

Unchained Melody: Economic Performance After the Asian Financial Crisis

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Abstract

Indonesia, Malaysia, Philippines, South Korea, and Thailand have not recouped their losses from the 1997 Asian Financial Crisis. Unless their economic performance is better than the recent trends, another economic miracle story is needed to reclaim past economic standings. Unless economic policies move in a positive direction – taking up the useful strategies in the past but also putting in new components for the current challenges – economic progress is limited and punctuated by crises.

1. INTRODUCTION

This paper presents another analysis to the on-going retrospections on the 1997 Asian Financial Crisis (henceforth, crisis).¹ It raises three items that seem to be overlooked in the discussions, the first being that recent economic performances of Indonesia, Malaysia, Philippines, South Korea, and Thailand (henceforth, crisis-affected economies) are actually inferior when compared to pre-crisis performances. The second point is that the crisis-affected economies have not recouped the losses in 1997. Stronger economic performances are needed to reclaim the lost opportunities. The last point is that unless economic policies in the crisis affected economies move in a positive direction – taking up the useful strategies in the past but also putting in new components for the current challenges – economic progress is limited and punctuated by crises. A related point is the attitude of complacency with a seemingly stable economic environment. In fact, this view is misplaced if the international financial system is characterized by massive and volatile financial

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flows, while economies are ill equipped to deal with the challenges produced by massive and volatile financial flows. If the international financial system is the culprit in creating and propagating crises, policy actions are indeed needed to address these threats. The effectiveness of policy largely depends on political decisiveness to take up unpopular measures and also the skillfulness of policy makers in forging international cooperative arrangements that lead to coordinated actions.

The paper has six parts. Framing a crisis is discussed in Part 2, followed by an application in terms of, first, analyzing how a crisis affects economic performance and, second, on costing a crisis. Part 5 present some policy discussions. The last part concludes.

2. FRAMING A CRISIS

There are different ways to analyze the relationship between the economic performance and crisis. One view is that an economy is able to bounce back quickly after being hit by a crisis. As such, if there is a strong crisis, there is also a strong recovery. A crisis becomes a mechanism that pushes a government to undertake serious adjustments to achieve robust economic performances. Thus a crisis is seen as transitory because no economic derailment is expected and no loss in economic momentum is expected. Moreover, the cost of a crisis is quickly recouped. In fact, it can also be argued that because of the reforms brought about by the crisis, the economy is thrust to a higher economic growth trajectory.

The alternative view is that an economy cannot completely bounce back after being hit by a crisis. In fact, it faces difficulties in terms of its recovery and recouping the costs of the crisis. This situation occurs because domestic institutions are weak or they are not designed to respond to the crisis, more so when the nature of crises is changing and intensifying. Or, they were damaged during a crisis. Of course, repeated crises undermine the institutions. As such, when a crisis hits, the economy is pushed to a lower economic growth trajectory. The costs of a crisis linger because of restorative capacities of the economy were compromised. There are therefore serious economic

implications of a crisis. Arguing that an economy is unharmed because of what appear to be strong recoveries in the post-crisis period is misguided. Thus the resulting lower growth trajectory means that a one-shot adjustment is not enough to recoup the losses. Constant adjustments in policies are important to not only bring the economy to superior growth trajectories but also to sustain robust economic expansions.

Of course, there are many sources of economic perturbations. Some of these thrust the economy to achieve stronger economic expansions. There are also non-transitory effects, but they are positive in this case. For instance, the discovery of oil deposits brings commercial benefits to relieve an economy of foreign exchange constraints, so enabling it to finance economic growth and development projects. Of course, if the earnings are squandered or not well utilized, a Dutch disease can occur in due course thereby reversing the gains with economic stagnation. Similarly, capital inflows brought in by the re-organization of the global manufacturing system and finance can lead to stronger economic expansions. Again, if the opportunities are not capitalized to bring about human capital formation, technology adaptations, and industrial deepening, etc., bottlenecks soon materialize to produce vulnerabilities that are destabilizing in the long term and putting the economy at risk of crises. If economic stagnation, economic mismatches, institutional rigidities, and so on, corrode the institutional capacities, the economy can be easily pushed down to a lower economic growth trajectory when it is hit by a crisis.

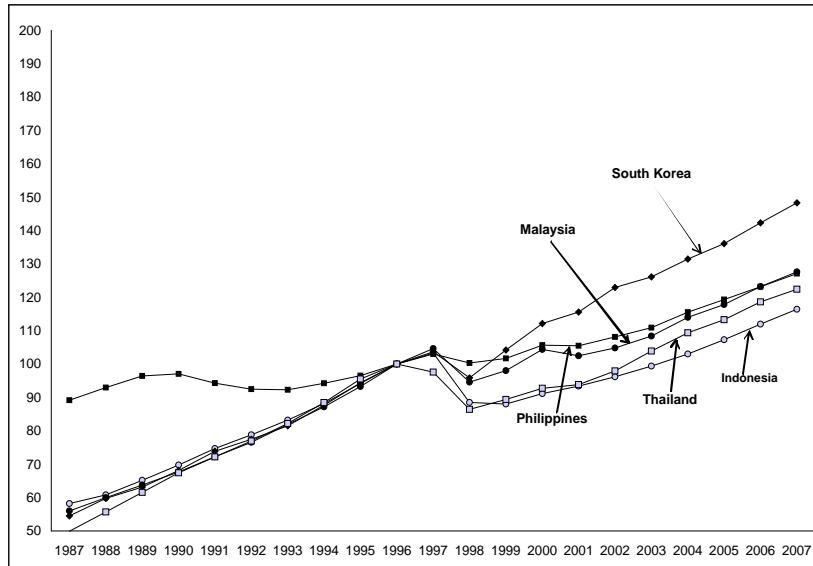
3. PERFORMANCE POST-CRISIS²

Taking off from the above framework, economic performances of the crisis-affected economies are analyzed. GDP per capita (in 2000 prices) data were compiled from the *Asian Development Outlook 2007* and *World Development Indicators 2007* for the period 1987 to 2007. The data are normalized to 1996 to distinguish the trends before and after the crisis.

Figure 1 illustrates that by mid-2000s the crises-affected economies have exceeded their 1996 GDP per capita, albeit at different speeds. Indonesia has taken the longest to regain its 1996

GDP per capita, which was reached by 2004. Thailand has a comparable experience, regaining its 1996 GDP per capita level in 2003. In the case of Malaysia, 1996 GDP per capita was regained in 2000. Both the Philippines and South Korea bounced back quickly from the contractions in 1998, exceeding 1996 GDP per capita by 1999.

