The Asian Crisis: Causes and Consequences

The Background:

The crisis which hit a number of economies in Asia in 1997/98 attracted a huge amount of attention in the international press, and among many academics. Most of the economies impacted by the crisis had been growing fast in per capita terms for well over a decade; six were included in the "Asian Miracle" report which was published with much fanfare by the World Bank in 1993. While acknowledging that these eight economies(called high performing Asian economies or HPAEs) were not the only ones to have experienced rapid economic growth in the years from 1960 to 1990, the report claimed that they did 'share some economic characteristics that set them apart from most other developing economies' (World Bank 1993:2). These included avoidance of large fiscal deficits, which helped ensure low to moderate rates of inflation, flexible exchange rates which facilitated the move to export-oriented industrialisation especially in Japan, Taiwan and the Republic of Korea, political leaders who were prepared to follow the advice of technocrats on economic policy, and a generally business-friendly environment, combined with government investment in infrastructure, and education at the primary and secondary levels. Although the report did not address issues of financial liberalization in detail, it pointed out that savings rates in the HPAEs were high by world standards and this was the result of positive real rates of interest, together with policies which 'ensured the security of banks, and made them more convenient to small and rural savers' (World Bank 1993: 16). The report also claimed that the HPAEs had managed to combine rapid growth with declining inequality, in contrast to economies such as Brazil, where growth had been quite rapid, but inequality had increased. As a result of the shared economic growth, human welfare had improved, as measured by life expectancy and educational attainment.

The report claimed that the success was achieved by getting the basics right; private domestic investment grew along with improved human capital. The agricultural sector, while declining as a proportion of GDP, had experienced solid growth and productivity improvements. The basic message of the report was that these economies, which included the Republic of Korea (ROK), Taiwan, Indonesia, Thailand, Malaysia and Singapore, had all pursued "open economic policies" which supported rapid growth of non-traditional exports, which meant manufactured exports rather than the traditional agricultural staples and minerals. All the HPAEs were open to foreign technologies. While the governments of Japan and the ROK had not encouraged foreign direct investment, their companies had relied on licensing of new technologies as well as imports of capital goods to produce a range of manufactures which could compete on global markets. The governments of Hong Kong and Singapore, as well as Thailand, Malaysia and Indonesia had all encouraged foreign direct investment in manufacturing, and in all these economies foreign-invested firms had played an important role in increasing manufactured exports. Their policies contrasted with those in India where economic nationalism was stronger, and foreign investment was not encouraged but domestic firms often had difficult in accessing modern technologies from abroad.

The 1993 report was not without its critics who argued that the World Bank did not acknowledge the key role which governments played not just in Japan, but also in the ROK, Taiwan and Singapore in assisting firms, whether domestic or foreign, to compete in

international markets. The critics claimed that the report rather underplayed this assistance, although it did acknowledge that these governments had often imposed tough performance criteria on assisted firms and withdrew assistance to firms which failed to meet the government targets, especially regarding exports. Some observers also pointed out that, in spite of their progress since the 1960s, Indonesia, Thailand and Malaysia had lower per capita GDP than Taiwan and the ROK in 1996, and this gap reflected problems in these countries which the report did not address at all. Indeed one Japanese economist had criticised the economic growth which had taken place in these three economies, as well as that in the Philippines as "ersatz". Unlike Japan, Taiwan and the ROK these economies had not produced competitive firms managed by indigenous entrepreneurs but rather depended on foreign firms. The larger local firms were often owned and managed by ethnic minorities, especially Chinese, or by members of well-connected families. These firms often depended on protection from imports, and other forms of assistance including bank loans on favourable terms, often from state-owned banks. Unlike in the northeast Asian economies, this assistance was not usually based on strict performance criteria but rather on cronyistic links to those who had political power (Yoshihara 1988).

The term crony capitalism had been used first in the context of the Philippines under Marcos, whose presidency had been brought to an end through a so-called people power revolution in 1986, although his demise did not lead to an immediate improvement in the country's economic performance. Increasingly by the early 1990s critics were pointing to the similarities between the regimes of Marcos and that of Suharto in Indonesia; in 1993 Suharto had been in power for over 25 years, and was increasingly autocratic and impatient with political dissent. Since the 1970s, a number of powerful conglomerates had flourished in Indonesia; most were controlled either by members of Suharto's family or by ethnic Chinese known to be supportive of Suharto and his associates. Supporters of Suharto could point to the fact that his economic policies had produced rapid growth, and this growth was reducing poverty. Indeed the World Bank (1993: Table 1) claimed that over the 1970s and 1980s, poverty had declined more rapidly in Indonesia than in Thailand, Malaysia and Singapore although this finding was challenged by some researchers[1]. But the evidence from the GDP data did show that GDP per capita in Indonesia increased by over 60 per cent between 1983 and 1993, not as fast as in Singapore, Thailand, the ROK and Taiwan but better than China (Table 1). Many observers, both Indonesian and foreign, expected this growth to continue, not just in Indonesia but in the other HPAEs as well. So what went wrong?

This paper will suggest that while economic growth went into reverse in all these economies except Japan and Taiwan in 1998 (in fact GDP per capita fell in Thailand in both 1997 and 1998), the reasons for the growth collapses differed between countries. Thus it could be argued that there was no single "Asian crisis", but rather a series of crises which affected different economies differently. Of the Asian miracle economies (excluding Japan) only Taiwan escaped a decline in per capita GDP, but in several others, including Singapore the

[1] Booth (1997). In that paper I compared the poverty estimates for Indonesia and Thailand and pointed out that although both used roughly the same calorie estimate, the Thai poverty line made higher provision for non-food expenditures, and was thus higher than the Indonesian poverty line. This explains the claim by the World Bank (1993: Table 1.1) that the headcount measure of poverty in was higher than in Indonesia in the 1980s, which many observers, myself included, found implausible

decline was slight and there was a recovery in 1999. By 2000, per capita GDP in Korea, Singapore and Taiwan was above the 1997 level (Table 2). This was also true of the Philippines which had not been included in the World Bank report because of its weak growth record in the 1980s and early 1990s. But Malaysia, Thailand and Indonesia took longer to recover; in Indonesia real per capita GDP only surpassed its 1997 level in 2004. In both Indonesia and Thailand the crisis led to major political changes; President Suharto who had been in power since 1966 resigned in 1998, while in Thailand, political changes led to Thaksin becoming prime minister in 2001.In Malaysia Mahathir stayed on as prime minister but his deputy was forced to resign, and then was imprisoned on charges which many found dubious.

