

Asian national economies are descending into the Inferno

by William Engdahl

While much global attention since late last year has been put on the financial aspects of the alarming collapse of currency and stock market values throughout much of Asia, including Japan, relatively little attention has been paid to the physical economic dimension of the crisis in what only 12 months before was the world's fastest growing industrial region.

One reason for this lack of attention to the economic devastation is the complex nature of the delayed effects of the financial shocks. In January, most of the world's so-called leading economists and financial press were confidently predicting a flood of cheap Asian exports into the markets of Europe and North America. Some even issued dire warnings of a \$300 billion annual U.S. trade deficit as a consequence. This could have triggered a catastrophic collapse of confidence in the dollar. Yet, it has not materialized; today, the deficit stands at a none too admirable \$160 billion.

Outside select areas such as computers and electronics, the world has yet to see any Asian export offensive. Why? The answer sheds light on the ominous nature of the present global crisis. "Traditional textbook economic theory projects a positive boost in exports if a country devalues its currency," said a director of a European central bank in a recent interview. "But the models are based on a devaluation of a normal 10-15%. In Asia, we have seen unprecedented collapses of 40%, 50%, to more than 70% for Indonesia's rupiah. This in the space of only weeks, not years. It is now clear when we have shocks of such a huge magnitude, entire national economic structures are being destroyed. Indonesia, for example, cannot buy the imported parts or components to make final assembly for its exports. Prices of some imports in rupiah are up 300% in six months. The economy is grinding to a halt."

The depth of the collapse

Some recent data for various Asian economies illustrate the depth of the collapse of economic structures under way. On April 16, it was announced that four Indonesian electric power projects are on the brink of default on \$885 million in bonds, unless the government intervenes and supports the power companies. The debts are in dollars, and the rupiah fell some 74% in value compared to the dollar after last August, making it impossible for the power companies to service their

debt. The collapse of the domestic banking system, a severe drought, and soaring food prices are creating a social tinderbox. In recent weeks, prices of basic foods, including rice, have soared in some areas of Indonesia by 200-300%, putting the economy on the brink of hyperinflation. The World Bank recently issued an estimate that another 20 million Indonesians, in the country of some 210 million, will likely be forced into poverty. That would put the number of those in poverty at more than 20% of the population. Poverty is defined as living on \$2-3 per day.

In the past 25 years, as the World Bank noted, Indonesia had succeeded in reducing the percentage of the population living in poverty, from 60%, down to 11%, a remarkable advance. Much of this had been in the large cities like Jakarta, where unemployment has doubled from 4.4 million to 8.7 million since the crisis began last July. Indonesian companies are being bankrupted by the collapse of the currency, and left unable to service their dollar debts. Lack of trade finance has all but halted any trade by the world's fourth most populous nation. Because of the national wage freeze in effect since 1997, and an inflation rate of 50%, real wages will be slashed by half for those fortunate enough even to have a job.

In South Korea, a member of the Organization for Economic Cooperation and Development (OECD), and formerly the world's 11th largest industrial nation, the situation is similarly catastrophic. Despite a creditor reorganization agreement between the Korean *chaebol* industrial companies, foreign banks, and Korea's government, extending the due date (at an added interest cost, of course) for \$23 billion of Korea's \$160 billion foreign debt, that is only a small part of the problem. The Korean currency, the won, is down some 40% since last November, and the next chunk of foreign debt comes due at the end of May to early June. Lack of any recovery in the won makes it impossible for Korean companies to repay the dollar or yen debts, and paralyzes them from undertaking urgently needed restructuring or export initiatives.

Since this past November, when the crisis hit Korea full force, Korean companies have gone bankrupt at a rate of 2,000 per month. According to Korean officials, high interest rates, a condition demanded by the International Monetary Fund

(IMF) to “stabilize” the won, have accelerated the rate of company failures. Seoul is now in an open policy fight with the IMF and the World Bank over Korean plans to use a small part of the \$60 billion IMF and World Bank rescue funds to help stabilize critical *chaebol* industrial groups. To date, major economic disruptions have occurred in Korea’s economy, as smaller parts suppliers to the large *chaebol*, such as Daewoo or Samsung, have gone bankrupt, disrupting a far larger production flow. World Bank President James Wolfensohn reportedly told Korea, “No public funds for bailing out industry.” But, there are ample funds, it would seem, for bailing out reckless foreign lender banks in Paris, London, and Tokyo.

