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THE EAST ASIAN CRISIS: LESSONS FOR OIC COUNTRIES

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The crisis, which erupted in Asia's financial markets in 1997, had severe effects on the involved countries. It started in Thailand with a sudden fall in the stock market and then spread to Indonesia, South Korea, Malaysia and to other countries in the region. It also spread to financial markets around the world, threatening the global economic expansion. Within East Asia, the crisis resulted in a decline in living standards, rising unemployment and falling real wages. The crisis also influenced other distant regions. This paper analyses the causes and consequences of the East Asian crisis, tries to draw lessons for the OIC member countries and makes policy recommendations for the recovery process.

1. INTRODUCTION

Following over thirty years of rapid economic growth, which led the East Asian countries to be known as Asian Tigers, the East Asian countries found themselves facing one of the most severe economic crises of the century. As a result of the crisis, the halt in the rural credit to the rural areas has lowered the income levels of many. Accompanied by the sharp recession in Asia, the East Asian crisis created a risk to the world economic growth. Getting back to the previously enjoyed level of income in the crisis-stricken economies may take some time, although recovery in the involved countries is at its last phase.

The East Asian crisis affected not only the financial sector, but also the real economic prospects, demand and international trade. Additionally, its spillover effects are much more global than those of the financial crises experienced in the past two or three decades, including those in Latin America. For the first time, a financial crisis in the South has had a profound impact on capital markets in the North. A drop in global growth is an anticipation created by the overall crisis environment, in which the East Asian crisis occupies an important place.

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The East Asian crisis stemmed mainly from the financial sector fragilities, weaknesses in governance in corporate, financial and government sectors, which made the crisis economies increasingly vulnerable to deteriorating external market conditions. Only in Thailand, the existence of external current account imbalances added to the causes of the crisis.

Although the economic problems encountered prior to the crisis are experienced commonly by most of the developing countries, the magnitude of the combined effect of these problems distinguishes the East Asian case from the others. The problems encountered can be summarised as a serial speculative attack on a regional group of countries, provoking massive capital outflows, simultaneous crises, and recession for a whole region.

Furthermore, the economic conditions during the crisis have not been promising at all. With the reverse turn in the capital flows, the currencies started to depreciate causing inflationary pressures, especially in Indonesia. The worsening conditions of the domestic banks and corporations had negative impacts on domestic demand and production. The growth turned into a downturn in all crisis economies and the current accounts showed fluctuations.

Thailand, South Korea, Indonesia, Philippines and Malaysia have been severely affected by the crisis and experienced deep recessions, whereas Singapore, Taiwan, Vietnam and China could so far avoid the recession, but still experienced a fall in their growth paths. The crisis erupted after three decades of rapid growth during which the East Asian countries achieved a remarkable economic success. Particularly for this reason, the crisis was a big shock for the world.

This paper will analyse the causes and consequences of the East Asian crisis and try to draw lessons for the OIC member countries. It would be fair to say that the implications of the East Asian crisis on the developing countries have been enormous. It is not a coincidence that the Japanese recession and Russia’s financial crisis in August 1998 were experienced very shortly after the East Asian crisis. Thus, the spillover effect of the East Asian crisis on Japan and Russia as well as the economic turmoil in other regions, such as Brazil in Latin America, have indeed created a global impact from which the developing economies have gravely suffered.

The paper will first examine the causes of the crisis, then explain how the crisis started and continued. The reason of contagion of the crisis will also be included under this heading. A part of this section will describe the economic situation before and after the crisis in four crisis-stricken countries (Thailand, South Korea, Indonesia and Malaysia) in the region. The crisis has forced Thailand, Indonesia and South Korea to sign stand-by arrangements with the International Monetary Fund (IMF), whereas Malaysia did not necessarily need an IMF-supported program to overcome the effects of the crisis. The following section concentrates on the regional and global implications as well as the impact on developing and oil-exporting countries. Finally, the paper discusses a series of lessons drawn from the East Asian crisis, especially for the developing countries and makes policy recommendations for the recovery process. The last section of the paper is the conclusion.

2. CAUSES OF THE CRISIS

2.1. Current Account Deficit and the Overvalued Real Exchange Rate

TABLE 1: CURRENT ACCOUNT BALANCE
Million US Dollars

	1993	**1994**	**1995**	**1996**	**1997**	**1998**
Thailand	-6364	-8085	-13554	-14691	-3024	14241
Indonesia	-2106	-2792	-6431	-7663	-4889	3972
Korea	990	-3867	-8507	-23006	-8167	40552
Malaysia	-2991	-4520	-8469	-4596	-4792	9200
Philippines	-3016	-2950	-1980	-3953	-4351	1287

Source: *International Financial Statistics*, January 2000, IMF.

From the theoretical point of view, a country with a high current account deficit and a fixed exchange rate regime is open to trouble as foreign investors start attacking the overvalued currency. In Thailand, the current account deficit (Table 1) has been high since 1990 and the country was running an exchange rate that had been pegged to the U.S. dollar (Table 2). However, the high current account deficit alone cannot explain the emergence of a crisis of this magnitude. What is more important here is how this deficit was financed. In other words, the composition of capital account inflows used to finance the deficit is more important than the fact that the country had a large deficit plus a fixed rate.

TABLE 2: EXCHANGE RATES IN 5 ASIAN COUNTRIES

National Currency per U.S. Dollar (Period Average)

	1993	1994	1995	1996	1997	1998
Thailand	25.320	25.150	24.920	25.340	31.360	41.360
Indonesia	2087.100	2160.800	2248.600	2342.300	2909.400	10013.60
Korea	802.670	803.450	771.270	804.450	951.290	1401.440
Malaysia	2.574	2.624	2.504	2.516	2.813	3.924
Philippin	27.120	26.417	25.714	26.216	29.471	40.893

Source: *International Financial Statistics*, January 2000, IMF.

In East Asia, the current account deficit/GDP ratios (Table 3) during the two years prior to the crisis were not very high, except for Thailand and Malaysia. Additionally, in East Asia there was generally a fiscal surplus (Table 4) and high investment and savings rates. Besides, in Thailand, returns on domestic capital formation were sufficiently high to repay foreign creditors and additional productive capacity was converted into extra earnings in terms of foreign currency.

