New Crises in Asia

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NEW CRISSES IN ASIA

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BRADLEY BELT:¹

Our discussion today is quite timely because top officials from the World Bank, International Monetary Fund ("IMF") and the G-7² gathered, in Washington, this week to discuss economic problems in Japan and Asia.³ Furthermore, finance ministers, central bank governors, and economists will gather, later this year, to discuss the modernization of the architecture of the international financial markets, as championed by Treasury Secretary, Robert Rubin.⁴

What happened to the "Asian Miracle"? For the past thirty years, peace among the Asian nations permitted their economies to enjoy remarkable economic growth and prosperity. In 1996, there was a total of $93 billion in private capital inflows to Indonesia, Thailand, South Korea, Malaysia, and the Philippines.⁵ During the last six

¹ Vice President, International and Economic Policy, Center for Strategic and International Studies.
² See G7: G-7 Preparing Leaders' Statement on Global Crisis, Administration Says, BNA INT'L BUS. & FIN. DAILY, Nov. 2, 1998, at D2 (explaining that the G-7 consists of the United States, Canada, the United Kingdom, Germany, France, Japan, and Italy).
⁵ See Michael M. Phillips, Asian Crisis Could Sop Economic Gains: World Bank Says Hard Times Might Affect Millions, WALL ST. J., Sept 30, 1998, at A15 (stating that the net private capital outflow from the five Asian countries will come to an estimated $24.6 billion this year, after a $6 billion outflow last year
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months of 1997, however, these markets saw an outflow of $12 billion. This turnaround of $105 billion in one year represented 11% of their pre-crisis Gross Domestic Product ("GDP") and about 15% to 20% of their post-crisis GDP.

What accounted for this dramatic change? What can be done to prevent similar financial crises in the future? What caused the Asian financial crisis ("Asian Crisis")? There has been a great deal of finger pointing as to what precipitated the Asian Crisis. Former Malaysian Prime Minister Mahathir bin Mohamad claimed that hedge funds and speculators were the proximate cause of the Asian Crisis, however, an IMF empirical study concluded that hedge funds were not the cause of the Asian Crisis. This study suggested that hedge funds actually make financial markets more stable. The study further indicated that most hedge funds followed the local markets and, as a result, the hedge funds lost. Nonetheless, the hedge funds exacerbated the Asian Crisis because of the pressures their speculators placed on the Asian markets.

and a $93.8 billion inflow in 1996).


7 See id. (stating that the shift of $105 billion in one year was the equivalent to 11% of their combined GDP).

8 See Asian Stocks Fall Sharply For a 2d Day, N.Y. TIMES, Aug. 29, 1997, at D2 (stating Mahathir's belief that hedge-fund operators caused the turmoil in Malaysia's market to make profits for themselves and their clients).

9 See B. Eichengreen and D. Mathieson, Hedge Funds and Financial Market Dynamics, IMF OCCASIONAL PAPER NO. 166 (1998); see also Stephen J. Brown, James Park and William N. Goetzmann, Hedge Funds and the Crisis of 1997, NBER WORKING PAPER NO. 6427 (1998) (finding that there has been no indication that major hedge funds profited from the fall of Southeast Asia's currencies during the summer or fall of 1997); A Hitchhiker's Guide to Hedge Funds: The Villains of Global Finance Deserve a Better Reputation, ECONOMIST, June 13, 1998, at 2 [hereinafter Hitchhiker's Guide to Hedge Funds] (explaining how hedge funds are small players when compared with banks and mutual or pension funds which engage in similar types of speculation).

10 See Hitchhiker's Guide to Hedge Funds, supra note 9 (reporting that forward sales of the Thai currency, the baht, occurred after domestic firms and international banks had wagered that the baht would collapse).
Some commentators and economists believe that changing economic policies in the region caused the Asian Crisis. For example, Paul Krugman asserted that the Asian Crisis was the result of poor banking regulation. Jeffrey Sachs and Joseph Stiglitz suggested that the crisis was linked to the private sector and under-regulated financial decisions. Although Paul Krugman, Jeffrey Sachs and Joseph Stiglitz disagree on the actual cause of the Asian Crisis, they agree that the Asian Crisis was unforeseen and would not have occurred had the Asian economies been sound.

Many commentators blamed the IMF as the source of the Asian Crisis. They stated that the IMF caused the Asian Crisis by encouraging Thailand to cease fluctuating the baht against the U.S. dollar. Thailand complied with this prescription, and the value of the baht fell dramatically. Some believe that this devaluation of the baht triggered the Asian crisis and led to a devastating chain reaction that caused a near depression.

Paul R. Krugman is the Ford International Professor of Economics at Massachusetts Institute of Technology.


Jeffrey D. Sachs is director of the Harvard Institute for International Development and an economic advisor to governments in Asia and other parts of the world.


See id.; see also Jeffrey D. Sachs, The Wrong Medicine for Asia, N.Y. TIMES, Nov. 3, 1997, at A23 [hereinafter Wrong Medicine].


See id.


See Jeffrey D. Sachs, International Monetary Failure? The IMF's Prescriptions Might Actually Make Asia's Financial Turmoil Worse, TIME INT'L, Dec. 8, 1997, at 20 (explaining how the panic in Thailand spread to its neighbors even though there was nothing fundamentally wrong with them); see also William Pesek Jr., Dis-Oriented Markets: A Year Into the Asian Crisis. No Light At the End of the Tunnel, BARRONS, July 27, 1998, at 17 (stating that when Thailand effectively devalued the Baht over a year ago,
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Of particular concern is that the IMF, the institution responsible for ensuring the stability of the monetary system, prescribed harsh "medicine" that contributed to this economic crisis. By requiring stringent austerity measures, the IMF failed to take into consideration what measures were actually needed to stimulate growth within the Asian region. Equally disturbing is the fact that IMF economists have candidly admitted that they did not know how or why the contagion spread. These statements call into question the efficacy and merit of the IMF's monetary policies and prescriptions.