The Crisis in Thailand:

Although some commentators argued that the crisis emerged with little warning in mid-1997, the problems in Thailand had already attracted international attention at least a year earlier. While the World Bank continued to make optimistic statements about the future performance of the HPAEs until 1996, other widely read economic journals were raising doubts. The *Economist* in August 1996 drew parallels between Thailand and Mexico in the run-up to the crisis there in 1994; one obvious similarity were the large current account deficits relative to GDP in both Thailand and Malaysia. In Malaysia much of the deficit was funded by, or indeed resulted from, large inflows of long-term foreign investment, this was less the case in Thailand. In December 1996, the *Financial Times* published a survey of the Thai economy which argued that the high export-driven growth rates of the previous decade were not sustainable, not least because real wages were growing rapidly and the baht was appreciating in real terms[2]. Many of the export-oriented industries which had powered the rapid growth of the previous decade were struggling to compete with products from other parts of Asia, including China. But the Thai government, and especially the Bank of Thailand, appeared determined not to allow the baht to depreciate, because of fears that this would make bankrupt many Thai firms and financial institutions which had borrowed heavily in dollars and yen in the 1990s. By 1997, the foreign debt held by the private sector was estimated to have been around eighty billion dollars.

An important reason for this rapid rise in foreign debt was the establishment in March 1993 of the Bangkok International Banking Facility (BIBF). This was supported by the Bank of Thailand with the intention of making Bangkok a financial centre that could compete with Singapore, especially in the business which was expected to develop in the transitional economies of Southeast Asia which were geographically close to Thailand (Myanmar, Vietnam, Laos and Cambodia)[3]. But in fact the BIBF led to a rapid increase in foreign borrowing by Thai firms and financial institutions, and much of these borrowings went into non-traded sectors of the economy, especially urban real estate. A property boom which had started in the 1980s was given renewed impetus after 1993 (Siamwalla 1997: 66). In

[2] See *Economist*, 24 August, 1996, pp.67-8 and *Financial Times*, 'Thailand Survey', 5 December 1996.

[3] In his analysis of the Asian crisis, Stiglitz (2002: 99-100) argued that capital account liberalization was the single most important factor leading to the crisis and was pushed upon Asian countries in the late 1980s and early 1990s. In fact the establishment of the BIBF was strongly supported by the politically powerful Bangkok banking groups. In Indonesia controls on the capital account had been largely removed by 1970, although there was some pressure to re-impose them after the 1986 devaluation. But these pressures were resisted by most technocrats who argued that more controls would only lead to more corruption.

addition, inflation in Thailand rose above that in other parts of the global economy including the USA, Europe and Japan. This led to a real appreciation of the baht which together with rising wage rates put more pressure on firms trying to export. In the second half of 1996, export growth had slowed from the double digit rates of the previous decade to zero.

Despite these signs, and the growing unease expressed in various publications about the so-called Thai miracle, the Bank of Thailand refused to take any action on the exchange rate, but instead "blustered its way out" with arguments about the supposedly strong fundamentals of the Thai economy which would allow it to weather what were viewed in government circles as short-term problems caused by disturbances in the global economy (Siamwalla 1997: 66-7). The Bank of Thailand used much of its foreign exchange reserves in futile attempts to defend the baht in the early months of 1997, and when the baht was finally floated on July 2, there were in effect no foreign exchange reserves left. What was called a managed float by the authorities in fact led to a rapid devaluation of the baht against the dollar; by early November the price of the dollar in terms of baht had increased by 50 per cent.

Siamwalla (1997) in his perceptive essay on the Thai crisis, places much of the blame for the mismanagement in the years leading up to July 1997 on the decline of the influence of technocrats over economic policy-making. The so-called four agency system was established in 1950s and 1960s by Dr Puey, who used his position as Governor of the Bank of Thailand to coordinate policies between the central bank, the Ministry of Finance (MOF), the Bureau of the Budget and National Economic and Social Development Board (NESDB).Although the Bank of Thailand was nominally under the control of the MOF, in fact it enjoyed considerable independence and Dr Puey used his authority and reputation for honesty to coordinate fiscal and monetary policies across ministries. This gave economic policy a continuity and credibility, in spite of the political upheavals of the 1970s which led to the exile of Dr Puey himself. In 1976. But gradually over the 1980s and into the 1990s the influence of technocrats declined. The two devaluations of the baht in 1981 and 1984 were met considerable opposition, not least in the army, and increasingly the MOF resisted further devaluations. The rapid economic growth of the decade up to 1996 caused both Thai and foreign observers to overlook the decline of an autonomous technocracy, but when serious problems became more obvious in 1996, the cooperation between the four key agencies was minimal (Siamwalla 1997: 71)[4].

Why the Contagion?

Quite quickly after the Thai decision led to a rapid decline in the value of the baht, a consensus seemed to emerge among many observers that there was unlikely to be much contagion to other parts of Asia. Many thought that the Thai problems were serious but not contagious, and pointed to the "strong fundamentals" in the other HPAEs. The reasons for this argument varied across countries. In Indonesia, it was argued that since the large rupiah devaluation in 1986, the government had moved to a managed float which allowed the rupiah to depreciate slowly over the decade up to 1997. This policy, combined with a duty drawback scheme, and other regulatory reforms had led to a rapid export diversification

[4] Further background on the origins and demise of the four agency system can be found in Suehiro (2005).

away from oil and gas, and especially growth in manufactured exports after 1986 (Hill 1996: Chapter 8). Other countries in the region also appeared to have a more flexible approach to exchange rate management, and in several cases including Indonesia, balance of payments deficits were not considered very high relative to GDP. But by the last months of 1997, problems were emerging in several of the other HPAEs, including Indonesia, Korea, Malaysia and even Singapore. On the other hand, Taiwan was not much affected by the crisis; the currency was quite stable, and per capita GDP did not fall at all in 1998, and only by a small amount (less than four percent) in Singapore. But various commentators, and the ratings agencies failed to predict the magnitude of the problems which emerged in Indonesia, Malaysia, and the ROK. Most models also failed to predict the magnitude of the GDP declines, especially in Indonesia. Why was that?

