The recent Asian financial crises: possible lessons and implications for South Africa*

JOSEPH J NORTON**

"The global financial system has been evolving rapidly in recent years. New technology has radically reduced the costs of borrowing and lending across national borders, facilitating the development of new instruments and drawing in new players. One result has been a massive increase in capital flows. . . . This burgeoning global system has been demonstrated to be a highly efficient structure that has significantly facilitated cross-border trade in goods and services and, accordingly, has made a substantial contribution to standards of living world-wide. Its efficiency exposes and punishes underlying economic weaknesses swiftly and decisively. Regrettably, it also appears to have facilitated the transmission of financial disturbances far more effectively than ever before."1

"Small open economies are like rowing boats on an open sea. One cannot predict when they might capsize; bad steering increases the chances of disaster and a leaky boat makes it inevitable. But their chances of being broadsided by a wave are significant no matter how well they are steered and no matter how seaworthy they are."2

1 Introductory remarks

How to prevent domestic financial crises and the impact of international contagion from such crises is a most important and current topic, especially given the potential threat of these sorts of crises to the development process, as most recently evidenced by the East Asian financial crises. Nonetheless, no matter how successful the solutions may be to a given financial crisis in any particular country, any financial crisis in any country is an expensive and unpleasant situation, with the potential for extremely negative consequences (economic, social and political) for the financial system and economy of the country individually, its region, and possibly the international financial system and economy as a whole. South Africa is very familiar with these sorts of issues following its own financial and currency problems in both 1984–86 and in 1996, as well as its exposure to contagion following the recent Asian crises.

* Inaugural address, as honorary Professor of Banking Law, Rand Afrikaans University, 22 April 1998.
** Sir John Lubbock Professor of Banking Law (University of London); James L Walsh Distinguished Faculty Fellow and Professor of Law (SMU School of Law, Dallas, Texas); and Chief Law Examiner, University of Hong Kong. Head, International Financial Law Unit, Centre for Commercial Law Studies, Queen Mary and Westfield College, University of London; Executive Director, London Institute of International Banking, Finance and Development Law; and Co-Director, SMU Institute of International Banking and Finance. Distinguished Visiting Professor of Law at the University of Hong Kong during 1999. Appreciation is extended to Douglas Arner, Research and Teaching Fellow — Emerging Markets, at CCLS (London), for his research assistance. The author expresses his sincerest appreciation to the Richard Lee Trust at the SMU Law School for supporting the underlying research.

1 Testimony of chairman Greenspan before the committee on banking and financial services, United States house of representatives, 30 January 1998.
By their very nature, mechanisms for resolving financial crises are necessarily of an *ex post* nature. While a number of *ex ante* measures may be taken, unfortunately in most areas there is no final agreement as to what is necessary and of greatest value in this respect. In that regard, I would like to discuss some of the developing mechanisms for preventing these sorts of crises in the domestic law reform efforts of emerging markets and developing countries. While South Africa has made significant progress in this respect, its continued low foreign reserves and future exposures coupled with the need for significant foreign capital for development and its high levels of domestic unemployment highlight the need to further consider recent developments and the implications for commercial law reform and regional cooperative efforts.

Following a discussion of recent financial crises and their implications, I will discuss what countries with emerging markets might do to develop their domestic financial systems to help prevent the sorts of crises that have been so damaging to countries such as Mexico, Bulgaria and Thailand, among others. Further, I would like to discuss what appears to be a developing international consensus in regard to the question of financial stability in emerging economies—a development that I regard as of significance from a number of different levels, from the domestic to the regional to the international.

Unfortunately, despite the significant progress that may be made at the international and regional levels, the final response must of necessity be at a domestic level. Because of that, I would like to draw from my experiences a few observations in respect to the needs of domestic law reform in regard to crisis prevention and the development of financial stability. Finally, I would like to conclude with a few suggestions for the sorts of themes and issues that must be addressed in this process. In this respect, I will discuss the implications for South Africa and regional efforts within the Southern African Development Community (SADC).

### 2 Recent international financial crises

#### 2.1 The Mexican Peso crisis of 1994–95

Beginning in December 1994, Mexico experienced the onset of a severe liquidity crisis, subsequently termed the “Mexican Peso Crisis”, the effects of which continue today in on-going efforts to resolve Mexico’s troubled financial institutions. The onset of the Mexican crisis became readily apparent as the large net inflows of capital, primarily from portfolio investors (and including the return of significant flight capital), that followed Mexico’s accession to the North American Free Trade Agreement (NAFTA) and its admission to the Organisation for Economic Cooperation and Development (OECD) declined abruptly with perceptions of political instability following the assassination of presidential candidate Colosio in March 1994. Outflows continued to increase due to continued perceptions of political instability in Mexico, and were further exacerbated by rising interest rates in the United States.

As a result of the impending exhaustion of its foreign currency reserves, on December 20, 1994, the Mexican government unilaterally devalued the peso by fifteen percent, which resulted in the loss of almost US$4 billion in foreign exchange reserves in two days; and on December 22, 1994, the Mexican government allowed the peso to float from its previously fixed exchange rate parity with the US dollar. The fact that the Mexican government repeatedly an-
nounced that it would not devalue and float the peso substantially undermined market confidence when these actions were in fact effected. Further, as uncertainties developed over the accuracy and extent of released Mexican economic data, the short-term impact of President Ernesto Zedillo's emergency economic relief plans on the Mexican economy were viewed as highly uncertain. This, in turn, led investors to question Mexico's ability to service its short-term debt obligations, mainly in the form of dollar-denominated tesobonos. This all but extinguished institutional investor interest in subsequent tesobono auctions in early January 1995. By the end of January 1995, the peso had lost nearly 20 percent of its value against the US dollar, and the Bolsa had fallen another 30 percent.

While the US Treasury, US Federal Reserve, and IMF officials purportedly did not anticipate the magnitude of the liquidity crisis despite the fact that they engaged in frequent consultations with Mexican government and monetary officials, these institutions quickly concluded that outside assistance would be required to prevent the imminent collapse of the Mexican banking and financial system and to limit the contagion effect of the crisis to other developing countries in the Americas and Asia. Importantly, the US and international monetary officials viewed the crisis as a direct threat to the market-oriented economic and legal reforms the IMF and the US had successfully urged both Mexico and other developing countries to adopt, and that had in the case of Mexico in fact served as the preconditions for the NAFTA. Further, the resulting US-induced financial assistance package assembled by officials in the Clinton Administration made clear that the US viewed such assistance to Mexico as a political and moral necessity following the entry into force of the NAFTA.

For these reasons, president Clinton announced a US package of loan guarantees of up to US$40 bn for Mexico on January 12, 1995, but concerns regarding congressional approval led to its withdrawal. In addition, on January 31, 1995, president Clinton announced a US$48.8 billion multilateral financial assistance package to Mexico consisting of a facility of US reserves (US$20 billion) collateralised by Mexican oil export revenues, loans from the International Monetary Fund (US$17.8 bn), loans from foreign governments assembled through the Bank for International Settlements (BIS) (US$10 bn), and other sources, primarily commercial banks. The package assembled by the Clinton administration, the IMF and the BIS served temporarily to calm institutional investors and international banks. However, further uncertainties as to its ultimate approval by the US congress and concern as to whether the foreign exchange reserve figures disclosed by the Mexican government were accurate quickly eroded any temporary confidence in this respect. Institutional investors continued to liquidate their positions in Mexican equity and debt securities, and currency traders continued aggressively to sell the peso. Thus, by March 1995, the peso reached a low of 7.45 to the US dollar, and as the Banco de Mexico attempted to defend the peso from freefall, Mexican interest rates rose to nearly 80 percent.