Figure 1: GDP per Capita, Normalized to 1996



What is more interesting in Figure 1 is that between 1987 and 1996, Indonesia, Malaysia, South Korea, and Thailand had a tight pattern of economic expansions, especially during the first half of the 1990s as if increasingly chained to one another with sustained robust economic growth. If the timeframe is stretched back earlier periods, 1987 to 1996 becomes an exceptional period for the four economies. Arguably, the decade before the crisis was a period of economic convergence among these economies that is not found in performances of the other economies in the region.³

Thailand diverged from the group in 1997, when GDP per capita contracted by 2.4 per cent. The other four economies experience contractions the following year: Indonesia by 14.3 per cent, Malaysia 9.6 by per cent, South Korea by 7.5 per cent, and Philippines by 2.5 per cent. From 1998, economic performances of the crisis-affected countries became increasingly unbundled. As Figure 1 shows, Indonesia has dropped the farthest relative to South Korea. Malaysia, Philippines and Thailand are between the two economies. These trends are expected to continue in the coming

years. It can therefore be concluded that the crisis resulted in a divergence in economic expansions in the region.

Further analysis can be had if the information in Figure 1 is transformed, particularly by applying rotational analysis. Note that because the Philippines has a different trend, the trends of the other economies are used as control trend. In the first step, a line is obtained – called rotated axis – that captures the convergence in 1987 to 1996, ensuring that it crosses the reference year in normalizing the data. The next step is to draw a perpendicular line on the rotated axis at 1996 = 100 to form a modified plane. Thus an orthogonal of Figure 1 is obtained.

Figure 2: GDP per Capita in 2000 Prices, Rotated at 1996

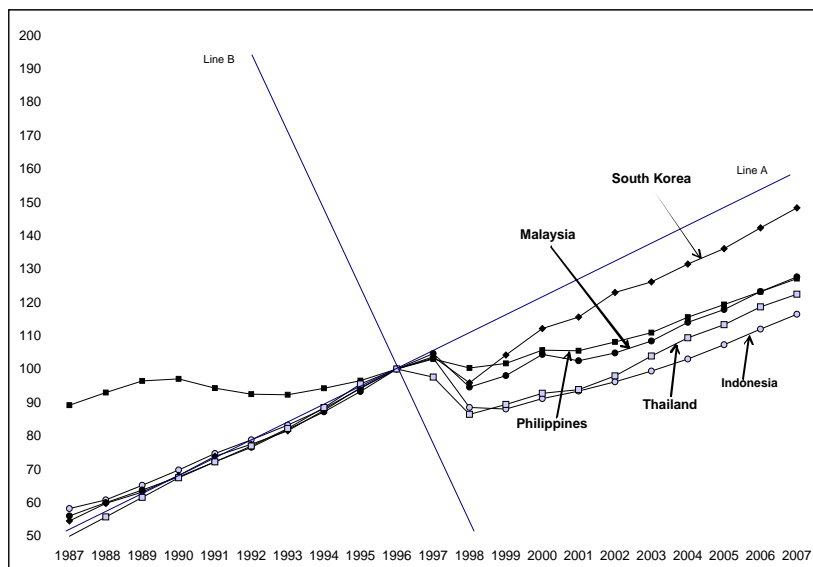


Figure 2 shows that the crisis-affected economies have remained below the rotated axis in the decade after the crisis. With the possible exception of South Korea, economic performances have been increasingly worse relative to the decade before the crisis, as if continuously plunging below the rotated axis. Indonesia and Thailand have moved the farthest and still departing from the rotated axis in 2007. Malaysia and the Philippines have similar trends after 2005, but at a higher level compared to Indonesia and Thailand. For the Philippines, Figure 2 reveals that its trend has actually been on a constant decline since 1987. In fact, this downward direction started much earlier if the data extend back to 1980.

More importantly, Figure 2 shows the counterfactual economic performances of the crisis-affected economies between 1997 and 2007. The conjecture is that the socio-economic conditions in the period 1987 to 1996 might have continued into succeeding period had the deteriorations in the economic fundamentals been addressed, had captured bureaucracies and institutional rigidities been remedied, had the governments maintained effective management of their economies, even allowing for proper sequencing of deregulation and financial liberalization such that progressive industrialization and broad-based economic expansions been sustained, and so on.⁴ Of course, the counter argument to this scenario is that the crisis-affected economies are nevertheless going to experience a deceleration in economic performances by the early 2000s if they had sustained the same level of economic expansions. Still, the deceleration would not be as dramatic as the one they experienced in 1997. Adjustments were done in the counterfactual that would avert the economic debacles. Nevertheless, Figure 2 highlights the observation that what occurred in 1987 to 1996 is something desirable notwithstanding other issues that came with robust economic expansions like inequalities and environmental consequences. It is therefore clear that while it can be argued that the crisis-affected economies have already exceeded their 1996 GDP per capita, they unfortunately have not regained the robust economic expansions that distinguished the Asian miracle economies before the crisis.

4. COSTING THE CRISIS

Figure 2 means that, for the crisis-affected economies, counterfactual economic expansions can be obtained as $y_{t,i} = \alpha + \beta \text{year} + \gamma y_{t-1,i} + e_{t,i}$, where $y_{t,i}$ is GDP per capita (in 2000 prices) of an economy i . In other words, current GDP per capita can be obtained using the general direction of economic expansion proxied by a period indicator (i.e., year), past information as embedded in past GDP per capita (i.e., y_{t-1}), and other factors affecting y_t as represented by $e_{t,i}$.⁵ If there are transitory impacts on the economy, the difference between the estimated GDP per capita, y_t , and the actual value, y_t , is small. Subsequent amounts are smaller and decreasing to zero in period $t+j$.

The reverse is the case if there are permanent impacts of a crisis or when no real economic recovery has occurred, so $(y_t - y_{t-1})$ is large and the subsequent differences are larger over time. It is not discounted that growth accelerations can occur in some future period and that full recovery takes place then.

With y_t , the total accounting cost of a crisis is obtained as the annual foregone output per capita, $y_t - y_{t-1}$, multiplied by the population. Using the United States Treasury bill rate, r , the total economic cost of a crisis, ec_t , is obtained as the opportunity cost per capita $[(1+r)(y_t - y_{t-1})]$. Lastly, the total social cost of a crisis, sc_t , is the accumulated cost per capita, $[(1+r)sc_{t-1} + (ec_t - ec_{t-1})]$, multiplied by the population. Both ec_t and sc_t are assumed zero in period $t-1$. Note that using r is a rudimentary way of calculating the costs but it is used to allow for easy comparison of the figures. More importantly, other items are not included in the calculations, such as the costs of unemployment, poverty, or the psychological impacts of the crisis, etc. Put simply, the economic and social costs are rough measures. Obviously, if other costs are included, ec_t and sc_t are much larger than those estimated here. GDP per capita (in 2000 prices) are again taken from the *Asian Development Outlook 2007* and *World Development Indicators 2007*. The costs for each economy are discussed next.

