

REGIONAL APPROACH TO THE FINANCIAL AND ECONOMIC GLOBALIZATION

ASEAN'S RESPONSE TO THE CRISIS

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WHAT is the cause of the crisis?

What caused the East Asian financial panics and economic crisis? Several kinds of causes have been pointed out as the main factors, which led the East Asian financial panics and economic crisis. At the regional and national level, inadequacy and immaturity of banking and financial sectors in the region are assumed to be main causes of the crisis. At the external level, there are certain causes, namely, the speculative money flow in a massive scale utilizing the world-wide linking cyber net, and therefore the lack of effective international financial architecture and organization which moderately regulate and govern the massive global short-term capital flow.

However the underdevelopment of domestic banking and financial sectors itself is one of common characteristics of most developing economies, not confined to the case of these East Asian economies. Speculative financial move and the lack of any proper regulating measures and authority on the short-term financial flow are also common environmental conditions to most developing countries.

What has invited the financial crisis to the East Asian economies is summarized into two basic factors: historically unprecedented rapid economic growth of East Asian economies and premature and haste financial liberalization in these economies.

The lasting rapid growth over more than the last three decades of the East Asian economies can be achieved through region-wide trade interdependence and production linkage. Given the international absorbing market like the United States during these decades and the foreign direct investment inflows from Japan and the Asian NIEs particularly since the late 1980s, ASEAN economies can mobilize their economic resources into establishing industrial production bases supplying for the both domestic and overseas market. ASEAN's investment needs in the manufacturing sector and infrastructure construction are always beyond their savings. They must keep sizable investment inflows from advanced and newly industrializing economies. However China has emerged as a competitor in the international financial market as a promising investment object since 1980s. The development investment flow into ASEAN region was stagnant and rather diminishing in 1990s.

ASEAN economies had faced to the pressed demand for securing the comparative advantage in alluring international financial resources in order to compete with the other Asian and emerging economies. ASEAN had decided to launch to establish the ASEAN Free Trade Area (AFTA), which should introduce further serious competition among the member-countries. ASEAN countries initiated to liberalize financial and capital market while promoting industrial investment through further liberalization in industries from the late 1980s and the early 1990s. They shifted relatively the source of investment resources from the FDI (foreign direct investment) and long-term financial credits to short-term borrowing.

However because of premature liberalization of domestic finance and banking, the sizable capital flow into the private sector and stock market was not invested efficiently and productively.

Open Developmentalism: East Asian political economic system

The East Asian rapid growth experience over the previous more-than three decades has been sustained by the specific type of political economic regime, which is called as 'developmentalism' by Y. Murakami. 'Developmentalism' can be defined as follows¹ :

Developmentalism is an economic system which adopts the private ownership system and market economy as its own basic framework, and it aims primarily at the attainment of industrialization and from a long-run perspective allows the government intervention in the market system as far as its making for the aim of industrialization, ... there is often the case in which the parliamentary democracy is restricted under monarchism or mono-party dictating system or military administration.

This concept of developmentalism belongs to the late-comer's or catching-up policy and theory of industrialization, or the nationalist view and policy on the development which is classically found in the German historical school. In particular Japan's development experience represents the most influential and successful model of developmentalism for the East Asian countries..

Although there can be no fixed model of developmentalism, Prof. Murakami summarize the essential factors of the policy framework of prototype developmentalism, which is derived from Japan's and East Asians' experiences. The following six essential elements show that developmentalism, as a systematic set of policies, consists of three-classified factors, as it were, industrial policies, distribution policies, and 'invisible social infrastructures:

- (1) principle of market competition based on private ownership: principle of Capitalism
- (2) adoption of industrial policy by the government: the government as a judge and arbitrator sets a guided price to foster a newly promising industry which is to be a diminishing marginal cost industry, and promotes the technology transfer and development.
- (3) export-oriented manufacturing industry is included in the above promising industry.
- (4) attaching importance to the small and medium industries
(the above four policies are belong to industrial policies in a narrow sense)
- (5) fostering domestic demand mainly consisting of mass consumption by making distribution more equal
- (6) making farm-land distribution more equal as a supplement policy to an equalization of distribution
(the above two are distribution policies, which are united with industrial policies)
- (7) providing an education system of elementary and secondary level at least
- (8) founding a fair and capable modern bureaucracy system beyond nepotism
(the above two are invisible social infrastructures)

ASEAN's and the NIEs' development experiences are regarded as a mixture model of 'developmentalism' and that of open economy depending strongly on international trade and investment, which can be called as 'open developmentalism'. Open developmentalist model, which is developmentalism based on the international trade and financial market, is very effective in pursuing a rapid growth. However the developing model easily become to be vulnerable and invalid if the international monetary and financial system comes into disorder and instability, which would hamper export-oriented industrialization, and if the national bureaucrats cannot be capable to manage macro- and micro- economic policies. The exchange rate system, whether it is a fixed system or floating system, is always exposed to the threat

caused by the speculative attacks.

