FINANCIAL CRISIS IN FAR EAST & SOUTH EAST ASIA

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INTRODUCTION

In 1997, we have witnessed amazing and almost melodramatic fluctuations in global economic fortunes. Where as the western economics lead by the United States and other G7 rich countries (with the exception of Japan) have continued their progress to further richness, with uninterrupted growth since the last several years, we have seen an unexpected fall of the miracle economics of East Asia.

Countries like South Korea, Malaysia, Indonesia, and Thailand, which were referred to as miracle economics due to their unusually fast pace of growth and rapid industrialization in the last two decades, have collapsed at a speed even greater than their rise.

Beginning with the drop of the Thai baht in July of last year, a currency crisis spread throughout Asia, affecting the Hong Kong dollar in late October and by November, the South Korean won. By year's end, the balance of payments crisis led Thailand, Indonesia, and South Korea to request International Monetary Fund (IMF) assistance. As has already been pointed out by numerous commentators, the currency crisis and the financial crisis in Asia have mutually amplified one another, thereby intensifying economic destabilization. Before the currency crisis developed, financial institutions in Thailand, Indonesia and South Korea were already saddled with bad loans. The drop in the value of East Asian currencies made repayment all the more difficult for financial institutions and corporations which carried foreign currency debts. As a result, the bad loan problem worsened and currency speculation intensified. Additionally, trust in financial institutions decreased, making it harder to produce letters of credit, leading to a reduction in imports and exports in these countries. This credit contraction had a serious impact on real economic activity in all the region. The macroeconomic problem points that often lead to a financial crisis, namely a reduced savings rate, inflation, and budget deficits, have not appeared in the present crisis. Rather the unsound domestic financial systems of East Asian nations and exchange rate policies that do not reflect the level of economic interdependence with other nations are the two factors that are chiefly to blame for the present financial woes of the region.[1]

However, a record 1 billion people—a third of the global worth-force—are, unemployed or under-employed, the International labour office estimated last week, warning that millions more will be through out of work this year as the Asian Crisis spreads. Growing unempolyment would bring more poverty and unequality across the world.

The East-Asian financial Crisis would increase joblessness by 10 million directly and upto 20 million indirectly this year. The Crisis had boosted Indonesia's unemployment rate from 4 per cent to 12 per cent, increasing the numbers of those in poverty from about 22 million to 80 million.

In South Korea unemployment had jumped from 2.6 per cent to 7 percent, while in Thailand the jobless rate was expected to reach 6 per cent this year, compared with between 1 and 2 per cent two years ago, about 3.5 million workers are expected to be laid off in China this year as state enterprises are "restructured".[2]

FINANCIAL CRISIS

The metaphor most frequently used to portray Asia's financial crisis is drawn from medicine. A virulent economic panic jumped borders to infect any vulnerable country: it hit Thailand first, moved on the Indonesia, Malaysia, the

Philippines, South Korea and is now coughing away at Hong Kong and the Chinese mainland. The virus was spontaneous, impossible to contain, and the resulting illness has proven difficult to cure. The analogy conjures up a map with each Asian land tinted to show a different level of contagion. South Korea is getting a bit pinker these days; Indonesia is marked with a great, red quarantine sign.

Now imagine another map, on which all the countries in Asia are connected by lines; like patients fed by intravenous tubes. The tubes converge somewhere north of Taiwan, melding into one thick lifeline as they head toward the financial capital of the region, Tokyo. The lifeline carries money in all its forms--trade, investment, loans, aid, tourism—and without those connections between Japan and its southern neighbours, it's hard to imagine today's Asia at all.[3]

For all the drama behind the unravelling of Thailand's economy, the roots of Asia's crisis were quietly developing as far back as the early 1990s. Those were the go-go years when, boosted by financial liberalization, Asian stock-markets took off and European and American fund managers discovered emerging markets. In the U.S., and economic boom combined with low interest rates released a torrent of money looking for high returns. Funds and banks from a depressed Europe and recession-bound Japan too were tempted by the high profit margins of Southeast Asia. It was all so easy: Interest rates were high, and risk very low because currencies were pagged to the U.S. dollar.

