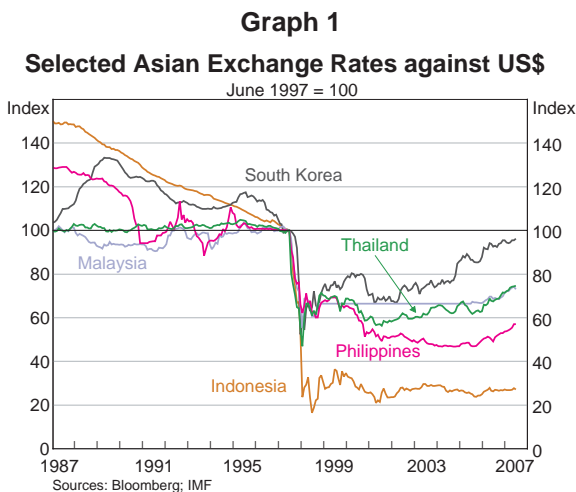


THE ASIAN CRISIS: A RETROSPECTIVE¹

*Address by Mr Glenn Stevens, Governor, to
The Anika Foundation Luncheon Supported by
Australian Business Economists and Macquarie Bank,
Sydney, 18 July 2007.*

Thank you all for coming out today to support the Anika Foundation.² Since a similar function last year the Foundation has continued to build up its capital, and this year will be making its first grants by way of scholarships, called The Anika Foundation Depression Awareness Scholarships, as a part of the NSW Premier's Teacher Scholarship Program. These will enable teachers and counsellors in our schools to travel, study responses to adolescent depression in other countries and return to NSW to raise awareness and improve responsiveness to depression among school students. Your interest in being here today will help us to build further over the coming year, when we hope to expand this same sort of scholarship to other Australian states.³ In time, funding permitting, we would also like to establish a PhD-level research scholarship in the field of adolescent depression.

Thank you also to Macquarie Bank for providing the venue and food for today's event, and to the Australian Business Economists for their logistical and advertising support.



Ten years ago this month, the Thai baht was allowed to float. It promptly fell very sharply (Graph 1). There were danger signs before then, but if we were looking for one event that marked the start of the Asian financial crisis, this would be it. By the end of the year, the crisis had engulfed Thailand, Indonesia, Korea, Malaysia and the Philippines, countries with a combined population of around 400 million. It had very pronounced effects on neighbouring countries like Singapore, serious

1 I thank Vanessa Rayner for assistance in preparing this address.

2 The Anika Foundation was established in 2005 to raise funds for the purposes of supporting research into adolescent depression and suicide. For details, see <http://www.anikafoundation.com>.

3 Further details about the scholarships can be found in the 2007 NSW Premier's Teacher Scholarships handbook.

financial contagion effects on Hong Kong, and had a discernible impact on the global economy.

More fundamentally, perhaps, the crisis brought to an end a period of extraordinary economic growth in Asia, and seriously deflated optimism about future growth. It has proven very difficult to recapture that sense of optimism. While that earlier ebullience may, of course, have been overdone, the scars of the crisis remain fresh in some respects even a decade later.

With the passage of time it is of some value to revisit the crisis, to ask what has been learned, what steps have been taken to strengthen national, regional and international arrangements against a recurrence, and what remains to be done. That is the task that I shall begin today, though it is probably too big a task to finish in one session.

What Happened?

I start with the question: what happened?

There are many detailed treatments available elsewhere of what occurred, and I cannot do full justice to the literature or to the events themselves, which were fairly complex.⁴ We must be mindful, too, that 'Asia' is not some homogenous mass, but a group of countries and economies that have considerable variety in their historical development and their approach to some economic policies. Nonetheless, I have to generalise for the sake of brevity.

Asian economies grew rapidly through the mid 1990s. Average rates of GDP growth were between 7 and 10 per cent in most cases over the decade up to 1996 (Table 1). Rates of investment were high, and current account positions in several cases showed substantial deficits. Put another, and more illuminating, way, there was substantial capital inflow. In the case of Thailand, capital inflow amounted to about 10 per cent of GDP per year between 1990 and 1996, though that was at the high end of the range in the region. In Indonesia's case the corresponding figure was 3½ per cent. From an Australian viewpoint, that does not seem all that big, actually, but it had the Indonesian authorities concerned at the time.