One explanation is that many commentators misinterpreted the balance of payments data, and were particularly influenced by the so-called new view of the balance of payments which emerged over the 1990s. According to authors such as Corden (1994: Chapter 6), it was not the size of the current account deficit that mattered but its causes. A current account deficit, whether positive or negative, is the net result of savings and investment decisions in both the public and the private sectors. If governments habitually run a large budget deficit, and if this deficit is not matched by private savings, then a current account deficit will emerge. If the deficit is funded by borrowing abroad as happened in a number of Latin American countries, then the probable outcome will be a debt crisis, especially if the loans were at variable rates and global interest rates were to rise. But what if the government budget was in balance or even in surplus but a balance of payments deficit were to emerge as a result of increased borrowing by the private sector? Such investment could be directly financed by inward investment, or it could be financed by a domestic investor who borrows abroad. In these cases the domestic investment is tightly tied to inward capital flows, and the current account deficit can be seen as the net result of private investment decisions. If these decisions were based on sound judgements about the economic return on the investments, then there was no need for governments to take policy action. If the judgements turned out to be flawed, as was the case in Thailand, then the cost would be borne by the investor, whether domestic or foreign, and the bank of financial institution which lent the money.

This view of the current account had become influential in several HPAEs by the early 1990s (Montes 1998). But some analysts argued that there were problems with the view that private investment decisions should not be a matter for government concern. If a few relatively small investments turned bad, then that would probably have little impact, but what if some large, high-profile investments were to yield low or even negative returns, such as in the property sector? Would the resulting loss of confidence in turn trigger large-scale capital flight? Withdrawal is easier, if not costless, for portfolio investments, but foreign companies have been known to close factories which they perceive to be unprofitable. And foreign bankers can refuse to roll over loans to corporate clients which are suddenly seen as high risk. It seems clear that is what happened not just in Thailand but also in the ROK, Malaysia and Indonesia in 1997/98.

But if the private sector had run up dangerous levels of foreign debt by the mid-1990s why had the problem not been spotted, either by the governments or international agencies? It

has been argued that the especially in Indonesia, the quality of the data on private capital inflows which were available to both the central bank and the Ministry of Finance was very weak (Kenward 1999: 90). But some evidence was available. Firman and Stiglitz (1998: 28) pointed out that 'roughly two-thirds of the external debt to banks reporting to the Bank for International Settlements was incurred by the non-bank private sector, which was among the highest proportions of any country in the world'. The report issued by the Independent Evaluation Office of the IMF in 2003 stated that the stock of private foreign debt in Indonesia had increased rapidly to US$65 billion before the crisis. The report admitted that "IMF surveillance grossly underestimated the magnitude of short-term debt, hence the vulnerability of capital flows to a shift in market sentiment" (IMF 2003: 61).

A further explanation for failure to detect warning signs in the financial sectors was that many economists in the 1980s and 1990s were inclined to view financial liberalisation as desirable, and ignored the possible damage that liberalisation could cause. In various parts of Asia, financial liberalization took several forms. One was the liberalisation of the capital account of the balance of payments, where the experience across the HPAEs varied widely. Indonesia had removed most controls on capital movements by 1970; the main reason was that, given the corruption known to have been rampant in both the central bank and the Ministry of Finance, it was better to remove the controls and it was preferable for policy makers to have an open system which was easier to monitor. In addition, as Nasution (2000: 153-4) pointed out there were, at least until the 1980s, few reputable private companies in Indonesia that could access international markets. Controls remained in place in Thailand until the establishment of the BIBF in 1993; as was noted above it was expected that the new agency would facilitate loans from Bangkok banks to the emerging markets in other parts of Asia, but in fact most of the lending went to Thai companies. In the ROK, capital account liberalization proceeded in fits and starts from the 1980s onwards, although even by 1996, when the ROK joined the OECD, some controls were still in place, at least in part to curb destabilising capital inflows (IMF 2003 93-4).

In Taiwan, Chu (2012:34) argued that since the 1980s, governments 'fought hard against the rising tide of financial liberalization'; as well as applying a full array of monitoring mechanisms; he claimed that the authorities had not hesitated to introduce temporary capital controls when necessary. Chu (2012: 10) also pointed out that Taiwan has tended to give priority to domestic liberalization of the financial system before removing controls on international flows. This contrasts with Thailand where the BIBF was introduced when the domestic financial system was dominated by a few large domestic banks; this was also the case in Malaysia, although there the government from 1970 onwards was preoccupied with increasing lending to favoured Malay entrepreneurs, who often enjoyed close association with the Malay-dominated coalition which had governed since independence. In Indonesia, the relatively liberal capital account coexisted with a state-dominated banking system until October 1988, when the government removed many controls on the private banking sector, and also permitted some foreign banks to operate more freely. Numbers of private banks proliferated and competition for new depositors became more intense. But by the early 1990s it became clear that the very rapid growth of private banks was causing problems; many of them were closely connected to large conglomerates and most of their lending went to firms connected to the conglomerate. In addition there was inadequate supervision of their foreign activities; in 1991 one of the largest private banks lost hundred of millions of

dollars in currency speculation, mainly carried out by one employee. It was rescued by a massive capital injection from a foundation known to be controlled by the Suharto family. Another large private bank, connected to a leading industrial group whose core business was unrelated to banking, ran into serious liquidity problems in 1992, and finally had its license revoked in 1994.

