

Southeast Asia and the Asian and Global Financial Crises

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ABSTRACT *Despite the deleterious impact of the 2008–09 global financial crisis, which seriously undermined mainstream economists' claims that the world economy has matured enough to prevent the return of a global depression, policymakers are still grappling with uncharted territory to insulate their economies from debilitating regional and global contagions. This article provides the introduction to a special issue targeted at dissecting the experience of the Southeast Asian market economies in confronting comparatively the Asian financial crisis of 1997–98 and the global financial crisis of 2008–09.*

KEY WORDS: Financial crisis, liberalisation, regulation, Southeast Asia

The global economy is still in a state of shock and uncertainty over the state of financial markets and the real economy, with the developed countries of the United States and the European Union mired in low growth and high unemployment. Despite greater cooperation between the financial chiefs of the developed economies and the International Monetary Fund (IMF) it is still unclear if growth in the largest industrial economies has bottomed out. The great financial crisis of 2008–09 has encouraged a plethora of studies that either question the virtuous self-regulating role of markets or the financial approaches assumed by heads of governments to coordinate both monetary and fiscal policies. Instead of listening to accounts of asymmetries and imperfections of markets by Keynes (1936) and Akyuz and Cornford (1999), policymakers were increasingly moving in the direction of market-clearing rational conduct of economic agents. Indeed, Krugman (2009) put into perspective postulations and predictions by eminent economists such as Lucas (2004) and Bernanke (2004) that the world had learnt so much that major crises were no longer possible. The great financial crisis also vindicated Stiglitz's (2010) passionate crusade to dismiss self-regulation by markets as the solution to maintaining equilibriums.

While there are now convincing accounts of how the 2008–09 financial crisis unfolded (see Krugman 2009; Stiglitz 2010), policymakers are still being surprised by its unexpected consequences, and hence, making it difficult for them to formulate action plans for a recovery. There are still serious gaps on how speculative movements of capital (both

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sudden and gradual) have affected particular groups of economic agents in individual economies and how governments have responded to check its deleterious consequences on the real economy. Also unresolved are issues like the legitimacy of the use of capital controls in Malaysia, which was much vilified by the neoliberals during the Asian financial crisis.

Regional Focus

Given the inter-border linkages between trade and investment (both portfolio equity and foreign direct investment), and exchange rates in closely integrated regions, Southeast Asia offers a good laboratory to analyse the effects of and responses to the crises. Since the formation of the Association of Southeast Asian Nations (ASEAN) in 1967, with Indonesia, Malaysia, the Philippines, Singapore and Thailand as the pioneering members, the grouping has integrated strongly through first political ties to combat the communist threat in the early years following the breakout of the Vietnam War, but has subsequently become an increasingly strongly bonded economic caucus. As a consequence, intra-ASEAN exports in total exports rose from 23.8% in 2000 (Dennis and Zainal Aznam 2003, 36) to 26.4% in 2011 (ASEAN 2013). Especially since the formation of the ASEAN Free Trade Area (AFTA) in 1992, the region's nations have carefully liberalised trade with the target of achieving an ASEAN Economic Community by 2015 (Basu 2012). Under the common effective preferential tariff (CEPT) mechanism, all countries established deregulation schedules to turn the region into a common market. Inter-country exports among AFTA members enjoy preferential access so long as they meet the rules of origin condition of 40% value added. Brunei became a member of ASEAN in 1984. Vietnam entered ASEAN in 1995 to become the group's first transition economy. Laos and Myanmar joined ASEAN in 1997, while Cambodia was admitted in 1999.

