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GLOBAL CRISES, FISCAL IMBALANCES AND GLOBAL INSTABILITY
Interests and Reactions of Asian Economies

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GLOBAL CRISES, FISCAL IMBALANCES AND GLOBAL INSTABILITY: INTERESTS AND REACTIONS OF ASIAN ECONOMIES

This paper concerns the impact of global crises in 2007-9 on Asian economies. Before addressing that issue, however, the first three sections argue that what is often abbreviated to GFC included three distinct crises:

1. a financial sector crisis, which was not global. The North Atlantic financial crisis of 2007-8 hit some small economies (Iceland, Ireland), but the big news was the USA and UK and to a lesser degree some other EU members.
2. recession in the USA and UK triggered a global economic crisis in 2008-9
3. public finance crises resulted from large bail-out or stimulus packages exacerbated by falling taxes due to recession (as in Ireland, USA, UK), or to some extent coincidentally (e.g. Greece due to culmination of budget deficits fuelled by cheap debt since joining the euro). If central banks are committed to low inflation, then increased budget deficits mean larger public debts and potential sovereign debt crises.

An important distinction between the first two types of crises is that the effects of a financial crisis are much longer lasting than those of an economic crisis triggered by an external shock, such as reduced demand for exports.[1] The implications of a sovereign debt crisis are national, but may have regional implications (e.g. for eurozone members) or global implications (e.g. if there are doubts about US debts).

The fourth section analyses the impact of these crises on Asian countries. The Asia-Pacific region did not experience significant financial crises. The open economies were affected by the global economic crisis, but they recovered relatively rapidly after a drop in exports and in economic growth in 2009. An important consequence is that the weight of Asian economies in the global economy, which had been increasing for several decades, grew even more rapidly in 2009-11 as the economies of the USA and Europe faltered. This poses challenges for global economic governance, which is dominated by the USA and western European countries. However, there are constraints on Asia being a more assertive force, due to the competition for leadership among the larger economies and limited leadership resources in the smaller economies.

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[1] Eichengreen (2011, 386-9) provides recent references, and discusses the difficulty of determining the counterfactual with which to compare the aftermath of financial crises.

1. The North Atlantic Financial Crisis of 2007-8

The USA experienced a major financial crisis in 2007-8. The trigger was falling house prices from a mid-2006 peak, which led to the subprime mortgage crisis. The crisis was realized in April 2007 when New Century Financial filed for bankruptcy, and in the remainder of 2007 many institutions announced losses associated with delinquent mortgages. An additional component of the US financial crisis was the collapse of the investment banks which first became apparent in March 2008 when Bear Stearns was bought by JP Morgan Chase in a fire sale (paying $240 million for a company worth $18 billion a year earlier) supported by a $30 billion loan from the Fed.

The US financial crisis peaked in September 2008. On September 7 the U.S. government placed Fannie Mae and Freddie Mac into a conservatorship, effectively nationalizing them at the taxpayers' expense. On 15 September 2008 Lehman Brothers went bankrupt and Merrill Lynch was bought by Bank of America. The following day the Fed announced an $85 billion rescue package for AIG, the country's biggest insurance company, in return for an 80% stake in the firm. On 25 September 2008 Washington Mutual, which had assets valued at $307 billion, was closed down by regulators and sold to JPMorgan Chase.

The US government moved quickly to provide support for the financial sector. On 28 September US lawmakers announced a bipartisan agreement on a rescue package, allowing the Treasury to spend up to $700 billion buying bad debts from ailing banks. The plan was rejected by Congress the next day, but a revised plan was passed on 3 October. On 14 October the US government unveiled a $250 billion plan to purchase stakes in a variety of banks in an effort to restore confidence in the sector. On 23 November the US government announced a $20 billion rescue plan for Citigroup after its shares plunged by more than 60% in a week. On 25 November the Fed announced that it would inject a further $800 billion into the economy to stabilise the financial system and encourage lending; about $600 billion would be used to buy up mortgage-backed securities while $200 billion would be targeted at unfreezing the consumer credit market.