TABLE 3: CURRENT ACCOUNT AS PERCENT OF GDP

Percentage

	1993	1994	1995	1996	1997	1998
Thailand	-5.1	-5.6	-8.1	-7.9	-2.0	12.8
Indonesi	-1.3	-1.6	-3.2	-3.4	-2.3	4.2
Korea	0.3	-1.0	-1.7	-4.4	-1.7	12.6
Malaysia	-4.7	-6.2	-9.7	-4.6	-4.9	12.9
Philippin	-5.5	-4.6	-2.7	-4.8	-5.3	2.0

Minus indicates deficit.

Source: Derived.

Therefore, the large current account deficit cannot be the factor which triggered the crisis. However, the way chosen to finance it becomes crucial in understanding the fundamentals that underlie the East Asian crisis.

TABLE 4: GOVERNMENT FINANCE

Million US Dollars

	1994	1995	1996	1997	1998
Thailand	4025.4	5415.9	1708.9	-480.3	-3117.8
Indonesia	-121.3	1172.7	133.6	-52.6	n.a.
Korea	1224.7	1341.9	535.8	-6041.3	-14034.8
Malaysia	1679.7	743.1	721.4	2355.7	-1274.6
Philippines	685.7	430.7	238.6	53.1	-1222.2

Minus indicates deficit.

Source: *International Financial Statistics*, January 2000, IMF.

2.2. Short-term Foreign Borrowing

Short-term debt accumulation became possible in the East Asian countries because of liberalisation of the capital account. Even in South Korea, where strict controls on foreign direct investment are practised, controls on short-term borrowing had been removed. In Indonesia, South Korea and Thailand, the ratio of short-term debt to foreign exchange reserves was more than 100 percent in mid-1997 (World Bank Global Economic Prospects 1998). It is worth noting that these three countries were the worst affected by the crisis. On the other hand, the Philippines and Malaysia, with short-term debt ratios below 100 percent were not affected by the crisis as much.

TABLE 5: PORTFOLIO INVESTMENT LIABILITIES IN 5 ASIAN COUNTRIES

Million US Dollars

	1994	1995	1996	1997	1998
Thailand	2486	4083	3585	4798	159
Indonesia	3877	4100	5005	-2632	-2002
Korea	8149	13875	21183	12287	-292
Malaysia	-1649	-436	-268	-248	n.a.
Philippines	901	2619	5126	600	-276

Source: *International Financial Statistics*, January 2000, IMF.

Prior to the crisis, certain similarities could evidently be observed across Indonesia, South Korea, and Thailand. In all three countries, inadequate regulation and supervision in the financial sector as well as varying degrees of traditional government guarantees and a heavy governmental role in credit allocation had been reflected in the misallocation of credit and inflated asset prices. Credit was combined with the prevalence of large unhedged foreign-currency-denominated corporate and bank debt. The large unhedged private short-term foreign currency debt in all three countries contributed to the observed fragilities. The overvalued real exchange rate has been the main reason of the unhedged foreign currency borrowing. As a result of this unhedged currency borrowing, especially in the absence of adequate financial regulation and supervisions, banks and corporations were rendered vulnerable to sudden currency fluctuations.

As domestic interest rates were higher than foreign interest rates, corporations started to borrow heavily from foreign banks in order to finance their expansion and became vulnerable to interest rate surges. This risk was also bolstered by the exchange rate risk faced by the East Asian companies. The absence of developed bond and equity markets caused an increase in the borrowing from banks, which in turn increased the interest rate risk. The excessive borrowing abroad by the private sector or excessive lending by the international financial markets may be considered the bottom line that highlights the East Asian crisis. The over-lending by foreign financial markets was encouraged by the high marks given to the East Asian banks and firms by the Western rating agencies as well as by the implicit and explicit government guarantees. These guarantees were even institutionalised in Thailand through the establishment of the Bangkok International Bank Facility (BIBF) – a tax-exempt entity specialised in short-term borrowing from abroad and on-lending in the domestic market. The growth in short-term foreign liabilities exceeded the growth in international reserves and created a potential for liquidity problems.

In his study (Akyüz, 1998) Yılmaz Akyüz argues that the acquisition of property and securities by non-residents have also played some role in sustaining speculative bubbles in equity and property markets in South East Asia: "*Indeed increased access by non-residents to securities markets (as well as greater access by residents to dollar assets) tends to establish a close link between the two inherently unstable markets, namely currency and equity markets. This generates destabilising feedbacks: a currency crisis could easily lead to a stock market collapse, while a bearish mood in the equity market could easily translate into a currency crisis. Again, one may need more direct measures to control such destabilising linkages, including restrictions over foreign acquisition of domestic securities*."

The role of central banks in containing the effects of crisis is very important. If foreign capital inflows are the main driving force behind the crisis, as in the East Asian case, then the central banks should take steps to sterilise the impact of foreign capital inflows on domestic liquidity. If the central banks are not able to do that, there will be an increase in domestic lending which will eventually spill over from the financing of safe and productive investments to risky and speculative assets. Lending was increasingly channelled towards property and non-traded activities. 20 to 25 percent of commercial bank debt was allocated to real estate in Indonesia and between 15 and 20 percent in the Philippines, Malaysia and Thailand (Ranis and Stewart, 1998, p.5).

2.3. Private Capital Inflows and Imperfections in the Domestic Financial System

As stated earlier, the continuous rapid growth and successful economic progress of the East Asian countries for three decades have put a mark on the welfare of the region. These favourable economic circumstances, bolstered by low government indebtedness, have led to a significant amount of private capital inflows to the economies of the East Asian countries.

In addition to the favourable economic circumstances, another reason of the massive capital inflows to the East Asian economies is the overvalued real exchange rates and rapidly growing asset prices. The inflows caused an increase in the domestic credit expansion. In the 1990s, Indonesia, Malaysia, the Philippines and Thailand experienced a more rapid expansion of credit than any industrial country.

However, despite improving growth, these capital inflows were intermediated through poorly regulated and/or supervised domestic financial systems. Financial institutions played an important role in channelling these inflows and provided guarantees on foreign borrowing by corporations. While the inflows were perceived as being attributable to favourable investment prospects associated with a sound macroeconomic environment, it was then understood that these inflows were used to finance asset price inflation and the accumulation of non-performing loans in the portfolios of banks and other financial intermediaries. In fact, financial reforms were introduced in the East Asian countries during the 1980s and the 1990s. However, enforcement and implementation of regulation of the financial sector remained far behind, resulting in a significant proportion of credit being allocated to unproductive or speculative investment.

