LESSONS FOR OTHER DEVELOPING COUNTRIES FROM RECENT ASIAN FINANCIAL CRISIS

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I. INTRODUCTION

The Asian financial crisis was triggered by the speculative attack on the domestic currencies. This caused the devaluation of Asian currencies, starting with Thai bath on July 2, 1997 and then spreading to other Asian countries such as the Philippines, Malaysia and Indonesia. The contagion even influenced countries in other region, such as Korea.

To defend these attacks, Asian countries allowed their exchange rate widened to respond and adjust to the market and hence the Asian currencies depreciated. Some countries, for instance Thailand and Indonesia needed assistance from the International Monetary Fund (IMF). As a consequence, they had to receive the IMF policy package not only covering loans, but also introducing a tight macroeconomic policy, financial sector restructuring, capital account liberalization as well as domestic economic reform.

If we look back, we find the existence condition that are contrary to what Asian's policy makers and economists believed. When there was a currency crisis in Mexico at the end of 1994, they believed that they had better economic fundamentals. Therefore, they were sure that this crisis would not happen in their region or at least engulf their country. The were proved wrong.

To identify exactly the causes of the Asian financial crisis is not easy because each economist whether they come from a university or international institution has a different point of view. Therefore, this paper summaries the important factors which engendered this crisis and identify that factors.

There are some valuable lessons to be learnt including the need for soundness the macroeconomic policy to manage appropriately the exchange rate regime, eliminate excessive capital inflow, and maintain a feasible interest rate. In addition, building a powerful domestic financial system on the basis of transparent principles, openness, and prudential bank supervision as well as establishing economic cooperation in terms of financial management are also necessary.

II. MAJOR FACTORS CAUSE THE ASIAN FINANCIAL CRISIS

Although various economists present their individual point of view or they come, the literature suggests that there are at least seven important factors which are played a role in causing the crisis.

1. The worsening macroeconomic performance, especially in Thailand was one of the factors which led to the economic crisis (Kawai, 1998). For instance, the Thai government implemented a high interest rate policy to overcome overheating of its economy and high inflation rate. Thailand applied this policy because its exports tended to stagnant after 1996 due to increased competition from China and Vietnam. As a result, Thailand depreciate its exchange rate and faced a current account deficit of almost 8% of its gross domestic product (GDP). In this regard, Roubini (1998) points out that the depreciation of a

domestic currency has two effects: (1) The depreciation appreciates the 'effective' real exchange rate, and (2) The depreciation reduces the competitiveness of other countries in a region that have not depreciated their currencies.

2. Another factor is an excessive capital inflow. This occurred because of the high domestic interest rate and the expectation of the stability of the domestic exchange rate. Tobin (1998) explains that before the crisis, banks and business in the region had borrowed heavily in the short-term in yen and $ US. As a consequence, the domestic currencies became overvalued or too expensive and thereby Asian countries faced increasing trade deficits.

   Another economist, Kawai (1998) contends that one of the properties of the short-term capital inflow is that the capital is resistant to market sentiment. By this means, the capital can flow out easily and quickly whenever there is lack of confidence in the domestic currency.

3. Kawai (1998), Roubini (1998), and Shirazi argue that the policy of fixed exchange rate to the US $ which was implemented in several Asian countries was also partly responsible for the crisis. They explain that this policy did not reflect the basic pattern of their international transactions. Therefore, it created sustained overvaluation of domestic currencies, reduced the competitiveness domestic products in the international market and subsequently was followed by significant decreased exports.

   Moreover, Meigs (1998) thinks that a fixed (pegged) exchange rate policy is highly sensitive to both domestic political development and external factors which influence investors' expectation, especially for foreigner investors. For the international market, he explains that a change in investors' estimate of relative risk and return possibly causes a backward movement in the direction of the net capital flow.

4. Some economists, for example Camdesus (1998), Fisher (1998), Kawai (1998), and Shirazi (1998) agree that one fundamental cause of the crisis was the fragility of the financial system in Asian countries. Furthermore, Kawai (1998) explains that this condition is plausible because the application of financial market deregulation and capital flow liberalization just started in the second half of the 1980s. By that means, it was logical that the financial system could not overcome satisfactorily and adjust to the fast changes and demand of global environment. Besides, this condition was exacerbated by the fact that financial institutions (bank and non-bank financial intermediaries, NBFIs) did not have adequate quality, for instance technologies, expertise, and human resources to carry out prudent asset-liability management as well as risk control. Unfortunately, authorities tended to provide a guarantee to protect liability of financial institutions.