More or less at the same time and speed, the UK faced a financial crisis triggered by mortgage loans. In September 2007, Northern Rock sought and received a liquidity support facility from the Bank of England and in February 2008 Northern Rock was taken into state ownership; the bank's principal problem was non-performing mortgage loans. In September 2008 the mortgage lender Bradford & Bingley was nationalized; the British government took control of the bank's £50 billion mortgages and loans, while its savings operations and branches were sold to Santander. The banking crisis spread and on 3 October 2008 the UK government announced plans to pump £37 billion of taxpayers' money into three banks: Royal Bank of Scotland, Lloyds TSB and HBOS.

In September and October 2008 other large EU economies faced specific banking problems, which were met by bail-outs, but the systemic impact was nowhere near as large as in the UK. For example, the Belgian, French and Luxembourg governments contributed 6.4 billion euros to bail out Dexia, and the German government announced a €50 billion deal to save Hypo Real Estate. A much larger national crisis occurred in Ireland, whose government foolishly guaranteed all deposits in the country's main banks. Relative to the size of the national economy, the largest banking crisis was in Iceland, whose banking system collapsed in October 2008, leading the government to negotiate a $2 billion loan from the International Monetary Fund, the first IMF loan to a western European country since for over a quarter of a century.

Other countries, notably in eastern Europe, experienced financial crises which were related to the difficulties of western European banks or to a sudden stop in capital inflows. In Central Asia, Kazakhstan had a financial crisis that was largely home-grown, resulting from a real estate bubble that was fuelled in part by foreign depositors and that burst in 2007.

A striking feature of the 2007-8 financial crises was that they did not have serious transcontinental contagion effects. The 1997-8 Asian Crisis triggered a reconsideration of emerging market debts that led to crises in Brazil and Russia, with the latter contributing to the Long Term Capital Management crisis in the USA. In 2007-8 there was no financial crisis in South America, Africa or Asia. Even countries closely linked to the US economy, notably Canada, had no financial crisis. Although financial liberalization, and the associated pre-2007 economic boom, contributed to the likelihood of a crisis, Australia illustrated that a crisis was not inevitable.

In the USA and the UK the financial crisis was over by the end of 2008. In the first half of 2009 most banks were back to good health. In June 2009 ten of the largest US banks announced that they would be able to repay the US Treasury the money they were lent under the October 2008 bail-out. Goldman Sachs announced a net profit of $3.44 billion for April to June, and set aside $6.65 billion for pay and bonuses in the quarter. In the UK, Barclays announced an 8% rise in first-half profits, and other banks announced mixed results for the period (profits at HSBC and RBS, losses at Lloyds and Northern Rock).[2] In both countries the popular focus had shifted from worrying over a financial crisis to outrage over high earnings in the financial sector.

The financial crises were important for their impact on the real sector. As people's financial and real estate wealth declined, aggregate demand fell, starting with deferred purchase of consumer durables.[3] Already by December 2008 governments in the USA and EU were becoming as worried about the health of their automobile sector as about that of the financial sector. On 4 December French President Nicolas Sarkozy unveiled a 26 billion euro stimulus plan, with money to be spent on public sector investments and loans for the country's carmakers. On 19 December President George W Bush announced that the US government would use up to $17.4 billion of the $700 billion meant for the banking sector to help the Big Three US carmakers, and on 29 December the US Treasury unveiled a $6 billion bail-out for GMAC, the car-loan arm of General Motors. Over the following year the US and EU economies would experience a deep recession, whose impact would be transmitted to the rest of the world through reduced demand for imports.

2. The Global Economic Crisis of 2009

In 2008 average growth in the high-income countries had slowed to a standstill and in 2009 their GDP fell by 3.5 percent (Table 1). The decline was driven by the recessions in the USA and UK and was transmitted through reduced demand for

[2] The common pattern was that, although some financial institutions were hard hit (albeit with a blow often softened by public assistance), other banks, such as Barclays, benefitted from selective purchase of assets sold by the ailing institutions or by their liquidators.