The capital flows to each of the crisis-stricken East Asian countries have been excessive and much more than the countries could absorb in the short-term without destabilising the foreign exchange and the other domestic financial markets. The capital inflows caused an excess supply of foreign exchange and led to a substantial appreciation of the real exchange rates.

The weak monitoring and supervising capabilities of the central banks is the main reason that lies behind the banking fragilities. According to Kumar and Debroy, under such setting, commercial banking and non-banking financial companies have been characterised by the following:

- significant undercapitalisation, widespread insider, connected or directed lending, weak credit appraisal and portfolio management capacities,
- non-observance of prudential norms, unsatisfactory asset classification, and
- inadequate loan loss provisions (Kumar and Debroy, 1999, p.7).

TABLE 6: NET PRIVATE CAPITAL FLOWS IN 5 ASIAN COUNTRIES
Billion US Dollars

	1996	**1997**
Private Flows (Net)	97.1	-11.9
Non-debt Flows	18.7	2.1
Foreign Direct Investment	6.3	6.4
Portfolio Equity Investment	12.4	-4.3
Debt Flows	78.4	-14.0
Banks	55.7	-26.9
Non-banks	22.7	12.9

Source: *IIF, Capital Flows to Emerging Market Economies quoted in East Asia: The Road to Recovery.*

The inadequate legal framework in the crisis-stricken countries, which worsened the situation even further, accompanied this characterisation. In 1997, capital flows turned negative. The negative change in the net private capital flows in 1997 from the previous year was very significant in the five East Asian countries (Table 6).

2.4. Macroeconomic Environment

For three decades, trade has been the engine of growth in the East Asian economies. Implementation of reforms and adoption of appropriate trade and investment regimes as well as exchange rates and sound macroeconomic policies by the East Asian governments yielded a considerable increase in the Gross Domestic Products (GDP) of these countries. The export-promoting government policies played an important role in this achievement. In 1995, the share of trade in GDP was 50 percent in the region. Between 1970 and 1995, exports grew by 10 percent per annum every quarter and per capita exports grew from

$100 to $400 in South Korea and from $80 to $850 in Thailand (World Bank, 1998, p.20).

However, economic growth in the region slowed in 1996. In South Korea and Thailand the deceleration in the output growth was more visible than in the other countries, causing increases in the unemployment rates. With the real effective exchange rate appreciations accompanied by the weakening demand in the partner countries, Indonesia and Thailand experienced a fall in their export market shares. The sharp decline in the prices of key import commodities such as semiconductors, contributed to that fall by further decreasing the export revenues. In 1996, following years of rapid economic expansion, all three countries experienced a fall in their export growth (Table 7), the largest in the last 15 years, which was coupled by a negative terms-of-trade shock.

The World Bank lists the causes of the fall in the export growth as follows:

- A large fall in world trade growth,
- Yen depreciation in Japan,
- Real effective exchange rate appreciations in some East Asian countries, and
- Significant price declines for major export products in some countries in the region (The World Bank, 1998, p.36).

In 1996, export growth fell from an average of 25.3 percent in 1995 to an average of 6.9 percent in 1996 in the 5 East Asian countries (Table 7). This situation put pressure on the external balances and domestic economic activity, curbing the overall growth rate. The slowdown in growth yielded a deterioration in the quality of the asset portfolios, and the fragilities of the financial sector became more clearly visible. This situation caused concerns among foreign investors regarding the credibility of East Asian financial institutions.

TABLE 7: GROWTH RATE OF EXPORTS IN 5 ASIAN COUNTRIES
Percentage

	1994	**1995**	**1996**	**1997**	**1998**
Thailand	22.4	24.8	-1.3	3.4	-5.7
Indonesia	8.8	13.4	9.7	7.3	-8.6
Korea	16.8	30.3	3.7	5.0	-2.8
Malaysia	24.5	25.9	6.0	0.3	-6.9
Philippines	18.6	32.2	16.5	22.8	17.7

Source: Derived.

Notwithstanding that the economic tensions, prior to the crisis, had been clearly visible in all three countries, the macroeconomic imbalances in Thailand were more serious than those in the other two. Thailand recorded a negative export growth (Table 7) in nominal terms in 1996. The improper financing of the large current account deficit, which reached 8 percent of the GDP (Table 3) and was financed by short-term flows, associated with the overvalued real exchange rate led to sudden reversals in the Thai economy. The private sector, relying on the pegged exchange rate, borrowed enormously from abroad without taking into account the foreign currency risks. Most of the credit acquired by the poorly-regulated finance companies was invested in the real estate market. Prior to the crisis, Thai finance companies could borrow in Japanese Yen at almost zero interest rates and invest in the property market whose expected annual return was 20 percent.

Thailand suffered the most from the export contraction in the region. This situation was owing to various reasons such as the decline in the demand for its products, the slow-down in the Japanese economy, the stop in the growth of the real asset prices and appreciation-accompanied loss of wage competitiveness. In fact, declining asset prices provided the earliest sign of trouble in the region. During 1996, stock prices fell by an annual average of 20 percent in South Korea and one-third in Thailand. The decline continued in Thailand in 1997. In South Korea, although the stock price decreases could be interrupted for a certain period, they started to decline again in the second half of 1997. Similarly, property prices declined in Thailand prior to the crisis.

3. ANALYSIS OF THE FOUR ASIAN ECONOMIES

For the three most affected countries (Thailand, Indonesia and South Korea), the crisis paved the way for arrangements with the IMF. All three countries were forced by the crisis environment to sign stand-by arrangements with the IMF. Malaysia, on the other hand, did not need to sign a stand-by with the IMF, but started annual Article IV consultations with the Fund. This section tries to explain the economic situations in the four crisis-stricken countries before, during and after the crisis.

3.1. Thailand

The economic situation in Thailand prior to the crisis can be summarised as one characterised by an unsustainable current account deficit, significant appreciation of the real effective exchange rate, rising foreign debt (in particular short-term), a deteriorating fiscal balance, and increasing difficulties in the financial sector. As a policy response, the Bank of Thailand provided liquidity support for troubled financial institutions, which in turn sharply accelerated the reserve money growth.

The exchange rate was floated on July 2, 1997 following mounting speculative attacks and concerns about the reserve position. However, the accompanying policy package was inadequate and failed to restore market confidence. The baht depreciated by 20 percent against the U.S. dollar during July 1997, while short-term interest rates were allowed to decline sharply after a temporary increase.

