International Journal of Research Publication and Reviews

Journal homepage: www.ijrpr.com ISSN 2582-7421

The Role of International Communities in Asian Financial Crisis: A Review Article

Mannir Salisu

Hassan Usman Katsina Polytechnic, P. M. B. 2052 Katsina, Katsina State, Nigeria.

ABSTRACT

The financial crisis that erupted in 1997 and swamped Asia in misery through the end of the millennium came as a shock to virtually all observers. Asian countries were hit hard by the financial crisis, even though, every country had different challenges. This paper explores the materials needed from the secondary sources (i.e. online databases and other research platforms), where a set of themes was developed through the review analysis in discussing the role of international community in Asian financial crisis. The issue has been widely examined in a large volume of articles from the second half of 1997 to well into the second half of 1998, with analysis from economic and financial experts all over the globe. The paper also attempts to address the various causes of the crisis, and to analyse the operational solutions to it.

Key words: Financial crisis, World Bank, Economic growth, Asia, Economy.

1. Introduction

The financial crisis that erupted in 1997 and overwhelmed Asia in misery through the end of the millennium came as a shock to virtually all observers. The crisis started in Thailand, and in a matter of weeks after the country stopped defending it national currency, those countries such as Malaysia, the Philippines, as well as Indonesia were also forced to let their currencies fall as speculative market force built. The Asian financial crisis, in contrast, delivered an extraordinary blow to a region that had managed to bring its macroeconomic variables into reasonably good order and had continued decades of rapid growth driven by exports.

The effects of the crisis throughout Asian countries were more severe than any since the great depression of the 1930s. In many economies like Indonesia, Korea, Thailand, Malaysia, Hong Kong and Singapore have had suffered deeply as their trading partners fell into crisis. The crisis intensified the financial weaknesses of Japan, where only China and Taiwan managed to maintain stability.

Even though signs of initial recovery in majority of the Asian economies were noticeable by early 1999, financial systems remained flimsy, hampered by bankrupt banks and high volumes of non-performing loans. Most economies came under pressure despite that those countries with concrete economic essentials and bulky foreign exchange reserves performed much better. Subsequently, the World Trade Organization (1999) attributed the Asian crises for the considerable slowing in trade growing in 1998. Likewise, the World Bank (1999a) projected that the consequences of the Asian crises might be a crash in commodity prices, a decelerating of world trade, and tighter long-term funding would cause average growth rates in most Asian economies in 1999. The International Monetary Fund (IMF) estimated that the crisis would cause a loss of real income in most African economies of more than two per cent (Harris, 1999).

2. Causes of the Crisis

The main cause of the global financial crisis is as a result of the financial and economic policies of the advanced economies, particularly the United States. Asian economies are not responsible, but seriously affected. Similarly, based upon the research by Reisen (1998), there were many causes of the crisis right from the domestic financial problems such as a large capital inflows, overestimated real exchange rates, as well as rapidly rising asset prices. However, the crisis was embedded in several areas of industrial, financial, monetary policies of government as well as the direction of investment. After the crisis originated, markets in most of the Asian countries reacted powerfully and different currencies gradually coming under pressure.

2.1 Weakness of the Financial System

Despite that financial transformations have been introduced over a given period (e.g. 1980s & 1990s), financial sector regulation were not been properly established, resulting in a substantial amount of credit being allocated to unproductive investment. It was highlighted that domestic financial system liberalisation is usually not accompanied by necessary improvements in financial sector supervision. Equally, Kaminski and Reinhart (1996) discover that financial liberalisation over a given period (1970 to 1995), as well as private lending explosion, plays a significant role in influencing the likelihood of a banking crisis; in this instance, they find out that banking crises help predict currency crises. For the majority of Asian economies, lending was gradually channelled to property and non-traded activities. Moreover, Ranis and Stewart (1998) concerned that at least 20 to 25 per cent of commercial banks debt was usually allocated to real estate in Indonesia and around 15 and 20 per cent in the Philippines, Malaysia as well as Thailand.

