Once Again: Ten Years After the Asian Crisis

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Abstract A review of the economic performances of Indonesia, Malaysia, Philippines, South Korea, and Thailand in the decade following the 1997 Asian Crisis finds that they have been performing unsatisfactory relative to the previous decade's performances. The review also finds that as of 2007 these economies have not recouped the losses produced by the Crisis. The results basically suggest that unless GDP per capita growth rates are pushed to much higher levels than the current trends, progress will remain on down-scaled growth trajectories – that is, below full potential – and, more importantly, they will continue to suffer the costs of the Crisis.

Key Words Asian Crisis, Indonesia, Malaysia, Philippines, South Korea, Thailand

JEL Classification E10, E60, N10

1. STARTING THE RECOLLECTION

The 1997 Asian Crisis was both unexpected and unprecedented. The "consensus" then – led by the World Bank and the International Monetary Fund – was that the Asian miracle economies of Indonesia, Malaysia, South Korea, and Thailand [henceforth, crisis-affected economies] would continue to have rapid economic growth in the 2000s, as they averaged 6.9 per cent growth in gross domestic product (GDP) per capita in the decade before the Asian Crisis. In fact, Indonesia and Thailand did not experience negative economic growth rates prior to 1997, whereas Malaysia and South Korea had economic recessions in the early 1980s, they recovered quickly to achieve high economic growth rates.

The Asian Crisis affected the Philippines, albeit not as significantly as four Asian miracle economies included in this paper. While the Philippines faced small damages relative to the other affected economies, it needs to be pointed out that its economic performance had not been impressive over a long period either, as it averaged a GDP per capita growth of 1.4 per cent between 1987 and 1996. Studies have shown that the Philippines' boom-and-bust performances ushered in by periodic internal and external shocks contributed to a failure to reach real economic accelerations, in turn, stalling it from taking off to higher growth trajectories similar to what the Asian miracle economies accomplished (see, e.g., Beja 2007a).

It is now clear that the Asian Crisis uncovered the weaknesses of the miracle economies story, and the ensuing debacle led to a sudden change in sentiments toward them. From being successful emerging economies, characterized by virtuous expansions complemented with poverty reductions, they were quickly condemned as the principals of crony capitalism, the bastions of corruptions, the facilitators of wide-scale inefficiencies, and the initiators of structural defects, not to mention wayward external borrowings and unsound investments, that caused the collapse of these economies.[1] Thailand, where the Crisis erupted, experienced a 2.4 per cent contraction in GDP per capita growth in 1997, and it went on to face the worst of the Crisis in 1998, as growth continued to contract by 11.4 per cent, or totaling 13.8 per cent contraction. Meanwhile, Indonesia, Malaysia, Philippines, and South Korea reported negative growth rates in 1998. In fact, their performances in 1997 already indicated that they were shaken by the Crisis. The 1998 data show that Indonesia had the worst contraction among the group, at -14.3 per cent. Malaysia had -9.6 per cent, South Korea had -7.5 per cent, while the Philippines, -2.5 per cent economic growth.

In addition, the Asian Crisis bared the incompatibility of the Asian model of economic growth with that advocated by the Washington Consensus, a model characterized by wide-scale privatization, deregulation, and financial liberalization with minimal government interventions in the domestic economy and freedom of capital and trade in the external economy. Jomo (1998)

and Jomo (2003), among others, pointed out that the aggressive financial liberalization in these economies without strengthening – or, in some cases, even weakening of – governance structures and regulatory capacities on international flows generated additional structural vulnerabilities that in turn aggravated the existing institutional weak points. The reform programs created mismatches between the domestic and external sectors, which widened opportunities to exploit the situation. Policy-making and implementation were captured by elites or, in other contexts, allowed by the governments. Inferior industrial policies discouraged capital accumulation and deepening, as well as technological adaptation, removing some of the fundamentals for long-term expansion. In the end, these crisis-affected economies were vulnerable to speculation and crises. They were robust to the extent that international finance fueled economic expansions, albeit driven by unproductive activities, and as long as export-oriented strategies remained viable. When the Crisis occurred, capital quickly rushed out, making the adjustment process much more difficult and painful. It was intense and caused wide-scale damages. Yet domestic observers were not unaware of the brewing domestic problems, neither did they not want reforms introduced. But domestic and international players were more determined to consolidate their control over capital as the governments relaxed their regulations and controls, hence making the crisis inevitable.