Perhaps more importantly for other developing countries, especially those in Latin America, the Mexican crisis procured a fundamental re-evaluation of risk in emerging markets, which led to an uneven rebalancing of institutional investor debt and equity portfolios. This widespread portfolio rebalancing was the mechanism for transmitting the Mexican disturbance to other emerging
markets. Immediately following the devaluation of the Mexican peso, and continuing over the first quarter of 1995, the uncertainty over the scope and prospects for a successful US-induced rescue package (and the common acceptance that, if successfully completed, this would be a "one time deal"), caused most of the larger Latin American countries (especially Argentina, Brazil, and Venezuela) to experience relative degrees of volatility in their foreign exchange markets and noticeable declines in their equity markets respectively, due to repercussions from the Mexican crisis.

2.2 The Asian financial crises of 1997–98

Despite the significant analyses of and international reactions to the Mexican crisis, the scenario was repeated in all too similar a fashion in Thailand in 1997, with contagion severely impacting upon numerous countries in East Asia, resulting in international bailouts for first Thailand, followed by Indonesia and South Korea. The immediate cause of the onset of the crisis in Thailand, followed by those in Indonesia and South Korea, was a reversal of capital flows, upon which the economies of all three countries had become dependent. According to estimates by the Institute of International Finance, net private inflows to the five East Asian countries hardest hit by the crisis (Indonesia, South Korea, Malaysia, the Philippines, and Thailand) decreased from US$ 93bn to US$ 12.1bn, a reversal of US$ 105bn on a combined pre-shock GDP of approximately US$ 935bn or approximately 11 per cent of the GDP. Of that US$ 105bn decline, US$ 77bn was in the form of commercial bank lending, US$ 24bn in portfolio equity, and US$ 5bn in non-bank lending, while direct investment remained constant at approximately US$ 7bn. In contrast to the situation in Mexico, these flows had not been used to fund domestic consumption, but rather extraordinarily high rates of investment (much of which were in speculative areas such as real estate, which created an exaggerated "asset price bubble"). Unfortunately, as currencies were defended, foreign exchange reserves were exhausted to the point where they were insufficient to cover the large stock of short-term foreign debt becoming due. As a result, international bailouts became necessary in Thailand, Indonesia and South Korea. Including contributions from multilateral and bilateral creditors, these financing packages totalled US$17bn for Thailand, US$40bn for Indonesia and US$57bn for South Korea.

At this time, two main hypotheses have emerged in regard to the causes of the recent East Asian financial crisis. According to the first view, espoused principally by Jeffrey Sachs of the Harvard Institute for International Development (HIID), financial panic resulting from sudden shifts in market expectations and confidence in the face of otherwise sound fundamentals, was the key source of the initial turmoil and resultant contagion. According to the second view, the chief proponent of which is Paul Krugman of Massachusetts Institute of Technology (MIT), the crisis reflected an unsustainable deterioration in economic fundamentals and poor policies in the countries affected. Even according to this view, however, market overreaction and "herd behaviour" of investors caused the crisis to be more severe than warranted by the underlying weaknesses that led to the initial declines.

A third view incorporating elements of both fundamental weaknesses and international panic appears, however, to contain the most appropriate description of the situation. Essentially, the initial onset of the crisis was made possible
by fundamental errors and weaknesses, but the market over-reacted to these vulnerabilities as their extent was revealed. This is based on a model of “self-fulfilling” crises, under which existing vulnerabilities make a crisis a possibility but not a certainty. Unfortunately, the analysis to date does not suggest at what point underlying vulnerabilities will move from being a potential for crisis to the point at which a crisis is a certainty. In this vein, according to Alan Greenspan, Chairman of the US Federal Reserve Board, once the crisis was triggered by Thailand’s forced abandonment of its exchange rate peg, it was apparently the combination of pegged exchange rates, high leverage ratios, weak banking and financial systems, declining demand in Thailand and elsewhere, and increased competition from countries such as China and India, that transformed a correction into a collapse.

I suggest that in the face of potential self-fulfilling crises, countries should act in advance to reduce their potential vulnerabilities, both to an initial crisis and to contagion resulting from the onset of a crisis elsewhere, whether through panic, fundamental problems or the unpredictable potentialities of vulnerabilities. Rather than look in detail at the factual background to the crisis in Asia, I will focus on the vulnerabilities that caused or exacerbated the crisis and suggest what individual countries might do to reduce not only their own vulnerability to such crises and the possible contagion from crisis elsewhere. In addition, while there is at present extensive debate taking place about the role of the “architecture of the international financial system” in both preventing and responding to crises, my focus will not be on the international financial system, but rather on the policies of individual countries within that system.

2.3 Outlook for future financial crises

Given that crises of these sorts were not uncommon in developing countries during the 19th century, it can be predicted that, in the unstable macro-environment of the 21st century, further crises are possible if not probable. This is especially so given that the underlying lessons of the Mexican crisis were not translated into reforms in other countries, especially in East Asia, despite the clear need to do so. My goal then is to attempt to describe the lessons to be learnt from Mexico and East Asia, their implications for emerging market economies in general, and for South Africa and the SADC in particular.

3 Implications of recent East Asian financial crises

3.1 Underlying causes of the crises

The underlying causes of the crises can be seen in over-valued real exchange rates, weak and unsupervised banking sectors with perceived implicit political guarantees, and ill-effected and dysfunctional financial market liberalisation in the context of poor exchange rate and banking policies.

First, exchange rate misalignment developed as a result of appreciation of the Japanese yen which began in 1985 and led to aggressive monetary expansion in Japan, eventually resulting in asset price bubbles, first in Japan and later in a number of countries of East Asia. Second, this flow of capital was directed into fragile, bank-centred financial systems. Authorities in these systems permitted the development of serious asset-liability mismatches, with banks financing long-term domestic lending through short-term foreign cur-
The involvement of foreign institutions was discouraged, except as lenders to domestic institutions. Domestic financial systems were politicised, with financial decisions being influenced both by government intervention and corruption, leading to perceptions of implicit government guarantees. Third, as export growth weakened due to exogenous factors such as the reduction in prices of computer chips due to excessive production (resulting from excessive government-directed investment), depreciation of the yen following the bursting of the Japanese bubble and the devaluation of the Chinese currency in 1994, the bad loans began to drag the financial systems away from supplying necessary credit to the economy. Finally, foreign lenders, rather than suffering from moral hazard as a result of the Mexican bailout, did not adequately predict the coming downturn. In addition, they perceived their positions to be protected as a result of domestic political factors.

Four principal causes of the crises, then, can be delineated: exchange rate misalignments; weak financial institutions; an export slowdown; and moral hazard leading to improper borrowing and lending decisions. Even Radelet and Sachs agree that the vulnerability of the economies affected by the crises resulted from macro-economic imbalances, weak financial institutions, widespread corruption leading to moral hazard problems, and inadequate legal foundations in each of the affected countries.