Between 1993 and 1996 money managers from the U.S., Europe and Japan pumped in short-term credit that turned the economies of Thailand, Indonesia and Malaysia steaming hot. Short-term foreign loans to Thailand amounted to 7%-10% of GDP in each of the year 1994-96, while foreign direct investment languished about 1% of GDP, according to the IMF. Thailand's total external debt--public and private—rose from 38.3% of GDP in 1990 to 50.9% of GDP six years later.

According to IMF estimate, by the end of 1996, European banks had lent \$318 billion, and their Japanese and American counterparts \$260 billion and \$46 billion, respectively, in the East Asian countries. Much of this was in the form of short-term loans. Leaving aside the financial centres of Hong Kong and Singapore, the highest international lending went to South Korea (\$100 billion), followed by Thailand (\$70.2 billion), Indonesia (\$55.5 billion), China (\$44 billion), Taiwan (\$22.4 billion) and Malaysia (\$22.2 billion). When the crisis broke in Asia, mutual-fund investments in the region stood at \$38.5 billion.

The First sign of trouble brewing — the first plank to give way-was the mid-1996 collapse of Bangkok Bank of Commerce. This exposed the failure of Thailand's central bank to crack down on corrupt banking practices. Then in early February 1997 Somprasong Land became the first real-estate company to default on a Euro-bond. This was a sign that the floor of foreign funds had created a real-estate bubble waiting to burst. Also in February, Finance One, Thailand's largest finance company, indicated it was in trouble by seeking a merger with a commercial bank. This was a cue for investors to stampede to the door.

The situation took an alarming turn when the news spread that many of the banks had accumulated a mountain of bad debts and had become technically insolvent, and as such they may not be in a position to service their external debts.[4] Many of these banks started buying the badly needed foreign currencies from the currency markets to meet their impending commitments.

When this position became known in the market, the hard currencies were hard to find (pun unintended), as the speculators started buying and hoarding US dollars and other hard currencies because of the immeasurable anticipated demand from such banks.

Thus, the local currencies of these countries, viz., baht, rupiah, won, and ringgit have continued to plunge since one year, one after the other, against the US dollar and other hard currencies.

As the currencies started falling the losses of the banks escalated further making them even more insolvent. These conditions brought gloom, doom and despair leading to an unprecedented crash of the currency as well as stock markets. Since the start of this crisis in last may, the Thai baht has fallen by nearly 59 per cent, Indonesian rupiah by more than 100 per cent, Malaysian ringgit by 49 per cent, and South Korea won by 58 per cent.

The East Asian banking crisis is actually of two types: the type seen in Thailand and the type seen in South Korea. The Thai banking crisis emerged as the result of the collapse of the country's speculative bubble in real estate, an area in which the banks were deeply involved, in South Korea and Indonesia, by contrast, the main cause of bank's woes was the souring of loans to major industrial groups (South Korea's Chaebol and the Indonesian conglomerates owned by the president's family). And the cause of these industrials groups' troubles was over investment in plant and equipment, in South Korea's case, excess investment in was especially marked in such core industries as electronics automobiles, and petrochemicals.[5]

The turmoil will, without any doubt, create lasting impact on all aspects of the lives of the people of these countries. The economic difficulties will inevitably lead to social and ethnic strains and unrest. Several million workers will loose jobs creating unemployment on a massive scale.

With depreciated currencies, the banks and financial institutions will find themselves in a position where it is impossible to pay their external debts leading to bankruptcies.

Life, will become hard and painful for several months, may be years, until some degree of confidence is revived and normalcy returns. Despite the battering these economies have received, there is however, little doubt about the inherent strength of these economics to bounce back and revive.