For now, the Asian Crisis has stabilized. Notwithstanding the uncertainty surrounding the Indonesian economy, currencies and stock markets have rebounded from their earlier lows, and bargain hunters are sifting through the wreckage. Growth, the currencies of its neighbors have tumbled in a devastating chain reaction that has produced a near depression.

See Wrong Medicine, supra note 15. Jeffrey Sachs, in addition to other economists, has advanced the theory that the IMF's medicine failed because the Asian Crisis had a very different set of problems than the IMF typically has to solve. The work of the IMF has generally been to rescue, monetarily, governments living beyond its means. In this type of scenario, a prescription that calls for a cut in the budget and restriction on central bank credits to the government cuts inflation and halts weakening of the currency and loss of foreign exchange reserves. The Asian Crisis, however, had a very different set of problems that could not be solved from this type of prescription. See also Asian Business: the Crisis, BUSINESS WEEK, July 13, 1998, at 20.

See M.L. Burstein and Alan Reynolds, Devaluations Don't Bring Prosperity, WALL ST. J. EUR., Sept. 1, 1997, at 6 (stating that the IMF should understand what happened in the crisis and should have been prepared to support measures to make Asian currencies immune to assault). See Wrong Medicine, supra note 15. Jeffrey Sachs theorizes that Indonesia, Malaysia, the Philippines and Thailand had running budget surpluses, not deficits. In addition, inflation had been low and federal reserves had not been falling. The IMF should have let the Asian currencies float downwards, resulting in those countries exports being cheaper and therefore more competitive. It should further moderate the strong forces pushing Asia into a recession, rather than adding to them. See Effects of Southeast Asian Crisis Revisited, REAL ESTATE FINANCE TODAY, Feb. 20, 1998, at 10 [hereinafter Asian Crisis Revisited] (stating that the situation in the Pacific Rim may have stabilized with the introduction of new measures by Asian countries to stimulate their domestic economies, namely lowering interest rates; but see Paul Krugman and Jeremy Kahn, Saving Asia: It's Time to Get Radical. The IMF Plan Not Only Has Failed to Revive Asia's Troubled Economies But Has Worsened the Situation. It's Now Time For Some Painful Medicine, FORTUNE, Sept. 7, 1998, at 74 (reporting that while Asia's currencies have stopped plunging for a moment, its real economies are getting weaker, not stronger).

See Asian Crisis Revisited, supra note 23 (reporting that currencies have rebounded and stock prices have appreciated from their current lows).

See Jathon Sapsford, Now Japanese Are Up in Arms About U.S. Investment in Distressed Properties,
however, will be slower throughout 1998 and into early 1999. Therefore, one can expect significant deflation in the region.

The question now is whether China and Japan will become the engines for economic growth in the region. Thus far, Japan has done very little to signal to the rest of the world that it is willing to stimulate domestic demand and assume this role.\textsuperscript{26} China, on the other hand, has enhanced its commitment not to devalue the yuan, but it too has deep-rooted structural weaknesses in its economy and therefore, can not serve as the engine in the region.

What, if anything, can be done to lessen the likelihood of a recurrence? How can the world lessen the severity and magnitude of such problems?

Generally, reform recommendations are in three different areas.\textsuperscript{27} First, there is a need to foster greater transparency and enhance information flows.\textsuperscript{28} Second, there is a
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need to regulate the financial sector of the affected markets, as well as all emerging markets.  

Third, there is a problem of moral hazard.

World leaders, economists and commentators are mandating reform of the global monetary system. For example, Treasury Secretary Robert Rubin has unveiled architecture for a new international financial market. Japan's Vice Finance Minister has called for a new Bretton Woods system. George Soros has proposed the creation of an international credit insurance corporation to ensure global liquidity. This organization would play a similar role to that played by the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation. Henry Kaufmann, an American markets watcher, has proposed the creation of a new international financial regulator that would monitor participants in global capital markets. This institution would set minimum capital standards and establish uniform trading, reporting, and disclosure

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30 See Bob Davis, *Rubin Urges Foreign Bank Crackdown – Call is for Financial Powers to Press Emerging State to Beef up Regulations*, WALL ST. J., Apr. 15, 1998, at A2 (noting that economists use the term "moral hazard" to describe a situation where a lender of last resort steps in and saves institutions that have made imprudent lending decisions); see also Eric Altbach, *The Asian Crisis and the IMF: After the Deluge, The Debate*, JEI REP., May 1, 1998, available in 1998 WL 9332251 (theorizing that IMF bailouts encourage lender irresponsibility and inevitably perpetuate financial crisis because lenders act knowing that any losses they incur will be absorbed by the IMF).

31 See Rubin, supra note 4 (explaining how Rubin's plan focus' on four key elements, including: "supporting reform programs in individual nations; providing temporary financial assistance when needed; encouraging strong action by Japan and the other major economic powers to promote global growth; and fostering policies in other developing and emerging economies to reduce the risk of contagion").

32 See *Asia Looks for Answers*, WALL ST. J., Mar. 6, 1998, at A14 (stating that it was at Bretton Woods, the New Hampshire resort, where financial officials from more than 40 countries agreed in 1944 to link currencies at fixed exchange rates in order to provide stability and growth to the post-war era).


34 See id. (noting that the company George Soros aims to create would administer bailouts for countries in payments crises).

35 See *Perils of Global Capital*, supra note 6.
requirements. Jeff Sachs, an advocate of this recommendation has called for an international bankruptcy policy structure, which would be modeled after the U.S. framework. These ideas and many others will be considered and more details will be offered in the months ahead.