3.2 Significant underlying vulnerabilities

3.2.1 Moral hazard and the role of the banking system

In explaining both the East Asian crises and the earlier Mexican crisis, most analyses agree that a fundamental role was played by the banking system. This line of reasoning suggests that a significant problem in these cases was excessive bank lending following financial market liberalisation. Domestic banking crises are common in developing countries for a variety of reasons. Often they are the result of bad lending practices, exacerbated by political influences on bank lending or actual policy lending to state owned enterprises or politically favoured enterprises. These problems are exacerbated when banks’ source of funds is borrowing in unhedged foreign currency, because in the event of currency pressures, domestic on-loans go into default, worsening domestic lenders’ balance sheets as their own currency position worsens due to external unhedged borrowing. Given investor overreaction leading to denial of roll-over of existing debt, a domestic crisis quickly takes on regional and even international proportions. Importantly, all of these problems are worsened by a financial system that is fragile, and poorly regulated and supervised.

It has long been realised that financial intermediaries whose liabilities are guaranteed by the government, pose a serious problem of moral hazard: the US savings and loan debacle is the classic example. The case in East Asia, however, is more murky because creditors of financial institutions did not receive explicit guarantees, but rather perceived that they would be protected from risk due to implicit guarantees, enforced by the politicisation of the financial system. While South Africa is recognised for the strength and sophistication of it’s financial system, moral hazard implications must be made both credible and explicit: if there is no deposit insurance scheme (arguably a potential problem in a country with significant wealth differentials such as South Africa), then pre-commitment to non-bailout policies must be explicit. If in-
stitution feel that because of political connections they will not be allowed to fail, this plants the seeds for excessive financial risk-taking and eventual bad debt problems.

3.2.2 Improper sequencing of liberalisation

An analysis suggests that financial market liberalisation may be the best predictor of a financial crisis. This has proved true in Latin America and the US in the 1980s, in Europe in the early 1990s, in Mexico in 1994 and in Asia in 1997. In East Asia, financial liberalisation lifted some restrictions, including those on bank lending to real estate, before putting in place a sound regulatory framework.

In terms of self-fulfilling crises, financial liberalisation makes attacks possible and exposes underlying vulnerabilities to the vagaries of international capital markets. The lesson to be learned is that financial liberalisation should only be contemplated when the situation is ripe. First, significant financial weaknesses, such as banking system weaknesses, large external debt, high unemployment and unsettled macro-economic conditions, must be eliminated. Second, countries which accept full capital mobility must sacrifice either fixed exchange rates or monetary policy independence. Monetary policy independence requires a reasonably flexible exchange rate, while a tight exchange rate requires the abandonment of monetary policy independence, for instance through a currency board arrangement. Full capital liberalisation should be the last step of this process.

This approach is explicitly expressed in the policies of the SADC Committee of Governors of Central Banks, established under the aegis of the Council of Ministers of Finance Development of the Finance and Investment Protocol to the Treaty of the SADC, chaired by South Africa. Further, South Africa’s own sequenced response to the elimination of exchange controls, while subject to criticism, in retrospect appears to have been the most effective mechanism for achieving the adjustment of the South African financial system into the international one.

3.2.3 Political instability and uncertainty

As in Mexico, perceptions of political uncertainty and instability were very significant causes of the initial confidence crisis among external investors in East Asia. Much as in Mexico, perceptions of the weakness and inability of the Thai government to deal with underlying economic problems, uncertainty over the continued health of president Suharto in Indonesia and the December elections in South Korea, caused investors to question the political stability of the three countries which eventually required bailouts. While countries such as Malaysia and the Philippines were also badly effected, their perceived levels of political stability were viewed much more favourably than those of the bailout candidates. Political problems also impeded the implementation of appropriate political responses to impending and developing financial problems, especially in Indonesia. While the initial responses in Thailand and South Korea were the cause of much uncertainty, the situation was quickly taken in hand and the improvements in political stability and eventual successful reform yielded rapid benefits, giving hope for a rapid turn around, as has in fact occurred in Mexico. Indonesia’s continued vacillation has undermined perceptions of the viability of its economic situation.
The lesson to be learned from this is that countries with weak and indecisive governments and institutions, in conjunction with other underlying vulnerabilities, are more likely to suffer external or internal confidence crises than those with strong and decisive governments and capable institutions. Further, such weak and indecisive governments and institutions have the potential to severely worsen the effect of any crisis or contagion through their ineptitude. That this is true of Indonesia is inescapable. Furthermore, the lessons for Russia in particular to learn in this regard, are clear. Taking the above into account, South Africa and the countries of Southern Africa should recognise that international perceptions of political instability will weaken international confidence and increase vulnerability to international capital withdrawal.

3.3 Withstanding future crises

The collective interconnection of major developing countries into the international financial system implies that disturbances in any other market, whether developed or developing, can be rapidly transferred in the form of financial contagion into developed or developing markets. Empirical investigations by the IMF and other international organisations have confirmed that the increase in cross-border capital flows over the past ten years, most notably through portfolio investment, has bound national capital markets more closely together and that the cross-border transferral of disturbances can occur with unnerving speed. This concept was reinforced by the ensuing contagion from the Mexican and East Asian crises which extended to other countries in the region and world-wide. Most countries in these regions, even those with fundamentally sound economic indicators, experienced temporary exchange and equity market disturbances during the respective crises.

According to Greenspan, vicious crisis cycles such as that in Mexico in 1994 and Asia in 1997 may in fact be "a defining characteristic" of today's high-tech international financial system. As a result, while human panic reactions may not be controllable, at least the imbalances that exacerbate them can be addressed, maybe even in advance.

According to Fischer, first deputy managing director of the IMF, in order to avoid crises, a country needs both sound macro-economic policies and a strong financial system. A sound macro-economic policy framework is one that promotes growth by keeping inflation low, the budget deficit small, and the current account sustainable. This is traditional IMF fare, and is reflected in the IMF's most recent Article VII consultation with South Africa.

The focus on the importance of the financial system, however, is a more recent development. The critical role of the strength of the financial system was becoming clear before the Mexican crisis. It was crystal clear in that crisis and its aftermath, and it has been equally clear in the East Asian crises and their aftermath. In this respect, Greenspan notes eight factors that have been present in international and economic disruptions, but which appear in more stark relief today, namely: excessive leverage; interest rate and currency risk; weak banking systems; interbank funding, especially in foreign currencies; moral hazard; weak central banks; underdeveloped securities markets; and inadequate legal structures. I would suggest that in fact all of these problems are law-based failures and must be addressed in that context. While South Africa has developed a strong domestic financial system reflecting most of these elements, the final element regarding the further development of commercial legal
infrastructure should be emphasised as a mechanism for driving forward domestic growth and foreign investment.

4 Law reform and financial stability

Today, scholars, governments, international institutions and business recognise that one of the most important aspects of economic growth for any economy is financial stability. Financial stability is based on the underlying legal and financial infrastructure in an economy, and, for the first time, an international consensus is developing on exactly what is necessary in the way of legal and financial infrastructure for financial stability. The consensus in this area is that in order to develop economically, emerging markets must have in place appropriate structures to guarantee financial stability, especially given the increasing mobility of international capital and the reliance of emerging markets on that capital to fund their own development processes. Further, as Japan is experiencing today, an effective financial infrastructure is as necessary to a developed economy as to an emerging one such as Thailand. However, as both Thailand and Mexico have experienced, it can be less precipitous for a developed economy to extricate itself from problems than for an emerging economy.

