Does Asian Financial Crisis Serves as a Precursor for Global Financial Crisis?

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ABSTRACT
This study is motivated with the recent happenings in the global economy. A financial crisis hit Asia in 1997-1998 which led to the down fall of some Asian countries financially. With the fall of socialist Soviet government which led to recommendation of new world economic order in a conference in Washington D.C called Washington Consensus. Moreover, among the Washington consensus recommendations and the financial liberalization which there will be no government intervention in the working of invisible hands? In 2008 another financial crisis occurred signifying that lesson where not learnt from the previous financial crisis. However, evidence from this study reveals the similarities in the causes and emergence of two financial crises. Therefore, the study upheld that lessons from Asian financial crisis where not learnt and adequate measures were not taken into cognizance. In this view the paper concludes that there is an urgent need to take precautions against occurrence of another financial crisis. The study offers recommendations to prevent possibilities of another financial crisis and also suggests ways to prevent future financial crisis.

1.0 INTRODUCTION

The Asian financial crisis in 1997- 1998 led to fall of Asian financial market with devastating effect on Indonesia, Malaysia, Philippines and Thailand. The crisis started with the depreciation of Thailand currency. Loss of confidence in the financial institutions exacerbates the situation. It also manifests contagion effect to other healthier Asian Countries. Economics argues that financial panic creates the crisis. However, Warr (2003) Question the contagion effect as emphasized by the critics that, why is that some neighbours of Thailand are not affected like Korea. He claims the vulnerability is more likely to cause the crisis than contagion effect. Hale (2011) associated the course of the crisis to financial asymmetric of information in financial market; investing in non-productive investment with high foreign currency risk exposures. Chowder and Goyal (2000) understand that countries that have financial crisis experience two dropping in the value their currencies and trade equities. Mishkin (1999) outline unequal dissemination of financial information and imbalances in balance sheet of almost all financial institutions that cause the financial crisis. He stresses that, the financial liberalization result in massive inflow of investment that allow relaxation of restriction that leads to excessive risk and financial problems.

The International monetary fund as a banker of last resort fail to understand the causes of the financial crisis, neither goes to under predict the deterioration in output from the beginning nor do they underestimate the efficient rescue package for such countries (Woo, 2000). This is supported by research of Stiglitz (2001) and Krugman (1998). Woo (2000) emphasises that alternative multilateral institution should be formed to remedy the inefficiency of IMF in order to check their monopoly power. King (2001) suggests that banks trigger Asian Financial Crisis due to their unscrupulous attitudes that create financial panic which leads to devaluation of Thailand currency (Thai). Hale (2011) outline that the currency mismatch and financing of domestic investment in foreign short term credit resulted in balance sheet mismatch to huge debt. The East Asian bank proceeds to finance riskier project with credit they accessed from foreign banks. Their government guarantee motivates them to act without efficient regulation and guard lines. During that time Asian financial market was in the stage of embryonic. Therefore the exposures and miracle deceive them to trust the foreign credit with high risk. The Asian economies need to understand the paradigm of global financial market and the volatility in the financial market (Yu, 2001).

2.0 LITERATURE REVIEW

Washington consensus was formed in 1990 by William John to transform the countries after the falloff Soviet Union. The recommendation of William become an enthusiasm is seen as the Ten Commandments. Rodrick (2006) explain that the consensus worked as not intended or expected. Therefore it regarded as not successful. He lamented trust is lost in Washington consensus. Lee and Mathew (2009) recognised that there are achievements in industrial development Japan, China, and Taiwan that result in increased in standard of living. Although, the success recorded by Asian tigers is due to openness, deregulation with a mixed conservative macroeconomics regulations, the drive for technology and manipulating of the markets. The assertion by Rodrick (2006) was supported by lee and Mathew (2009) which express that Washington consensus is a complete total failure. The Asian Tiger's devices their way with different assumption to achieve their success. Their success emerges not from Washington Consensus recommendation but from different approach to market economics. Malaysia government formulates their austerity programmes without contacting IMF for assistance and deal with their crisis excellently (Singh, 1999). Arestis (2004) joint the fight that Washington Consensus was catastrophe and not promising. Developing countries suffers serious disaster, financial famine when they embark on the consensus recommendation especially financial liberalization. Gore (2010) and Stiglitz (1998) expressed that the negative effect of Washington consensus needs to be changed with a new friendly paradigm with more human approach.

