ARTICLE

Crisis and Reemergence in the Asian Economy: Implications for Japan and Mid-East Economic Relations

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Ⅰ. The Currency and Financial Crisis and the Asian Economies

Ⅰ-1. The currency crisis which surfaced in Thailand in July 1997 subsequently spilled over to Indonesia and other ASEAN nations and from there to Hong Kong and the ROK. It spread over the entire Asian region in the blink of an eye. Thailand had ended its dollar peg and turned to a floating exchange rate in May of the same year. In the just two months after that, massive falls were recorded: the Thai baht fell 32 % against the U.S. dollar, the Indonesia rupiah 20 %, and the Malaysia ringgit 17 % (Table 1). It was the first time that such a large scale fall in currencies had struck the Asian countries all at once. The impact on the global economy was huge. The falling currencies triggered stock market crashes and the crashing stock markets triggered a further fall in the currencies in a downward spiral chain reaction. Not only this, it induced a massive financial crisis. The simultaneous depreciation of the currencies and fall in the stock markets affected Russia and the Latin American countries as well. Signs appeared of this developing into a global economic crisis embroiling even the economies of the industrialized countries in a major way.

Table 1. Exchange Rates of Asian Currencies Against U.S. Dollar

	Jan. 14, 1997	Jan. 27, 1998	Decline (%)
China (rmb)	8.30	8.28	0%
India (rupee)	35.80	38.50	7%
Indonesia (rupiah)	2,378.00	14,000.00	83%
Japan (yen)	117.00	126.00	7%
ROK (won)	849.00	1,678.00	49%
Malaysia (ringgit)	2.47	4.51	25%
Philippines (peso)	26.30	43.25	39%
Taiwan (NT dollar)	27.40	34.05	20%
Thailand (baht)	25.70	54.70	53%

Source: The McGraw-Hill Companies

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As everyone knows, the Asian economies, as praised by the World Bank in its policy research report “The East Asian Miracles,” had rapidly increased their productivity due to their vibrant economic activity and the formation of local economic areas since the 1980s and become a global “growth center.” In July 1997, however, the currency crisis suddenly struck these Asian economies and in an instant blew away the results of decades of growth. No one could have predicted that such a large scale crisis would have suddenly hit the Asian economies.

Ⅰ-2. Looking at the Thai currency crisis which precipitated the Asian economic crisis, the IMF points out that this was caused by sluggish exports and a reckless influx of foreign capital and criticizes the Thai government for errors in policy. It is true that the sluggishness of exports since 1996 had suggested that there were problems in Thai's industrial structure and competitiveness and it is a fact that behind this were failures in the monetary policy of the Thai government. The Thai government kept the baht pegged to the U.S. dollar for a long time and failed to take any effective steps to deal with the rise in the value of the U.S. dollar on the exchange markets. In the cases of the ROK and Indonesia as well, the rapid influx of large amounts of foreign capital, excessive investment, the adherence to trade-oriented policies, etc. promoted rapid economic growth and at the same time led to over evaluation of the currencies on the exchange market, instability of the foreign balance, and a poor approach to macroeconomic policy. Superimposed over all of this were a slow pace in institutional reforms and structural collusion between the public and private sectors. This only exacerbated the crisis.

Ⅰ-3. At the bottom of the current Asian currency and financial crisis, however, lie several extremely important fundamental problems. One is the structural change in the global economy which began with the adjustment of the exchange rates and subsequent movement of global capital after the 1985 Plaza Accord. The massive outflow of inexpensive labor from the former Soviet Union and Eastern Europe and shift to market economies resulting from the collapse of the Cold War structure, globalization, information age, and other trends were further overlaid on this. The globalization of economies resulting from rapid technical innovations and the global deregulation was one of the fundamental factors which caused these structural changes.

The second was the excessive reliance on foreign capital, the export orientation, and the resource-dependent nature of the high growth of the Asian economies. Under rapid “trade and investment oriented” growth policies, the various contradictions and strains came to a head in the Asian economies. The slow pace of construction of infrastructure, the insufficient technology, capital, and human resources, and the slow reforms of the economic systems put stress on the growth of the Asian economies and robbed them of their vitality. The low efficiency of energy use, unease over food supplies, and deterioration of the environment added to this and further aggravated the situation.

