Comment on “Asian Currency Crisis and the International Monetary Fund, 10 Years Later: Overview”

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Ito (2007) seems too ready to concede that the rapid recovery of the crisis-hit Asian economies lends support to the view that the crises were attributable largely to external forces and much less to domestic factors. The speed of recovery may have as much to do with the size of the problem as with the nature of the problem. In the East Asian case, it is true that macroeconomic fundamentals were fairly strong when the crises began to unfold. However, the key macroeconomic indicators cannot reflect the deep fault lines in the microeconomic setting. Some banks in the region had overstretched themselves with too many questionable loans, whereas many corporate entities had gone overboard on borrowed capital.

Although the details vary from country to country, the pattern seems strikingly similar. It is not an exaggeration to say that the roots of the 1997–1998 financial crisis were in corporate excesses. This does not mean that governments are absolved of any blame. The policy environment, for which the governments were solely responsible, that had encouraged corporate entities to do what they did cannot be ignored. Although fiscal management had been fairly prudent in all countries, as Ito points out, there have been serious government policy missteps. Unsustainable input-driven gross domestic product growth with huge current account imbalances financed by footloose short-term capital inflows, not to mention the unholy alliance, the government–corporate–banking trinity, were a recipe for disaster. Seen in these terms, the Asian financial crisis was essentially homegrown, with external factors playing no more than a secondary role.

The 1997–1998 Asian crisis was the result of a backlash by market forces. No open economy can escape from the wrath of international discipline when things go seriously wrong. There is no denying, however, that the Asian economies were hurt more than they deserved, simply because market forces tend to overshoot.

The role played by the International Monetary Fund (IMF) in the Asian crisis management has been the subject of much controversy. The contention that the IMF program made the crisis worse is valid only insofar as the IMF’s macroeconomic prescriptions are concerned. One-size-fits-all measures with fiscal austerity and monetary tightening caused much pain when the opposite was in order. It is noteworthy that IMF has subsequently backtracked on this. It is not difficult to surmise that the crisis would have been prolonged in the absence of IMF’s help. No one would deny that liquidity injections by the IMF were

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helpful, but the conditions attached have been severely criticized. Upon closer examination, it appears that the manner in which these conditions were imposed was more objectionable than the conditions themselves. It does appear that the IMF, totally oblivious to political sensitivities, had crossed the line arrogantly or carelessly.

It would be senseless for the IMF to lend huge sums without any conditionality, but the conditions must be realistic, relevant, and feasible. It would be counterproductive to impose too many conditions at a time when the capacity to undertake reforms is rather limited; hence, the need to prioritize the reform agenda. This is not to overlook the importance of reforms. The quick turnaround in South Korea was flattering to the IMF, as it was proof that its restructuring program could work.

Understandably, the focus of Ito (2007) is Thailand, the epicenter of the crisis, and Indonesia, the worst affected of all. Malaysia is not in Ito’s radar, except for some casual references here and there. Malaysia was left out perhaps because it did not come under the IMF program. The fact that Malaysia was the only crisis-hit country that did not seek IMF’s help makes it all the more interesting. Malaysia chose not to seek IMF’s help simply because there was no need for it, as its short-term external debts were small and reserves were more than adequate, an option that others did not have.

Upon closer scrutiny, what Malaysia had done was quite similar to what others had done, except for the exchange rate system. Malaysia opted for fiscal stimulus and easier monetary policies. So did the others after a brief fiscal and monetary tightening. Malaysia set up special-purpose vehicles to buy up bank bad loans and to re-capitalize commercial banks. So did Thailand and Indonesia. Capital controls imposed by Malaysia sounded dramatic because of the hype. Capital controls against foreign short-term capital were totally unnecessary as they were imposed 18 months after the beginning of the crisis. In any case, the controls on foreign capital outflows were short-lived and removed within a year. Malaysia was not the only country to have capital controls. Thailand also had capital controls of sorts but without hype. The only major difference was the ringgit peg, which arguably was unwarranted as it was imposed in September 1998 when all regional currencies (except the Indonesian rupiah) were already stabilizing.

Another notable omission is the regional effort in the wake of the Asian crisis. There is no reference to the currency swap arrangements, the so-called Chiang Mai Initiative. Such regional efforts might not have been much help, but were nonetheless significant as embryos of bigger things that could happen in the future. An important question not adequately addressed by Ito is whether Asia has learned anything from the crisis and if these lessons will help avoid future crises.

Reference