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Unfolding the spatial architecture of the East Asian financial crisis: the organizational response of global investment banks

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Abstract

The East Asian financial crisis had a major impact on the regional operations of banks, and in particular investment banks. As the financial crisis deepened during 1997 and 1998, numerous European and North American banks began to restructure their organizational capabilities in capital markets, foreign exchange, securities, and project finance, as they became exposed to bad debts and reductions in the volume of trading in the region's financial markets. Banks managed the risk and uncertainty of the financial crisis by downsizing employment levels in order to reduce fixed costs in the region. Unfortunately, the plight of the Asian banks was far worse than their non-Asian counterparts, not least because they could not offset major losses in the region against profits generated in other regions. In this paper, we specifically explore the organizational and employment change in investment banking to investigate the wider political economy of the crisis, and its effect upon the global financial system. Following a detailed theoretical re-reading of the crisis, which centres on the 'missing geography' that sustains the operation of the global financial system, we focus upon organizational and employment change in investment banking. We suggest that the Asian financial crisis affected the global financial architecture of the region, and that investment banks, being fluid, flexible, and responsive organizations, were able to react very quickly to the crisis, as if it were just one more event in the continuous (mal)functioning of the capitalist system. © 2001 Elsevier Science Ltd. All rights reserved.

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1. Introduction

The financial crisis in East Asia, which was triggered by the devaluation of the Thai baht in July 1997, had a major impact upon the activities of banks, and in particular investment banks, in Pacific Asia. In the immediate aftermath of the crisis, Standard & Poor's – the United States-based credit-rating agency – estimated that European banks had losses of up to US$200bn on their lending to Asia (Graham, 1998). As a response to specific problems with banks and the general downturn in financial activity, numerous European and North American banks quickly began to downsize, often closing parts of their branch office networks and investment banking activities. Moreover, as turnover began to shrink in the region's financial markets (for example equity and securities trading) and other investment banking activities (for example project finance), job losses became inevitable. Job losses were not just restricted to the giant European, Japanese, and North American banks. The financial crisis also had a severe effect upon the activities of Asian banks, particularly in Thailand and Indonesia, where over 100 banks have been closed or suspended since 1997 (The Economist, 1998a; Euromoney, 1997a; World Bank, 1998).

The major aims of this paper are twofold. First, to discuss how the crisis effected the architecture of the global financial system, with particular reference to investment banking in the region. Second, to analyze how banks, especially European and North American global investment banks (and to a lesser extent Asian banks), responded organizationally to the financial crisis. The plight of banks has so far received little attention in the literature (see Chang et al., 1998; Freeman, 1998; Haggard and MacIntyre, 1998; Henderson, 1998b; McLeod and Garnaut, 1998; Miller and Luangaram, 1998; Wade, 1998a,b). An examination of the organizational

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responses of European and North American banks to the crisis provides an opportunity to investigate how transnational banks employ different corporate strategies to check major destablilizing events in the international finance system. Accordingly, the paper is organised into three substantive parts. First, we offer a new theoretical appraisal of the East Asian financial crisis, emphasising the ways in which the political economy of the crisis unfolded through a particular spatialization of the financial architecture of the world economy. Second, we discuss the effects of the crisis on both the global financial system and international banking within the region. Third, we analyze how European, North American, and Asian investment banks managed the ensuing turmoil in East Asian markets, through office closure and redundancy programmes. In addition, we also consider the plight of Asian banks, and analyze the collapse of the Hong Kong-based Peregrine Investment Bank. Finally, we conclude the paper by considering the fallout of the Asian crisis for Asian, European, and North American investment banks, and the global financial system itself.

2. The East Asian financial crisis in its manifold context

While the early to mid-1990s saw a plethora of books expounding the fundamental *Lessons of East Asia* (Leipziger and Thomas, 1993), proclaiming *The East Asian Miracle* (World Bank, 1993), announcing *Asia Rising* (Rohwer, 1995), and preparing for *The Pacific Century* to come (Borthwick, 1992), the late 1990s have seen innumerable books ringing the region's death knell. East Asia is now routinely figured as *Under Siege* (Gill, 1998), *In Crisis* (Corden, 1999; Delhaise, 1998; Pemple, 1999), *Falling* (Henderson, 1998a), *Downsizing* (Godement, 1999), and experiencing *Meltdown* (Flynn, 1999; Gough, 1998). Worse still, there is an *Asian Contagion* (Jackson, 1999) through which *The Asian Crisis Turns Global* (Montes and Popov, 1999). For many, the financial crisis that broke in Thailand in the summer of 1997, and came to embroil Indonesia, Malaysia, the Philippines, South Korea, Taiwan, and, to a lesser extent, Hong Kong and Singapore, was an irrefutable demonstration of the rupturing of so-many bubble economies, which had become engorged on the permanent outflow of yen from 1995 onwards following the bursting of the Japanese bubble economy.

2.1. From currency collapse to financial crisis

"[T]he sense of crisis in East Asia in the third quarter of 1997 was generated by the successive collapse of several Southeast Asian currencies" (Garnaut, 1999, p. 93). What was so calamitous about these currency collapses was the fact that the "entire game plan for Southeast Asia was founded on stable exchange rates pegged to the US dollar" (Winters, 1999, p. 89). For export-oriented economies, pegging against the US dollar was attractive because in the late 1980s and early 1990s it was weak relative to the Japanese yen and some European currencies. As the US dollar appreciated export competitiveness declined. However, whilst this decline paved the way for the currency and financial crises, it was arguably other factors that proved to be decisive for the crisis to break as it did. According to Hill (1999, p. 8), "the core technical factors explaining the crisis were fixed or quasi-fixed exchange rates, in the context of rapidly rising short-term debt and shaky financial systems. The result of the first factor was that few overseas loans were hedged. Thus, when currencies began to fall sharply, external debt in domestic currency terms rose sharply." Short-term private-sector debt had become a significant problem owing to:

- relatively high domestic interest rates designed to attract foreign portfolio investment and bank capital;
- the resulting speculative activity that flourished on the back of interest-rate differentials;
- recent capital account liberalization in many East Asian countries;
- generally weak financial supervision and regulation (although not in the case of Hong Kong and Singapore).

Consequently, many East Asian banks and corporations borrowed US dollars and converted them into domestic currency for investment in a range of activities. Booming property markets saw much of the inflow. Meanwhile, the long-standing growth and profitability of East Asia in particular, and other emerging markets more generally, meant that the region had been hugely attractive to those investment bankers and fund managers who needed to secure high returns against the background of low interest rates in Europe, Japan, and North America. "Banks, non-bank financial intermediaries and corporations borrowed short term in dollar-denominated form (or in yen) and failed to hedge their debts. Steep depreciations then raised their domestic currency foreign liabilities to unsustainable levels, and in effect bankrupted them" (Corden, 1999, p. 32). Their inability to lend fuelled the deflationary pressure. Of particular concern was the difficulty of securing trade finance, a state of affairs which frustrated the translation of currency depreciation into export growth. In short, the crisis in the domestic financial sectors of East Asia was due to immoderate and imprudent lending, mal-investment, recession, a liquidity crunch, and the huge increase in the foreign liabilities of banks, financial intermediaries, and corporates as a result of significant unhedged currency depreciation.

The 'meltdown' of the Thai baht in July 1997 triggered the East Asian currency and financial crises, by the end of which "the de facto pegs were mostly blown

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