Advocates of financial deregulation in Indonesia tended to dismiss these episodes as inevitable when a system dominated by a few state-owned banks was opened up to competition from the private sector but by the mid-1990s some observers were raising concern about growing cronyism in the financial sector, and the increasing politicization of major investment decisions. Cole and Slade (1996: Chapter 10), who had earlier been prominent advocates of banking deregulation, admitted that at some stage Indonesia would probably face a financial crisis, the handling of which would be an important test of how sound a structure the reforms had created. Two years later, when the full impact of the crisis on the banking system was becoming clear, they conceded that their cautionary assessments had been much too moderate (Cole and Slade 1998: 62). Others argued that even trying to implement financial reforms in the context of 'deeply entrenched patrimonial state structures' was a mistake (Pincus and Ramli 1998: 732). While this view had considerable support in Indonesia, it should be remembered that the state-dominated banking system which had evolved after 1950 was itself riddled with inefficiencies and dubious lending practices. The problem of connected lending to favoured companies by the state banks was widely discussed well before 1998, and after the crisis erupted it was clear that state banks still accounted for a high proportion of non-performing loans (Pardede 1999: 26).

It can thus be argued that it was politically invoked regulatory failure, rather than premature liberalization which precipitated the crisis in the Indonesian financial sector. In Thailand and Malaysia, although neither country had followed the rather unusual reform sequence of Indonesia, there were also signs of increasing financial sector vulnerability by the mid-1990s. Siamwalla (2001: 5-8) pointed out that although the pre-bubble banking system in Thailand did share some of the features of the continental European bank-based systems which had evolved in the early decades of the 20th century, it lacked many of the strengths of the system, especially compared with Germany and Japan. A number of finance companies incurred difficulties in the late 1970s and early 1980s; some had to be closed although depositors were compensated. Commercial banks were not immune to difficulties either; one collapsed outright in 1984 and had to be taken over by the central bank, and two others had to be given soft loans and capital injections. But when the economic boom accelerated after 1985, the pressure to apply tighter regulatory standards to financial institutions abated, even before the BIBF was established in 1993. Although intended to allow a greater role for foreign banks, in fact the BIBF led to a greater role for Thai banks in the provision of capital to Thai business groups, with important consequences for the Great Bubble of 1993-6 (Siamwalla 2001: 11).

In Malaysia, a modern financial system had begun to develop in the colonial era, with an important role for foreign banks, although their clients were mainly foreign businesses. In addition several banks were established which catered largely to the emerging Chinese business community. After 1970, when the New Economic Policy was introduced in the wake

of serious race riots, the government became far more concerned with assisting Malay business groups through the provision of bank credit. Partly because of this concern, the official approach to financial liberalization had been cautious, as it was feared it might favour foreign business groups and those owned by Malaysian Chinese. Reform of the capital account was also modest, and the central bank had considerable autonomy in exercising its regulatory functions (Athukorola 1998: 91). But some signs of vulnerability were emerging by the mid-1990s; lending to the real estate sector accounted for around 30 to 40 per cent of total lending which was higher than in the Philippines, Korea and Indonesia and about the same as Thailand (Reisen 1998: Table 4)[5]. Bank Bumiputera, which had been established to lend to Malay businesses had already received considerable liquidity support from the state oil company (Petronas) before the crisis, which aggravated the problems of moral hazard for other banks with political connections to the ruling coalition.

As the crisis unfolded in several of the HPAEs in late 1997, several influential commentators pointed out that, in contrast to earlier crises in Latin America and elsewhere, the problems in both Indonesia and Thailand were brought about by private actors; both governments had in fact run modest budget deficits, or even surpluses in some years. This fiscal conservatism had its disadvantages, especially in Thailand, where government education policy was based on a compulsory six year primary cycle, beyond which parents had to pay most of the not inconsiderable costs of second and tertiary education. For many rural households the cost of education beyond the primary level, which often included boarding school fees, was prohibitive. In addition, government policy on infrastructure development was cautious, which led to a concentration of manufacturing industry in the Greater Bangkok region, where port and ground transport facilities were far better than in other regions. In Indonesia by the early 1990s, government planners were placing more emphasis on private sector investment in infrastructure and education, which suited those large conglomerates who wanted a larger share of lucrative projects in telecommunications and other rapidly developing sectors. In addition it had been clear for many years in Indonesia that the government figures on budget deficits were misleading in that they did not take into account the off-budget financing of the state enterprise sector through the state banking system. Hill (1996: 60-61) estimated that the monetary impact of the government sector was negative in a number of years from 1969 to 1992, if the state enterprise loans were taken into account. In other words, government deficits were often much larger than the official estimates showed.

To sum up, there is considerable evidence that the rapid contagion from Thailand to Indonesia, Malaysia and Korea in the latter part of 1997 could have been spotted by warning signals which were downplayed or completely ignored by the governments and by international agencies, let alone the ratings companies. The evidence of large current account deficits was downplayed on the assumption that, to the extent that they were financed by private sector inflows, they should not be the concern of government regulators. Liberalization of both the domestic banking system and the capital account of the balance of payments was generally encouraged by international agencies, even if it took

[5] Pepinsky (2009: 122-3) points out that by the middle years of the 1990s, the composition of capital inflows shifted from foreign direct investment to portfolio investment. The ratio of foreign reserves to the total stock of mobile capital (bank lending and portfolio inflows) fell to below one; it was not the lowest in Asia but lower than Indonesia.

place in a context of weak prudential control over the financial system as a whole. Too much reliance was placed on data about government deficits which were flawed, especially in the Indonesian case. In addition, it was alleged that economic policy-making in most of the HPAEs was taking place in the 1980s and 1990s in the context of political systems which were becoming increasingly riddled by corruption, cronyism and nepotism. The next section looks at this allegation in more detail.