On August 20, 1997, the Thai government signed a 3-year stand-by arrangement with the International Monetary Fund (IMF), amounting to US$4 billion (505 percent of quota). Additionally, further financing, totalling US$2.7 billion was pledged by the World Bank and the Asian Development Bank, which included extensive technical assistance. Japan and other interested countries also provided financing support, totalling US$10 billion. In accordance with the policy package, Thailand was to introduce measures that aimed at restructuring the financial sector (including closure of insolvent financial institutions); bringing the fiscal balance back into surplus, contributing to a reduction of the current account deficit; reconstituting foreign exchange reserves; limiting the rise in inflation; and controlling the domestic credit, with indicative ranges for interest rates.

To help stabilise the exchange market situation, additional measures were introduced. Reserve money and net domestic assets of the Bank of Thailand were to be kept below the original programme limits, the indicative range for interest rates was raised, and a specific timetable for financial sector restructuring was announced. Measures also included strengthening of the social safety net and broadening the scope of structural reforms to strengthen the core banking system and promote corporate restructuring.

After falling to an all-time low against the U.S. dollar in early January 1998, the baht began to strengthen in early February as improvements in the policy setting revived market confidence. Growth projections, however, still remained low. Implementation of tight fiscal and monetary policies caused a decrease in the overall economic activity. Exports remained low.

After September 1998, the programme for financial and corporate sector restructuring was broadened significantly and the structural reform agenda in other areas such as privatisation, foreign ownership and social safety net was strengthened.

3.2. South Korea

Although South Korea initially appeared relatively less affected by the crisis than Thailand and Indonesia, its high level short-term debt and only moderate international reserves caused the South Korean economy to be troubled during the months following the crisis. As South Korean banks began to face difficulties rolling over their short-term foreign liabilities, the Bank of Korea shifted foreign exchange reserves to the banks' offshore branches and the government announced a guarantee of foreign borrowing by South Korean banks.

By early December 1997, the won had depreciated by over 20 percent against the US dollar and usable foreign exchange reserves had declined to US$6 billion (from US$22.5 billion at the end of October).

On December 4, 1997, the South Korean government signed a 3-year stand-by arrangement with the IMF, amounting to US$21 billion (1939 percent of quota). Other financing commitments included a total of US$14 billion by the World Bank and the Asian Development Bank, which also provided extensive technical assistance. Additionally, other interested countries had pledged US$22 billion.

In order to restore market confidence, the programme aimed to improve the current account position, build up foreign exchange reserves, and contain inflation through a tightening of monetary policy and some fiscal measures. In addition, the programme included a range of structural reforms in the financial and corporate sectors.

Following the temporary agreement reached with private bank creditors on December 24, 1997 to maintain exposure, the structural reform agenda of the programme was strengthened and interest rates were raised significantly.

In January 1998, signs of stabilisation emerged. Usable international reserves stabilised, and the won appreciated moderately against the U.S. dollar. The current account had moved into surplus, but due to the large depreciation of the exchange rate, inflation was now expected to exceed original programme projections. In addition, there were growing concerns about the deceleration of economic activity.

By February 1998, the won had appreciated 20 percent from its low December level, the agreement with bank creditors had helped to improve financing conditions, usable reserves had increased, but signs of a pronounced decline in economic activity had increased. Monetary policy was expected to remain tight as long as the exchange market situation continued to be fragile. The structural reform agenda was broadened to take into account trade liberalisation, an accord between business, labour and the government, strengthening of the social safety net, an increase in labour market flexibility, promotion of corporate restructuring and enhancement of corporate governance.

By August 1998, South Korea had made substantial progress in overcoming its external crisis. The won remained stable and appreciated against the U.S. dollar in July, permitting a further easing of interest rates. South Korea had successfully launched a global sovereign bond issue. Significant capital inflows into the domestic stock and bond market had been registered, and usable reserves now exceeded US$30 billion. The slow-down in the output growth and the impact of economic conditions in the region, however, continued to raise concerns about the domestic recession. Interest rates declined further back to the levels prior to the crisis, and a supplementary budget was under preparation to support economic activity and strengthen the social safety net.

3.3. Indonesia

In Indonesia, the macroeconomic environment was stronger than in Thailand. The current account deficit had been modest, export growth had been reasonably well maintained, and the fiscal balance had remained in surplus. However, as was the case in Thailand, Indonesia's short-term private sector external debt had been rising rapidly and there were weaknesses in the financial sector. In July 1997, following the floating of the Thai baht, pressure on the rupiah intensified and it was floated on August 14, 1997. This was followed by a sharp depreciation (Table 8) of the exchange rate. Although the exchange rate indicated temporary recoveries as a result of measures to prevent a deterioration of the fiscal balance, the cumulative depreciation, which reached over 30 percent in October, was the largest in the region.

On November 5, 1997, the Indonesian government signed a 3-year stand-by arrangement with the IMF amounting to US$10 billion (490 percent of quota). Additionally, further financing totalling US$8 billion was pledged by the World Bank and the Asian Development Bank, which included extensive technical assistance. Other interested countries also provided financing support totalling US$18 billion.

TABLE 8: APPRECIATION/DEPRECIATION OF NATIONAL CURRENCIES AGAINST U.S. DOLLAR

Percentage

	1994	1995	1996	1997	1998
Thailand	0.68	0.92	-1.66	-19.20	-24.18
Indonesia	-3.41	-3.90	-4.00	-19.49	-70.95
Korea	-0.10	4.17	-4.12	-15.44	-32.12
Malaysia	-1.91	4.79	-0.46	-10.57	-28.32
Philippines	2.66	2.73	-1.91	-11.04	-27.93

Minus indicates depreciation.
Source: Derived.

The aim of the underlying adjustment programme was to restore market confidence, bring about an orderly reduction in the current account deficit, limit the unavoidable decline in output growth and contain the inflationary impact of exchange rate depreciation. In accordance with the policy package, Indonesia was to introduce measures that aimed at maintaining a tight monetary policy, stabilising the rupiah with exchange market intervention if necessary, strengthening the fiscal position to enable current account adjustment, strengthening the financial sector and enhancing efficiency and transparency in the corporate sector. Upon approval of the programme, Indonesia drew US$3 billion from the Fund.

As an initial response to the programme the rupiah strengthened briefly. The measures undertaken temporarily boosted market confidence and the exchange rate. However, the latter fell sharply during December

1997-January 1998. While the current account improved, capital outflows increased and reserves declined sharply. The deterioration stemmed mainly from problems related to the imbalance of implementation between support for the exchange rate and strong liquidity expansion in the face of financial sector strain and runs on deposits as well as uneven implementation of important structural measures.

