

***Global Financial Crisis: Fundamental Causes and Remedies***

By

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**23<sup>rd</sup> Asia-Pacific Roundtable**

1-4 June 2009

Sheraton Imperial Kuala Lumpur Hotel

## ***Global Financial Crisis: Fundamental Causes and Remedies***

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The real cause of the current global economic crisis is the global macroeconomic imbalance.

Like anything in life, an imbalance leads to adjustment and / or a fall.

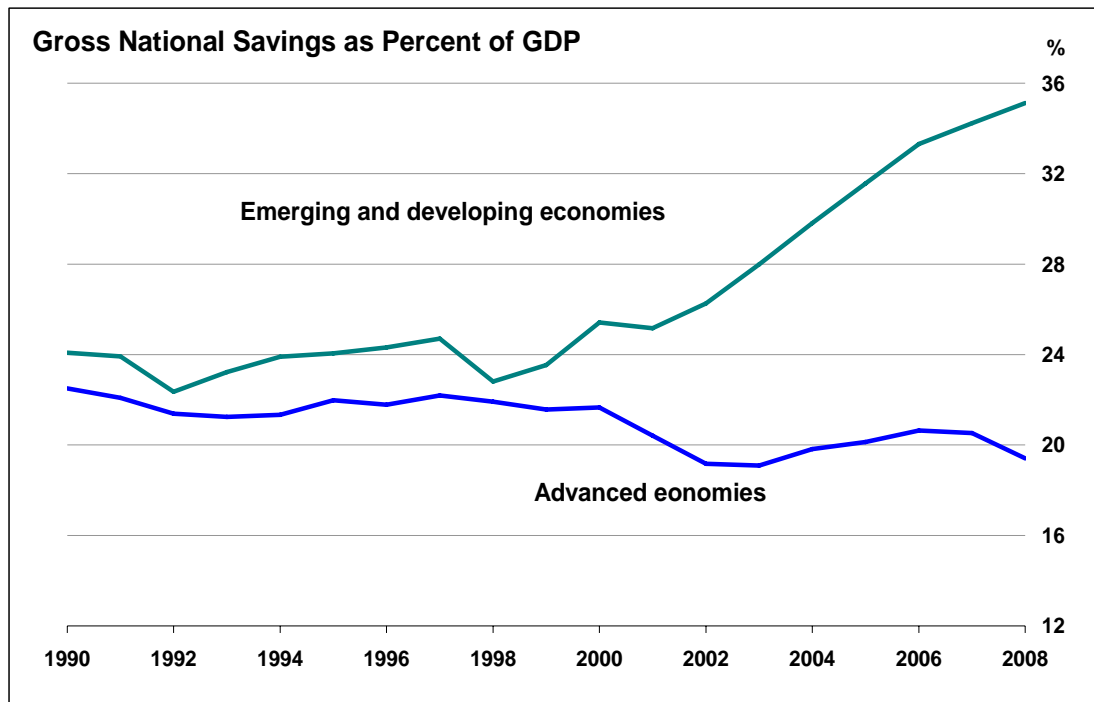
The bigger the imbalance, the bigger the fall.

This imbalance is about the industrialized West consumed too much, and the rest of the world particularly Asia produced too much, for consumption by the West.