2. Difference in attitudes and principles between international financial institutions, multinationals, and LDC governments

It would be significant to recognize the behavioral and attitudinal difference between the economic entities, namely, international financial institutions, transnational corporations, and governments of LDCs (see Table). When we see from the side of LDC's government, international safeguards are required. The scale of LDC economy is mostly small and vulnerable compare to the available amount of financial resources operated by the strategic alliance of international financial institutions. The present international institution, the IMF cannot provide sufficient stability of international monetary and financial system. As one of possible and potential ways to prevent the currency turmoil and its contagion, region-based approach can be worth to pursue while making the IMF system improved. ??

Table : Behavioral and attitudinal difference between international financial institutions, multinationals, and LDC governments

	International Financial institution	Foreign Direct Investment by MNCs	LDC economies
Agent	Hedge Fund (Highly leveraged institution), Commercial Bank, Mutual Fund	Multinationals of Advanced economies and NIEs	Government, local public and private companies
Space of activity	Global, information network (cyber-space)	Global and regional	Local, regional and global
Span of target	Short-term	Medium- and Long-term	Long-term
Motivation	Pecuniary and Arbitrage profit	Productive profit, Optimal international utilization of productive resources	Growth, industrialization and stability of national economy, Eradication and alleviation of poverty
Characteristics	Speculative, Opportunistic, Rapid come-in and withdrawal Neglect on local economic development	Cooperative operation with local governments and Trans-border location of production bases	Vulnerable to external influences and shocks, defective and immature in organizational system

ASEAN's response to the crisis

Contagious diffusion of the financial panic among the ASEAN economies shows that the financial and capital market has regarded the ASEAN economies as almost in all and commonly suffering from the roughly alike financial, economic, and social deficiencies.

ASEAN countries have been making the effort to promote their economic development especially in the area of industry, trade and infrastructure under the government-led developmentalist regime. In the regional level ASEAN regional integration policies and measures have been developed and adopted in order to facilitate intra-regional trade and investment. However the regional cooperation in financial area has been lagging behind and neglected before the outbreak of this financial crisis. However ASEAN had started to lay

down the framework for strengthening cooperation in financial areas just before the Asian Financial crisis happened. It is on 1 March 1997 that the First ASEAN Financial Ministers Meeting (AMMF) was held in Phuket

ASEAN Vision 2020

In the midst of the crisis, ASEAN countries struggled to escape from the economic, political and social turbulence collectively as well as individually. The Second ASEAN Informal Summit, held in Kuala Lumpur on 15 December 1997, adopted the ASEAN Vision 2020 which provides a ASEAN's broad vision towards the year 2020². That vision is of ASEAN as: (i) a concert of Southeast Asian nations, (ii) a partnership in dynamic development, (iii) a community of caring societies, (iv) an outward-looking ASEAN.

ASEAN's position on the reform of the international financial architecture

The third ASEAN Finance Ministers Meeting held in Hanoi on March 1998 agreed the ASEAN's common stand on the required elements in the process of reforming the international financial architecture.³ These elements are : (i) the global effort to resolve the crisis must recognize the diverse circumstances and priorities of individual economies at different stages of development. (ii) the reform of the international financial architecture must involve the participation of all countries, including the emerging economies. (iii) ASEAN shall adopt a more proactive role at various international arena to ensure to incorporate ASEAN's interests and priorities in any proposal to reform the international financial architecture. (iv) the efforts of any international reform must accounts for the measures to protect the poor and most vulnerable segments of society. (v) measures to strengthen the international architecture would need to include a review of the role of the international financial institutions, as well as the international regulatory bodies. (vi) appropriate mechanisms are needed to enhance greater private sector participation in crisis management and resolution. (vii) standards of transparency and disclosure must be applied equally to the public and private sectors, particularly including highly leveraged institutions. (viii) given the important role that credit rating agencies play in the international financial markets, there should be greater transparency in the rating process. (ix) there should be global agreement on the disclosure requirements for short-term capital flows and closer collaboration and information-sharing among national and international regulators. (x) to complement the ASEAN Surveillance Process, we shall explore options to regional support activities. (xi) we support an orderly and well-sequenced approach to capital account liberalization in tandem with the degree of development of the domestic financial sector and supervisory regime. (xii) we recognize that sound, consistent and credible macroeconomic policies are fundamental the stability of any exchange rate regime. We also believe that there is no single exchange rate regime and , therefore, that countries have a right to choose their own exchange rate regime based on their national objectives and priorities.

