ASIAN TIGER ECONOMIES: WHAT WENT WRONG?"

A discussion of the financial underpinnings of the economic crises in Indonesia, Malaysia, Indonesia, and Thailand

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Introduction

Over the past decade, East Asian economies of Indonesia, Malaysia, Singapore, South Korea, Taiwan, and Thailand have produced an economic miracle unparalleled in modern history. No other group of countries in the world has produced more rapid growth and reduction in poverty than these countries. In the process, they earned the nickname "tiger economies."

These countries and their governments worked very hard to achieve these results. Most of the fundamentals within the economic miracle were right on the mark-a commitment to education, sound fiscal policies, high domestic savings rate, and a global outlook. With economic growth rate averaging 9%, the miracle seemed to have no end (table 1). Then in July of 1997, the Thai government suddenly announced that after decades of keeping its currency, the baht, fixed to the United States dollar at approximately 25 baht to a dollar, it was going to let its currency float. The decision was calamitous. Instead of floating, the baht took a plunge in value and continued its slide. Within a few days the baht had dropped by 60 % to 40 baht to a dollar. Before long, the currencies of the other so called Asian tiger economies of Indonesia, Malaysia, South Korea, Taiwan, and Thailand all plunged.

Following is a summary explanation of the Asian financial crisis. I will restrict my remarks to just three countries of Indonesia, Malaysia, and Thailand. Other speakers will cover the crisis in South Korea and Taiwan. I must preface my statements by stating that, I have the luxury of analyzing this crisis from hindsight and therefore appear to have all the answers. Whereas, the economic planners in these countries could not have easily discerned the symptoms, especially when they were riding a wave of economic success.

The Asian crisis began as a financial crisis and then spilled over into the economy. The effect was dramatic and fast. The economic crisis that followed hit both the output as well as employment. The general feeling among some experts is that the Asian miracle might have been over without the crisis. The argument goes, "these countries could not possibly grow forever at 8-10% per year rates, as diminishing returns kick in. " Were there signs of trouble even before the crisis started? Apparently 'yes'.

Symptoms of Trouble

The symptoms of the Asian crisis did exist even before the collapse started. Only thing is, people in some quarters just ignored it. Between 1993 and 1996, foreign investors and banks were lending huge amounts to the private sector in these countries. But, the short-term borrowing was mainly used to support long-term investments in real estate and other non-exporting sectors. The other apparent signs included: some doubts about the economy by foreign investors during the early part of 1997; a slow but steady attack on the currencies; decline in the value of stocks (chart 2); and a combination of rising wage costs and competition from low priced countries such as China (see table 2).

Reasons for the Crisis

The crisis in Asia was not just a debt crisis, but also a currency crisis. As the crisis has revealed, the local political, financial, and corporate structures were not well suited to cope with an increasingly inter-linked global economy and marketplace. The financial sectors in these countries were generally weak, disclosure requirements were very transparent, corporate structures were too closely linked to banks and government agencies (they formed a triad, see chart 1), and weaknesses in external liability management. There was also the misallocation of resources and a build-up of short-term private sector debt. This huge debt was unsustainable, and left these economies vulnerable to a sudden collapse of confidence. The financial crisis led to an economic crisis affecting production, employment, and consumption (table 3).

A lot of the economic growth in these countries was due to growth in labor and capital (input growths). This generated a rate of investment of 40% of GDP per year. This rate of growth is not sustainable over a long period of time. In addition, the high savings rate achieved in these countries was also bound to fall over time.

Structural Problems

Following is a list of the most fundamental structural problems identified in the tiger economies that may have contributed to the financial and economic crisis:

- Lax oversight mechanisms and Lack of controls
- Integrity of financial information published by companies
- Close relationships between powerful politicians and large companies (crony capitalism)
- Excessive borrowing by companies
- Undercapitalized banks
- Ineffective economic system
- Ineffective political leadership
- Rapid expansion
- Poorly planned large capital expenditures
- Depletion of foreign reserves to fund private sector projects
- Foreign investor's role

Consequences of the Crisis

In a crisis of this magnitude a large number of people, institutions, and constituencies suffer. Some of the negative consequences are: Consumers have to pay more for goods and services; families suffer due to lower wages and or unemployment; bankruptcy rates rise causing further tightening of the economy; decrease in government spending causing social programs such as health and education to be cut; imports suffer causing exporting countries to deal with reduced revenues from trade; higher interest payments may lead to higher costs; slower economic growth; and the unwanted scrutiny of domestic policies by the international agencies.

Economic crisis also leads to some reforms that may benefit the country and its people in the long run. These changes are: government oversight of institutions and the private sector will be on the rise making the system less corrupt; some economic reforms may improve the confidence of investors leading to needed capital inflows; a move towards trade liberalization may benefit consumers through improved product quality, choices, and lower prices; there may be a consolidation in the banking industry leading to stronger financial institutions; and there may be attempts to dismantle the cozy relationships between politicians and the corporate sector that may in the long run help make the system fair and efficient. See table 4.

Prescription for Recovery

A follow up seminar will explore this area in more detail. Here I would like to suggest just a few steps to be undertaken by these governments.

1. Governments should impose controls on excessive short-term-inflows.
2. Instituting some social protection for the poor. As the crisis has revealed, the mistakes of some in power, has led to sufferings for many.
3. Improving the disclosure mechanisms. Both government institutions and the private sector has to have more realistic and accurate disclosures to avoid a new wave of financial crisis.

