Continuing Problems in the Asian Financial Crisis
The Purpose of This Presentation is to Provoke Discussion on the Asian Financial Crisis in a Focused Manner that:

First Analyzes Its Economic Origins

Second Avoids Issues Relating to Regulatory Reform or “Crony Capitalism”

Third Questions If the Current Recovery and Related IMF Programs Address Potential Flaws in the Asian Growth Model

It also introduces Kindleberger’s Paradigm for Financial Crises to Assess Whether a Similar Crisis Could Occur Again Soon
Several interrelated factors have driven the current financial situation in Asia from high growth to financial and economic crisis:

Large Japanese Firms' FDI combined with the "Bubble", its Aftermath, and International Portfolio Flows

China’s growth targets and inefficient state owned firms

Unique local issues particularly impacting Korea, Thailand and Indonesia
Leading firms have a disproportionate and leveraged influence on the economy:

- keiretsu relationships

- over 60% of small firms are subcontractors

- 2000 listed companies account for 45% of GNP

- "Competitive Compulsion" lends weight to company actions

- Steel and Electronics Chains account for over 80% of exports and FDI

- The globally successful firms set the competitive agenda especially abroad
COMPETITIVE CULTURE

Top management is still wedded to

Long-term employment and corporate survival by process innovation, cost improvement, and price declines

as well as

CHASING GROWTH AND GLOBAL SHARE IN EMERGING MARKETS WITH FDI TO SECURE TECHNOLOGY AND MARKETS

since world market manufactured goods is growing faster than US or Japanese markets.
COMPETITIVE DYNAMICS

This is part of a worldwide system that reduces prices and increases production.

Asian FDI is part of strategy to maintain position as low cost global producer while preempting growth and competition in those countries. But FDI shifts with changes in growth and exchange rates. This can and has affected trade and capital accounts.

Success FDI has weakened yen while contributing to Asian boom and bust with dramatic investment swings.
THE BUBBLE ECONOMY

This scenario has been made more complex by the congruence and collapse of the Bubble economy. However, it is useful to recall the Bubble is an outcome of the success of these strategies.

Trade surplus, increased liquidity and financial liberalization of 1980s combined with the impact of yen appreciation on large portfolio investors who turned inward after 1985 due to large foreign exchange losses to create

- asset inflation
- over-investment
- FDI stimulus
It is useful to recall contributing factors:

- Domestic market saturation

- Strong dollar and oil bust


- Portfolio investors over cycled surplus leading to interactive effects weak yen, trade surplus, lower yen rates, yen/$ interest differentials, and capital flows which was sharply reversed with yen appreciation.

- Banks capital was deleveraged while asset loans lost value due market drop of over 60%, or more than $2 trillion. Capital problem and bad loans have grown worse over time
GAINERS AND LOSERS

Losers are arguably:

- Banks: due to loan loses, decrease in capital, and weaker relationship with major customers;

- Other lenders and investors due to loan losses and decrease in value of real estate and portfolio assets;

- Securities firms due to market crash and affect on reputation;

- MOF due to loss of credibility from mismanagement of crises, scandals, and economic aftermath;

- Politicians and especially LDP due to scandals and demand political reform.
Gainers appear to be large multinational firms who through redistribution of power and assets have:

- Gained financial independence with access to global financial markets and Yen 50 trillion raised in cheap equity;

- Increased power relative to bureaucracy and politicians;

- Reduced influence of banks and large lenders while improving their own financial sophistication;

- Achieved more experience, freedom and resources to pursue overseas strategies and interests;

- Modernized plant and equipment, improved technology, and expanded their global reach through FDI;

- Recovered economically while maintaining or expanding global market share.
Outlook Rest 1990s and Beyond

Internationally, Japan’s influence will be defined primarily by MNCs pursuing global market share.

