INTRODUCTION

The Asia-Europe Foundation (ASEF) and Centre d'Études Prospectives et d'Informations Internationales (CEPII — France's leading research centre in international economics) organised an important conference on the Asian crisis in Paris from 11–12 May 1998. It was the first initiative to create a dialogue between European and Asian economists concerning the common outlook of the two continents, following the financial crisis which struck Asia in 1997.

Emanating from the Asia-Europe Meeting (ASEM) which brings together the 15 member states of the European Union, the seven ASEAN countries (Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand and Vietnam), Japan, China and South Korea, ASEF is a foundation with the specific objective of favouring the exchange of views and dialogue between Asia and Europe. The collaboration of CEPII with ASEF, in the joint organisation of a conference, conveys the importance that CEPII accords to Asia. This is also witnessed by the numerous opinions stated by the Centre's economists in analysing and explaining the financial crisis in Asia.

It has often been said, and not without reason, that Europe was largely absent during the first developments of the crisis. Yet, future trade and financial links between Europe and Asia are of prime importance to Europe, if only because Europe is the major creditor of the region. The second ASEM summit, held in London on 3 April 1998, launched a positive political dialogue on this matter, which it is hoped will lead to concrete actions in the future. The conference organised by ASEF and CEPII thus came at precisely the right moment.

It is still too early to talk about the "aftermath" of the crisis. Nevertheless, it is useful to draw some conclusions concerning the first developments of the monetary and financial turmoil, and to reflect on better solutions for the future of the region and for its relations with Europe. To stimulate such thinking, ASEF and CEPII brought together approximately 20 top-level, Asian and European economists, who are among the foremost experts on these issues. They were drawn from international organisations (the Asian Development Bank, the World Bank, the European Investment Bank, the Bank of International Settlements and the OECD), as well as from the international financial community and academia.

Certainly, the approaches to the Asian financial crisis have been different among Asian and European economists. Our assumption is that through a confrontation of these different viewpoints, one can achieve progress towards a better understanding of the issues and to find new solutions. The present volume, which contains papers prepared for the conference, is only a first endeavour in this direction. For this reason, the lively nature of the debate and the cultural diversity have been preserved. Some papers are of an academic nature, others are more action-oriented. But all of them contribute to the debate and, as a whole, they are quite representative of the current state of the debate among economists on the causes, consequences and policy solutions of the crisis.

The analyses of the causes and the unfolding of the crisis were conducted thanks to the participation of experts from the four countries most affected: the Republic of Korea (Yung Chul Park), Indonesia (Soedradjad Djiwandono), Malaysia (Haflah Piei) and Thailand (Akranasee Narongchai). The rapid development of the financial sector had permitted growth to accelerate, as was recalled by Soedradjad Djiwandono (former Governor of the Central Bank of Indonesia). But the region's integration into the world market had also weakened its economies. Furthermore, growth in recent years has been the result of less and less efficient investment financed partly by foreign capital. Haflah Piei (Deputy Director of the Malaysian Institute for Economic Research) also underlined the fact that over the last years the total factor productivity growth in Malaysia had fallen considerably, and even became negative in

1997, hence making the growth process progressively less sustainable. Henri Matre (former CEO of Aerospatiale and Chairman of the *Club d'Information et de Réflexion sur l'Economie Mondiale* (CIREM), a club of enterprises created by CEPII to improve the understanding of world economic issues by the French business sector) indicated that the distortions created by the government had a certain responsibility in the crisis. Insufficient strictness on behalf of national authorities was also questioned, but the responsibility of the international banks, which had submerged these countries with credit prior to the crisis — even though they could not have been completely ignorant of the lack of rigour in the management and supervision of national financial systems — was widely stressed by the participants. Thus, to Akranasee Narongchai, Minister of Trade in Thailand when the crisis broke out, the instability of the system had been created, amongst other things, by excessive private capital seeking investment opportunities that were too limited and the search for high, immediate financial gains. Neil Saker (Director of the Regional Economic Research Department for SocGen Crosby in Singapore) acknowledged that the banks had a responsibility for the crisis due to their herd behaviour. He also reckoned that the banks would shoulder some of the burden of the debt restructuring operations, which are estimated to run to between US$50 and US$100 billion.

