Resolution of Crisis Hinges on Sustaining Demand for Asian Exports

ANNANDALE-ON-HUDSON, N.Y.--The IMF bailout in Asia will play a critical role in resolving the current financial crisis there, and the U.S. should increase its quota to the fund, according to a policy briefing paper just released by The Jerome Levy Economics Institute. But more important to the ultimate resolution of this crisis will be efforts by the United States, Europe, and Japan to sustain worldwide demand for Asian exports, say the paper's authors, Wynne Godley and Jan Kregel.

"If policies to sustain demand are not implemented, the Asian recovery will not occur," write Godley and Kregel, who contend that the recovery of financial stability in Asian economies will require an increase in their ability to earn foreign exchange to repay their foreign borrowing. This increase can come about only through growth in their net exports, the authors contend.

In the United States and the more developed countries the impact of the crisis has so far been small, and while the direct effect on U.S. trade will probably not itself be large, the authors say that a balanced assessment must take account of indirect effects working through trade linkages worldwide. In this context there are reasons to believe that the full impact on American jobs and profits could eventually be substantial.

Deficit cutting in Western Europe in order to reach new EMU limits is a cause for concern, as is Japan's stagnant economy, the authors say. The booming U.S. economy, which has been driven to new heights largely by rising private spending relative to income, could slow substantially if this rise in private expenditures begins to slacken. This could come about as a result of decreased lending by financial institutions or from a reduction in the rate of growth in incomes caused by the Asian crisis or as a result of losses incurred by banks on their Asian lending.

"Even with the current IMF bailout of Asia, the return to growth and stability in these countries will require sustained expansion in the rest of the developed world," write Godley
and Kregel. "This will require positive policy measures to offset the restrictive effect of the increase in Asian exports to the developed world."


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