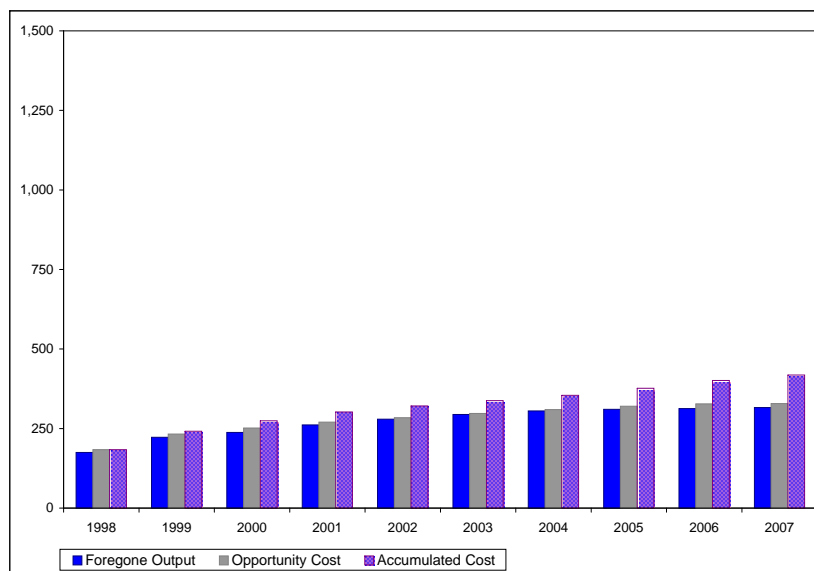
Indonesia

As the crisis intensified in 1998, Indonesia GDP per capita fell to US\$ 777 from US\$ 906 in 1997. It further fell to US\$ 773 in 1999. That is, GDP per capita contracted by 14.3 per cent in 1998 and another 0.5 per cent in 1999. The contraction meant that the foregone output per capita was US\$ 175 in 1998 and US\$ 223 in 1999. The opportunity costs per capita were US\$ 184 and US\$ 233, respectively. The accumulated cost per capita was US\$ 241 for the two years, about 30 per cent of GDP per capita in 1999.

Five years after the crisis, Indonesian GDP per capita remained below its 1996 amount, reaching US\$ 844 in 2002. The foregone output per capita in 2002 then was US\$ 280, while the per capita opportunity cost on the foregone output and accumulated cost reached US\$ 284 and

US\$ 321, respectively. By that time, those amounts were 30 per cent and 40 per cent of GDP per capita, respectively. In fact, Figure 3 indicates GDP per capita remained below the counterfactual scenario and thus the costs have risen over time. In other words, there was no economic recovery. As such, the foregone output per capita was larger than the previous amounts, reaching US\$ 306 in 2004. The opportunity cost per capita reached US\$ 310, while the accumulated cost per capita was US\$ 355. These figures remained around 30 per cent of GDP per capita in 2004.

Figure 3: Costs of the 1997 Asian Financial Crisis per Capita in 2000 Prices

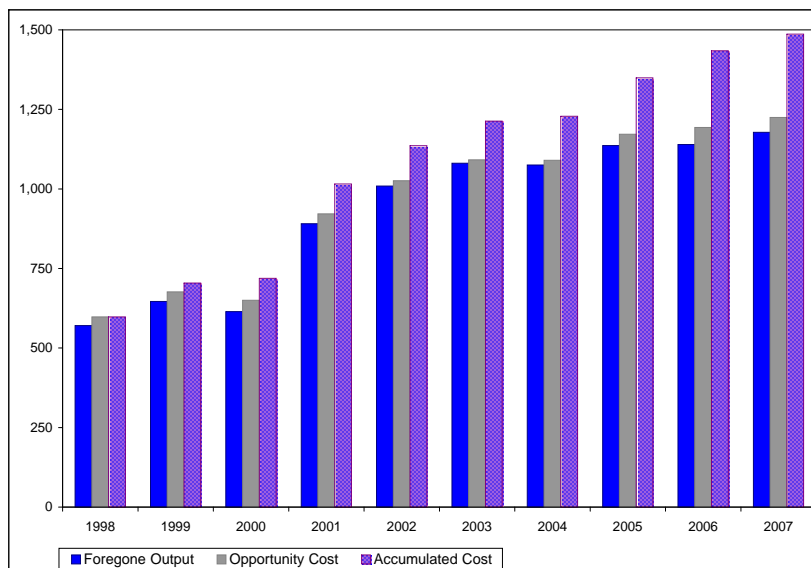


Provided that GDP per capita growth does not slow down in the coming years, the costs are expected to flatten out, suggesting that at least the foregone output per capita and opportunity cost per capita do not exceed US\$ 350. What is a cause of concern, however, is the continued rise in accumulated cost per capita, projected to reach US\$ 418 in 2007. This amount is still growing in the medium term with the current rate of economic expansion. Only with accelerated GDP per capita expansions – faster than the projected growth rates – that the trends are reversed and thus the costs are recovered. At the present, however, it is disappointing that because of unaddressed constraints to economic growth, Indonesia cannot move to a higher gear of economic performance, including weakened public investments, deteriorating public services, and falling competitiveness. Significant progress on addressing growth constraints is crucial in the coming years.

Malaysia

Malaysian GDP per capita fell from US\$ 3,938 in 1997 to US\$ 3,560 in 1998 as its economy contracted by 9.7 per cent. This reduction meant a foregone output per capita of US\$ 571 and an opportunity cost per capita of US\$ 598, about 16 per cent of GDP per capita in 1998. GDP per capita grew by 3.7 per cent in 1999, enabling Malaysia to regain its pre-crisis GDP per capita by 2000. But the expansion in these years was not enough to recoup the losses in 1998. Foregone output per capita was down to US\$ 614 per capita in 2000 from US\$ 646 in the previous year. The opportunity cost per capita was US\$ 650, and the accumulated cost per capita was US\$ 719. The gains in this period were reversed with an economic recession in 2001 as the economy sputtered to a -1.9 GDP per capita growth.