Growing Corruption and Nepotism

One of the rather surprising aspects of the large literature which emerged on the crisis after 1997 was that a number of authors, whose views on the causes of the crisis otherwise differed quite sharply, appeared to agree the corruption was not an important factor. Indeed in the decade before the crisis hit, several influential commentators took a rather relaxed view of the evidence of cronyism, nepotism and corruption, especially in Southeast Asia. The argument put forward by McLeod (1998: 46) and Hill (1999: 68-9) was that pervasive corruption had been compatible with rapid economic growth in Indonesia since the 1960s, so it was implausible to argue that it was corruption which precipitated the crisis. The subject of corruption had received very little attention in the Asian Miracle report, except for a rather brief discussion of the importance of 'insulated bureaucracies' in implementing economic policies (World Bank 1993: 167-9). The report suggested that the poor performance of the Philippines was due to the power of vested interests in that country, and implied that this was much less the case in the HPAEs. While some commentators agreed that, with the exception of Singapore, ASEAN economies were hardly strong development states like Japan, Taiwan and Korea, they pointed to the economic growth of the decade from 1983 to 1993 in Indonesia, Malaysia and Thailand as evidence that these countries were capable of better growth performance than most of the rest of the developing world. Chang (2000: 41), with the Korean experience in mind, argued that cronyism was only a minor factor in bringing about the crisis in the HPAEs; he claimed that it had always been there in most of these countries and there was little evidence that it got worse in the 1990s. At the very least, these arguments ignore the argument of Siamwalla about the decline of the influence of technocrats in Thailand. It also ignores the evidence of the much weaker role of technocrats in Indonesia after 1993. Suharto was re-elected for a sixth five-year term as president in that year, and then announced a cabinet where the role of technocrats seemed much weaker, and that of the controversial Minister of Research and Technology, Dr B.J.Habibie, much stronger (Booth 2001: 29-30). The IMF Independent Evaluation Report (IMF 2003: 64) argued that in Indonesia by the early 1990s, "corruption was being transformed into an ever widening system of deliberate rent creation for the well-connected", which included the children of Suharto as well as favoured Chinese business groups. But some commentators apparently did not agree with this assessment.

A serious problem in those countries where the press was controlled and independent public opinion polls were not available was that it was difficult, if not impossible, to gauge changing perceptions of corruption among the wider population. The extreme aversion to any kind of independent public opinion polling felt by Suharto and his key security advisers was well known, and those newspapers and journals which published articles on corrupt practices were in some cases shut down. At the same time, business journals did publish quite extensive articles on the growing role of conglomerates including those owned by the

Suharto family. Certainly the students who protested in Jakarta and other cities in 1998 were angry about what they termed KKN (corruption, collusion and nepotism) and they appeared to have much sympathy among the general public[6]. In the post-Suharto era attempts were made to tackle these problems, with variable success.

Why Was the Republic of Korea Affected?

In several respects, the spread of the contagion to the ROK in the latter part of 1997 was puzzling. In 1996 per capita GDP was considerably higher than in the other economies which suffered serious growth collapse in 1997-8, although lower than in Taiwan and Singapore (Table 2). As noted above, its approach to financial liberalization had been rather erratic, even after joining the OECD in 1996. But that by itself is unlikely to account for the problems which emerged in late 1997, leading to the contraction in per capita GDP of 6.8 per cent in 1998. Were there warning signals which were not picked up? Haggard and Macintyre (2000: 69) claimed that, unlike Thailand, there was no strong evidence of a serious over-valuation of the currency in 1997, and the country's foreign debt burden was modest, around 25 per cent of GDP, compared with 47 per cent in Indonesia and 46 per cent in Thailand. There were few reasons to believe that Korea's debt burden was unsustainable. These authors argued that 'there can be little doubt that the events in the Hong Kong and Tokyo stockmarkets in the week of 20-24 October played a major role in setting off the Korean crisis'. Korea experienced substantial capital flight at that point, and many firms began to feel a severe liquidity crunch. At this time, American and European banks failed to roll over short-term debts, and the ratings agencies downgraded a number of Korean banks. All these developments had to be set in the context of major changes in Korean politics which led to the electoral victory of Kim Dae Jung in 1998.

It has been argued that the financial crisis which affected Korea in 1997 was not inevitable and had it not been for the problems in Thailand and Indonesia, which were widely publicized in the global media, the Korean economy might have muddled through (Noble and Ravenhill 2000: 105). But compared with Taiwan and the Philippines, the ROK did share some weaknesses with the other crisis economies. By the 1990s, the average debt/equity ratios in Korean manufacturing, and especially in the top 30 chaebol were much higher than in the USA, Japan and Taiwan (Noble and Ravenhill 2000: 85). Other indicators were also worrying, as Reisen (1998: Tables 3 and 4) argued. Non-bank foreign liabilities exploded in both Indonesia and Korea between 1994 and 1997, bank lending to connected firms and government directed bank lending was high, and accounting standards and enforcement of existing regulations was often weak, as was the case in the other affected economies. As Mo (2008: 252-3) pointed out, although many observers tended to see the ROK as a strong development state, very much like Japan, by the mid-1990s the model had come under increasing strain, for both political and economic reasons. The transition to a more democratic political system had begun in 1987, and after that economic growth had become more uneven and exporters faced increasing competition in world markets. No economic model, however successful, can last forever, and by the early 1990s it was increasingly clear

[6] For a summary of the rather different views about the role of the urban middle classes in toppling Suharto see Pepinsky (2009: 162-68).

that the Korean model was no longer fit for purpose, even before the crisis erupted in Thailand in July, 1997.

Why the Variations in the Pace of Recovery?

As the full impact of the crisis on national output in the HPAEs became more clear in the latter part of 1998, pessimism about their future intensified. But in fact by the end of 1999, it was clear that several countries had been only mildly damaged, not just in terms of GDP, but also in terms of other development indicators, including employment and poverty. In Taiwan the economy had managed to grow by around three per cent in 1998 while in Singapore there was a decline in per capita GDP in 1998, but a rapid recovery after that. In 2000 per capita GDP in both Singapore and the Philippines had surpassed the 1997 level (Table 2). The Singapore recovery was not surprising, as international confidence in the country's economic management remained fairly strong. The currency had experienced only a slight depreciation and although the severe contraction in Indonesia inevitably had some impact on the Singapore economy, the government was able to cushion the impact through expansionary fiscal policy. The rather minor impact of the crisis in the Philippines is more surprising. The country was famously omitted from the Asian Miracle report, because of its weak growth performance after 1975, which was blamed by many observers on corruption and cronyism. In fact, its growth performance up to the 1970s had been quite strong, although population growth was rapid by Asian standards. But after 1975 growth slowed, and there was not much improvement after Marcos left office in 1986. Between 1983 and 1993, per capita GDP growth was negative, and per capita GDP had fallen well behind Indonesia by 1996 (Tables 1 and 2)