Based upon the Report from the Bank for International Settlements (BIS 1997) stressed the financial fragility of Asian countries, particularly in Indonesia, Malaysia, the Philippines as well as Thailand throughout the 1990s, whereby those Asian countries that experienced a more prompt growth of credit than any advanced country. According to the BIS, such fragilities in banking industries affecting Asian economy can be described by numerous factors, like violent asset price cycles determined by an excessive enlargement of bank credit, the harm of degrees of freedom for country’s monetary policy due to capital account liberalisation, as well as the smooth of bad debts inherited from directed lending policies.

2.2 Overproduction

Overproduction is one of the major factors responsible for the crisis rather than overconsumption. As indicate earlier, the explosion in bank loans was primarily channelled towards investment rather than consumption. This overinvestment categorically leads most of the Asian economies to overproduction. However, there are number of factors (i.e. external factors) that have significantly contributed to such scenario (overproduction). Some of these factors include the depreciation of Japanese Yen against the United States Dollar (in 1995), this is in addition with the Chinese Yuan devaluation (in 1994), affected negatively the competitiveness of the countries in the region, this is because the currencies of majority of the countries in the region were effectually nailed to the US dollar. According to the Park and Song (1998), foreign capital is the main factor responsible for the investment explosion. The authors’ demonstrates that the financial sector liberalisation together with the introductory of the capital account enlarged the availability of foreign direct investment (foreign capital).

2.3 External Factors

According to the data from the Institute of International Finance (IIF 1998), in the period between 1994 and 1996 some Asian countries that affected by the crisis have significantly received great levels of private external finance. Similarly, the data reveals a melodramatic reversal of capital flows where countries such as South Korea, Malaysia, Indonesia, the Philippines and Thailand severely affected by the financial crisis experienced economic contraction in 1996. Majority of this problem happened in commercial bank lending, as well as short-term portfolio capital flows, but foreign direct investment continued to be safer.

The sudden upsurge in short-term foreign borrowing has numerous consequences, particularly for the Asian economies. The BIS (1996) disputes those snugger domestic monetary policies in most of the Asian countries encouraged foreign borrowing. Accordingly, Reisen (1998) worries that the differences of interest rate among Asian economies is due to the structural deficiencies in the domestic financial sector. Actually, the liberalisation of domestic financial systems in the region as well as the introduction of capital accounts attracted high levels of short-term and potentially reversible loans. The tightness of local equity and bond markets also brings more pressure to borrow substantially from abroad.

2.4 Changes in Sights by International Investors and Lenders

The most disturbing issues about the Asian financial crisis is that the affected countries in the region recognised as most successful globally over a given period, this is not only in terms of economic growth and development but also in terms of great vigorous in their exports of goods and services, coupled with low levels of inflation, high amounts of savings as well as income inequality. Despite that majority of these countries had extraordinary current account deficits in their balance of payments, there are two reasons for that according to the analysts. Initially, such deficits were usually financing very high investment levels, and the current account deficits did not instigate in fiscal deficits.

Almost every time foreign direct investments are determines by the level and nature of the economy. Advanced economies possibly guaranteed high returns and shorter payback period. As such, if international investors find it easier to enter these economies, as if their entry is facilitated by capital account liberalisation, they incline to rush in, making a great flow of capital influxes that affects key economic variables. Any changes, which is domestic or international, or it might be economic or political ones, important or otherwise. This transformation initiates a severe alteration in perceptions, leading to a big reduction in confidence in the economy amid internationally movable investors that is both foreign and nationals’ investors’ willingness to make a huge gains. As per as Asian economy, there exists a considerably overshooting. In as much as exchange rates collapse, stock markets and property prices also decrease harshly.

3. Financial Liberalisation surrounded by a Weak Policy Agenda

Asian countries have been adopting risky lending practices which considerably contributed too many problems which included among others, continuous investing in basically unproductive activities. Many business enterprises were already creating considerable overfilling in some sectors of their economy. Similarly, the new inflows of foreign direct investments in the early 1990s worsened the imbalance between available capital as well as productive investment opportunities. These caused bank and non-bank credit facilities in these countries to expand much faster in their domestic economy. However, a substantial percentage of the new investment flows was focused to the real estate and stock markets, increasing speculative boils. Ultimately much of this new lending would add to the non-performing loans held by local commercial banks of the Asian region.