[3] This contributed to falling share prices. The world's stock markets fell by about a third in the final quarter of 2008, in many countries continuing to decline to a trough in the first or second quarter of 2009, which added to the negative wealth effect on aggregate demand.

imports, which first hit countries exporting consumer durables whose purchase could be postponed, e.g. car exporters in Japan, Germany and France.[4] By the start of 2009 the volume of world exports had fallen to about three-quarters of their level in April 2008, and alarm bells were sounding about the scale of the decline in world trade (Baldwin and Evenett, 2009); analysis of the causes was in full swing by November (Baldwin, 2009), although by then trade volumes were starting to recover.[5] Over the year 2009 the world's real output fell by 0.5 percent, after growing by 3 percent per year in 2000-8, and the volume of trade in goods and services fell by 10.9 percent (IMF, 2011, Table A9). In sum, the financial crisis was not global, but, when the world's two largest importers (the EU and USA) run into a serious domestic recession, the world economy is affected.

The global economic crisis struck countries with differing degrees of severity. Countries which suffered both from a financial crisis and the slowdown in global demand inevitably saw large dips in economic activity. The countries of eastern Europe and the former Soviet Union, which had grown rapidly over the previous decade and in many cases had become closely connected to the economies of the pre-2004 EU15, saw the largest declines in output in 2009 (Table 1). In some cases, notably the Baltic countries and Bulgaria, the immediate effect was exacerbated by a strong policy response in the form of cutting budget deficits, driving an internal devaluation (i.e. falling wages and prices) while maintaining a fixed exchange rate.[6] Countries less integrated into the global economy, i.e. primarily low-income countries, were relatively less impacted by the global crisis.

A noteworthy pattern was that emerging market economies as a group weathered the storm better than the high-income countries. Several authors confirm that GDP growth declined less in emerging economies, even after controlling for

[4] Alessandria et al. (2010; 2011) show that sales of foreign cars began to decline in the USA in mid-2008 and the ratio of inventories to sales increased by 45 percent over the next six months. Car sales began to revive in early 2009, but imports only picked up after inventories had been run down.

[5] Some authors saw a direct link between the financial crises and the decline in trade. Ahn, Amiti, and Weinstein (2011) claim that financial factors may explain about 20 to 30 percent of the decline in world trade that occurred in the 2008-2009 crisis, and they support this claim by showing that the prices of manufactured exports rose relative to domestic prices during the crisis and that U.S. seaborne exports and imports, which they assume to be more sensitive to trade finance problems, saw their prices rise relative to goods shipped by air or land. Others have argued that trade finance was not a major contributor to reduced trade volume in 2008-9. One difficulty is the lack of hard data on trade finance (Korinek, Le Cocguic and Sourdin, 2010).

[6] Aslund (2011) argues that the policy response helped the countries to a rapid recovery and improved long-term growth prospects.

several variables (Frankel and Saravelos, 2010; Rose and Spiegel, 2010; Rose, 2011). Didier et al. (2011) argue that, using the drop from pre-crisis highs as the criterion, there is no significant difference between high-income and emerging economies, but they acknowledge that emerging economies recovered faster and as a group had returned to pre-crisis levels of industrial output in 2010, whereas high-income countries did not achieve this until 2011. A superior recovery was evident in the large emerging economies with sound economic policies before the crisis, such as China, India, Brazil and Indonesia.

Table 1: Growth by Region, 2000-2010

	Ave 2000-7	2008	2009	2010
High income countries	2.4	0.3	-3.5	2.6
Asia	7.7	6.5	5.1	8.8
Eastern Europe & Central Asia	6.1	4.1	-5.4	3.9
Latin America & Caribbean	3.6	4.1	-2.0	5.8
Middle East & Africa	5.5	5.3	1.6	4.3

Source: real GDP growth from IMF *World Economic Outlook*, as reported in Didier et al. (2011, 33).
Notes: regional averages are weighted by 2007 nominal GDP in USD; high income countries are as defined by the World Bank July 2010 classification; Asia includes South and East Asia except Japan, and Pacific except Australia and New Zealand.