Economic analysts agree that the roots of the current crisis in Indonesia whose currency has lost 80 per of its external value are as much political as they are economic. And that is the result of 32 years of authoritarian rule under President Suharto which bred the kind of flourishing 'crony capitalism' that has not been able to withstand the external shocks.

South Korea too has the same kind of malady, though not under one man's rule, that has resulted in sending two former presidents to prison, discrediting of the incumbent president Kim Young Sam on charges of corruption and election of an opposition leader, Kim Dae Jung, as the President for the first time. Much of that has happened after South Korea had joined the wealthy nations club of OECD, its exports had crossed 100 billion dollars and it began making massive investments in the West, particularly Britain.[6]

In Thailand, too, the economic debacle was the result of prolonged military rule and generals trying to rule after doffing off their uniform. After the debacle Prime Minister Chavalit, a general, resigned saying he did not know much about economics. In fact, the ministers and generals were tied up with the Thai banks that borrowed heavily from abroad, indulged in any orgy of lending and then collapsed.

Compared to the economies of these countries the economy of Singapore and Hong Kong, which was better regulated has fared far better, though bruised by the regional storm. Even Taiwan, which though has an authoritarian system, has been more efficiently ruled and has less of crony capitalism.

In country after country the story was remarkably similar. Corruption and crony capitalism had weakened solid economies built on years of hard work and prudent investment. Lax, outdated banking rules had left nation unprepared to handle a flood of foreign funds. In short, a potent mix of globalization, poor governance and greed brought about the crisis that now engulfs the region.

However, recent developments have raised concerns about the quality of East Asia's banking systems. Prolonged financial distress in Japan, banking problems in Korea, the financial crisis in Thailand, and pressures on exchange rates throughout the region have led many observers to question whether the East Asian model of banking and banking reform needs revision. In many countries, such as Indonesia, non-performing loans are not declining, and estimates of non-performing loans across the region (including in Japan) reach as high as $660 billion (*Business Week*, 24 February 1997). Many banks also have liquidity problems, and state-directed lending, political pressure, and poor lending practices, particularly by state-owned banks, remain pervasive. Moreover, in quite a few countries basic accounting, auditing, and disclosure procedures are not up to international standards. These shortcomings point to structural problems and the need for rapid reform–especially given the increasingly integrated global economy.[7]

Building more robust banking systems will require liberalizing financial systems-that is, allowing greater competition—and creating incentives for prudent, safe, and sound banking. Crafting such incentives will require bolstering supervision and oversight of the financial system, with particular attention to enforcement; strengthening regulations (on accounting, capital, valuation guidelines, and the like) to foster market discipline; and improving the quality and timeliness of information disclosed to the public, which can also help discipline market participants.

East Asian economies are undergoing rapid structural changes as a result of global and regional economic and social processes, such as the increasing integration of international markets, rapid aging of the population, and rising urbanization and formalization of employment, including moves away from traditional corporate control mechanisms (such as family control) toward open, market-based systems. These processes will require changes in corporate financing and corporate governance. Driven by large infrastructure requirements and the need for market-based housing finance, demand for long-term finance from domestic sources is also increasing in the region. Although institutional investors, domestic and foreign, could theoretically provide this financing, most economies lack a well-established institutional investor base. Thus many East Asian economies will need to strengthen capital markets and reform contractual savings systems.

Freer trade in financial services is of regional importance because many countries maintain significant entry barriers to foreign providers of financial services. Many countries have capital controls in place as well. Freer trade could generate significant benefits since, relative to their economic development, most countries in the region have under – developed financial systems.[8]

It seems to that the IMF has failed to give sufficient consideration to issues of sequencing with respect to structural reform measures to deal with the banking crisis. In South Korea, many financial institutions were suffering from a loss of capital adequacy as they struggled to write off their heavy loads of bad debts, and yet the IMF came in and demanded that they meet the 8% capital adequacy ratio set by the bank for international settlements no later than the end of December 1997, in order to meet this demand, they rushed to reduce their lending, and as a result, even healthy non-banking businesses found themselves strapped for cash. It was a case of painful credit crunch.[9]

Today, the International Monetary Fund is working to contain the damage and to mandate a strict new building code to get Asia's economic house in order. A new era of prosperity is possible, but only if the crisis-stricken countries learn the lessons of how their golden growth years went terribly wrong. And despite the antiforeigner rhetoric emanating from some parts of the region, any Asian recovery will require help from abroad-and that won't be forthcoming unless the foreigners are convinced that fundamental changes are afoot.