MALCOLM BINKS:

While we could discuss the causes of the Asian crisis at length, I would prefer instead to focus on the current status of the crisis and what is being done to resolve the problem.

The world discovered Asia in the 1990s as foreign investors recognized the region’s potential for growth. As a result, the influx of capital from foreign investors and lenders led to strong economic growth and great progress for the region throughout the decade. In 1997, however, the euphoric bubble that had embraced Asia finally burst.

The most alarming aspects of the crisis that followed were its devastating effects on currency and stock markets in the immediately affected areas and its rapid contagion effect on neighboring countries’ economies. As a result of the varied development of economies in the area, the contagion effect’s impact differed from country to country. Consequently, the crisis’ effects and the appropriate reform measures for its resolution are

36 See id.
37 Managing Director and Senior Vice President, Merrill Lynch International.
39 See Jim Rohwer, Asia’s Meltdown: It Ain’t Over Yet, FORTUNE, July 20, 1998, at 92 (citing OECD figures to show that as of mid-1997, Japanese banks’ loans to Asia constituted 110% of the Japanese banking system’s capital as well as noting comparable figures for Europe).
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not uniform throughout the Asian economies, but rather differ depending upon the countries’ level of economic development. These levels of economic development may be categorized into three classes: developed countries, newly-industrialized countries ("NICs") and developing countries. Before drawing any conclusions as to why the Asian crisis transpired and how it should be remedied, it is necessary to analyze the affected countries in light of these classes.

Japan is the only Asian country that may be characterized as a developed country, having a mature, industrialized economy that is the second largest in the world. After forty years of extraordinary growth, the Japanese economy growth rate slowed in the 1990s. Nonetheless, as the yen grew strong and Japanese workers became more expensive, Japan entered an era where it needed a flexible, service-oriented, and entrepreneurial economy. In the midst of seven years of economic stagnation and a rapidly aging population, Japan is still trying to adjust to fulfill these economic needs.

As a result, a fundamental issue for Japan is domestic confidence. While the Japanese public does not feel a sense of crisis, they are worrying about their jobs and the implications of old age. These are problems that do not have easy solutions.

40 See On the Edge: The Risks of a Deep Global Recession Are Increasing, ECONOMIST, Sept. 5, 1998, at 19 (describing the crisis as “the bubble bursts” and noting that the most disturbing aspect of the crisis has been its effect on Wall Street and other developed markets).
41 See Robert Isaak, Making "Economic Miracles": Explaining Extraordinary National Economic Achievement, AM. ECONOMIST, Apr. 1, 1997, at 59 (noting that Japan had a multiwave performance of annual GDP growth beginning in the 1950’s and averaging 9.4% for the next 22 years).
42 See Gillian Tett, The Economy, FIN. TIMES, July 14, 1998, at 2 (stating that Japan’s population is aging sharply and their manufacturing sectors are losing competitiveness compared to other Asian rivals).
44 See id. (explaining how a lack of crisis mentality in Japan means that there is little public pressure to push for the deregulation necessary to revive the economy); see also See Gillian Tett, The Economy, FIN. TIMES, July 14, 1998, at 2 (noting Japan’s rapidly aging population and loss of industrial competitiveness).
There is a fear that Japan's inability to get its economy into a growth mode could potentially start another crisis.\textsuperscript{45} As the second largest economy in the world and the largest trading partner for many Asian countries, an economic recession in Japan would certainly affect our global economy.\textsuperscript{46} While the Japanese government's proposed measures might be sufficient to maintain a secure economy, Japan remains the most troublesome country in terms of our global economy.

Taiwan, Hong Kong, and Singapore are currently characterized as NICs, although their economies are approaching the status of developed countries. As a result of this transition, solutions that may have worked for these economies in the past may now be obsolete.\textsuperscript{47}

These nations were in relatively good shape at the onset of the crisis. Though not immune from the fallout, their economies are still fundamentally strong.\textsuperscript{48} Even if these economies experience slower growth this year, there appears to be little need for concern in the near future.

The remaining Asian countries comprise the developing countries class. While Malaysia and Thailand have made the most economic progress out of these countries, the Philippines, Indonesia and China still have a lot of room for improvement.

Malaysia was not as severely impacted as many of its Asian neighbors. Interestingly, it did not implement the IMF's policy prescriptions and is already showing

\textsuperscript{45} See Finance and Economics: Asia Trembles Again, ECONOMIST, June 20, 1998, at 81 (stating that the fallen yen, together with the worsening economic data and political worries, has helped flatten the rallies that lifted most of Asia's battered stock markets).

\textsuperscript{46} See id. (explaining how a weak yen affects competition and demand between the Asian countries and reduces the availability of credit from Japanese banks to Asian borrowers).

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signs of recovery. The Philippines also fared better than many of its neighbors. An upcoming election, however, will determine which economic policies the Philippines will choose to implement.

China's insulated economy was largely unscathed by the crisis. China can be distinguished from other Asian countries because Chinese officials have publicly recognized that their problems lie with the Chinese banking system and state-owned enterprises. They appear to be trying their best to alleviate the problems.

Indonesia, on the other hand, may be in for a long period of economic difficulty. Indonesia is currently in the final stages of a dominating regime that is unwilling to reform its economy. As it is not clear when the Suharto regime will end, Indonesia may experience more difficulties in the near future.

