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In Search of a Third Way: between liberalization and intervention

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Santonu Basu (2002) *Financial Liberalization and Intervention: A New Analysis of Credit Rationing* (Cheltenham, UK, and MA, USA: Edward Elgar), viii + 158 pp., hardcover, ISBN 184064 965 8, £49.95/US$80.

This book provides a critical theoretical perspective on the complex linkages in the credit markets with special reference to South Korea and India. Neoclassical theorists claim that the market mechanism governs the allocation of loans through interest rates. Basu argues, however, that since the loan market operates in the presence of uncertainty, two additional factors—credit standard and credit risk—are the most important in determining borrowers' access to the loan market.

The book is organised around two themes: first, it critically investigates the policies of financial liberalisation and intervention with regard to their impact on the credit market; and, second, it offers an interesting new analysis of credit rationing. Financial liberalisation, according to its proponents, was supposed to bring about increased savings and investment through financial de-repression and increased interest rates, as well as a better allocation and more productive use of resources; instead, it has brought financial crisis and reduced growth. Financial intervention on the other hand, before financial liberalisation came into being, did not produce the intended results either, in terms of faster economic growth and better distribution of wealth and resources.

While there exist enormous empirical observations, which identify the failure of the markets as well as governments, there exists no theoretical work providing an analysis of the two phenomena of financial liberalisation and intervention. This book provides a theoretical explanation for why both the policy of financial liberalisation and government intervention in the past, have been unable to achieve their intended goals. While liberalisation brought crisis, intervention rendered fragility without necessarily improving borrowers' access to the loan market. Basu argues that the banks do not maintain a uniform credit standard for all borrowers, thereby causing a variation in the access to the loan market.

As financial liberalisation was followed by a series of crises in the 1990s, intervention is inevitable. But the author argues that intervention in the past did not work. It was the initial failure of the liberalised economies that brought in intervention while, subsequently, the failure of intervention led to recent liberal-

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isation. Basu has analysed theoretically why both policies failed in the light of why interest rates alone do not clear the loan market.

The author identifies the heart of the problem as credit rationing. He argues that the existing literature on credit rationing, despite its enormity and richness, does not take us very far, since it mainly attempts to provide an explanation for how monetary policy works in the presence of interest-insensitive borrowers. The book develops an explanation as to why access to the loan market differs between two individuals. A new theory of credit rationing by introducing the two concepts of *credit standard* and *credit risk* is then used to provide an explanation for why both policies have failed.

This delightful little book is highly recommended reading, since it presents a unique perspective and offers the reader up-to-date and in-depth insights into key issues of credit market uncertainty. Although the book is not comprehensive with regard to empirical application of the concepts developed in it, such studies are needed to facilitate a detailed understanding of the credit market. To demand such comprehensiveness would probably be unfair, given the book's aims, but supplementary studies would enrich understanding of the new analysis of credit rationing presented in this book.