But in fact the so-called sick man of Asia experienced only a mild case of flu in 1998, after which per capita GDP growth was positive. Why was that? First, the Philippines financial sector was by 1997 stronger than others around the region (Noland 2000). This was the result of reforms put in place after 1986.The indicators of bank system risk exposure put together by Reisen (1998: Table 4) showed that the ratio of non-performing to total loans was low compared with the ROK, Thailand and Indonesia, and exposure to the real estate sector was moderate. The ratio of foreign liabilities to foreign assets of both banks and non-bank borrowers in mid-1997 was low compared with Indonesia, Korea and Thailand (Reisen 1998: Table 3). In addition, Noland argued that, compared with the worst affected HPAEs, the Philippines was uniquely insulated from regional contagion. Ironically, this might well have been the result of its negative treatment by the World Bank and other commentators in the 1980s and 1990s; its reputation as a weak and corrupt state, with low economic growth, meant that the country did not receive the massive 'hot money' flows which other countries in the region experienced in their boom years. Although the currency did experience a real appreciation in the early 1990s which was higher than in the HPAEs, in the years from 1994 to 1997, the rate of appreciation moderated (Reisen 1998: Table 2)[7]

In Taiwan as in the ROK, from the 1980s onwards, policy makers had to meet the twin challenges of globalization and democratization. But there were differences, not just with

[7] Alburo (1999) argued that although GDP contraction was mild, there were other adverse effects on education enrollments, and poverty incidence in the Philippines.

Korea but with the other HPAEs as well. Since 1978, Taiwan was no longer a member of the World Bank or the IMF; and for two decades before the crisis broke, the country existed in a diplomatic limbo. Chu (2012: 13-14) argued that this led to extreme caution on the part of successive governments in Taiwan, and especially the powerful central bank, about fiscal and monetary policies. While the Bretton Woods institutions continued to play an advisory role, they were not in a position to impose their views about economic policy including liberalization of capital markets. The government did bow to American pressure in the late 1980s when the huge surplus on the balance of payments was attracting adverse comment, and permitted some revaluation of the currency, although it did not allow a full internationalization of the Taiwan dollar. Again bowing to American pressure the government did open the stockmarket to foreign institutional investors in 1991, but caps were imposed on their activities. Thus Taiwan managed to insulate itself from the turmoil which affected the other HPAEs after 1997.

Was the Malaysian Approach Different?

The Malaysian response to the crisis attracted considerable attention after 1998, because in spite of the substantial decline in per capita GDP, over nine per cent in 1998, the country refused to seek assistance from the IMF. In the immediate aftermath of the Thai decision to float the baht, the Finance Minister, Anwar Ibrahim, embarked on what were termed IMF policies without the IMF. Public expenditure on a number of projects favoured by the prime minister and other senior ministers was cut back and interest rates rose. In fact according to several indicators of financial vulnerability and risk exposure of the banking system, in mid-1997 Malaysia looked quite sound, at least compared with Indonesia and Thailand (Reisen 1998: Tables 3 and 4). But in the latter part of 1997 and early 1998, the ringgit declined sharply against the dollar. In spite of the sharp devaluation, exports in dollar terms also fell (Pepinsky 2009: 143-6). In a very open economy, export decline quickly affected GDP. The government responded by blaming the problems on currency speculators, both domestic and foreign, and exhorted Malaysians to repatriate their foreign assets and buy local products. When it became clear that these policies were having little effect, and that output was contracting at an alarming rate, Anwar was dismissed as Finance Minister. In late August and early September 1998 the government announced a package of measures, including a number of regulations regarding capital account transactions, and the pegging of the ringgit at the much depreciated level of 3.8 to the US dollar which had been reached at that time.

These measures were greeted with hostility in international financial circles, and in Malaysia the governor and deputy governor of the central bank resigned in protest (Stiglitz 2002: 122-5). It was argued that capital flight would continue anyway, and pegging the ringgit would only lead to black markets emerging, and further capital flight. It was also claimed that the policies failed to address the underlying problems, which according to many foreign observers, and also to many Malaysians outside the government, were the legacies of the New Economic Policy adopted in 1970. By the 1990s, it was clear that the NEP had created a class of rich Malay rent seekers, whose main interest was to maintain their privileges, while the real wealth creators were the Chinese, Indian and foreign businesses who would almost certainly be driven away by further controls. But the prime minister was adamant that the country should not go to the IMF. He argued that the policies which the IMF would insist on

as conditions for assistance would destroy the New Economic Policy, so any approach to the IMF was politically unacceptable (Pepinsky 2009 :152-3).

In fact the policies adopted in 1998 did not have the adverse consequences which many feared. Stiglitz pointed out that the capital controls were applied quite liberally and in effect amounted to an exit tax on capital outflows which the government considered undesirable. The repatriation of profits by foreign companies was not much affected. But the impact of the measures on GDP was not at first very dramatic and in 2000 per capita GDP was still below the 1997 level. Recovery took place after 2000, and Dr Mahathir remained in power until handing over to a carefully vetted successor in 2003. Anwar Ibrahim was jailed on grounds of sexual misbehaviour which many Malaysians thought were politically motivated, and intended to discredit him, especially among Moslems. Many of the problems associated with the NEP remained, and were only revealed when the IMDB scandal erupted in the second decade of the new century. As a result of this scandal, political realignments led to Anwar's return to politics; he became prime minister in 2022.

Recovery in Thailand and Indonesia: Why Slow?

