

The Impact of the Asian Economic Crisis on Trade

by Nakagawa Katsuhiko

The East Asia Economic Summit held from October 12 to 14 in Singapore was sponsored jointly by the Switzerland-based World Economic Forum and the Singapore Economic Development Board. This article has been prepared to document the comments made by Katsuhiko Nakagawa, adviser to the Ministry of International Trade and Industry, at the plenary session on the "Impact of the Asian Economic Crisis on Trade" on the morning of the 13th. At the session, Nakagawa discussed factors behind the Asian crisis, the structure of trade stagnation in East Asia and responses

from the Japanese government. Besides Nakagawa's comments, the article contains an outline of the comprehensive package of assistance Japan is providing to the rest of Asia.

I would like to indicate the following five points on this issue.

The first point is that sudden declines and increased volatility in exchange rates significantly disrupt real trade. So, we have to create a new and more stable international financial system. In the Asian crisis, Thai and South Korean exchange rates depreciated by 40%, while the

Indonesian currency fell to one-sixth of its previous value. Under these circumstances, these countries could not continue to maintain normal trade relations with their trading partners. There were various factors contributing to the Asian crisis. By far the most direct and significant cause of the crisis was the massive and abrupt outflow of short-term foreign capital that caused the sudden currency depreciation and eventually a credit crunch. In an age of globalization accelerated by IT development, turmoil in currency and financial markets in one country can easily and

Finance

Current Measures

(Total \$43 billion)

- **International Payment Support** (\$19 billion)
- **Industrial Finance Support**
 - Two-step loans (EXIM Japan & OECF)
(Thailand \$0.6 billion, Indonesia \$1.0 billion)
 - EXIM Japan investment finance
(\$1.4 billion in February package)
(\$1.1 billion in April package)
 - Trade insurance
(\$2.0 billion overseas untied loan insurance)
- **Trade Finance Support**
 - Continued underwriting of trade insurance
- **Humanitarian Support, etc.**
(unemployment measures, food aid, etc.)
(\$1 = ¥130)

New Measures

- **Maintain support for international payments**
- **Provide financing for Japanese companies injecting capital into their local subsidiaries**
- Japan Financial Corporation for Small Business*, JODC etc.
*Planning to introduce new scheme
- **Dispatch experts to strengthen the examination capacity of local financial institutions and strengthen the management abilities of corporate borrowers**
- **Underwrite reinsurance for Asian trade insurance institutions, support development of a trade insurance system**



instantly spread to all regions of the world. The world is now experiencing unprecedented economic turmoil caused by so-called cyber capital transfer. Though there are no simple or obvious solutions to the question of how to establish a new architecture for an international financial system, I believe the time has come for serious discussions of this issue. Under the Bretton Woods System, the forums of GATT and WTO have achieved expansion of global free trade mainly through tariff reductions without creating serious confusion. But the free movement of global capital has been dramatically advanced without sufficient discussion within an



Photo: W.W.P.

Japan's role: Finance Minister Miyazawa announces a \$30 billion assistance package at the G-7 Meeting in Washington

international framework, including the IMF. Recently, the G-7, G-22 and other international forums began to

concentrate their efforts on formulating a new international framework for capital transactions and reconsidering the new role of the IMF. I think this work should be accelerated.

The second point is that currency depreciation does not mean an immediate surge of exports. Trade finance is very important. Immediately following the outbreak of the Asian crisis last year, there was concern among some advanced economies that, with the benefit of currency depreciation, the drive to export from East Asia would increase. However, what actually happened was that East Asian exporters could not even import raw

Human Resources and Technology

Current Measures

- Accept trainee managers and engineers
- Dispatch experts in management and engineering
- Conduct joint research with research institutes in Asian countries



New Measures

- Securing employment for skilled workers and engineers (Training for 10,000 people)
- Proactive use of Japanese corporate retirees (Dispatch experts)
- Promotion of human resources and supporting industrial development utilizing industrial districts
- Enhancing ties with human resource development centers and science & technology universities. (Including implementation of a distance learning education system)
- Support for accelerating product development for commercialization

Structural Reform

Current Measures

- **Develop systems utilizing technical assistance tools**

- **Infrastructure development utilizing yen loans**
 - Establish yen loans for environmental development (September 1997)
 - Establish yen loans for regional integration (December 1997)