The IMF along with other lenders has announced various bail-out packages amounting in aggregate to $120 billion to rescue these economies and to restore investor confidence. But, so far, there is no glimpse of light at the end of the East Asia tunnel, as their currencies and share prices continue to pummel.

More experts are asking if the Fund, which has led recent bailout packages totaling 100 billion US dollars, is issuing the right medicine to East Asia's economics. Jeffrey Sachs of the Harvard Institute for International Development, an adviser to several Asian governments, says it is time to stop and see what the illness is before giving medicine.

"The IMF arrived quickly on the scene, but the East Asian financial crisis is very different from the set of problems that the IMF typically aims to solve," Sachs wrote in a commentary published recently in the Asian Wall Street Journal.

Since the start of the new year, the IMF has finally relaxed some of its excessively strict conditions. For example, it raised South Korea's inflation target from 5% to 9% and postponed the imposition of the BIS capital equacy standard from last year to this. And it has allowed Thailand to run a fiscal deficit of 1% — 2% of LDP. Thus far, he says, the IMF has come with the same, old cure it has used for decades: deep budget cuts, sharp rises in interest rates, bank closures and tightening of credit.

Malaysia's Prime Minister Mahathir Mohammad did not give up easily. During three days in February, he trundled through three Southeast Asian Capitals peddling his latest proposal for an Asian Solution to Asia's economic turmoil. The idea: Reduce dependence on the American dollar by trading goods in national currencies. Mahathir's suggestion picked up support in Bangkok and Manila, but may economists questioned its validity. The latest brain wave follows an earlier proposal backed by the Malaysia Prime Minister to set up an Asia fund to rescue the region's struggling economics without relying on International Monetary Fund. That idea never took off.

More than seven months after the Asia economic volcano erupted, the Association of Southeast Asian Nations hasn't found a formula for tackling the crisis. Although ASEAN leaders are talking more than ever before, concrete measures to shore up the region's economics are coming instead from institutions such as the IMF and countries such as the United States.

The goal of Mahathir's regional trade plan is to reduce the demand for US dollars and help local currencies retain their value. Precisely how the mechanism would work hasn't been spelled out. One idea would be for an importer to pay for a neighbour's products in the exporter's native currencies. Another option would be to use the Singapore dollar – rather than the greenback – as the peg.

Economists say using ASEAN currencies might make sense it trade within ASEAN was booming. But intra–ASEAN trade reached only 22.8% of the total $ 170.6 billion traded by the ASEAN states in 1996. Nor would a Singapore – dollar peg have much mitigated the effect indonesia, Malaysia, Thailand and the Philippines have plunged almost as far against the Singapore dollar as the American currency.

What's more, Indonesia has announced that it will implement a currency – board system that would effectively peg the rupiah to the US dollar and would immediately undermine any ASEAN effort to rally around the Singapore dollar.

ASEAN may have failed to come up with solution, but the grouping's leaders have been busy conferring. In recent weeks, Mahathir has shuttled between Jakarta, Bangkok, Singapore and Manila, while Singapore Prime Minister Goli Chok Tong has consulted with Indonesian President Suharto three times. "There is much more direct communication between ASEAN leaders", observes paintan Wattanayagorn, a Security – affairs adviser to Thai Premier Chuan Leekpai.

More frequent contact is improving relations among ASEAN leaders, but they've been unable to find a quick fix to halt the economic meltdown. And different countries have proposed different formulas for tackling the troubles.