Figure 4: Costs of the 1997 Asian Financial Crisis per Capita in 2000 Prices



The effect of the recession on the costs was expected. The foregone output per capita rose to US\$ 891, the opportunity cost per capita increased to US\$ 922, and the accumulated cost per capita became US\$ 1,015. It is clear that sustaining economic expansion in the recovery period is crucial to recouping the losses. As economic expansion became slower in the following years, the costs continued to increase. In 2006, the foregone output per capita reached US\$ 1,130, and the opportunity cost per capita was US\$ 1,193. These figures were 25 per cent of GDP per capita in

2006. The accumulated cost per capita was US\$ 1,434 or 30 per cent of GDP per capita.

The estimated figures for 2007 suggest even larger costs: a foregone output per capita of US\$ 1,178, an opportunity cost per capita of US\$ 1,225, and an accumulated cost per capita of US\$ 1,487. It is unclear, however, if a flattening in the trends is taking shape in the medium term because of cyclical economic expansions. That is, costs increase as economic growth slows down, flatten during economic recovery, and then increase as growth eases up. Because of this pattern of growth, the accumulated cost per capita is expected to continue to increase. Only robust economic expansions – again, faster than the projected rates – can arrest the rise in the costs and reverse the trend. Perhaps, because the economic performance of Malaysia is constrained by global economic performance or, at least, its major trade partners that robust economic growth is contingent. While the exports sector remains crucial to buoy Malaysia in the short and medium term, however, for the long term, it also needs to deal with the infrastructural and human capital constraints to keep the economy in competitive shape.

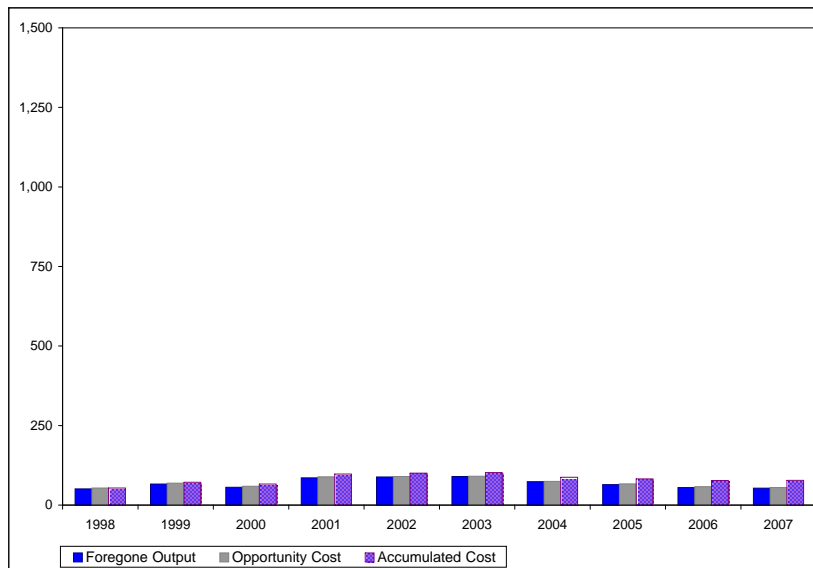
Philippines

Recall in Figure 1 that Philippine GDP per capita remained steady from 1987 to 1996. As pointed out, the trend reflects the boom-and-bust economic performance of the country between the 1980s and 1990s. In fact, the Philippines had been in constant decline as Figure 2 illustrates and if the data are stretched back to 1970. Moreover, it exceeded GDP per capita of 1982 only in 2002. There was an important economic turnaround by 1993 with wide scale deregulation and financial liberalization. In this period, the Philippines regained access to the international capital markets. In fact, the economy went on a steady expansion, albeit not at the level that distinguished the Asian miracle economies in the pre-crisis period. In a way, the Philippines experienced smaller costs because it was overlooked by the large capital flows in the 1980s and 1990s. An economic crisis in 1991 and 1992 also contributed to reduce the impact of the crisis in 1997.

Figure 5 shows that GDP per capita fell by a small amount, from US\$ 970 in 1997 to US\$ 945 in 1998. The foregone output per capita in 1998 was US\$ 51. There was a comparable amount

for the opportunity cost per capita at US\$ 54. These figures were 5 per cent of GDP per capita in 1998. The strong economic expansion in 2000 meant reductions in the costs, but the slow down in 2001 reversed the gains. By 2002, the foregone output per capita was US\$ 89, and the opportunity cost per capita was US\$ 90. The accumulated cost per capita stood at US\$ 100. These figures were about 10 per cent of GDP per capita in 2002. The costs were further reduced as economic growth was sustained into 2005. By 2006, the foregone output per capita and opportunity cost per capita were comparable to their 1998 levels. The accumulated cost per capita stood at US\$ 77, down to 7 per cent of GDP per capita. It is clear that the Philippines has started to recoup the costs of the crisis. What must be pointed out is that because of the relatively mild economic expansions in the post-crisis period, recouping the cost has been slow.

Figure 5: Costs of the 1997 Asian Financial Crisis per Capita in 2000 Prices



The forecasts for 2007 suggest that there are steady reductions in the costs, though not large reductions. If the forecasts hold, the figures for 2007 are: foregone output per capita of US\$ 53, opportunity cost per capita of US\$ 55, accumulated cost per capita at US\$ 78. Notice that these amounts are not significantly different to those in 1998 and 2006 figures. As with the other crisis-affected economies, the Philippines has to realize and sustain robust economic expansions to recoup the costs of 1997. But for the Philippines to recoup the lost opportunities from its earlier

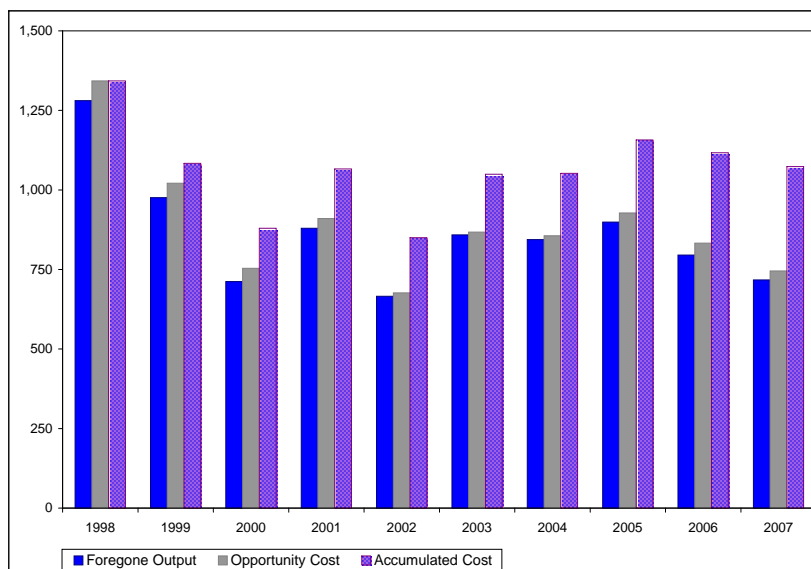
crises, there certainly needs to be exceptional economic expansions.

Even with positive developments in recent years, there are concerns that recent economic expansions are weak. Notwithstanding, the role of overseas workers remittances in buoying the economy from a balance of payments crisis in 2005, there is a budding Dutch disease as economic performance remains narrow (i.e., limited to electronics), shallow (i.e., limited domestic linkages) and hollow (limited industrialization). It is vulnerable to global economic performances and to the swings in domestic agriculture production. National elections in 2007 turned out to be respectable and reforms are expected to proceed at pace as in the earlier years. But political instabilities haunt the present government that the economy cannot gear up to reach higher growth trajectories.