The common links between member countries makes the region an excellent platform to examine the implications of financial crises on Southeast Asia from a comparative, as well as a developmental perspective. The relevance of Southeast Asia lies in it being the home of the Asian crisis of 1997–99 but a victim of the global crisis that began in 2008. Although there are contrasting arguments over the origin of the Asian financial crisis (see Jomo 1998, 2000; Stiglitz 2010; Krugman 2009; Rasiah 2000a), its deleterious consequences were felt by the Southeast Asian market economies. In the process of seeking lessons, Southeast Asia offers a good laboratory also to examine the interventions to insulate from and to overcome its damaging consequences as economic growth of many of these countries contracted in the 1997–98 crisis, while exports to developed countries collapsed during the 2008–09 crisis. Malaysia, Singapore and Thailand experienced a fall in real gross domestic product (GDP) in 2009 as exports of goods and services in GDP of these countries were high. For example, in 2010, exports of goods and services in GDP of Thailand, Malaysia and Singapore were 71.3%, 93.7% and 207.2% respectively (World Bank 2012). Indonesia and the Philippines did not face a contraction in GDP because exports of goods and services accounted for only a small share of their GDP. For example, in 2010, exports of goods and services of Indonesia and the Philippines were 24.6% and 34.8% of GDP respectively (World Bank 2012). Nevertheless, growth rates of all the affected countries rebounded back by 2000 and 2010 respectively.

A major issue worthy of discussion that differentiates the positive experience of the Southeast Asian countries during the 2008–09 crisis from those in other parts of the world

is the macro-micro governance framework that had been put in place after the Asian financial crisis to shield firms from destabilising external crises (Chowdhury and Islam 2001). The Southeast Asian economies experienced massive exposure to debt service problems during the Asian financial crisis so that their huge non-performing loans (NPLs) exacerbated their vulnerabilities with Indonesia's and Thailand's soaring to 48.6% and 38.9% of loans in 1998, respectively (World Bank 2010, 95). NPLs as a share of loans were 11.0% in the Philippines and 10.6% in Malaysia respectively, in 1998. Prudent management led to NPLs as a share of loans falling to 3.7% in Indonesia, 1.8% in Malaysia, 3.7% in the Philippines, 4.9% in Thailand and 2.4% in Singapore in 2009 (World Bank 2010, 95; IMF 2012, 25). Hence, whereas a massive number of Latin American firms folded under the siege of liberalising currents each time there was a deregulation of tariffs or exchange rate devaluations (see Katz 2010), firms in Southeast Asia enjoyed safety insulations to avoid such destabilising crises. The few exceptions in Latin America include Embraer and Petrobras in Brazil, both of which managed to achieve comparable success through internalising strategies that helped these firms overcome the daunting currents of competition. Given that the Southeast Asian nations have embarked on ambitious growth strategies within the global capitalist economy since the 1970s (market economies) and since the 1990s (transition economies), the crises offer an opportunity to examine how governments responded to them and to what extent their roles have been developmental. The role of the state in regulating by providing disincentives to discourage unproductive rent seeking and incentives to stimulate technological catch up is particularly important during times of crises. The latter was discussed at length by Schumpeter (1942). Especially, the global financial crisis of 2008–09 destroyed the cash flow of leading firms in developed countries thereby giving an opportunity for latecomer firms to catch up and leapfrog them as often seen in the electronics industry (Brown and Lindgren 2010). Hence, the industry article in the issue shall address the question: to what extent have governments in Southeast Asia been developmental? Veblen (1915), Johnson (1982) and Evans (1995) have argued over the role of government in propelling economic development through examining the specific roles of particular organisations and institutions.

Implications for Economic and Political Stability

From a developmental perspective, the analysis of crises permits insights into their impact not only on economic growth, but also on poverty and distribution. The sharp reverse of fortunes in the Asian financial crisis was said to have plunged millions into poverty, undoing decades of government-led poverty eradication efforts. At the same time, the structurally diverse set of economies that make up Southeast Asia have faced different poverty alleviation and distributive instruments, including stimulus packages targeted at resuscitating the economies during crises, which have generated different social outcomes. Poverty alleviation figured prominently in the development agenda of both the founding as well as new members of ASEAN. Apart from the states of Brunei and Singapore where land tenure systems did not figure owing to their small size, agricultural development with strong land tenure mechanisms has been important in Indonesia, Malaysia and Thailand. Indeed, land tenure and agriculture has been a major channel through which the governments of these countries have targeted poverty alleviation. Malaysia and Indonesia launched ethnic restructuring policies to address income and social inequalities. Some