In developing financial stability, four issues seem to be paramount: (i) a robust financial system, including an independent central bank; (ii) corporate governance and the creation of an effective incentive and monitoring structure for corporate performance; (iii) the strengthening and expanding of domestic capital markets; and (iv) the need for an effective insolvency regime combined with the creation of a social safety net, in order to resolve businesses and prevent political and social instability.

4.1 Building robust financial systems

Experience has shown that a robust financial system is one of the most important components of successful and sustainable development. A robust financial system allows a country to mobilise domestic savings and international finance and to channel these resources to productive, growth-enhancing investments. Further, the existence of an independent central bank enables a country to have pre-determined and credible objectives underlying financial stability. The performance of South Africa’s central bank has been exemplary in the face of difficult domestic and international pressures: it is now perceived as a capable and independent political entity, strengthening external confidence in the future of development of South Africa.

Many of the elements required for building robust financial systems are now understood. In response to an initiative at the Lyon summit of the Group of Seven in June 1996, representatives of the countries in the Group of Ten and of emerging market economies jointly sought to develop a strategy for fostering financial stability in countries experiencing rapid economic growth and undergoing substantial changes in their financial systems. In their Report, the G-10 focused on three key elements necessary to the development of a robust financial system: (1) the creation of an institutional setting and financial infrastructure necessary for a sound credit culture and effective market functioning; (2) the promotion of the functioning of markets so that owners, directors, investors and other actual and potential stakeholders exercise adequate discipline over financial institutions; and (3) the creation of regulatory and supervisory
arrangements that complement and support the operation of market discipline. The creation of an independent central bank with clearly defined objectives should be added to this list.

Importantly, given that a safe and efficient financial system is essential for the functioning of any economy, the G-7 at their Lyon Summit in 1996, in the wake of the Mexican Peso Crisis of 1994–95, directed the international financial institutions, especially the IMF, the World Bank and the Basle Committee on Banking Supervision, to develop standards for financial regulation to be implemented in both developed and developing countries, and also to develop solutions for domestic crises with international implications, such as the Mexican Crisis. As a result, the international financial organisations (IFOs) have been producing standards in a number of areas: the Basle Committee on Banking Supervision (Basle Committee) published its Core Principles for Effective Banking Supervision (recently finalised); the International Association of Insurance Supervisors (IAIS) published supervisory principles in September 1997; the International Organisation of Securities Commissions (IOSCO) will soon present securities principles; and the International Accounting Standards Committee (IASC) will present a comprehensive set of international accounting standards to the membership of IOSCO for approval in July of this year. In addition, the Joint Forum on Financial Conglomerates (a cooperative effort of the Basle Committee, IOSCO and the IAIS) is also to produce some sort of “principles” document. South Africa has been actively involved in all of these international efforts and has endeavoured to duly implement the resulting consensual decisions in its domestic financial system, not only increasing external confidence in the system, but also giving South Africa a valuable international role and voice in the on-going debates on these issues.

Recent work by the Basle Committee (composed of the G-10 central bank governors) and others has shown that one of the most prevalent problems in any emerging economy is effective regulation and supervision of the banking system. In essence, the goal is the combination of strong incentives for prudential behaviour with an effective regulatory system. Incentives are provided through capital requirements and franchise value, ie, the value of future profits, while regulation should focus on every level of financial activity, from risk management to individual transactions.

While of fundamental importance, capital adequacy has to be judged on the basis of the risk characteristics relevant to banks in each country and the Basle risk-based capital adequacy standards must be taken as guides or minimums, and certainly not as a maximum of capital adequacy irrespective of country specific factors. In addition, supervision and regulation should address excess non-performing loans expeditiously.

Beyond the various emerging “Core Principles”, recent studies have suggested a number of factors that are of importance in the development of a stable and effective banking system. Of special importance are the development of adequate lending infrastructure, effective corporate governance for banks and access to derivatives markets.

First, an adequate lending infrastructure is based on the problem of mismatches between bank lending and borrowing (“duration”). An adequate lending infrastructure enables banks to extend the time horizon of their loans through greater security. In this regard, two aspects of the lending infrastructure are especially important: an effective system for taking security and the
development of credit rating systems and/or agencies. An effective system for the taking of security allows banks to be more confident that they will be able to realise collateral taken on loans. Providing a system of registering and taking security therefore provides two functions for bankers: first, it allows them to reduce monitoring costs because their investment is protected; and second, it provides greater certainty in making lending decisions, thereby increasing the number of such decisions that will be made. The development of credit rating systems and agencies serve similar functions in that they decrease the need for initial research and subsequent monitoring, thereby reducing the cost of credit and increasing lending and loan maturities.

Second, effective corporate governance for banks is necessary to avoid the sorts of problems faced by the US during the SandL crisis of the 1980s. Banks must be adequately capitalised so that their investors have incentives to protect their own investments by making careful borrowing and lending decisions. As an aspect of this, banks must know that they will be allowed to fail if they make bad decisions; otherwise, the provision of capital has no real disciplinary effect. This is another aspect of the "moral hazard" problem mentioned throughout this paper. Further, managers must be responsible to owners — also achievable through adequate capitalisation and limitation of moral hazard.

Third, banks and other financial institutions need to have access to advanced risk reduction and hedging techniques, especially as currencies move closer to full convertibility. During the Mexican Crisis, the lack of access to risk sharing and hedging techniques contributed to the severity of the impact of the crisis on the domestic financial system. During the East Asia crises, because of perceptions of currency stability, borrowers and lenders did not protect their foreign currency positions through hedging activities. In this regard, domestic derivatives markets should be developed, albeit very carefully, due to the complexities and potential dangers of these sorts of financial instruments. Recent standards by IOSCO are instructive in this respect. The development of South Africa's capabilities in this regard are instructive for emerging markets around the world.

4.2 Effective corporate governance

In terms of improving the productivity of assets, a vital consideration is corporate governance. Without effective corporate governance, companies will not become more productive and efficient. Importantly, no single form of corporate governance model has emerged as dominant one, but the important consideration is that corporations are in some way accountable to and monitored by their owners — whether public or private. Fundamentally, corporate governance is a reflection of policy choices, but it is also a reflection of underlying legal choices in the organisation of companies and financial relationships. Policy-makers must realise that the legal framework of business and finance relationships will determine the outcome of the economy's corporate governance system. Further, corporate governance concerns, especially in respect to the protection of minority shareholders' rights, are of great importance to both international and domestic investors. While numerous countries have been looking at these issues around the world, no international consensus yet exists. The OECD, however, may attempt to synthesise some sort of statement of international principles of corporate governance. In line with increasing international concern in respect to corporate governance, this is an important issue
that South Africa must address. While conglomerates are beginning to diseg-
gregate to some extent, the historical concentration of ownership and cross-
linkages needs to be addressed, not only to encourage the involvement of
international investors, but also to bring a larger portion of the population
into the financial system and reduce efficiency-reducing structures while en-
hancing capital market liquidity.

