Emerging from Crisis: The Beginnings of a New Asia

Prepared remarks of
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Thank you for giving me this opportunity to discuss the seismic changes under way in Asia and what they will mean for the United States.

It is now a little more than seven months since the troubles in Asia first hit the newsstands, with the July 2nd devaluation of the Thai currency. Since that first day the United States has been intensely focused on finding the right way to restore stability to the region: the right way for American workers and businesses, the right way for Asia, and the right way for the global economy. These economies have a long way to go before stability and long-term growth are restored for good. But in many of them, we can at least say that the core elements of a resolution are starting to fall into place.

I will spend a little time today describing the United States’ stake in a successful end to these crises. But my main focus will be on Asia – and the opportunity that these crises afford to put Asian finance on a firmer long-term footing.

I. Our Stake in Restoring Stability

In an interconnected world, a threat to the growth and stability of Asia is a threat to our own: to American workers’ wages, their savings and their security.

Nearly one third of our exports go to Asia: more than we send to Europe. California, Oregon and other Western states are even more exposed, with more than half of their exports going to Asia. Already, major Fortune 500 companies such as 3M, Boeing and Motorola have felt the impact of the crises in Asia in reduced export orders that will translate into fewer new high-paying jobs, and smaller pay checks for American workers.

It says something about this new global economy that USA Today now reports every morning on the day’s events in Asian markets. Americans have roughly 2.5 trillion dollars in portfolio investments overseas. Most important of all, the fate of our investments in markets at home is increasingly linked to events in markets elsewhere. Federal Reserve figures reported yesterday suggest that Americans now have nearly 30 percent of their assets invested in the stock market – more than they have invested in their homes, and more than at any time since records began. Prolonged instability in Asian and other markets stands to have a direct impact on those assets – and a direct impact on everything from investment in tools and equipment for workers to mortgages for new homes.

Finally, we have a core national security stake in resolving these crises because a prolonged financial crisis threatens the stability of a strategically vital region with a bloody past. We have 100,000 troops based in Asia, 37,000 on the Korean
peninsula alone, and history shows well enough the scope for financial
instability
to trigger broader conflicts.

In short, as Secretary Rubin has said, we have acted to help restore stability in
Asia for a clear purpose: to protect and benefit the American people.

II. Systemic Roots of the Crisis

While there are enormous differences between these economies and it is easy to
over-generalize, I think it is fair to say that there have been a number of
common features of the economic and financial approach pursued by many Asian
countries in what has historically been a tremendously positive period. It is an
approach, in many respects, that tracks the postwar economic success of
Japan.

This "Asian" approach to finance was built on the fundamentals – on high
savings, high levels of education and hard work. But it was also an approach that
favored centralized coordination of activity over decentralized market
incentives. Governments targeted particular industries, promoted selected
exports, and protected domestic industry. There was a reliance on debt rather
than equity, relationship-driven finance not capital markets, and informal rather
than formal enforcement mechanisms.

While this model has had important and profound successes – and while the
performance of Asia has been truly spectacular – it is a difficult question of
interpretation how much is due to the strong universal fundamentals of high
savings and education and how much due to particular practices distinct to Asia.
Even before the onset of the recent financial problems a reassessment was
under way from a number of quarters:

Japan's disappointing economic performance had led to plans for a
"Big Bang" liberalization of the Japanese financial sector and repeated
calls for deregulation of goods and services.

prominent Korean observer Kim Dae Jung – who is now, of course,
the President-Elect – had published books and articles calling for
wholesale reform of the Korean economic system: for an end to
government-directed lending to industry, for the promotion of
non-inflationary macroeconomic policies, for reforming the chaebol,
and for opening up the financial system.

respected academic studies of Asia's growth record – by economists
such as Paul Krugman, Alwyn Young, and others – began to suggest
that the miraculous growth of Asia might owe rather little to sustained
growth in productivity and a great deal more to rapid accumulation of
labor and capital.

Concerns about the distinct features of these markets began to be
raised more forcefully by their trading partners. In Korea, for example,
the close and preferential relationship between the chaebols, the
banks and the government – and resulting poor market access and
excess capacity – has been a mounting source of friction with the
United States.

