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Impact and Response of Asian Economic Crisis and Global Imbalances of Emerging Market Economies

Thanet Wattanakul
(Khon Kaen University, Nong Khai Campus, Muang, Nong Khai, Thailand)

Abstract: This chapter aims to examine and describe the impact and response of Asian debt crisis and global imbalances particularly of emerging market economies. It is necessary to explain the related backgrounds to address the objective. These backgrounds consist of Asian debt crisis, current global imbalances situation and importance of emerging market driven economies. The content of impact and response of Asian debt crisis and global imbalances of emerging market economies will be also discussed. Furthermore, the effective policy implementation is suggested to tackle the problems. In addition, the perforation and role of regional economic integration especially in the ASEAN region as ASEAN Economic Community (AEC) will be included. This is possible instrument to develop the economic integration level of this region to be deep economic integration as single market to decrease the global economy imbalances and accelerate mutual benefits.

Key words: Asian economic crisis; global imbalances; emerging market economies
JEL codes: F31, F33, F36, F38

1. Introduction

Economic and financial crisis attacked the Asian region starting from Thailand in 1997. Many countries in this region had been domino affected by the crisis. Balance of payment twin deficit from both balance of trade and capital balance contributed to the massive loss of international reserves. The regional currencies had also been speculated and then led to the over devalue of these currencies particularly for Thai baht. Thailand has also been affected by the non-performing loan (NPL) of bank and non-bank financial institutions and over supply of real estates are other essential factors contributed to the crisis. NPL created by financial institutions from the advantage of the cost of borrowing differentiation between on shore and off shore. This economic situation in Thailand can be called the bubble economy. This chapter reviews and investigates the impact and responses of Asian debt crisis. It also explains about the global imbalances of emerging market economies that can be considered as one important of the crisis.

Thanet Wattanakul, Ph.D., Assistant Professor, Deputy Dean of the Faculty of Integrated Social Sciences, Lecturer of Economic Department, Head of Indo-China Economy Research Division, Khon Kaen University; research areas/interests: international economics, international trade policy, international monetary economics, international economic cooperation, economic integration and ASEAN economy. E-mail: thanet.w@nkc.kku.ac.th, thanetwat@hotmail.com.

2. Causes and Consequences of Asian Debt Crisis

Many factors can be considered as the causes of Asian debt crisis. Most of Asian countries' currency have overvalued during the 1990s because of the emerging market economies boom in the region. The obvious examples of these economies are China and India. In addition, the financial and capital flow restriction has been changed to be more liberalized. As a result, the financial institutions gained an advantage of outsource capital and fund borrowing because of the very different rate of interest as well as the deregulation concerning to this. The mismatch of credit allocation is another issue to be addressed to this crisis.

There were different and various causes led to the financial instability especially in Asia during the past two decades. These causes had been addressed to both policy makers and market participants. These causes can be explained as follows (Ellis, 2009):

(1) Boom-Bust Cycle;

(2) Financial Sector Instability;

(3) Credit-fuelled Booming.

The economic growth and structural changes has been emerged particularly for the past two decades. This growth can be regarded as miracle growth because of the spectacular growth performance characteristics. Many perspectives can explain this experience as follows. These aspects can be divided into two factors as primary and secondary factors. The miracle growth also associated with the economic policy implementation as well as the changing of trade policy and the attraction of massive foreign direct investment in the industrialized export production (Dowling & Valenzuela, 2004).

All Southeast Asian economies grew very rapidly especially in the 1990s. The export performance had been growth over the expectation. The large amount of capital inflows injected to portfolio investment contributed to the stock market booming. Consequently, the money supply expansion motivated the massive lending growth under the fixed exchange rate system. Therefore, the bank credit allocation in proportion of GDP increased dramatically. Furthermore, both the inflation and short term foreign currency debt began continue to increase led to the loss of liquidity of financial institutions. Bank of Thailand also spent huge of reserves to protect the speculation in order to maintain the Thai baht's value stabilization. These factors caused the financial sector weakness because of the foreign debt, NPL from bank lending and over price asset bubble (Dowling & Valenzuela, 2004).

Other factors can be contributed to the Asian financial crisis are as follows (Sheehan, 2009):

(1) Ineffective quality of fund management system;

(2) Ineffective capital inflows stabilization;

(3) Foreign banks entry restriction;

(4) Higher cost of financial services and NPL.

The financial liberalization is an additional factor used to explain the cause of Asian financial crisis. Financial liberalization is defined as the restriction elimination of financial repression. The examples measurement of financial liberalization include lower reserve requirement and allow the interest rate to response the market forces. In the late 1990s, the financial liberalization started to implement in the NIEs and South East Asia. The regulations had been more relaxed from the intense competition and large direct credit allocation distributed to the non-profit performing sectors particularly for the real estate and portfolio investment. There are three essential components combined to address the Asian financial crisis. These components were banking sector, stock market booming and bubble economy. As a consequence, the many efficient policies had been implemented to strengthen the weakness of financial sector.