South Korea

While South Korea faced an economic collapse in 1998, its economy rebounded quickly in 1999. Such turnaround confirms the fundamental strength and constitution of the economy. The crisis produced large costs nonetheless. In 1998, GDP per capita fell to US\$ 9,307 from the 1997 level of US\$ 10,064. The foregone output per capita in 1998 was US\$ 1,281, and the opportunity cost per capita was US\$ 1,343. These amounts were 14 per cent of GDP per capita. These costs were significantly cut down with robust economic growth of 8.7 per cent in 1999. The economic

Figure 6: Costs of the 1997 Asian Financial Crisis per Capita in 2000 Prices



expansion continued into 2002, cutting the costs to half even with a setback in 2001. Consequently, the foregone output per capita fell to US\$ 666, opportunity cost per capita was US\$ 677, and the accumulated cost per capita was down to US\$ 850. These amounts were 6 per cent of GDP per capita in 2002.

Since 2001, however, South Korea has experienced a cyclical pattern of economic growth, constrained by global economic performances or, at least, the performances of its major trade partners. At the same time, this pattern points to some challenges for South Korea as its economy navigates through the reforms along with competing domestic interests. As such, there have been no significant reductions in the costs in 2006, at least relative to the successes achieved by 2002. The figures were US\$ 795 foregone output per capita, US\$ 834 opportunity cost per capita, and US\$ 1,117 accumulated cost per capita. In fact, with the exception of 2005, latter cost was higher than its previous amounts in the preceding five years. Again, robust economic expansions – also steady economic performances are important in the periods following a crisis.

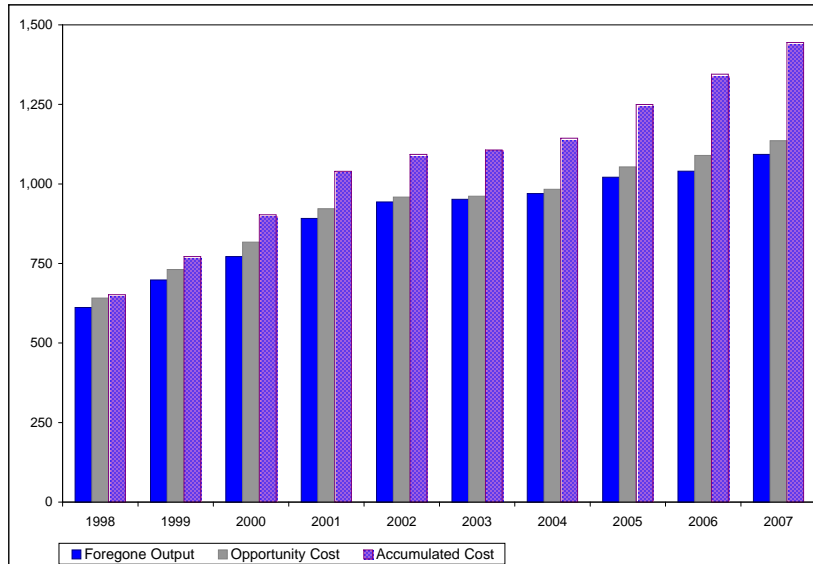
The forecast for 2007 are encouraging. Steady economic expansions are expected in the medium term, which strengthen confidence in South Korea and support further economic growth. After the consumer credit problem in 2003, there was a re-examination of the reform programs and there is a steady progress on them, contributing to the positive sentiments on the economy. It is to be expected that there are going to be further reductions in the costs in the coming years. The figures for 2007 are: foregone output per capital, US\$ 717; opportunity cost per capita, US\$ 745, and accumulated cost per capita, US\$ 1,074. A steady pace of economic growth is crucial to cut the opportunity and accumulated costs per capita. But for South Korea to significantly reduce the accumulated cost per capita, it is necessary to reignite robust economic growth of the type seen during the pre-crisis period. A slow down in economic expansion to a level lower than the recent trends can disappoint the recovery process.

Thailand

The crisis was thought to inflict a modest cost on Thailand. Its GDP per capita in 1997

shrank by 2.2 per cent, falling to US\$ 2,101 from its 1996 level of US\$ 2,154. As the crisis gained momentum and extended, serious costs became apparent. Economic growth further contracted by 12 per cent in 1998. Foregone output per capita became US\$ 612, and opportunity cost per capita was US\$641. The accumulated cost was US\$ 652, which was 35 per cent of GDP per capita.

Figure 7: Costs of the 1997 Asian Financial Crisis per Capita in 2000 Prices



In 2000, Thailand embarked on expansionary spending to put the economy on track for a strong recovery. But economic growth tumbled to 1 per cent in 2001 as the global economic slow down affected Thailand. By 2001, the foregone output per capita was US\$ 892, the opportunity cost per capita was US\$ 922, and the accumulated cost per capita was US\$ 1,040. The amounts for 2002 were higher as can be observed in Figure 7. Except between 2002 and 2004, when some momentum in economic expansion was seen leading to a flattening in the costs, economic growth since 2005 has declined. The costs rose quickly as a result, especially the accumulated cost. So by 2006, the foregone output per capita was US\$ 1,040, the opportunity cost per capita was US\$ 1,089, and the accumulated cost per capita stood at US\$ 1,345. What is alarming to note is that the accumulated cost in 2006 stood at 50 per cent of GDP per capita.

It is interesting to note is that the pattern of cost recovery in Thailand since 2001 is similar to that of Malaysia. Thailand is unable to realize growth accelerations and consequently, the costs

continued to increase. A flattening in the trends is expected as decent economic growth continues, but the social cost per capita is expected to increase steadily. To date, the prospects are not good compared to the previous years, especially with economic growth at its worst in six years. The estimated costs for 2007 are: foregone output per capita of US\$ 1,093, opportunity cost per capita of US\$1,136, and accumulated cost at US\$ 1,444. In 2007, these costs relative to GDP per capita are not significantly different compared to the preceding years. The trends can be reversed with robust economic expansions sustained in the medium term.

Nonetheless, problems hit the economy that limited economic expansion. The tsunami in December 2004 adversely affected the tourism industry that, in turn, affected economic growth. Tourism went into a lull for most of 2005 but has now recovered. Political unrest in the southern contributed to delay the recovery in tourism. Export performances are expected to be unstable with high oil prices. Of course, large public infrastructure projects contributed to the economic expansion in the past, which can be an option that the government can take.