The promotion of financial liberalization by Washington consensus is based on non-factual economic neither prove nor evidence .Finally, Washington consensus is fragile that create massive problems in Argentina, Latin America and Asian tigers (Stiglitz, 1998 in Williamson, 2000). Aristis, (2005) the consensus recommends redirection of investment and credits to specific countries. Williamson (2000) highlighted that Washington consensus is dead and a total failure. It creates contagion crisis due to it advocacy of capital account liberalization that engulf Asian countries into tragedy. The consensus preaches for property rights that benefits the rich at the expense of poor. Therefore Washington consensus advocates less government role and intervention to reduce poverty and bring developments. It emphasized on the fourth rule of the consensus Aristis (2005).

2.1 FINANCIAL LIBERALIZATION

Financial liberalization is not a new phenomenon it affects economic growth in various ways. Lee and Shin (2008) believes that it reduces barriers to financial market, enhanced the possibilities of borrowing that comes along with crisis and banking disaster. They conclude that it brings increase in interest rate and increase in gross domestic products GDP. Arestis (2005) sees financial liberalization as a flow of credit without intervention of government that allow the invisible hands to determine the allocation to individual and markets. He proceeded to show that equilibrium would be achieved through eliminating low return investment and would improve the market to advanced level.

The recommendation of multi literal corporation of market financial liberalization, removal of subsidies, tariffs is classified as a total failure .Lack of knowledge of the remedies of the financial crisis (Aristers, 2005) and Yu (2001).UNCTDA (2011) recommends that financial markets did not guaranteed welfare unless with government intervention because financial liberalization is shattered by naive and failed the test of time. Asymmetric of information exist in the financial market. Although, government cannot know the market equilibrium prices due to the behaviour of hedgers and speculators or the participants of the market.

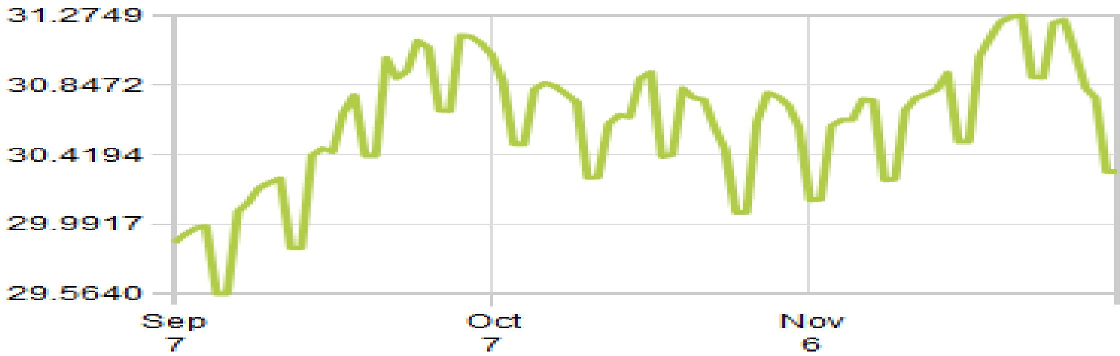
2.2 CAUSES OF ASIAN FINANCIAL CRISIS

Much have been written and debated about the crisis. Chowdary and Goyal (2000) sees currency crisis and lax government regulation which gives speculators opportunity to determine the effectiveness of currency. The exposure of the currency is too expensive to maintain by the government in fixed exchange rates. Secondly, IMF and government guarantee of bailing out banks that indicates nonchalant attitude of banks in assets management that leads to the loss of confidence and it bubbles. Thirdly, the loss of confidence is due to financing long term investment with short term credit.

Yu (2001) highlighted the following as causes of the crisis; firstly massive inflow of investment from developed countries to Asian countries in 1995-1996 and massive withdrawal of investments with the aim of creating problem of short working capital that create panic. Secondly, the inflow of the investment creates a temporal growth in Asian financial markets and higher stock value in relation to stocks in developed economics. The investment was all sold by the investors that crash the prices into crisis. Thirdly, the impact of contagion that affects some Asian countries. Fourthly, nepotism of the government officials with owners of corporation. The crisis is due to weak supervision, low regulatory framework by the government and pegging currency in American dollars.

