The Asian Economic Crisis and the IMF Prescriptions

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Introduction : The Outbreak of the Asian Economic Crisis and its Process

When the issues of "East Asia's Economic Miracle" was much debated, *The Economist* issued a feature article named "Asia's Precarious Miracle" (7 March, 1997). The article outlined the problems which Asian economies would face in the future, but the situation of Asian economies deteriorated much worse than predicted earlier.

On the 2nd of July, 1997, the Thai Baht was devalued and the Dollar Peg System which linked the Thai Baht with the US Dollar transformed into the managed floating exchange system. The contagion of the Thai Baht devaluations was immediately spread in other ASEAN countries. It triggered a chain reactions of falling currencies and stocks. This was the beginning of Asia's currency and economic crisis which originated from Thailand. Both Thailand and Indonesia in August and October, 1997, respectively accepted the IMF's conditionality in return for loans of $17. 2 billion and $40 billion.

The contagion of the currency crisis in Southeast Asia spread to Hongkong and on the 23rd of October, 1997, the collapse of shares in Hongkong bourse and the crash of equities in markets around the world occurred. Furthermore, in November, 1997, Korean Won faced a crisis. On the 3rd of December, 1997, the South Korean government in the end requested a loan of $55 billion from the IMF and accepted the IMF's conditionality for that loan.

In January, 1998, it became apparent that Indonesia's Suharto government, which once accepted the IMF's conditionality for a loan, was reluctant to implement the conditions set by the IMF. As a result, its currency the Rupiah plummeted. The collapse of Rupiah was enormous. It plunged from one US Dollar=2, 400 Rupiah to 14, 000 Rupiah, and at the same time currencies in other ASEAN countries also heavily depreciated. For example, Thai Baht depreciated from one US Dollar=25 Baht a year ago to 55 Baht and thus the value of Baht was halved.

After that the 8th of April, 1998, the agreement was reached between the IMF and the Suharto government, and the resumption of the loan to Indonesia was agreed. Some perceived that this agreement would bring the Asian currency crisis under control. In reality, it resulted in the collapse of Suharto government on the 21st May, 1998. Meanwhile, although it is said in some corner that under the IMF's guidance Thailand and South Korea are steadily moving towards economic recovery, the real economic conditions of these two countries are likely to deteriorate further, and result in wage-cuts, unemployment, tax increase, inflation, cutbacks in governmnent's welfare expenditure. Hence the likelihood of serious unrest is on the rise.

1. The Background of Thai Currency Crisis and its Effect on the ASEAN Countries

What will be discussed below are the reasons why the currency crisis originated in Thailand. In general, the downturn in exports is considered to have triggered the crisis. The fact that major export partners of Thailand, namely the United States, Japan and Singapore, experienced the recession, the downturn in the semiconductor industry, and the decline in the competitiveness of labour-intensive industries can be listed as the causes of the crisis in Thailand. While the wage in Thailand was on the rise, Thailand failed to upgrade her industrial structure and advance human development. Thus, her exports became stagnant in the face of latecomers like China and Vietnam, which have been rapidly catching up with Thailand. What we should not miss out here is the fact that Thailand adopted the Dollar Peg System. While the Chinese Yuan was devaluated in January, 1994, and the Japanese Yen began to depreciate from 1995, Thailand lost her competitiveness in terms of currency.

One the other hand, Thailand's imports of intermediary goods and capital-intensive goods increased due to her Export-Oriented Industrialization strategy, which was dependent on foreign capital. As a consequence, massive current account deficit, which comprised 8% of Thailand's GDP, was recorded. Thailand compensated this current account deficit by the inflow of short-term capital. In the 1990s, Thailand implemented the liberalization and deregulation of her financial market three times. In particular, the establishment of the BIBF (Bangkok International Banking Facilities) resulted in the inflow of massive short-term capital. As a result, the inflow of huge amount of capital generated the bubble in real estate and stock market. The subsequent collapse of asset and equity caused the outflow of foreign capital. Thai Bath was heavily sold, and Thailand was forced to abandon the Dollar Peg System. The currency crisis, which originated in Thailand, promptly spread to other ASEAN countries. It is because the other ASEAN countries adopted the Export-Oriented Industrialization strategy and the Dollar Peg System as well as Thailand.

2. The Perspectives of Asian Economies

What follows are the perspectives of the Asian economic crisis. In general, there are two conflicting perspectives of the crisis.

One is a highly optimistic perspective. According to this perspective, Asian economies are at adjustment stage and would manage to achieve high economic growth soon. The article written by American Scholars, Jeffrey Sachs and Steven Radelet, "Asia's Reemergence" is a typical example of it (*Foreign Affairs*, November / December, 1997). This crisis is a short-term financial panic, and in the history of capitalism it has often occurred. Also, it is argued in the article that Asian economies would resume high growth in two or three years time provided that the currency crisis appropriately resolved. Professor Toshio Watanabe at Tokyo University of Technology also offers similar perspectives ("Asia's economic miracle is not over", in *Chuo Koron*, January, 1998).