The economic fundamentals and social welfares of Asian economies were upset as the Asian Crisis spread across the region and got worse. Days after the Crisis erupted, in Thailand, the Philippines peso was devalued when the central bank realized that it could not fight the situation with only limited international reserves. Malaysia next took the ringgit off its peg. The Indonesian rupiah was hit next, and it also went off its peg. By the end of August 1997, these four economies had adopted flexible exchange rates. As the Crisis gained momentum, Indonesia announced some revisions in its spending plans for the year, which actually did not happen: the budget announced in January 1998 indicated that Indonesia was not determined to pursue reforms. By late-1997, Thailand, Philippines, and Indonesia had signed on rescue packages and stand-by arrangements with the International Monetary Fund (IMF), the World Bank, and the Asian Development Bank (ADB).[2]

Taiwan Province of China unexpectedly devalued its dollar in October 1997, which sparked serious concerns that the Crisis was spreading outside Southeast Asia. Speculative attacks next hit the Hong Kong dollar, where large sell offs in the stock market impacted the markets in Japan, Europe, and the United States. The collapse of Yamaichi Securities Co. Ltd., the fourth largest brokerage in Japan deepened heard behavior. South Korea followed, with the won devalued in November 1997 and floated by the end of the year. Of course, bankruptcies had earlier hit the chaebols: Hanbo Steel in January, then the most publicized closure of Kia Motors in June. By the

end of 1997, South Korea had signed on an IMF rescue package of US$ 57 billion. Other actions followed in due course like an ADB emergency assistance package of US$ 3.5 billion and US$ 4 billion for Indonesia and South Korea, respectively. The United States and 12 other industrialized countries pledged US$ 10 billion assistance to South Korea if the additional funds would be needed. Speculations of President Suharto having a stroke renewed fears in Indonesia, thereby sending the rupiah to nose-dive, subsequently spilling over again to the other stock markets and currencies in the region. And making the situation worse was the downgrading of Southeast Asian sovereign debts into junk bond status by Moody's Investors Service.

The following year started on a low note, as Singapore devalued its dollar in January. The Crisis had already affected other countries in Asia, including India and Pakistan, and extending to Australia and New Zealand. Social unrest and violence erupted in Indonesia in April 1998 when food, fuel, and electricity subsidies were removed. Panic escalated and riots overwhelmed Jakarta starting April, and the Indonesian rupiah plunged to a historic low. President Suharto resigned in May.

Just when everyone thought that the Crisis was confined to Asia, the Russian stock market crashed in June 1998. Meanwhile, Asia had to cope with the worst of the Crisis as rescue and bail out packages were long-drawn. When they arrived, they provided some assurances for economic stability to be regained. Complicating the ongoing troubles in Asia was the announcement in June that Japan was in an economic recession. In fact, earlier in January, Japan had released what could be the bleakest assessment of its economy in more than 20 years. It was a frustrating – though not an unexpected development – as Asia looked to Japan for economic intervention. The yen plunged in June, which triggered attacks on the other currencies in the region once again. As though a fire was being reignited, renewed attacks ensued starting with the Hong Kong dollar. Speculations that China would devalue the renminbi did not help ease attacks either. Then, Russia defaulted on its domestic debts, declared a moratorium to foreign creditors, and devalued the rubble. Another wave of the Crisis was also ignited in September 1998, which hit Latin America. Brazil's stock market plunged first. As stock markets in Latin America reacted to the Brazilian and Russian debacles, sell offs in the stock markets in the continent occurred as investors rushed out of the Latin American equities. The tragedies in Japan, Russia, and Brazil rattled Wall Street, where sell offs continued as there were no apparent signs that the Crisis was slowing down.