Why did emerging economies ride out the crisis so calmly? They were open economies and hence exposed to sharp drops in export demand. However, trade shocks typically are shorter-lasting than financial crises, which may be followed by a lengthy period of deleveraging and domestic recession. Moreover, and in contrast to earlier decades, many emerging economies had shifted from being net external debtors to net creditors and held liquid foreign assets (e.g. in the form of reserve assets) and illiquid foreign liabilities (e.g. as direct foreign investment), so they were not exposed to a sudden deterioration in the capital account of the balance of payments. Finally, some countries, notably China, introduced pre-emptive stimulus packages to prevent the initial negative shock from turning into a major recession.[7]

3. Public Finance Crises

[7] Warnings by the US government of systemic risk and a new Great Depression contributed to global uncertainty (Taylor, 2009). The media working out of the north-eastern USA and London, spooked by the dramatic US and UK financial collapses in September and October 2008, may have contributed to panic among policymakers in late 2008, even in countries which experienced no financial crisis such as Australia or China.

By 2010 all regions of the world were enjoying positive economic growth. However, the sense of crisis persisted as a number of countries experienced difficulties reducing their public sector deficit and ran into debt problems. Some of these debt crises were related to the financial crisis in cases where governments had been involved in expensive bail-outs (e.g. Ireland) and others to the size of the stimulus packages adopted to deal with the economic crisis (e.g. the USA and UK), while other debt crises were essentially independent of the financial and economic crises but came at a bad time (e.g. Greece).

In 2010-11, public sector budget crises were debt crises because all governments were committed to not monetizing budget deficits. This was, of course, not an option for individual eurozone countries or for countries with debt denominated in foreign currencies, but (at least up to the time of writing) neither the USA, the UK nor the ECB appear to be contemplating the inflation option. Moreover, they were to a large extent external debt crises because foreigners held large amounts of the sovereign debt (or government-guaranteed private debt) of the USA, Ireland, Greece and other highly indebted countries. Any default by the USA would have systemic effects because US Treasury bills are the benchmark risk-free access for the international financial system.

The eurozone sovereign debt crises had varying origins. The Irish government made one foolish policy decision, guaranteeing all creditors of the major Irish banks and had to pay a large price for that error.[8] The Greek government benefitted from lower borrowing rates after it adopted the euro to run non-transparent budget deficits, including for prestige projects like the 2004 Olympic Games. A Greek default was a potential contagion event for two reasons. First, it sounded a warning to creditors that they should check whether other eurozone countries had been borrowing heavily on the basis of low interest rates which ignored individual countries' default risk; they

[8] This was a choice. The Icelandic government pointedly refused to guarantee foreign deposits in Icelandic banks that went under, and stuck to this position despite heavy pressure from the UK and Netherlands in both of which subsidiaries of Icelandic banks had attracted large numbers of depositors. Whelan (2011) argues that the Irish economy already faced serious problems in 2007-8 after a real estate bubble had burst, which made it even more incredible that the government on 30 September 2008 announced a near-blanket guarantee to the creditors of Irish banks. When Allied Irish Bank's losses were assessed at €30 billion in September 2010 and the government issued promissory notes to cover the bank's debts, Ireland's budget deficit reached 32% of GDP. By spring 2011 the total bill to Irish taxpayers for bank bailouts had exceeded €70 billion, for a country of less than 4.5 million people.

found Portugal, which like Portugal had been running large current account deficits since introducing the euro (Table 2).[9]

Table 2: Balance on Current Account, Selected Countries, 2003-2010
(percent of GDP)