A strengthened programme was announced on January 15, 1998 to reverse the decline of the rupiah, but market reaction was sceptical. The programme included comprehensive structural reforms and a bank restructuring plan, but implementation of these structural reforms continued to lag, and the requirements of the macroeconomic programme were not met, as Bank Indonesia's liquidity support for financial institutions increased rapidly, resulting in an increase in the base money growth. The economic deterioration deepened and inflation accelerated sharply.

As the economy was now on the verge of a vicious circle of currency depreciation and hyperinflation, the programme was revised in order to stabilise the exchange rate at a more realistic level and to reduce inflation. In addition, the programme sought to limit the decline in output, eventually restore growth, and protect the poor from the worst effects of the crisis. Additional measures included tightening of monetary policy with sharply higher interest rates, strict control over central bank's net domestic assets, adjustment of fiscal framework that allowed for the cost of bank restructuring and a strengthened plan for the restructuring of the banking system. Furthermore, a variety of structural reforms such as privatisation, dismantling of monopolies and price controls to improve efficiency, transparency and governance in the corporate sector were introduced. In addition, talks on agreements with private creditors regarding the restructuring of corporate sector obligations and the rollover of short-term bank debt were under way.

The civil unrest, in May 1998, caused a severe downturn in the Indonesian economy. Production, exports, and domestic supply channels were disrupted, banking activities were paralysed, unemployment started to rise and food prices started to increase. The rupiah hit an all-time low of 16,650 against the U.S. dollar in mid-June, with a cumulative depreciation of 71 percent during 1998 (Table 8).

By July 15, 1998, the programme expectations have been severely altered due to this situation. Output was expected to decline by 10–15 percent in FY1998/99 (Table 9) and inflation was projected to average 60 percent. Restoration of the distribution system and a strengthening of the social safety net became immediate key priorities. Monetary policy remained focused on inflation and the exchange rate, while the fiscal deficit target was adjusted significantly in view of the sharp contraction of output and special expenditure requirements. Bank restructuring plans were strengthened to deal with the deteriorating conditions in the financial system, and further steps were taken to facilitate corporate debt restructuring. Access under the stand-by was increased by the equivalent of US$1 billion.

TABLE 9: REAL GDP GROWTH RATE IN 5 ASIAN COUNTRIES

Percentage

	1981-90	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**
Thailand	7.9	8.5	8.6	8.8	5.5	-0.4	-8.0
Indonesia	5.4	7.3	7.5	8.2	8.0	4.6	-13.7
Korea	9.1	5.8	8.6	8.9	7.1	5.5	-5.5
Malaysia	6.0	8.3	9.3	9.4	8.6	7.7	-6.8
Philippines	1.7	2.1	4.4	4.7	5.8	5.2	-0.5

Source: *World Economic Outlook*, May 1999, IMF.

In view of the deep-seated nature of Indonesia's structural and balance of payments problems, the stand-by agreement was replaced on August 25, 1998 by an extended arrangement with the same access (US$6.3 billion, or 312 percent of quota, for the remaining 26 months). Additional financing sources included US$2 billion from the World Bank and the Asian Development Bank, close to US$1 billion from bilateral sources, and a prospective rescheduling of external debt to official creditors.

On September 23, 1998, an agreement was reached on the rescheduling or refinancing of Indonesia's bilateral external debt to official creditors. The agreement covers principal payments on official debt (excluding public enterprises) and export credit for the period August 6, 1998 to March 31, 2000 (US$4.1 billion in total).

Market sentiment has improved in recent months and the rupiah has appreciated significantly, providing room for lowering interest rates.

Fiscal targets were eased further in the light of the deteriorating economic outlook. The output decline in 1998 has been 13.7 percent and year-end inflation stood at 80 percent, with a marked deceleration in recent months. The current account has registered a surplus of 4.2 percent of GDP (Table 3). The structural reform agenda has been broadened further, but implementation has been somewhat uneven, particularly in the area of corporate restructuring.

As of the end of September 1998, US$9.5 billion of the augmented financing package for Indonesia (US$42 billion) had been disbursed (most of which—almost US$5.7 billion—was disbursed since the end of April 1998).

3.4. Malaysia

Starting from early 1997, the East Asian crisis showed its effects on the Malaysian economy. The first signs of the crisis in Malaysia took the form of sharp falls in Malaysian share prices and the external value of the ringgit (Table 8). As a first step to avert the further contagion of the crisis, fiscal and monetary policies were tightened with the aim of restoring stability and confidence in financial markets, as well as containing the impact on inflation of the depreciation of the ringgit. Despite these measures, however, equity prices continued to fall and the exchange rate continued to depreciate. In 1998, the ringgit had depreciated 28.3 percent (Table 8) from its previous-year level, while the Kuala Lumpur Stock Exchange composite index was down 52 percent (IMF, Public Information Notice, No.99/88).

In Malaysia the collapse of market confidence led to a contraction of consumer and investment spending by early 1998. Furthermore, financial institutions were faced with non-performing loans and capital losses. Domestic demand fell by 26 percent in 1998 (IMF, Public Information Notice, No.99/88). This contraction in demand was reflected in the fall in total imports, and, therefore, Malaysia's current account balance turned from a deficit of around 5 percent of GDP in 1997 to a surplus of 13 percent of GDP in 1998 (Table 3). Overall, real GDP declined by 6.8 percent in 1998 (Table 9). The weakness in the domestic demand limited the rise in inflation arising from the depreciation of the ringgit. As a result, the 12-month CPI inflation rate rose from a little over 2 percent prior to the crisis to a peak of 6.2 percent in mid-1998 before declining to 5.3 percent by the end of the year (IMF, Public Information Notice, No.99/88).

The economic measures adopted by the Malaysian authorities in order to restore market confidence aimed at strengthening the financial system. Measures taken included the partial reversal of earlier cuts in government expenditure, interest rate reductions, expansionary government budget, credit growth and accelerated implementation of the financial and corporate sector restructuring program as well as the establishment of entities to restore the financial system through recapitalisation and the purchase of non-performing loans.

In September 1998, the Malaysian government, in order to insulate domestic interest rates from continuing pressures and volatility in the foreign exchange market, introduced capital controls and pegged the exchange rate of the ringgit to the dollar. According to the IMF authorities, the pegging of the exchange rate to the U.S. dollar had been positive for the economy, so far, while the under-valuation of the exchange rate had implications for the inflation outlook over the medium term.