These above elements reflect obviously the position and stance of ASEAN countries. ASEAN had launched into engage itself to establish intra-regional surveillance system and commit to build a new international financial architecture as well.

ASEAN Surveillance Process

Since the first meeting of Financial Ministers several bodies have been established to support the AMMF process and promote ASEAN financial cooperation.

What should be noted is that the ASEAN Surveillance Process (ASP) has been formally established at the Special Meeting of the ASEAN Finance Ministers on 4 October 1998. The ASP involves peer review process and frank exchange of views on important finance matters. The ASP is supported by the ASEAN Surveillance Coordinating Unit (ASCU) based at the ASEAN Secretariat in Jakarta and the ASEAN Surveillance Technical Support Unit (ASTSU) assisted by the Asian Development Bank (ADB). ASEAN has also initiated a process of monitoring short-term capital and

macroeconomic indicators through the ASP.

Hanoi Plan of Action

The Hanoi Plan of Action (HPA) is drawn up to realize the goals of the ASEAN Vision 2020, which has a six-year timeframe covering the period from 1999 to 2004, and shall be reviewed on its implementation every three years at the ASEAN Summit Meeting⁵. The HPA consists of the ten measures. Those are: (i) strengthen macroeconomic and financial co-operation, (ii) enhance greater economic integration, (iii) promote science and technology development and develop information technology infrastructure, (iv) promote social development and address the social impact of the financial and economic crisis, (v) promote human resource development, (vi) protect the environment and promote sustainable development, (vii) strengthen regional peace and security, (viii) enhance ASEAN's role as an effective force for peace, justice, and moderation in the Asia-pacific and in the world, (ix) promote ASEAN awareness and its standing in the international community, (x) improve ASEAN's structures and mechanisms.

Statement of Bold Measures

Besides the above medium-term plan of action toward the ASEAN Vision 2020, ASEAN leaders agreed upon the concrete set of 'bold measures' to retrieve business confidence, facilitate economic recovery and growth⁶. First, ASEAN decides to accelerate the process of the AFTA (ASEAN Free Trade Area). The six original signatories to the Agreement of the CEPT scheme for the AFTA would advance the establishment of ASEAN Free Trade Area by one year from 2003 to 2002. They also agreed to achieve a minimum of 90 % of their total tariff lines with tariffs of 0~5% by the year 2000. Second, ASEAN countries individually would take short-term measures to attract investments into the region. For example, Indonesia offers wholesale and retail trade up to 100% foreign equity ownership to qualified investors. Malaysia allows 100% foreign equity ownership in all areas of manufacturing excepts for 7 specific activities/ products. Thailand will allow 100% foreign equity ownership for manufacturing investment projects. Third, The exclusions under the Framework Agreement on the AIA (ASEAN Investment Area) signed on 7 October 1998 will be progressively phased out by 2003 instead of 2015. Fourth, ASEAN agreed to waive the national-equity equipment of 30% for investment under the AICO (ASEAN Industrial Cooperation) scheme during the period 1999-2000. Lastly ASEAN leaders have agreed to initiate a new round of negotiations on the trade liberalization of services beginning 1999 and ending 2001. The negotiations will be expanded to cover all services sectors and all modes of supply.

Consequently the Asian financial and economic crisis has worked not to hamper but to accelerate the process of regional integration of ASEAN. The above ASEAN's responses to the crisis would be almost all that ASEAN as the regional organization can do. However, as ASEAN recognizes, the Asian financial crisis cannot be disposal of by ASEAN solely. A wider regional and global approach should be required to establish a new international financial architecture.

Conclusion: Establishing a Regional financial Architecture

As discussed the previous section, developing economies, which intend to develop domestic production base and create employment opportunity, have to invite the inflow of foreign financial resources including the foreign direct investment while raising or keeping the domestic saving ratio. However monetary and financial liberalization is inevitably accompanied with further involvement into the global financial market. In a globalization process of domestic economy, the efficiency and capability of domestic financial system are of great importance. As in the case of most developing economies, domestic financial system remains immature and far from efficient and proper one.