In reviewing these countries, it is interesting to see the effect of IMF intervention in the crisis. Of the countries worst hit by the crisis, Thailand and Korea have

48 See Ouattara, supra note 27.
49 However, newly announced Malaysian Government policies with respect to capital controls will make recovery more difficult. See also Mark L. Clifford, Can Mahathir Go His Way? So Far, He Is Avoiding Reforms- and the Economy Shows It, BUS. WK., Mar. 30, 1998, at 50 (noting that the evidence of corporate distress increases daily in Malaysia).
50 See Elaine Kurtenbach, Asia's Crisis Both Good and Bad For Unscathed China, SEATTLE POST- INTELLIGENCER, Feb. 23, 1998, at A2 (stating that China is the one major Asian country not involved in the crisis thanks to its relatively insulated economy).
51 On May 21, 1998, Indonesian President Suharto resigned and was replaced by the Indonesian Vice President Bucharuddin Jusuf Habibie.
52 See Personal View: Jeff Sachs, FIN. TIMES, July 30, 1997, at 1 (theorizing that Thailand's crisis may be attributed to overvaluation of the real exchange rate, coupled with booming bank lending that was heavily directed at real estate).
53 See John Burton, S. Korea Agrees to IMF Terms for Loan, FIN. TIMES (Seoul), Dec. 1, 1997, at 1 (noting that the IMF bailout in Korea called for a slowdown in economic growth, an increase in interest rates, a radical corporate restructuring, an increase in the employment rate, and a shake in the country's troubled financial industry).
responded best to the IMF’s "medicine." While Thailand and Korea knew that such remedies were necessary before the onset of the Asian crisis, there was a lack of political desire to take the "medicine" until IMF intervention forced the issue. In the aftermath of the move, both countries will experience negative growth, high inflation and rising unemployment. Nonetheless, Thailand and Korea have implemented the proper policy prescriptions and experienced positive results.\textsuperscript{54}

While optimism that the crisis may have passed is warranted, we must avoid generalizations when determining whether the crisis is over or whether the Asian contagion will return stronger than ever. After a crisis of this magnitude, there is a tendency for economists and economies to produce new ideas, systems and schemes to solve the underlying problem. It must be recognized, however, that Asia is a collection of unique countries with unique problems. Consequently, economists do not need to reinvent the global economy in light of minute differences or fluctuations.

In the short term, the situation has stabilized. The financial markets and currencies have recovered from their lows late last year and it appears that the panic has passed. Meanwhile, the Asian slowdown has assisted the United States, the United Kingdom and other industrial countries in fending off inflationary pressures. Hopefully, with two-thirds of the global economy moving forward, Asia will recover.

\textsuperscript{54} See id., at 1 (noting that the IMF bailout called for a slowdown in South Korea's economic growth rate below 3%, an increase in interest rates of 18% to 20%, a radical corporate restructuring, an increase in the employment rate possibly up to 6% as well as a shake out in the country's troubled financial industry).

\textsuperscript{55} See Ouattara, supra note 27 (theorizing that without the IMF's programs and the international support behind Korea and Thailand, "the slowdown in these economies would be much more dramatic, the costs for the general population much higher, and the risks to the international economy much greater").
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DR. DOMINICK SALVATORE. 56

The Asian Crisis is the most serious financial crisis to occur since the international debt crisis of the early 1980s. While the savings and loan crisis of the 1980s cost the United States 3% of its GDP, 57 the Asian Crisis is five times larger, at approximately 10% to 15% of Asia's GDP. 58 In addition, the Asian Crisis is more serious than the Mexican crisis because no one saw the Asian Crisis coming or the extent to which it would spread.

In hindsight, it is easy to identify the problems leading up to the Asian Crisis. In the spring of 1997, I wrote an article comparing the Asian economic conditions to those of Mexico in 1994. 59 The analysis compared economic and financial data from different countries and strongly suggested the presence of serious problems in Asia. While no one could tell exactly when a serious crisis might occur, one could tell that it would take little to trigger one. Naturally, we are not as interested in the past as we are in the future. If the indices that I will present today have any validity, they should prove useful in anticipating future crises.

For example, consider whether the current situation in Latin America is approaching Mexico's economic situation in 1994. Although some of the indices would

56 Distinguished Professor of Economics and Department Chair, Fordham University. He was President of the International Trade and Finance Association; Chairman of the Economics Section of the New York Academy of Sciences; and serves as a consultant to the United Nations and to the Economic Policy Institute in Washington.
57 See Kimberly Blanton, Japanese Yen Continues Fall Against Dollar, BOSTON GLOBE, June 26, 1998, at C1 (comparing Japan's proposed bailout costs, which are 8% of Japan's GDP, with U.S. savings and loan crisis costs, which were 3% of the U.S. GDP).
indicate that this is indeed the case, the underlying conditions are so different that a crisis may not be in the making at present.

Today, I would like to present some of Mexico's macroeconomic financial indices for 1994, which were analyzed in my 1997 article. I will then compare the Mexican indices with indices for the Asian nations currently in crisis, as well as with those Asian economies that have not been strongly affected by the crisis. The comparison should prove that indices from the latter countries were substantially different from the former.

In table 1, we see some of the economic and financial indices that I have studied. From this information, we can compare Mexico's values in 1994 with those of the Asian economies immediately preceding the crisis.

