Asian Economic Recovery: Policy Options for Growth and Stability Edited by Tan Kong Yam, The Institute of Policy Studies, Singapore University Press and World Scientific, Singapore, 2002, pages 300.

Very few economic events other than the Great Depression of 1929 have generated such worldwide interest as the East Asian financial crisis of 1997-99. Not only its sudden emergence in the lands of fiscal rectitude and export competitiveness but also their remarkable recovery in a short span of time have given rise to heated debates on a host of diagnostic issues, opening new horizon and dimension in open economy macroeconomics. The crisis has also left the ardent proponents of free trade defensive and even introspective. For instance, Jagdish Bhagwati has noted in his recent writings that while mutual gains from free trade in goods and services are obvious, they are not so in the case of free capital movements. To the least, the crisis has rendered the causal relation between free capital flow and economic development tenuous. Set against such backdrop, the volume under review, which is a selection of 10 Conference papers presented in June 1999 at the Institute of Policy Studies, Singapore, delineates the lessons and policy options for the post-crisis East Asia in pursuit of growth and stability.

In projecting the scenarios for post-crisis East Asia, Tan Kong Yam identified the improper pricing of the exchange rate risk as the key distortion that led to excessive short-term foreign borrowing and lending which lay at the core of the financial crisis. The post-crisis South East Asia, Yam visualises, could be one burdened by the ballooning foreign and domestic debt, and dominated by the resurgent China and Latin America particularly when Japan, caught in a muddle since long, could no longer be expected to act as a locomotive for the South East Asia. Alternatively, the South East Asia could come out reformed and resurgent. In such a scenario, there could be intense competition for scarce capital to deliver goods and services to the people by both the democratic and authoritarian regimes in the region. The structural reforms undertaken in sequel would avoid much of the excesses of over-borrowing and over-investment, ensuring a robust recovery of the East Asian countries. In a similar vein, Manu Bhaskaran presented an optimistic scenario for the post-crisis East Asia on the basis of its continuing reform and restructuring even though the pace of such reforms was admittedly slow in some countries characterised by 'crony capitalism'. In his comments, William Overholt disagreed that the exogenous banking crisis was an important trigger. Indeed, the Thai economy and the property markets were headed into a crunch two years before the financial crisis with the asset market bubbles in Japan and the withdrawal of capital from the Asian Markets by Japanese banks. Besides, the competition between China and South East Asia was not viewed to be a zero sum game. As a matter of fact, the East Asian economies displayed remarkable resilience, staging a robust recovery in less than 18 months on the strength of their fundamentals anchored in high domestic saving, export competitiveness and fiscal prudence. This essentially underlines the importance of strong macro-fundamentals (*i.e.,* solvency) even in rendering the liquidity problem short-lived.

In search for a viable exchange rate regime for the East Asia, John Williamson felt that most exchange rate crises including the East Asian one were attributable to the failure to maintain a competitive exchange rate. He felt that a regime of floating exchange rate (free or managed), which was likely to be pursued by the East Asian countries might not be consistent with the objective of restoring high growth. Instead, a crawling band would be suitable to avoid any over-valuation of the domestic currency in the wake of capital inflows. Besides, the East Asian countries should go for pegging to a common basket that reflects their average trade pattern instead of a single currency peg. This would help in maintaining the relative

competitiveness position within the East Asian countries and outside, especially in the face of swing in US dollar-yen rate. In their comments, both Donald Brash and Sven Arndt advocated for a clean float as against a pegged exchange rate regime. This would avoid or survive not only speculative attack but would make the domestic banks hedge the currency risk of foreign borrowing unlike in the pegged exchange rate regime. Besides, the proposed regime of a crawling band or pegging to a common basket demands high discipline on the part of an individual country or countries pegged to a common basket, which is unlikely to be met with. As a matter of fact, the East Asian economies have subsequently switched over to a floating exchange rate system without much hitch. However, in emerging economies like India where the foreign exchange market is yet to attain its depth or maturity, clean float with its attendant fluctuation and exchange rate risk may adversely affect the export oriented or import intensive industries. Possibly a managed float might work better if guided by avoidance of over- (or under-) valuation of the currency and supplemented by market-based restriction on short-term capital flow and central bank intervention without any specific exchange rate target. It is in this context, India's success in exchange rate management stands out.

The East Asian crisis has brought the issue of corporate governance to the fore, so much so that the crisis is often taken to be routed in the culture and practices of business and society aptly labelled as 'crony capitalism'. Here, a change of mindset has been advocated by Mario Antonio Lopez at least in the case of the Philippines. What is required is a clearly defined legal and administrative framework, openness and transparency, integrity and accountability as well as a lean and well-paid bureaucracy. Echoing the concerns of Lopez, Richard Wong in his comments underlined the relevance of a market-oriented corporate governance based on maximising shareholder value in an increasingly globalised world. Wong, however, noted the importance of small and medium sized, family-owned firms in the Asian economic growth and the role of family in resolving the principal-agent problems. In his comments, Dong-Sung Cho noted that corporate governance norms vary from country to country, *e.g.,* focusing on shareholders in the US, various stakeholders in the Europe, employees in Japan, and major shareholders in Korea. In the aftermath of the East Asian crisis, while the American model is widely advocated, learning by doing approach could be a better guide in resolving the key issues. Indeed, the corporate US itself has been caught unaware in a series of accounting scandals in the recent past.