Capital markets in the region were underdeveloped, so the capital inflow tended to be intermediated through the banking sector. Exchange rates were heavily managed, and the counterpart of the inflow was a large build-up in money and credit in the domestic financial sectors, an associated inflation of asset values and some rise in prices for goods and services.

Foreign currency risks associated with these flows were large, and were being incurred by domestic entities rather than being shared around the global markets. In many instances, neither borrowers nor their bankers were managing these risks at all well, in part due to weak risk-

4 Some recent articles and speeches that reflect on the Asian crisis 10 years on include: 'Ten Years after the Asian Crisis: What Have We Learned or Not Learned?', *Asian Economic Policy Review*, 2(1), 2007, pp 1–168; Geithner T (2007), 'Reflections on the Asian Financial Crises', *remarks at the Trends in Asian Financial Sectors Conference, Federal Reserve Bank of San Francisco, San Francisco, 20 June*; Kuroda H (2007), 'Asia Is Moving Forward: Ten Years after the Crisis', *speech at the Asian Development Bank International Symposium, Mandaluyong City, 2 July*. A large number of books covering the general topic of the Asian crisis were written shortly after the event. To name a few: Goldstein M (1998), *The Asian Financial Crisis: Causes, Cures, and Systemic Implications*, *Institute for International Economics, Policy Analyses in International Economics No 55*; *The World Bank* (1999), *East Asia: The Road to Recovery*, *Oxford University Press, Washington DC*; Hunter WC, GG Kaufman and TH Krueger (eds) (1999), *The Asian Financial Crisis: Origins, Implications, and Solutions, papers presented at a conference held on 8–10 October 1998 at the Federal Reserve Bank of Chicago and co-sponsored by the International Monetary Fund, Kluwer Academic Publishers, Dordrecht*.

Table 1: East Asian GDP
Average annual percentage growth

	1987–1996	1997–1999	2000–2006
Hong Kong	5.2	–0.8	4.7
Indonesia	7.1	–6.4	4.9
Korea	8.1	1.0	4.6
Malaysia	9.5	–0.8	4.7
Philippines	3.6	1.4	4.6
Singapore	9.2	2.8	4.6
Taiwan	7.2	5.1	3.3
Thailand	9.5	–3.3	5.1
East Asia*	7.6	0.0	4.5

* Excluding China and Japan
Sources: CEIC; IMF; RBA

management capacities and ineffective supervision and, in part, no doubt, because the exchange rate regimes were assumed – wrongly as it turned out – to be robust. Foreign counterparties also seemed insufficiently attuned to the likely difficulties that could be experienced by the Asian borrowers and financial institutions, and their own limited ability to exit collectively what were quite small markets in the event that things went wrong.

Pressures on the Thai currency began late in 1996, with early signs of some problems in local lenders coinciding with a rise in the effective exchange rates (and hence a decline in competitiveness) of some Asian countries owing to the rise in the US dollar and a downturn in the semiconductor market, which had been an important source of growth. For a time the Thai authorities were able to resist these pressures but they had to give up by mid 1997, as foreign exchange reserves were exhausted.

The baht was floated on 2 July. It fell by 13½ per cent that day and ended the month 23 per cent lower. Intense pressure quickly flowed to currencies of neighbouring countries. A period of stability following the announcement of the support program for Thailand in early August was short-lived and by early October the currencies of Thailand, Malaysia, the Philippines and Indonesia were again under intense pressure. Attention then shifted to the economies of north Asia, which up until then had been only lightly affected. There was tremendous pressure on the Hong Kong dollar peg, where overnight interest rates soared and the share market slumped. As corporate and banking problems intensified in Korea, foreign lenders cut back credit lines, and in November Korea approached the IMF for assistance in meeting foreign currency obligations. Political and economic uncertainty in Indonesia became extreme in the first half of 1998, and the rupiah lost 85 per cent of its value. Even today, the rupiah trades at a 75 per cent discount to its pre-crisis level.

In recent years, we have lived in an environment of unusually subdued volatility in international financial markets, so we tend to forget just how discontinuous price movements can sometimes be. But the uncertainty and financial skittishness that encompassed the global economy in 1998 were pervasive.