have argued that class differences were among the reasons that led to the ethnic bloodshed of 1969 in Malaysia (Jomo 1986). Yoshihara (1988) noted that the Chinese have spread themselves shallowly in business because of the fear of harassment and capture by *Bumiputera*-led governments in Indonesia and Malaysia. Jesudason (1989) contended that ethnic policies have limited the capacity of Chinese businesses to become globally competitive. Others arguing over the greater danger of horizontal inequalities were quick to note the ethnic cleansing that took place in Kalimantan in 2001 as a result of ethnic Dayaks' resentment at the accumulation of wealth enjoyed by the ethnic Madurese settlers (*The Telegraph*, 2 March 2001). For example, Stewart (2000) referred to horizontal inequalities as inequalities that exist between different social and political groups. In the case of Malaysia, inter-ethnic differences qualify as a measure of horizontal inequalities. Some have argued that Thaksin Shinawatra took advantage of regional differences in poverty to convince constituents of Northern, Northeastern and parts of Central Thailand that the government had overlooked their interests, which has divided Thailand since 2005 (Pasuk and Baker 2008). Meanwhile, Aceh's balkanisation arose for similar reasons as the local rebels gained support from the constituents for devolution against control from Java (Basyah Said 2008), though it became possible only after Suharto became a casualty of the Asian financial crisis of 1997–98 (Chandra and Kammen 2002; Pepinsky 2009).

Regardless of the strategies pursued, this impact fell unevenly upon countries depending on their economic structure and on different groups. Thus, countries less dependent on trade or more reliant on agriculture fared better during the global financial crisis (Akyuz 2010). At the same time, groups like foreign migrants or workers, lacking economic and political leverage, suffered disproportionately from government responses to protect citizens (Rasiah and Schmidt 2010). Thousands of foreign workers were sent back to their home countries from Malaysia and Thailand during both crises. These reverses raise issues of the vulnerability of the widely accepted development paradigm based on markets to shocks that are also of the markets' creation.

In addition, because of the spread of crony businesses with strong links to the state that some authors claim have generated inefficient alliances (Gomez and Jomo 1999; Hill 2000), the Asian financial crisis and global financial crisis offered opportunities to hasten economic reforms. The governments of Chavalit Yongchaiyudh in Thailand and Suharto in Indonesia fell as a consequence of the Asian financial crisis but the governments of Malaysia and the Philippines remained, though Malaysia's deputy prime minister who was viewed as a reformer became a casualty (Rasiah 2000). Furthermore, the crises forced some of the affected governments to construct social protection policies. The Asian financial crisis caused massive retrenchments, particularly in Indonesia and Thailand, thereby causing popular movements that led to the introduction of social protection instruments (see Rasiah and Hofman 1998). Thus, this issue also offers the opportunity for an assessment of government responses to the crises.

Southeast Asia is also home to large migrant communities of ethnic Chinese and Indians that had settled in the region over the course of over a century. Ethnic-based discriminatory policies have been an integral part of the development story of Southeast Asia. In Malaysia, their role had been crucial to the development of primary production – tin and rubber – and ethnic Chinese were instrumental in the development of local banking, and wholesale and retail trade. How the crises impacted them and the nature of their responses are also important dimensions of Southeast Asia's development going forward. Given the long history of ethnic Chinese entrepreneurship, it will be interesting

to investigate both the impact on as well as the responses of ethnic Chinese businesses in Southeast Asia. Also, because the governments of Indonesia and Malaysia have pursued explicit policies to mould indigenous entrepreneurs, it will be interesting to examine how the two crises and their mediating influences affected the fortunes of the ethnic Chinese businesses.