The most controversial issue in the wake of the East Asian crisis has been the role of the IMF in resolution of the crisis. As many as four papers of the volume under review are devoted to a critical assessment of the IMF sponsored programmes in Indonesia, Korea, Thailand and Malaysia. Mari Pangestu and Hadi Soesastro in their paper on Indonesia held the IMF and/or the Indonesian government responsible for the banking panic and closures in the absence of preventive steps such as temporary full deposit insurance. In their opinion, the IMF underestimated the risks and effects of structural reforms on vested interests around the President Suharto. The resultant ambivalence and mixed signals brought the confidence to its nadir. In the case of Thailand, Chalongphob Sussangkarn noted, the IMF prescription of swift upgradation of the prudential standards intensified the vicious cycle of recession, non-performing loan, liquidity crunch and further recession. The full guarantee extended to depositors and creditors as part of confidence-building measures, however, absolved the foreign creditors of much of the attendant risk. On the whole, Thai experience underlines the need for some global norm on management of short-term capital flows. In the context of Malaysia, Mohd. Haflah Piei felt that the IMF conditionalities, which demand structural reforms including further capital account liberalisation at the height of a financial crisis, were

largely inappropriate. Indeed, the Malaysian recovery came with loosening of the IMF sponsored fiscal and monetary austerity coupled with imposition of capital controls.

On the other hand, the Korean experience of crisis management turned out to be relatively smooth with establishment of the legal institutions spearheading reforms in banks, corporate sector and labour market. However, the real dilemma, Chungsoo Kim observed in his paper, lies in actual implementation and practices particularly when the extent of government intervention has considerably increased in the economy in course of crisis management. While presenting the IMF's views, Donald Donovan clarified the rationale for structural reforms since the crisis was routed largely in structural factors. The fiscal and monetary programmes were often reviewed, leading to their subsequent easing. Donovan, however, accepted that bank closures in Indonesia could have been thought out more carefully. On the whole, as per Donovan, the single most important lesson of the East Asian crisis is that participants in the global capital market need to be properly forewarned. While the limitations of the IMF's routine reliance on conventional wisdom in tackling the East Asian crisis were too obvious particularly for countries known for fiscal rectitude, the challenge lies in devising alternative crisis management formulation. Here, however, the picture is not all that unequivocal when pursuit of divergent crisis management policies has produced broadly uniform results – resurgence of the East Asian countries. The turnaround of Malaysia definitely goes against those, who argued that the imposition of capital controls would result in unmitigated disaster. On the other hand, the resurgence of Korea and Thailand does not lend support to those who advocated that the tight monetary and fiscal policies accompanying the currency float would do long-term damage to these countries. In the absence of a consensus, the real world policy making, unfortunately, continues to be a *terrain incognito* dogged by confusion and dilemma.

As part of the regional policy options for the East Asia, Masayuki Kichikawa chalked out an agenda for action during the transition to growth and stability. Regulation of short-term capital flow was advocated particularly in times of financial instability. Besides, partial linkage of the Asian currencies to Yen was prescribed to contain the adverse implications of large swings in Yen-dollar rate as the Asian countries in general imported parts and capital goods from Japan and exported final goods to the US. In his comments, Augustine Tan recommended for developing a long-term bond market to reduce dependence on short-term capital inflow. Similarly, Manuel Montes traced the origin of the crisis to abundance of international liquidity that swamped the domestic financial systems and created dilemmas for exchange rate management. As part of regional cooperation, joint exchange rate management, regional fund for emergency liquidity, and internationalisation of Yen and Singapore dollar were suggested. Indeed, the case for concerted action in the area of fiscal, monetary and exchange rate policies can hardly be emphasised for the East Asian countries having strong financial and trade linkages. Not surprisingly, the initial attempts to stabilise the currency market by pushing interest rate high coupled with fiscal tightening acted as a dampener in an otherwise closely inter-twined region.

In the concluding paper, Antonio Borges focused on the G-3 exchange rates and international monetary system coupled with their implications for the East Asia. In the context of the mounting US trade and current account deficits, Borges visualised a weakening US dollar and volatile G-3 exchange rates between US dollar, Yen and Euro. He felt that like the European Union, Asia would not be bereft of currency volatility and speculative attack since it was hardly an optimum single currency area. In their comments, Khor Hoe Ee and Edward Robinson observed that the appreciation of Yen during 1986-95 worked as a positive external

shock for the Asian economies with FDI flows from Japan. The shift in Japanese production base led to an economic boom in the region.

While the volume has flagged out a number of issues for resolution, it has hardly thrown light on the needed future global financial architecture or issues pertaining to central bank maintenance of foreign exchange reserves. Both these issues have generated lots of interest and assumed considerable importance in recent public policy debates. While the need for an international lender of last resort has long been felt, among others, by Lord Keynes, to tide over a temporary liquidity crisis or its snowballing into a systemic crisis, the possibility of such an establishment appears to be remote in the foreseeable future. Meanwhile resources at the disposal of the existing institutions like the IMF need to be enhanced in order to reduce their dependence on the major sponsors (G7 countries) in times of crisis. The potency of foreign exchange reserves in defending a country's currency has been demonstrated by the contrasting experiences of China, Hong Kong and Taiwan, on the one hand and that of the crisis afflicted East Asian countries, on the other. It is in this context, India's record accumulation of foreign exchange reserves to the tune of over US $ 78 billion signals a creditable cushion against external shocks. The crisis has once again highlighted the virtues of transparency and reliability of information disseminated by economic agents including the central bank. Such shortcomings notwithstanding, the volume has turned out to be an important contribution to the understanding of origin and ramifications of the currency crises.

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