5. Yellen (1998) contends that one of the substantial causes of the crisis was that capital allocation was determined by 'behind-the scenes mechanisms'. She argues that a lot of capital allocation was not made by open capital market through transactions, but was determined on the basis of personal and business relationships or under government influences known as crony capitalism. This situation led to poor investment decisions and the an initial stages of catastrophic economy or crisis.

6. According to Roubini (1998) one of the problem at the heart of the crisis is the moral hazard problem, that is, governments promised to bail out banks by

allowing them to borrow a large amount of foreign currency and lend too much on 'risky' projects or 'wrong' sectors with low interest rates compared to the risk of the project. He points out that these projects include the finance of non-trade goods, real estate, consumer loans, and speculative asset built-up. Consequently, when the project failed to gain profit as planned, the banks faced difficulties to repay their debt that was dominated by foreign currencies. And this implies that the real burden of domestic currency was enlarged and caused an exchange rate crisis.

7. The regional contagion effects played an important role in the Asian financial crisis. This is proved by the fact that the Thai bath was depreciated in July 2nd 1997, the currency attack engulf on the neighboring domestic currencies of the Philippines, Indonesia, and Malaysia. Kawai (1998) contends that the regional contagion effect was formidable in terms of its speed and scope due to the fact that the financial and economic structure was closed linked among Asian countries.

III. VALUABLE LESSONS FROM THE ASIAN FINANCIAL CRISIS

Understanding deeply the causes of the Asian crisis per se is an initial steps to know clearly and get outstanding lessons behind the crisis. This is momentous to secure not only the crisis itself but also urgent matters in order to black the negative impact of the crisis for other countries. Several prominent lessons from the crisis is follow:

First, To prevent currency crisis, Fisher (1998) and Kawari (1998) suggest that a country belongs sound macroeconomic policy to manage the exchange rate regime and powerful financial system. This is urgent to keep away from excessive capital inflow and currency overvaluation. In addition, macroeconomic policy has to be directed to realize bot internal (full employment and low inflation) and external (sustainable current account) balances.

Second, In line with pegging exchange rate policy, it is better to refer what Sato (1998) warns. He warns that the implementation of the pegging currencies combine with free flow of capital can be economic calamity when domestic market have not liberalized because this policy encouraged excess borrowing.

Third, Appropriate ordering of the capital account liberalization is one momentous element to maintain stable currency. In this regard, Kawai (1998) explains that the ordering is initiated by preparing stable macroeconomic conditions, and then current account liberalization and lastly domestic financial market deregulation. With regard to Asian experienced, Kawai (1998) and Yellen (1998) contend that the main requirement of capital account liberalization is that a country must have irrepressible and strapping domestic financial system. This requirement cover some aspects, for instance capability and expertise to manage assets, liabilities and risk, supervision and strong willingness to communicate and accounting standard without providing guarantee to the financial institutions, transparent and openness.

Fourth, Camdessus (1998), Fischer (1998), and Kawai (1998) think that to maintaining prudent financial and well-supervised mechanism are the main prerequisite the stability of the financial system toward wholesale liberalization the capital account. Furthermore, capital adequacy is needed to convince prudent financial institutions.

Fifth, One of the substantial strategy to combat contagion effect of the currency crisis according to Kawai (1998) is that arrange an establish and efficient cooperative framework in financial management. This notion is logic because of currency crisis in one country can broaden quickly to other neighboring countries.

Sixth, Fischer (1998) believes that one of the primary message from the crisis is that the macroeconomic policy has to be put on the right position as a sound footing with respect to at least two aspects: (1) limited fiscal deficit, that is, balancing between financing and external debt, especially the short-term component, and (2) a coherent approach to monetary and exchange rate management.

Seventh, Learning from Asian crisis Heller (1999) believes that a high-quality growth is fundamental thing for a country. She moreover argues that we were aware that having rapid growth economy that built on the basis of asset price bubbles, inefficient and expensive infrastructure project was meaningless. This was because the foundation for rapid economic growth and sustained income level produced from the condition was shark.

IV. CONCLUSIONS

The Asian financial crisis gives important lessons for both the Asian countries themselves and other developing countries. These lessons are valuable to prevent a similar crisis occurring in the future whether only in one country or even in a region. In short, one lesson is the importance of a sound macroeconomic policy to manage appropriately the exchange rate regime, eliminate excessive capital inflow as well as have a feasible interest rates. Secondly, each country with on emerging economy must build a powerful domestic financial system on the basis of transparent principles, openness, and prudential bank supervision. And finally economic cooperation among countries, especially in financial management, should be established.

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