4.3 Strengthening domestic capital markets

Domestic capital markets serve as an additional outlet for savings and as a
mechanism for the generation of investment. However, they take time to develop,
especially in regard to the understanding of their dangers posed to investors, as is
especially clear from the political instability caused by the collapse of pyramid
schemes in Albania. Another, less threatening, situation can be seen in Shanghai
where riots have occurred as a result of share allocations. This situation is dan-
gerous in that there exists the possibility of the development of a classic “bubble
market” in which share prices are pushed too high too quickly, and then when
investor confidence is shaken by some event, crashes very quickly and with
potentially damaging consequences, as happened in the UK in 1719 and the
US in 1929. In both cases, the crash led to severe economic consequences and a
strong legal and popular reaction against capital markets.

This brings to light the need, then, for the second level of building blocks
(following the creation of a general corporate infrastructure) necessary for the
further expansion of domestic capital markets: a system of securities regulation
that fosters market confidence through transparency and investor protection.
As has clearly been shown by the development of the US securities markets and
the increasing convergence of domestic securities regulatory regimes interna-
tionally, demonstrated by harmonisation in Europe and proposals in Japan,
transparency and a strong system of securities regulation fosters confidence in
domestic capital markets, increasing investment and efficiency.

While the Johannesburg Stock Exchange has the twelfth largest market
capitalisation in the world, as discussed above, historical concentration of
ownership and cross-linkages has reduced its liquidity. In order to increase
international investment its role as a potential engine for development in the
SADC, South Africa needs to address these problems because the capital
market is not only a mechanism to attract portfolio investment, but also for-
eign direct investment (FDI) and venture capital investors, to whom the stock
exchange and its provision of liquidity provides a necessary and attractive
means of eventual exit. As one mechanism of developing its domestic capital
markets, further privatisation is an obvious (and generally effective) choice.

Finally, as already mentioned, the development of domestic derivatives mar-
kets for risk-sharing and hedging are important to financial stability and also
allows investors (especially institutions) to protect their investments from ad-
verse shocks to currency rates.

4.4 An effective insolvency regime combined with a clear and predefined
social safety net

Not all banks and other firms will be capable of survival, nor should they be.
As one aspect of corporate governance, those that are not should be faced with
a viable threat of bankruptcy. Unfortunately, at the moment, many banks and
other corporate entities in developing countries are simply "too big to fail" because of their vital role in social and political stability. This indicates the necessity for important government policy choices in these areas. In most cases, an effective insolvency regime must be combined with an effective social safety net in order to allow banks and other companies to become insolvent without severe domestic consequences.

The dangers inherent in this situation can clearly be seen from the recent riots in South Korea resulting from intended government changes to the system of lifetime employment there. Further, in order to decrease moral hazard, any safety net for depositors must be clearly and explicitly defined before the onset of any crisis situation. While South Africa has chosen not to have an explicit deposit insurance system, one wonders whether in the case of a significant domestic banking crisis this would prove a credible commitment. Further, a minimal system may in fact attract small depositors into the system who might otherwise have remained outside.

5 Law reform in the search for financial stability and sustainable development in South Africa and the SADC

While standards and themes are of some significance, they are in fact the easy part of the process: the difficult process of implementation in countries around the world still lies ahead. This is the point where countries must make their own decisions. However, I think it is useful to note not only a few themes, but also certain suggestions in this regard.

5.1 Insights into the domestic economic and financial law reform process in emerging markets

Five words can be seen to embody the lessons of recent financial crises for the law reform process: "chance", "coherence", "sequencing", "evaluation", and "interconnection".

Chance While academic analysis can perhaps categorise the development of different countries into different tiers and groupings, analysis and experience indicates that the law reform in each country is sui generis and should be treated as such. Elements of chance have certainly been present in numerous country situations, but the broader lesson is that each country presents an individual setting for law reform. Quite simply, there is no universal model!

Given South Africa's increasing use of the developments of international models and its quick assimilation thereof, there exists a need to re-focus certain elements of the domestic educational structure to take account of these developments and their underlying rationales. This need is even clearer in the whole of the SADC.

Coherence According to many writers, a country may not need to adopt one total system, but often should "pick and choose" what appears to be best in defined situations. However, such an amalgam should be a "mosaic", which implies coordination and coherence. Uncoordinated, piecemeal adaptations may, in the long-term, be counterproductive.

South Africa is reaching that dangerous level of development where exchange controls are to be eliminated and the system fully opened to the international financial system. It is during this time that crises seem most common and potentially damaging. For that reason, it is important that reforms and
liberalisations are not done in a piecemeal fashion, but according to a broader picture of the eventual goal. It is in this respect that the need for careful analysis of any potential underlying problems remaining must be carried out and these problems attended to before they are exposed to the upheavals of the international financial system.

Sequencing The “European Union model” is based on this concept. However, sequencing is not a mechanical process, but should be customised and “fine-tuned” on a country-by-country basis. The need is to approach law reform from a “made to order” and not from a “ready made” perspective. As has been demonstrated, improper sequencing (ie liberalisation preceding strengthening) of financial reforms has been a critical underlying factor in many financial crises. In light of the need for coherence, proper sequencing must also be carefully attended to. This must especially be so in the case of financial harmonisation and liberalisation within the SADC.

Evaluation Clearly, economic law reform efforts to date have been largely unscientific processes, with little or no built in procedures to ensure accountability, monitoring and reevaluation. The need for appropriate and on-going monitoring and evaluation mechanisms are perhaps the ultimate challenge for IFOs, IFIs and concerned emerging economies. As can be seen, temporary success is not a sufficient evaluation. Domestic efforts must focus on determining potential problems before they are exposed by the market and treating them decisively and effectively. As noted before, small open economies do not have the luxuries that large economies do in this respect.

Interconnection Today, various areas of law reform are inextricably inter-connected (eg, banking with securities law reform). The need for interconnection of related and interlinked areas of law reform cannot be understated, although it is sometimes neglected, even in the “developed” world. Once again, underlying problems such as those described in the context of corporate governance need to be addressed before they impact some seemingly unrelated (and potentially economically significant) variable or vulnerability.

With these thoughts in mind, different nations may need to adopt solutions corresponding to their different levels of development and their different needs, especially in relation to the financial sector. However, this must be done carefully, thoughtfully and rationally—not simply at the behest of foreign investors or the IMF.

5.2 Underlying issues

In terms of domestic implementation (as well as international standard setting), a number of issues are of underlying importance, namely: accounting and auditing standards, transparency, a strong Rule of Law and the reduction of corruption, and the creation of a favourable international investment environment.

5.2.1 Accounting and auditing standards

Accounting standards clarify relationships and encourage investment, both domestic and foreign, because they provide an understandable common language with which businessmen can communicate about their businesses and finances. In addition, internationally accepted accounting standards encourage investment because they provide transparency and comprehensibility. For
these reasons, consistent accounting standards are absolutely essential for the success of continued financial stability and development in any emerging market economy. With the accounting profession applying internationally accepted accounting standards that should not be compromised, companies will gain greater experience and confidence with accounting systems and practices, thereby increasing their own role in the international financial system. Perhaps more importantly, business people in emerging markets will find that clear systems of accounting are not only good for encouraging foreign investment, but also for their own internal management purposes and maintenance of profitability in the long term.