Only in September 1998, after Long-Term Capital Management (LTCM) was found on a brink of financial collapse, did the Crisis become a serious threat to the United States. It became apparent that if LTCM collapsed, that would trigger a crisis in the United States, pushing it to an economic recession, and aggravating the economic meltdown. To avert the Crisis from sparking

in the United States, the Federal Reserve coordinated a US$ 3.5 billion bailout for LTCM. Other actions followed: the Federal Reserve cut interest rates three times between September and December 1998 to help ease speculations and the European banks also cut their interest rates in October. Meanwhile, back in Asia, Malaysia introduced capital controls to insulate the economy from further attacks. Malaysia reasoned that capital controls would enable it to pursue counter cyclical measures to bounce quickly to good economic health. It should be noted, however, that the political conflicts between Prime Minister Mahathir and Deputy Prime Minister Ibrahim and the denouncement of the Prime Minister of currency traders and speculators did not help stabilize its economy. Fortunately, by late-1998, the financial markets responded positively to the actions of the Federal Reserve and to the various rescue operations. The Miyazawa Plan of US$ 30 billion assistance package also contributed to further stabilize the situation. Then, most of the Asian currencies and stock markets rebounded with strong recoveries. By the start of 1999, the Crisis had subsided.

The poor international responses as the Asian Crisis was unfolding made clear that there was a limited appreciation of what was going on. The mishandling of the IMF in dealing with the crisis-affected economies did not improve the situation. Contractionary government actions did not help regain stability either. With domestic political turmoil and social disintegration in some countries, recovery efforts were not only difficult to introduce but also painful when introduced. Uncertainties in the political leadership complicated the policy responses and limited the options open to the governments.

Ten years after the Crisis, the economic and social impacts are still recognizable. At one level, the Crisis has ushered in the much needed reforms to strengthen financial governance, introduced social insurance to mitigate the adverse effects of economic adjustments, and renewed commitments to reduce poverty. At another level, however, the Crisis was a traumatic experience. The economic performances in the crisis-affected economies are not as dynamic when compared to their previous intensity, reduced to the so called pragmatic levels. Investors have become more cautious after experiencing large losses and have become hesitant in undertaking investments without the guarantees they previously enjoyed. The evident sizeable international reserves that many Asian countries hold today attest to the painful experiences of dried-up liquidity and the consequent economic contractions. Evidently, such action is a precautionary stance against future crises. While adequate international reserves are important, the direction it has taken has become too defensive, downplaying possibilities for using some of such funds for expanding spending on public goods and services. At the micro level, investors are more concerned about shifting funds away from physical capital accumulation into short-term or liquid assets that can be easily pulled

out in an event of a crisis or unfavorable developments. Of course, there are emerging threats, such as high oil prices, overheating in China and India, or a hard-landing of the United States that can disrupt the region and the global economy once again.

And as the Asian Crisis has reconfigured the region into something qualitatively different to that of pre-1997 Asia, there are other issues that the region must confront, the most important of which is regional economic integration and the manner by which to proceed with the plan with an Asian character. As this integration takes shape, the economic challenges are also extended across countries. How to safeguard one's economy from and respond to future crises are important challenges that must be addressed. Clearly, the nature of future crises will not be like the Asian Crisis. They can take different forms, ignited by other means or channels, and more likely to be as violent and virulent as the Asian Crisis. Unless the economic foundations from which the Asian economies embark on their economic expansions are strong enough, governments are sufficiently equipped to deal with challenges generated by, say, regional economic integration or the ever-increasing fluctuations and magnitudes of finance crossing markets, a solid international financial architecture is in place for regulation and support, and so on, crises will interrupt and disrupt the economies from realizing long-term economic growth.

This paper argues three points that seem to be overlooked in the on-going retrospections of the 1997 Asian Crisis. The first point is that the crisis-affected economies have all performed unsatisfactorily in the decade after the Crisis if juxtaposed to their earlier decade performances, albeit the trends for Philippines seem to suggest some recovery after decades of relatively poor performances. Indonesia, Malaysia, South Korea, and Thailand are noticeably below the trends that characterized the Asian miracle economies story. And it appears that there is no apparent economic acceleration in the coming years. The second point of this paper is that an accounting of the costs over past decade reveals that these economies have yet to recoup their losses in 1997. For Indonesia, Malaysia, and Thailand, the results suggest that the costs have risen continuously, while the Philippines and South Korea have shown some cost recoveries. The two points suggest that dynamic performances in these economies are much needed; otherwise, the burden of the lost opportunities from 1997 will persist, which could engender social instability. In the case of the Philippines, the challenge is tougher because unless extraordinary performances are realized, the economy will again be left behind when the other four economies regain growth accelerations. There is therefore an urgency to realize dynamic performances. That is, whether or not the crisis-affected economies have recouped their losses is an important issue that needs to be grappled with if the Asian region is to demonstrate that it can cope with the challenges that will be generated by, say, regional economic integration and the present setup of the international financial architecture.

