underlying realities of the economy if one is to avoid currency misalignment. Even though an overvalued exchange rate benefits import dependent industries, it penalizes exporters and consequently contributes to the external deficit;

3. Inflation rates need to be further reduced to single digits to reverse the real appreciation of the exchange rate, enhance export competitiveness, and thereby improve the trade balance. Since food items are heavily weighted in the CPI, policies aimed at improving agricultural productivity will be instrumental in reducing inflation. In the context of a flexible exchange rate system, rising inflation results in a depreciation of the nominal exchange rate. However, a sustained downward spiral in the nominal rate may cause investors to hedge their positions by selling the local currency, which in turn leads to subsequent depreciations, promotes uncertainty and induces capital flight;

4. The central bank's commitment not to honor government spending beyond the Public Sector Borrowing Requirement (PSBR) is a laudable step in the direction of monetary and fiscal discipline. However, since Treasury Bills can be used for the dual purpose of Open Market Operations (OMO's) and public sector borrowing, there is the need for a transparent mechanism to ensure that funds accruing from OMO's, are not available for government spending. Lapses in this area could compromise the credibility of the bank's commitment to low inflation, and thus undermine investor sentiment about the health of the economy.

5. It has been suggested in some circles that the East Asian crisis highlights the volatility and potentially destabilizing effects of short-term capital flows and hence, signals the need for capital controls (e.g., Malaysia instituted foreign exchange controls on September 1st). Indeed, Paul Krugman, a widely respected economist, advocates controls to break the link between domestic interest rates and the nominal exchange rate, so that the interest rates can be cut to spur domestic growth without weakening the currency. The danger is that capital controls can be used as a substitute for necessary but unpopular reforms required to address the underlying distortions that triggered the capital flows in the first place. Furthermore, by heightening investor anxiety regarding the safety of their investments, capital controls could adversely impact on future capital flows. Hence, controls should only be employed as a short-term palliative, and not a long-term solution.

   In contrast, a policy mix of fiscal tightening and mild controls, such as requiring a reserve requirement on capital inflows, may be more effective. The benefit of a flexible exchange rate regime, as obtains in Ghana, is that capital inflows cause the nominal exchange rate to appreciate without a corresponding increase in the money supply. Flexibility also introduces uncertainty and discourages some short-term speculative capital inflows. However, large inflows lead to large currency appreciations, and tend to undermine export competitiveness.

- ***Banking Reform and Transparency***

The East Asian crisis identified the need for countries in the process of liberalization, to improve financial legislation; upgrade the supervision and regulation of financial institutions; review the strategies for dealing with troubled institutions; and set new standards for public disclosure and transparency. Until recently, however, Treasury Bills have been a lucrative and safe investment for domestic banks, hence, the investment portfolios of banks have been both conservative and lucrative. As Treasury Bills decline in importance and banks compete for equally profitable but more risky investments, a closer examination of bank portfolios may be warranted. To this end, the legal and regulatory institutions that oversee their activities must be provided unimpeded access to information to ensure that sound banking practices are not sacrificed on the alter of profit-seeking. To this end, the establishment of an Independent Supervisory Agency to monitor banking activities together with periodic self-assessment of the quality of the assets of financial institutions, may help to foster credibility and confidence in the lending practices of the banking sector.

CONCLUSION

The experiences of the East Asian countries suggest the need for caution in emulating the Asian model. African countries in the process of financial liberalization must come to terms with the fact that liberalization is a process that requires the painstaking creation and regulation of the institutions that facilitate liberalization. Policy makers must also realize that policy errors are severely penalized in a liberalized environment; hence, the need for consistency and discipline in policy formulation and implementation. Finally, as policy makers strive to attract foreign investment, they must be cognizant of the fact that a major contributing factor to the crisis was maturity mismatches. Thus, quality and term of foreign investment should be an overriding consideration in the quest for capital inflows. Medium to long-term inflows must be the preferred option relative to portfolio investments, which tend to be volatile and destabilizing. Furthermore, to the extent that short-term inflows predominate in the investment portfolio, mechanisms must be put in place to ensure that short-term inflows are not disproportionately channeled into long-term investments. Such measures will be helpful in forestalling some of the problems experienced by the East Asian countries.

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