Volume LVIX No. 1
ISSN 1655-1516
June 2022

The Philippine Review of Economics

ARTICLES IN THIS ISSUE

A joint publication of the **University of the Philippines School of Economics** and the **Philippine Economic Society**

The Philippine Review of Economics

A joint publication of the UP School of Economics (UPSE)
and the Philippine Economic Society (PES)

Aims and Scope: The *Philippine Review of Economics* (PRE) invites theoretical and empirical articles on economics and economic development. Papers on the Philippines, Asian and other developing economies are especially welcome. Book reviews will also be considered.

The PRE is published jointly by the UP School of Economics and the Philippine Economic Society. Its contents are indexed in the *Journal of Economic Literature*, EconLit, and RePec. PRE's readership includes economists and other social scientists in academe, business, government, and development research institutions.

Publication Information: The PRE (ISSN 1655-1516) is a peer-reviewed journal published every June and December of each year. A searchable database of published articles and their abstracts is available at the PRE website (http://pre.econ.upd.edu.ph).

Subscription Information:
Subscription correspondence may be sent to the following addresses:

- css@pssc.org.ph
- PSSC Central Subscription Service,
  PSSCenter, Commonwealth Avenue, 1101, Diliman, Quezon City, Philippines.
  P.O. Box 205, UP Post Office, Diliman, Quezon City, Philippines 1101
  PHONE: 922-9627, FAX: 924-4178/926-5179

Submissions: Authors may submit their manuscripts to the addresses below:

- pre@econ.upd.edu.ph or pre.upse@upd.edu.ph
- The Editor, The Philippine Review of Economics, Rm 237, School of Economics, University of the Philippines, Diliman, Quezon City, 1101.

Manuscripts must be written in English and in MS Word format. All graphs and tables must be in Excel format. Submission of a manuscript shall be understood by the PRE as indicating that the manuscript is not under consideration for publication in other journals. All submissions must include the title of the paper, author information, an abstract of no more than 150 words, and a list of 3–4 keywords. Complete guidelines can be viewed in the PRE's website.

Acknowledgements: The PRE gratefully acknowledges the financial support towards its publication provided by the Philippine Center for Economic Development (PCED). The Review nonetheless follows an independent editorial policy. The articles published reflect solely the editorial judgement of the editors and the views of their respective authors.

The Philippine Economic Society

Founded 1961

The Philippine Economic Society (PES) was established in August 1962 as a nonstock, nonprofit professional organization of economists.

Over the years, the PES has served as one of the strongest networks of economists in the academe, government, and business sector.

Recognized in the international community of professional economic associations and a founding member of the Federation of ASEAN Economic Associations (FAEA), the PES continuously provides a venue for open and free discussions of a wide range of policy issues through its conferences and symposia.

Through its journal, the *Philippine Review of Economics* (PRE), which is jointly published with the UP School of Economics, the Society performs a major role in improving the standard of economic research in the country and in disseminating new research findings.

At present the society enjoys the membership of some 800 economists and professionals from the academe, government, and private sector.

- Lifetime Membership – Any regular member who pays the lifetime membership dues shall be granted lifetime membership and shall have the rights, privileges, and responsibilities of a regular member, except for the payment of the annual dues.
- Regular Membership – Limited to individuals 21 years of age or older who have obtained at least a bachelor's degree in economics, or who, in the opinion of the Board of Directors, have shown sufficient familiarity and understanding of the science of economics to warrant admission to the Society. Candidates who have been accepted shall become members of the Society only upon payment of annual dues for the current year.
- Junior Membership – This is reserved for full-time college or graduate students majoring in economics. Affiliation for junior membership is coursed through the Junior Philippine Economic Society (JPES).

For more information, visit: www.phileconsociety.org.

The Philippine Review of Economics

Vol. LVIX No. 1
June 2022
ISSN 1655-1516
DOI: 10.37907/ERP2202J

PRE The Philippine Review of Economics
59(1):156-163. DOI:10.37907/6ERP2202J

Book Review

Sarah Lynne S. Daway-Ducanes*
University of the Philippines

Hoe Ee Khor, Diwa C. Guinigundo and Masahiro Kawai, eds. *Trauma to triumph: rising from the ashes of the Asian Financial Crisis*. 2022. Singapore: World Scientific Publishing Co. Pte. Ltd. and ASEAN+3 Macroeconomic Research Office (AMRO).