	2003	2004	2005	2006	2007	2008	2009	2010
USA	–4.7	–5.3	–5.9	–6.0	–5.1	–4.7	–2.7	–3.2
Canada	1.2	2.3	1.9	1.4	0.8	0.4	–2.8	–2.8
UK	–1.6	–2.1	–2.6	–3.4	–2.6	–1.6	–1.7	–2.5
Eurozone	0.4	1.2	0.4	0.4	0.2	–0.6	–0.2	0.1
Germany	1.9	4.7	5.1	6.5	7.6	6.7	5.0	5.3
France	0.7	0.5	–0.5	–0.6	–1.0	–1.9	–1.9	–2.1
Italy	–1.3	–0.9	–1.7	–2.6	–2.4	–2.9	–2.1	–3.5
Spain	–3.5	–5.3	–7.4	–9.0	–10.0	–9.7	–5.5	–4.5
Netherlands	5.6	7.6	7.4	9.3	6.7	4.3	4.6	7.1
Belgium	3.4	3.2	2.0	1.9	1.6	–1.9	0.8	1.2
Austria	1.7	2.2	2.2	2.8	3.5	4.9	2.9	3.2
Greece	–6.6	–5.9	–7.4	–11.2	–14.4	–14.7	–11.0	–10.4
Portugal	–6.5	–8.4	–10.4	–10.7	–10.1	–12.6	–10.9	–9.9
Finland	4.8	6.2	3.4	4.2	4.3	2.9	2.3	3.1
Ireland	–0.0	–0.6	–3.5	–3.6	–5.3	–5.6	–3.0	–0.7
Japan	3.2	3.7	3.6	3.9	4.8	3.2	2.8	3.6
China	2.8	3.6	7.1	9.3	10.6	9.6	6.0	5.2
India	1.5	0.1	–1.3	–1.0	–0.7	–2.0	–2.8	–3.2
Korea	2.4	4.5	2.2	1.5	2.1	0.3	3.9	2.8
Taiwan	9.8	5.8	4.8	7.0	8.9	6.9	11.4	9.4
Indonesia	3.5	0.6	0.1	3.0	2.4	0.0	2.6	0.9
Malaysia	12.0	12.1	15.0	16.4	15.9	17.5	16.5	11.8
Philippines	0.4	1.9	2.0	4.5	4.9	2.2	5.8	4.5
Singapore	22.7	17.0	21.1	24.8	27.3	14.6	19.0	22.2
Thailand	3.4	1.7	–4.3	1.1	6.3	0.8	8.3	4.6

Source: IMF *World Economic Outlook*, April 2011 (Tables A11 and A12), at http://www.imf.org/external/pubs/ft/weo/2011/01/pdf/tables.pdf (accessed 9 September 2011).
Notes: Eurozone calculated as the sum of the balances of individual Euro Area countries excluding Estonia.

A second source of contagion arose because banks in other eurozone countries held large amounts of the sovereign debt or, equally disastrous, loans to Greek banks that would go under if the Greek government defaulted. This was especially true for banks in EU countries, such as France and Germany, which had not been involved in

[9] Current account deficits may be a sign of dynamism if their counterpart is capital inflows in productive investments. They signal future problems if the deficit is being used to fund private or public consumption.

pre-2008 real-estate lending to the same extent as banks in Spain, Ireland or the UK. The French and German banks weathered the 2008 financial storm better, but in 2010 found themselves over-exposed to Greek borrowers. Thus, EU leaders, with the French President and German Chancellor in the vanguard, spent much energy in 2010 and 2011 organizing relief for Greece, ideally to avoid default but at a minimum to buy time so that foreign banks and others could reorganize their balance sheets before formal default occurred.[10] As long as the eurozone's debt problems are restricted to the smaller member economies, these are largely regional matters, centring on the fundamental question of whether eurozone or EU members are jointly and severally responsible for the union's sovereign debts, but if the debt problems spread to Spain or Italy or if the French or German banking sectors experience a major crisis then there will be impacts on the global economy.

The debt crises, earlier financial crises and debt resolution programs illustrate the ubiquity of time inconsistency problems in the sense that short-run measures which buy popularity for governments may have adverse long-run implications. Governments which had accumulated assets in sovereign wealth funds (e.g. Chile or Kazakhstan) or as reserves held by the central bank had foregone opportunities to spend during the boom, but were better placed to weather the storm in 2009. Countries which used crises as opportunities to cut out wasteful government expenditures and carry out difficult but desirable reforms (e.g. the Baltic countries) experienced deeper recessions but emerged in better shape. On the other hand, countries that spent money rather indiscriminately as stimulus packages, including Australia and China, may have gained short-term breathing spaces at the cost of long-term problems.[11]

Another apparent dilemma was that countries more integrated into the global economy or with more liberal financial sectors were likely to be hit the hardest,

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[10] Some confusion surrounds the term ""default", in part because formal default would trigger the need for pension funds and others to hold a fire sale of assets issued by the issuer in default. As Reinhart and Rogoff (2009) point out, however, any outcome which leaves creditors short of their contracted real returns, including "voluntary" rescheduling or inflation, is tantamount to default.