As recently as February, the IMF projected Korea’s economic growth for 1998 at 1%. In 1997, it was 5.5%. Today, the IMF has been forced to lower growth estimates to -0.8%. Korean companies, mainly small and medium-sized, are going bankrupt at a record pace, and the entire chain of production is being damaged as a result. Until April 21, a national strike of 14,000 workers at the bankrupt KIA Motors Co. was protesting a threatened takeover and mass layoffs at the automaker after it went under several months ago. IMF conditions for releasing some \$60 billion to bail out Korea include demands for savage industry restructuring, which will drastically increase unemployment in coming weeks.

Malaysia, which set a national goal to bring the country into the ranks of the industrialized OECD by 2020, is being forced to slash new spending on infrastructure. The government has cancelled some \$18 billion in projects because of the crisis. Construction jobs this year will contract by -0.5%, the first negative growth after years of job growth at the rate of 11-14%. A monorail transport project in Kuala Lumpur, a 221 kilometer mountain highway linking the interior to the capital, the Bakun Dam, an international airport in the north, and a 95 km bridge across the Malacca Strait, have all been cancelled or delayed indefinitely.

The crisis hits Japan

The economic impact of the Asian crisis is stark in the case of Asia’s largest industrial economy, Japan. In 1997, some 40% of all Japanese exports went to Asian countries, including China. Japan enjoyed a huge trade surplus, but that is now collapsing and threatening the economy with a new wave of crises.

In March, Japan’s trade with the rest of Asia dropped 25%, compared with a year earlier. The March trade surplus with Thailand fell 81%, and with Korea, 65%. The Asian economies are simply unable to finance needed Japanese machine tools and other imports for their own economic growth. In many cases Japan exports sub-components for Asian assembly of cars, computers, and manufactured goods.

One vital example is the area of semiconductor equipment, the sophisticated machines used to produce the computer memory chips such as DRAMs. Last year, South Korean companies imported 20% of all Japanese equipment manufac-

ture. In the past four months, Korean imports of the sophisticated chips equipment has collapsed. New orders for the industry in Japan were down 31% in January, with no bottom in sight.

The impact of the Asia crisis on Japan’s depressed economy as well is devastating. Despite historic record lows in Bank of Japan interest rates of 0.5% since 1995, and despite a Weimar-style printing of money at an annual rate of more than 51% in recent months, Japan’s economy continues to descend into depression, bankruptcy, and price deflation, in its worst crisis since the 1920s. One simple reason for this plunge is that Japanese banks, still choking on more than \$1 trillion in bad loans to construction and other companies from the wild 1980s “bubble economy,” are desperately calling in their loans to domestic Japanese companies, forcing many into bankruptcy for lack of funds. In the year ended March 31, according to Tokyo Shoko Research, a record 17,300 Japanese companies, with assets of \$107 billion, went under, a rise of 57% on the year. It estimates that bankruptcies this year will be even worse. Hardest hit will be Japanese construction companies, where banks are already refusing to roll over old debts. Large automakers, such as Mazda and Mitsubishi Motors, are in serious trouble, and several large steel companies, including Kobe Steel and NKK, may go under if Japan’s economy does not rapidly reverse direction.

A collapse of capital inflows

Japanese banks, reeling from the domestic problems, are also the world’s largest creditors to the collapsed Asian countries, with some \$253 billion in Asia loans. The banks, fearing more bad loans, have refused to extend any new credit to Asia, making recovery there almost impossible. In the past seven years, Japanese banks had financed 60% of all project construction in Asia. All Asia is now suffering from a collapse of capital inflows since the crisis last summer.

One of the starkest signs of the devastation to the physical economies of Asia in recent months, has been the emergence of primitive barter trade, a desperation attempt to try to avoid complete trade collapse within Asian economies. Thailand, unable to pay for new F-18 fighter jets, has bartered them to Kuwait, which will pay in oil to the Thai Petroleum Authority. Indonesian airplane producer IPTN will deliver 40 propeller jets to Korea, Thailand, and Malaysia. Thailand will pay in rice, Malaysia with cars. A South Korean government delegation is in Indonesia to discuss barter of Korean electronics, cars, and textiles in exchange for Indonesian oil, rubber, wood, and coal.

The resort to medieval and inefficient barter is a consequence of the cut-off of most trade finance in the region, as domestic banks struggle with bankruptcy, and foreign banks fear the risk of new trade lending. The effect on the economies of East Asia, Japan, South Korea, and the rest of the world are only slowly beginning to be felt. In coming months, that impact will become clearer.