From graph (1) shows the depreciation of Thailand (Thai) in relation to dollar within the start of Asian financial crisis. The exchange rate volatility of the currency from the commencement of the crisis is 29.8 per Dollar within thirty days, the dollar appreciate to 30.7. The currency depreciates to 31.2 in November due to the countries maintaining peg interest rate. The devaluation of Thai increases the depreciation of currency.

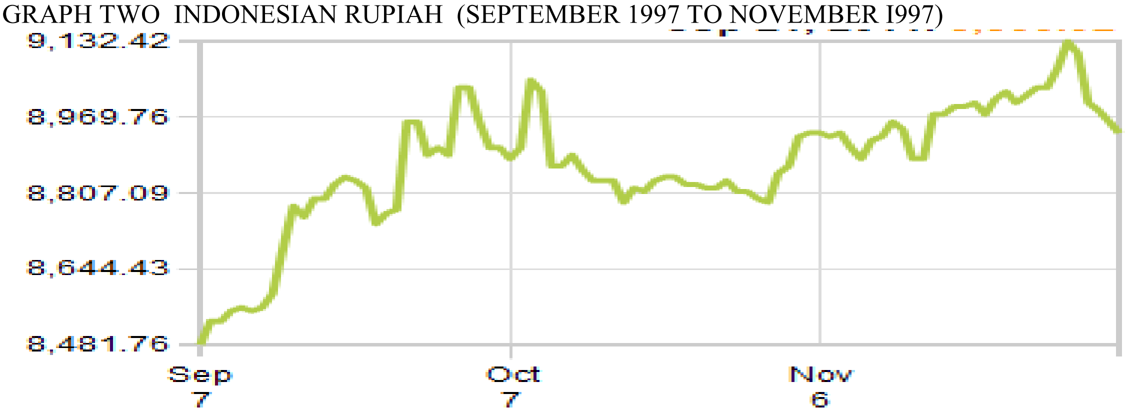
GRAPH ONE THAILAND CURRENCY (THAI)



Source,Oanda, 2011

Graph two 2 explain that the indonosia Rupiah is highly affected due to the vulnerability of the country. In sepember 2007 Dollar in relation to is Rupiahis 8,481.76 it depreciates to 8,644.48 to 8,807 in few days. The currency exposure is greater in relation to indonosia domestic currency. On september rupiah appreciate and then depreciate to 8.969. by November it reaches it peak due to contagion effect and wide spread financial panic.

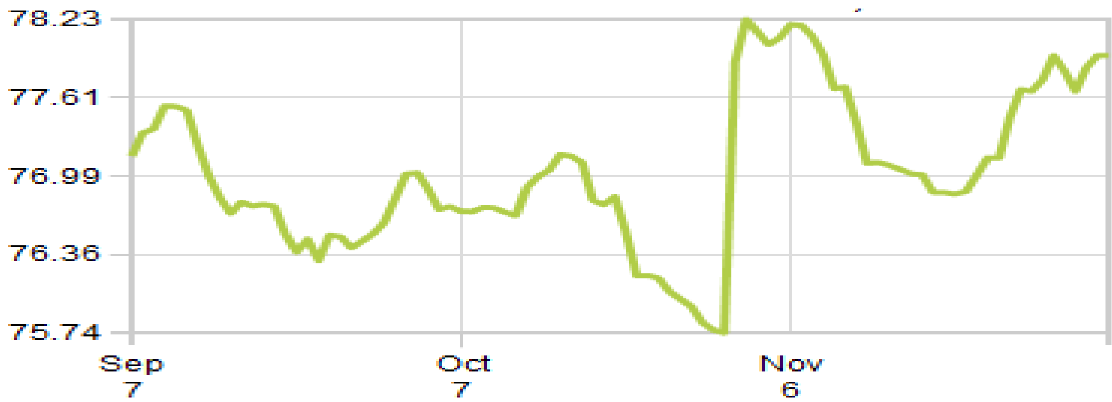
GRAPH TWO INDONESIAN RUPIAH (SEPTEMBER 1997 TO NOVEMBER I997)



Source,Oanda, 2011

The graph 3 showe In September the exchange rate of japanise yen to united states dollar is 76. Within ninety days Yen depreciated to 78 per $1 US Dollar. The spread of contagion affect the japanise Yen.