Consistent accounting standards are absolutely essential for the success of enterprise reform in any country. Accounting standards clarify relationships and encourage investment, both domestic and foreign. Further, accounting standards are the basis of the operational fiction that in many cases allows financial institutions to continue to exist in the face of probable technical insolvency. While accounting standards must eventually be internationalised in order to provide transparency for both domestic and international investors, this process can take place gradually as debt overhangs are eliminated, currencies move towards convertibility, and markets open to international capital.

In regard to international accounting standards, IOSCO and the IASC have committed themselves to the development of international accounting standards for securities and companies by July 1998. This development will be of massive importance to all countries wishing to participate in international capital markets. The development of such standards will mark the creation of a truly international language of finance and investment, allowing comparisons to be made directly between investments in different markets. For this reason, all countries (including the US) would do well to consider the developments in this area and to work to use and facilitate the use of such international standards.

South Africa, with its developed accounting and auditing standards and profession, can serve as an important aid to Southern Africa — much in the same way that Hong Kong SAR serves this purpose for China. Further, South Africa’s on-going involvement in the IASC and assimilation of its efforts should be noted and encouraged.

5.2.2 Transparency

Transparency is necessary so that all the various players understand the rules of the game, so that it can continue successfully. As the recent experiences of Japan, South Korea and Thailand have shown, legal and financial transparency is of the utmost importance in the long-term successful development of an effective financial system. The emerging international consensus on the requirements for financial stability is built on the principle of transparency, and for this reason the financial and legal infrastructure of any emerging market must be transparent. Moreover, the advantages of transparency are a baseline for financial and legal development and resulting financial stability and economic success.

Transparency is necessary not only for international investors, but for domestic investors as well. Transparency is necessary for whatever solution a government chooses to resolve banking problems, because without it investors,
companies, banks and markets will not understand the process chosen and will not have confidence in it. It is necessary in accounting so that investors can determine values for productive and non-productive assets and make decisions accordingly. It is necessary for banks in order to lengthen loan horizons and evaluate borrowing and lending decisions. It also is necessary for capital markets in order for investors to understand the nature and risks of investing in securities and can thereby prevent the potentially disastrous rise and collapse of stock market bubbles. Finally, it is necessary for international investors to enable them to make comparisons and secure and well-thought out business decisions, which will benefit not only themselves but also companies making choices that encourage investment and eventual success in the market.

Both the Mexican and the East Asian crises were partly triggered and exacerbated by investors finding out that reserves were smaller than they had thought and that short-term debt was higher. One of the many lessons drawn from Mexico and East Asia is that the extent of the crisis was worsened by the poor quality of information supplied to both the official sector (including the IMF) and the markets. The East Asian crises reinforce the argument for better and more timely provision of information, including information on central bank forward operations.

There are two arguments in this regard: (i) better informed markets are likely to make better decisions, and in both Mexico and in Asia this would have meant that markets would have withdrawn funds sooner than they did, thereby hastening adjustment; and (ii) the obligation to publish information on certain interventions would affect the extent and nature of those interventions, helping to prevent some unwise decisions. In this regard the IMF is presently only seeking to further strengthen its Special Data Dissemination Standard (SDDS). However, it is quite possible that stronger measures will soon be forthcoming.

According to Greenspan, the primary protection from adverse financial disturbances is effective counterparty surveillance and hence government regulation and supervision should seek to produce an environment in which counterparties can most effectively oversee the credit risks of potential transactions. In this respect, a “major improvement” in transparency, including both accounting and public disclosure, is essential. However, given the financial crises which occurred earlier in the decade in Norway, Sweden and Finland—countries with highly transparent economic systems and advanced institutional frameworks—transparency is probably not sufficient in and of itself.

South Africa not only participates in the SDDS, but is also one of the few countries in the world to release information on its central bank’s net open forward position. While this may seem to expose a potential vulnerability, as was shown with similar though undisclosed positions in Thailand, international advance knowledge of weakness is preferable to investors discovering that a perceived stable situation was in fact completely untenable, resulting in rapid deterioration of confidence and capital flight.

5.2.3 A strong Rule of Law and the reduction of corruption

The emerging international consensus is that a transparent, predictable and enforceable legal regime underlies successful economic development. It is important for investors and businesses to feel that their investments are safe and can be protected in order to provide the necessary confidence in the financial
system.

The "Rule of Law" as to economic or other societal regulation is of little practical value unless fair and effective enforcement can be attained and sustained. As such, regulatory authorities require adequate personnel and technological capabilities to ensure effective enforcement. The enforcement must also be fair, both substantively and procedurally: this will require transparent and judicially reviewable administrative processes. Also, administrative enforcement cannot be entirely fair and effective without an independent, well-educated and non-corrupt judiciary.

Corruption can undermine the reform process by reducing public confidence. As corruption increases, confidence in the fairness and openness of the financial system decreases, causing investment to decrease and move to other shores. In this regard, the recent experiences of Hong Kong are instructive: its system must be allowed to continue its anti-corruption efforts in order to maintain its status. However, Singapore has become increasingly competitive: while its legal system is viewed as very strict, it is also viewed as largely uncorrupt. Thus, for example, if Hong Kong SAR is increasingly viewed as a less fair and open place for business, then business will increasingly move to Singapore, with its strict but fair and noncorrupt system.

Corruption can undermine the reform process by reducing public confidence. While corruption in some countries such as China, Russia and certain of the Latin American countries is of international concern, it nonetheless must always be a concern in any country. From the standpoint of general financial stability, if corruption is too pervasive, confidence in the financial system will weaken and investment and stability will decrease. From the standpoint of banking, if corruption palpably exists, banks may be weakened by insider lending practices, such as has been the case in Thailand. These are the moral hazard problems discussed earlier, commonly referred to as "crony capitalism". Finally, from the standpoint of capital markets, corruption can cause wariness to invest due to perceptions of a "rigged" market or can even shake confidence to such an extent that the market collapses. Corruption in fact can be seen as the primary cause of the collapse of the UK stock market at the time of the South Sea Bubble in the early 1700s.

Corruption, however, does not necessarily equate with the absolute requirement of arm's length business transactions. In some cultures, such a solution is obviously impossible. However, a few requirements are probably in order: maximum lending limits to a single borrower in line with international standards, prohibition and punishment of market manipulation, and the punishment of self-dealing, perhaps through the development of corporate fiduciary duties. Obviously, such minimum requirements protect ownership interests as well as enhance general confidence in the financial system, and so should be strongly implemented.

Given South Africa's unique situation and the strong domestic perceptions of corruption and crony-capitalism existing before 1994, efforts in this respect are of great significance. Most importantly, these problems undermine domestic confidence in capital markets, the financial system, the judicial system, and individual perceptions of potential for development and success. Unfortunately, as an American, coming from a system that often suffers the same sorts of criticisms, I cannot offer any internationally accepted solution. However, efforts such as those of the Truth and Reconciliation Commission are ob-
viously extremely important. Further, efforts to update laws on monopolies and insider lending and dealing, along with appropriate enforcement of these sorts of provisions, would help to reduce perceptions of a rigged financial and judicial system and increase domestic, as well as international, participation.

5.2.4 Favourable environment for international investment

International investment encourages growth and the transfer of know-how. However, as shown by experiences in other countries (eg, Mexico in 1994–95 and Thailand, Indonesia and South Korea in 1997–1998), it can also have its dangers. In terms of the creation of an environment favourable to international investors, developing countries probably have two primary focuses: first, attracting foreign investment; and second, access of domestic companies to international capital markets.