The basis for their argument is as follows. One is a kind of external factor explanation. According to this explanation, the rapid inflow and the outflow of short-term capital were mainly responsible for the crisis. If the financial system will be properly managed, sound economic fundamentals such as high saving rate, high investment rate, stable price levels, budget surplus and so on, will contribute to the prompt resumption of economic growth. The second basis for their argument is the fact that the so-called "The Wild Geese Flying Pattern of Economic Development", which can't be seen in the areas other than East Asia, will enable East Asian economies to resume economic growth smoothly. Under this pattern of economic development, economic dynamism will spread from the core to periphery. In East Asia, economic dynamism has spread from Japan to the Asian NIEs in 1960s-70s, to the ASEAN countries in 1980s, then to China in 1990s, most recently to Vietnam and Myanmar and so forth.

Meanwhile, there are also pessimistic perspectives. For example, the viewpoint expressed by Dr. Wu Jin-hua at the Japan Research Institute is one of the pessimistic perspective about Asia's economic recovery ("The end of East Asian development model", *The New Oriental Economic Review*, 17 January, 1998). According to this sort of perspectives, Asian countries would have faced economic predicament sooner or later even though the currency crisis did not hit Asian countries. Pessimists argue that the fundamental cause lies in the fact that the "East Asian Development Model", which is based on the Export-Oriented Industrialization strategy and the Authoritarian Development political system, has reached the limit.

Here, I would like to offer my own perspectives about the Asian economic crisis as follows.

First, I would like to point out the historical fact that the ASEAN countries adopted this Export-Oriented Industrialization (EOI) strategy, in the middle of the 1980s, in order to overcome the recession that was said then the worst one since the Second World War.

Secondly, this EOI strategy requires the inflow of foreign capital and the export of manufactured goods, which are "the engines of growth" together with the import of intermediary and capital goods, thus this strategy is by nature vulnerable to external shocks.

Thirdly, "The Wild Geese Flying Pattern of Economic Development", which are highly regarded by Sachs, Radelet and Watanabe, will be discussed. They argue that under this pattern of economic development the dynamism of economic growth would spread from the core to periphery, but this pattern would be sustained only if advanced countries upgraded their industrial structure into higher value-added one. If the shift to higher value-added industry is not realized, the slowdown in manufactured goods and the withdrawal of foreign capital, which would be caused by the rise of latecomers, will occur and the engines of growth will deteriorate. In that sense, the fact that Asian currency crisis at first took place in Thailand is not a coincidence. In East Asia, Thailand is in the middle between advanced economies in the region (Japan, South Korea and Taiwan) and latecomers (China and Vietnam), and was squeezed between labour-intensive industry and middle level technology-intensive industry.

Fourthly, the foreign exchange system will be discussed. The stable exchange rate is necessary for the countries which adopt the EOI strategy and want to accept foreign capital. The Dollar Peg System (fixed exchange system) was adopted due to the fact that the US Dollar is the key currency and the United States is a major market for East Asian countries. As mentioned above, the inflow of foreign capital and the export of manufactured goods are essential for the success of the EOI strategy. Meanwhile, unless aggregate demand policy is implemented, the introduction of foreign capital under the Dollar Peg System would result in the situation, which would generate the following pattern of reactions ; the inflow of foreign capital → the increase of domestic demand → inflation → the rise of real exchange rate. In other words, the inflow of foreign capital would be favourable to imports and exports would suffer. Hence, the introduction of foreign capital and the export of manufactured goods are contradictory.

Nevertheless, in fact, the contradiction mentioned above did not appear in the past 10 years. The inflow of foreign capital and the export of manufactured goods did not show much contradiction after the mid-1980s. It is because East Asian countries other than Japan, under the Dollar Peg System, were able to expand exports because of a favorable exchange rate, which maintained higher Yen and lower Dollar after the Plaza Accord in 1985.

Hence favourable conditions, particularly the exchange rate after the Plaza Accord, contributed to the success of the EOI strategy. In other words, when the favourable historical conditions disappear and the exchange rate swung towards lower Yen and higher Dollars after 1995, the ASEAN countries including Thailand promptly lost their international competitiveness about manufactured goods. In that sense, a view presented by Mr. Takeo Kondo that the decade after the Plaza Accord was "the decade of the Plaza effect" is convincing. He described the Asian currency and economic crisis as the beginning of the Post-Plaza era ("The collapse of the Asian bubble", *Asahi Newspaper*, 22 November, 1997).

As discussed above, the EOI strategy, which is dependent on foreign capital, has a number of problems, it is possible to argue that the success of the EOI strategy depends on special historical conditions like the one mentioned above. Consequently, the views by Sachs, Radelet and Watanabe, which state that Asian economies would return to the previous high growth pattern due to sound fundamentals and "The Wild Geese Flying Pattern of Economic Development", is doubtful. The viewpoint of Professor Kiyoshi Kojima, which contends that East Asian countries should take Asian currency crisis as an opportunity to transform their development strategy, is significant ("Re-examination of East Asian Development Model", *World Economic Review*,, January, 1998).