**Table 1**

Macroeconomics and Financial Indicators for Mexico in 1994 and East Asian Emerging Markets with Weak Fundamentals in 1996 (percentages)

<table>
<thead>
<tr>
<th></th>
<th>Mexico 1994</th>
<th>Korea</th>
<th>Thailand</th>
<th>Malaysia</th>
<th>Indonesia</th>
<th>Philippines</th>
<th>India</th>
<th>China</th>
</tr>
</thead>
<tbody>
<tr>
<td>S/GDP</td>
<td>18</td>
<td>33</td>
<td>33</td>
<td>37</td>
<td>29</td>
<td>20</td>
<td>25</td>
<td>43</td>
</tr>
<tr>
<td>BB/GDP</td>
<td>-0.7</td>
<td>-0.1</td>
<td>3.0</td>
<td>0.9</td>
<td>1.2</td>
<td>0.0</td>
<td>-5.3</td>
<td>-0.9</td>
</tr>
<tr>
<td>CA/GDP</td>
<td>-7.3</td>
<td>-4.8</td>
<td>-7.9</td>
<td>-4.9</td>
<td>-3.3</td>
<td>-4.7</td>
<td>-1.3</td>
<td>0.9</td>
</tr>
<tr>
<td>EDT/GDP</td>
<td>34.3</td>
<td>15.3a</td>
<td>32.1b</td>
<td>50.3</td>
<td>59.7</td>
<td>47.3</td>
<td>25.6</td>
<td>16.0</td>
</tr>
<tr>
<td>EDS/GDP</td>
<td>9.3</td>
<td>4.9a</td>
<td>10.3b</td>
<td>20.8</td>
<td>11.7</td>
<td>14.9</td>
<td>9.1</td>
<td>1.9</td>
</tr>
<tr>
<td>(CA-</td>
<td>-4.6</td>
<td>-5.2</td>
<td>-6.8</td>
<td>-4.0</td>
<td>-1.4</td>
<td>-0.6</td>
<td>-0.4</td>
<td>5.9</td>
</tr>
</tbody>
</table>


60 See id.
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<table>
<thead>
<tr>
<th>Country</th>
<th>FDI/GDP</th>
<th>DS/X</th>
<th>RES/M</th>
<th>GDP</th>
<th>BB/GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mexico</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Legend:
S = Domestic Savings
CA = Current Account
RES = International Reserves
GDP = Gross Domestic Product
EDT = Total External Debt
FDI = Foreign Direct Investments
BB = Budget Balance (deficit (-) and surplus (+))
EDS = Short-Term External Debt
DS = Debt Service Payments

X = Exports of Goods and Services of the Nation in the Year
M = Imports of Goods and Services (average monthly value);
a = originally reported; b = actual

First, consider the rate of savings (S/GDP). In 1994, Mexico's rate of savings was 18%. This is fairly low for a developing country. Mexico should have maintained at least a 25% savings rate in order to employ the new workers that enter its labor market each year. Although Mexico could have used capital inflow to obtain the same results, that choice may have resulted in financial difficulties in the short run.61

Next, observe the budget balance as a percentage of GDP (BB/GDP). In 1994, it was -0.7% in Mexico. This was not a serious problem because a budget balance deficit

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61 See Anil Padmanabhan, *I Think Interest Rates Can Fall Further*, BUS. STANDARD, Oct. 3, 1997, at 10 (quoting C. Rangarajan, Governor, Reserve Bank of India, discussing how absorbing capital inflows can be problematic in weak domestic financial systems); *See also* Brian Reading, *Why the IMF Has Got it Wrong: Blame the West for Korea's Crisis, Argues Brian Reading*, FIN. TIMES (LONDON), Dec. 20, 1997, at 2 (noting that unneeded capital inflows were a partial cause of the crisis in South Korea); *Monetary Instability in Asia: Hearing Before the Joint Econ. Comm.*, 104th Cong.(Nov. 13, 1997) (transcript available at 1997 WL 799715) (reporting testimony of Robert D. Hormats, Vice Chairman, Goldman Sachs (International), noting that East Asian domestic financial systems were unable to effectively absorb the large foreign capital inflows and domestic savings the economic systems were generating).
did not cause the Mexican crisis. Although the balance was negative, any deficit below 1% of the GDP is not a major problem.

Next, we move to the ratio of the current account deficit with respect to GDP (CA/GDP), which is very large. While there is no specific reason why this index necessarily indicates a problem, economists know that anything above 4% to 5% in the current account trade deficit, plus earnings from investments, is evidence of a problem in the making. In 1994, Mexico’s current account trade deficit was -7.3%.

Mexico’s short-term debt (EDS/GDP) was 9% of GDP. This is a small figure, but even 10% may present a problem because this type of capital can move in and out of an economy very quickly.

Next, consider the current account less foreign direct investments ((CA-FDI)/GDP). This represents the portion of the current account deficit financed by stable long-term investments, as opposed to the amount financed with predominantly short-term capital. A negative number above 3% to 4% in this index indicates the possibility of a financial crisis. Mexico’s current account less foreign direct investments represented -4.6% of GDP in 1994.

The next index represents debt service as a percentage of exports (DS/X). Any increase in the amount of export earnings funneled toward debt service makes it difficult

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63 The term short term means six months or less.
64 See David L. Roberts, Ph.D., Short-term Debt and the Asian crisis: What Did We Know and When Did We Know It?, EMERGING MARKETS DEBT REP., Apr. 27, 1998, at 1 (noting that the rapid build-up of short-term debt in the Asian countries was a hidden factor leading to the Asian crisis); Conrad Raj, Singapore Unlikely to Go Into Recession Soon: S&P Local Banks Among the Few in Asia with Investment Grade,
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for a country to address other financial obligations. This value was 28.1% for Mexico in 1994.

Finally, we come to the reserves to imports index (RES/M), which represents the number of months of imports that can be financed through reserves. Mexico's value was less than 1% in 1994. If we turn to look at Korea, Thailand, Malaysia, Indonesia, and the Philippines, the five countries that recently suffered serious crises, one sees that their figures are similar to Mexico's in 1994.

India and China are in a different class or category, because their controlled financial markets sheltered them from some of the Asian Crisis' effects. I have included their figures solely for the sake of comparison. In addition, we will consider figures for Hong Kong, Singapore, and Taiwan that were undoubtedly affected when the market tried to attack the Hong Kong dollar. Hong Kong, Singapore and Taiwan are also in a different category.