In 1999, there were increasing signs in Malaysia of an improvement in economic activity. These signs appeared to be reflected in stabilising property prices and a significant recovery in equity market prices. Inflation also fell to a little under 3 percent as the effects of the earlier depreciation of the ringgit wore off. Progress in restructuring the financial sector was significant. Malaysia's external current account position remains in substantial surplus, and foreign exchange reserves have strengthened to over $30 billion, equivalent to approximately seven months of imports of goods and services.

4. THE CRISIS

The declines in the stock and real estate prices and the slow-down in the economic activity reinforced each other and caused stock imbalances in Thailand, South Korea and Indonesia. What followed this situation were bankruptcies in all three countries. In Thailand, significant amounts of increases in the non-performing loans were observed in the Thai-owned commercial banks. Similar difficulties erupted in South Korea and Indonesia as well. In 1997, there was a sharp fall in the deposits of the Bangkok Bank of Commerce. The financial turmoil, accompanied by the erosion in the foreign exchange reserves, created a funding crisis which caused the collapse of the exchange rate regime in Thailand.

The finance companies started to experience serious difficulties in 1997. In response, the Bank of Thailand provided liquidity support for the troubled finance companies and this caused a sharp increase in the reserve money growth. Following the speculative attacks and emergence of concerns regarding the reserve position, on July 2, 1997, Thailand was forced to float the baht in response to the depletion in the foreign exchange reserves and the difficulties in deferring the payment of short-term debt. The policy package failed to restore the market confidence. The baht depreciated by 20 percent against the US Dollar in July.

4.1. Reasons for the Contagion of the Crisis

Other than the emergence of the crisis itself, another surprising feature of the East Asian crisis is its deep, contagious and prolonged nature. The reasons for the contagion may be listed as follows:

- Inappropriate management of the crisis, both by the governments and the IMF,
- Close trade links between the East Asian countries,
- Financial linkages in the region, and
- The recession in Japan.

Inappropriate management of the crisis can be attributed to the inexperience of the East Asian countries in these matters as well as to mistakes made in the crisis management. Also, there is concern among the economists that the IMF policies are not helping to restore market confidence.

Despite being a favourable factor under normal circumstances, close trade links between the East Asian countries had a negative effect on the deepening of the crisis. The East Asian countries are main trade partners with each other. With the exclusion of Japan, intra-regional exports among the East Asian countries account for 40 percent of the total exports in 1996 (World Bank, 1998, p.11). Besides, this high level of intra-regional trade takes the form of a specialisation of activities from more advanced to lower-income countries in the region. Such a structure speeded the contagion of the crisis. Therefore, the recession in East Asia weakened demand for intra-regional imports and hampered the growth of the countries in the region.

An important factor that should be taken into consideration while dealing with the contagion of the crisis is the attempts of the affected countries to restore their export competitiveness. In general, the immediate effect of a devaluation on an export-oriented corporate sector will be an increase in international competitiveness. In a regionally contagious crisis – as in the Asian case (Park and Song, 1998, p.21) – this has led to competitive devaluations (Table 8). However, these devaluations do not always result in positive improvements in all economies. An initial depreciation in the currency of a crisis-stricken country could lead to deteriorations in the current account balances and competitiveness of other partner countries. That is exactly what happened in East Asia. The devaluations worsened the economies of the crisis-stricken economies through the following channels:

a. A devaluation increases the domestic currency value of the foreign-denominated debt burden. This is particularly damaging in the case of short-term debt, which has to be repaid before the exchange rate gets back to its previous stable level. Even in the case of longer-term obligations, devaluation increases the domestic currency value of debt servicing costs. This problem is further exacerbated if interest rates have to be raised in order to stabilise the value of the currency, since such a move also increases the debt-servicing cost of loans denominated in domestic currency. Furthermore, a devaluation can lead to an increase in the prices of imported inputs, therefore have adverse effects on domestic firms. These adverse effects can be dismissals of workers and, in cases of serious deterioration, bankruptcies.

b. A devaluation increases the profitability of exports in terms of domestic currency terms and may result in increased exports. However, if a simultaneous increase in exports of the countries in the region is concentrated in the same sector, the world market prices will be depressed. In addition, the ability of emerging economies to increase their exports would depend upon the availability of trade credit, which the East Asian countries lacked right after the crisis. Trade credit is expected to increase exports to developed countries, but a major part of the trade prior to the crisis took place within the region. As a result, the export markets were not sufficient to compensate for the falling demand in East Asian economies including Japan.

With respect to the financial linkages in the region, financial events in one country affected the others. This aspect includes capital market activities, foreign direct investment and bank lending. In this context, foreign investors may sell assets in one country in response to losses in other countries. In a highly economically-integrated region, like East Asia, the financial links among the countries can automatically pass the real shocks over to the financial markets of the other countries. Park and Song add to this reason one very important view: If the financial markets of the countries in the region are tightly integrated, then market participants will expect to see co-movements in financial asset prices in those markets. This condition may give rise to contagion of a shock (Park and Song, 1998, p.22).

Finally, the recession in Japan implies that, given the fact that Japan is accounting for over half the output of the Asian region, any negative or positive development in the Japanese economy would have a significant impact on the economies of the region. Therefore, the slow-down in the Japanese economy has affected the crisis economies through both financial and trade channels. The sharp decline in the Japanese imports from the East Asian countries put a load on the trade balance of these countries. Also, the decline in the Foreign Direct Investment (FDI) from Japan led the East Asian countries to switch to bank finance and short-term borrowing.

5. REGIONAL AND GLOBAL IMPLICATIONS

5.1. Regional Implications

As stated earlier, the East Asian crisis started in Thailand, then spread to the whole Southeast Asia. During the six-month period from July 1997 to December 1997, prices in the stock markets fell by 49 percent in South Korea, 48.6 percent in Indonesia, 41 percent in Thailand and 32.7 percent in the Philippines. Furthermore, these falls continued thereafter until September 1998: 64.7 percent in Indonesia, 38.6 percent in Singapore, 38.5 percent in the Philippines, 37.7 percent in Malaysia and 17 percent in Thailand *(The Economist*, October 3-9, 1998, p.136). These drops in the stock markets triggered a sudden shift in the perceptions of the investors, caused by a large fall in confidence in the economy. The five East Asian countries hardest hit by the crisis (South Korea, Indonesia, Malaysia, Thailand and the Philippines) experienced a turnaround of US$109 billion in a single year, a shift from an inflow of US$97 billion in 1996 to an estimated outflow of US$12 billion in 1997 (Table 6). Most of this swing occurred in commercial bank lending, followed by short-term portfolio flows, whilst foreign direct investment remained constant. The turnaround of US$109 billion in the five Asian economies represents more than 10 percent of their combined GDP (The East Asian Financial Crisis, Jones, Cailloux and Pfaffenzeller).

