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The Asian Economic Crisis and our Agenda

Hajime Shinohara
Managing Director, IIMA

I am most honored to address this audience of the joint meeting of MAJECA JAMECA on "The Asian Economic Crisis and Our Agenda". It gives me special pleasure to be here because I have happy memories of occasions when I participated in administrating this conference, working together with many friends to bring it success, back in the days when I was based in Kuala Lumpur.

I am aware that the custom of this conference requires me to report on the Japanese economic situation of the past year, but today I would like to shift my focus and review the agenda that we face in the coming century, after presenting a birds eye view analysis of the economic and monetary crisis of the past year and eight months from which East Asia has suffered, including Malaysia and Japan. I would then like to discuss the available options for cooperation between Japan and Malaysia.

Evolution of the Asian Crisis

The Asian crisis began with the Thai baht currency crisis in July 1997, and as the crisis expanded, many theses which aimed to analyze the hitherto unforeseen situation evolved. I will not try to introduce all the theories here, but would like to use some as a means by which to show how the crisis evolved.

"Failure of the Dollar pegged System" Theory:

This theory became popular when the Thai baht had to be devalued, followed by a sell off of the Malaysian ringgit, explaining that the crisis occurred because these currencies chose for a long period of time to be semi fixed to the US dollar, as can be seen from reviewing their exchange rate to the dollar over the years. The dollar pegged system contributed to the stability of these currencies, and enhanced the competitiveness of their exports as the

dollar continued to decline. This enabled these economies to realize high growth rates, pushed by expanding exports. However, once the dollar began to rebound, the situation was overturned and their external balances began to deteriorate.

The theory also explains that the stability of the currency against the dollar meant that there were no foreign exchange risks when foreign capital poured into recipient countries, which ballooned short term borrowing to an uncontrollable size. This theory seems correct, but the rest of the picture must not be ignored: the turbulent fluctuation of exchange rates among the currencies of industrialized countries, especially the dollar yen exchange rate. At the same time, the lessons to be learned from this theory are obvious: the need to switch from the dollar pegged system to a basket system, diversify utilized currencies, and mutual use of Asian currencies, among others. These measures will certainly mean keeping more of a distance from the dollar in economic transactions, but that is not the only consequence. It will also mean distancing from the dollar in our value judgments.

“Nemesis of Crony Capitalism” Theory:

As the end of 1997 approached, Indonesia, then South Korea, appealed for IMF assistance. With this new development, another theory became prevalent. This theory explained that these countries invited the crisis because they were “very Asian”. All sorts of judgemental words were mobilized developmental dictatorship, cronyism, wide spread bribery and corruption. The theory categorized these characteristics as Asian, and Asia was told that it had invited the crisis because it was Asian. This is an illustrious turnabout of the theory that the East Asian miracle occurred because East Asia was Asian. The Asian model and Asian values were deemed to have lost their supernatural power. Is that truly so? I would like to touch on that later.

“International Short Term Capital as the Culprit” Theory:.

Then as dark clouds began to cast shadows over Russia and the Latin American economies a new theory joined the scene. This named international short term capital as the culprit. The reasoning is simple. Since the speculative short term capital that moves freely around international markets is irresponsible and has been the culprit of crises in many countries, some form of regulation must be devised. Some supporters of this theory go on to explain that “the means to regulate such movement must be global, simple, and effective.” In general terms, it is true that some form of regulation is necessary. However, when going into specifics and asking what specific regulations should be implemented, suddenly the whole argument becomes blurred and supporters are unable to focus on any aspect. Unfortunately, this lack of focus has been characteristic of this theory, and to my astonishment, some followers of it see no inconsistency in hysterically criticizing Malaysia's introduction of the new economic package in September 1998.

Post facto study of the evolving theories on the East Asian economic crisis reveals the following: It was capital, broadly defined, that has continued to demand free market principles and globalization to secure freedom of movement and freedom to pursue profit, as well as its maximization. The demands for free movement of capital were reflected sometimes in the form of IMF remedies, sometimes in the form of joint communiqués of the conferences attended by industrialized countries, and sometimes in the media, reflecting the voices of

journalism and academia.
Remedies

It is widely acknowledged that the "attending physician" of the crisis in Asia was the IMF, the same role it played during the Latin American debt crisis in the 80s. It has also been the architect designing the nation building of the new democracies which came into existence with the collapse of the Cold War structure in the 90s. It was assumed, with optimistic expectations, that the IMF would have the know how to cope with the crisis in East Asia because of these experiences and experiments.