[11] The Chinese stimulus program introduced in 2008Q4 included RMB 1.18 trillion in central government funding, but more importantly it unleashed massive spending from sub-national governments much of which was funded by local investment corporations (*difang zhengfu rongzi pingtai*) whose activities are often non-transparent; LICs had been successful in promoting growth, e.g. in Shanghai which had provided the inspiration for the model, but before 2009 they tried to maintain a low profile. The stimulus announcement released any perceived political constraints on the LICs' scale of activities, and in 2009 the actual gross stimulus from all levels of government reached about a fifth of GDP (Wong, 2011).

whereas countries outside the global economy were insulated from the crises. This is, however, not an argument for autarchy or financial reregulation. Countries with more liberal financial sectors enjoyed superior growth in the decades before 2007 which far exceeded the size of the decline in GDP in 2008-9 (Pomfret, 2010); Table 3 provides some comparisons. The gains from financial liberalization are primarily in terms of improved allocation of capital rather than increased saving and investment, as evidenced from financially repressed economies in the twentieth century,[12] and also in recent empirical work based on a broader range of countries (Kukenova, 2011; Buera et al., 2011). These benefits tend to be more pronounced in the longer term, although financial liberalization inevitably exposes an economy to greater volatility.

Table 3: GDP in Current US Dollars (billions), 1992-2007

	1992	**2007**	**% change**			**1992**	**2007**	**% change**
USA	6,286.8	13,811.2	119.7		Germany	2,062.1	3,297.2	59.9
UK	1,074.0	2,727.8	154.0		France	1,372.8	2,562.3	86.6
Spain	612.6	1,429.2	133.3		Italy	1,265.8	2,107.5	66.5
Ireland	54.3	255.0	369.6		Greece	128.4	360.0	180.4
Australia	320.6	821.7	156.3					
High-income OECD	19,764.1	38,219.0	93.4		World	24,533.6	54,347.0	121.5

Source: Pomfret (2010, 26) -- data from World Bank *World Development Indicators*.

4. Implications for Asia

There was no significant financial crisis in Asia (except Kazakhstan, and that was largely home-grown). There was an economic crisis in 2009, but recovery was relatively rapid and Asian countries' share in world trade continues to increase. There are no public finance crises, as in the USA and Europe, although some governments

[12] Countries which repressed their financial sectors during the1950s and 1960s import-substitution era suffered negative consequences for long-term economic growth; there was little loss of savings because the interest elasticity of supply of saving is low, but excess demand for loans at low interest rates was associated with misallocation of capital (Fry, 1988). The inefficient allocation of capital was indicated by increasing incremental capital-output ratios (ICORs) in countries like India or the Soviet Union in the 1970s and 1980s. India's ICOR increased from 4-4.5 in the first half of the 1960s to a peak of 10.5 in 1975 (reported in the Asian Development Bank's *Asian Economic Outlook 1990,* p. 138), i.e. an additional unit of capital made less than half the contribution to output in 1976 than it had made a dozen years earlier. In the Soviet Union the ICOR increased from 3.7 in the period 1950-60, to 5.0 in 1960-75 and 14.8 in 1975-85 (Gregory, 1994, 129).

undertook large prophylactic stimulus packages (e.g. China and Australia), and some faced independent shocks (notably Japan's natural disaster in March 2011). These are ad hoc and need not be long-term negatives (although they could turn out to be negative if the monies were poorly used or if returning to prudent budgets is difficult).

An important reason for Asian financial stability in the first decade of the twenty-first century was the lessons drawn from the 1997-8 Asian Crisis. The strongest image from that event was of the managing director of the IMF standing over the President of Indonesia who was signing a loan request, and many in the region resolved to reduce their dependence on the Euro-US-dominated IMF. A Japanese push for greater Asian financial integration and creation of Asian multilateral financial institutions met with little success.[13] Countries did not want to compromise their monetary policy autonomy and looked to their own defences by building up national reserves (Table 4).