3.1 Pegged Exchange Rates

Nevertheless, maintenance of fixed exchange rates (ordinarily against the United States Dollar instead of basket of regional currencies) seriously worsened the exposure of Asian economies to crisis, where majority of regional governments found it impossible to safeguard local economies from the effect of increased inflows of foreign capital with such system of nailed exchange rates. The flows of foreign capital had numerous vital consequences. Consequently, in as much as currency appreciation increasingly becoming hopeless and ruled out, capital inflow substantially influencing money supply, thereby increase inflationary pressures in almost all Asian countries. According to Goldstein (1998), almost all the countries in the Asian region experienced lower growth rates of export in the year 1996 which is more than what happen in previous years. This situation was principally noticeable in the countries such as Korea, Malaysia as well as Thailand. The superficial obligation of most governments in maintaining fixed rate brings about moral hazard tricky. Accordingly, financial institutions and many other borrowers had very little incentive to be protected against the exchange rate risk especially when borrowing in foreign currencies.

4. The Role of International Community to Overcome the Problem

There is a significant degree of variation in the initial position of the Asian countries with respect to the crises. Some countries have high international currency reserves; some have a considerable inland market. Nevertheless, many countries have already been severely depleted by the food and energy crises.

4.1 Fiscal Incentive Measures

While rich countries responded with wide-ranging fiscal interventions, numerous Asian countries launched programmes of this kind. Economies with substantial international currency reserves and a low budget deficit, such as China, were in a right position to do so. China announced investment in domestic infrastructure programme for the years 2009 and 2010 for social security, environment, technology and education. However, a procedure centred on individual programmes for each Asian country was considered insufficient, and a multifaceted coordinated approach.

4.2 Monetary Policies

Many economies, like India, considering other routes, as the country have substantial international currency reserves, whereas it has high fiscal deficits which leave slight room for increased expenditure. Accordingly, India lays more emphasis on monetary measures, particularly in facilitating credit access options for manufacturers. However, for many Asian countries, these monetary policy measures are severely limited because easement in interest policy influences the exchange rate of their currency and the rate of inflation. Equally, the impact of devaluation of currencies as a precise export incentive measure will probably be limited in such as global demand doesn't rise more strongly. In contrast, some countries have introduced selective trade restrictions on non-essential luxury goods.

4.3 International Financial Institutions Activities

The International Monetary Fund (IMF) and the World Bank, as well as other multilateral financing institutions addressed these financial and economic crises early and on their own edge. In this regard, the G-20 resolutions also added stimulus, where the heads of these organisations were not reluctant to call urgently on the G-20 head of States for rapid and more intensive action. The principal concerns included the policy counselling of the member countries and financial support, which is to be extensively increased. In this respect, all the multilateral financing institutions had to considerably expand their own resources. At the same time, the financial crisis had necessitated increased pressure on the reform of governance. Both the IMF and World Bank use the mechanism as well as season meetings to present their measures and activities in the best possible way.

5. Conclusion

There is no doubt that one of the concerns of the financial and economic crisis was a change in power and influences. In respect of the enormous government and central banks refinancing programmes; together with the comprehensive economic incentive measures, there is also a long term threat of huge budget deficits and mounting public debt, because currency and financial crises can abruptly increase poverty and disrupt any sound government policy for the poor, even in countries where the rate poverty is very small, if care is not taken properly. The proper design of accurate and sound macroeconomic policy is difficult for countries undergoing financial and currency crises, and research is needed on the most efficient and most cost-effective instruments, from a poverty alleviation perspective, that can be developed for offering social amenities; research is also required on how such social protection can best be funded, e.g. by increased taxes or cutbacks in non-essential government spending. The design of concrete policy must be developed in forms that are consistent with, and encourage, economic recovery.

REFERENCES

Bank for International Settlements (BIS, 1996). The Maturity, Sectoral and Nationality Distribution of International Bank Lending, First half 1995, January, Basle.

Bank for International Settlements (BIS, 1998). 'Consolidated international banking statistics for end-1997', BIS press release, 25 May 1998.

Corsetti, Giancarlo, Paolo Pesenti and Nouriel Roubini, 1998, What Caused the Asian Currency and Financial Crisis? Asian Crisis homepage, March 1998.