The conference also sought to clarify the measures that have already been implemented, and the progress which is still to be made both in Asia and Europe, as well as at the level of the international organisations. The role of the austerity policies implemented with the help of the International Monetary Fund (IMF) was discussed, especially by Professor Yung Chul Park (President of the Korean Institute of Finance) for whom deflationary fiscal and monetary policy is necessary to restore the confidence of foreign investors. Yet he also stressed that if there is no massive inflow of liquidity, then the restructuring of banks and companies, which alone is able to generate the confidence of foreign investors, could take years. In particular, the lack of credit facilities for international trade would be highly damaging. The need for massive and immediate liquidity inflows was stressed by numerous participants from the countries affected by the crisis, but was also underlined by Alfred Steinherr (Chief Economist at the European Investment Bank).

Generally speaking, the macroeconomic policies put in place by the IMF were widely discussed, in particular the exchange rate and capital movements policies. Alfred Steinherr condemned the choices that were imposed on the countries most affected, namely, to let their exchange rates float. Jean-Pierre Landau even felt that they should adopt a target, since stability is vital for investor confidence. However, Michael Hadjimichael (Deputy Director of the IMF in Paris) stressed that the countries were free to choose their forex systems. The IMF representative added that liberalisation of capital accounts was desirable, even if it should be progressive. In contrast, Stephanie Griffth-Jones (Professor at the University of Sussex) joined other participants to plead for the regulation of short-term capital flows, in order to limit their amplitude, by using an approach that is similar to that which has been experimented with success in Chile.

It became apparent that the different countries suffering from the crisis have experienced different rates of progress. This was linked to the capacity and the willingness of their respective governments to implement serious macroeconomic reforms, especially concerning the functioning of financial institutions. The progress recorded by Thailand and Korea has been considerably more important than that of Indonesia and, generally speaking, the changes in government which occurred during the crisis have allowed the reforms to be accelerated. This may be a positive outcome of the crisis, as it has led a number of countries to foster reform, so that the political credibility of the governments in place is now on the road to being re-established. This was pointed out by Manu Baskaran (SocGen Crosby).

But if, in principle, the outlook for long-term growth remains relatively favourable, short-term growth will be negative in the region, ranging from –1% in Malaysia to –3% in Thailand and Korea, and to –10% in Indonesia, according to Manu Baskaran. A wide range of scenarios are presently possible for the medium term, ranging from rapid recovery in a country like Korea to the persistent worries expressed by numerous economists concerning the future of Indonesia. For Jean-Michel Severino (Vice-President of the World Bank) there are three possible scenarios: the first, which is least likely to happen, is based on a return to previous growth rates within two or three years; the second is based on a political collapse accompanied by negative growth rates for at least five years; and the third, median scenario, is varied across countries and suggests a return to 5–6% growth in the medium term. Claude Martin (Deputy Secretary-General at the Ministry of Foreign Affairs) underlined the fact that growth will necessarily be self-financed, and will require a diversification of exports. Furthermore, the market-oriented approach adopted by the Southeast Asian economies will necessitate an extension of their social security systems. Whatever the outlook, Patrik Artus (Chief Economist at the *Caisse des Dépôts et Consignations*), stressed that as a result of previous low-quality investment, these countries have accumulated an unusable capital stock equivalent to one year's GDP, which will have to be purged. It must, therefore, be asked how this burden is to be shouldered by the different sectors, be they national and international or public and private. For David Vines (Professor at the University of Oxford) the fact that the crisis has not been rapidly absorbed stems from the classic co-ordination problems brought about by the presence of a large number of actors.

The conference also made possible the evaluation of past and future consequences of the crisis for international trade, investment and growth, both at the regional and global levels. The Euro-Asian debate organised by CEPII and ASEF was an occasion especially to recall the incalculable social consequences of the crisis in the region. This was stressed by numerous participants, especially François-Xavier Ortoli (Governor of ASEF), in the light of the discussions which have been launched at the political level at the ASEM summit in London. There is a major risk that the crisis will lead to a social crisis in several countries, notably Indonesia.

