

26/10/1998

US, Wall Street begin to see crisis threat

Jun Nishikawa

SAKAKIBARA: The global economy is facing its worst crisis since World War II. In other words, the free flow of capital and so forth was being backed by the market force, and global capitalism was moving rapidly backed by that market force. But that global capital is now facing a crisis.

The United States and Wall Street, which is really the core and centre of the global capitalism, is now beginning to see the danger and collapse in their own place.

So the collapse of Long-Term Capital Management Fund is really a symbolic thing. When the LTCM went bankrupt, Financial Times published an article saying that it was an incidence of Western crony capitalism.

When Asian economies collapsed, countries in the West attacked the Asian so-called crony capitalism. But now LTCM is being criticised as being representative of Western cronyism. The Financial Times article was very interesting.

So Wall Street and the Western financial system are facing the crisis, banks and financial institutions are all facing hard times and they are undertaking restructuring activities as well.

Times really are changing and I believe that the Japanese economy is also facing one of the most serious, I should say the most serious crisis, since World War II.

What is happening is a global credit crunch and this is happening not only in Asia but also in other developing countries.

Latin American countries, for example, even if they want to get private capital to come in, will have to pay a high interest rate, perhaps an interest rate of treasury bills plus 15 per cent added to it. That is the kind of premium interest rates they have to pay if they want to get private capital to come into their country.

And as for hedge funds and the Western banks which supported them, they are now aware of the risks and they are withdrawing their money and I think this is happening in Japan too. You know that as well, the Japanese banks are withdrawing their money and so there is a severe credit crunch in Japan.

How do we go about responding to this credit crunch? I think that is one of the most important things that we have to think about.

For the time being, I think private capital will not be going to the developing countries. Or I should say that private capital will not be going across borders. They will try to stay within their own country.

In the past three years, there was such rapid movement of capital; capital was moving not only to neighbouring countries but to other countries as well as from the US and other advanced countries.

But now all these countries, the advanced countries, as well as the US are hard hit and so now I think people are starting to have a change in their direction.

How are we going to go about responding to this? I think it was done in the 1930s since the co-ordinated Keynesian policies are very important. I think the public sector has to play a great role in terms of economic stimulus packages and so on.

When public money is available, use the public money. Because there is such a credit crunch among the private capital and public money can supplement or complement that.

Here in Japan, that would mean infusion of public money into banks and

this has to be done as quickly as possible. Now in Asia, we have the so-called Miyazawa initiative or concept which was pronounced at the International Monetary Fund annual meeting. That concept should be employed with some US\$30 billion (RM114 billion) being channelled into Asian countries.

We would like to have large sums but for the time being US\$30 billion would be channelled into Malaysia and to other Asian countries as quickly as possible so that with that money Asian countries can be assisted to come back and stand on their own feet once again.

For the global economy, the recovery of the Japanese economy is extremely important as the US will go into a decline somewhat. The American GNP growth will decline. I hope America will have a soft landing but America will be in recessionary phase.

I think Europe also has to take steps as I think in the years to come, the European economies will be heading towards contraction of their economies and I think Latin America is going into a real serious situation now and they will be exposed to great dangers and risks.

That being the case for the global economy, only Asia will be able to support the global economy. Asia was the first one to face the crisis and so Asia should be the first one to get out of this crisis and support the global economy. I think it is important for us to try to build that kind of structure.

NISHIKAWA: Mr Sakakibara was fighting all by himself with no support whatsoever. Because of the Asian crisis, people began to say, especially the West and Europeans, that the Asian crisis was due to Asian corruption and Asian sort of crony capitalism and so forth and at that time Sakakibara was saying that the Asian crisis was really a part and aspect of capitalism.

He was trying to convince the West - America and Europe - but he was the only one who was saying that and fighting alone.

But Dr Mahathir also said the current crisis is not just an Asian crisis but it was a global crisis of capitalism. And I think people are beginning to realise that globally. So I think in the last eight months there have been some very rapid changes in people's thinking.

The post-Cold War market economy system and with the current crisis, Malaysia has adopted the fixed exchange system. Does that mean an end or a modification to market economy, free economy or is this something that is happening only in Malaysia? Or is it going to happen in other countries as well?

HATAKEYAMA: This is not a modification. The fixed exchange rate has been implemented everywhere. Japan used to have fixed exchange rate and even now Hong Kong has a currency board and they have pegged their currency to the US dollar.

In Malaysia as in other countries, until last July, they had linked their currency to the US dollar and they enjoyed market economy and liberal economy, and so the fixed exchange rate is not against the market economy. Any comments Prime Minister Sir?

DR MAHATHIR: I agree that a fixed exchange rate is not something against free market economy. Simply because in the immediate post-World War period, everybody was happy to practise fixed exchange rate under the Bretton Woods regime.