Since development must also be understood through political lenses, the crises also offer an excellent platform to examine the political players that shape the democratic space both for expressing dissent as well as for pushing electoral reforms. Whereas after the 1997–98 financial crisis the political hegemony of the ruling party UMNO remained in Malaysia, Suharto's collapse offered room for devolution and decentralisation in Indonesia. The collapse of the Chavalit Yongchaiyudh government in Thailand preceded both developments, being the first political casualty of the Asian crisis. These changes raise important questions that have yet to be fully studied. They include the extent to which these crises triggered political collapse, and whether such collapse had deleterious or salutary effects on the countries' response and recovery. In Malaysia's case, evidence suggests that Mahathir may have cleverly taken on such a belligerent approach to undermine the image of his potential challenger, Anwar Ibrahim. Following the sacking of Anwar, Mahathir was right in calling for the shielding of the economy from external volatilities as he implemented drastic measures to re-liquefy the economy by directing *Danamodal* (capital-fund) and *Danaharta* (asset-fund) to acquire and sell the rapidly expanding non-performing loans and forcing interest rates down to small and medium firms (see Jomo 2000; Rasiah 1998). These Keynesian measures may have stimulated a more general departure from the IMF's policy framework, as interest rates were also lowered in Korea, Thailand and Indonesia after that. However, some believe that a lack of political reform blocked the accountability essential to sterilise rent creation from crony dissipation in Malaysia (see Jomo 2001; Rasiah 2000a).

Rasiah (2000b) provided support to cast doubt on the alleged positive impact of liberal foreign capital flows on economic growth. Especially, portfolio capital flows have had deleterious consequences on a number of economies. Unlike the developed economies, crises bring different implications for developing economies. While crises generate a sudden fall in demand in mature economies, developing economies face crises well before resources are close to full employment (Kalecki 1976). Government finance either falls into a deficit before essential public services are met or governments' developmental plans supporting technological catch up are affected by crises. Also, as Katz (2010) has pointed out, thousands of firms went bankrupt during the peso crises in Argentina and Mexico. Similarly, thousands of firms in Indonesia, Korea, Malaysia and the Philippines were either liquidated or were acquired by other firms during the Asian financial crisis. Hence, the micro-macro institutional coordination often becomes important to not only provide a soft landing for the economies, but also to insulate development plans.

In Southeast Asia, Singapore has largely used a leveraging strategy to stimulate technological upgrading, while the government focused on building an efficient bureaucratic machinery to deliver world-class basic and high technology infrastructure. In Malaysia efforts to follow the developmental state approach of Japan, Korea and Taiwan (Johnson 1982; Amsden 1989; Wade 1990) since 1981 targeted national capital for grants and government support until 2005. While the ethnic-based trade-off associated with the restructuring policies may have offered strengthened political stability in Malaysia (Rasiah and Ishak 2001), they have largely failed to stimulate technological

catch-up as a consequence of ethnic-coloured policies directed at ethnic restructuring. The Indonesian government promoted national industries such as steel and aircraft and joint-venture (for example, automobiles) heavy industries in Indonesia until the collapse of the Suharto government in 1998 that was one of the consequences of the Asian financial crisis. Import-substitution policies did exist in the Philippines and Thailand in the 1960s and 1970s but they were not systematically coordinated *a la* the developmental states of Japan, Korea and Taiwan. Apart from the introduction of quotas and tariffs, the governments of Indonesia, Malaysia, the Philippines and Thailand had no policy framework to vet, monitor and appraise the rents enjoyed by firms. As noted by the World Bank (1993), Indonesia, the Philippines and Thailand favoured far more liberal market-augmenting policies than did the Northeast Asian economies of Korea and Taiwan. One finds a similar contrast in the management of transnational corporations: Malaysia, Thailand and Indonesia have generally practiced “passive” approaches to foreign direct investment whereas Korea, Taiwan and Singapore have adopted more “active” FDI policies by complementing investment inflows with effective domestic research and development and vendor development programmes (Yusuf and Nabeshima 2009, 159; Doner 2009).