Let us return to table 1 for a moment and see what has happened in these countries. Looking at savings as a percentage of GDP, Korea, Thailand, Malaysia, and Indonesia saved at a much higher rate of GDP than Mexico did in 1994. This is characteristic of these countries' reputations for having high savings rates.
Consequently, when contrasted with the situation in Mexico, inadequate savings were not a problem in these countries.

Similarly, these countries did not have budget balancing problems. Budget deficits did not cause the crises in Mexico or Asia. In fact, out of these countries, only Korea had a small deficit. Thailand, Malaysia, and Indonesia all maintained surpluses and the Philippines had a balanced budget. India had a large deficit, but as I stated earlier, India and China are in a different category.

Warning bells should ring when current account deficits reach a level of 4% to 5%. In 1994, Mexico's current account deficit was 7.3%. In 1996, Thailand had a serious current account deficit, at 7.9%. Malaysia was at 4.9%, Korea was at 4.8%, and the Philippines was at 4.7%. All of these current account deficits, like Mexico's 1994 current account deficit, were above the warning threshold.

Next, let us observe total debt as a percentage of GDP. At one time, it was thought that Korea's total debt was approximately 15% of GDP. It officially estimated its foreign debt at $45 billion. Korea's actual total debt grew larger. First, it grew to $65 billion and then it rose to $104.5 billion last year. According to the figures the Korean government gave, the total debt of $45 billion would have been 15.3% of GDP. Because

savings rates have always been considered the pillars of East Asian growth); See World Bank: Global Development Finance 1998 Report (stating that East Asia had a high savings rate from 1993-1996, averaging over 30% of GDP in Indonesia, Korea, Malaysia and Thailand).


See Recovery in South Korea Fuels Growth in Output, Trade Deficit, ASIAN WALL ST. J., June 2, 1994, at 3 (noting the South Korean Central Bank's $45.1 billion estimate of its total foreign debt, as of March 31, 1994).

See South Korea's Meltdown, ECONOMIST, Dec. 13, 1997, at 33 (noting South Korean finance ministry's admission that earlier short-term debt estimates of $65 billion were inaccurate and should be adjusted to over $100 billion).
the total debt was more than double the originally stated amount, we have a ratio of total debt to GDP of 32.1%, not 15.3%. Similarly, the ratio of total debt to GDP was 50% in Thailand, 42% in Malaysia, 60% in Indonesia, and 47% in the Philippines, all of which are much larger than Mexico’s 34%. This was yet another warning signal that problems might lie ahead.

If one reviews short-term debt as a percentage of GDP, once again we see Korea’s values are more than twice as large as believed. Korea’s ratio of short-term debt to GDP was 10.3% in 1996, as compared with Mexico’s value of 9.3% in 1994. Similarly, the ratio of short-term debt to GDP was 21% in Thailand, almost 12% in Malaysia, almost 15% in Indonesia, and at 9% in the Philippines. The ratio of short-term debt as a percentage of GDP was much too high. This was another warning signal.

The next value is short-term financing of trade or current account less foreign investments, divided by GDP. In Korea, it was -5.2%; in Thailand, it was -6.8%; in Malaysia, it was -4.0%; and in Indonesia, it was -1.4%. Again, we see yet another warning signal.

The last two indices shown here are less important. All of the Asian countries, except for Indonesia, were doing well compared to Mexico with respect to debt service as a percentage of GDP. The number of months of imports that could be financed by these nations’ reserves was much higher than Mexico, which barely had enough reserves in 1994 to finance two months of imports.71

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71 See Economists Contend Mexican Peso’s Fall Won’t Have Costly Effect for Latin America, ORLANDO SENTINEL, Dec. 26, 1994, at A7 (stating that Mexican reserves dropped from $25 billion to $6.5 billion in 1994, barely enough to cover two months of imports).
finance five months worth of imports, and the others had similar reserves.\textsuperscript{72} This is true even though Korea, once again, reported their reserves at twice their actual size.

It is important to note that the exchange rate index is not listed here. The exchange rates in Korea, Thailand, Indonesia, Malaysia, and the Philippines did not change much in 1996. Nonetheless, the exchange rates have become grossly overvalued, even though the actual numbers did not seem to indicate the situation. The reason for this overvaluation was the linkage of these currencies to the dollar. As a result, when the dollar appreciated approximately 53% with respect to the Yen between the first quarter of 1995 and the first quarter of 1996, the Asian countries were similarly affected.\textsuperscript{73}

In addition, China's 30% currency devaluation at the beginning of 1994 resulted in an overvaluation of other currencies, even though this was not indicated by actual figures.\textsuperscript{74}

Therefore, the current account deficit, total debt, short-term debt, amount of the current account financed by short-term capital, and the exchange rate were all certainly warning signals. They all indicated that these countries were about to enter into a crisis. No one could anticipate or forecast when a crisis might occur, but an economic spark from any direction could set it off. Nonetheless, with all due respect, there were some people who had anticipated the crisis.

\textsuperscript{72} See Thailand's Current Account Deficit Surpasses Expectations, AGENCE FRANCE PRESSE, Mar. 5, 1996, available in 1996 WL 3816103 (stating that Thailand had enough foreign reserves to cover approximately six months of imports in the spring of 1996).

\textsuperscript{73} See Anthony Rowley, Export Competitiveness Shifting Fast, BUS. TIMES (Sing.), Apr. 18, 1997, at 5 (noting appreciation of the U.S. dollar against the Japanese yen and the consequent increase in the exchange rate of Asian countries linked to the U.S. dollar).

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When the Soviet Union collapsed, people who had studied the Soviet Union had not forecasted that the collapse was coming.75 As a result, many wondered if all of this studying served a purpose. Of course, after the fact, the same analysts came up with many different explanations.