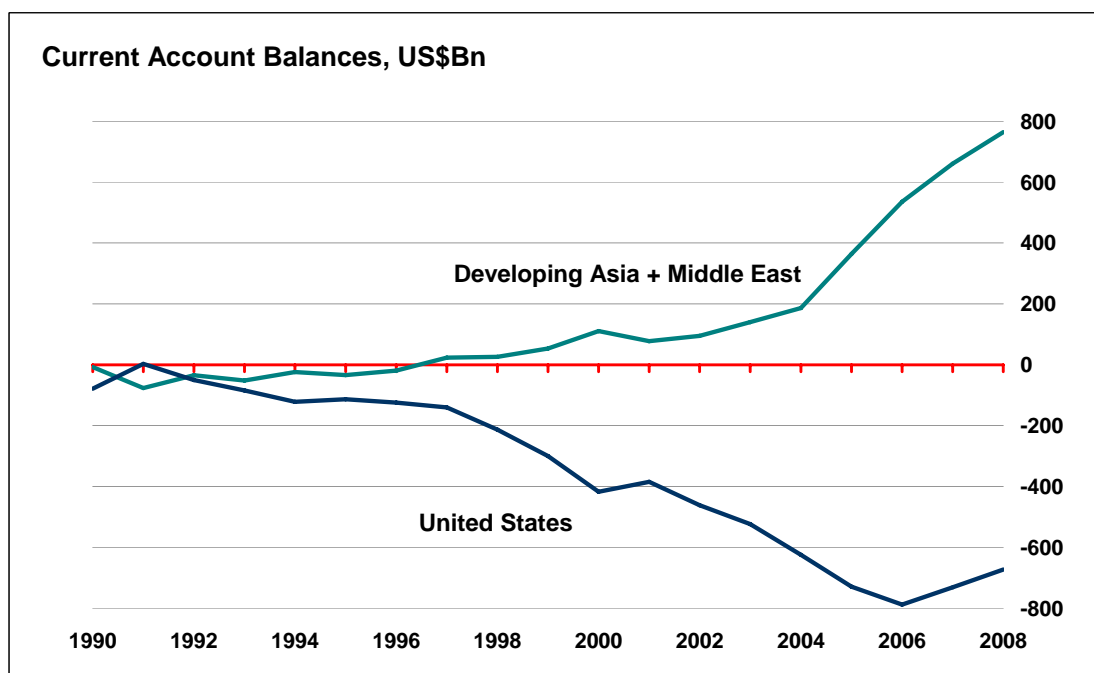
The serious imbalance started about 2000, and was able to go on accumulating for a long time because the financial market facilitated the flow of the surplus countries, i.e. Asia, to be used by the deficit countries, mainly the US.

As eventually the buyers have to pay, the whole process of buying, selling, and financing collapsed.

The rest is history !



Source: IMF



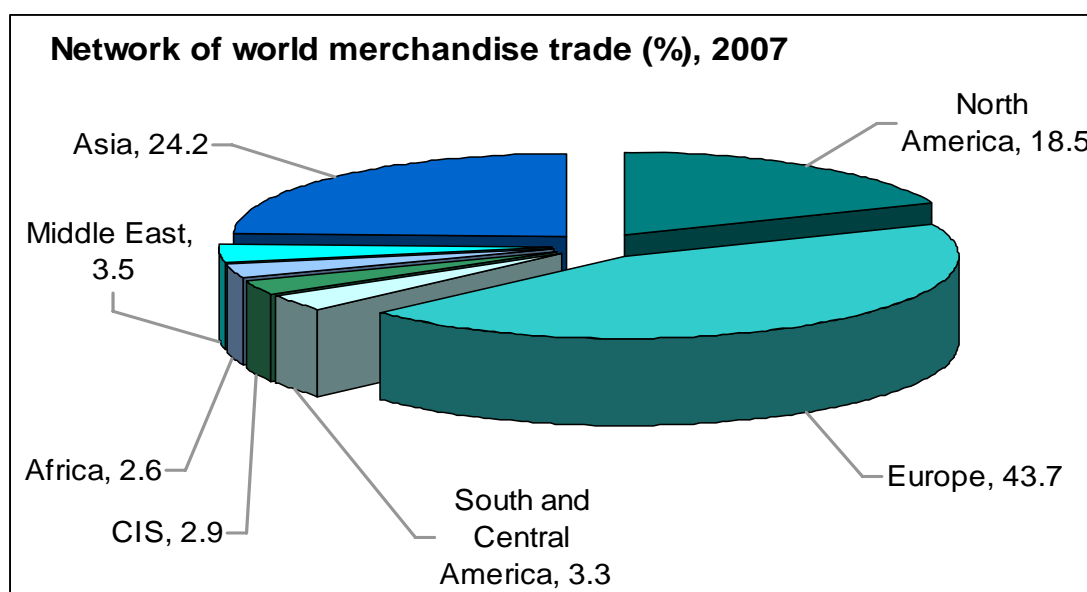
Source: IMF

In retrospect, the current global economic crisis should have been foreseen.

It could be said to have started when practically every country has adopted an export – oriented market economy strategy.

1960s	NIEs
1970s	ASEAN
1980s	China
1990s	India, Indochina, etc., etc.

As the West was the only real market, most exports, about 2/3, ended up in the West. Thus the deficit West and the surplus East.