It was not confined to emerging markets either. By August 1998, we had the Russian default, followed by the LTCM crisis in September. Around that time, the US dollar/yen exchange rate

moved 30 big figures in three months, and at one point nearly 15 per cent in one day. Now *that's* volatility! One observer later described the international financial system in the late 1990s as having endured perhaps its 'greatest stress in the post-war period'.⁵

In Asia, as the financial market prices adjusted, some of the underlying vulnerabilities came more clearly into focus. The unhedged foreign currency positions meant that the authorities in the crisis countries faced a huge dilemma: as the exchange rate fell, the borrowers or their bankers, or both, went under water owing to the valuation changes on the debts. But raising interest rates to support the currency damaged capacity to repay as well.

It was this financial dimension that made the Asian crisis so costly. And costly it certainly was. Per capita real GDP fell by about 9 per cent in east Asia excluding China and Japan (Table 2). The fall in Indonesia was 15 per cent. On the best available figures, non-performing loans (NPLs) reached nearly half of all loans in Indonesian and Thai banks, and NPL ratios reached double-digits in several other countries in the region.⁶ The process of sorting out banking problems of this magnitude required, as it usually does, extensive public funding. The net fiscal costs of the banking crises are estimated to have been over 20 per cent of a year's GDP in Korea, 35 per cent in Thailand and about 40 per cent in Indonesia.⁷

Table 2: East Asian GDP Per Capita

	Change post-crisis* Per cent	Years to recover
Hong Kong	-6.4	3
Indonesia	-15.0	7
Korea	-7.5	2
Malaysia	-9.5	6
Philippines	-2.7	3
Singapore	-4.6	2
Thailand	-11.6	5
East Asia**	-8.8	3
<i>Memo items:</i>		
United States (1981/82)^	-3.8	2
Australia (1990/91)	-3.8	3
* Taiwan did not experience a contraction in GDP		
** Excluding China and Japan		
^ Assumed to start in September quarter 1981, as per NBER dating committee		
Sources: ABS; CEIC; IMF; RBA; Thomson Financial		

We sometimes read that Asia quickly recovered. I am not so sure. In due course, recovery in Asia did take hold, but it was very slow in some cases. The pre-crisis peak in real per capita GDP was regained within two or three years in Korea, the Philippines, Singapore and Hong Kong. But that achievement took five years in Thailand, six years in Malaysia and seven years in Indonesia. To put that in perspective, after the 1982 recession in the United States, real per capita GDP took about two years to regain its previous peak. In Australia after the 1990–91 recession, it took about three years. As I recall, those episodes were widely seen as serious.

Even accepting that the pre-crisis situation was unsustainable, it is clear that the cost of the Asian crisis was enormous, and the recovery slow. In fact, the average rate of per capita GDP growth in east Asia post-crisis was a little more than half what had been seen in the decade up to 1996.

5 See McDonough W (2001), 'The Role of Financial Stability', address at the XIII International Frankfurt Banking Evening, Frankfurt, 3 May. Available at <<http://www.bis.org/review/r010504a.pdf>>.

6 The World Bank (2007), East Asia & Pacific Update – 10 Years after the Crisis, April, p 60.

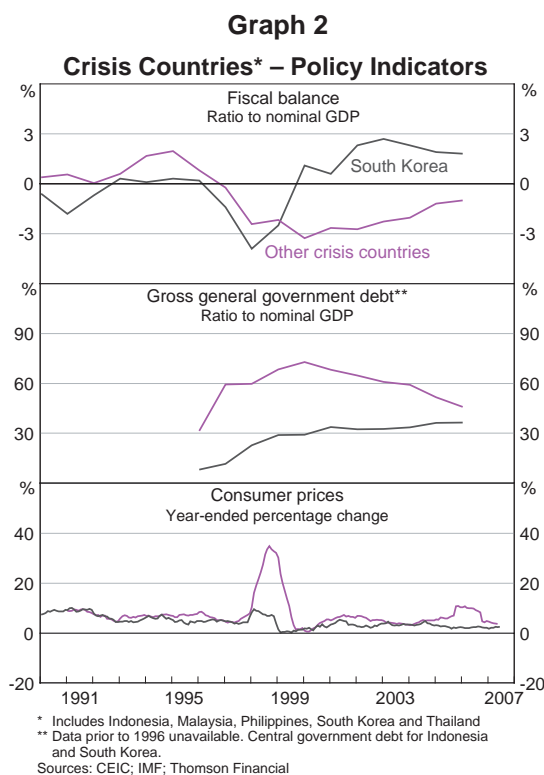
7 International Monetary Fund (IMF) (2004), 'Indonesia: Selected Issues', IMF Country Report No 04/189, p 35.