GRAPH THREE JAPANESE YEN (SEPTEMBER 1997 TO NOVEMBER 1997)



Source, Oanda, 2011

The bankruptcy of many firm escalate the financial crisis .The advocates of the panic stricken approach sees that the government have close working relationship with the private sectors .The government has been excessively hasty of liberalization of the financial system, which leads to greater bubbles. The speculators have the chance of the vulnerability of Asian economics to attack the currency (Noble and Ravenill, 2000). It could be understood that speculation plays a greater role in triggering the financial crisis. Fisher (2002) sees contagion effect created by Thailand that manifest to large external debt deficits, Stock market bubbles Secondly, the ego of some government to maintain pegged exchange rate for long time, thirdly, the collapsed of bank portfolio due to lower government regulations. Fourthly, the "carry trade notion" which comes from the lower interest rate Asian countries like Korea. Lastly, is high expectation of return on investment from foreign investors. Also, contributing to the crisis is the volatility of the Yen/ Dollar exchange rate for over three years. King (2001) outlines that crony capitalism, moral hazard, problem of balance sheet in most private institutions and investor panic. He made his point that "hot money" was flowing to East Asia.

2.3 EFFECT OF ASIAN FINANCIAL CRISIS

So many literatures on the crisis have been written. Gore (2010) indicates that during the financial crisis it has exacerbated the contagion effect and compound the problem. Therefore, the financial crisis brings sharp economic contradictions that rapidly transformed to affect employment, gross domestic product and high social consequences. The effect of the crisis translates into currency depreciations that lead to higher increase in price and fall in demand of labour. It increase unemployment, loss of saving, panic in investment and immerse bank failures or bankruptcy. Nevertheless, there is high fall in government tax income.

The resources that would be utilized for development and provision of infrastructures are sacrifice for debt servicing. Radelet and Sach (1999) among the causes are moral hazard and absolute corruption.

3.0 METHODOLOGY

This research is purely a library work utilizing secondary data. The study uses South and East Asian countries because the financial crises affect them much and were regarded as Asian tigers with United States of America. The United States as the highest recipient of foreign direct investment (FDI) it is also included in the study. The study uses secondary data available for the research.

4.0 DISCUSSIONS

WHAT WAS THE LESSONS LEARNT FROM THE ASIAN FINANCIAL CRISIS?

There are some similarities in the causes of Asian financial crisis and the recent global financial crisis that indicates that the lessons were not? Hale (2011) demonstrated that the crisis was never being expected but the early warnings signifies a geometric progression of the Asian economies without adequate government regulations. The excessive current accounts deficits, short term credit with high currency exposures financing long term investments in Asian countries. Also, government guaranteed to stimulate the banks to engage in higher risk investments. Moore and Baker (2008) analysed the global financial crisis as the multiplier negative effect of financial market; the banking sector lack Re-regulation in investment; presence of violation of Up-tick rule, welfare crisis of housing and nonchalant attitude of the creditors in financing long term assets with short term borrowings. Therefore, the Asian financial crisis and global financial crisis has similarities in terms of lax government regulation in equity financing and government guarantee of bailing out institutions e.g. AIG in US and Government guarantees in Asia. There is non-disclosure in balance sheets of developed countries that treated as non-report items due to their higher figures.

