

February 26 1999

The Asian Crisis: The Beginning of the End?

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1. Background

- East Asia did indeed achieve a miracle over the last three decades: the living standards of more people increased far more rapidly than at any time in history. Many elements helped produce the success: outward-oriented policies, high rates of saving and investment, investments in human capital, entrepreneurship, hard work, governments oriented to economic development, and prudent macroeconomic policies. Engines of growth were the export sectors — increasing integration into the world economy was one of the keys to success. Most of these elements of success remain.

2. The Current Crisis

- Against the backdrop of these achievements, the crisis — and particularly its depth and breadth — came as an enormous surprise. Although country circumstances varied, its origins lay primarily in capital account and financial sector problems.
 - ▶ Fundamental structural problems, financial sector weakness and poor corporate governance, came to the fore under the stress of the crisis.

¹ This is an outline of comments prepared for delivery at the Asia Society's 10th Annual Corporate Conference, "Asia's Choice: Open Markets or Government Control", held in Manila, February 24-26 1999.

- ▶ These problems were exacerbated in part by inappropriate exchange rate policies and capital account weaknesses, due particularly to the prior encouragement of short-term capital inflows.
 - ▶ Rapid reversals of capital flows were an important triggering factor, one that was spread through contagion.
 - Policies adopted by governments to deal with the crisis — in many cases with IMF support — had to be comprehensive to resolve structural as well as macro problems. The conclusion from the IMF's recent self-assessment of its programs is that the strategy was broadly appropriate — and it is now clearly yielding results.
3. An important lesson of the crisis is that the choice posed by the title of this conference is a false one. East Asia succeeded in large part through being open and by opening up, by seeking to integrate into the world economy, *but* some of its problems were caused by opening the capital account in an inappropriate way. East Asia succeeded too because of generally good economic policies, *but* some of its problems were caused by inadequate government policies and controls:
- Among them were the lack of transparency in public-private sector relations, and excessive reliance on implicit government guarantees;
 - Further, government control was inadequate in financial markets, where efficient regulation and supervision is essential.

The choice is not between open markets and government control, but rather to ensure that in the context of generally open markets, government regulation and supervision is appropriate, effective, and efficient.

4. Governments have been forcefully confronted in this crisis by the choice of whether to remain open, in both the trade regime and in the financial markets. Despite the unprecedented stresses to which they have been subject, they have almost

unanimously made the same choice: to remain open, and to strengthen their economies and systems so that crises like this one do not recur. At the same time, the international system has to be strengthened in a number of critical areas to help produce a more stable environment — the well-known discussion of strengthening the international economic architecture.

5. Openness will remain central to Asia's growth strategy, accompanied by measures to strengthen the functioning of markets.
 - All of post-World War II history shows the benefits of maintaining open trade regimes, and there has been very little retreat on that front — but there is much more to do, not least in liberalizing international trade in agriculture.
 - At the same time, countries will and should continue moving toward open capital account regimes, but with safeguards and appropriate sequencing.
 - Effective regulation and supervision of domestic financial institutions is critical, to ensure both that they perform their intermediary function efficiently, and that they are sufficiently strong to withstand stresses arising from the international system.
 - Effective competition within the domestic economy, and the avoidance of excessive leverage in corporate financing, are needed to ensure a healthy corporate sector.
 - And of course, prudent macro policies are essential.

6. The Philippines' recent experience supports the validity of this approach.
 - In the pre-crisis period, the Philippines launched an impressive set of reforms comprising:
 - ▶ liberalization of trade, foreign exchange, and investment regimes
 - ▶ privatization
 - ▶ elimination of entry barriers into important industries (e.g., banking, telecom)

- ▶ financial sector reforms (opening up to foreign investment, improved prudential and supervisory standards; and creation of an independent central bank).
- These reforms boosted growth and helped make the economy more resilient to shocks.
- During the crisis:
 - ▶ quick action to let peso float, accompanied by tightening of monetary policy
 - ▶ early dialogue with Fund on policy response (i.e., did not wait until crisis was full-blown)
 - ▶ continuation/deepening of financial sector reforms
 - ▶ early and clear commitment to keeping the system open and continuing with market-oriented reforms
- As a result, the Philippines has weathered the crisis remarkably well.

7. Conclusions

- Most elements of Asia's successful growth strategy, including open markets, do and should remain in place.
- Nevertheless, changes are needed to contain risks associated with domestic financial liberalization and openness to international capital flows.
- Strategies adopted by Asian crisis countries (some with IMF support) are working.
- The role of government is to provide a suitable regulatory framework to support efficient markets, as well as to sustain appropriate macro policies.
- The IFIs and industrialized country governments should move rapidly to strengthen the international system — that work is now under way.

As this crisis is overcome — and it is being overcome in most countries — and given both that the ingredients for success remain in place and the ways in which most

Asian governments and societies have responded to the crisis, most countries in Asia will emerge from the crisis with their economies strengthened and growing at rates that are once again the envy of the rest of the world.