Table 1

COUNTRY STATISTICS

	Indonesia	Malaysia	Thailand
Economic growth (1988 - 1995)	7%	9%	9%
GDP (PPP) 1995 (billions of $)	710.9	193.6	416.2
GDP/Capita ($)	3,500	9,800	6,900
Inflation	8.6%	5.3%	8.6%
Current account (billions of $)	+7.90	0.00	-8.8
External debt (billions of $)	97.6	27.4	53.7

Chart 1

ECONOMIC TRIAD

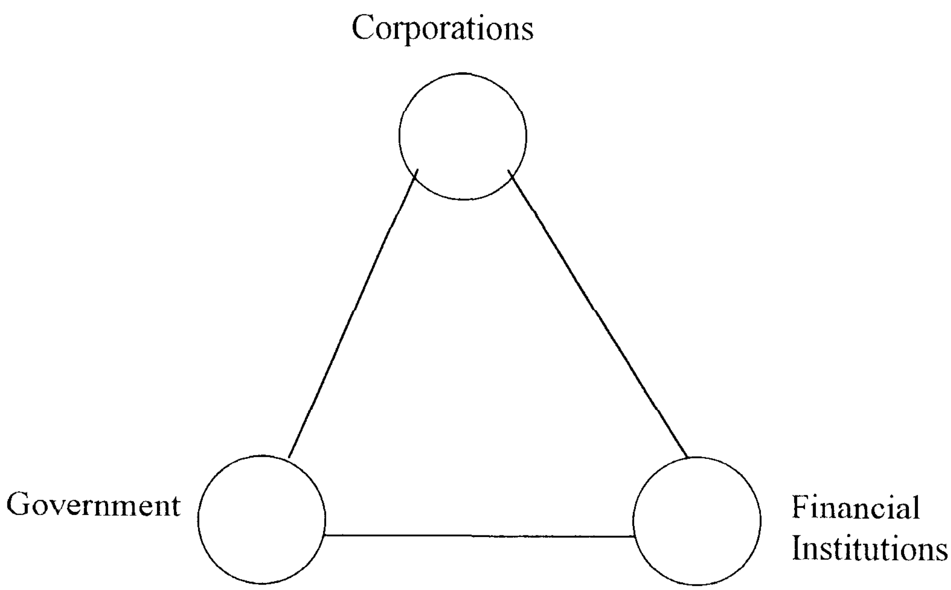

Chart 2

Composite Indices of Stock in Indonesia, Malaysia, and Thailand

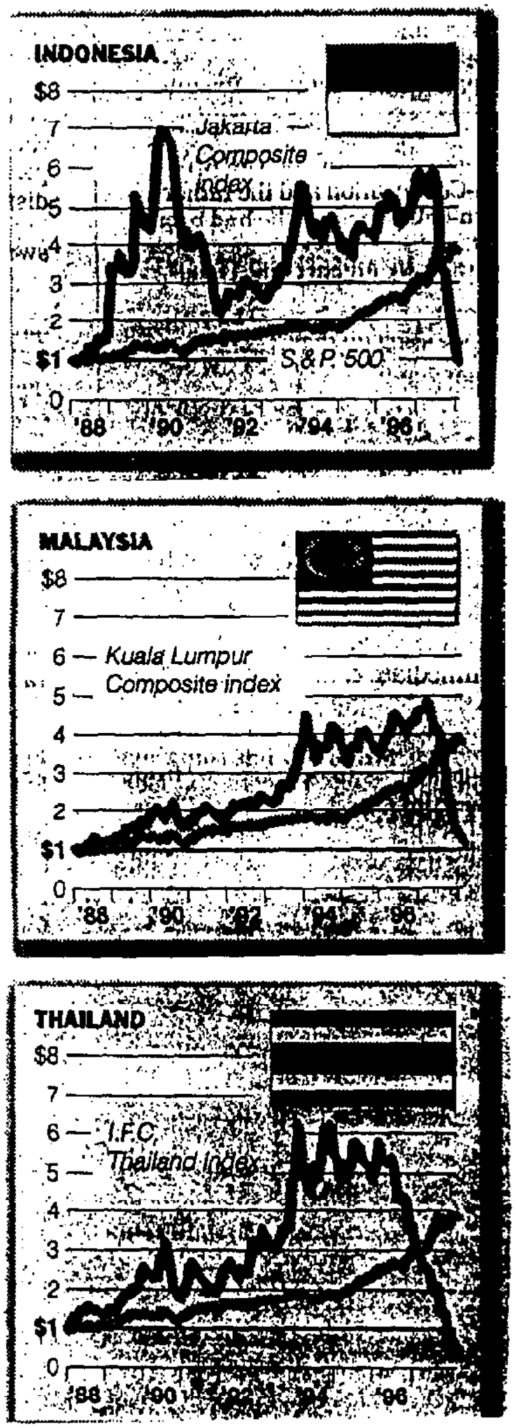

Table 2

SYMPTOMS OF TROUBLE

- Foreign investor's doubts about the economy
- Currency traders attack on the currencies
- Decline in value of local currencies
- Explosion of foreign debt
- Slide in stock market prices
- Price increases in domestic markets
- Real estate developments failed to fill tenants
- Huge borrowings by the private sector (and willing foreign banks ready with the check book)

Table 3

Reasons for Crisis

Increasingly Global Economy

Weak Financial Sectors

Cosseted Corporate Structures

Inadequate Disclosure of Information

Weakness in External Liability Management

Misallocation of Resources

Build up of Short Term Debt

Collapse of Confidence

Financial Crisis

Economic Crisis

Affects Production

Affects Employment

Affects consumption

Table 4

CONSEQUENCES

- Higher prices
- Declining incomes
- Unemployment
- Decrease in government spending
- Higher number of bankruptcies
- Consolidation in the banking industry
- Declining imports
- Liberalization of trade
- More government oversight
- Untangling of cozy relationships between politicians and businesses
- Economic reforms
- Unwanted scrutiny by international agencies
- Slower economic growth
- Higher interest payments