The third was the de facto linkage of the currencies of the Asian countries to the U.S. dollar so as to procure massive amounts of funds from other countries and meet the demand for funds accompanying growth (Table 2). That is, these countries chose de facto linkage with the U.S. dollar when simultaneously faced with the two contradictory goals of stabilizing the currency for the massive introduction of foreign capital and devaluation of their currencies for promoting exports. The Asian economies industrialized and realized high growth using this.

Table 2. Balance of Foreign Debt of Five Asian Countries

(US$ billion, %)

	Balance of foreign debt	Balance of private debt	Ratio of balance of private debt (%)
Thailand (June 1997)	93.3	71.8	77.0%
Malaysia (June 1997)	45.2	n.a.	—
Indonesia (December 1997)	136.1	74.0	54.4%
Philippines (May 1997)	44.8	10.9	24.3%
ROK (November 1997)	151.2	n.a.	—

Source: JETRO

After 1995 when the yen starting falling in value and the dollar began rising, however, the products of the ROK and the ASEAN countries rapidly lost competitiveness due to the rise in their relative prices - placing these countries in difficult straits. On the other hand, the economic infrastructure, in particular the financial markets, were slow to be established. As a result, there was a rapid increase in the influx of short-term funds (Table 3). As of June 1997, about US$370 billion in funds flowed into the Asian region in the form of bank loans. Of this, US$242 billion was short-term capital maturing in less than one year. Direct investment is not necessary bad for a receiving country, but short-term funds are strongly speculative in nature, sensitive to risk, and quick to flow out.

Table 3. Net Private Flows to Five Asian Emerging Market Economies

(US$ billion)

	1995	1996	1997 (1)	1998 (2)	1999 (2)
Private Net Flows	83.8	93.8	−6.0	−24.6	−15.1
—Commercial Banks	58.0	58.3	−29.0	−30.5	−17.8
—Other Debt (bonds)	9.9	18.1	23.3	−2.1	−3.8
—Portfolio Equity	11.0	11.6	−6.8	1.1	−0.9
—Foreign Direct Investment	4.9	5.8	6.5	6.9	7.4

(1) supposed　(2) predicted

In relation with these fragile Asian emerging market economies, it must be pointed out that there were problems in the stance of the IMF as well which forced rapid liberalization upon them. This was the fourth problem. Forcing rapid liberalization on the Asian developing countries with their fragile economic infrastructure and inexperienced financial markets resulted in major damage to the economies of these countries and was not wise at all. At the time of the current currency and financial crisis, the IMF gave Indonesia, Thailand, and the ROK a total of US$100 billion (as of January 1998) in financial assistance, but made this conditional on reforms of the economic structure focusing on improvement of the foreign balance, fiscal austerity measures, and reforms of the financial system. This had a minus effect on attempts to buoy the economies at the time.

The current Asian economy crisis is a complex one born by the synergism of these factors plus the slow action and policy errors of the Asian countries and mistakes in judgement of the IMF. It was a new type of crisis which arose during the post-Cold War globalization, transformation to market economies, liberalization, and information age. Accordingly, this crisis is inherently global in nature and must be solved by both reforms in the economic and financial systems in Asia and adjustments on a global level.

Ⅱ. Economic and Industrial Changes Under the Crisis

Ⅱ-1. The Asian economies have contracted remarkably due to the currency and financial crisis. Trade has also shrunk by an annual 20 to 30 %. All industrial sectors have been forced to dramatically cut back on operations. The changes in production costs and prices of the products due to the fall in the currencies, the inability to raise funds due to the financial instability, shrinking domestic demand, and the cool down in production, investment, trade, and other economic activity as a whole are continuing even now. In particular, the drop in the ASEAN and ROK economies, which were directly impacted by the currency and financial crisis, was terrible. These countries were unable to escape from zero growth even in 1998. In the ROK, credit has been shrinking due to the increase in bad debt and the operations of the financial institutions have been deteriorating. Corporate performance has continued to falter due to the deterioration in the real economy. In Thailand, in contrast to the improvement in the current account balance etc., the unemployment rate has climbed to 6 %. The real economy cannot be said to be headed in a good direction. Further, in Indonesia, the exchange rate, while once recovering, has fallen once again. On the other hand, prices of rice and edible oil have skyrocketed - fanning social unrest.

