

APEC and the Lessons of the Asian Economic Crisis

By Kojima Akira

The Asia-Pacific Economic Cooperation (APEC) forum was founded around the same time the Berlin Wall fell, symbolizing the end of the Cold War. With new members Russia, Vietnam, and Peru joining in 1998, APEC became an enormous regional-cooperation group accounting for nearly 60% of the world's gross domestic product (GDP), just under 50% of its trade, and more than 40% of its population. It has become the stage upon which many dreams aimed at achieving "peace and prosperity in the Asia-Pacific region" in the post-Cold War era compete. Unfortunately, the Asian economic crisis, which began as a currency crisis in Thailand in July 1997 and spread throughout the surrounding region, has crushed many of those dreams. It is fortunate that the various crisis-ridden countries have avoided the pitfalls of narrow-minded nationalism and have maintained a spirit of cooperation. Still, APEC has revealed the limitations of cooperative efforts in overcoming crisis. Unlike the European Union (EU), which is comprised of relatively homogeneous members, APEC's member nations are in vastly differing stages of economic development and thus cannot all be approached in the same manner. The immediate challenge facing APEC in the 21st century is not merely to pursue its long-standing dreams, but to learn lessons from the Asian economic crisis that has plagued so many of its members.

APEC's Cooperative Structure Powerless against Asian Crisis

The Asian economic crisis that began in Thailand brought an end to the "Asian miracle." Because the crisis resulted from the exchange rate collapse as well as a financial market

crisis, it has been called a "twin" or "compound" crisis. What is interesting to note about the crisis is that it struck the economies that were experiencing the economic boom that many called the Asian miracle. In this sense, the crisis has been a major shock to APEC.

Essentially, this crisis occurred as a result of a rapid exodus across national borders of an enormous amount of short-term capital, against a backdrop of global financial and capital markets. One could say that the crisis originated beyond the scope of APEC cooperation. That is, there will be limits to the long-term success of regional cooperation in dealing with the real market — trade and investment — if there is no cooperative structure governing currency and financial markets.

In the middle of the crisis, a meeting of APEC member finance ministers was held. However, the fact that the meeting of the finance ministers covering monetary and financial matters was neither linked to nor coordinated with the meeting of trade ministers covering real market issues such as trade and investment revealed that the organization had fallen into the trap of sectarianism.

Member Nations Choose Different Courses

During the Asian crisis, there were large differences in the measures taken and calculations made by the APEC members. If we fail to determine why this was the case, the efficiency of Asia-Pacific cooperative structures on the APEC stage cannot be assured.

The lack of coordinated action by different countries may be attributable to a lack of interest in the crisis on the part of the U.S. In July 1997 when the currency crisis first struck

Thailand, the U.S. did not provide any direct assistance. The U.S. government likely thought that multilateral assistance, such as that provided by the International Monetary Fund (IMF), would be sufficient. Or perhaps it thought that the Thai crisis (1) was not that serious and could be handled locally by APEC or by the Asian region, or that (2) Asia was not as important to the U.S. as Central and South America, and thus did not warrant aid. In either case, the U.S. response to the Asian crisis was much more nonchalant than its response to the Mexican currency crisis in the mid-1990s.

The lack of coordinated action by APEC nations has also given rise to a debate over "crony capitalism." In the beginning, the Thai crisis was seen as being "Thailand's crisis." It quickly spread to Indonesia, however, and by the end of 1997 it had even reached South Korea, a nation that had just joined the ranks of the advanced countries by becoming a member nation of the Organization for Economic Cooperation and Development (OECD). The speed with which the crisis spread to other nations surprised not only those nations, but also economic experts and international institutions worldwide. For example, until the crisis spread to Indonesia, the World Bank and others had treated that nation as "the honor student of the developing nations." The World Bank had determined that Indonesia had maintained a certain standard in its fiscal policies and its economic fundamentals were basically healthy. In reality, however, even Indonesia, widely seen as a model of good behavior, fell prey to the crisis. In international dialogue, the term "contagion" was one of the terms

Changes in the Volume of Trade between Japan and 20 APEC Member Nations

(Unit: US\$ Million)

Year	The Volume of Trade with 20 APEC Member Nations		
	Exports	Imports	Total
1989	193,538	137,893	331,431
1990	197,023	147,103	344,126
1991	211,698	150,354	362,052
1992	229,345	149,525	378,870
1993	258,461	159,975	418,436
1994	293,122	183,488	476,610
1995	328,918	226,068	554,986
1996	309,046	235,504	544,550
1997	297,632	236,118	533,750

Source: *Direction of Trade Statistics Yearbook 1998*.

Note: U.S.S.R. figures are used for Russian trade from 1989 to 1991.

often heard in discussions of the crisis. Another was "crony capitalism." This refers to a connection-based or nepotistic capitalism, a distorted form of capitalism that gives benefits to the same groups of people, and in which politicians, bureaucrats, and businesses stick together and rely on each other for support. It is quite different from a transparent, impartial, free-market economy.