Trauma to triumph: rising from the ashes of the Asian Financial Crisis (edited by Hoe Ee Khor, Diwa C. Guinigundo and Masahiro Kawai) is an epic endeavor to link the devastation and "trauma" from the 1997-98 Asian Financial Crisis (AFC) in the ASEAN+3 region to the adoption of key domestic structural reforms and the establishment of regional financial cooperative mechanisms, which would be instrumental to the region's "triumphs" of recovering and growing in the AFC's aftermath, weathering the adverse effects of the 2007-08 Global Financial Crisis (GFC) and even thriving in the post-GFC period. In the midst of the still looming threat of the COVID-19 global pandemic, and the new threats posed by the Ukraine-Russia war and cost-push global inflation, the titular "triumph" may also extend to the current opportunities for greater regional cooperation to overcome these challenges.

With its almost 900 pages spread over five main parts, this book is indeed a deep wellspring of reference material for classes on macroeconomics and monetary and financial economics. Economic history classes would also benefit from the richness of the narratives and diversity of perspectives on the effects of two financial crises on the region and the corresponding policy and institutional responses. "Part I: Introduction and Overview" alone may be used as a stand-alone supplementary reading for both undergraduate and graduate classes as it not only contextualizes, but also presents a preview of the main points of the succeeding chapters.

"Part II: What Happened During the Asian Financial Crisis and the Global Financial Crisis" is a never-before-seen compilation of interviews of those who were at the helms of their respective economies, as well as representatives from the International Monetary Fund (IMF) and the World Bank, who were directly involved in the policy discussions during the AFC. These interviews bring to

* Address all correspondence to ssdawayducanes@up.edu.ph.

light the rationale and motivation, including the socio-political considerations, for the concoction of policies adopted to address the AFC, and at the same time enable the reader direct insights into the interviewees' forthright assessments on the appropriateness of these policy responses. Some of the main takeaways from these interviews are as follows:

- The AFC was unlike any crisis seen anywhere before. Except for Thailand (Chapter 2), whose fundamentals were already considered weak in the eve of the AFC and where the speculative attacks first occurred, the rest of the Asian countries that were subsequently subjected to speculative attacks had fundamentals that were considered sound. Accordingly, the severity and speed with which the contagion spread was largely unexpected in Hong Kong (Chapter 7), Indonesia (Chapter 3), Malaysia (Chapter 5), the Philippines (Chapter 6), Singapore (Chapter 8), and South Korea (Chapter 4).
- The AFC brought to the fore hidden vulnerabilities among the hitherto hailed "Asian Tigers", mainly in terms of "double mismatches" in currency and maturity, large unhedged external corporate debt, and banking supervision weaknesses and regulatory oversight.
- Countries that sought the help of the IMF, such as Indonesia, South Korea, and Thailand, were subjected to its "panacea" of contractionary fiscal policy to raise fiscal surplus and contractionary monetary policy to raise interest rates and prevent currencies from further depreciating, along with impositions for fast-tracking structural reforms in the midst of uncertainty, which turned out to be more destabilizing, and thus, aggravated the recessionary effects of the AFC in these economies. This largely stemmed from the IMF's limited technical capacity and resources to understand and address the country- and region-specific features of the crisis. For instance, the high interest rates imposed in Korea discounted the fact that promissory notes were used as credit in corporate transactions [Khor, Guinigundo, and Kawai 2022:100]. Thus, raising interest rates, which rendered some firms insolvent, had adverse cascading effects even on firms that were in good standing, but held the former's post-dated checks. Moreover, the IMF was unprepared to mete out large-scale bailout packages in a timely manner [Khor, Guinigundo, and Kawai 2022:101], so that Japan had to initiate what became known as the "Friends of Thailand" group, which provided supplementary financial assistance of about USD 7 billion [Khor, Guinigundo, and Kawai 2022:164].
- The right policy implemented in the wrong way may have disastrous effects. In particular, wrong timing and conflicting political interests may derail the best laid plans. The IMF-imposed structural reforms

such as pushing for greater liberalization, restructuring of the financial system, bank closures, etc., which would likely have been beneficial to an economy during normal times, only served to exacerbate the AFC-induced recession when there was much uncertainty in the economy, resulting in adverse unintended consequences, such as the bank runs that happened in Indonesia [Khor, Guinigundo, and Kawai 2022:78]. Moreover, "politics undermined the bank reform effort" in Indonesia [Khor, Guinigundo, and Kawai 2022:78], as some favored yet weak banks were kept liquid, while others more deserving of liquidity support were closed.