What Did We Learn?

We learned a good deal about the nature of crises from these events. This was a different sort of crisis from the ones that had often been seen in earlier periods. It was not a standard example of a currency crisis resulting from lax macroeconomic policies, in which large budget deficits (often funded from abroad), easy money, high inflation and so on lead to a loss of confidence in the policy regime and capital flight. In those cases, the standard remedy is mainly macroeconomic tightening to restore discipline and investor confidence.⁸

In Asia, by contrast, fiscal and monetary policies had always been reasonably conservative. Inflation rates were low by developing country standards, budgets were reasonably controlled in most cases, and government debt levels were generally not excessive (Graph 2).⁹

At its heart, the Asian crisis was a *banking* crisis brought on by banks and their customers taking on too much foreign currency risk. No doubt macroeconomic policies were not always perfect, but the real problems were in the financial structure more than the macroeconomic settings. This is now well understood, but it was not fully appreciated at first by many outside observers, even though some Australian commentators, to their very great credit, understood it very quickly.¹⁰ A period of learning



8 Prior to the Asian crisis, the academic literature attempted to explain currency crises as a result of unsustainable fiscal policies or self-fulfilling speculative attacks. As the Asian crisis was not able to be adequately explained under these models, a raft of new research emerged, and so-called 'third-generation' models were developed. For example, see Krugman P (1999), 'Balance Sheets, the Transfer Problem, and Financial Crises', *International Tax and Public Finance*, 6(4), pp 459–472; Chang R and A Velasco (2001), 'A Model of Financial Crises in Emerging Markets', *Quarterly Journal of Economics*, 116(2), pp 489–517; Caballero R and A Krishnamurthy (2001), 'International and Domestic Collateral Constraints in a Model of Emerging Market Crises', *Journal of Monetary Economics*, 48(3), pp 513–548.

9 Some have argued that in some respects the Mexican crisis was a precursor to the 'new' type of crisis seen in Asia (see Ito T (2007), 'Asian Currency Crisis and the International Monetary Fund, 10 Years Later: Overview', *Asian Economic Policy Review*, 2(1), pp 16–49). There were some similarities but also important differences, not least that the Mexican crisis required restructuring of sovereign debt, whereas in Asia the problem was private debt. Nonetheless, Ito argues that important lessons that could have been drawn from the Mexican experience were not applied in the Asian crisis.

10 The early and clear analyses of these issues by Ian Macfarlane and, especially, Stephen Grenville were ahead of most in comprehending the situation. See the following speeches: 'Asia and the Financial Sector', December 1997; 'The Changing Nature of Economic Crises', December 1997; 'Exchange Rates and Crises', January 1998; 'The Asian Situation: An Australian Perspective', March 1998; 'The Asian Economic Crisis', March 1998; 'Some Thoughts on Australia's Position in Light of Recent Events in Asia', March 1998; 'The Asian Crisis and Regional Co-operation', April 1998; 'The Asia Crisis, Capital Flows and the International Financial Architecture', May 1998; 'Capital Flows and Crises', November 1998; 'Recent International Developments in Perspective', November 1998.

about how this type of crisis was likely to unfold and what needed to be done was inevitable, but it delayed recovery. Macroeconomic tightening was always going to be some part of the response, but far from sufficient on its own, and if carried too far would be counterproductive. General structural reform of the economy's supply side, moreover, however desirable from the point of view of raising long-run growth rates, was always likely to play little role in the immediate recovery from a crisis of this nature, in which demand collapsed. In fact, recovery depended on addressing the financial burden of the debts as directly and quickly as possible.

The biggest problem that the countries of Asia had was that they had not developed the financial infrastructure needed to provide resilience to swings in mood before becoming more open to flows of international capital. In drawing lessons, much discussion focused on the difficulty of maintaining relatively inflexible exchange rates in an environment of relatively open capital accounts. While the early tendency to conclude that only corner solutions – hard pegs or unfettered floating – were viable has softened over time, I think most observers would say that a degree of flexibility is needed, in most cases, to build resilience to swings in capital flows.