The IMF knew that these countries were in trouble,76 but it was not free to tell others. Michael Mussa, of the IMF, asked, “Where were all the fund managers? Were they asleep? They make millions of dollars in profits, they should have known a crisis was coming.”77 This statement was a clear indicator that there was a predictable crisis in the making after all.

The three economies that I placed in a separate category earlier, Singapore, Hong Kong and Taiwan, were affected by the Asian Crisis very differently. When looking at the per capita income in Singapore, Hong Kong, and Taiwan, South Korea is the only other country whose income approaches these levels. All of the others are below $5,000 in real per capita income.

Table 2

Macroeconomics and Financial Indicators for Mexico in 1994 and East Asian Emerging Markets with Weak Fundamentals in 1996 (percentages)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Singapore</th>
<th>Hong Kong</th>
<th>Taiwan</th>
</tr>
</thead>
</table>


76 See Thai Authorities Ignored IMF Advice, ASIAN WALL ST. J., Aug. 13, 1997, at 3 (noting that the IMF warned the Bangkok government that the economy was heading for trouble); G7 Moves Closer to Giving IMF More Teeth, AGENCE FR.-PRESSE, May 17, 1998, available in 1998 WL 2282612 (noting that Thailand ignored repeated warnings from the IMF prior to the Asian crisis).

Chalmers Johnson, a renowned expert in U.S.-Japanese relations, said that the United States was in trouble, that Japan would rule the world, and that its per capita income was already higher than that of the United States. This, however, is not entirely accurate. If income is converted from yen to U.S. dollars, Japanese per capita income is $36,000 per year, as compared to $24,000 or $25,000 in the United States. Nonetheless, Japan's cost of living, as we know, is much higher than our own. Thus, simply using the exchange rate makes little sense. If we adjust the income per capita for the much higher real estate and food costs reduce Japanese purchasing power by 20 to 30 percent; see also Brian J. Barna, An Economic Roadmap to Korean Reunification: Pitfall and Prospects, ASIAN SURVEY, Mar. 1, 1998, at 265 (comparing currency conversion methods using “traded-goods” exchange values with those using “purchasing power parity”).
higher cost of living in Japan, we find that the actual per capita income in Japan is $21,000 to $22,000, as opposed to $25,000 in the United States.

Nonetheless, Hong Kong, Singapore and Taiwan were not in trouble. The figures reveal that all of these countries maintained unbelievable savings rates. Furthermore, except for Taiwan, each of the countries maintained large budget surpluses. With the exception of Hong Kong, the ratio of the percentage of the capital account to GDP for all these countries was positive. The ratio of total debt to GDP in these countries was also much lower than in Mexico or other countries, and each country held billions of dollars in reserves. These countries are all in a different league. While the market’s test of the Hong Kong dollar affected them, the above figures indicate that they did not collapse.

In summation, a crisis in East Asia should have been anticipated. If it had been, the problem would not have escalated as it did.

Problems within the Asian countries intensified when those countries borrowed excessively in dollars and entered into business endeavors outside of their main

Table 3
Growth of Real GDP

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</thead>
<tbody>
<tr>
<td>Advanced Economies</td>
<td>2.0</td>
<td>2.5</td>
<td>2.7</td>
<td>3.0</td>
<td>2.5</td>
</tr>
<tr>
<td>Asia</td>
<td>8.1</td>
<td>8.9</td>
<td>8.1</td>
<td>6.8</td>
<td>5.7</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>5.3</td>
<td>4.5</td>
<td>4.9</td>
<td>5.3</td>
<td>5.0</td>
</tr>
<tr>
<td>Singapore</td>
<td>8.7</td>
<td>8.8</td>
<td>7.0</td>
<td>6.0</td>
<td>5.5</td>
</tr>
</tbody>
</table>

As a result, they experienced phenomenal growth at rates of 7%, 8%, and 10% per year, as opposed to our growth rate of 2% or 2.5% per year. Local businesses also borrowed heavily, overestimating their abilities. Their borrowing costs were approximately 9% to 10% per year despite paying higher rates in local currency, when adjusted for inflation. As a result of this heavy borrowing in dollars, Asian currencies became overvalued. When the markets realized that a problem existed, a panic began, capital inflows stopped, exchange rates plummeted, and the debt could not be repaid. This was not a panic based on rumors or ignorance of the real world; the panic started due

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83 See IMF Proposal to Stem Asian Financial Crisis: Statement of Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System, CONG. TESTIMONY BY FED. DOCUMENT CLEARING HOUSE, May 21, 1998, available in 1998 WL 11518445 (quoting Chairman Greenspan’s testimony that East Asia maintained real growth rates of close to 10% per year for an extended period of time); see also Where to Invest in 1998: Strategies for Stocks: Asia, BUS. WK., Dec. 29, 1997, at 112 (stating that East Asia had approximately 8% to 10% growth over the 15 years prior to the crisis).
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to capital over-borrowing. Corruption, nepotism, and crony capitalism added to this effect. Each government, Japan and Korea in particular, must be frank in addressing these issues. They must not contribute to the problem by obfuscating them. Facing the problems directly and openly is the only way these economies will grow strong again.

DISCUSSION:
MALCOM BINKS:

As we have many traders in the room today, let us engage in speculative fiction. We have had, in recent weeks and months, people as distinguished as Jim Wolfenson, President of the World Bank; Alan Greenspan, in testimony to Congress and others noting the inevitability of such financial crises. In a Washington Post article, Wolfenson stated that, "it's inevitable that within the next five years we are going to have a crisis of similar magnitude." This is the nature of the international financial system now. With information flowing rapidly and large sums of capital coursing through the veins of international commerce, our ability to control devaluation or stem panic is not really there yet. Simply put, we do not have the architecture Treasury Secretary Rubin recommends.