But recent developments has raised concerns about the capacity of the economy to regain robust economic growth, particularly after the coup d'état in September 2006 sparked fears that political issues are once again resolved through military interventions, as in earlier decades. And compounding the situation was an economic faux pas in December 2006 in which capital controls were introduced but quickly reversed when it did not work out as planned, indicating that the program was not well thought-out. Uncertainties weaken confidence, reduce investments, etc. in turn weaken the prospects for robust economic expansions. A credible national election in 2007 is important to stabilize the political climate. Also, there seems to be an emerging move to inward-looking strategies that is problematic because they can be captured by vested interest and reverse the useful reforms. What is disappointing is that Thailand is losing steam and moving to a lower gear of economic performance.

Summary

The above discussions emphasize two points: the crisis-affected economies have inferior

performances in the decade following the crisis, and they have not recouped their losses in 2007. While there were robust economic growths in the immediate years after the crisis that resulted in some reductions in the costs, subsequent sluggish economic expansions meant that further cuts in the costs were not realized, thus the costs increased as a result. The persistent gaps between the counterfactual and actual GDP per capita suggest that the crisis has long-lasting effects.

Among the crisis-affected economies, the Philippines and South Korea illustrate successes in recovering the losses. While the experience of the Philippines was to be expected as it did not face large costs. That of South Korea clearly demonstrated the crucial role of strong and sustained economic expansions in recouping the costs. Its strong economic rebound in 1999 meant that cost recovery started almost immediately after the crisis, although further progress was delayed when economic growth eased up. Those for Indonesia, Malaysia, and Thailand clearly demonstrate what weakening economic expansions can do to increase the costs of the crisis.

The aggregate figures shown in the Appendix substantiate the contention that the crisis-affected economies have endured the trauma of the crisis. For 2007, the projected total social cost of the crisis in Indonesia is US\$ 95 billion (41 per cent of GDP); in Malaysia, US\$ 39 billion (31 per cent of GDP), in the Philippines, US\$ 7 billion (7 per cent of GDP), in South Korea, US\$ 53 billion (8 per cent of GDP), and in Thailand, US\$ 95 billion (55 per cent of GDP). Therefore, at the aggregate, Indonesia and Thailand have had the worst experiences from the crisis. Again, it needs to be noted that the Philippines did not face a major trauma in 1997. The conclusion is clear: robust economic expansions in the post-crisis period are crucial to recoup the costs. Subsequent shocks that reduce economic performances need to be compensated as well with robust economic expansion and appropriate policies are needed for growth accelerations. If economic growth has mellowed down or deliberately adjusted to supposedly tolerable levels in the post-crisis period, it is going to be difficult to recoup the lost opportunities.

Without doubt, how each of the crisis-affected economies responded to the crisis in 1997 is another dimension to consider. In part, the large costs in Indonesia and Thailand were the result

of the way both economies handled the crisis, and the IMF had an important role in that process. The IMF is liable to the extent that they pressed for the incorrect responses, albeit modified when belatedly found that the prescriptions were not working or worsening the situation. In Indonesia, for instance, contractionary policies mixed with sectoral reforms that were not directly related to the crisis were demanded by the IMF. While Indonesia tried to resist the IMF, the political crisis that compounded the situation complicated the policy responses and limited the options available to Indonesia.

In Thailand, the closure of banks following the standard stabilization prescriptions of the IMF such as raising interest rates, fiscal austerity, and so on, produced panic that escalated the crisis. The backlash was contagion, as confidence in the region dried up and insecurity prevailed. Malaysia likewise pursued IMF-style pro-cyclical policies in 1997 even though the IMF was not involved in the economy. Maybe because Malaysia did not have the IMF impinging on its policy space that it reversed itself to introduce counter-cyclical measures to insulate the economy from further damages. To some extent, the 1998 capital controls helped lessen the losses. Needless to say, the political events in Malaysia intensified the impact of the crisis. The Philippines had to go to the IMF because its economy was still recuperating from an earlier crisis and clearly not strong enough withstand any attack. Ironically, the IMF intervention provided some shield. Nonetheless, the Philippines experienced some costs because, to an extent, it could not follow a Malaysia-style strategy.

There was a combination of Indonesia and Thailand IMF strategies in the case of South Korea, although a more systematic approach took shape in terms of the amounts extended and the attention to economic recovery. In a way, the IMF helped ease the recovery process. Interestingly, South Korea was also able to act cautiously in going about policy adjustments. While vigorous but effective reforms were made, South Korea smartly ignored IMF advice to restructure its economy in drastic ways. Instead, it salvage the economy by focusing on the institutional rigidities yet not resorting to Malaysian-type capital controls, thereby igniting economic growth and supporting the

recovery process.

5. ANOTHER DECLARATION OF INTERDEPENDENCE⁶

Ten years after the crisis, what are the needed policies to realize robust economic expansions and prevent future crises? Five items are discussed below for the crisis-affected economies.

On Economic Growth

More than before, robust economic expansions are needed. Domestic management must support economic growth, expand incomes, and create jobs. GDP per capita can be enhanced when nominal output increases and/or population decreases. Complementary social programs for basic needs and social insurance are thus needed to stabilize population and enlarge labor productivity. It need not mean that governments supply all that is required for economic growth and capabilities formation but the essentials need to be available. While current investments in the crisis-affected economies have gone down to satisfactory levels, especially after their elevated levels prior to the crisis, it must be stressed that the previous flows were mainly facilitated by ignoring the long-term implications of weak governance. Sound management of investments is needed to facilitate capital deepening, enhance competitiveness, and avoid unnecessary indebtedness, and thereby supporting economic expansions.

It is clear from Parts 3 and 4 that economic growth must be higher than the current levels and sustained for full recoveries to happen. From Figure 1, GDP per capita needs to expand at a rate of at least 6 per cent each year, which is the low-end average for the period 1987 to 1996. Downgrading economic growth in the economic plans in order that they conform to projections of international institutions and rating agencies is unwarranted considering that sufficient capacities are available for robust expansions. What is important, though, is that the past growth strategies are not to be replicated. The destruction of the resources and the environment brought about by mindless economic expansions must be considered in drawing up economic plans. Transitions to the superior structures must be facilitated to avoid destabilizations that come with rapid economic

transformations.

On International Flows of Capital and Trade

There is a large literature on the causes of the crisis, and there is no need to rehearse them here. One important dimension is that financial liberalization with loose regulations and weak or weakened management of international flows underpinned the crisis and produced large costs. Thus the burden is to show that the purported benefits of unrestrained international flows not only materialize, but more importantly, accrue to domestic residents. If capital flows out of developing countries like capital flight or even as legitimate capital outflows, while capital surges generate fragilities or reduced effectiveness of economic policies, there is a strong case for intervention. As such capital flows management is important. As long as the rules are clear and enforcement is fair, such techniques can contribute to increasing economic welfares, as capital flows support the expansion of production and increase economic growth. It would be a tragedy if the fear of capital regulation results in a situation in where capital stopped flowing to the region.