It was only because a few countries decided to renege on their undertaking to the Bretton Woods regime and devalued their currencies that later on, it was decided that the market should fix the exchange rate.

But under the fixed exchange rate regime of Bretton Woods, the countries after the war prospered and were able to overcome all the difficulties they had during the war. So it is not a bad system.

The problem now is that we have a fixed mind. We seem to think that we should not fix the exchange rate no matter what happens. If people die and if a million people were thrown out of work and if people suffer, that is all right because we must support the market controlled exchange rate.

I think we should get away from that kind of thinking. We should examine the effects rather than just the cost.

If you believe in something and you believe in it almost as if it is a religion, it cannot be changed at all even if people suffer. Then, of course, we are going to continue suffering.

But I think when you come to a stage when you see the bad effects of the market fixing and playing around with fluctuating exchange rate, then we should be prepared to revise our thinking to open up our minds and to see new evidence as to whether the present system is good or bad.

And if we find that the fixed exchange rate would help the world's economy we should examine it, perhaps modify it, or regulate it but we should not shut our minds from considering alternatives.

SAKAKIBARA: This is the time that huge amounts of capital moves across borders instantly, so what kind of exchange rate policy should we take?

Academically and practically, we have no answers to this. We are now facing a new situation where huge amounts of money can be moved in an instant. It is very important for each Government to prepare prescriptions against that.

But as Dr Mahathir said in his speech on market fundamentalism, we should not stick to market fundamentals as markets are not perfect and markets cannot do everything. So we experienced market failure in the past year, there are defects in the markets. So we must recognise that.

So what kind of exchange policy should we take? That is a very difficult question. Even among G-7, it was agreed that we should continue and develop discussion on this matter.

In Indonesia and Thailand, the IMF and G-7 would like to propose a float exchange rate but in Russia, they should have a fixed currency exchange. In Hong Kong, there is a currency board that pegged their currency to the US dollar. And we support the currency board.

Even in the IMF, or the G7, we do not know what kind of exchange rate regime is best and we have not done a good discussion, we have no consensus yet. But we will have such a discussion.

But the most important thing is the current crisis, the system of capital flow that we have which I call global and virtual system and this is unstable.

The global and virtual system is very unstable. A few months ago, a few hedge funds, a lot of hedge funds failed so this system is unstable. And everybody agreed that it is unstable.

So how can we stabilise this unstable system? We have to discuss this, and about capital regime and exchange rate regime.

Dr Mahathir has taken one policy that is very bold, experimental. However, in such a confusing era, this is one of the boldest challenges against this difficult age.

NISHIKAWA: Is it possible to regulate? Ever since the crisis occurred, we have been saying that the IMF should monitor the movement of short-term capital.

Monitor, really, is a strong word. What kind of short-term capital is going where and is used for what? That kind of information is needed.

In the case of Indonesia, the Indonesian companies borrowed so much money from Singapore on a dollar-denominated basis. How much was that? And what kind of transactions were taking place particularly the off-balance trade in the derivatives trading and so forth?

I think the disclosure of information is extremely important and we have

been asking for information disclosure, particularly where there is a lot of money being lent. The lenders' activities must be monitored and the information must be disclosed about them. And it is the same with the borrowers.

DR MAHATHIR: Talk of huge amounts of capital, huge amounts of money in this world. But actually it does not exist. There is no such money.

We know, for example, that trade in currency is 20 to 30 times bigger than total world trade. Now, do we have 20 or 30 times that amount of money? Actually we don't.

In Malaysia, the total amount of money, actual money, cash issued by the Government, is only about US\$20 billion but, of course, our trade is very, very much bigger than that.

But in currency trading what they are doing is moving figures on computer screens and they leverage their funds by 20 times and in the case of LTCM by 200 times. They had US\$4 billion and they had borrowed more than 200 times more.

Was the money actually transferred to them? It was not. It was just a number of figures which they can use to buy and sell the currency.

So this money, this habit of leveraging at such a high rate should be stopped. Once you stop that, the problem becomes proportionately smaller and easier to deal with.

The first move really is to prevent these people from borrowing multiples of the amount of the money that they have because they are dealing with virtual money, not real money.

If they borrow, LTCM borrows, US\$1 trillion it does not mean that they move US\$1 trillion. These are figures and they are supposed to be trading and the figures are exchanged as they trade but actually there is no money involved.

If we can stop them from borrowing huge multiples of their capital, then I think the problem becomes more controllable. So this is one aspect that we have to study.

We must really deal in real things, not virtual things and currency trading is very much virtual trading and yet the damage that it causes to countries and people is very, very real.

(END)