The slowdown in production indexes was most marked in Thailand, Indonesia, and the ROK. The reason was that the domestic demand industries were struck unexpectedly hard by the currency and financial crisis. In particular, the automobile, steelmaking, petrochemical, and other industries suffered heavily due to the slump in personal consumption, rising prices of imported raw materials, the recession in the real estate sector, and turmoil in the distribution markets (Table 4).

Table 4. Production Index of ROK and ASEAN Countries

(compared to the previous year)

	1995	1996	1997	1997				1998	
				1Q	2Q	3Q	4Q	1Q	2Q
ROK	12.0	7.1	6.7	5.1	7.6	8.7	5.4	−8.1	−12.0
Thailand	12.0	7.5	−0.1	6.1	5.8	−2.7	−10.4	−17.7	−15.7
Malaysia	14.2	12.3	12.4	13.9	13.5	11.7	10.9	−1.9	−9.2
Indonesia	11.0	6.6	13.0	14.9	17.3	13.1	7.7	−10.3	−15.9
Philippines	18.5	8.3	11.4	−3.0	3.9	0.2	20.2	−4.5	−12.7

Remarks: (1) Standard year = ROK (‘ 95), Thailand (‘ 88), Malaysia (‘ 93),
Indonesia (‘ 93), Philippines (‘ 85)

Source: Economic statistics of each country

Ⅱ-2. When viewing the currency and financial crisis by industry, the most seriously impacted sectors were the materials industry and automobile industry, which had achieved rapid growth during the real estate boom and consumption boom. These industries are now being forced to reorganize on a massive scale and are seeing a succession of companies go bankrupt. This trend is expected to continue this year as well. In the ROK, the reorganization of the financial groups has resulted in more strident labor-management conflicts and plummeting factory operating rates. The electronics, electrical machinery, textile, resource processing, and other industries, however, have not been affected by the crisis to the same extent as the materials processing and automobile industries. This was because they developed a wider range of export customers and increased the rate of their own local procurement. In particular, since the export-oriented electronics and electrical machinery industries are in large part comprised of Japanese and other foreign-funded companies and joint ventures, the efforts taken by the parent companies to deal with the crisis paid off and the crisis was stopped.

Ⅱ-3. The electronics and electrical machinery industries are star industries which had previously driven growth in Asia, but recently both exports and domestic sales have begun to feel the effects of the crisis. This is because the plummeting currencies have made the countries more export competitive and have resulted in fierce price competition. In particular, in Malaysia, a global center of production for the electronics and electrical machinery industries, the fall in the ringgit and the recession in the real estate sector have resulted in a succession of projects being reevaluated or suspended since 1998. Exports have also slowed. Looking at Asia as a whole, however, foreign-funded and other assembly makers have been doing well overall since they export to the western countries, whose economies are strong, they produce high added value products, and they have high local procurement rates. The sales of electronic and electrical products are determined by the difference in basic technical expertise. Therefore, these manufacturers fortunately had adopted international strategies using their technical abilities early on and switched sales to outside the Asian region at the same time as the currency crisis.

Ⅱ-4. The Asian petrochemical industry had achieved sharp growth since the late 1980s due to the development of demand industries such as the automobile, electronic and electrical machinery, and textile industries. The slump in domestic demand accompanying the current currency and financial crisis, the global glut of supply, including the Middle East, shortages of funds, and other factors however imposed serious handicaps on it. In Thailand, a series of plant construction plans were frozen, such as Mitsubishi Chemical's acrylic acid feasibility plan. In Indonesia as well, two large-sized projects on Java island - the petrochemical complex planned by British Petroleum and four Japanese trading companies and the ethylene center proposed by Thai and Japanese trading companies - were frozen. The plant construction plans of Malaysia, which had been planned to elevate that country to the level of a major exporter of petrochemical products by the year 2000, remain dreams.