A complementary intervention is trade management techniques. Beyond issues associated with trade access and facilitation, trade coordination is important to avert domestic disintegrations and social dislocations. The focus on export-oriented growth is difficult to sustain if there is no clear direction to push industries to higher levels of production and learning how to compete, not just being competitive. The crowding of global exports market must also be addressed. Obviously, intensive production can generate robust economic expansions despite the structural inefficiencies, but it cannot go on forever. Trade management techniques are important to administer production and facilitate industrial deepening and propel the economy to higher levels of industrialization. As such, sound industrial policies and planning are crucial, though they need to be flexible to allow adjustments with changing circumstances.

Similar to the case of capital flows, it must be demonstrated that the benefits of trade flows not only materialize and exceed the costs, but more importantly, the gains from trade accrue to the domestic residents. Again, as long as the modes of interventions and industrial-

facilitation are clear and facilitation is fair, trade management techniques can contribute to increasing economic welfares. It would be a tragedy if the uneasiness with strategic domestic interventions resulted in a situation in which economies end up shutting their borders or introducing protectionist policies that constrain global economic performances.

On the Role of Governments

The role of the government in economic management and execution of reforms must be rethought. Governments that are unsuccessful face larger pressures to remove themselves from further participation in the economy. In turn, they become much weaker or more ineffective. Weak governments cannot sustain stability in their economies or secure the basic needs of their peoples. Weakening governments, in turn, find increasing difficulties in regaining the level of effectiveness they once enjoyed. Governments that allow external forces to undermine their autonomies and capacities find that they degenerate quickly. In the end, years of economic progress are reversed with the costs imposed on the people. Governments that wait for the market or events to unfold to produce for them the needed stabilities and securities are bound to fail. While those afraid to take serious measures in the interest of the domestic economy likewise fail. When governments weaken or fail, they actually violate the fundamental human rights and liberties of their people to decent, meaningful, and substantive existence. They are thus responsible for such injustices and miseries.

Strong governments remain important, at least to ensure economic growth and progress. Strong governments mean having effective governance, in which governments are at the center of domestic management and policy-making. They effectively respond to domestic challenges, while they negotiate the external demands. They facilitate cooperative relations with the private sector and civil society rather than obstruct broad-based initiatives. They have long-term plans but pace reforms such that adequate regulatory institutions and supervisory mechanisms are in place, thus reducing vulnerabilities. Those that maintain autonomies and continuously improve capacities to the changing conditions are the ones that succeed in steering economies to higher economic growth trajectories and raising economic welfares. Thus, it is important to challenge the governments of

the crisis-affected economies to take decisive actions to stabilize their economies and secure their peoples. It is important that they consider legitimate social concerns like objectives for balanced and clean environments, peaceful societies, and so on, to rethink how reforms have been done in the past and the costs of misguided policies or wrong implementations, and the consequences of lost autonomies and capacities, etc. And this challenge is important for pro-active engagements to happen that lead to the identification of the legitimate alternatives for broad-based economic expansions.

On Opportunism and Hesitation

There is no doubt that the misdiagnosis of the causes of the crisis and the overloading of rescue packages for the crisis-affected economies contributed to the escalation of the crisis. To an extent, the interventions by the IMF and others were opportunistic, driven by a longing to bring in reforms that were difficult to introduce earlier since governments succeeded in parrying away the reforms. The crisis provided an opportunity to strengthen that engagement. Recall that the crisis-affected economies were quickly branded as principals of crony capitalism, corruption, large-scale inefficiencies, etc. External interventions forced structural changes when economic environments went increasingly volatile and uncertain, thus undermining the reforms, which became part of the crisis.

The initial hesitation of the international institutions to provide support in a crisis situation was understandable, but the extended reluctance to help was not. Concerns about moral hazard were valid because, in the past, rescue efforts benefited those who not only took advantage of the loose or weak environments but also played a part in producing a crisis. But precisely because of the inaction or delayed actions of the international institutions that the crisis produced an outcome that on hindsight was largely preventable. When these interventions came, however, they targeted the structural problems rather than first ensuring economic stability. That is, the crisis-affected economies could have been steered away from the large costs if measures were introduced in a timely and appropriate manner. Concerns such as moral hazard can be addressed if guidelines on

lender-creditor duties and responsibilities existed.

On international Cooperation

The items above are some of the institutional underpinnings for the construction of a strong economy in the post-crisis period. It follows that the international community must also contribute in this endeavor. Efforts that enhance transparency of international flows, mechanisms to monitor the regional dimensions of vulnerabilities, and so on, are in the right direction. At the global level, there is a need to foster international cooperation. The crisis illustrated how a shock in one place can snowball into a serious crisis in another if there is no solid cooperation among economies concerned. Thus the international community must work to design democratic rules of operations and for engagements to reduce uncertainties, forge a stable international economy, and secure the international polity. The international community must take up the responsibilities for external management and cooperate in domestic management in order that international trade and capital flows do not cause havoc elsewhere. In the event of a crisis, the international community must take up the challenge to provide quick response in order that the crisis is not extended or transformed into a more virulent kind. Ultimately, international coordination is needed so that the global economic expansions raise incomes and reduce poverty.

6. CONCLUSION

This paper presented a review of the economic performances of Indonesia, Malaysia, Philippines, South Korea, and Thailand in the decade following the 1997 Asian Financial Crisis. It showed that these crisis-affected economies have performed unsatisfactorily relative to previous performances. Full recovery requires sustained robust economic expansions to compensate for the losses in 1997. If economic growth mellowed down to supposedly pragmatic levels, it would be difficult to recoup the costs.

As of 2007, the crisis-affected economies continue to endure the trauma of the crisis. They have exceeded their 1996 GDP per capita, albeit with years of significant lost opportunities. For

2007, the total social cost of the crisis in Indonesia is US\$ 95 billion (41 per cent of GDP) or a per capita social burden of US\$ 418. Malaysia is burdened with US\$ 39 billion (31 per cent of GDP) or per capita terms, US\$ 1,487. In the case of the Philippines, the total social cost is US\$ 7 billion (7 per cent of GDP) or per capital social cost of US\$ 78. South Korea needs to deal with US\$ 53 billion (8 per cent of GDP) or a per capital social cost of US\$ 1,074. Thailand is overloaded with US\$ 95 billion (55 per cent of GDP) or a per capital social cost of US\$ 1,444.

Finally, to realize robust economic expansions in the region, decisive policies are needed from the governments of the crisis-affected economies. These actions must ensure economic the stabilities and preserve political securities in the region. While reforms have been introduced after 1997, challenges remain – old and new ones that must be addressed as well so economic growth is raised to levels that once characterized the Asian miracle economies before the crisis. Short of a positive direction in policies – taking up the useful components of past arrangements and putting in important missing elements like sustainable and equitable growth, sound domestic and external management, and solid international cooperation – economic progress is limited and punctuated by crises.