Governments of developing economies can manage industrialization process through trade and direct investment liberalization under the developmentalist regime. However financial liberalization and development is beyond management ability of a developing country. In the

process of financial liberalization developing economy with premature financial system has become easily to be over-borrowing from the external private **financial institutions and to be exposed to the international financial speculative attacks.**

How is it possible that developing economies can avoid the direct speculative attack on their currencies under the liberalized regime of international trade and finance, and that developing economies can secure their long-term target of developing national production basis? One of solutions is to establish a regional financial architecture and institution.

Asian Monetary Fund

In September 1997, Japan proposed the establishment of an Asian Monetary Fund (AMF) with an amount of 100 US billion dollars funded by Asian economies, namely, Japan, China, Singapore, and Taiwan. The AMF would be expected to have an effect and function to forestall speculative attacks on the region's currencies. However, despite of Malaysia's strong support, the proposal was turned down at the fifth Asia-Pacific Economic Cooperation meeting in Manila. The United States and the IMF opposed to the idea of a new regional fund for mainly two reasons: financial support without any conditions attached would lead moral hazard, and there would be potential conflict and lack of coordination between the both funds.

A regional financial architecture like the AMF, nonetheless, should be established because of the following several reasons: First, financial and currency crisis have fast and strong spillover effects.⁷ Financial instability of a regional country easily spreads contagiously over its neighbors even if the neighbors' economies have no pressing fault in fundamental conditions. Second, given the contagion effects of financial crisis on region-wide economy, regional financial architecture and surveillance system, which can provide early warning of impending problems to the regional economies and make them to take necessary actions through peer pressures, would be needed. Third, given informational advantage and economic intra-regional interdependence, a regional financial institution would likely be more receptive to its regional crisis than a global institution. Lastly, the IMF could not initially provide a sufficient amount of resources to head off the Asian crisis contagion. A regional financial institution equipped with a certain amount of resources on a permanent base could provide a line of defense.

Japan's New Initiative

Japan proposed a new way supporting Asian recovering process in October 1998, so-called 'New Miyazawa Initiative'⁸. In the New Initiative, Japan's government stands ready to provide a package of support measures totaling US\$30 billion available for the medium- to long-term financial needs for economic recovery, and possible short-term capital needs during the process of implementing economic reform. Japan also proposed 'Resource Mobilization Plan for Asia', which focuses on assistance measures to the market, including: (i) providing assistance to mobilize, a total amount of up to \2 trillion of domestic and foreign private-sector funds for Asia, (ii) promoting the influx of good-quality funding (long-term funding denominated in Asian currencies) from outside the region and to build up a stable financial system, (iii) upgrading and fostering of Asian bond markets with sufficient volume as part of the efforts toward establishing a stable financial system in the region, (iv) vitalizing the Tokyo market through promoting the issuance of the Samurai bonds and upgrading the government bond markets and settlement systems.

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- ² ASEAN Secretariat, *ASEAN VISION 2020*, <http://www.aseansec.org/summit/>
- ³ ASEAN Secretariat, *ASEAN's Position on the Reform of the International Financial Architecture*, <http://www.aseansec.org/>
- ⁴ These bodies are: (i) ASEAN Senior Finance Officials Meetings (ASFOM), (ii) ASEAN Select Committee (comprising representatives from ASFOM and ASEAN Central Banks), (iii) ASEAN Insurance Regulators Meeting (AIRM), (iv) Working Group of the ASEAN Senior Finance Officials Meetings (ASFOMWG), (v) Working Group of ASEAN Select Committee, (vi) ASEAN Central Banking Forum (ACBF). At the Third AFMM, the Ministers agreed to integrate the ASMOF and Selected Committee into one body as ASEAN Financial and Central Bank Deputies Meeting. See ASEAN secretariat, *ASEAN Financial Cooperation*, <http://www.aseansec.org/economic>
- ⁵ ASEAN Secretariat, *Hanoi Plan of Action*, <http://www.aseansec.org/summit/>
- ⁶ ASEAN Secretariat, *Statement on Bold Measures*, http://www.aseansec.org/economic/invest/sum_bold.htm
- ⁷ See M.G. Quibria, *The Case for an Asian Fund, Asia week, 25 June 1999*, <http://pathfinder.com/asiaweek>, and also ADB, *Asian Development Outlook 1999. p.44*
- ⁸ <http://www.mof.go.jp/english/if/sien.htm>
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