Mahathir, who has picked up Suharto's mantle as de facto leader of ASEAN since Indonesia slumped into an economic crisis, has tried to mobilize regional co-operation. It's not the first time: A few years ago, he proposed an East Asian Economic caucus to by pass the US dominated Asia-Pacific Economic co-operation grouping, but the idea never took off due to Japan's reluctance to endorse it and stiff opposition from the US.

Take the case of Singapore. Like Malaysia, the Republic has a great deal to fear from economic turmoil in Indonesia, which could translate into the flight of thousands of ethnic Chinese. It has mounted a diplomatic offensive of its own to keep its neighbour from slipping into chaos. But Singapore's proposals are very different from Malaysia's regional approach. The city states suggestions are largely in line with those from the west and the IMF.[11]

Asia before the Great Bank Shakeout at the end of the 20th century. In just the past few weeks, Indonesia has begun an historic restructuring: 32 banks have been identified for merger, liquidation or nationalization. South Korea recently announced the merger of its third – and sixth – largest banks into a new institution that will be the country's largest. Thailand has nationalized six commercial banks — and decided to liquidate four of them. And the Japanese government is trying to force Sumitomo Trust & Banking, the 19th – biggest bank as ranked by Asiaweek's Financial 500, to take over the crippled Long-Term Credit Bank of Japan (No.13).

This year's Financial 500, Asiaweek's fifth annual ranking of the region's largest commercial banks and life insurance companies, is a catalogue of woe. The total assets of the 500 listed banks have fallen nearly 11% in the past year. In both South Korea and Thailand, the same number of institutions made the list in 1998 but they are worth much less — 24% less in South Korea's case and 36% in Thailand's. The lousy performance of Asia's banks is generally showed in the bottom line. Together the 500 institutions earned 22% less in profits this year than in 1997. And talk about losses. Most of the bad news comes from Japan, where banks hemmorhaged a staggering $36.8 billion, or 14 times more than they did in 1997. (Losses aren't figured into 500 profit totals.)

Worse is still to come. Banking problems are at the root of the Asian Crisis. In a sentence, banks lent too much money to too many people for unproductive uses. The currencies meltdown that began in Thailand in July 1997 merely exposed the system's frailties. "The weaknesses were there," says David Marshall, Hong Kong based managing director for Asian financial institutions at ratings agency Fitch IBCA. "But it was not at all easy to foresee a crisis." Or how this one will end. Financial troubles now have spread to Russia and Latin America. Many banker are concerned that a second wave of devaluations may be headed this way.

And Asian banks are standing on shaky ground. They can recapitalize. Or close. But consider the complications. They must attract capital to cover bad loans when they look the least appealing to potential investors. They must be especially tough in demanding that borrowers repay loans during the region's worst recession in four decades. And they must cut cost – the obvious place to look is bloated workforces – at a time when unemployment rates are at record highs.[12]

IMPACT ON PAKISTAN

Pakistan directly benefits from this crisis, Pakistan exports rose by 12 per cent during July – December, 1997-98, with simultaneous increase in imports by 7.7 per cent.

Exports in the first six month of 1997-98 amounted to Rs.18.7 billion, as against Rs.16.7 billion in the corresponding period of 1886-97. The imports as Rs.48.7 billion were higher, compared to Rs.45.2 billion in the first half of 1996-97.

According to the Federal Bureau of Statistics (FBS), exports to Malaysia jumped to Rs.758 million, compared to Rs.594 Rs.2.3 billion from Rs.1.1 billion. Exports to Philippines increased to Rs.454 million from Rs.260 million, followed by Rs.727 million to Thailand from Rs.399 million, while exports to Japan declined to Rs.8.8 billion compared to Rs.9.9 billion during July – December, 1996-97. Exports to Singapore during first six months of 1997-98 remained almost same at Rs.1.1 billion, while exports to south Korea increased to Rs.4.5 billion as against Rs.4 billion.