Table 4: Foreign Reserves held by Emerging and Developing Countries, 2003-2010 (billion US dollars)

	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Total	1,341	1,792	2,304	3,073	4,369	4,950	5,597	6,481
Developing Asia	670	935	1,156	1,489	2,129	2,534	3,078	3,658
China	409	616	823	1,070	1,531	1,950	2,418	2,890
India	100	127	133	171	268	248	266	292
CIS and CEE	206	282	378	564	813	764	813	902
Russia	74	122	176	296	468	413	418	456
LAC	195	221	255	310	445	497	548	651
Brazil	49	53	53	85	180	193	237	288
Mexico	59	64	74	76	87	95	100	120
MENA	230	294	434	596	837	1,000	1,001	1,108
SSA	39	61	81	114	145	156	158	162

Source: IMF *World Economic Outlook*, April 2011 (Table A15), at http://www.imf.org/external/pubs/ft/weo/2011/01/pdf/tables.pdf (accessed 9 September 2011).
Notes: CIS= Commonwealth of Independent States, CEE = Central and Eastern Europe, LAC = Latin American countries, SSA = Sub-Saharan Africa.

By 2010 China and Japan were the largest holders of US Treasury securities, with over two trillion dollars between them, and South Korea and Taiwan also held large amounts of US government debt. The desirability of monetary stability to

[13] The 2000 Chiang Mai Initiative, a swap arrangement among the ASEAN+3 group (the ten ASEAN members plus China, Japan and South Korea), was expanded and multilateralized in 2009, but the amounts remained small compared to, say, the credit lines some of the participants had with the US Fed and the facility proved to be redundant during the 2008-9 crises (Pomfret, 2011, 58-73).

facilitate trade was, however, recognized; governments generally maintained a loose *de facto* dollar peg and low inflation, so that bilateral real exchange rates within East Asia did not fluctuate greatly in the 2000s.

A second and more long-term lesson taken from the Asian Crisis was the desirability of reducing dependence on international financial markets by building up Asian bond markets. Artificial attempts to stimulate Asian bonds made limited progress but by 2010 some domestic bond markets had become substantial, and between 2010Q2 and 2011Q2 local currency bond markets in emerging East Asia grew by almost eight percent to US$5.5 trillion, of which China accounted for $3,052 billion, South Korea $1,149 billion, Malaysia $247 billion, Thailand $225 billion, Singapore $179 billion and Indonesia $107 billion (ADB, 2011, 5-6).[14] Capital inflows were primarily in the form of foreign direct investment, which in combination with the large official reserve assets holdings, meant that the Asian countries were in the happy position of having external assets which were more liquid than their external liabilities (in contrast to the situation faced by the crisis countries in 1997 which suffered a sudden and large call on their external liabilities).

Whatever the role of these individual drivers, East Asian countries have not experienced a financial crisis in the twenty-first century, despite the events of September 2008 in New York and London. Financial markets showed concern about the creditworthiness of some Asian countries, but the concern was misplaced. In October-November 2008 credit default swap spreads soared to 1200 basis points for Indonesia and lower (but still high) peaks for the Philippines, Thailand, South Korea and others, but the spreads fell during 2009 and by the end of 2010 the spreads were less than 200 basis points for all Asian countries, which was less than the spreads for Italy or Spain (ADB, 2011, 5).

Since 2000 Asian economic integration has centred on a network of bilateral trade agreements, especially in East Asia. This has been driven by the increased density of regional value chains, and perhaps by lack of progress on trade facilitation in the Doha Development Round (Pomfret, 2011). A consequence of the value chains is that the extent of the decline of global trade, which is measured by summing gross value at each border crossing, relative to the decline in GDP, which is measured by summing value-added, was exaggerated. Factory Asia was hit in 2009 because North

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[14] Emerging East Asia is defined here as China, Hong Kong, South Korea, Malaysia Philippines, Singapore, Thailand and Vietnam.