Eichengreen, B. and D. Mathieson, 1998, Hedge Funds and Financial Market Dynamics, IMF Occasional Paper No 166.

FAO – Food and Agriculture Organisation, 1997, Special Report: The Impact of el Niño and Other Weather Anomalies on Crop Production in Asia, http://www.fao.org/WAICENT/faoinfo/economic/giews/english/alertes/nino997.htm

FitzGerald, Valpy, 1998, Global Capital Market Volatility and the Developing Countries: Lessons from the East Asian Crisis, Paper presented at the East Asia Crisis workshop at the Institute of Development Studies, http://www.ids.ac.uk/ids/research/fitz.pdf

Frankel, J.A. and S. Schmukler, 1996, Crisis, Contagion and Country Funds: Effect on East Asia and Latin America, Pacific Basin Working Paper Series No PB9804, Federal Reserve Bank of San Francisco.

Griffith-Jones, S., 1996, 'How can future currency crises be prevented or better managed?' in Jan Joost Teunissen (ed), Can Currency Crises Be Prevented or Better Managed? The Hague, FONDAD.

Griffith-Jones, S., 1998a (forthcoming), Global Capital Flows, London, Macmillan Griffith-Jones, S., 1998b, How to Protect Developing Countries from Volatility of Capital Flows? Paper presented at the East Asia Crisis Workshop at the Institute of Development Studies http://www.ids.ac.uk/ids/research/sgj3.pdf

Howell, Michael, 1998, Asia's 'Victorian' Financial Crisis, Paper presented at the East Asia Crisis workshop at the Institute of Development Studies, http://www.ids.ac.uk/ids/research/howell.pdf IIF – Institute of International Finance, Inc., 1998, Capital Flows to Emerging Market Economies, http://www.iif.com/PublicPDF/cf_0598.pdf.

ILO – International Labour Organisation, 1998, The Social Impact of the Asian Financial Crisis, ILO Regional Office for Asia and the Pacific, Bangkok, http://www.ilo.org/public/english/60empfor/cdart/bangkok/index.htm.

IMF – International Monetary Fund, 1997, World Economic Outlook: Interim Assessment, December 1997, Washington, International Monetary Fund IMF – International Monetary Fund, 1998, International Financial Statistics May 1998, Vol. LI, No. 5, Washington DC.

Kaminsky, G. and C. Reinhart, 1996, The Twin Crises: The Causes of Banking and Balance-of-Payments Problems, International Finance Discussion Paper, No 544, Board of Governors of the Federal Reserve System, Washington, DC.

Marshall, Andrew, 1998, 'Indonesia stares into uncharted depths', Reuters: 2 July 1998 12:56 EDT, http://www.pathfinder.com/money/latest/rbus/RB/1998Jul02/245.html.

Park, Young Chul and Chi-Young Song, 1998, The East Asian Financial Crisis: A Year Later, Paper presented at the East Asia Crisis workshop at the Institute of Development Studies, http://www.ids.ac.uk/ids/research/parksong.pdf.

Ranis, Gustav and Frances Stewart, 1998, The Asian Crisis and Human Development, Paper presented at the East Asia Crisis workshop at the Institute of Development Studies, http://www.ids.ac.uk/ids/research/stewart.pdf.

Reisen, Helmut, 1998, Domestic Causes of Currency Crises: Policy Lessons for Crisis Avoidance, Paper presented at the East Asia Crisis workshop at the Institute of Development Studies, http://www.ids.ac.uk/ids/research/reisen.pdf.

Robb, Caroline M., 1998, Social Aspects of the East Asian Financial Crisis: Perceptions of Poor Communities, Paper presented at the East Asia Crisis workshop at the Institute of Development Studies, http://www.ids.ac.uk/ids/research/robb.pdf.

Stiglitz, Joseph, 1998, Knowledge for Development, Paper presented at Annual World Bank Conference on Development Economics, Washington DC.

Wade, Robert, 1998, The Asian Crisis: Debt Deflation, Vulnerabilities, Moral Hazard or Panic? Paper presented at the East Asia Crisis workshop at the Institute of Development Studies.