Source: WTO

And there was very little trade adjustment because the surplus East kept their exchange rates lower than what they would have been.

By the end of 2007, foreign exchange reserve of Asia, excluding Japan, and the Middle East amounted to \$3Trillion.

#### Major holders of FX reserves, US\$Bn

	2007
China	1,528.2
Taiwan	270.3
India	266.6
Korea	262.7
Hong Kong	152.7

These reserves were mainly invested in the West.

**Major Foreign Holders of US Treasury Securities, BnUS\$  
(Holding at end period)**

	2006	2007	2008
Japan	622.9	581.2	626.0
China	396.9	477.6	727.4
Hong Kong	54	51.2	77.2
Taiwan	59.4	38.2	71.8
Singapore	31.3	39.8	40.8
Korea	66.7	39.2	31.3
Thailand	16.9	27.4	32.4
India	14.6	14.9	29.2
<i>Sub-total</i>	<i>1,262.7</i>	<i>1,269.5</i>	<i>1,636.1</i>
<i>Share to grand total (%)</i>	<i>60.0</i>	<i>53.9</i>	<i>53.2</i>
<b>Grand total</b>	<b>2,103.1</b>	<b>2,353.2</b>	<b>3,076.9</b>

*Source: Department of the US Treasury*

The financial market of the West was very free. Financial institutions were allowed a high degree of freedom for financial transactions, with incentive system encouraging short term gains.

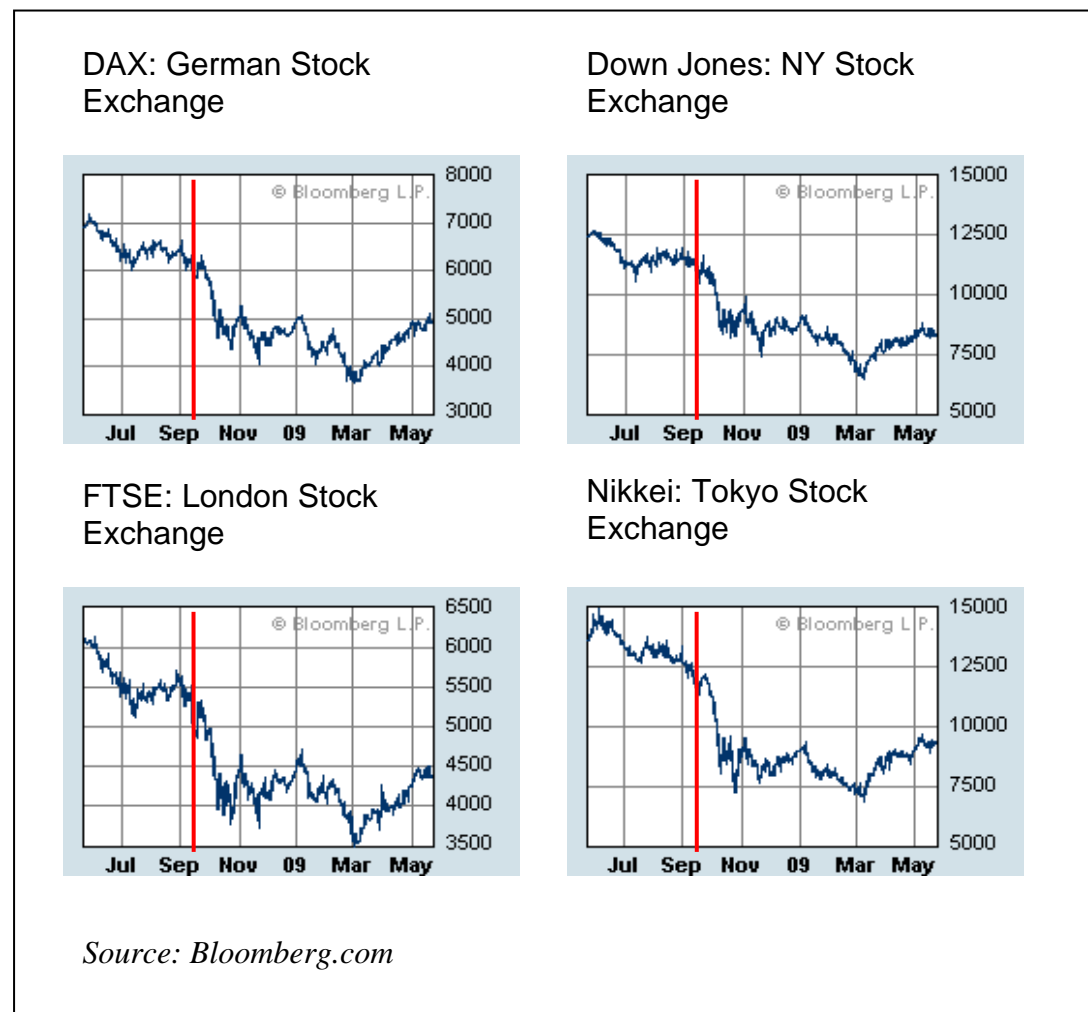
And as financial products are less subject to the law of diminishing marginal utility, meaning that the more the better, financial market should not be expected to be self-adjusting.