The petrochemical industries of the ROK, Singapore, and China have been boosting their performance due to export growth and an increase in domestic demand. The ROK has gained export competitiveness due to the depreciation of the won. China on the other hand is scheduled to increase its ethylene production capacity to over 4 million tons by the year 2000. Note however that 4 million tons is reportedly not enough. China has strong potential for absorbing the exports of petrochemical products from the Middle East oil-producing countries and the ASEAN countries.

Ⅱ-5. The currency and financial crisis has struck the Asian energy markets and energy industries as well. Global oil prices fell by as much as US$5 a barrel in October 1997. In the following year, 1998, oil demand further cooled. As a result, oil prices dropped below the US$10 per barrel level. The average price of the OPEC7 (basket price), an indicator of Middle East crude oil, dropped to a 22-year low of US$9.46 per barrel in early December 1998. In the ROK, oil demand fell to -4.8 % in 1998. A succession of plans for import of overseas LNG were also canceled. The slowdown in economic activity acted positively in easing the strain in the supply and demand of energy, but the government's financial austerity program and declining corporate investment following the currency and financial crisis caused regional energy development and activity in the energy industry to slow. Further, the Russian financial crisis caused Russian oil and natural gas prices to drop. It should be noted that this impacted Venezuelan oil prices and exacerbated the turmoil in the Latin American economies. With the globalization of economies and the transition to the market and with massive amounts of funds circulating around the world instantaneously, the global oil and energy industries and markets were also forced to change structurally.

Ⅱ-6. According to a survey of the Institute of Energy Economics, Japan regarding the economies and supply and demand of oil in 10 major Asian countries and regions (Japan, China, the ROK, Taiwan, the Philippines, Thailand, Singapore, Indonesia, Malaysia, and India) conducted at the end of last year, oil demand in these countries fell 4 % over a year period and will not return to the levels before the currency crisis until at least the year 2001. Therefore, crude oil imports fell from the 10.95 million barrels per day in 1997 to

10.21 million barrels per day in 1999 and will not return to the 1997 level until at least the year 2002. Reliance on Mid East oil is also projected as falling from the 76 % of 1996 to 73 % in the year 2000. Further, the economic crisis prompted further deregulation and liberalization on the oil industry and companies. Therefore, some major restructuring of the oil industry is expected to go on in these countries.

Ⅲ. How Can the Asian Economic Crisis Be Overcome?

Ⅲ-1. Will the Asian countries be able to overcome the present day economic crisis? Many projections and recommendations have already been made in this regard. Table 5 shows growth projections for the Asian economies in 1999 by various international financial institutions and think tanks. According to this, all of the Asian countries except China and Taiwan will be forced to operate under severe economic conditions. Leaving aside Hong Kong and Indonesia, however, which are expected to suffer minus growth, the table interestingly suggests that the economic slump will bottom out in all of the countries. Further, if the projections of the policy authorities of the countries concerned are included, then the general consensus would seem to be that the Asian economies will get back on the track of recovery in the next one or two years.

Table 5. Economic Growth Rate of Nine Asian Economies in 1999 (%)

	IMF	ADB	IDE	Sakura	G. Sacks
China	6.6	6.0	7.0	7.7	8.3
ROK	-1.0	0.0	0.3	-1.7	1.4
Hong Kong	-1.0	-2.0	-1.0	-2.9	-0.5
Taiwan	3.9	5.2	4.8	5.3	4.9
Philippines	2.5	1.0	2.6	2.6	2.4
Thailand	1.0	0.5	-0.2	0.0	-0.5
Malaysia	-2.0	-2.0	-0.1	0.5	1.5
Singapore	-0.8	1.0	1.9	-0.5	2.0
Indonesia	-3.4	-3.0	-5.0	-2.0	-3.4

IMF = International Monetary Fund
ADB = Asian Development Bank
IDE = Institute of Developing Economies, JETRO
Sakura = Sakura Overall Institute
G. Sacks = Goldman Sacks, U.S.
Source: Nihon Keizai Shimbun, 1999.1.4