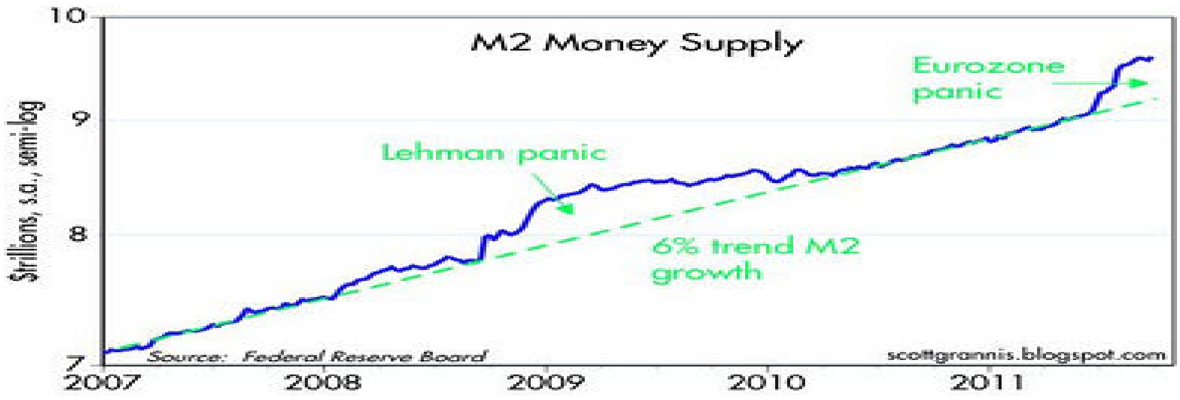
Hale (2011) argues that the Asian financial crisis and the global financial crisis are different despite some similarities. He consequently, outlines the diversity of developed economics with the emerging economics. He made his argument that there are greater restrictions and measures in the developed countries financial market. Secondly, the emerging economics are replicating and copying from developed countries financial system, regulation and banking guidelines.

Rotheli (2010) acknowledges that the tax payer is at detriment in bailing out banks in global financial crisis therefore, government should stop the baling out because banker. Rotheli (2010) says there is significant loans that are not reported in the balance sheet of US firms especially vehicles loan which have higher number. The Asian financial crisis is related to the fault of some Asian government. While, the global financial crisis originated from market actors. The IMF recommends the needs for more transparency and adequacy of reporting. Linsmeier (2010) studies shows that prior to the Asian financial crisis and Global financial crisis the IMF fails to recognised the losses in the balance sheets of firms in those countries it gradually exacerbated to financial crisis in developed and the emerging economies which shows that the lesson is not learnt.

4.1 EARLY WARNING OF GLOBAL FINANCIAL CRISIS AND CAUSES

Moore and Baker (2008) indicated that there is no any early warning but alarms. They emphasized that global financial crisis was unheeded due to sophistication of the financial markets. Rotheli (2010) says the global financial crisis started with the subprime financial market which lends credits to with low credit ratings. Moore and Barker (2008) outline that non-compliance with accounting standard (SAS 59) and the valuation of asset by banks. The Auditors were not concerned with the transparency in their report; however they concentrate on going concern of those firms. The collapse of Lehman brothers increases the volatility of the market. In 1999 the panic raises high. The loss of confidence creates a greater Eurozone panic. Financial panic is among the leading indicators of global financial crisis. The house bubbles in 2002 result in loss of confidence in the banks and the deficiencies in Basel II (see GRAPH 4)