America and Western Europe are still major markets for the final products of the regional value chains, but this is changing as consumers in regional markets become more affluent. Between 2009 and 2011, the Chinese economy grew from just under $5 trillion to $6.5 trillion and the Indian economy from $1.3 to $1.7 trillion, while ASEAN has a combined GDP of over $1.5 trillion.[15]

In sum, East Asia did not suffer a major crisis in 2008-9 - certainly nowhere near as bad as that of 1997-8 - and the reasons for that are sound.[16] Creation of deeper domestic financial markets, avoidance of large balance of payments or public sector deficits, outward-oriented trade policies and specialization by comparative advantage are all part of a recipe for continued economic growth. Such growth will narrow the income gap between East Asia and the USA and European countries which continue to experience deleveraging and slow growth. Such a major shift in global economic weight poses challenges to the system of multilateral institutions established in the 1940s and other fora for global economic governance.

The G7/G8 grouping has been challenged by the rise of the G20 which includes six Asian economies (not counting Russia): Australia, China, India, Indonesia, Japan and South Korea. However, despite dissatisfaction in Asia the IMF and World Bank remain US/EU dominated, e.g. with no Asian candidate to challenge Christine Lagarde's IMF nomination in 2011. These situations are clearly unstable.

By contrast, the emerging Asian economies have managed to make substantial progress in liberalizing trade to meet the needs of their strengthening regional value chains. The WTO is the only one of the three major economic multilateral organizations that has had an Asian head, and there is almost universal WTO membership and acceptance of its international trade law and dispute resolution mechanisms. The slow process of multilateral trade negotiations was augmented by substantial unilateral trade liberalization in East Asia and trade facilitation measures within ASEAN, and these patterns continue in bilateral and plurilateral agreements and in Asia-Pacific Economic Cooperation (APEC). A regional approach to trade liberalization may be second-best, but as tariffs diminish in importance and interest centres on trade facilitation it is less likely that regional agreements will be

[15] For more details see Sanchita Basu Das "Asia Holds Promise as US, Eurozone Falter", *The Business Times* (Singapore), 24 August 2011.

[16] Asia may have been helped by the collapse of commodity prices in 2008-9.

discriminatory and more likely that measures such as simplified customs procedures or single windows will benefit all trading partners.[17]

There are, however, constraints on a concerted Asian push for greater global influence. The region lacks a clear hegemon, and is characterized by pervasive competition between the big states (China-Japan, and to lesser extent India) and historically based distrust (China-Japan-Korea); there has been no counterpart to the post-1945 Franco-German agreement on Europe or the North Atlantic security alliance. In the emerging economies there is a further constraint of scarce leadership resources, which is perhaps exacerbated by domestic political uncertainties in China, India, Indonesia, Thailand, Philippines, and elsewhere. At the same time, in southeast Asia ASEAN does not have even the limited degree of unity of the EU, and the governments of other large ASEAN economies may have reservations about Indonesia being the only country from their region sitting at the G20 table.

Conclusions

Asia weathered the global economic recession of 2008-9 remarkably well. This was partly because no country in East Asia, South Asia or Australasia experienced a financial crisis. These countries were well-placed to deal with an external trade shock because their economic growth in the twenty-first century had been based on firm foundations, and many countries had built up substantial foreign exchange reserves or sovereign wealth funds which provided a cushion against any balance of payments problems. Moreover, even given these potential stabilizing force, some of the larger regional economies, notably China and Australia, undertook massive pre-emptive fiscal stimulus programs. The only serious long-term implication for the national economies is whether those programs can be reversed without significant political disruption before the countries run into sovereign debt issues.

For the global economy, the main challenge posed by the relative success of Asian economies as the USA and western Europe went through major recessions is whether this will be the catalyst for reform of the multilateral economic institutions established over sixty years ago by the World War II victors. Agreements such as the

[17] Asian regional agreements in the 1990s and 2000s are described and analysed in Pomfret (2011). Pomfret and Sourdin (2009) provide evidence of trade facilitation within ASEAN also reducing the costs of trading with non-members.

head of the World Bank being from the USA and the head of the IMF being European are clearly anachronistic. The composition of the G7 has been a little more malleable, as it expanded to a G8 in the 1990s after Russia abandoned central planning, and then was superseded by the G20, but this arbitrary division between twenty important countries and the unimportant rest of the world is also unstable, in Asia as much as anywhere else. Economic reasons for why the potential role of Asia in reform of these institutions for global economic governance has increased are easy to find, but the political constraints within and among Asian countries will impede any clear-cut regional leadership in pushing a reform agenda.

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