- In contrast, countries that did not seek IMF funding, like Malaysia and Hong Kong, were able to adopt policy remedies to tailor-fit the shape and form that the crisis took in their respective economies. Malaysia correctly identified the large roles that speculators and the offshore ringgit market played in shorting the ringgit and facilitating capital flight, exacerbating the crisis in Malaysia (Chapter 4). To further prevent speculators from wreaking havoc on the Malaysian ringgit market, it imposed selective exchange controls, particularly on short-term flows—a move, which was heavily criticized by the US Federal Reserve System (Fed) and the IMF at that time. This, however, turned out to be the appropriate response for the Malaysian economy, further enabling policy makers to implement expansionary fiscal and monetary policies and at the same time implement much-needed reforms in the banking and corporate sectors even at the height of the recession. As a result, Malaysia experienced one of the strongest recoveries in the region, supported by strong external demand; and its aggressive imposition of capital controls on short-term flows served to attract instead more growth-enhancing long-term investments.
- In response to the "double play" made by speculators in shorting both the HKD and the Hong Kong (HK) stocks, the Hong Kong Monetary Authority (HKMA) came back with a "double counter play" by then secretly setting up stocks and futures trading accounts for the HKMA with the three largest stock brokers in Hong Kong. This enabled the HKMA to prevent speculators from shorting the Hong Kong stock market (Chapter 7). While this unconventional monetary policy move was met with international criticism, it was able to successfully stave off speculative attacks against both the HKD and HK stock market.
- As Duck-koo Chung opined, "International finance is closely related to aspects of international politics…" [Khor, Guinigundo, and Kawai 2022:199]. Japan advocated an "Asian Monetary Fund" or AMF (Chapter 9), "a regional financial safety net" [Khor, Guinigundo, and Kawai 2022:166], "which would be more attuned to the needs

and circumstances of its Asian member countries as compared to a globally-oriented IMF" [Khor, Guinigundo, and Kawai 2022:167] and would provide financial assistance supplementary to IMF assistance to troubled member countries. However, the idea was vehemently opposed by the US and the IMF, citing that the presence of such a mechanism for disbursing rescue funds without strict conditionalities, such as those imposed by the IMF, would run the risk of encouraging moral hazard [Khor, Guinigundo, and Kawai 2022:168]; although Eisuke Sakakibara, Japan's vice minister of finance for international affairs, contended that the "unspoken reason" for such opposition was that the AMF would have diminished the dependence of the region on the IMF and the US [Khor, Guinigundo, and Kawai 2022:169]. Thus, the AMF was unable to see the light of day in the face of such international politics at play, including the neutrality of two key regional players—Australia and China—even though the rest of ASEAN+3 were open to the idea.

"Part III: The Asian Financial Crisis and the Global Financial Crisis: Experiences from the ASEAN+3 Economies" is a collection of more in-depth country-specific analyses of what occurred from the eve of the AFC to the GFC and the post-GFC "Taper Tantrum". The analyses benefit from the advantage of both better-evidenced hindsight and a wider perspective afforded by the availability of longer and updated time series data, the use of more formal statistical methods for verification of hypotheses, and the availability of policy lessons from two financial crises. This part also includes a chapter on how ASEAN's newer members—Brunei Darussalam, Cambodia, Lao People's Democratic Republic (PDR), Myanmar, and Vietnam (BCLMV)—fared during the two crises. While each chapter primarily deals with a specific country experience, there were common threads scattered in the different chapters.

1. Before and during the AFC

- "Too early" financial globalization, without the appropriate regulatory and supervisory mechanisms to manage an onslaught of short-term financial flows, resulted in a "buildup of vulnerabilities" [Khor, Guinigundo, and Kawai 2022:247], rendering these Asian economies susceptible to the occurrence of a self-fulfilling bad equilibrium. The Philippines, which did not experience as much capital inflows as its neighbors and already had some of the necessary regulatory and supervisory mechanisms in place as part of the lessons learned from its own balance-of-payments-cum-financial crisis in the early 1980s, was relatively insulated from the adverse effects of the AFC (Part III, Chapter 5).

- The disregard for the warnings of the Mundellian Trilemma at work in the face of financial account openness and pegged currencies (to the USD), coupled with the inordinate focus on the current account instead of the capital account, resulted in a misjudgment of the nature and severity of the crisis, and a subsequent mishandling of IMF policy prescriptions and an aggravation of the AFC's adverse effects.