Even Adam Smith, the father of free market capitalism, advised that financial market needs to be more regulated than other markets.

So the accumulation of huge reserves denominated mainly in US\$ was made possible by the nature and the structure of the financial market in the present form.

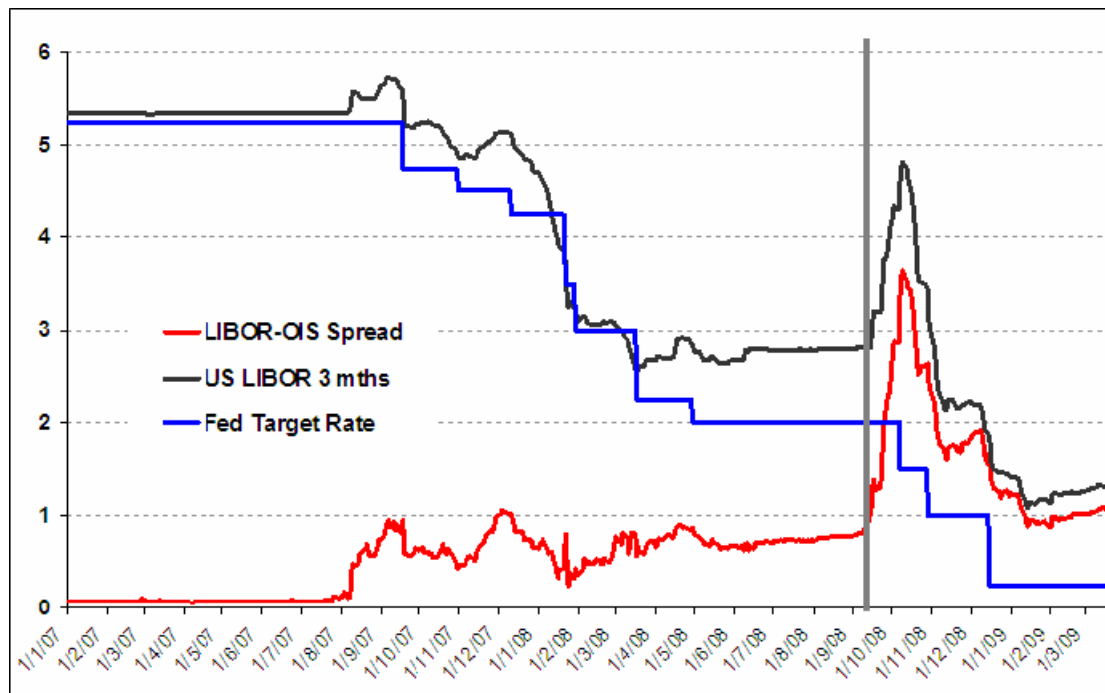
By 2008 when debt defaults began to be serious, the impact spread very quickly to the whole global finance.

The fall of Lehman Brothers on 9/15/2008 signaled the collapses of the global capital market.