During the Asian crisis the term "Washington consensus" was also mentioned frequently. This is the contention that a nation's economy and society will run smoothly if it has a fully developed free-market economy and democracy. It has been dubbed the "Washington consensus" because its strongest advocates are the Clinton administration and the IMF, an organization led by and headquartered in the U.S. From this perspective, Thailand, Indonesia, and even South Korea, where the power of the chaebol extends even to politics, are like problem children. Advocates of the Washington consensus contend that an economic crisis of this nature occurred in these

Asian nations because of crony capitalism. Thus, or so the argument goes, crony capitalism itself must be reformed if the crisis is to be overcome.

In his memoirs, written immediately after retirement from the post of Vice-Minister of Finance for International Affairs at Japan's Ministry of Finance, Sakakibara Eisuke discusses the Washington consensus advocates:

In the summer of 1997 when the Asian currency crisis erupted, the U.S.'s first thought was that it wanted to see the Asian style of capitalism change into a global standard capitalism. At the time, the U.S.'s mass media often reported that Asian capitalism gave rise to functional flaws because of the region's relationship-based economies, which were driven by blood ties and personal connections. Naturally the U.S.-led IMF also took that position. Out of a sense of justice and good intentions, the U.S. wanted the Japanese

financial system to conform to global standards. (*My Historical Fight against the U.S. Treasury Department*, Bungei Shunju, September 1999)

Sakakibara also pointed out that the idea of an Asian Monetary Fund proposed by Japan for overcoming the crisis was strongly opposed by then-Deputy Secretary of the Treasury Lawrence Summers (currently Secretary of the Treasury). Summers' opposition was probably due to his belief that the provision of large amounts of loose-conditionality soft loans to Asia, as called for in that proposal, would prevent the Asian economies from carrying out structural reforms.

The Asia-Pacific Conference for addressing the problems of APEC held in Yokohama in June, 1999 included experts from various nations including the APEC SOM delegates of New Zealand's Ministry of Foreign Affairs and Ministry of Trade. The one representative from Japan in attendance declared, "We are disappointed by the U.S.'s lack of regard for APEC. The only nation to be absent from two meetings of APEC economic leaders is the U.S. In spite of its position as the world's largest economy and leading advocate of liberalization, it has displayed a lack of regard for the strategic and political importance of APEC."

The representative from South Korea also made a statement. "Since its inception ten years ago, APEC has contributed much to this region, but the environment in which APEC finds itself has undergone enormous changes. Asia has fallen into a crisis, and is discovering that things that worked in the past may no longer work in the future. When APEC was founded, its main concern was to promote the success of the Uruguay Round, but today financial stability has become its most important objective. With the development of globalization, the gap between the U.S. and other member nations has

increased, with some of the members receiving a disproportionate share of the benefits. The addition of new members has resulted in a loss of unity and increasing political tensions within APEC."

It is useless to blame the current Asian crisis on crony capitalism because it is that very form of capitalism under which the Asian nations could achieve an amazing degree of economic development and growth over the past 15-20 years. It may need to be revised for the sake of ongoing development in the future, but at the very least, it is not a direct cause of the current crisis. The mixed debate over this point is liable to unnecessarily increase the "political tensions" feared by the representative of South Korea cited above. Paul Krugman of the Massachusetts Institute of Technology, in his recent work, *The Return of Depression Economics*, comments on this:

...many Westerners have turned the story of Asia's crash into a sort of morality play, in which the economies received their inevitable punishment of the sins of crony capitalism... while cronyism and corruption were very real in Asia, they were nothing new... The only answer that makes sense to me to at least is that the crisis was *not* (mainly) a punishment for sins. There were real failings in these economies, but the main failing was a vulnerability to self-fulfilling panic... Were the Asian economies more vulnerable to financial panic in 1997 than they had been, say five or ten years before? Yes, surely — but not because of crony capitalism, or indeed what would usually be considered bad government policies. Rather, they had become more vulnerable partly because they had opened up their financial markets — because they had, in fact, become better free-market economies, not worse. (Paul Krugman, *The Return of*

Depression Economics, New York and London: W.W. Norton & Company, Inc., 1999, pp. 99-101)

Concern Over Mechanical Liberalization

Krugman's suggestion that "the crisis countries were weakened by their sound free-market economies" may resound with his typical cynicism, but it is something that must be addressed by APEC in the future.

It has been strongly suggested that the Asian crisis unfolded as follows: (1) The crisis was initiated by the movement of large amounts of short-term capital. (2) Underlying this outflow was the liberalization of the global financial and capital markets, and the crisis countries liberalized their economies without installing the necessary safety nets. (3) To avoid a crisis, countries need to conduct liberalization in accordance with their own circumstances, such as their level of economic development and the sophistication of their economic infrastructures. Item 3 is the so-called sequencing debate.