As for the future, we must attempt to foresee where the next crisis will arise. Consider Russia. Our Russian analysts hypothesize that, given the political instability

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See David Smith, The Asian Tigers Turn Tail, SUNDAY TIMES- LONDON, May 24, 1998, at 10 (discussing the crisis's secondary effect of exposing crony capitalism in East Asian governments and businesses); Skip Kaltenheuser, Go as You Pay: An International Attack on the Business of Bribery, BARRON'S, Sept. 28, 1998, at 59 (noting that South Korea's citizens blame corrupt bureaucrats for bringing about the crisis); Helen Hughes, IMF Is Right On Indonesia, AUSTL. FIN. REV., Mar. 12, 1998, at 18 (noting widespread nepotism and corruption in Indonesia, South Korea, and Thailand, the most affected countries in the crisis).
there, the Russian economy is on the brink of implosion, and it could happen at any time.
Consider also Brazil; their current account deficit is creeping up close to five percent
now. Finally, we have continuing concerns about Japan and their sustained period of
deflation and what that could do to the regional economy.

There is also talk about the “bubble” here in the United States, which could pop
and change investor expectations. It could be something like the “millennium bug” or the
Y2K problem. In the Wall Street Journal an author predicted a 66% chance of global
crisis in the latter half of 1999 due to the Y2K problem. These are all crucial points
to consider.

DR. DOMINICK SALVATORE:

The IMF has been accused of many things, and to some extent it is deserved. The
world financial markets’ huge financial flows, however, can move at the spur of the
moment, based on rumors and many other reasons. As a result, it is inevitable that we
run the risk of a crisis in the future as long as there are liberalized capital markets.

My opinion on how to avoid these problems is to let the markets operate freely. If
all the information were required to have been made available, the markets would have
realized that problems were in the making, and would have reacted much earlier. The
problem may not have been avoided, but it would have been much less extensive than it
is now.

In short, the IMF should stimulate nations to release essential economic
information. For instance, if Mexico had not hidden information, and other nations knew
how serious their situation was, the crisis may have come earlier and been of a smaller
magnitude. The same is true for Asia. Even if the IMF cannot force countries to release
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information, it can and should encourage them to do so. Markets would then assume that a nation’s failure to provide timely and adequate information as an indication that the nation is hiding something. While we may not be able to avoid future crises, we can provide the markets with information, which will allow them to respond to crises in a timely manner. This may be the only measure that minimizes the number and seriousness of future crises.

BRADLEY BELT:

Malcolm Binks, I know that individual countries can decide whether or not to release IMF reviews of their economies. Some countries that release IMF reviews are Argentina, Chile, Hong Kong, Germany, Japan, the United States, and India. Countries that do not release reviews are Brazil, Malaysia, Mexico, Indonesia, Thailand, China, and Russia. If investors do not receive IMF critiques will they refrain from investing in these countries?

MALCOLM BINKS:

Perhaps they should, but I do not think it is something that investors look at every day. There is another element in all of this, one item in particular is the confidence factor. It is an elusive, intangible thing. There were a lot of signals for the Asian economies as to the nature of their problems. Korea avoided telling the world about their problems, even if they had not concealed them. Conversely, Thailand revealed their numbers for the world to see. Everyone knew about the boom in the real estate market in Bangkok and everyone knew about the state of disarray of account. Yet, business in Bangkok continued because people had confidence. They incorrectly assumed, problems
notwithstanding, that other factors existed in the market at the time to allow the public to remain confident.

It is very hard to predict which country will experience a crisis because of the elusive element of confidence. It behooves everyone to look more closely at the numbers.

What is needed is a better IMF credit agency monitoring system to provide early warning. The coda to this, however, is to heed the warning signs; to ignore the signs will tempt fate a second time. Therefore, more thought should be directed towards the response mechanism, be it the IMF or a new agency. A response mechanism may provide a prompt response when these countries run into a crisis.

The Asian Crisis began in Thailand, spread to Malaysia, and then spread over Asia. The loss of confidence in these countries resulted in severe remedies. Less affected countries were adversely affected regardless.

Tough years are ahead for nations such as Thailand and Korea. There must be a better way to head off these crises and to deal with the contagion effect. While analysis is good, transparency and improved regulation is needed. Additionally, most of these countries are still developing and must contend with growing pains.

QUESTION #1:

The tables present a snapshot of the crisis, one-year. If you follow the data, how long did it take Mexico or other countries to end up in crisis? Do you have any data on that? How long can they sustain those ratios before a crisis takes place?

DR. DOMINICK SALVATORE:
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In Mexico, the crisis developed in 1993 and 1994. In Asia, the 1996 data presented became available in the spring of 1997, after the crisis in Thailand arose. At that point it was too late. The 1995 data for Mexico was available in the spring of 1996, before the problems began.

The IMF has to prevent a localized financial crisis from becoming a real and extensive economic crisis. The IMF had no choice but to help these countries out after the crisis began. Aiding these countries, however, creates a moral hazard problem. A forty to fifty percent increase in earnings is considered a private return; any decrease in earnings becomes a public loss. Thus, more transparency would prevent some crises and make those that occur weaker. If a third of the banking and business sectors that conducted irresponsible transactions went out of business, as they should, markets would not have to suffer. If large and devastating losses were born by those who make serious mistakes, then the problem of moral hazard will diminish significantly.

QUESTION #2:

Dr. Salvatore, did you do a schedule on the United States, and are there any warning signs for us? Do you have an extended one that we might be able to see?
No. In the United States we say we are in a “bubble economy”, which is a completely different economy than those being discussed. It is difficult to compare Asia to Mexico, but to compare the United States to Mexico is not feasible. One could not use these indicators to draw an inference from what happened in Asia or Mexico to the United States.