On the other hand, it is also true that there have always been those who are concerned with the IMF's dogmatic approach of applying the same free market principles to all. The typical attitude is evident in the phrase, "one size fits all" which is often used by IMF officials. The result of this approach to East Asia is now well known. A succession of almost complete misjudgments of situations. Macroeconomic policies were applied with the remedy of slashing government expenditures and drastically high interest and the cutting of foreign exchange rates. This led to economic shrinkage, increases in unemployment and worsening of poverty rates. Private enterprises in the real sector suffered as a result, which in turn increased burden of financial institutions. This led, in some countries, to political turmoil.

The resulting course of events reveals that the Asian countries that the IMF was dealing with were quite different from those dealt with in the 80s and 90s, and even if the crisis was inevitable, as in this region, the players involved were quite different. It also shows that the IMF and other firefighters did not recognize these differences.

A major characteristic of Asia is where public institutions stand and the roles they play. Unlike Japan, these Asian countries had maintained a very healthy fiscal policy, and consequently had very little public debt, whether domestically or internationally, to cover the fiscal deficit. One of the reasons for the increase in the current account deficits of East Asian economies in 1996 may have been the solitary strengthening of the dollar and accompanying revaluation of their currencies in real terms. However, the exchange rate could have been adjusted accordingly if there had been the judgement that the dollar would continue to strengthen, leaving all other currencies behind. If, on the other hand, the situation was seen as just a short term phenomenon, short term liquidity might have done the job. Is it not the job of the IMF to prescribe adequate measures to stabilize exchange rates by judging the relative movement of the currencies of industrialized countries?

The most outstanding feature of the East Asian crisis was that the major players who were the debtors were private industries. The IMF remedies failed to take this consideration into account. It was also a grave mistake to try to cope with all the factors that were seen as weaknesses of the economic system under the banner of regaining market credibility without regard to whether they truly contributed to the crisis or not. Admittedly, the IMF remedies helped to bring about some dramatic progress in areas where debates had been going on for years without producing any outcome. Enactment of bankruptcy laws and bankruptcy procedure laws in Thailand and Indonesia would come under this category. However, it cannot be denied that macroeconomic austerity measures and the remedies aimed at social structural changes, including where they called for a medium to long term approach, invited the

downward spiral.

I feel a deep sense of disappointment in some Western media and economists who took advantage of the theory that the Asian crisis occurred because "Asia was Asian." They proclaimed that the global standard was the only standard, and denied everything Asian, including a certain sense of values that could have been shared by many in Asia, as well as an Asian model which is a notion encompassing various values in Asia. Surprisingly, Japanese media and economists were among those who voiced such opinions most loudly, which shows how many among us had also lost confidence.

We must not forget that Asia has many virtues that are rare in countries of other regions: high savings rates, high quality of labor and underlying strict labor ethics, generally healthy fiscal conditions, the belief shared by the government, private sector, and the people in a better future, which leads to higher aspiration, and many others. It is only rational that the formula for recovery from the current crisis should reflect the economic strength inherent in these Asian virtues.

The lesson of this East Asian crisis is that we should never again fall victim to multiple turmoils simultaneously. It is clear that we must construct a framework to avoid the resurgence of such a crisis, and I believe the starting point for creating it should be these Asian virtues.