But it was not just exchange rates that were the problem. The capacity of financial institutions and corporations to manage risk, and of the supervisors to enforce better management, were far too weak. The markets required to manage such risks – to hedge foreign currency exposures, for example – were small or non-existent. More generally, capital markets were underdeveloped, especially local-currency denominated ones. Hence, not only were the risks concentrated in the banking system, but when the banks could no longer extend credit there was no other channel to make up the difference.

As the countries concerned and the international community came to grasp these lessons, the nature of the debate changed. We began to hear much more discussion about 'capital account' crises, and the proposed responses became much more nuanced. Hitherto seldom-disputed notions about the optimality of rapid opening-up to international capital flows became more widely questioned. Capital controls – anathema in the world of the early 1990s – became respectable under certain circumstances. Much more focus was placed on developing bank supervision, and also such supporting frameworks as bankruptcy laws, corporate governance standards and so on. In international circles, there was considerable discussion about the need for some sort of international counterpart to domestic commercial bankruptcy procedures – 'standstills'.

The countries most affected by the crisis drew their own particular conclusions too. One was that while the international financial institutions might come to their assistance, there would be a lot of strings attached, and the assistance might prove to be neither timely nor sufficient. From this judgment, whether it was correct or not, about the international mutual insurance arrangements embodied in the IMF, two things followed. First, the countries of Asia decided to self-insure, by building larger foreign currency reserves (Graph 3). In the face of speculative attacks in future they would be better armed. Ironically, the IMF itself encouraged this reserve build-up initially.

Second, the countries of the region re-doubled their efforts towards building regional-support arrangements. There had been much discussion of this prior to the crisis, and some largely symbolic arrangements had even been put in place. But after the crisis, there was much more activity in this space.

What then has been achieved in the area of strengthening the countries concerned and the international system since the crisis?

What Has Been Achieved in Asia since the Crisis?

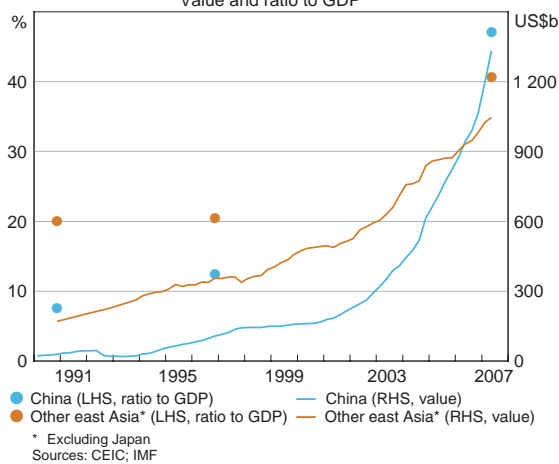
At the risk of over-generalising, several common themes emerge at the national level. First, as one would expect, there has been an even greater emphasis first on pursuit of sound macroeconomic policies. Of some note is that in several countries monetary policy frameworks have moved towards inflation targeting.

This is a natural progression when the exchange rate is no longer available as an anchor for policy. Thus far this framework has been operated with a fair degree of success. Fiscal positions in most countries have been improved, after a period post-crisis when some countries showed large deficits.

Countries in the region have also done a lot of work aimed at making their financial intermediaries stronger. The frameworks for dealing with impaired assets in the immediate aftermath of the crisis have, together with the economic recovery, resulted in a gradual improvement in the shape of balance sheets of the core institutions, though more progress is needed yet in some countries. One World Bank report puts the average ratio of NPLs to total loans in the five initial crisis economies at 6 per cent in 2006 – still a high figure by industrial country standards, but down from close to 30 per cent in 1998 (Table 3).¹¹ Foreign participation in local financial systems has increased in several countries, which brings both capital and expertise.¹²

Emphasis has been placed on beefing up bank supervision and fostering a stronger culture of risk management in the private sector. This is an area, however, where rapid progress is very difficult, and several countries still have difficulty meeting the relevant international standards. Developing and maintaining a strong supervisory apparatus is a challenge in any country at any time, no less so in the Asian region. Countries have also pursued stronger requirements for disclosure, better accounting and auditing standards and so on. That said, progress towards improving the broader regulatory and governance arrangements that condition the ‘investment environment’ has, in the view of at least some commentators, been mixed, at best.¹³

Graph 3
East Asian Foreign Reserves
Value and ratio to GDP



11 *The World Bank* (2007), East Asia & Pacific Update – 10 Years after the Crisis, April, p 36.

