Preface

The depth and the contagious effect of the Asian crisis have taken the world by surprise. Countries that were widely seen as on the path of rapid and sustainable growth were plunged into a deep depression with devastating social consequences. The ripple-effect of it has hit and threatened other emerging countries and they will not leave the industrial world unaffected.

This development has of course created an intensive and far-reaching debate among economists and politicians about causes, cures and preventive measures for the future.

The old debate about business cycle policy seems to be returning in a new guise. The subject had faded away from the attention of policymakers in the industrial countries who seemed to have learned the art of maintaining a more stable growth. But now the Asian crisis has set in motion many of the forces and cumulative effects that were well known in business cycle theories. Our instruments to maintain reasonable stability in the globalising world economy seem to be inadequate.

This book brings together the papers and discussions from a Fondad Conference on this subject held in March 1998 in which I was a participant as well.

The contributions made by the various experts range from detailed matters confronting international and national supervisors (in the second half of the book) to the global implications of the crisis and the approach of the international institutions (found in the first part). All this is very useful and enlightening in my view. And some more fundamental issues emerge.

Ariel Buira, for example, argues forcefully that the IMF should make available more liquidity to defend exchange rates against excessive depreciation. This has indeed been a serious problem in the current Asian crisis. Of course, the initial overvaluation first had to be corrected; but the correction was far too deep and destructive. I think, therefore, that there is strength in Mr. Buira's argument. After all, firm surveillance of exchange rate policies is an essential task of the Fund! The aim of this surveillance should be a reasonable exchange rate *stability* – which is not the same as *rigidity*.

But, on the other hand, there is the feeling that the IMF is already fueling excessive amounts of public finance into these countries. Here another important idea should be considered. Is the IMF already bailing out imprudent private creditors too easily and would more financial support

only feed into this? Would it not be better to create an international mechanism for an IMF-sponsored debt moratorium instead? It is beyond a doubt that if, in future cases, such a moratorium could be introduced at an initial stage of a crisis, less IMF money would be needed for repayment of short-term debts, and more would be available to stabilise exchange rates. In my view, a combination of these two seemingly opposing ideas would be an important improvement of our "financial architecture".

But I believe that more is needed. There is one essential element in the Asian crisis that has not yet been recognised sufficiently. That is that the excessive flows of bank credit into these countries – which came in addition to large inflows of portfolio investments – were possible and to some extent stimulated by credit and liquidity *creation* in offshore financial markets. International bank credit is generally seen as a capital movement from one country to another. However, these capital flows to Asian countries did not in any way diminish bank credits in the industrial countries. They could be financed by attracting deposits in the international inter-bank market. The practice of re-depositing the proceeds of loans in this market leads to the creation of international liquidity in the same way as lending by money-creating banks does within a country.

This uncontrolled source of international liquidity is a fundamental weakness in the present world financial system. Bank credit, which central banks in industrial countries have learned to control within their own borders, has become internationalised and has escaped from normal central bank influence by shifting to Euromarkets and other offshore markets. In my view, this fundamental flaw in our financial system must now be urgently addressed. Central banks should not continue to focus almost exclusively on their own money supply. As I suggested earlier, central banks should cooperate to set up a systematic surveillance system for international liquidity together with the IMF and the BIS. For this purpose they should create a new instrument for international monetary policy, by imposing reserve requirements on international bank lending, for example. This could either be done on the total increase in international lending or on lending increases to specific regions or countries.

A difficulty in such a policy could be that the adequacy or excessiveness of international liquidity cannot be determined by a simple statistical measure. Within countries, the *velocity* of the circulation of money has to be taken into account, besides the *supply* of money. Something similar applies to the international financial scene. A deeper analysis of the world's financial situation is needed. Does a large increase in private international liquidity find its counterpart in the hoarding of official reserves? And is a contraction of bank lending and private international liquidity perhaps compensated by the deficit spending by governments and the reduction of

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official reserves? Or does it threaten to become a recessionary spiral? Such questions have to be addressed in designing an adequate international monetary policy – in the same way that central banks have to learn to do this in their national monetary policies.

Much further thought will have to be given to the different ideas that are discussed in this book. The conference from which it emerges was a well-organised and thought-provoking meeting. We must be grateful to De Nederlandsche Bank and to Fondad for organising it and presenting the results in this book.

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