Asian Crisis Essay, Research Paper

Identification and Origins of the Asian Crisis As the economist Walden Bello said “the evaporation of the Asian economic miracle probably ranks second only to the unraveling of Soviet socialism as the greatest surprise of the last half-century” (Bello). The Asian crisis is a combination of several negative changes in their economy. The characteristics of the Asian Crisis are a lower G.D.P, foreign investment and value of a country’s currency. There was a drop of forty to eighty percent in Southeast Asian countries. The bankruptcy of the banks and other financial institution’s was another major characteristic of the Asian Crisis. Another common characteristic of the Asian crisis was people began to try to sell their currency for American dollars in a frenzy, which became a currency crisis. Total production of the countries has dropped severally (G.D.P). A frequent sign of the Asin Crisis was how high current account deficits were compared with the G.D.P of a country. It got as high as five to seven percent in some countries. The exact cause of the crisis is impossible to decide, that is why in this essay we will discuss five theories. The theories are competition from China and Japan, investments in high risk sectors, foreign investment into currency, financial intermediates, the Japanese economy and Asian country’s involvement into their dollar. Though the crisis was inevitable, it was not till July 2, 1997, that the inflated markets in Asia began to feel the crisis. This is when Thailand devalued its currency against the U.S. dollar. This devaluation started an effect like a ripple in a pond. This led to devaluations in Indonesia, Malaysia, Philippines, Taiwan and Vietnam. These devaluations were because most of the Asian economy deals with exporting. If Thailand had a lower dollar than it would make it easier for them to export, compared with the other Asian countries. When Thailand devalued the Baht, they forgot that the twenty billion dollars in foreign accounts would cause the account holders to sell. This is what eventually happened. Too many baht were chasing too few dollars that led to an enormous sell off which caused the currency crisis. The Asian countries characterized the hazards of fast-track capitalism. They entered billions of dollars through investments and loans into the Asian economy. Instead of this capital being put into the domestic manufacturing sector, which is commonly an area that provides a low yield but also low risk. They instead put this capital into high risk sectors of the economy like real estate, stock market and consumer financing. The abundance of real estate began to grow at an alarming rate. By 1996 there was more than $20 billion unowned property in Thailand alone. Since government policies did not regulate the financial sector, the banks were highly overexposed to the real estate market. Foreign investors began to notice that the Asian banks had significant amounts of money in real estate ventures that eventually turned into unpaid loans. With the overexposure in real estate, weak export growth and a spreading current account deficit was signaling fear of a currency devaluation that would devastate their investments. Another factors which caused the Asian crisis was competition of China and Japan versus the developing countries of Asia. Since the developing countries in Asia have been growing for the last thirty years, people were are starting to earn higher wages. As a result companies that produced low value goods began to move production from Southeast Asia to China. Southeast Asia faced the same challenge but it is with high value goods against Japan. Until the crisis the Yen had been slowing decreasing as the other Asian country’s currency’s began to rise. This meant that Japanese goods were becoming cheaper while Southeast Asian goods were becoming more expensive. Japan was not really a factor in creating the recent Asian crisis, but it plays a very large role in getting out of the crisis. Since Japan accounts for between five and 12% of all Southeast Asian country’s G.D.P, while Japan struggles other Asian countries will struggle. Since Japans G.D.P had also been hit hard with an annualized decrease of 5.3 percent, this has only fueled the crisis even more. The devaluation of the Yen to an 8-year low of 147 against the American dollar had a unbelievable effect on Asia. It undermined the competitive advantages that Asian countries had exporting because of their historical lows currency compared with the Yen. The governments lack of responsiveness to the financial sectors problems have also lead the Japanese economy into a whirling tailspin. The pillars of Japan’s banks have crumbled during the Asian crisis. Only now is the government beginning to intervene and take control of weaker banks in Japan. You probably are wondering how the Japanese banks go so into debt. Well under the governments guidance, the banks kept worthless companies in business by giving them loans that undermined the economy. . The Impact of the Asian Crisis Domestically and Foreign The impact socially and financially that the Asian crisis has had on the world is immeasurable. We once knew the Asian countries for the technology and economic power. Now they are responsible for the downturn in the global economy. “Asia was once feared for its economic