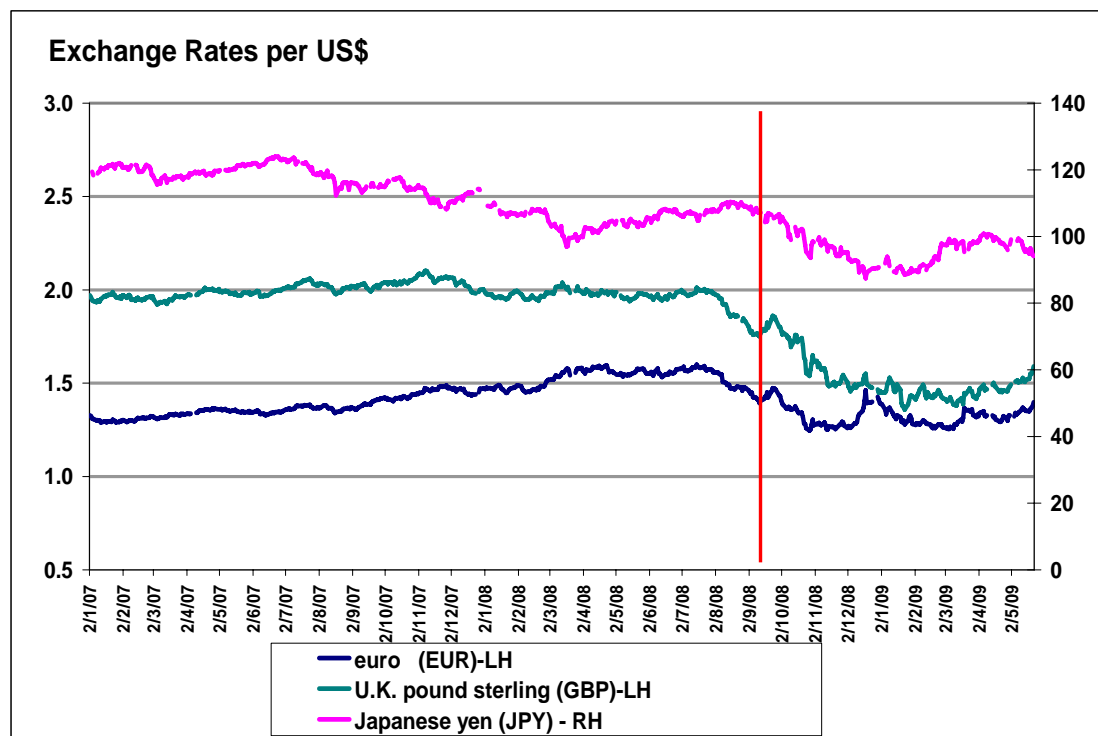
Then global liquidity started disappearing, created havoc in the money market.

Interest spread went up.



Source: Bloomberg.com

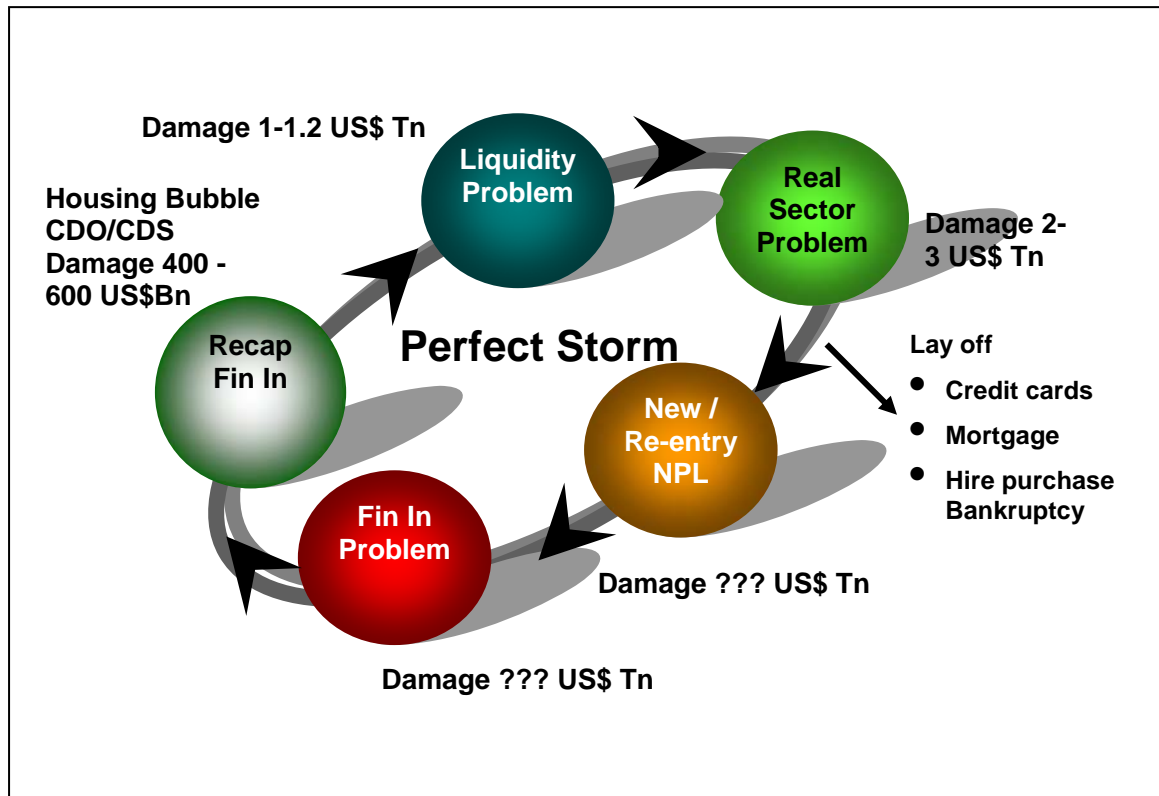
Exchange rates went haywire.