In fact, Thailand, Indonesia, the ROK, and other Asian countries hit hardest are working furiously to pull out of the crisis and are having some success. The Asian countries have learned a valuable lesson from the current economic crisis. Based on this, they are strengthening their policy approaches to economic reconstruction. First, they are correcting the domestic factors which caused the current Asian economic crisis, that is, the government-led financial and investment structure, the distorted distribution of resources, the close collusion between the government and business sectors, and other facets of premodern business management and are trying to institute thorough reforms in their financial and economic systems. As seen in the ROK and Thailand, policies have been adopted such as fiscal austerity programs, elimination of fiscal deficits, promotion of reforms of the market economies, promotion of ethical economic practices, and streamlining of capital. The exchange rates have been changed to floating systems with the result that imports have nosedived and the current account balance has been brought to a surplus. Exchange rates have regained stability and investment from overseas has started flowing in once again.

Second, they are attempt to prevent the massive influx of short-term funds (hedge funds) and other external factors, considered major causes of the crisis, by introducing restrictions on foreign capital transactions, controlling foreign exchange, instituting a fixed exchange system, etc. as may be seen mostly prominently in Malaysia. Prime Minister Mahathir has come out with a policy of restricting the excessive influx of short-term funds to deal with this. This however stresses easing of financing and fiscal action rather than institutional reforms.

Third, they are maintaining capital and foreign exchange controls externally and moving forward with market economic reforms internally. This is seen in countries like China, Singapore, and Taiwan, where the effects of the currency and financial crisis were relatively light. These countries had enjoyed good current account balances and foreign currency reserves and had maintained thorough foreign exchange and capital controls as well, so were relatively closed to speculative investment by short-term funds. China is moving forward with reforms in its state-owned enterprises and establishment of financial institutions and therefore projects an 8 % growth in its GNP this year, but even if this is not possible, it can achieve a 6 to 7 % growth rate.

Ⅲ-2. While different measures are being taken to overcome the economic crisis in different countries, so long as the Asian countries continue working to reform themselves, capital will undoubtedly actively flow in from abroad sooner or later and give them flexibility in economic recovery. Already, American interest rates have been reduced and the depreciation of the yen is being corrected. Great progress is also being made in stabilization of the foreign exchange and stock markets and stock prices are rising.

No one believes however that this will be enough to finally solve the crisis. A long time will be required for a fundamental recovery. If the reforms prove too slow, then another crisis may hit the Asian economies with their weak economic infrastructure. Therefore, the Asian countries must hurry and make the necessary reforms such as improvement of their financial markets. The most important thing however is to study the nature, speed, etc. of the economic growth as well and develop approaches from a long term perspective. Why did such a currency crisis suddenly occur and develop into massive financial instability and economic turmoil in the Asian economies which had been enjoying continued high growth and sound fiscal balances? Was it because, in the current crisis, the exchange rate of the Asian currencies against the U.S. dollar collapsed and caused instability in the foreign exchange markets? Even more, how should we view the cracks which occurred in the very structure which had supported the high growth of the Asian economies? The Asian economies have much to learn from this.

Ⅲ-3. The economic growth of the Asian economies originally started despite numerous limiting factors in capital, technology, human resources, resources, and the environment. High growth was enjoyed while keeping these limitations to a minimum. This was made possible by the introduction of massive amounts of foreign capital and the success in establishment of export industries. In the future, however, the globalization and instability of economic and financial transactions will be added as new limiting factors.

The reliance of the Asian economies on the U.S. dollar has also been pointed to as being related to the current currency and financial crisis. How this should be dealt with is another problem. The Asian countries can now more easily prevent the excessive influx of short-term capital by the transition to fluctuating exchange rates, but the problem is not solved. Steps such as disclosure of information on short-term funds, strengthening of the supervisory system, and greater stress on the responsibility of the private banks have to be taken immediately. Further, construction of a new balanced financial system based on the U.S. dollar, Eurodollar, and yen should also be considered. German Treasury Minister Oskar Lafontaine and former French President Valergy Giscard D 'estaing have even proposed establishment of a target exchange rate zone for the three currencies.