In order to advance the process of foreign investment, the factors already discussed are of prime importance, ie international banking standards, effective corporate governance, improving domestic capital markets, an effective insolvency regime, international accounting standards, transparency, and enhancing the rule of law and reducing corruption. The combination and effective implementation of the above should ensure the confidence of foreign investors.

Second, in regard to access to international capital markets, the same set of factors is once again implicated. However, a few comments are worth highlighting. Even more so than with domestic investors, international investors must understand the nature of the government's policy solution before they will be willing to take part in it. Only if transparency and certainty exist will investors have the necessary confidence to take part in the process. Further, as a vital aspect of the process, any access to international capital will require transparent and effective accounting standards. Without this basic device, domestic companies will not be able to list their shares on other markets and international investors will likewise not be able to evaluate and invest unless they understand the relevant accounting standards.

6 Concluding observations

Unfortunately, despite our best efforts, we do not seem to be able to present any comprehensive solution to the problems of financial law reform in emerging markets. While the emerging international consensus is very important and useful in terms of general standard setting and detailing of policy options, no one choice is always appropriate. Choices should rather be tailored individually in each case. In this regard, it is obviously important to South Africa to learn any lessons that it can from the experiences of Mexico and East Asia in order not only to avoid these sorts of crises, but also to enhance its own path of development.

6.1 Continuing problems

Looking specifically at the overall problems likely to continue to affect the financial systems in many emerging markets for the near future, the following come to mind: the weakness of banking institutions, the prevalence of corruption and crony-capitalism, the lack of effective and consistent regulatory en-
forcement, the lack of sophisticated and efficient judicial mechanisms for the resolution of financial disputes, the inexperience of market participants, and the shortage of domestic savings. In South Africa, the shortage of domestic savings and the inexperience of a large percentage of the population in conjunction with significant unemployment would appear to be the most significant problems, rather than inadequacies in the domestic financial environment.

At a more fundamental level, the inefficiencies of general corporate law and of investment firm regulation, and in particular the absence of appropriate solutions to questions of conflicts of interests and insider dominance in corporate governance and securities activities, are likely to impede the smooth and rapid maturation of financial systems. While the financial system of South Africa is well-developed, these sorts of problems are likely to be of major importance in the near future, given South Africa’s need to develop confidence and broaden participation in its financial system.

These are all problems without easy, quick or necessarily direct solutions. However, I think that in the final analysis we can agree on a few points. First, the international standard setting process is encouraging in that in the past little attention was paid directly to this very important issue and little was done directly to address these fundamental problems. Second, the role of the intergovernmental organisations (whether on a world-wide, regional or sub-regional level) and of internationally-orientated domestic institutions in weaving together the strands for sustainable financial and economic development in transitioning and emerging economies cannot be underestimated, yet they cannot be overestimated. This role can be viewed as largely directive (in a general sense) and supportive of a particular country’s national commitment to true market, legal, political and social reform.

Indeed, the fundamental reform problems are long-term and will depend upon the building of the appropriate educational infrastructure within a particular country, along with the development of a cultural ethos conducive to the development of transparent, open and non-corrupt financial markets and financial institutions and a judicial and administrative framework staffed and supported by a well-trained and honest bureaucracy and legal and accounting profession. We are not talking solely about economic reform or transition, but more broadly about legal, social, political, educational and cultural reform.

However, increased cooperation on the international, regional and national levels, can shine considerable light on the formulation, implementation and (as yet to be directed to any significant degree) the monitoring and evaluation stages of meaningful economic and law reform in emerging economies, particularly as these reform efforts are geared to the development of viable and sustainable financial markets. It is in this respect that international cooperative efforts within the educational system can be of immense importance to the long-term development of South Africa and the SADC. Academic linkages to the rest of the world need to be strengthened in order to provide the basis for the development of South and Southern Africa’s human capital necessary for true social, political and economic development.

6.2 Short-term capital flows
Some are now arguing that short-term capital flows such as those that triggered the recent financial crises in Mexico and East Asia do not bring ancillary benefits, but instead only increase the vulnerability of an economy, especially in situations such as East Asia where high domestic savings rates existed and resulted in misallocation of marginal investment. Even the editors of the Financial Times (London) agree that the case for early and complete freedom for international capital flows has been damaged and that the question is how to maximise the benefits of capital flows to developing countries, while minimising both the number of panics and the damage they cause. The question, and it is a complex one that no one knows the answer to, is how to do this. Stiglitz suggests that at the domestic level, first, tax, regulatory and policy distortions that may have stimulated such flows and encouraged short-term foreign borrowing, such as the Bangkok International Banking Facilities, need to be eliminated. Second, capital in-flow inhibitions, such as those in Chile (essentially a tax on short-maturity loans), may be appropriate. The suggestion is that these, together with solid fundamentals and a sound financial system, may be the reason that Chile has been relatively unaffected by recent crises.

While South Africa has been significantly affected by capital flows in recent years, its strong financial system and its system of exchange controls have helped it to weather the effects. These effects, while negative, have not resulted in the melt-down of the domestic financial system or the reversal of the reform process, as could have been the result without the presence of these factors. In the future, however, because South Africa needs international capital for development, it would do well to focus on mechanisms such as lending infrastructure and domestic currency markets to encourage longer-term, domestic currency lending, while at the same time increasing its international reserves. The recent reforms to the national payment system show the commitment of the Reserve Bank to developing the underlying financial infrastructure in South Africa, which should also enhance its role as a regional financial centre. Further, the taking of precautionary steps such as the recent signing of a Syndicated Medium Term Revolving Credit Facility from a group of thirty-four international banking institutions to the Reserve Bank are to be applauded.

6.3 Regional responses to financial crises and the SADC

The globalisation of financial markets has increased the complexity of the international financial system and the volume and size of international capital flows. These complexities present new challenges and opportunities to international trade arrangements, law reform, and economic development. In the 1996 Lyon Summit Economic Communiqué the G-7 nations asserted that, in calling for the strengthening of economic and monetary cooperation, their respective economic policies would continue to be coordinated towards sustaining non-inflationary growth and that their finance ministers would continue to cooperate closely on economic policy and in the foreign exchange markets. The G-7 declared that strong and mutually beneficial growth in trade and investment "will be sustainable and therefore most beneficial to all if conducted within a strong multilateral framework of rules", thus reaffirming the central role of the World Trade Organisation (WTO) and the pre-eminence of multilateral rules to serve as the framework for regional initiatives. Nonetheless, the recent crises
have highlighted the potential role of regional organisations such as the SADC. According to Stiglitz, senior vice president and chief economist of the World Bank, in addition to global standards and risk protection, a complementary regional response is also warranted, primarily because contagion effects have tended to be strongest within the region of the country immediately affected. Further, regional neighbours may be better poised both for cost effective surveillance and for effective peer monitoring. Possible mechanisms include funding, surveillance and technical cooperation.

Beyond the high profile efforts of the European Union, other regional organisations are beginning to venture into the financial sphere. Of most recent note, of course, are the recent initiatives being taken in South East Asia, through the Association of South East Asian Nations (ASEAN). Beyond Southeast Asia, NAFTA and Mercosur are both increasingly influential in the sphere of financial regulation and supervision within their respective member countries, and should become even more so if the preliminary international work currently underway for the April 1998 Second Summit of the Americas to be held in Santiago, Chile, is any indication of the future.