12 Ghosh SR (2006), East Asian Finance: The Road to Robust Markets, *The World Bank, Washington DC*, p 64.

13 See Asian Development Bank (ADB) (2007), ‘Ten Years after the Crisis: The Facts about Investment and Growth’, in Beyond the Crisis: Emerging Trends and Challenges, ADB, Manila, pp 1–20.

Table 3: Non-performing Loans
Per cent of total loans

	At peak*	2006
Indonesia	48.6 (1998)	6.1
Korea	13.6 (1999)	0.9
Malaysia	11.5 (2001)	4.8
Philippines	17.3 (2001)	6.0
Thailand	45.0 (1998)	8.1

* Year of peak in brackets
Source: World Bank

A good deal of work has also been done, particularly of a co-operative nature between countries, aimed at fostering deeper, more resilient capital markets. The Asian Bond Funds, initiated by the regional central banks, established cross-border mutual-fund type structures allowing regional investors to hold obligations issued *in local currency* by regional governments and quasi-

government authorities. The ASEAN+3 group has encouraged the issuance of local-currency debt by the multilateral institutions. The development of securitisation and credit guarantee markets in the Asian region has been promoted through a number of regional fora, and securitisation in east Asia has grown quite rapidly since 1999, particularly in Korea, Hong Kong and Malaysia. These sorts of initiatives typically involve trying to remove the various small impediments that individual countries have (sometimes unintentionally) put in the way of investors, and progress towards the mutual recognition of regulatory frameworks in differing countries. These have been very useful examples of practical co-operation – and of how much work is involved in giving practical effect to general ideas agreed to so easily in international meetings.

More ambitious ideas for mutual support have also been pursued, of which the Chiang Mai Initiative (CMI) is probably the most concrete. CMI provides for the countries in the ASEAN+3 group a series of bilateral swap lines, with the amounts committed being increased progressively.¹⁴ Recently, an in-principle agreement was reached to make the lines multilateral rather than bilateral, which would presumably make for more efficient activation in a crisis.

As a result of these developments, I imagine that today few countries in Asia would, if they got into trouble, consider an early approach to the international financial institutions for assistance. But while the regional initiatives are all useful, they remain to be tested under less benign conditions in the global financial system. In fact, it is open to doubt whether they would necessarily prove sufficient as a defence mechanism, were really big changes in sentiment about the region to occur in international markets the way they did in 1997–98. If most countries in the region were under pressure at the same time, there would surely be questions as to whether regional counterparties could meet all the commitments for support.

In any case, few financial crises are confined to one region: even those that start with a regional focus have a habit of spilling over quite quickly, as events after the Asian crisis demonstrated. So while everyone has an interest in regional crises being effectively dealt with at the regional level, we surely still need global mechanisms for dealing with crises, and preventing them as far as possible. That prompts the obvious question: what has been done since the Asian crisis to improve the global arrangements?

¹⁴ Currently, the CMI involves a network of 17 Bilateral Swap Arrangements, totalling US\$83 billion. The swaps are all US-dollar based, except for swaps between Japan-China, Japan-Korea and China-Philippines, which are local-currency based.

What Has Been Done Internationally since the Crisis?

A good deal of effort has gone into crisis prevention. There has been a step-up in national and regional level surveillance by the international official bodies, and an emphasis on more timely and accurate data being made available by governments. A stronger focus on financial sector soundness is another key element, with a number of countries undergoing Financial Sector Assessment Programs, in conjunction with the IMF.

These and other efforts represent serious attempts to use what was learned from the Asian and other crises to reduce susceptibility, or at least to get an early warning of regional-level problems, in future. But as useful as these things are, no-one could say that they will definitely prevent future crises. Hence, *crisis management* arrangements have still been given attention.