The outflow of capital from the crisis countries increased the demand for foreign currencies, especially for the US Dollar. This forced the currencies to be devalued. From July 1997 to the end of 1998, the Indonesian Rupiah was devalued by 71 percent, the Malaysian Ringgit by 28.3 percent, the Philippine Peso by 27.9 percent, the Thai baht by 24.2 percent and the South Korean Won by 32.1 percent (Table 8). The devaluation process in the crisis economies played an important role in the need for arrangements with the IMF. That is because, with the devaluation, the indebted companies in the region failed to pay back their debts and forced their governments to borrow from the IMF.

Thailand, South Korea, Indonesia and Malaysia have fallen from their high level of growth to deep recession. Their state of recession also continued in 1998. This even took the form of a negative growth in the crisis-stricken East Asian economies: -13.7 percent in Indonesia, -8 percent in Thailand, -6.8 percent in Malaysia, -5.5 percent in South Korea and -0.5 percent in the Philippines (Table 9).

On the trade side, the value of imports fell by an unprecedented 17 percent in the Asian region and by as much as 31 percent in the five most affected Asian countries. In volume terms, the fall amounted to 22 percent for those five countries, compared to 10 percent for the Asia region as a whole. On the export side, only the Philippines, among the most affected countries, registered a sharp increase of 16.9 percent. With the exception of strong increases in South Korea and Philippines, the export volume declined in the other countries (UNCTAD, 1999, p.25).

Currency instability, which stemmed from the crisis, caused unexpected shifts in the relative positions of individual countries and created considerable uncertainty regarding the competitiveness of various industries across the region. Therefore, investment in tradeables, including intra-regional investment prospects, have been undermined to a certain extent.

Unemployment in the region has increased dramatically and is expected to continue increasing in the future. In Thailand, unemployment increased from an annual average rate of 1.54 percent in 1996 to 5.6 percent by 1998 (ILO 1998). The situation continued to deteriorate, with around 2,000 job losses occurring daily since the beginning of July 1998 (Reuters, 1998d). In South Korea, unemployment rose from 2.3 percent to 7 percent, the highest unemployment rate on record (Reuters, 1998e). The immediate effect of this was a dramatic fall in the income of the affected workers since unemployment provision was almost universally absent (with the partial exceptions of South Korea and Japan).

5.2. Global Implications

The East Asian countries, with their successful economic history, have not only become major actors in the world economy but also role-models for developing countries in the world. A decline in the growth rates of the crisis economies and a reduction in their contribution to global demand made it especially difficult for industrial economies, in particular Europe and Japan, to expand at rates needed to reverse the upward trend in their unemployment rates.

The crisis also influenced other distant regions. The first impact was on Japan. Being a net creditor to the crisis economies, Japan has been a main player for the East Asian countries. From July 1997 to July 1998, the Japanese Yen lost 20.4 percent of its value, the Tokyo stock exchange fell by 39.1 percent and the Japanese economy contracted by –1.8 percent. The contraction continued in 1998 by –2.8 percent (World Economic Outlook, May 1999). This situation is partly due to the weakening demand in the crisis economies and partly to the weakening in private demand as a result of declining confidence in the financial sector.

The East Asian countries have been major contributors to global demand. They have been running large current account deficits and financing it with short-term capital flows. As a result of the crisis, however, these countries had to cut their deficits, which meant a cut in their contribution to global demand. This may show its impact on the U.S. and European markets. For some countries in the E.U., exports to

East Asia have been the most dynamic component of the aggregate demand in recent years. In order to overcome the vulnerability to an interruption of capital flows, the East Asian countries may tend to cut their imports and external deficits, which in turn implies a decrease in the net exports of European and U.S. markets to the crisis-stricken region. This situation implies that the global economy was indeed affected by the East Asian crisis.

5.2.1. Implications for Developing Countries

By October 1998, developing countries in Latin America and Eastern Europe as well as Russia also began to feel the effects of the crisis with plunging stock markets and rising interest rates. A year after the emergence of the East Asian crisis, Russia’s economy plunged into a deep crisis, following the devaluation of the ruble and the meltdown in its foreign exchange and financial markets.

According to the World Bank, the East Asian crisis cut Latin America's growth in 1998 by 1.0 percentage point. Growth is now expected to slow to 2.7 percent, down from 5 percent in 1997 (Rojas Research Unit, Press Release, 1998). Although there is always the risk of being exposed to similar problems in the region, the Bank says that, on balance, Latin American economies look stronger than their Asian counterparts.

Furthermore, flows from international capital markets fell sharply. Bond issues were particularly hard hit. Only one developing country, Argentina, issued a sovereign eurobond during the last two months of 1997. In a number of other countries, outflows of portfolio equity investment were coupled with sharply falling stock prices. For the year as a whole, net long-term flows from capital markets were $127 billion, about the same as 1996. However, total external finance was significantly smaller in 1997 because of short-term outflows and capital flight in the fourth quarter of 1997 (Rojas Research Unit, Press Release, 1998).

Private capital flows to developing countries experienced a sharp fall right after the East Asian crisis. This took mainly the form of a retreat from new investments in emerging markets. Furthermore, the world economy suffered a sharp fall in commodity prices. Both oil prices and the prices of non-fuel commodities weakened steadily throughout 1998. By March 1999, the prices of non-fuel commodities were more than 15 percent below their level in the previous year. Subsequently, the import demand in the industrial countries for the goods and services of the developing countries declined, which in turn had negative effects on the exporters of oil and raw material products.

In addition, a World Bank report shows that official assistance to the poorest developing countries continues to fall as a result of tighter aid budgets in donor countries and a decision by many governments to reduce direct lending as private capital flows to developing countries.