Based on the analysis and reflections that I have presented, I would now like to spell out the agenda that we must face as we approach the 21st century. The Task for the 21st Century

I would like to touch on two subjects. First is an agenda for the region, the Asian Monetary Fund scheme. The second is a more short term theme, the possible areas of financial cooperation that Japan can extend towards Malaysia. Asian Monetary Fund:

The Asian Monetary Fund scheme was first discussed at the ASEM meeting in Bangkok in the fall of 1997, and at the following IMF / World Bank Meetings in Hong Kong. I am sure you are all aware of the rugged road the scheme has walked, so I would like to emphasize just one thing. Throughout 1998, Japan had not disavowed the scheme, nor had we accepted the Manila Framework as the last word, considering it just a step in the direction of its establishment. It seems that after the Russian crisis in the summer of 1998, the United States withdrew its antagonism towards this scheme, and we are now at a stage where we should give earnest study to it. Since the scheme was first raised as the Asian crisis began to evolve, arguments tended to concentrate on crisis management and fund mobilizing capabilities, but there are other aspects that should be considered.

a. Organization

I believe the Asian Monetary Fund should be established as an independently institutionalized body with its own full time staff, which should come from the nationalities of member countries. Participation is a political issue and member countries will be decided by the countries involved. However, reflecting the type of responsibilities the organization will be entrusted with, the members will be Asian economies that possess relatively well developed monetary markets, such as the ASEAN countries, the Asian NIEs, Oceanic countries, China, and Japan.

b. Functions

There are quite a number of functions that this organization is expected to have, but I would like to concentrate on three in particular.

First is to enhance policy dialogue among the participating countries. The Manila Framework can be followed in its present form. The AMF should provide a venue for exchanges of opinion on macroeconomic situations and foreign exchange and monetary market trends, and for enhancing dialogue on respective policies and trends in the funds and foreign exchange markets of those countries. Exchanges of opinion and deeper understanding among member countries will enable them to mutually apply peer pressure when necessary.

If one of the lessons of the current crisis is that a failure in one country can unexpectedly spread to other countries, it is clear that East Asian countries will now regard adventurous acts of another country as something that could affect themselves as well. The process of such dialogue will certainly enhance a deeper understanding of respective economic policies and, further, lead to policy coordination.

The second function is crisis management, which function must be backed by the capability to mobilize funds. There are two possible ways of fund raising. First is borrowing from member countries, a mechanism similar to GAB (NAB) of the IMF. However, the mechanism must operate much faster than GAB, for which some means should be devised. The other is fund mobilization on the markets in a broad sense. A mechanism must be devised to raise funds in the market backed by the foreign reserves of the member countries as collateral, or by guarantee contract or some form of callable subscriptions to its capital by member countries. Some means must be formulated to raise substantial funds quickly from the markets.

In addition to these two fund mobilizing capabilities, the Asian Monetary Fund must be equipped with a substantial capability to manage crises by serving as guarantor to member countries in raising funds from the markets. I believe the most appropriate way for the AMF to complement the credibility of its member countries in this case is to extend its guarantee using the callable capital of its member countries. Using these three methods, I believe the total amount of capital that the Asian Monetary Fund can mobilize directly and indirectly will amount to more than 100 billion US dollars.

The third function this organization must have is to become the core of various structures aimed at preventing the resurgence of a monetary crisis. One way is to provide a forum for the monetary authorities of member countries to coordinate their policies. An Asian BIS was discussed at one point, and I believe it quite possible for the Asian Monetary Fund to have the same principal functions. Information and the experiences of the monetary authorities of member countries will be shared in this organization, and there will be coordination in the supervision of financial institutions and the monetary system.

The next step is to establish a settlement system for the currencies of member countries. Another lesson of the current crisis is to enhance the use of the currencies of the region. There are many benefits to this policy, and I believe it will be beneficial to have the netting system affiliated to or part of the Asian Monetary Fund, to carry out a smooth settlement among these currencies.

The third step is to establish an economic research institute. I spoke

earlier about the rebuilding of the Asian model and applying Asian virtues. It is necessary to have a strong theoretical backbone to this thinking and that the new Asian Monetary Fund operate on these new theories. In this, we are facing the need to have both the chicken and the egg at once. To support the theory side of the equation, an economic research institute must be established to face many challenges. Just picking on one area of foreign exchange policy, there are numerous questions to be thought out: What is the best foreign exchange theory? The best basket theory? What is the best way of common baskets, creating a common calculating unit, application of this unit to commercial transactions, or moving further in the search for a common currency?