3. Global Economy Imbalances Circumstance

Global economy imbalances have been currently happened between developed and developing countries. These imbalances can be described from various economic development gap aspects. The global financial weakening and instability is one essential factor distributed to global financial crisis. This circumstance has currently originated from the US that has affected credit markets and financial system in other countries very rapidly. There are eight transmission channels that can be described as follows (Sheehan, 2009):
(1) Financial Market Conditions;
(2) Real Activity in the Impact Industries;
(3) Expectations;
(4) Export Shocks-The Impact Industries;
(5) Export-Other Industries;
(6) Wealth and Profitability Effects;
(7) Resources and the terms of trade effects;
(8) Reduction in Capital Flows, FDI and Foreign Aid.

4. Importance of Emerging Market Economies and Impacts of Economic Crisis and Global Imbalance

The important of emerging market economies has been increased in the present. The World Bank categorized the classification of countries into the newly industrialized economies consist of Singapore, Hong Kong, Taiwan, Korea, Indonesia, Malaysia, Thailand and China. These countries have common characteristic as the dominated of Asian growth attribute to continue and sustain rapid growth. Saving rate and huge amount of investing increased rapidly in many Asian countries during that time. These Asian economies can also be regarded as emerging market economies.

Four main issues have been analyzed in this section as follows:
(1) The Impact of the Global Economic Crisis on China;
(2) The response of China to the Crisis;
(3) Domestically and Internationally Emerging from the Crisis of China;
(4) The Possibility of China turns to the Challenging Again.

Many Asian countries had been affected from the global economic storm, debt crisis and intense global imbalance economies. One of these affected countries is the world third-largest economy and second-largest trading nation, massive outbound invest, important destination of the FDI and the largest foreign reserves holder. This country is apparently China. China has implemented many economic policies to respond and tackle the crisis. These policies can be considered as the new effective ways for other Asian developing countries to be adapted. Most important policy is the high ability of transforming crisis to economic opportunity via maintaining the sustainable development and growth as well as alleviating risks of the social and political instability (English, 2009).

It is necessary to explain the China's structure of economy prior to describe the impact of recent global economic crisis on China's economy. It can be affirmed that the economic development during the post of 1979 until the present has been in transition period. The intensive post-Mao economic reform has been resulted in the obvious economic growth used as key engine of development. These economic policy reform packages include stimulation of massive local innovation which led to the economic growth although these policy reforms has been decided and made decision by the central government.

The above economic development can be considered as decadal cycles (English, 2009). The early stage of development started from the 1980s prioritized by the rural reform and development that led to both continued price increasing and inflation before slowed down by the later efficient macroeconomic policies implementation. The market liberalization have been adopt since 1990s until present despite the foreign direct investment slowdown from the East Asia economic crisis contributed to the decreasing of the export. Both the intensive urbanization development and service industries growth stimulation have also implemented during the last decade. These stimulus policies are essential and effective engine to drive the China's economy reach the sustainable economic development target.

Nevertheless, the economy of China has been affected from the economic crisis resulting in the lower GDP's growth. These impacts can be explained as follows:

(1) Banking Sector and Investment;

(2) Trade.

In spite of the effects from the crisis, the China's economy has remained continued growth as target in 2009 and 2010. The intensive and efficient economic reform during past two decades contributed to tackle the challenges. Many mega infrastructure investments increased sharply between 2007 and 2008 especially in the property market and stock market bubble accompanied by high inflation. It was necessary to slowdown the economy. As a result, different measures had been used such as lending quota, interest rate and reserve requirement increasing and tightening the lending contribute to property investors (Sheehan, 2009).

The stimulus economy package had been injected via various strategies to achieve the target (English, 2009). This stimulus plan has four ultimate goals of rebalancing the economy, efficiency, social balancing and stability. These goals need to effective transmission instruments that can be described as follows:

(1) Rebalancing the economy by determining long-term growth via increasing domestic consumption as well as slowdown the exports.

(2) Efficiency by restructuring the high potential industries to reach more productivity.

(3) Social balancing led by strengthening and expanding social welfare and employment to decrease high unemployment.

(4) Stability by continuing implementation of the above strategies to maintain economic reform and long-term sustainable development.

Besides that, the monetary measures were included in stimulus package by using accelerate spending and more flexible monetary policy. The examples were alleviation of prior bank loans quota, more incentive to banks for increased lending, decreasing the reserve requirement, lowering the interest rate and enforcing laws and regulations led to the private lending market legal. Furthermore, the other policies of social welfare improvement, intensive rural development, enormous infrastructure investment and export industrial competitiveness stimulation have also been implemented during the past three decades until present.