2. Post-AFC recovery

- Export-led growth enabled the most affected Asian economies a relatively quick bounce back, as currencies were allowed to float and depreciate against the USD, enhancing competitiveness in the global markets for goods and services. Singapore, which kept its currency pegged to the USD, suffered a protracted recovery from loss of competitiveness until it was able to build a comparative advantage in financial services and rise to become a financial center in East Asia.
- To discipline monetary policy in the face of floating exchange rate regimes and open financial/capital accounts, most economies adopted an inflation-targeting regime.
- Given that the pre-AFC definition of "fundamentals" failed to adequately capture the country risks involved, other indicators should be included in the expanded definition of "fundamentals", namely, the real exchange rate, the banking system's strength, and the foreign reserve size [Khor, Guinigundo, and Kawai 2022:249]. For instance, including these considerations would have raised a red flag on Indonesia's vulnerability (i.e., in terms of large unhedged private foreign debt and banking sector regulation weaknesses) to a speculative attack (Chapter 2).
- While the AFC experience showed that reserves alone cannot prevent a massive speculative attack mounted against the local currency in the midst of a crisis, an extensive reservoir of precautionary reserves along with meeting the requirements for an expanded definition of "sound fundamentals" may serve as a signaling mechanism to ward off speculative attacks. Accordingly, the post-AFC period saw monetary authorities in the region building up substantial official reserves as a precautionary measure.
- The common subsequent recognition that financial development is important to overall economic growth spurred domestic financial sector reforms and greater efforts to foster both bilateral and multilateral financial cooperation to build stronger and more resilient financial systems in the region.

3. During the GFC, Post-GFC and Taper Tantrum

- The fallout from the GFC in Asian economies was mainly in the form of reduced export demand for the goods and services by the affected developed economies. Greater dependence on China and intra-regional export demand afforded some insulation during the GFC and V-shaped recoveries in its aftermath.
- Risk aversion and structural reforms and policies adopted as part of the lessons learned during the AFC meant that Asian financial systems were less exposed to “toxic assets” that plagued the financial systems of developed economies in the eve of the GFC.
- In the aftermath of the GFC, the troubled financial sectors of the US and other developed economies in Europe coupled with near-zero interest rates as a result of credit easing in these economies saw financial flows favoring China and emerging economies in Southeast Asia. This resulted in credit and liquidity expansion, and lower costs of borrowing, which contributed to regional growth. However, the surge in financial flows, particularly, in short-term flows, did not come without a downside, as this threatened (1) the stabilities of Asian financial systems in general, as private-sector risk appetites increased with easy credit and liquidity and of inflation-targeting regimes to a certain extent; and (2) the competitiveness of their respective export sectors as domestic currencies started to appreciate in real terms.
- The GFC brought to light the importance of overseeing and managing systemic risk via macroprudential policies (as provided in Basel III) to ensure the overall soundness of the financial systems, as opposed to the pre-GFC emphasis placed on monitoring the soundness of individual financial institutions via microprudential measures. Acknowledging that systemic risk has both cross-sectional (interconnectedness of financial institutions) and temporal (procyclicality) dimensions, countercyclical capital buffers were introduced by monetary authorities in 2011 [Khor, Guinigundo, and Kawai 2022:483] in line with then Fed Chair William McChesney Martin’s statement that the monetary authority’s role is “to take away the punch bowl just as the party gets going” [Fraser 1955:12 as cited in Khor, Guinigundo, and Kawai 2022].
- The late-2013 “Taper Tantrum”, which occurred when the Fed announced its plan to taper its credit easing, resulting in an increase in US bond yields, further resulted in sudden reversals from financial inflows to outflows from Emerging Asia. However, strong fundamentals as well as greater monetary policy credibility and transparency and financial system resilience with the adoption of Basel III requirements enabled Asian economies to weather this with relatively less disruption to their respective financial systems.

"Part IV: Assessments of the Crises and the Development of Regional Financial Cooperation in Asia" takes off from a more regional perspective on the crises and how these crises necessitated the birth and subsequent evolution of key regional financial cooperative mechanisms. Chapter 12 revisits the role that the IMF has played during the AFC and GFC; and how the mishandlings in policy prescriptions in response to the AFC resulted in "IMF stigma" [Khor, Guinigundo, and Kawai 2022:712]. This led the IMF to reevaluate its intervention strategy, shifting from the heavily intrusive "structural conditionality" to "national ownership" of IMF conditional programs.