Domestically, the economy will not grow rapidly, probably three percent or less:

- Domestic demand for many products is saturated while many industries are mature
- Competitive advantage is migrating to other countries while potential yen appreciation continues
- The labor force is not expanding and productivity increases in services may be structurally difficult
- Fiscal and monetary policies on balance will be conservative
- Firms thus seek growth abroad while economy undergoes major structural change, focusing politics at home.
SUMMARY ASIA IMPACT

Relatively strengthened leading Japanese MNCs will set agenda based on export globalization and FDI

This will affect other Asian countries: trade, capital flows, exchange rates, interest rates, and fiscal & monetary policies

Conflicts within government and among ministries limits “national initiatives” or Japan as growth engine for Asia

Japanese banks targeted Asia for growth but now must retrench domestically and overseas

Recent devaluations will shift FDI towards Asia if yen appreciates due reflection stock and real estate markets
ROLE CHINA

Devaluation 1994 response success of Japanese FDI strategy shifting exports to lower cost Asian countries

China needs exports to grow and support inefficient state firms

This then made other Asian countries less competitive and reduced incentives FDI Japan and elsewhere

Thus source economic pressures on wages, real estate and stock markets reduced

Depreciation yen due Bubble and success FDI strategy led appreciation of “tied” currencies which became overvalued

Reduction FDI and export growth led asset deflation and sequential economic collapse, affecting employment and politics

Competitive devaluation a legitimate US and Japanese policy concern
THAILAND

As most heavily dependent Japanese FDI along with Japanese bank loans perhaps not surprising first collapse

Rapid collapse stock and real estate values coupled substantial currency devaluation

Dollar borrowing and currency stability compound problem compared US or Japan who only owe dollars or is net creditor

First of IMF bailout packages

Role Japan and Japanese companies
KOREA

Larger and more complex due:

- Larger economy, population
- State ownership and very weak banks
- Role chaebols and intrachaebol lending
- Limited foreign ownership
- Difficulty establishing “value”
- Relatively closed economy
- Size of Economy
- Dollar debts coupled large devaluation
- Second IMF package
- Union support an important issue

Politics however moving right direction combined security interests US and Japan. Also some manufacturing very efficient
INDONESIA

Arguably worst situation:

- Large economy and very large population

- Bad politics

- Limited security interests US and Japan

- Bad oil market, exacerbated by Asian economic weakness

- Difficulties arranging and implementing IMF package

- Inefficient manufacturing sector and weakness banks compound problem
There are three key interrelated trends driving the current situation and especially its Asian connection:

Large Firms' Administrative Heritage and Foreign Direct Investment

The "Bubble", its Aftermath and the current Asian Financial Crisis

An Aging Economy and Population
Administrative Heritage

Leading firms have a disproportionate and leveraged influence on the economy:

- keiretsu relationships

- over 60% of small firms are subcontractors

- 2000 listed companies account for 45% of GNP

- "Competitive Compulsion" lends weight to company actions

- Steel and Electronics Chains account for over 80% of exports and FDI

- The globally successful firms set the competitive agenda especially abroad
COMPETITIVE CULTURE

Top management is still wedded to

Long-term employment and corporate survival by process innovation, cost improvement, and price declines

as well as

Chasing growth and Global Share in emerging markets with FDI a way to secure technology and market share

since world market for manufactured goods is growing faster than US or Japanese markets.
COMPETITIVE DYNAMICS

This is part of a worldwide system that reduces prices and increases production.

Asian FDI is part of strategy to maintain position as low cost global producer while preempting growth and competition in those countries. But FDI shifts with changes in growth and exchange rates. This can and has affected trade and capital accounts.

Success FDI weakened yen while contributing to Asian boom and bust and dramatic investment swings
THE BUBBLE ECONOMY

This scenario has been made more complex by the congruence and collapse of the Bubble economy. However, it is useful to recall the Bubble is an outcome of the success of these strategies.

Trade surplus, increased liquidity and financial liberalization of 1980s combined with the impact of yen appreciation on large portfolio investors who turned inward after 1985 due to large foreign exchange losses to create

asset inflation

over investment

FDI stimulus
It is useful to recall contributing factors:

- Domestic market saturation

- Strong dollar and oil bust


- Portfolio investors over cycled surplus leading to interactive effects weak yen, trade surplus, lower yen rates, yen/$ interest differentials, and capital flows which was sharply reversed with yen appreciation.