The final point of the paper is that decisive policy actions are needed today as the crisis-affected economies outline the future directions of each of their economies. Yet, at the same time, there is need for complementary actions from the community of nations; there is a need to cooperate with each other to contribute toward ensuring that the economic stabilities and political securities are achieved. The accounting of the impact of the Crisis is one approach to present the large tradeoffs if decisive actions are not taken today or actions are delayed. Indeed, an important lesson from the Crisis is that a sense of complacency is misplaced when the international setup is characterized by fluctuating and unregulated finance, many economies are ill equipped to cope with the economic challenges, and the international financial system is an architect that recreates and promotes such problems.

The paper has six sections. Part 2 presents a justification for a recollection of the Asian Crisis and the analytical framework for the analysis. The impact of the Crisis on the economic performances of each Indonesia, Malaysia, Philippines, South Korea, and Thailand, and the magnitude of the costs to each economy are presented in Parts 3 and 4, respectively. Policy is discussed in Part 5. The last part of the paper concludes the discussions.

2. FRAMING THE 1997 ASIAN CRISIS

Ten years after the Asian Crisis, the recovery of the crisis-affected economies is being debated once again. In its latest report, the World Bank has highlighted the remarkable recoveries of the crisis-affected economies, yet the tough challenges that confront the region in how to push further the recoveries (World Bank 2007). The International Monetary Fund has also reached the same conclusion, though stressing that there remain matters unaddressed that could limit recoveries, especially those on income inequality and unstable capital flows (Burton and Zanello 2007). Asian Development Bank has pointed out that a normal economic environment has returned in the crisis-affected economies but they have grown at lower-level trajectories (ADB 2007). What remains of the Asian model is still a subject of debates. Without a doubt, the Crisis has inflicted serious long-term economic damages. There also remain vulnerabilities in the region, particularly emerging external threats to growth that can compromise the recoveries (UN ESCAP 2007).

How big really has been the damage inflicted by the Asian Crisis to Indonesia, Malaysia, Philippines, South Korea, and Thailand? There are earlier studies on the cost of the crisis, but they presented preliminary estimates as it was still difficult filtering out the dramatic changes in the late 1990s or even in the early 2000s. The Crisis has many aspects that continue to be debated and researched – hence this paper. Retrospective studies are coming out on the tenth anniversary of the Crisis to inform prospective actions, recognize the historical and think historically to inform future directions. The jury may have earlier given their decision on how the Crisis impacted the

economic performances of the crisis-affected economies.[3] But ten years hence, this paper has the advantage of a longer history on which to base a review. For one, the complicating and conflicting factors that were still manifesting in the late 1990s or continued to be at play in the early 2000s have now fully worked themselves out. Accordingly, the paper revisits economic performances using a counterfactual scenario. In the end, it hopes to contribute to sustain the reform efforts in the crisis-affected economies given that there remain vulnerabilities from the past and there are rising challenges today like regional economic integration and how to deal with it in the Asian way. If no serious rethinking on how reforms have previously been done, crises are bound to recur, and when they do, there will be considerable costs and derail economic progress.

There are different levels to consider the relationship between the economy and crisis. At one level, one can argue that a robust economy can quickly bounce back from a crisis, similar to a spring that rebounds after being pushed down. As such, a strong crisis implies strong recoveries. In a way, the crisis has served as a mechanism that forced governments to undertake serious adjustments and reforms to achieve long-term economic growth. When the impact of a crisis is in fact transitory, there can be no serious implications on economic growth, as the momentum is recovered and the losses can be quickly recouped in the subsequent periods. It can furthermore be argued that because of the adjustments and reforms, the economy is thrust to a higher economic growth trajectory. Hence, the crisis can be considered non-consequential – in a way, an anomaly to the long-term growth trend – because the following one-shot adjustments have been enough to steer the economy into a robust recovery, regain previous momentum, and even do better in the ensuing expansion.