Fifthly, the Developmental Authoritarianism requires some consideration. Up to the present, some opinions in regard to the relationship between the Developmental Authoritarianism and economic development have been offered. One of them states that political stability under the Developmental Authoritarianism contributes to economic development, and the Developmental Authoritarianism and economic development complement each other. Another argument is that there are the following two patterns ; 1)From democratization to economic development (Western model) and 2)First economic development, and then democratization (East Asian model). However, what actually occurred in the Asian economic crisis is the fact that Suharto was described as "the cause of disorder" in the Indonesian economy (*Newsweek*, 21 January, 1998). Therefore, it is obvious that some arguments regarding the Developmental Authoritarianism has lost credibility.

3. The IMF's Prescriptions and Asia's Economic Reconstruction Policy

In this sections, I will discuss three points in relations to the IMF's conditionality.

First, I would like to discuss about the conditionality, which the IMF implemented in conjunction with the World Bank, and economic philosophy or ideology which support structural adjustment policy. Needless to say, the IMF's economic philosophy or ideology is that of neo-classical school of economics. According to Susan George and Fabrizio Sabelli, who analyzed the World Bank and named it after 'Medieval Church', the World Bank is an organization, which is 'tragically out of date' and has a 'bankrupt development paradigm' (Susan George and Fabrizio Sabelli, *Faith and Credit-The World Bank's Secular Empire*, Penguin Books, Ltd., 1994). In fact, in the 1990s the criticism of the conditionality has intensified and a new trend, which contributed to the paradigm shift or renaissance of development theory, has emerged. The old-fashioned neo-classical school of economics, particularly so-called "Washington Consensus" has been under pressure for change. For instance, the drift of development theory is becoming evident in social development theory or human development indicators of the UNDP (United Nations Development Plan), whose theoretical background has been presented by Professor Amartya Sen and others.

Secondly, the conditionality imposes enormous burden and sacrifice on the working classes and the poor people. For example, the conditionalities, which Thailand accepted, are as follows ; (1) an increase in consumer's tax from 7% to 10%, (2) an increase in public utility charges such as electricity, water supply and so on, (3) closing down of 42 financial companies, (4) maintaining more than $25 billion of foreign reserves, (5) reducing the current account deficit from 5% of GDP in 1997 to 3% in 1998, (6) the target of economic growth for 97-98 should be 3-4%, (7) the target of inflation rate for 97-98 should be 8-9%, (8) achieving a balanced budget, and so forth. These conditionalities follow the IMF's general guidelines and aim to achieve both internal and external equilibrium through austerity financial policy.

As a consequence, the slowdown in the Thai economy deepened and the life of ordinary people deteriorate due to wage cuts, unemployment, tax hikes, a price hike and cut in welfare budget. Unlike both domestic and international financial capital managers and real estate developers, ordinary people were not involved in speculation in shares or real estate. They were not responsible for the bubble economy. However, the IMF's conditionalities forces ordinary Thai people to pay the price of the collapse of the bubble and the currency crisis, and to face unemployment fear, tax hikes, price hikes and so on.

Thirdly, it is important to identify the currency and financial crisis of the 90s as a 'new type of crisis'. In fact, it is not the first time that Thailand accepted the IMF's conditionalities. When Thailand faced a currency crisis in the mid-1980s, Thailand accepted the conditionalo-ties in turn for a loan from the IMF. However, it is necessary to point out the difference in the situation of the present currency crisis and the previous one. The features about the crisis in the 80s such as budget deficit, cumulative debt in public sector and current account deficit are clearly different from the features of the present crisis, which are budget surplus, a rapid increase of short-term debt in private sector and current account deficit.

In short, budget deficit and cumulative debt in public sector triggered the crisis in the 80s, so it was logical that the IMF adopted austerity financial policies to reconstruct the economy. The crisis in the 90s occurred despite sound fundamentals including budget surplus. Thus, it is perceived that the inflow of short-term capital and easy many lending by domestic banks and financial institutions are responsible for the crisis in the 90s.

In reality, it is possible to observe that the simultaneous occurrence of currency and financial crises tends to increase in recent years. The reason for this situation can be attributed to the fact that the worldwide deregulation of financial sector and the liberalization of international capital transactions rapidly have advanced in the 90s, and the global movement of short-term capital amongst the private capital has been so huge and quick. As a result, the supply of credit in the banking sector is expanding, which tends to generate non- performing loans.

In sum, the present currency crisis in Thailand is different from that in the 80s. In other words, this new type of currency crisis could occur even if economic fundamentals are sound. The IMF's conditionalities are not only inappropriate but also ineffective, and its prescriptions which mainly contain austerity financial measures would deepen the financial crisis and contribute to the deterioration of the real economy. In that sense, a proposal which advocates a reorganization of the IMF in order to implement 'Global Keynsianism' is indicative of a new direction to cope with this new type of currency crisis.

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