5.2.2. Implications for Oil Exporting Countries

Notwithstanding the fact that the East Asian crisis did not affect the Middle East states directly because of their limited trade and financial links to the Far East, it did have a critical indirect effect on the region through the collapse in oil prices. Asian demand was one of the driving forces among all others behind the rising oil prices for the two years preceding the crisis. It was only in November 1999 that oil prices could reach their pre-crisis level. During the crisis, OPEC battled the excessive supply problem by reversing its quota rise and pushing a few non-OPEC producers into concerted cutbacks. However, this effort was not enough to recover the prices that dipped to a 12-year low in December 1998. In 1999, oil supplies still remained excessive. The compliance with the new OPEC quota was poor. The growing concern, during the crisis, that the low oil prices were not just a passing phase but a permanent feature of the years ahead led to a variety of policy responses by the OPEC countries. Even the most conservative states realised that oil revenues and investment income alone are not sufficient to keep the economy on track and began to turn to privatisation, deregulation, foreign investment and market liberalism.

In contrast with these concerns, oil prices began to increase during the first quarter of 1999 and reached their pre-crisis level by November 1999. As of today, the rise in oil prices is still continuing and the effects of the East Asian crisis on the oil exporting countries has been neutralised.

6. LESSONS FROM THE EAST ASIAN CRISIS

A recovery in the crisis economies is now under way. Together, the 5 Asian crisis countries--Indonesia, Malaysia, Philippines, Thailand and South Korea--are now expected to grow by an average of 3 percent in 1999 and 4 percent in 2000 (Fischer, 1999). The growth expectation for Asia as a whole is 4.1 percent for 1999 and 4.3 percent for 2000. Unfortunately, in Indonesia, renewed uncertainties over both the economic programmes, resulting in large part from the Bank Bali case, and the political situation, present risks to the recovery that was so clearly getting under way.

However, although the environment is now much better, there are certain risks and challenges to meet in order to ensure sustainable growth. Sustainable growth will depend upon several factors such as reactivation of aggregate demand, due implementation of the structural reforms, protection of low-income groups and restoring the international capital flows. These factors will have to be dealt with different priorities in each crisis-stricken country, since the domestic economic circumstances differ in each country. Therefore, the macroeconomic policies need to be accommodative in each country.

Some lessons that can be drawn from the East Asian crisis may be listed as follows:

- Although capital account liberalisation is supposed to facilitate growth and reduce risks, the benefits of such a practice are limited, especially in countries with high savings rates. Strengthening of regulatory institutions and safety nets is crucial in implementing a rapid financial and capital account liberalisation.

- Reforms which aim to stabilise short-term capital flows and effectively address systematic bankruptcy should be given more weight.

Past experiences of countries like England suggest that prudential limits on bank lending, capital adequacy requirements and currency matching conditions for assets and liabilities that are properly enforced can help prevent excessive risk-taking by banks, thus containing the adverse effects of widespread defaults.

- Government policy will play an important role in the future. Without government intervention to restore the economy, economic crisis can be deep and prolonged. The co-operation between the state and the other segments of the economy should be transparent and accountable. The Asian model of development with strengthened governance systems can provide the most efficient means of recovery. In the crisis economies, policies aimed at the rapid increase of the capacity to spur growth have been adopted. However, adoption of such policies has often resulted in unsustainable rates of capital accumulation and unhealthy debt levels. In the future, the East Asian countries should seek to spur growth by promoting productivity through moving away from the highly centrally directed systems toward a more market-oriented model.

- As regards the regulatory environment and institutional structuring, less developed countries have less capacity. However, even the countries with the most advanced regulatory framework should recognise that their regulatory tools may not be always sufficient to protect them from the impact of major shocks.

- Automatic stabilisers should be readily available when dealing with crisis and these stabilisers should be complemented with due macroeconomic policies. In developed countries, tax and welfare programmes act as automatic stabilisers, but in the Least Developed Countries (LDCs) these tools are either weak or absent. In the East Asian case, increased interest rates even for short periods, had large adverse effects on the net worth.

Another factor that contributed to the emergence of the crisis was the withdrawal of government support and a credit squeeze on working capital during the periods of overcapacity. This has to be avoided in the future.

- Measures to improve risk management and reduce vulnerability must play a central role in the region's longer-term strategy. Rapid innovation in capital markets should be accompanied by prudential and supervisory systems. Additionally, the macroeconomic imbalances, including unsound fiscal positions and current account positions, excessive external debt (particularly with short-term maturities), and unsustainable exchange rate policies should be tackled with care.

7. CONCLUSION

The recovery of the crisis-stricken economies will also depend upon the timing and the extent of the cyclical slowdown that is likely to occur in the U.S. and the ability of Japan and Europe to sustain stronger growth of domestic demand. The U.S. economy may not continue to grow at rates above any estimated potential growth, especially when unemployment is so low. Therefore, for the global recovery to continue, European and Japanese growth will need to accelerate sufficiently to offset the cyclical slowdown in the U.S. economy.

To sum up what we have learned from the East Asian crisis, we can say that certain policies weigh heavier than others during the recovery process. The most important policy is the implementation of institutional and regulatory policies, both by financial institutions and by the concerned governments. Reforming the financial and banking laws as well as the control mechanisms for short-term capital flows would be of great importance when countries attempt to recover from a crisis such as the East Asian one.

In other words, policies adopted for macroeconomic variables should also take into account the social, structural and human dimensions of the situation as a whole. Stabilisation of an exchange rate, for example, should not be considered a success, if this success is being accompanied by a danger of deep recession. Therefore, governments and institutions should adopt a more risk-bearing attitude than simply basing the increase in foreign debt on optimistic export growth projections, while in fact the actual exports grow at a much slower rate.

Both in the LDCs and in all developing countries, there is a need for a system of well-organised policies and studies based on rules and bankruptcy procedures governing international debtor-creditor relations. Improvements of financial institutions, corporate governance and transparency as well as not running a large current account deficit and not having an overvalued exchange rate will be central to the prevention of future crises. This overall picture needs to be looked at by the international community as part of the efforts to enhance the governance of international finance.

Considering the depth and prolonged nature of the East Asian crisis, one can ask the question: "*Why East Asia, and not another region in the world?*" Although the answer lies within the causes of both the crisis and the contagion, there is no particular intuitive answer to this question. However, as stated earlier, the economic problems encountered prior to the crisis are experienced commonly by most of the developing countries and it is the magnitude of the combined effect of these problems that distinguishes the East Asian case from the others. If we take the old Asian miracle that had continued for over three decades as given, it will not be an exaggeration to say that even the rapidly growing economies which lack due regulatory and legal financial frameworks as well as appropriate monitoring systems will be vulnerable to unanticipated shocks.

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