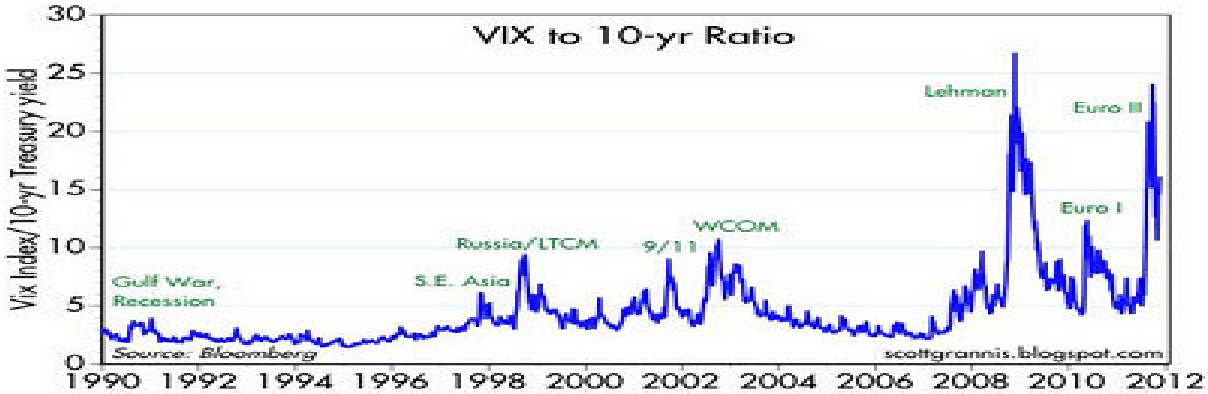
GRAPH FOUR INDICATORS OF GLOBAL FINANCIAL CRISIS



SOURCE, Scottgrannis .blogspot.com 2011

The financial crisis was caused by many factors that signify it's self in the financial markets. According to UNCTDA (2011) reports the global economic crisis has explained the systematic failure of the markets and the failure to reform the global financial architecture. Cochrane (2010) outlines the following as the causes of September 2008 financial crisis: loss of confidence (panic) in the financial institutions e.g. Lehmann brothers and Enron, WEBCOM refer to Graph five.

GRAPH FIVE GLOBAL FINANCIAL PANIC



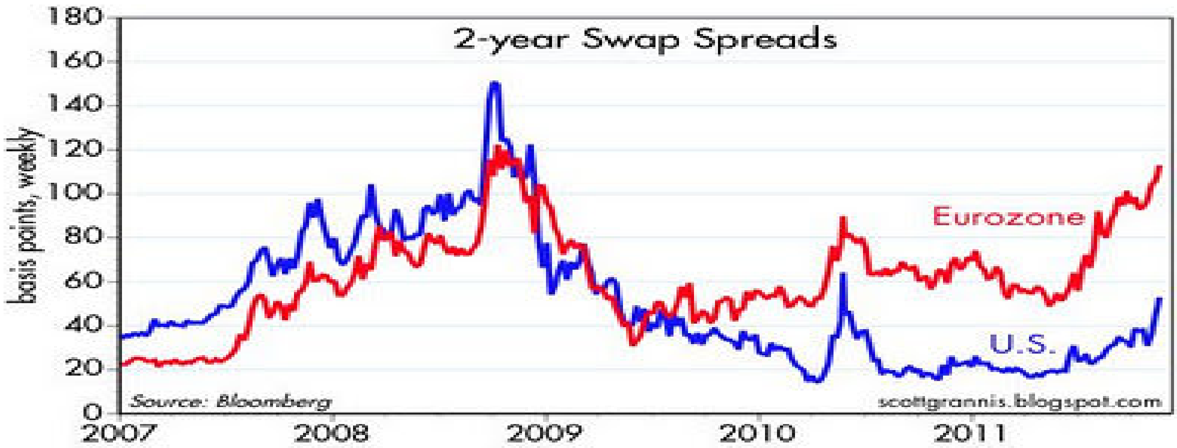
SOURCE, Scottgrannis .blogspot.com 2011

It also shows the measure of market volatility in relation to VIX calculation. Within 2008 and 2009 the market was up-shot in relation bankruptcy of Lehmann brother's bailout of AIG. His study shows that "the market has wiped out about $750 billion dollars. S&P 500 forwards Price Earnings ratio of 11.7, in ten years treasury yield 2%".he emphasized that the situation is critical that can put many euro banks out of business. It also has a contagion effect due to the global financial crisis Italy has a debt over $2 billion dollars and the Greece has to changed president.

The Russian long term capital management drastically falls in 1999. It was initially been bailed out in 1998. It is also, among the causes of Global financial crisis. WORLD-COM in 2003 collapsed due failure of hedge funds and corruption. The Enron bankruptcy increased the panic. September 11 attack was among the shock that raised alarm for financial panic. Currently, more countries like Portugal, Italy, and Greece are yarning for bailout in response to down turn investment and huge debts. Rotheli (2010) Indicates that Lehmann induces serious panic that exaggerates the crisis. secondly, the house finance bubbles also the subprime losses grew up to $400 billion, mortgage are designed in a high fragile structures that result the mortgage to lost it value which creates bubbles. Thirdly, the guarantee of government to bail out firms and the categorization of some firms as SYSTEMATIC FIRMS that are too big to fail. The removal of Glass- Steagal prohibition and the emergence of NFA that trust the working of the invisible hands without distortion from government. The NFA that heavily trust the market that create lax government regulation, low supervision and hedging of private equities that resulted to serious financial crisis in developed and developing countries. Thirdly, NFA triggers the crisis due to inefficient system, need for more government bail out that did not improved growth and developments (Cutty, 2008). Therefore the global financial crisis is due to quest for more markets domination and speculations.