To understand the economic impact of the two crises on Southeast Asia it will be instructive to examine their impact on the region’s electronics and automotive industries. The mass production of electronics originated as an outward-oriented industry, while the automotive industry was initially inward-oriented under import-substitution policies in the Philippines, Indonesia, Malaysia and Thailand. However, whereas electronics production in these countries (including Singapore) has continued to be driven by export markets, automotive production has enjoyed some amount of export growth in these countries. Especially in Thailand, exports have become a major source of production demand. Also, when domestic demand crashed during the 1997–98 Asian financial crisis, automobile producers began exporting regional brands abroad. Among the notable brands that became a success outside ASEAN were Honda’s City and Toyota’s Innova vehicles in India. Whereas export markets dominate demand for electronics, domestic markets have remained critical for the automotive industry in countries such as Indonesia and Malaysia. Among the ASEAN countries, it is only in Thailand that exports have been a major driver of automobile production.

Finally, this issue seeks to offer insights into the “decoupling” debate, the dimensions of which are first between the financial and the real economy, and second between east and west. How both dimensions pan out are material to the development strategy to be pursued by and the policy lessons for crisis-affected countries.

The case for a special issue rests on two arguments. First, it is rare that an opportunity arises for comparing the dynamics of two major crises that occur within a decade with economic implications for a similar set of countries. A decade is not too short a time for the implementation of lessons learnt to be felt but not too long for other intervening developments to confound their impact. Second, the discourse on development has been dominated by structural and long-term issues like those related to the poverty trap. The two crises of the past decade provide an opportunity to shed light on catastrophic events that occur for which the development consequences can be no less debilitating. At the same time, discussion of crises has been centred on macroeconomic impacts and government management of responses rather than on specific groups, including those already disadvantaged by state policies. All these elements can be found in Southeast Asia. This issue intends to address cohesively this lightly researched but critical area where real

dynamics of impact and responses can be carefully discerned. The multidisciplinary focus on Southeast Asia will also allow us to go beyond the esoteric and mechanistic ways in which macroeconomic assessments have often captured these issues.

The Papers

This introduction is followed by Doraisami's (2014) article, which analyses the macroeconomic responses of the three most crisis-affected Southeast Asian economies – Malaysia, Thailand and Indonesia. While the IMF packages introduced in Thailand and Indonesia inflicted major costs, Malaysia used capital controls, which helped prolong the policies of the incumbent ruling coalition. All three economies responded to the global financial crisis with fiscal stimulus packages. The article by Vithiatharan and Gomez (2014) analyses the political structure of Malaysia, growth of cronyism and the role of regulatory institutions created to enforce accountable functioning of the corporate sector during the two financial crises. They conclude that the regulatory and accounting bodies created were ultimately ineffective in checking corporate irregularities. The article by Cheong, Lee, and Lee (2014) offers a rare peek at a particular ethnic business group. The authors provide evidence to show how the housing sector, dominated by ethnic Chinese developers, was severely affected during the Asian financial crisis but not during the global financial crisis. The policy instruments implemented since 1998 which helped lower interest rates and raise demand for housing were also helpful during the global financial crisis.

Rasiah, Yap, and Chandran (2014) examine the impact of the crises on the electronics industry, which has been a major pillar of industrial exports from Singapore, Malaysia, Indonesia, Thailand and the Philippines. They argue that the Asian financial crisis actually strengthened exports following a fall in US dollar-based wages, while a severe contraction in external demand following the global financial crisis affected exports from these countries. The article by Doner and Wad (2014) assesses the impact of the crisis on Southeast Asia's automotive industries. Their argument is that the crises have largely reinforced existing national auto strategies, albeit to different degrees. In Thailand, for example, the Asian financial crisis accelerated a move towards exports already in motion in the early 1990s, with the 2008–09 crisis encouraging a more regional focus while discouraging serious upgrading efforts. In Malaysia, by contrast, neither crisis did much to push the country away from its relatively protectionist automotive development strategy. The final article by Lee and Ofreneo (2014) discusses the social consequences of the two crises, with considerable attention to labour outcomes. While arguing that the impact from the 1997–98 crisis was far more severe than the 2008 crisis, the article notes that labour markets in the region continued to be dominated by informal, vulnerable and precarious employment. Labour protests emphasising such vulnerable markets have triggered vigorous national and regional debates on rules for labour contracting, minimum wage adjustments and social protection.

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