In both Thailand and Indonesia, recovery was slower than elsewhere in the region. In Thailand where GDP per capita fell in both 1996 and 1997, the 1996 level was regained only in 2003, while in Indonesia the 1997 level was only reached again in 2004. So both countries can be said to have experienced six or seven years of lost economic growth from the crisis. That is a considerable loss for what were still middle income countries. In looking for an explanation, it is essential to look at the problems not just in the financial sector but also in the corporate sector. As Siamwalla (2001: 25-7) pointed out, many financial and non-financial firms saw their cash flows and balance sheets deteriorating; both the depreciation of the baht and the jump in interest rates had an immediate impact on cash flows for firms which had borrowed heavily, as did the contraction in GDP in both 1997 and 1998 which reduced domestic demand. Many large and medium-sized firms had substantial exposures to unhedged dollar and yen debts, so the sharp decline in the baht, from 25 to the dollar to more than 50 to the dollar in a few months, had a serious impact on their balance sheets. Siamwalla argued that, to anyone surveying the Thai scene in the second quarter of 1998, it would have been clear that the critical problem was the quality of balance sheets. If proper valuations were done on the assets, then most financial institutions and many non-financial corporations would be insolvent. This would include corporations which still possessed valuable assets, including new machinery embodying the latest technology. Until 1996, these firms had been profitable suppliers of goods to both domestic and international markets. Suddenly they were insolvent; domestic markets were contracting and problems in obtaining liquidity credits made it impossible for firms to continue to trade internationally.

Siamwalla (2001: 27) suggested that if an omniscient supercomputer had been available which had perfect knowledge of both the Thai and the global economy, it could have been asked to compute the general equilibrium result for the economy at full employment for mid-1998. Such a computation would yield current and future prices for inputs and outputs. Many non-financial firms would have been insolvent, or at the very least would have had unhealthy debt/equity ratios. 'Adjustments to liabilities would now have to be made, with shareholders' equity naturally taking the first hit'. If equity fell to a negative level, the

ownership patterns would have to change. Some conversion from debt to equity would have to take place. The computer would be programmed to make all these adjustments, with the constraint imposed that the combined balance sheets of all firms must be such as to generate sufficient new investment to ensure full employment. The computer would generate wages and interest rates and exchange rates to ensure this investment. The ensuing adjustments would affect the balance sheets of banks, which would require a recapitalization of the banking system. Given the government-mandated deposit guarantees, most of the funds would have to come from the government budget. The computer would have to take this into account in subsequent iterations, which would lead to the correct value of the items in all balance sheets.

Of course in Thailand in 1998, there was no such computer, and neither was there one in Indonesia, where the banking system, and much of the corporate economy, was by 1998 in an even worse state. Instead of a rapid series of calculations by an omniscient computer, there were countless meetings and court cases in Thailand to effect transfers of ownership, with some firms being declared bankrupt. One strategy would have been to warehouse temporarily all the bad loans in some sort of holding pen, which would have allowed banks to resume lending, at least to those clients which were still considered to have viable businesses. But the government which took office in Thailand in 1998 rejected this approach, and instead tried to adjust the values in balance sheets as quickly as possible. It started with the financial sector, partly because the authorities were legally empowered to effect changes in the balance sheets of financial firms; in addition because of the deposit guarantee the government and taxpayers were directly exposed to bankruptcy in the financial sector to a greater extent than with non-financial firms. But dealing with so many institutions was time consuming, and the legal system was unused to dealing with bankruptcy cases. With little sign of any improvement in the real economy between 1998 and 2000, many Thais lost confidence in the government. In January 2001, a new party funded by a prominent businessman, Thaksin Shinawatra, won a parliamentary majority with strong support from the northern part of the country, and formed a new government. Thaksin established an asset management company in which banks could park some of their bad loans, but by then it was too late for this to have much impact. But some economic recovery did take place, and by 2003 per capita GDP had finally surpassed the 1996 level.

In Indonesia, it was becoming clear by early 1998 that the impact of the crisis on both the real economy and the financial sector was far worse than many observers had predicted a few months earlier, and that the economic crisis was rapidly triggering a political meltdown. President Suharto had been in power for more than three decades, and was in poor health but appeared determined to hang on to power in order to promote the business interests of his family and their associates. The budget presented to parliament in January 1998 was widely criticised both in Indonesia and abroad, both for its unrealistic assumptions about growth, and for ignoring the problems in the financial sector. The new cabinet announced in March 1998 contained no credible technocrats; Suharto's oldest daughter was made a minister and it was widely thought that she was being groomed as his successor. Dr Habibie was appointed vice president. But violence increased, culminating in serious riots in Jakarta and several other cities in May 1998. Suharto at this point lost the confidence of most of his cabinet, and on May 21 he resigned in favour of the vice president. Debates continued about the reasons for his departure and the role of the Bretton Woods institutions, the American

government and other outside agencies. My own view is that Suharto's departure was largely driven by domestic pressures, including increasing public anger at the behaviour of an ageing president who, faced with major economic problems, appeared to be only interested in promoting the narrow interests of his family and their cronies[8].

The economic problems facing the Habibie government in mid-1998 were extremely serious, and had to be tackled quickly to restore confidence in economic management. It was decided to deal with the problems in the financial sector by establishing the Indonesian Bank Restructuring Agency (IBRA), which took over, in effect nationalised, most private banks, including those owned by several of the conglomerates which had grown mighty during the Suharto era. Most of these banks were forced to divest themselves of some assets, but the divestment process was far from transparent and there were several examples of businesses being purchased from IBRA by groups which were hardly at arms length from the original conglomerate which owned them. In addition the very serious problems of the state banks had to be addressed; this was done by amalgamating them, and recapitalising them with bonds. The interest payments on these were funded through the budget. Although there was pressure from the IMF to privatise the state banks, this did not happen (Sato 2005: 115-7). More broadly it became clear that powerful groups within the parliament, and in the governments of the three presidents which rapidly succeeded Suharto between 1998 and 2004, were able to influence IBRA, and other agencies including the courts to support business groups from the Suharto era[9].