Ⅲ-4. Strengthening cooperative trade relations should also be studied. Trade played an important role along with investment in the high growth of the Asian economies, as is well known. The reliance of Asia on intra regional trade was, with the exception of Japan and the ROK, a high level of 35 %. It would be effective even today to use this mechanism to increase the independence of the Asian economies. It would be extremely effective to establish an autonomous economic cooperation area in Asia and promote economic cooperation between this and the Middle East and Gulf countries. The reconstruction and sustained development of the Asian economies require stronger economic relations with the Middle East and Gulf countries and other countries - not just with the American, European, and Japanese economies.

Ⅲ-5. The Asian countries have strengthened their interdependence with the Middle Eastern economies through the high growth rates of their economies. In particular, they have strengthened and expanded relations with the Middle East through the development and import of oil and natural gas, the export of consumer electronics and other durable consumer goods, machinery and equipment, etc., and the supply of huge amounts of labor. The current currency and financial crisis has resulted in a fall in trade, investment, and other areas, but Asia remains an important partner for the Middle East and Gulf countries even today.

Ⅳ. Development of Economic Relations Between Asia and the Middle East in Era of Global Economy

Ⅳ-1. Japan announced a plan for providing financial assistance to the five main ASEAN nations and the ROK through the IMF in October of last year (pledging US$30 billion over 2 years), that is, the so-called "New Miyazawa Plan." This was welcomed by the Asian countries. In December of the same year, further, it announced the creation of special yen loans providing 600 billion yen at preferential interest rates over 3 years. This aid is being given by Japan on a bilateral basis. Japan has also however pledged to provide US$43 billion in relief to Asia through the IMF. In total, it is providing a massive US$80 billion (about 10 trillion yen) in aid. Never in the past has there been such an example of concentrated financial assistance. This is not being done only because of the traditional close interdependence of the Japanese economy with the rest of the Asian economies. Japan is providing this huge amount of assistance, regardless of the massive fiscal deficit which it is currently saddled with, because it has judged that the economic stability of the Asian region is extremely important for the development of the global economy in the 21st century.

Ⅳ-2. Further, the reconstruction and crisis of the Asian economies are inseparable from the development of the Middle Eastern and Gulf economies under the current rapidly globalizing world economic system. This is due first of all to the depth of the interdependence in energy supply and demand. As is well known, the Asian region has poor supplies of energy. Conversely, demand has been rising each year due to the population growth and rapid economic growth. All this had caused global concern. The majority of the oil and gas imported comes, of course, from the Middle East and Gulf region. While the volume of imports has been repressed for a while due to the Asian economic crisis, there is no change in the basic dependency on the Gulf countries for oil. Rather, the Asia Pacific Energy Research Center (APERC) predicts that while energy demand in the Asian region will decline in the short and medium term, it can be expected to grow by a large amount over the long term (approximately 60% of the Asia APEC region in 1995 to 2000). In particular, China has indicated that it intends to rely on the Gulf region for the majority of its imports of oil in the future and will be expanding its imports.

Ⅳ-3. Second, there is the potential for strengthening cooperative relations in the non-energy sector. Economic relations between Asia and the Middle East (Gulf) were strengthened during the rapid growth of the Asian economies, but the scale of trade and investment is still smaller than that with other regions. Further, the trade and investment are mostly oil and energy related. There is still little movement in other industrial sectors. Accordingly, stronger relations between Asia and the Middle East (Gulf) in the non-energy industrial sectors would be helpful for the coordinated development of the two economies and the global economy. This is because there is meaning as a buffer against rapid globalization.

Ⅳ-4. The early reconstruction of the Asian economies will give rise to major possibilities in the non-oil industrialization policies of the Gulf oil- and gas-producing countries. Japan is already strengthening investment and trade in the automobile, construction, tourist, and other industries in addition to the development and import of oil and gas. Corporate investments diversifying each year. Cooperation in human resources and technology is also increasing through ODA. The ROK has also been strengthening economic relations with the Gulf countries through primarily imports of oil and natural gas and has been more actively investing in non-oil industrial sectors. What should be watched is the presence of China with its huge population. China is also trying to strengthen relations with the GCC countries through trade in goods and services, exports of labor, and transfers of technology.

How enduring the relations that are set up between Asia and the Middle East (Gulf) through trade, exports of capital, transfer of technology, training of human resources, and cultural exchanges are is an issue for the future.

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