New Measures

- **Promotion of ASEAN-wide government-private sector dialogue using the Japan-ASEAN Economic and Industrial Cooperation Committee(AEICC)**
- **Support for AFTA and AICO promotion**
- **Development and harmonization of systems such as standards & conformance and property rights (Dispatch experts)**
- **Support for infrastructure development in relation to environmental protection and other areas where Japan has expertise (Proactive use of environment-related yen loans)**
- **Enhancement of project identification functions (Active use of F/S systems) and implementation of model projects to encourage the dissemination of environment-friendly, energy-efficient facilities**
- **Promotion of infrastructure development conducive to regional integration (Proactive use of regional integration yen loans)**

materials, parts and capital goods, because they could not get letters of credit from local financial institutions that had lost their ability to lend money because of the financial crisis. Japan provided J-Exim financing in order to improve the trade financing of these countries. In addition, by the initiative of MITI, major export credit agencies in the advanced economies agreed to maintain trade facilities for these countries in the region.

The third point is the important role

of foreign direct investment and its essential link to the expansion of trade. The level of intra-regional trade within East Asia is very high. If we define East Asia as the region comprising the four NIE countries, the four ASEAN countries (Thailand, Indonesia, Philippines, Malaysia) China and Japan, then the scale of regional trade interdependence of East Asia was 52% in 1996, 61% for the EU and 48% for NAFTA. The fact that the high level of trade interdependence was achieved without free trade

zones, as is the case with the EU and NAFTA, is very interesting. It is clear that expansion of direct foreign investment in East Asia, not short-term capital inflows, has been an essential link to increased trade. Japanese-affiliated companies in East Asia have played a very significant role in expanding trade in the region. In order to expand trade, free-trade principles are clearly important, but the expansion of direct foreign investment through capital liberalization should also be pursued.



Photo: W.W.P.

Brainstorming for East Asia: a panel meeting at the East Asia Economic Summit in Singapore

The fourth point is the role played by Japan, the U.S. and the EU in the recovery of East Asian economies. 40% of Japanese exports and 80% of Japanese direct foreign investment go to East Asia. From East Asia, 13% of exports go to Japan and 20% of regional direct foreign investment comes from Japan, while 20% of all exports are sent to the U.S., and 14% to the EU; 16% of East Asian direct investment comes from the U.S., and 9% from the EU. Therefore, the roles of Japan, the U.S. and the EU in the recovery of East Asian economies are really significant.

The fifth point is that as the leading nation in the region, Japan's role is the most important. Japan has already provided \$43 billion in emergency funding to ensure short-term liquidity throughout East Asia. Compared with the \$12 billion of assistance from the U.S. and the \$7 billion of support provided by the EU, Japanese assis-

tance is on an extremely large scale. In addition, Finance Minister Miyazawa announced a \$30 billion assistance package at the G-7 meeting. The most important thing is of course to realize the rapid recovery of the Japanese economy under a protracted severe recession. We believe it is of the utmost importance that confidence in Japanese banks and financial system should be restored and the credit crunch should be solved. The plan for financial reform consists of three pillars: 1) strengthening supervision of banks 2) taking aggressive steps to dispose of bad loans 3) drastic restructuring of financial institutions. Japan's first priority should be solving the credit crunch as quickly as possible. Some of the related new bills were passed in the Diet and the rest will be passed soon.

In addition, an economic stimulus package of ¥16 trillion was approved as part of the revised budget passed in June. Moreover, the new administra-

tion plans to implement permanent corporate and income tax cuts of ¥6 trillion and make up a second revised budget worth ¥10 trillion. The government will continue to seek economic efficiency through deregulation and assist in creating new businesses. The government hopes to see the creation of new businesses that will create 18 million jobs by the year 2010.

With rapid globalization, we are now in an era in which economic changes in one country spread instantly throughout the rest of the world. Close coordination among countries, including emerging nations, is becoming increasingly important. **WJI**

Nakagawa Katsuhiro served as a Vice-Minister of International Trade and Industry, and was a special adviser to the Ministry of International Trade and Industry at the recent East Asia Economic Summit.