In a world where capital moves freely across national borders, developing countries have increasingly been subjected to devastating financial crises caused by the sudden withdrawal of foreign capital. How do such crises come about? This book focuses on a novel causal path: that of miscommunication. It demonstrates how and why developing democracies are exceptionally vulnerable to breakdowns in communication between financial officials and the chief executive through a close examination of Asia’s financial crisis of 1997–8, and it outlines the disastrous consequences of such breakdowns.

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GLOBALIZATION, POLITICS, AND FINANCIAL TURMOIL

Asia’s Banking Crisis

SHANKER SATYANATH
New York University
To my family
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Preface

We now live in a world where capital often moves freely across national borders. In this world, developing countries have increasingly been subjected to devastating financial crises caused by the sudden withdrawal of foreign capital. These crises have had severe humanitarian consequences; in East Asia in 1997–98 some countries experienced economic contractions comparable to levels seen in the Great Depression. How do such crises come about? I focus on a novel causal path, that of miscommunication. I demonstrate why developing democracies are exceptionally vulnerable to breakdowns in communication between financial officials and the chief executive. These breakdowns have disastrous consequences because they result in inadequate bank regulation, which encourages the withdrawal of foreign capital.

This book contributes to three literatures. The first is the literature on globalization of capital. This literature has hitherto paid little attention to how globalization can have disastrous consequences in political environments where there are problems in the credible communication of financial information, and this is a contribution of my book. The second is the literature on the politics of financial crises. It is plausible that the presence of ill-informed chief executives raises the likelihood of financial crises. However, scholars of crises have hitherto been unable to systematically identify where we are likely to observe an ill-informed chief executive, thanks to the absence of any preexisting analytical framework for such an analysis. This book offers a framework for all scholars of crises to use when predicting where chief executives are likely to be ill informed about critical economic variables. Finally, the book also contributes to the booming literature on veto players, actors whose approval is necessary for policy change. The standard pathology of multiple veto players identified by this literature is policy stagnation. This book is the first to identify a new pathology. By showing that the presence of multiple veto players can damage the flow of accurate information
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between financial officials and politicians, the book demonstrates a fresh causal path from multiple veto players to catastrophic financial crises.

This book represents a unique opportunity for me to bring together what I have learned from my past in the world of international business, my immersion in the political economy of development, and my fascination with incomplete information game theory. When I started out as a graduate student at Columbia I could hardly have predicted that such an eclectic mix of knowledge could cohere in any one work. It was first Helen Milner, and subsequently Walter Mattli and Mark Kesselman, who took me under their wings and convinced me that this was possible. Frederic Mishkin, Prajit Dutta, and Raghu Sundaram convinced me that my findings were also of great interest to economists. It is to them and to my NYU colleagues, Bruce Bueno de Mesquita, Adam Przeworski, Steven Brams, Bill Clark, Mike Gilligan, and Alastair Smith, who provided invaluable advice at critical moments, that I owe the most for completing this project.

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