Source: IMF

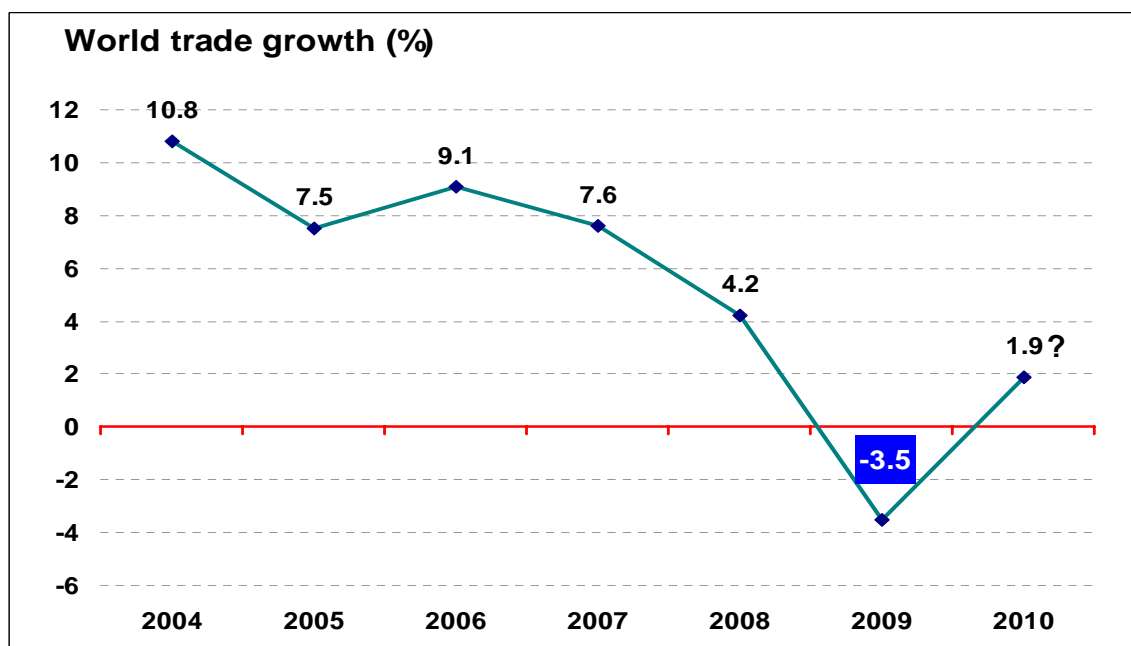
Fortunately for Asia, experiences from the 1997/98 financial crisis kept the Asian financial sector generally sound, thus not as much affected by the global financial crisis.

But eventually the real sector was affected, with growth rates started to fall in Q4 2008.