Differences in Growth Rates after 2004: Its the Politics, Stupid

A full discussion of the economic recovery across East and Southeast Asia after 2004 would take us into contemporary analysis, where economic historians probably should not venture. But a few comments seem in order. Was the crisis really a catalyst for change, and if so in what directions? A book edited and largely written by political scientists was published in 2009, drawing on papers originally prepared for two conferences held in 2006. Many of contributors were rather doubtful about the region's economic prospects. The editors in their introduction pointed out that the crisis had "posed a particular challenge to one distinctive feature of the East Asian pattern of economic development-growth with equity" (MacIntyre, Pempel and Ravenhill 2008: 13). In fact, the argument that the HPAEs all experienced growth with equity can be challenged; several of the countries included in the

[8] These views have been stated at greater length in Booth (2001) and Booth (2016), Chapter 5. Of course other views were held by a range of observers at the time, especially those, mainly foreign, commentators who wanted to blame the IMF or the Washington establishment more broadly defined, for destabilising what was fundamentally a strong economy. An extreme view was expressed by Williamson (2004: 835) who claimed that a crucial error was made when the Indonesian government abandoned the crawling band system in October 1997 in favour of a free float. He claimed that if the IMF had been prepared to give a large loan conditional on the retention of the crawling band, the events of late 1997 and early 1998 could have been avoided. Williamson offers little evidence to support this assertion, and ignored the fact that by 1997, problems in the banking system were already very serious and would have had to be addressed at some point. It seems to me to be implausible that Suharto and his family would have been prepared to do this.

[9] A valuable analysis of the final incidence of the costs of government support to the banking system is given in Frecaut (2004). He concludes that the crisis in Indonesia was ultimately a large-scale wealth distribution exercise, neutral to the banks, beneficial for corporations and those households which benefited from deposit guarantees, but disastrous for the public at large.

Asian Miracle report had experienced some increase in income inequality in the decade before 1997, including Thailand and Indonesia. It was only after the crisis hit that household income and expenditure inequality declined because the incomes of the better off urban households experienced a more severe decline than those in rural areas. In Malaysia, income inequalities had always been high, and government claims about changes over time had been challenged by several independent researchers in the years from 1970 to 1997. But there was a broad consensus by the early 1990s that even if inequalities were still quite high, poverty levels were declining, although the rate of decline was a matter of some dispute[10].

If we look at growth in per capita GDP across East and Southeast Asia in the decade from 2004 to 2014, it is clear that several countries have improved their performance compared with the decade from 1983 to 1993 (Table 1). The most spectacular improvement was in China, which was not included in the 1993 report, but whose growth performance after 2000 has received massive global attention. It is worth noting that per capita GDP in China in 2000 was lower than in most other countries in East and Southeast Asia except the Philippines and Vietnam (Table 2). The Philippines has in fact performed quite strongly after 2004, at least compared with the negative growth in the earlier decade, while Indonesia has managed to grow at roughly equal rates in both decades. Vietnam also saw improved growth compared with the earlier decade. But growth in Taiwan, the Republic of Korea and Thailand has slowed sharply Do these trends indicate that the crisis was a catalyst for change in Indonesia but not in Thailand or Malaysia? It was certainly a catalyst for political change after Suharto resigned but the impact of a more democratic polity on economic growth does not seem to have been very dramatic. It seems that political changes pull in different directions in different countries across Asia. Greater democracy has certainly affected economic policies in Taiwan and the ROK, but the impact on economic growth seems to have been negative, especially in the ROK. In Malaysia, the very damaging 1MDB scandal might have been avoided if Mahathir had been prepared to allow major changes to the NEP after 1998. In Thailand the army coup in 2014 was partly a response to the disappointing economic performance in the decade from 2004 to 2014, which was blamed by many on Thaksin and his associates. But economic performance after 2014 has also been disappointing and after elections in 2023, Thaksin was allowed back into politics in order to prevent a party apparently committed to more sweeping democratic reforms from taking office.

In the meantime, the countries of East and Southeast Asia have to deal with the challenges of the rise of both China and India as global economic powers. China remains a repressive one party state, while under the BJP, India also seems to be moving towards a government increasingly intolerant of religious and political minorities. Sorting out the complex links between economic change and political change across Asia and beyond will certainly keep

[10] For a more detailed discussion of these debates see Booth (2019: 172-77). The assertion of MacIntyre, Pempel and Ravenhill (2008: 13) that outcomes in terms of education, health, gender, and employment opportunities were “broadly egalitarian” across East Asia has been challenged by many researchers over the decades. But in spite of ongoing inequalities, some of them serious, it is true that on average living standards have improved. The rich have certainly got richer, but the poor have also benefited, even if the benefits have been modest.

scholars busy in coming decades. But they can and should learn lessons from the recent past, even as they focus their attention on difficult contemporary problems.

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Table 1: Percentage Increase in Per capita GDP: 1983-93 and 2004-14: Selected Asian Economies

Country	Decade Growth Rates (%)		Per capita GDP (2011$)	
	1983-93	2004-14	1983	2014
Singapore	72.2	55.9	15,720 (165)	65,655 (158)
Taiwan	100.3	38.4	9,530 (100)	41,472 (100)
Republic of Korea	116.8	29.4	7,612 (80)	34,493 (83)
Malaysia	55.2	43.7	6,529 (69)	21,683 (52)
Thailand	97.5	28.3	4,538 (46)	14.642 (35)
China	57.4	96.8	2,227 (23)	11,944 (29)
Indonesia	61.5	63.2	2,994 (31)	10.090 (24)
Philippines	-10.6	48.2	3,837 (40)	6763 (16)
Vietnam	42.2	58.7	1,333 (14)	5455 (13)

Notes: Countries are ranked by per capita GDP (2011$) in 2014. Figures in brackets show per capita GDP as a percentage of the Taiwan figure in 1983 and 2014.

Source: Maddison Project Website 2020 estimates; See Bolt and Van Zanden (2020) for more information

Table 2 GDP Per capita: 1996-2000 (US Dollars: 2011 prices)

Country	1996	1997	1998	2000
Singapore	32,724	34,868	33,590	37,773
Taiwan	22,390	23,438	24,131	26,787
R.o.Korea	20,205	21,056	19,625	23,108
Malaysia	12,669	13,345	12,130	12,637
Thailand	10,458	9,996	9,078	9,627
Indonesia	5,851	6,056	5,204	5,384
China	4,220	4,311	4,310	4,730
Philippines	3,791	3,928	3,853	4,034
Vietnam	2,323	2,467	2,564	2,773

Source : See Table 1: Countries ranked according to per capita GDP in 2000.