While the SADC has had a much lower profile than many of these organisations, its plans for financial development and potential integration in the rest of the region are exemplary and in fact could serve as a model for many other efforts around the world, especially given the lessons to be learnt from recent financial crises. In choosing what governor Stals calls a “bottom-up” strategy, the SADC has chosen an appropriate starting point that both ASEAN and Mercosur would do well indeed to consider. According to this approach, the first stage is focused on laying an appropriate foundation in the form of an effective institutional framework for the financial system in each country, including an independent central bank and the establishment of private institutions and markets. Following this initial programme (by no means an insignificant accomplishment), the goal is then to look at issues of market access and potential harmonisation and integration. If a similar coherent and sequenced approach had been followed in respect of East Asia’s entry into the international financial system, the crises there might have been avoided.

6.4 Success factors in development

To conclude, I would like to leave with a few more optimistic thoughts on development. It is important while looking at the negatives of recent crises, not to forget the positive lessons that have underlied the successful growth of the East Asian countries over the past decades. Some of the most important features of East Asia’s development were sound macro-economic fundamentals, including high savings; a commitment to education and technologically advanced factories; a relatively egalitarian distribution of income; and an aggressive pursuit of foreign exports. These elements are still present, not only suggesting that East Asia’s future will be bright, but further that these elements can continue to provide a model for successful development throughout the world.

I think these elements are instructive for South Africa. First, in order to increase macro-economic stability, unemployment needs to be addressed. However, the number of unemployed is so massive that this question seems almost insurmountable. While an immediate solution is not possible, steps can be taken that over time will generate improvement. In this respect, longer-term
commitments should be made to improving education throughout the population. Only in this way will the groundwork be laid for successful development and rising incomes.

Another idea that might bear consideration would be the development of a securitised mortgage market (enhanced with appropriate tax incentives), resembling that in the US. Success is currently being achieved on a similar scheme in Hong Kong. Such a development provides a mechanism to strengthen domestic capital markets, increase investment in housing, encourage savings and investment and economic participation through home ownership. Further, it provides a mechanism to draw long-term foreign investment into the domestic capital markets, providing the potential for growth in the housing market and related employment in the construction industry. While this is but a small thought, ultimate success will not be created from any single idea, but rather through the development of an inclusive culture that encourages economic participation, underpinned by respect for the rule of law.

6.5 Meaning for the new banking law
What might all this mean for the future teaching of banking law at RAU?

In terms of the future expanding regulatory content of "banking law" for legal education, general and specific efforts towards international supervisory and regulatory convergence in respect of international banks and securities firms (and other international financial institutions) should undoubtedly be of continuing importance to legal educators as we approach and enter the twenty-first century. Improved convergence in the regulation and supervision of financial conglomerates, derivatives, disclosure of trading activities, and effective money laundering measures are all on the current agenda of the international banks and securities authorities.

This taken into consideration, one quickly realises that the nature of the banking business (and of banking institutions and of financial markets) is in a dramatic state of metamorphosis. This metamorphosis is not only one of market interconnections but also of national-regional-international interdependence. On the educational institution side, a close interdisciplinary and international coordination among leading Southern Africa and international universities would appear to be highly desirable. In all events, the study of the "New Banking Law" in the twenty-first century in South Africa (and elsewhere) will be influenced radically by this on-going metamorphosis.

As to commercial law, it speaks for itself that many of the activities of banking institutions (such as the taking of deposits and dealing in cheques and other negotiable instruments, credit instruments and the taking of security), a viable insolvency regime and effective dispute resolution mechanisms, will remain "core" aspects of any future banking law. Further, the bank-customer relationship (whether as depositor or lender) will continue to be essentially contractual and commercial in nature. Yet the increasing role of electronic technology in banking and financial services will raise new legal issues that will need to be addressed by an evolving commercial law. In any event, commercial law must remain an important and integral component of the new banking law.

Also, as to the private law dimensions of the "new banking law", this will be heavily influenced by technological and product innovations in the increasing cross-border dimensions of banking/financial transactions.

Comparative understanding of the legal experiences of other countries (eg
US, Japan, EU, Latin America) will be highly desirable, as will be an understanding of the international legal implications of the international convergence and cooperative processes underlying the financial markets/institutions area. Further, a better understanding of private international law (conflict of laws) will be critical as financial transactions are increasingly becoming cross-border in nature.

In logically thinking through an optimum educational matrix for the study of banking law in South Africa in the 21st century, the importance of interconnecting the following also becomes clear: accounting principles, taxation rules, corporate law, property security and bankruptcy laws, and the development of legal approaches to new financial market innovations (eg swaps/derivatives and asset securitisation).

Overall, the future for legal education in Southern Africa should not be clouded by legal, cultural or ideological nostalgia, but should embrace academic innovation, openness and even daring in creating an educational process of transmission and assimilation. Such an approach is sure to lead to a greater intelligibility and receptivity (domestically, subregionally, regionally and internationally) of the ongoing changes and innovations in the financial services areas. All of this should contribute to even higher academic standards in legal teaching and scholarships. Teaching and scholarship at the RAU law faculty should become more enriched and made more relevant by the experience.

In conclusion, I wish to thank you for letting me be part of your Academy, and I sincerely pledge to use my best efforts to help the RAU Law Faculty maintain its preeminence in the banking law area and to help South Africa and the Southern African Region develop and sustain viable and economically contributory financial markets within an appropriate private and public legal framework.

SAMEVATTING

DIE ONLANGSE FINANSIELE KRISISSE IN ASIË: ENKELE LESSE VIR SUID-AFRIKA

'n Finansiële krisis in enige gegewe land het altyd ekonomiese, sosiale en politieke gevolge vir die finansiële stelsels en ekonomie van die betrokke land. Nasionale stelsels moet leer uit die ontwikkelings wat plaasvind in ander ontwikkelende lande. Die onlangse krisisse in Mexiko (1994-1995) en Asië (1997-1998) word deur die outeur ontleed en sekere faktore wat aanleiding gegee het tot die internasionale gemeenskap se oorreaksie op hierdie krisisse word geidentifiseer. Daar word aangevoer dat finansiële stabiliteit op die onderliggende regs- en finansiële infrastruktuur van 'n land berus. Vier aspekte noodsaaklik vir finansiële stabiliteit word voorgehou naamlik: (1) 'n gesonde finansiële stelsel; (2) kommersiële aanspreeklikheid; (3) die versterking en uitbreiding van kapitaalmarkte; en (4) 'n effektiewe insolvensiestelsel met 'n gepaardgaande sosiale veiligheidsnet. Sekere belangrike aspekte wat ook in Suid-Afrika nagestreef moet word, sluit in rekeninghoudende standaarde, die uitwis van korrupsie en die navolg van 'n gunstige beleggingsomgewing. Ten slotte wys die outeur op sekere aspekte soos uitgekristalliseer in Mexiko en Asië; en bespreek wat Suid-Afrika kan doen om soortgelyke finansiële krisisse te vermy; maar ook om voortgesette ontwikkeling te bevorder.

[ISSN 0257–7747]