Pakistan's main items of exports to these countries are textile yarn and fabrics, leather and leather products, rice, fruits, vegetable, raw cotton, fish and sports goods. According to Export Promotion Bureau (EPB), the share of ASEAN countries in Pakistan exports is 5 per cent.

An official in the EPB said that these countries cannot curtail their import of semi-finished products like leather, raw cotton and textile yarn because their industries will close down in case of stoppage in imports of primary products. An exporter said that the situation will clear from figures of January and February, adding that massive currency depreciation can only reduce demand of finished products from Pakistan and not the main raw material exports to these countries.

On import side, Malaysia topped in the seven countries of South East Asia as its exports to Pakistan rose to Rs.13.4 billion during July - December, 1997-98, as compared to Rs.9 billion in the same period.[13]

CONCLUSION

Twice, in the first half of this century, Europe plunged the world into devastating wars. Who could have forseen in 1945, that two generations later, Western Europe would be united, peaceful and prosperous with the historic enemies, England, France and Germany reconciled? The European Union is nothing short of a miracle. It is for this reason that I wish to ask what lessons can East Asia learn from the European Union.

The first lesson is that history need not repeat itself. It is possible to put aside deep divides of language, culture, religion and centuries of conflict and war. It is possible for visionary leaders to persuade their peoples to discard the bitter legacy of the past and to embrace the sweet promise of a better future. After the Second World War, Western Europe was blessed with such leaders. Jean Monnet and Robert Schuman of France were the architects of the European Coal and Steel Community, which came into existence in 1952. Paul-Henri Spaak of Belgium was the principal architect of the 1857 Treaty of Rome, which established the European Economic Community and the European Atomic Energy Community. Another European visionary is Paul Werner of Luxembourg who, in 1970, put forward a plan to establish economic and monetary union.

Is East Asia prepared to learn the first lesson? The answer in Southeast Asia is definitely yes. Formed in 1967, two years after the end of *konfrontasi*, Indonesia, Malaysia and Singapore put aside past quarrels in order to build a common future. When the Cold War ended, ASEAN welcomed Vietnam into the family. Both leaders and peoples in the region are determined to achieve the vision of one united Southeast Asia. This will be realized when Cambodia is admitted into the family.

The picture in Northeast Asia is less satisfactory. I do not think that a historic reconciliation has taken place between China and Japan or between Japan and Korea. The ghosts of the past continue to haunt the triangular relationship between China, Japan and Korea. It is time to exorcise those ghosts.

The second lesson which East Asia can learn form the European Union is the ability and the willingness of the members of the Union to engage in a free and candid exchange of views no matter how controversial the issue. Such openness does not yet exist in East Asia, not even in ASEAN.

The third lesson which East Asia can learn from the European Union is that institutions matter. At every critical juncture of its history, the European Union has been able to move toward its goal of an ever-closer union by creating or re-engineering institutions, such as the Council of Ministers, the European Commission, the European Parliament, the European Central Bank, etc.

In East Asia, leaders prefer to pursue their goals by building trust, by a process of consultation, mutual accommodation and consensus. This is sometimes referred to as "the ASEAN way." There is a general reluctance to build institutions and to rely on laws and rules. The recent currency and economic crisis in East Asia has, however, shown that the ASEAN way needs to be supplemented by institutions. There is no regional surveillance mechanism which could have alerted the seriousness of the situation. Once the Crisis occurred, there is no institution which could have mobilized our collective resources to help the economics in distress. Japan's initiative to establish an Asia Fund, linked to the IMF, was not properly understood. and had to be aborted. The time has come for East Asia, in general, and ASEAN, in particular, to strengthen existing institutions and to build new institutions to complement the ASEAN way.

To inspire East Asians with the vision that in the next millennium East Asia can become, like Western Europe, a united peaceful and prosperous community. To achieve that vision it need to bring about a historic reconciliation between China and Japan and between and Korea.

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