These longer term issues were conflated, in recent years, with a set of shorter
term problems of macroeconomic management: the maintenance of mutually
inconsistent monetary policy and exchange rate regimes; excess inflows of
private capital channeled into unproductive investments; substantially reduced
competitiveness; significant failures of debt management that led to
unsustainable quantities of short-term debt. All of these elements -- short- and
long-term -- came together to produce these crises, and were then reinforced
by lack of market confidence so as to set up a situation with many of the
features of a bank run.

It is important to recognize that this is a distinct kind of crisis. It has a common
element with almost all financial crises: money borrowed in excess and used
badly. But it is also profoundly different because it does not have its roots in
improvidence: excessive budget deficits, excess rates of inflation or insufficient
rates of saving.

The recognition that reform and renewal is essential to shaping effective
economic policy -- both in countries with major IMF reform programs and in
other important economies of the region. Relative to nearly all of the crises we
have seen in recent years, the problems that must be fixed are much more
microeconomic than macroeconomic, and involve the private sector more and
the public sector less.

III. The Challenge of Reform

The critical challenge of reform programs in all these economies is to create an
environment that is conducive to private investment. This means:

not just restructuring the financial system, but laying the ground for a
new one – one in which lenders can trust in transparent and
independent financial supervision and regulation and effective
bankruptcy laws, work-out procedures and other formal means of
enforcement
not just corporate debt work-outs, but system-wide changes with improved financial and corporate accounting standards and better disclosure to put corporate governance on a solid footing and assure shareholders their interests will be protected.

not just an end to government-directed lending, but wholesale market opening and deregulation to increase the power of market incentives and reduce the scope for official rent-seeking and corruption – to build a system, in short, which rewards hard work not hard graft, and settles disputes in the courts not the palace.

The IMF programs in Thailand, Korea and Indonesia commit these governments to taking dramatic steps toward this kind of systemic reform. To state just one example: by June the Indonesian government is pledged to abolish a dozen officially sanctioned monopolies that have dominated a whole swathes of the economy for decades – including every pad of paper sold in country, every piece of timber, and every sack of flour.

These changes are important with respect to both Asia's shorter and longer term imperatives: they will increase confidence and attract private capital in the short run. And they address the longer term problem of allocating capital on a more market-oriented basis. They are also important for the international community because a more market-oriented Asia will be a better trading partner, better able to grow and finance our imports and less likely to distort markets with excess capacity, excess concentration of industry and selective protection.

III. The Regional Underpinnings for Growth

An important aspect of this crisis is its regional dimension. Disturbances are transmitted from country to country and market to market in several ways. That makes each link of the chain important. All of the economies of the Asia-Pacific need to respond to the crises by pursuing sound policies aimed at promoting their shared interest in sound finance and solid growth.

The two dominant economies of Asia, China and Japan, have a special role to play in contributing to a resolution of the current crisis.

When we talked recently with Zhu Rhongji, the Chinese Vice Premier, in Beijing we were happy to hear him reaffirm China's commitment to a stable exchange rate, and to implementing long-needed reforms in China's own, debt-laden state financial system. He clearly recognizes the importance to regional financial stability of exchange rate stability in China.

Japan has played an important role in helping catalyze the international response.
to the Asian crisis, and has made a substantial financial commitment to the countries in crisis. But as Anwar Ibrahim, the Deputy Prime Minister of Malaysia, recognized earlier this week, the most important contribution Japan could make to the restoration of stability and growth in Asia is to take the steps necessary to strengthen domestic demand, deregulate its economy and open it up to imports, and resolve its financial problems.

The Prime Minister took important steps late last year to cut taxes and increase expenditures. But these were modest steps. Even by the Japanese government's estimates, they still leave Japanese fiscal policy contractionary for FY1998. And as a result, confidence in the outlook for the Japanese economy has deteriorated since these steps were announced.

Over the last several weeks there have been encouraging signals from some ruling party politicians and some officials that additional fiscal measures may be forthcoming soon. This has been well received by the financial markets, but virtual policy is not enough. Substantial, early additional fiscal action is critically important, not just for Japan, but for the region as a whole.