In the face of a serious crisis, Malaysia announced exchange and capital controls on September 1, 1998 and implemented a fixed exchange rate against the U.S. dollar on the following day. Designed to limit inflows and outflows of short-term capital, these measures prevented the export of Malaysian ringgits, gradually invalidated overseas (off-shore) ringgits (convertibility stagnation), and prohibited non-residents from exchanging or exporting ringgit income received from sales of stocks within one year of receiving that income. No limits were placed on foreign exchange transactions with regard to current account transactions or direct investments.

Malaysia's decision to implement these measures was loudly criticized by Europe and the U.S. as being "counter to the worldwide trend toward liberalization" and "a rejection of globalization." Later,

however, voices of approval were heard saying that "these were unavoidable emergency response or crisis management measures needed for mitigating the destructive effects of explosive short-term capital movements on the Malaysian economy." In the summer of 1998 when the effects of the Asian crisis transcended Asia, driving Russia into a default crisis and causing the collapse of one of the strong U.S. hedge funds, talk of "the need for emergency response controls" came to the fore. Since then, the IMF has been thinking about how to mitigate the economic chaos caused by international short-term capital flows.

At the second APEC Economic Leaders' Meeting held in Bogor, Indonesia in November 1994, the economic leaders agreed to set a political goal of free and open trade and investment in the region no later than 2010 for the industrialized economies and 2020 for developing economies. This was laid out in the Bogor Declaration of Common Resolve. In November of the following year at the third APEC Economic Leaders' Meeting held in Osaka, the leaders developed the Osaka Action Agenda, a blueprint of principles and specific actions needed to be taken to implement the Bogor Declaration goals of free and open trade and investment, and economic and technical cooperation. However, the Asian crisis in 1997 cooled these nations' fervor for liberalization and forced them to take a few steps backward in the liberalization process.

The fifth and sixth APEC Economic Leaders' Meetings held in November 1997 (Vancouver) and in November 1998 (Kuala Lumpur) focused on the efforts and cooperation of APEC members in dealing with the Asian crisis. Given the breadth and depth of the crisis, this was a natural development. The problem, however, is the lack of effective cooperation in areas vital to overcoming this crisis.

Economic globalization is

Comparison of GNP between APEC Member Nations (1996)

	Country / Region	Per Capita GNP	GNP (Million US\$)
1	Japan	40,940	5,149,185
2	Brunei Darussalam	27,682	8,000
3	Singapore	28,020	92,987
4	United States of America	30,550	7,433,517
5	Hong Kong, China	24,290	153,288
6	Australia	20,090	367,802
7	Canada	19,020	569,899
8	New Zealand	13,480	277,020
9	Chinese Taipei	12,439	266,195
10	Republic of Korea	10,610	483,130
11	Chile	4,860	70,060
12	Malaysia	4,370	89,800
13	Mexico	3,670	341,718
14	Thailand	2,960	177,476
15	Peru	2,420	58,671
16	Russia	2,410	356,030
17	Republic of the Philippines	1,160	83,298
18	Papua New Guinea	1,150	5,049
19	Indonesia	1,080	213,384
20	People's Republic of China	750	906,079
21	Vietnam	290	21,915

Source: World Bank, *The World Bank Atlas 1998*.

Note: Figures for Brunei Darussalam and Chinese Taipei are from the *ODEC DAC REPORT 1997*.

progressing at a rapid pace, but the degree of globalization that has been achieved in the financial and capital markets is stunning. This is due not only to the financial and capital liberalization measures undertaken by various countries, but also to the underlying rapid development of information technologies. The financial sector is reinforcing the capabilities of the so-called cyber-market or cyber-economy, and capital flows across borders are not only rapidly increasing, but are happening at the instantaneous speed of

computers.

The current Asian crisis has shown how the cyber-financial market can seriously shake the real economy. This suggests that in the future (1) this kind of crisis could occur not only in Asia, but in any country or region of the world, and (2) if the cyber-financial market is not well-managed, discussing and devising policies for real-market trade and direct investment independent of the cyber-market will have only a limited effect.

Consequently, one of the issues now

facing APEC is how to more organically incorporate discussions of financial and monetary matters into discussions of trade and investment.

APEC has repeatedly emphasized its desire to achieve "open regionalism." It is a concept that is likely to continue to be emphasized in spite of its futility. APEC member nations have been able to achieve such remarkable development because they opened themselves to the outside world and made positive efforts to invite foreign direct investment. This is a very different stance than that taken in the early period of economic development in Japan, where markets were closed, foreign direct investment was severely limited, and selective development was the order of the day.

APEC's problem is that when an economic crisis occurs that results in the kind of currency chaos being experienced today, each of its members has to resort to limiting the openness they had thus far eagerly pursued.

APEC has established many working groups and has frequently held many, perhaps too many, meetings on trade and investment. APEC is supposed to be a forum for regional cooperation rather than an institutionalized organization like the OECD, but as a result of its excessively numerous meetings and its overly detailed discussions laced with jargon that is difficult for the average person to understand, the general public's understanding of and interest in APEC has waned.

For the ten years since its inception, APEC has been standing on the verge of an enormous historical turning point, and it is now facing a challenge that demands an immediate response.

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