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APPENDIX**Table 1: Total Accounting Costs of the 1997 Asian Crisis in US\$ Millions and 2000 Prices**

Year	Indonesia	Malaysia	Philippines	South Korea	Thailand
1998	35,159.4	12,528.2	3,717.7	59,288.1	37,231.2
	22.5	16.0	5.4	13.8	32.9
1999	45,289.3	14,529.4	4,906.6	45,489.7	42,904.1
	28.8	17.5	6.9	9.6	36.3
2000	49,095.4	14,125.1	4,253.1	33,469.8	47,872.3
	29.8	15.6	5.6	6.5	38.6
2001	54,596.8	20,928.6	6,625.9	41,650.6	55,792.8
	31.9	23.1	8.6	7.8	44.1
2002	59,212.8	24,192.9	6,967.8	31,705.8	59,566.9
	33.1	25.6	8.7	5.6	44.7
2003	63,193.0	26,408.3	7,182.5	41,094.3	60,631.6
	33.7	26.5	8.6	7.0	42.5
2004	66,463.8	26,767.1	5,993.3	40,588.2	62,302.8
	33.8	25.1	6.7	6.6	41.2
2005	68,504.3	28,800.8	5,350.9	43,421.5	66,155.7
	33.0	25.6	5.7	6.8	41.8
2006	69,894.1	29,409.8	4,653.3	38,569.2	67,958.4
	31.8	24.6	4.7	5.8	40.7
2007	71,658.8	30,958.6	4,560.2	34,937.5	72,003.1
	30.9	24.5	4.4	5.0	41.5

Note: Calculation of author. Numbers below aggregate figures represent shares of gross domestic product.

Table 2: Total Economic Costs of the 1997 Asian Crisis in US\$ Millions and 2000 Prices

Year	Indonesia	Malaysia	Philippines	South Korea	Thailand
1998	36,853.8	13,131.9	3,896.8	62,145.3	39,025.5
	23.6	16.8	5.7	14.4	34.4
1999	47,398.6	15,206.1	5,135.2	47,608.3	44,902.3
	30.1	18.3	7.2	10.1	38.0
2000	51,962.2	14,949.9	4,501.4	35,424.2	50,667.7
	31.5	16.6	6.0	6.9	40.9
2001	56,481.3	21,651.0	6,854.6	43,088.2	57,718.6
	33.0	23.9	8.9	8.1	45.6
2002	60,167.6	24,583.0	7,080.2	32,217.0	60,527.4
	33.6	26.0	8.8	5.7	45.4
2003	63,833.4	26,675.9	7,255.3	41,510.7	61,246.0
	34.1	26.8	8.7	7.1	43.0
2004	67,376.5	27,134.7	6,075.6	41,145.6	63,158.5
	34.2	25.4	6.8	6.7	41.7
2005	70,663.3	29,708.5	5,519.6	44,790.0	68,240.7
	34.0	26.4	5.9	7.0	43.2
2006	73,194.3	30,798.4	4,873.1	40,390.3	71,167.2
	33.3	25.7	5.0	6.0	42.6
2007	74,479.8	32,177.3	4,739.8	36,312.9	74,837.6
	32.2	25.5	4.6	5.2	43.1

Note: Calculations of author. Numbers below aggregate figures represent shares of gross domestic product.

Table 3: Total Social Costs of the 1997 Asian Crisis in US\$ Millions and 2000 Prices

Year	Indonesia	Malaysia	Philippines	South Korea	Thailand
1998	36,853.8	13,131.9	3,896.8	62,145.3	39,678.3
	23.6	16.8	5.7	14.4	35.0
1999	49,138.2	15,832.4	5,320.3	50,523.4	47,427.3
	31.2	19.1	7.5	10.7	40.1
2000	56,632.0	16,535.9	5,007.1	41,338.6	56,011.9
	34.3	18.3	6.6	8.1	45.2
2001	63,194.2	23,854.2	7,546.2	50,483.4	65,062.8
	36.9	26.3	9.8	9.5	51.4
2002	68,003.2	27,223.6	7,909.0	40,471.7	68,995.7
	38.0	28.8	9.9	7.1	51.8
2003	72,473.1	29,649.0	8,181.1	50,218.0	70,493.3
	38.7	29.7	9.8	8.6	49.4
2004	77,142.2	30,578.3	7,132.6	50,588.3	73,460.3
	39.2	28.6	8.0	8.2	48.5
2005	83,026.8	34,196.0	6,823.9	55,875.8	80,964.5
	40.0	30.4	7.3	8.8	51.2
2006	89,700.4	37,011.5	6,528.2	54,174.8	87,853.9
	40.8	30.9	6.7	8.1	52.6
2007	94,790.6	39,067.3	6,685.6	52,300.3	95,153.4
	40.9	31.0	6.5	7.5	54.8

Note: Calculations of author. Numbers below aggregate figures represent shares of gross domestic product.

ENDNOTES

¹ See ADB (2007), Burton and Zanello (2007), IMF (2007), Ito et al. (2007), UNESCAP (2007).

² Version of Parts 3 and 4 have appeared in Beja (2007).

³ Only the trend for Singapore is closest to the convergence of Indonesia, Malaysia, South Korea, and Thailand. There was convergence among five Asian miracle economies in 1986 to 1996.

⁴ Even in the mid-1990s, the IMF and World Bank were optimistic that robust economic growth rates in the region would continue for another five years or early 2000s

In the early/mid-1980s, the governments of Indonesia, Malaysia, South Korea, and Thailand embarked on economic reforms and adjustments to produce robust economic performances in the following decade. In the counterfactual, these economies could have done similar reforms and adjustments in the 1990s to sustain robust performances. While this scenario may be difficult to defend for the Philippines, considering its dismal economic performances in the 1980s and early 1990s, it must be pointed out that the policy mistakes and misguided economic agenda in the mid-1980s could have been avoided had the government maintained policy autonomy and capacities to institute on sound economic reforms. The economic history of the Philippines also points to the fact that the deterioration of governance and capacities started much earlier, in the 1970s. It is also important to note that in the 1950s and 1960s, the Philippines had solid foundations that the country provided capacity building skills and training to Southeast Asian countries for them to embark on sound structural transformation and economic expansions.

⁵ In addition, $y_{t,i} = \text{year} + e_{t,i}$ was estimated and the geometric mean of the estimated values is used as y_t . Arguably, obtaining the geometric mean is an approximation to the Inada conditions in economic growth theory.

⁶ Section 5 is another take on Chapter 14 of Rubin and Weisberg (2003).