Japan has outlined some proposals to help shore up its banking system. The most important and constructive of these is the proposal to put more public money behind the government's guarantee of deposits in the banking system. Many of the other proposals are still not well defined. How they are defined and implemented will be important, for most of the established experience in confronting these problems suggests that the ultimate success of the strategy will depend on the degree to which the approach focuses on a number of critical goals:

- on providing clear and transparent rules for the use of public money
- on instilling confidence among depositors, not protecting managers
- on strengthening viable banks, not propping up weak ones
- and, finally, on attaching clear conditions on the receipt of money, so shareholders bear their fair share of the burden.

IV. The Reforms Ahead: Not a Bail-out But a Beginning

I have tried to make clear the stake the United States has in a successful outcome in Asia. And I have tried to make clear the approach we are supporting. A central part of political debate involves support for the IMF, which has played a large role in financing these programs.
In considering the merits of support for the IMF it is useful to recall what would happen on these occasions if there were no IMF: there would be no conditioned reform; there would be no internationally recognized source of apolitical advice; there would be further devaluations and greater reductions in these countries' capacity to purchase our goods; there would be more pressure on the United States to act unilaterally with taxpayer resources.

We might have a different debate if IMF imposed a real cost on American taxpayers, but the crucial thing to recognize is that it does not. Appropriations for the IMF are scored as a zero net cost to the budget. It is difficult to know what the impact of the Asian financial crisis will be on the United States economy, but if it is one half of one percent of GDP, as many observers suggest, this would translate directly into higher budget deficits over the next two years.

By contrast, through fifty years of bipartisan support for the IMF has not cost the American taxpayer one cent, because it has not had a major default, and because its lending is backed by very substantial gold reserves. The IMF presently has $65 billion in loans outstanding – and fully $40 billion in reserves. It operates much like an international credit union. We and other countries provide a line of credit, and when the IMF draws on our commitments, we receive a liquid, interest bearing offsetting claim on the IMF. That is why there are no direct budget costs. That is why our contribution does not increase the deficit, or impact other spending priorities.

There are legitimate questions that are debated within the IMF about how these programs should best be handled. In the immediate response to the crises, some difficult trade-offs have to be made. In particular:

the macroeconomic aspects of these programs need to be designed to balance the imperative to prevent further declines in markets and a free-falling currency, on the one hand, and the imperative of avoiding further knocks to domestic demand, on the other.

equally, in seeking to bolster the financial system, international and domestic policy makers must weigh the long-term need to ensure investors take responsibility for their actions against the short-term necessity to prevent confidence declining further.

The IMF will not get these trade-offs right on every occasion – and nor will the officials in the countries themselves. But one thing is clear: the IMF and the governments implementing these programs are agreed on the overarching goal: the restoration of lasting and sustainable growth.

We have worked vigorously to bring about change at the IMF: by creating mechanisms for it to lend at premium rates in short-term crises to improve
borrower incentives; by increasing IMF transparency and accountability through wider publication of IMF documents and more frequent publication of the Letters of Intent for programs; by successfully insisting that the IMF focus on the need to prevent the burden of adjustment falling heavily on the poor.

There will be a need for more of these kinds of changes. But not to fund the IMF now would be a little like canceling your life insurance policy when you have already gotten sick. It is simply not a risk that we should take. Nor is it a risk Americans would want us to take – especially when we can invest in the protection by the IMF at zero cost to our budget.

Let me be clear on one final point. Our involvement in this crises is not about charity or comity with other nations: it is about a hard-headed assessment of United States interests. Being involved in supporting reform – and stabilizing financial markets – in Asia is as good an investment in the future of our economy and living standards and security of American workers as we are likely to find. Thank you.

Lawrence H. Summers was sworn into office as Deputy Secretary of the Treasury, the second-highest-ranking official at the Treasury Department, on August 11, 1995. He serves as the American deputy in the G-7 international economic cooperation process. From April 5, 1993 to August 10, 1995, he served as Under Secretary of the Treasury for International Affairs. Prior to joining the government, Summers served as vice president of development economics and chief economist of the World Bank. He was the Nathaniel Ropes Professor of Political Economy at Harvard University from 1987 to 1993 and won the John Bates Clark Medal, given every two years to the outstanding American economist under the age of 40, in 1993. He holds a B.S. degree from MIT in 1975 and a Ph.D. from Harvard in 1982.