5. Enhancement Benefits Policies

This section discusses the enhancement of additional benefits policies for Asian countries to insulate the possible financial and economic crises emerge. Many following different policies have to be considered to adapt in different and individual country's economic environment.

The policy makers have currently proposed and debated about the efficient policies to assure the benefits particularly for solving and protect the economic and financial crises re-emerge. Government and central banks play an important role to implement macroeconomic policies including fiscal and monetary policies. One essential condition is to restructuring the regional and global financial system to be recovered and strengthened. The effective reform policies need to be focused.

Many procedures are crucial to restore the financial system particularly for banking system of the affected countries that mostly are in Asia. The examples of these procedures were substantial technical supporting to financial institutions and markets as follows (Ellis, 2009):

(1) Debt Insurance Guarantee;

(2) Bank Capitals Injection;

(3) Balance Sheet Risk Reducing.

The decreasing of balance sheet risk can be undertaken by many channels. The assets outright can be purchased and placed in an entity of banks separately by government or central bank. In addition, the assets on bank's balance sheet can also be assured to protect losses and the additional funding can be invested to buy the assets. These approaches have to be considered carefully to implement in term of the effectiveness. Many countries used most of these solutions has been used during the last decade.

The financial system still weak and fragile although the above solutions have been intensive implemented. The money and capital markets have remained ineffective and high risk. Only equity markets show gradual recovery. The regional and countries' financial architecture need to be massive reformed to prevent the re-occurring of the crisis. Regulations deal with the credit rating agencies and banks' liquidity and capital subject to be adjusted.

Central banks and policy makers in the region should enhance the cooperation policies to insulate their economy from the crisis despite the time consuming for different policies. The regional and global financial systems have to be transformed to the period of change. The high price of risk is one obvious factor lead to the financial crisis. The credit conditions have to adopt because of the changing circumstances, e.g., the tightening credit allocation standards by financial institutions that is possibly result in asset acquisition decreasing. Additionally, the speed of banks' balance sheet adjustment, the confident restoring, the increasing of liquidity and decreasing of non-performing loans (NPLs) are other crucial conditions to consider.

6. Roles and Importance of Regional Economic Integration

This section analyses the roles and importance of regional economic integration. Regional economic integration has been proliferated in many regions including Asia. It has an importance as first those countries in the same region develop the agreements to expand the economic cooperation not only for trade and investment liberalization but also to enhance the effective alleviation economic and financial crises polices. The free trade agreements (FTAs) can be used as possible measure to deal with this issue.

The current important example of regional economic integration is ASEAN. ASEAN has increases am important role in terms of not only regional trade and investment liberalization but also the expanding of other and deeper economic integration to be the ASEAN Economic Community (AEC) by the end of 2015 (Wattanakul, 2010). The ultimate goals of AEC are to be single market in order to create the efficient production hub and network. Furthermore, the service sector liberalization is also the additional important target of AEC.

Bilateral free trade agreements (FTAs) are an essential step that can be led to the building blocks for the comprehensive regional economic cooperation and plurilateral economic integration later. Many countries in ASEAN currently particularly for Thailand has enthusiastic negotiated and implemented the bilateral FTAs. Thailand has signed and implemented the bilateral FTAs with the countries both inside and outside the region.

Moreover, the enlarged ASEAN has been progressed because of the major East Asian countries of China, Japan and South Korea has very interested to be part of AEC as the ASEAN+3 (Wattanakul, 2010). This progress will be benefit to all partners lead to the more negotiation power under the WTO and other mutual benefits. Another enlarged ASEAN negotiation and progress in the present is ASEAN+6. ASEAN+6 consist of ten ASEAN members and China, Japan, South Korea, Australia, New Zealand and India. All mentioned East Asia economies are very important for regional economy’s growth because of the massive foreign direct investment (FDI) in export manufacturing in ASEAN host countries. In addition, China is also the largest international reserves holders in the global economy as well as the Chinese Yuan is very powerful currency.

7. Conclusion

Many countries in Asia have been affected by the financial and economic crisis during the past two decades although these countries have experienced continued economic growth. One of the key Asia’s economies is China. Others countries especially in the ASEAN region have also affected considerably. This situation and challenge caused the global economy imbalances. Global economy imbalances have led to different consequences under different economies. Therefore, these affected countries need to implement effective economic policies to response and solve the challenges.

The regional economic integration is one possible channel that can be applied to use as the solution. Consequently, the bilateral FTAs have developed both inside and outside the region. The enlarged ASEAN in terms of ASEAN+3 and ASEAN+6 is the opportunity to expand the economic collaboration to alleviate the adverse impacts and prevent the re-emerge of the crisis including the other economic collaboration. The current obvious example of this proposes is AEC that the ultimate goal as single market targeted by the end of 2015. Nevertheless, the plausible mutual benefits from the single AEC market need to be investigated by further studies.

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