Though increased supply of assets due to financial liberalization and large futures markets limits any bubble repeat, it does not limit sharp reversal value yen linked to stock market recovery.

Initial political and financial scandals were exacerbated by market fall and interplay
futures; this continues

Banks capital was deleveraged while asset loans lost value due market drop of over 60%, or more than $2 trillion. Capital problem and bad loans have grown worse over time

This has resulted loss credibility and influence of government (LDP and bureaucracy) as traditional monetary and fiscal policies have failed reflate the economy or asset values

Thus even with potential stock market rebound interest rates will remain low despite continued budget deficits
GAINERS AND LOSERS

Losers are arguably:

- Banks: due to loan loses, decrease in capital, and weaker relationship with major customers;

- Other lenders and investors due to loan losses and decrease in value of real estate and portfolio assets;

- Securities firms due to market crash and affect on reputation;

- MOF due to loss of credibility from mismanagement of crises, scandals, and economic aftermath;

- Politicians and especially LDP due to scandals and demand political reform.
Gainers appear to be large multinational firms who through redistribution of power and assets have:

- Gained financial independence with access to global financial markets and Yen 50 trillion raised in cheap equity;
- Increased power relative to bureaucracy and politicians;
- Reduced influence of banks and large lenders while improving their own financial sophistication;
- Achieved more experience, freedom and resources to pursue overseas strategies and interests;
- Modernized plant and equipment, improved technology, and expanded their global reach through FDI;
- Recovered economically while maintaining or expanding global market share.
Outlook Rest 1990s and Beyond

Internationally, it will be defined primarily by MNCs pursuing global market share.

Domestically, the economy will not grow rapidly, probably three percent or less:

- Domestic demand for many products is saturated while many industries are mature

- Competitive advantage is migrating to other countries while potential yen appreciation continues

- The labor force is not expanding and productivity increases in services may be structurally difficult

- Fiscal and monetary policies on balance will be conservative

This is why firms seek growth abroad while economy undergoes major structural change focusing political energies at home.
At same time, current economic success may mean will see stock as undervalued by Japanese investors. Stock buyback legislation combined with option incentives and large cash positions will thus lead share purchases which could stimulate market and retention funds in Japan. Given large trade surplus, shift in capital account could lead rapid yen appreciation.
In Japan, growth and prosperity have dramatically increased life expectancies while population growth has decreased.

So Japan is aging very rapidly and Japan's Elderly will Double in 25 Years or nearly twice as fast as any advanced country increasing firm and government pension and medical cost burden. Another reason for FDI and seeking growth abroad that increases resource competition with government.

i.e. government needs domestically will conflict with company needs globally.
In sum there is a growing divergence between corporate and national objectives,

while there are limits to the transfer payment burden without affecting incentives to work or consumption

as can be seen in the recent consumption tax fiasco. This argues for continued budget deficits.
SUMMARIZING

What has happened in the 1980 and 90s has apparently:

- Relatively strengthened leading Japanese MNCs

- Encouraging and helping them to extend their global reach via globalization of exports and FDI

Their global growth and organizational interests contribute to the domestic political vacuum where paradoxically their influence will increase while affecting other Asian countries: trade, capital flows, exchange rates, interest rates, and fiscal & monetary policies
In addition many traditional policies are in disarray

- Wave of future biotech and computers: traditional promotional policies have failed and foreign presence increased

- Software and finance trapped by history

- There are conflicts within government and among ministries

- Political instability and jockeying among parties and factions continue

- Corporate interests are global while politics is more parochial due aging

- Preservation and protection industries and employment have led managed competition not "creative destruction"

- Gap pension returns and obligations combined Big Bang is forcing restructuring asset management business

- Government must tap postal savings system and revise tax code to reflate real estate values and revive banking sector