Graph six depicted that global financial crisis creates loss confidence in the financial institutions. In America big corporations fails like Lehmann Brothers, American International Group and others. The emergence of Troubled Asset Relief Programme that bailout corporation and take over some companies. The euro zone crisis escalates with panic and non-performing loan. The bailout increased the creditors panic. Xafa (2010) it could be understood that the bankruptcy of Lehman brothers contributed and bailing out of AIG insurance company. The house boom and bust is the leading factor that causes the financial turmoil in United States and other countries.

GRAPH SIX CREDIT SPREAD IN THE MARKET



SOURCE, Scottgrannis .blogspot.com 2011

The graph 7 shows that in 1999 the exchange rate of dollar to euro is 1.15 even slide to 1.00 in the late 2002. Towards middle 2003 to 2005 it becomes stronger due to United States House bubbles in 2008. In 2006- 2007 the dollar shrink 1.45 .It also reaches the peak of 1.60 in 2008-2009. In 2009 euro to dollar drop to 1.40.Finally, in 2010-2011 greater volatility because of arguments of existence of euro and euro countries a massively looking for bailouts.

GRAPH SEVEN EURO STRONGER THAN THE DOLLAR

SOURCE, Scottgrannis.blogspot.com 2011

Many countries in Asia suffer bitterly due to financial liberalization. Singh (1999) out lines those negativities are: Thailand experience budget cut up to 100 billion Thai in 1998.secondly, Increased in value added tax from 7% to 10%.thirdly, Reduction in current asset deficit to 5%. Two (2) million people lost their jobs. Some women have no choice than to engage in prostitution in order to pay school fees of their children. In Indonesia, there is increase in prices from 250% to 500%; the real asset business bust-up; employment raise to 11%; massive layoff of workers from textile industries. Indonesian companies have $55 billion outstanding debt in foreign currency with 59% in short term categories. Philippian peso depreciated by 35% against Dollar in 1997. Banks has $10 billion debt in US dollars. Importation cost increased that makes repayment of $45 billion debt hard. All these problems are due to IMF recommendation for financial liberalization that brings financial crisis that warrant stringent conditions.

.5.0 CONCLUSION

The Asian financial crisis did not serve as a lesson to developed countries; consequently, some sees it as different from the recent financial crisis. Financial liberalization is among the recommendation of Washington consensus it is at the detriment of emerging countries .It also increase the financial crisis. IMF gives recommendation that favours the investing countries and their contributors, instead of solving balance of payment problem of the countries. The study finds that financial panic increases the crisis. Finally, countries like Malaysia formulate their economic policies that are suitable to convert financial crisis without contacting IMF and they succeed. United State government promote the financial crisis by bailing out financial institutions.

5.1 RECOMMENDATION

There is the need for more proper accurate measurement and adequacy of financial disclosure in financial statement and balance sheet. The need for more democratic response to financial crisis would reduce the negativity of the market. IMF/ World Bank should enhance their role to more humanly approach by eradicating moral hazard. Multilateral institutions would recommend positive austerity measures to countries in need of their assistance.

Moreover, countries should avoid corruption and non-transparent acquisition of wealth. Every country that is in crisis should formulate it austerity measures indigenously by itself. Washington consensus should be regulated and improved to serve humanity not a selected few. Information asymmetric system should be eliminated due to in equality to the market it brings. A well-functioning financial system is required and more efficient regulatory system before it open up for more liberalization. Moreover, financial market liberalization should be should open with regulations. The government guarantee of bail out should be stopped because the resources generated for economic and development is sacrifice for bailing out unscrupulous banks and bankers. Finally, strengthening the financial institutions is the ingredient of more improved accountability and transparency and effective banking regulation. There should be frequent review of international financial architecture. The banks and corporations with financial crisis should be allowed to fail or taking over by the government. Government should intervene to ensure equal distribution of resources. Conclusively, by a popular saying of Stiglitz that IMF has resources to bailout bank not to bailout retrenched workers and reduced poverty.

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