Alternatively, one can argue that an economy cannot fully bounce back after being hit by a crisis. In this case, the economy faces serious difficulties in the following period. The economic and political apparatuses may be limited or not be designed to respond to the crisis. Alternatively, the infrastructure may have been damaged during the crisis and that the restorative capacities of the economy have been compromised. Additionally, when repeated crises occur, institutions may have progressively undermined. Hence when a crisis hit the economy, it is pushed to a lower growth path. In this case, the economy can be likened to a weak spring that remained permanently distorted after being pushed down. In this case, a crisis has serious implications on the economy, and it cannot be argued that the crisis was an anomaly brought about by market processes. It is then misguided to argue that the affected economy has not faced serious consequences, say, in terms of economic growth or lost opportunities. Furthermore, the resulting lower growth trajectory means that a one-shot adjustment will not be enough to regain the lost growth and the costs of the losses. There needs to be dynamic adaptation in policies to pull the economy out from the crisis

and steer it to robust performances.

Of course, there are cases in which a shock perturbs the economy but the end result is that the economy is thrust to a higher economic growth trajectory. As such, there are non-transitory effects, too, although the shock is a sort of positive incident. Such shock can be due to, say, the discovery of natural resource deposits like oil and natural gas that when commercially exploited will relieve the economy of its foreign exchange constraints, enabling it to finance infrastructures and basic services, etc., engendering robust economic growth. But if the earnings are squandered or not well utilized, a Dutch disease might occur in the future, and produce economic stagnation. The shock can also be due to large capital inflows brought in, for instance, by the reorganization of global manufacturing system from advanced countries to emerging economies. Or, the capital inflow can be due to the shift of investments from the aging countries to relatively young countries to match capital with the abundant labor in the latter. If the opportunities such as these are not capitalized by the recipient economies with investments in human capital, technology adaptations, and so on, bottlenecks may soon materialize. In turn, they create the vulnerabilities that put the economy at risk. If global production is being relocated into the emerging economies, while the markets of the commodities remain in the advanced countries, this economic mismatch can turn out to be destabilizing in the long-term. As have been shown by past events, commodities supply gluts resulted in economic recessions, especially in the emerging economies. In any case, it can be argued that the strong spring analogy also applies. However, if the mismatches, institutional rigidities, and so on, corrode the capacity of the spring to function well, the economy can be pushed down to a lower growth path after being hit by a crisis. Policy-makers need to seize the opportunities to steer the economy away from the potential problems. Again, there needs to be dynamic adaptation and strategic in the policies to avert economic derailment.

3. RE-ANALYSIZING THE 1997 ASIAN CRISIS: PART I[4]

Data for GDP per capita (in 2000 prices) were obtained from the *World Development Indicators* and the *Asian Development Outlook* over the period 1987 to 2000 and normalized to 1996. Figure 1 shows that Indonesia took eight years (i.e., in 2004) to regain its 1996 GDP per capita. Malaysia regained its 1996 GDP per capita in 2000. Both the Philippines and South Korea bounced back quickly from the contractions in 1998, exceeding their 1996 GDP per capita by 1999. Thailand regained its 1996 GDP per capita level after seven years, in 2003. What is more interesting to note in Figure 1 is that between 1987 and 1996, Indonesia, Malaysia, South Korea, and Thailand had a rather tight pattern of economic performances – especially during the first half of the 1990s – as if they were increasingly chained to one another.

[Insert Figure 1 Here]

As expected, the economic performance of Thailand diverged from the group in 1997 when it experienced an economic growth of -2.4 per cent in GDP per capita. Starting in 1998, the figure illustrates that patterns of the five crisis-affected countries became increasingly unbundled, with Indonesia farthest away relative to the position of South Korea, while Malaysia, Philippines and Thailand are gathered closer to Indonesia. In fact, except for South Korea, the paths of the other four have congregated about each other starting from 2003, and arguably, these trends are going to continue in the coming years.