One of the key elements is calming behaviour in capital markets once a crisis occurs. The private sector has contributed with a code of conduct, known as the 'Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets', which provides a flexible framework for co-operative discussion and action between private-sector creditors and emerging-market sovereign debtors. A complementary initiative was the introduction of Collective Action Clauses (CACs) in emerging-market bond contracts. This is intended to lessen the problem of getting collective action when a debtor needs to reschedule, by preventing minority hold-outs from derailing the rescheduling. The use of such clauses is now widespread.^{15, 16}

A more far-reaching idea is that of standstill provisions. This is, conceptually, the international equivalent to bankruptcy proceedings, where, once a creditor cannot repay in full, there is a temporary cessation of all payments while an orderly process works out how much creditors can collectively expect to receive, rather than a disorderly and ultimately very costly rush to the exits. This idea found concrete expression in the proposed Sovereign Debt Restructuring Mechanism discussed at the IMF, but did not attract sufficient support from major countries and has not gone forward.¹⁷

There has been some evolution in the architecture of international groupings over time. The formation of the G-20 had its genesis around the time of the Asian crisis. Its membership is more representative of the global economy and financial system of the 21st century, as opposed to the mid-20th century, and it has become more prominent over recent years. In parallel, the G10 seems to be diminishing in importance. With no crises of any magnitude in the past few years, the G-20 has turned its attention to other matters, including issues on the structural side. We should hope, though, that the G-20 will retain a capacity to talk frankly about urgent issues in the highly informal but effective way it did at first, should some new crisis erupt. The Financial

15 According to the IMF, all sovereigns, except two, that have issued under New York law since May 2003 have included CACs in their bonds. In 2005, more than 95 per cent of new issues, in values terms, included CACs. See IMF (2006), Global Financial Stability Report, April, Chapter 1, p 46.

16 The use of CACs was encouraged by advanced countries agreeing to put such clauses in their own bond contracts so as to remove any perception of stigma, and by research, including some done at the RBA, showing that there was no discernible impact of including CACs on the cost of borrowing. See Gugiatti M and A Richards (2003), 'Do Collective Action Clauses Influence Bond Yields? New Evidence from Emerging Markets', Reserve Bank of Australia Research Discussion Paper No 2003-02. But it was the action of Mexico in unilaterally including CACs in their bond issues that did most to encourage others to move in this direction.

17 Some observers feel this issue still needs to be addressed. See Grenville S (2007), 'Regional and Global Responses to the Asian Crisis', Asian Economic Policy Review, 2(1), pp 54-70.

Stability Forum (FSF) was another creation of the more crisis-prone era, and is a useful body for getting key officials together regularly to identify potential threats to global stability.

But while these architectural changes are helpful, the G-20 remains a work in progress, and the FSF is a consultative group, not a decision-making one. The reality is that if there is to be collective international action in the face of a crisis, international financial institutions, with formal mandates and balance sheets, will remain very important. Focus on adapting the IMF to 21st century needs has intensified in recent years. Questions of governance have been to the fore, in particular relating to representation and voting power for emerging-market countries. A small but significant step was made last September with increased quota allocated to four important emerging-market countries which had been under-represented. The more laborious work of getting agreement on longer-run and more far-reaching changes is now under way and has some distance to travel.

But it is critically important too that resolution of the questions about the IMF's mandate – what we want it to do – accompanies the governance reform. It will not be sufficient for the emerging world simply to expect more say in how the international financial institutions are run, without being part of a clearer shared understanding of what the institutions are seeking to achieve. That is a topic for another speech, but suffice it to say that constructive engagement by the emerging world, and especially Asia, in finding an agreement on mandate will be a key prerequisite for genuine progress.

Asia's Future in the Global Financial System

After all this, then, how would we sum up the way things have changed since July 1997? Is Asia, or the world, less vulnerable to a crisis than it was then, or not?

Were we to ask policy-makers in the countries concerned, I am pretty sure they would say they remain acutely conscious of theirs being small countries in a world of large capital flows, with the attendant possibility of being overwhelmed by those flows – in both directions. Suspicion in the region of some of the larger players in international markets remains strong, as does the desire for regional co-operation in handling the financial ebbs and flows.