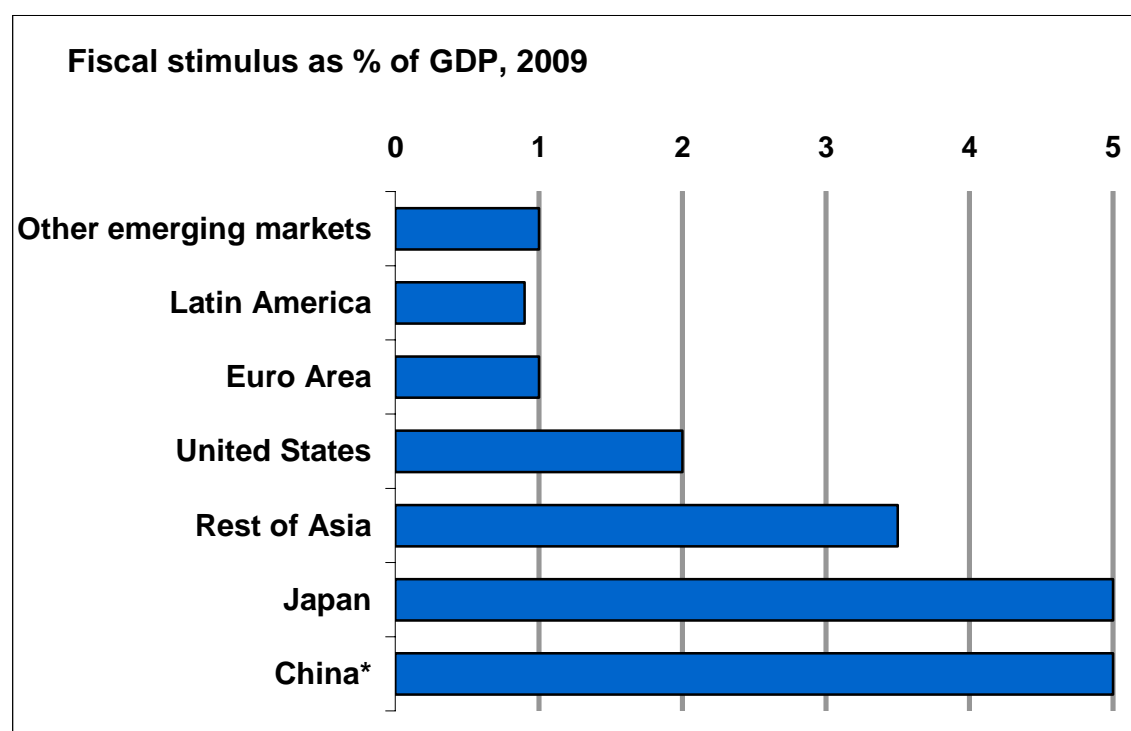


Now in 2009, world trade kept falling, affecting growth rates everywhere. Even with every country's adopting stimulus packages in all forms, the damages are done and could hardly be controlled.





*Source: EIU*



\* Including public infrastructure financed by banks

*Source: The Economist, May 13, 2009*

<b>GDP Growth (%)</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
<b>World</b>	<b>5.2</b>	<b>3.2</b>	<b>-1.3</b>
<i>Advanced economies</i>	<i>2.7</i>	<i>0.9</i>	<i>-3.8</i>
United States	2.0	1.1	-2.8
Euro Area	2.7	0.9	-4.2
Japan	2.4	-0.6	-6.2
<i>Developing Asia</i>	<i>10.6</i>	<i>7.7</i>	<i>4.8</i>
China	13.0	9.0	6.5
India	9.3	7.3	4.5
Malaysia	6.3	4.6	-3.5
Thailand	4.9	2.6	-3.0

*Source: IMF*

The crisis tells us very clearly that the global economic model of the last two to three decades is not sustainable.

Global macroeconomic must be more balance.

Global financial market must be more stable.

This crisis should not be wasted.

We should treat it as an opportunity for a real change.

For Asia, we should invest more in our infrastructure, education and health care. This would increase the share of our real intra-Asia trade, and reduce the surplus with the West.

This could mean bigger role for our state enterprises, which should be welcome if they are corporatised, with a strong system of good corporate governance.

As for the global financial system, we should support a more regulated regime, with stronger and more global – oriented public institutions like the IMF, the World Bank, [supplemented by](#) the Asian Development Bank.

We should also be more serious about the development of our Asian money and capital market, so that more saving and investment can be made in Asia, for Asia.

With these reform and changes, we can expect our economies to slowly recover, continuing with low growth for a few years.

[In the meantime](#), [we](#) must be ready to deal with poverty and social problems associated with low growth.

But, handled properly, we can come out of this crisis with a more sustainable economic development for all of us, and the rest of the world.