The ability of these countries to exit the crisis will depend on the regional context and should lead to greater, reciprocal surveillance at the level of ASEAN. This was noted by Ghon Ree (Asian Development Bank). It will also depend on the reactions of other countries in the region, primarily Japan, which is trying to revitalise its economy with Keynesian expansionary packages, though to little effect. Renewed Japanese growth will renew its capacity to import, but this is doubtful as her public sector deficit is currently running at 6% of her GDP. Other doubts surround the outlook of the Chinese economy, where growth is already slowing down and may, therefore, constitute a major handicap to the reform of the public sector. But, according to Professor Huijong Wang (Vice-President of the Development Research Centre in Beijing) there is no risk that the Chinese authorities will be tempted to devalue the renminbi. Furthermore, strict supervision of the forex markets and the non-convertibility of the capital account will limit the crisis in China in the future.

The economists drawn together by ASEF and CEPII also examined the architecture of the globalised, international financial system which has undergone a new crisis due to the events in Asia. The crisis has, in fact, implied excessive private, rather than public, indebtedness, within a macroeconomic environment in which the fundamentals are not necessarily bad. This was underlined by Kumiharu Shigehara (Deputy Secretary-General of the OECD). Numerous participants stressed the unpredictable nature of the crises: the self-fulfilling nature of expectations held by financial markets, which amplify capital movements in a manner that is not connected to the fundamentals. It is, therefore, necessary to create barriers to avoid chain reaction panics, such as those observed in Asia since the summer of 1997, which have included Hong Kong and Singapore. From this point of view, discussions took place on the importance of having a lender-of-last-resort while, at the same time, ensuring that such a system would not stop banks and other creditors operating in emerging markets from being sufficiently prudent. For Michel Aglietta (Scientific Advisor to CEPII), the function of a lender-of-last-resort and moral hazard are two twin consequences of the systemic risk which characterises the international financial system. Moral hazard would be reduced if the lender-of-last-resort acts with respect to markets and banks, and not governments. Alfred Steinherr supported this, especially the need to preserve the lender-of-last-resort from any political influence. For Michel Aglietta, a lender-of-last-resort should not be institutionalised, but should arise out of ad hoc international co-operation. It would act as a systemic regulator, setting a floor price for the fall in assets, which would be secret, but which would be defended by potentially unlimited funds. Corrective action should take place as early as possible, which would necessitate the multiplication of security measures in financial markets. In contrast, the speed of intervention is incompatible with the present system practised by the IMF, whereby negotiations focus on conditional loans, which take some time to be set up.

Michel Aglietta also opposed the views of many participants, for whom the greater transparency of financial markets would allow systemic crises to be avoided. Philip Turner (Bank of International Settlements) came out in favour of prudential regulations and insisted on the ease with which all actors should be able to gauge risks. Jean-Pierre Landau (*Inspecteur Général des Finances* and former French administrator at the IMF) added that it was not desirable to oblige the IMF to make public the financial information provided it by member states: if the IMF were not obliged to keep it secret, then member states would withhold information. In contrast, Alfred Steinherr suggested that if the IMF had made public its anxieties concerning Korea, the latter would have been forced to act earlier. Akrasanee Narongchai did not feel that it would be a problem for Thailand, or for any of the other countries, to be publicly credit-rated by the IMF. Jean-Pierre Landau, however, felt that such credit-rating should be carried out by private organisations.

The debate on the Asian crisis is clearly far from being over, but the bringing together of the divergent points of view held by European and Asian economists, who are working in the field or in academia, is fruitful and should be useful in the progressive formulation of unanimous economic policies. ASEF and CEPII intend to collaborate in the future in order to stimulate different initiatives in the debate between Asian and European economists, from the point of view of reinforcing the economic and financial links between the two continents, and with respect to the role Europe should play in the international economy following the creation of the euro.

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