That said, vulnerability to a 1997-style crisis must have been reduced. The build-up in reserves means that speculative outflows could now be handled more effectively. Furthermore, the fact that most exchange rates have some more flexibility now, even if they do not float completely freely, also means that the authorities would be in a much stronger position because they can allow that price to bear some of the adjustment before they intervene. The various regional initiatives have contributed to the development of capital markets and stronger mutual-support arrangements. The former still has some way to go and the latter have not been tested, but certainly progress has been made.

But maybe the question of whether Asia could withstand 1997 better if it occurred again is not the right question. A future crisis could be of quite a different nature. It is at least as likely to be truly global as to be regional, and just as likely to originate in the developed world as in the emerging world. A generalised re-assessment of risk would no doubt test the resilience of

the countries of Asia, along with everywhere else. That being the case, it is in Asia's interest that international efforts to manage risks more effectively on a global basis be continued. It would also be important therefore for Asia to be sure that Asian regionalism does not become inward-looking. Asia has mostly benefited from engagement with the global economy, and that will continue to be so.

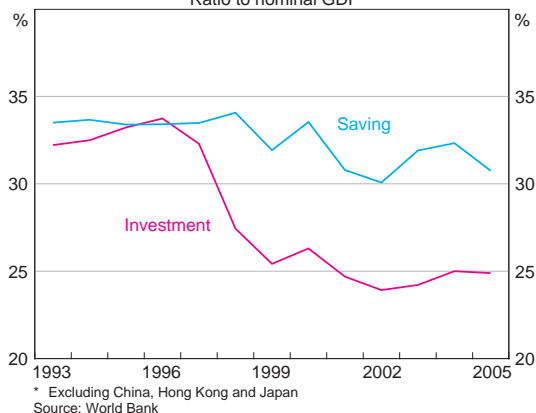
Another question is whether some aspects of the approaches being taken to avoid 1997 recurring are themselves starting to become a problem. In particular, the build-up in reserves has gone a long way past what seems sufficient for self-insurance purposes, and has surely complicated monetary policy in some cases, not least in China. The associated capital flows are big enough, moreover, to have a significant effect on global markets and potentially to rebound onto the Asian region. The rising size of sovereign wealth funds, and what risk profile they will have, is also a question that is likely to be important to countries receiving the capital flows.

For the Asian crisis countries, we should ask: is it optimal for so much saving to be funding investment in the developed world when the social return to investment at home surely ought to be higher? While investment prior to the crisis may have been unsustainably high, in some of these countries it is now arguably too low (Graph 4).¹⁸ Given that many changes over the past decade have been implemented to try and improve the stability of the region, do local investors still perceive the risks to be so great that they are unwilling to invest in their home countries? If so, why? Does that point to the need for further efforts at improving governance frameworks and regulatory environments, deepening capital markets and so on?

The reason to address these issues has something to do with avoiding crises in future, but it has more to do with improving Asian living standards. To see how relevant that is, moreover, we need only look at the sorts of per capita growth rates post-crisis compared with the decade leading up to the crisis. They are much lower. The growth is not as easy to get as it once appeared, which puts the focus squarely back onto policy frameworks.

Graph 4

East Asia* – Saving and Investment
Ratio to nominal GDP



18 A number of recent studies have argued that investment rates in east Asia are currently too low. See IMF (2007), 'Investment Recovery from Financial Crises: A View from Cross-Country Experiences', in 'Thailand: Selected Issues', IMF Country Report No 07/231, pp 3–23; Asian Development Bank (ADB) (2007), 'Ten Years after the Crisis: The Facts about Investment and Growth', in Beyond the Crisis: Emerging Trends and Challenges, ADB, Manila, pp 1–20. The following paper includes a summary of other research on this topic: IMF (2006), 'Asia's Investment Decline', in Asia and Pacific Regional Economic Outlook, World Economic and Financial Surveys, Chapter 5, May, p 33.

Conclusion

The Asian crisis was an extremely costly event for the countries concerned. The crisis is now a decade in the past, but those costs continue to be felt today in a number of countries.

The crisis dramatically changed thinking in Asia, and around the world, about the nature of economic and financial crises, the policies appropriate to dealing with them, and the role of the various regional and global bodies charged with fostering economic and financial stability. It is important that the passage of time, and the apparently benign environment we have recently enjoyed, do not prevent us from pressing on with the as yet uncompleted regional and global efforts to develop more resilience. Were we to slacken efforts there, we would surely come to regret it. ✖