Chapter 13 details how issues regarding the sufficiency, timeliness and appropriateness of the IMF financial assistance packages drove Japan and other ASEAN+3 economies to initiate regional financial cooperation in the form of the Chiang Mai Initiative (CMI) in 2000—a network of bilateral swaps among member central banks, designed to provide to troubled members "large-scale financing in a timely manner" [Khor, Guinigundo, and Kawai 2022:725] to serve as a supplement to IMF lending; and CMI's subsequent multilateralization, the Chiang Mai Initiative Multilateralism (CMIM) in 2010. To support the operations of CMIM and conduct economic surveillance in the ASEAN+3, the ASEAN+3 Macroeconomic Research Office (AMRO) was established in 2011, and its scope and influence have only expanded through the COVID-19 pandemic.

Chapter 14 assesses the post-GFC performance of regional financial cooperation, discussing the fortification of the scope and modality of CMIM, and the evolution of AMRO as an international organization—a status, which accords it autonomy, enhanced capacity, transparency and accountability, and its own legal identity to institutionalize crucial partnerships with multilateral organizations like the Asian Development Bank (ADB) and IMF. As of this writing, AMRO/CMIM yet falls short as a credible regional monetary fund, but the current global pandemic is expected to fast-track endeavors to strengthen CMIM in particular to ensure that it remains relevant in these crucial times.

Chapter 15 focuses on the contributions of the Executives Meeting of Asia-Pacific (EMEAP)—an annual venue for 11 monetary authorities in the region—to promoting economic and financial cooperation and development in the region; and, in particular, its instrumental role in establishing and developing the Asian Bond Fund (ABF) to promote financial market deepening in the region and provide the necessary liquidity in the face of another speculative attack on the currencies in the region.

Chapter 16 highlights the expected role of the Asian Bonds Market Initiative (ABMI) in mitigating Eichengreen and Hausmann's [1999 as cited in Khor, Guinigundo, and Kawai 2022] "original sin" of using the domestic currency "to borrow abroad or to borrow long term even domestically", as doing so with the existing weaknesses in international financial markets would only lead to currency and term mismatches. Salvation from original sin may come in the form of either dollarization or the development of "deep and liquid domestic markets long-term domestic-currency-denominated securities". While the Asian bonds market has grown in leaps and bounds in the last two decades, it still has a long way to grow for it to be able to adequately address the fast-growing and fast-changing needs of the region; and remains hampered by glaring gaps in levels of financial systems development across the region.

"Part V: Conclusion and Challenges Ahead" reiterates the AFC's deep impact on the region's growth and development trajectory and landscape of integration. The AFC uncovered hidden structural vulnerabilities in ASEAN+3 countries and in addressing these enabled these economies to build back better, to weather the GFC and to thrive even in the post-GFC period. Moreover, both the AFC and GFC highlighted the importance of "holding hands among regional peers to prevent regional crises" [Khor, Guinigundo, and Kawai 2022:855] and to be able to respond appropriately when they do occur. While the ongoing COVID-19 global pandemic has derailed regional growth and development, it has also opened up new challenges and opportunities to further strengthen and deepen existing regional financial cooperative mechanisms to fortify the region's resilience to shocks, and to expand the scope of these mechanisms to enable them to respond with sufficient resources and in a timelier manner.

Given its recurring emphasis on and expectations for greater regional cooperation moving forward, one would expect a discussion of the prospects for an Asian Monetary Union. However, it stops short of doing so, perhaps due to the existing divide not only in levels of economic development, but also equally important, if not more so, the diversity of socioeconomic and political ideologies in the region.

This book is not indeed for the faint-hearted. The main challenge to the reader is the sheer length of the tome, enforced by thematic repetitions, particularly in Parts II and III and also, to a certain extent, in Part IV. Given the multiplicity of authors involved, this is largely unavoidable. And yet this feature might also be considered a strength in that each country chapter may be used as a largely self-contained reference by the interested reader.

Reference

Khor, H.E., D.C. Guinigundo, and M. Kawai, eds. [2022] *Trauma to triumph: rising from the ashes of the Asian Financial Crisis*. Singapore: World Scientific Publishing Co. Pte. Ltd. and ASEAN+3 Macroeconomic Research Office (AMRO).