What I have now drawn up is a very rough sketch of the Asian Monetary Fund, and is far from a complete plan. I am happy to provide this idea as a base for discussion as we pursue this important scheme, and there is no doubt that Japan will continue to pursue this theme seriously. One indication of this is the Miyazawa Initiative, which can be seen as applying this concept and as evidence of Japan's readiness to shoulder the responsibility of mobilizing funds. The Miyazawa Initiative and Cooperation with Malaysia:

One thing that became clear during the Japan US summit meeting in autumn 1998 was that the United States was not going to increase its commitment to Asia. From this attitude, we can easily judge how the problems in Russia and Latin America are weighing heavily on the United States. On the other hand, Japan introduced the Miyazawa Initiative, which included a 30 billion US dollar rescue package for Asia. Half of this package is a traditional scheme, extending yen denominated loans to public financial institutions as part of development aid, which is nothing of a surprise. However, I am sure the recipients were quite relieved to receive this announcement, since it came from Japan which is itself suffering seriously from fiscal problems.

The other half is to be achieved by efficient utilization of Japan's abundant foreign reserves. There were many in and outside of Japan who cheered this idea because there actually were many who had been questioning Japan's pursued policy of using the largest foreign reserve in the world to finance America's current account deficit. In November 1997, Japan joined the other Asian countries in the buying operation of Indonesian rupiah, which resulted in having an Asian currency as part of its foreign reserve. Therefore, in a way, the road is already paved.

Many Asian countries have started to explore new measures to restructure their financial sectors, and some have overtaken the hitherto front runner, Japan. However, there is considerable concern when it comes to the question of whether there is an adequate supply of public funds or not. Here the Miyazawa Initiative can certainly assist. I hear that the plans of the two public organizations, Danamodal and Danaharta, to issue dollar denominated government bonds to raise necessary funds have been aborted because of their unreasonable downgrading by a rating company. Japan can use the Miyazawa Initiative to buy dollar bonds issued by the Malaysian Government, and I believe it is even worth considering going further and buying Malaysian ringgit denominated government bonds. The money from Japan could become part of the necessary public funds for these two institutions.

Theoretically, the changes to capital transaction regulations announced in February 1999 assumes that a huge amount in retained foreign funds will leave

Malaysia in September this year. I am sure that Malaysia's foreign reserve accumulation since September 1998 is abundant enough to cover this outward move. However, when the Malaysian economy gets back on track and production returns, there could be a period in which the country has an adverse balance of trade as it imports more capital goods and production goods. Why not think of a framework to cope with this shifting of foreign capital around the securities market by using Japan's foreign reserve to support Malaysia's short term funds management?

Part of the basic thinking behind the Asian Monetary Fund is to achieve effective mutual utilization of savings in the region. In August 1998, as we cooperated in forming a rescue package for Thailand and in its aftermath, we began to pick up this thinking, and the Miyazawa Initiative was revised to include a scheme that follows it as well. In other words, bilateral economic cooperation and various economic measures that will go through the Asian Development Bank and other institutions as part of implementing the Miyazawa Initiative will be able to go from Japan to a recipient country through the Asian Monetary Fund once it is established.

Japan's Responsibilities

Finally, I would like to touch on Japan's responsibilities. As you well know, the Japanese economy is suffering heavily, resulting in negative growth for two consecutive years, and many hold a very pessimistic outlook for 1999 as well. However, if you consider the fact that the economy did pick up in 1996, after stimulus measures were implemented in 1995, and that the 1998 package is still more ambitious, I am more optimistic that we will now climb out of negative growth. We have wasted too much time in figuring out remedies to revive the financial sector, but now, with the determination to pump in the huge sum of 60 trillion yen, I am sure that various measures necessary will actually be implemented.

Mergers and acquisitions cannot be avoided, and the players will come and go in the course of restructuring. Japan can only be said to be back on track when we have a clear course defined on financial restructuring and a clear outlook for the business climate. I look at 1999 as the turning point where we will gain a definite feeling that we are actually recovering.

The basic strength of the Japanese real sector has not changed. Once the economy improves tangibly, the business sector will be able to aspire to productive measures for the future, and as part of this trend direct investment will also increase. I hope that as their first destination Japanese businesses will choose Malaysia, where the investment environment will have improved considerably in comparison to what it was before this crisis.