might. Today it is feared for its economic weakness-and the harm its ailing system will do the rest of world” (The Economist June 20). The Asian crisis has impeded in the growth of countries globally and domestically, a currency crisis, exporting, bankruptcy of banks in relation to bad loans, and created lower social standards. The crisis not only affected Asia but it also hit other areas like Europe, North and South America. Though North America and Europe have had recent woes economically. The U.S. andCanadian economies should only have a percent drop of 0.5 to 1 in G.D.P. The North American, and some European economies are still moving firmly into building a stronger economy. “Although East Asia’s crisis will have a significant effect on the world economy, it will not be as damaging as earlier global shock” (The World Bank). The IMF has predicted that world growth will decline because of the recent crisis in Asia but sees growth in the year 2000. This is because of the recent capital inflow beginning to pour back into Asia. The G.D.P of all foreign countries to Asia but Latin America will see a 0.5 to 1.0 percent drop in the next year. Asia has been hit much harder though with a forecasted drop of 3.0 to 17.0 in G.D.P (gross domestic product). The major economic problem that the Asian countries face is their devaluing currency. Though a weak currency would benefit Asia exporting sector, their recent devaluations were much too extreme to benefit the economy. Indonesia was the hardest hit with a decrease in their currency of 80 percent at one point (\*). Most of the other Southeast Asian countries were hit with a forty to 50 percent drop in their currency value (\*). The only country that was not significantly affected was Singapore, which only had a 13 percent drop in their currency value(\*) . This devaluation was because of the myth that all Asian countries were weaker economically than expected. The two reasons why Singapore did get hit by the currency crisis. The first reason is that they did not have as weak of an economy compared to the other Southeast Asian countries. The second was that they had the proper monetary policies in place at the beginning of the crisis. The exporting business is crucial to Asia’s economic stability. With 53 percent of Asian countries intra-Asian traded, a recession proved that in anyone of the Asian counties can be disastrous. With Asia starting to stabilize, they will probably enter a recession for about two to three years. The end of this possible recession is going to be dependant on all the countries rebuilding and sustaining growth. With Asia’s countries currency very low, they will be able to undercut Non-Asian countries because the price of their goods will be cheaper.

Due to the lethargy of Asian governments specifically Japan, financial institutions have incurred large amounts of debt and bankruptcy. The impact of inefficiency of banks has created more than a trillion dollars worth of debt among banks in Asia. The hardest hit was Japan with more than 580 billion dollars in debt, which was all invested in Asia. “As markets tumble and commentators tear their hair, it is difficult to accept that Japan’s recession may have useful side-effects of this kind” (The Economist June 20). The Asian crisis could actually help Asian financial institutions in the future. This is because with the proper reform all the weak and poorly run banks/financial institutions will be run out of business. This will in turn make the financial sector stronger and more efficient. The crisis will also help to erase financial intermediates (mafia / loan sharks) which only add to the instability by charging high interest rates. The one consequential impact of the bankruptcy among banks is that because of the bad loans, it is likely that they will increase interest rates. If interest’s rates are raised, this will only add to the faltering economy. When the social standards are believed to decrease in a country, there a few key indicators that provide an excellent picture of some countries social status. The indicators are unemployment, cuts to public services and education. All of these signs have been evident in the Asian countries. Although poverty for the region as a whole has declined, 350 million people are still living on less than 1 U.S. dollar a day. Rising inequality among geographic regions, and among skilled workers has led to wage disparities. Most countries have virtually no unemployment insurance, social safety nets, and little provision for old-age pension insurance. Unemployment has already become a problem, in Thailand it is expected that 800,000 people will be laid of by the end of 1998. In Indonesia the problem is even worse, it is estimated that another twenty million workers will be unemployed by the end of 1998. The Southeast Asian countries overall have a free labor market that allows workers to go from job to job in a non-unionized workforce. Without unemployment insurance, this will undermine the purpose of a free labor market. Since Asia’s recovery will take time combined with a period of slow growth, protecting the poor should be one of Asia’s highest priorities. As a short term solution, public spending is the only way to ensure social protection. Social spending should be aimed toward filling the gap left by the aching economy. All countries in Southeast