Rotational analysis is applied on Figure 1 to look at the same data from another angle. Rotational analysis "transforms" the representation in Figure 1 to show another story, particularly with regards to the trends between 1987 and 1996. However, because the trend of the Philippines is distinct from those of the other four economies, the trends of the latter are used as the control information.[5] The next step is to draw a rotated axis, which is obtained by superimposing a line that captures the cluster of information in 1987 to 1996 and ensuring that it crosses at 1996 = 100, which is the reference point when the data were normalized for Figure 1. With the rotated axis, the next step is to draw a perpendicular line at 1996 = 100 to form an orthogonal axis.

[Insert Figure 2 Here]

It is clear in Figure 2 that the crisis-affected economies have all moved farther away from the rotated axis, with the possible exception of South Korea that appears to have been moving parallel but below the axis. Indonesia and Thailand have moved the farthest over time, and their trends appear to be still departing from the rotated axis in 2007. Malaysia and the Philippines have also moved away from the axis, but their trends after 2005 have converged at a higher level compared to Indonesia and Thailand, as was noted in Figure 1. But the trend of Malaysia became pronounced from 2001. For the Philippines, Figure 2 reveals that its trend has been on a constant decline since 1987. In fact, its downward trend relative to the rotated axis started much earlier if the data are extended earlier to 1980.

More importantly, Figure 2 presents the counterfactual scenarios for the crisis-affected economies in the context of revisiting the Asian Crisis. The conjecture is that the socio-economic conditions between 1987 and 1996 might have continued into the late-1990s and early 2000s had the deterioration in the economic fundamentals been addressed, the captured bureaucracies and institutional rigidities been remedied, the governments maintained effective management of their domestic economies, even allowing for a well-planned sequence of deregulation and financial liberalization, such that progressive industrialization and broad-based economic expansions been sustained, and so on.[6] Of course, the counter argument to the counterfactual scenario is that the crisis-affected economies would nevertheless experience a deceleration in economic performances

by the early 2000s if they had sustained the same level of economic expansions over such long period. Nonetheless, the deceleration would not have been as dramatic as that in the late-1990s. In the counterfactual, there would also be adjustments in policies that might have averted economic debacles like the Crisis.

Figure 2 thus presents a straightforward conclusion: while it can be argued that the crisis-affected economies have exceeded their 1996 GDP per capita levels (Figure 1), it cannot be easily argued that they have regained the dynamic performances that distinguished the Asian miracle economies before the Asian Crisis.

4. ANALYSING THE ASIAN CRISIS: PART II

Unimpressive economic performances in decade after the Asian Crisis thus suggest that the crisis-affected economies have not been fully recouped the costs inflicted by the Crisis, even by 2007. How big have been these damages in the five economies?[7]

Measuring the costs of the Asian Crisis involves forensic techniques. The counterfactual scenario described earlier remains applicable, and it is what forensics tries to determine. The first stage in the exercise is to estimate the counterfactual economic performances of each of the crisis-affected economies, using $y_t = \alpha + \beta \text{ time} + \varphi\, y_{t-1} + e_t$, where y is GDP per capita (in 2000 prices).[8] The setup basically says that current GDP per capita is determined by a time drift (i.e., a proxy for the general direction of economic progress), *all* past information embedded in past GDP per capita, y_{t-1} (i.e., a proxy for other factors that influence current performance including y_{t-1} due to $y_{t-[1+i]}$), and the residual (i.e., *other* factors affecting y_t). As such, if the Asian Crisis had transitory impacts on an economy, the differences between the actual and estimated values of GDP per capita, $\hat{y}$, is small, as well as the subsequent values. The reverse applies if the Crisis actually had permanent impacts. As such, the differences between y and $\hat{y}$ are large and long-lasting. And when real economic recovery had not occurred, the subsequent differences could become bigger over time. It must not be discounted that growth accelerations could occur in the future and that full recovery takes place then. Still, in the interim, there are large differences in actual and estimated values. In this case, $\hat{y}$ represents the counterfactual performance.