Asia have relied on private arrangements to provide social security. Without a modern form of unemployment insurance/worker’s compensation, the protection of the worker will be in jeopardy. Investing into social security, healthcare and pension reform ,that would provide more access to low-income groups. There should also be an increase in funding to the education sector of Asia This would contribute to an improved labor force, which would boost further growth in the economy. \* information on currency was as of Jan 30 1998 Solutions to the Asian crisis As the Asian crisis continues, people are starting to wonder when it will ever end. There can be an end to the crisis, but only if Southeast Asia seeks reform. It was not just one thing that triggered the crisis, so it will take a lot more than just the Japanese government agreeing on a bank regulation plan to end the crisis. The theories that I will discuss as answers to the economic problems in Asia are dollarization, government regulation towards banks and investments, and exporting. One theory believed to eliminate the currency crisis would be the process of dollarization. This means replacing Southeast Asia’s central banks with currency boards permanently. If they wanted to act more extreme even, they could replace the Asian’s currencies with the U.S. dollar. This would lower the instability of currency in the Asian countries. There is a significant drawback to dollarization though. Since the Asian countries rely on exporting as an integral part of their economy, this could only deepen the wounds that their economies are sustaining. Then the Asian countries would have a stable currency, but they would not be as able to undercut U.S. products because there currency would be the same as the U.S. The only country that would not need to follow these actions is Singapore because it has avoided the managerial problems that have been affecting the central banks. By Singapore not devaluing their currency, they avoided the currency crisis that harshly affected the other Asian countries. The next step that the Asian countries will definitely take is the regulation of banks and investments in Asia. A major cause of the crisis was that money that should have been spent domestically in sectors like manufacturing and agriculture. Instead it was invested in high risk loans and investments. With Japan’s banks overexposed in Southeast Asia they accumulated more than 580 billion dollars in bad loans. This is the key reason that restructuring and reforms of the Asian countries economic model are needed. The problem with most of Asian countries economic model of their economy was that it relied on state-assisted capitalism to heavily. This achieves high growth in the early phases of industrialization but is ineffective in an economy that is based on exporting to global markets. Since the Asian countries are an exporting economies, they were hit very hard by this problem. Another area that needs government reform is investments of capital to and from the Asian countries. There needs to be controls on the inflow and outflow of capital investment in the Southeast Asian countries. If capital investments can be controlled. The instability of the Asian markets can be some what cooled. Such reform that could be used, would be the idea that the Chile government has adopted. An interest free deposit equal to 30 percent of their total investment could not be withdrawn for at least for one or more years. This would allow for more stability in the markets needed immediately in Asia. It would be an asset to the Asian countries to incorporate a plan similar to Chile’s that encouraged more foreign capital investment. This would allow for growth in capital investment with the commodity of market stability. A common occurrence in the Asian countries that were hit the hardest by the crisis was that relied on foreign capital so that they would not have to tax themselves. Regressive taxation is quite a normal occurrence in Southeast Asia, which deeply taxes the poor to supply the main source of government revenue. This is while the minority of rich pay income tax. Now that crisis has slowed the outflow of capital into the Asian economies. It is about time that they look for an answer to new forms of government revenue. They could support their government revenue with a progressive tax that would lower the amount of people living in poverty, plus it would solve the governments problem with creating revenue. The exporting business is what kept the Asian countries economically stable. When the crisis hit exporting it only worsened the outlook people had upon the Asian economy. This reliance on exporting will create prolonged deflation rather than a quick recovery in Asia because people will lower prices so to undercut the other Asian countries. The problem with the crisis is that it created a domino effect on the Asian economies. Since 53 percent of Asian trade comes from intra-Asian trade, so each country became more unstable. Other countries felt the pain too. What will even aggravate the crisis even more is the uphill battle for the market against China and newly competitive Latin America countries. They key for the Asian economies to regain the strength they once had, is to look for other countries to export and to further proceed in the growth of different sectors of the economy.