Additional calculations are done in this forensics exercise. First, the accounting cost of the Asian Crisis is calculated as the direct cost per capita multiplied by the population at time t, where the direct cost is measured as the foregone annual output per capita, or $(\hat{y}_t - y_t)$. Using United States Treasury Bill interest rates, r, the economic cost of the crisis, ec, is calculated as the opportunity cost per capita multiplied by the population in time t, where the opportunity cost per capita is measured as $[(1+r_t)(\hat{y}_t - y_t)]$. Lastly, the social cost of the crisis, sc, is calculated as the accumulated cost multiplied by the population in time t, where the accumulated cost per capita is

$[(1+r)sc_{t-1} + (ec_t - ec_{t-1})]$, such that ec and sc have the value of zero for period t-1 and re equal in period t. Again, GDP per capita (in 2000 prices) from 1987 to 2008 were obtained from the *World Development Indicators* and *Asian Development Outlook*.

Indonesia

As the Asian Crisis went into full speed, 1998 Indonesian GDP per capita fell to US$ 777 and further down to US$ 773 in 1999. The economy plunged to a -14.3 per cent GDP per capita growth in 1998 and continued to contract by 0.5 per cent in 1999 (Figure 3a). Its GDP per capita in 1999 was 88 per cent of the 1996 figure, which was US$ 878. The contraction meant that the foregone output per capita was US$ 175 in 1998 and US$ 223 in 1999. As such, the opportunity costs per capita on those losses were US$ 184 and US$ 233, respectively, while the accumulated cost per capita was US$ 241.4 over those two years, which were in the range of 29 to 31 per cent of GDP per capita. The figures clearly suggest heavy burdens on the average economic welfare in Indonesia. Five years after the Crisis, Indonesian GDP per capita remained below the 1996 level, reaching an average income of US$ 844 in 2002. The foregone output per capita in 2002 increased to US$ 280, while the opportunity cost per capita of the foregone output reached US$ 284. These were at least 30 per cent of GDP per capita. The accumulated cost per capita in 2002 was US$ 321, close to 40 per cent of GDP per capita. The trends shown in Figure 3b indicate that the costs continued to rise over time, meaning heavy burdens on the economic welfare of the Indonesian people persisted. As Figure 1 illustrates, Indonesia took eight years to increase its GDP per capita to a level comparable to that of 1996. Over this period, losses were incurred. The implication as GDP per capita remained below the counterfactual scenario (Figure 2) is that the costs were mounting over time. Put another way, the gains from the economic recovery were not sufficiently large enough to offset the lost opportunities that resulted from the Crisis and its fallout. As such, it is expected that by 2004 the foregone output per capita was much bigger than the previous years' amounts, at US$ 306. The opportunity cost per capita reached US$ 310. After eight years, the accumulated cost per capita was US$ 355. These figures were about 30 per cent of GDP per capita in 2004, which means that the burden on economic welfare remained the same.

[Insert Figures 3a and 3b Here]

The average income for 2007 would continue to exceed the 1996 figure, projected to be US$ 1,338. Indicators suggest that GDP per capita growth could ease down, so the projected 2007 costs would still be bigger amounts. However, there is a positive sign that the trends are flattening out, suggesting that the foregone output and opportunity cost per capita figures would not exceed US$ 350. The expectation of course is that GDP per capita growth would not slow down in the coming years. But what is alarming in Figure 3b is that the accumulated cost per capita would

continue to rise, projected to reach US$ 418 in 2007. Even if the current growth is maintained, the accumulated cost of the losses would still be growing. Thus, it is only with accelerated GDP per capita growth – faster than the projected rates for Indonesia – over a long period that these costs could be significantly reduced and wiped out in time. At present, however, it is disappointing to note that because of serious or unaddressed constraints to economic growth, Indonesia would be unable to move up to a higher gear of economic performance. Weakened public investments, deteriorating delivery of basic services (including the civil service and the legal system), and falling competitiveness are some of the important issues why Indonesia could not regain the dynamic growth of the pre-Crisis period. Significant progress on addressing these issues needs to be achieved in the coming years.

Malaysia

Malaysian GDP per capita fell from US$ 3,938 in 1997 to US$ 3,560 in 1998, as GDP per capita growth dropped to -9.7 per cent (Figure 4a). Growth rebounded to 3.7 per cent in the next year. The fall in the average income meant a foregone output per capita of US$ 571 or an opportunity cost per capita of US$ 598 in 1998, which are about 16 per cent of GDP per capita. Thus, it can be argued that to an extent the capital controls helped lessen the losses in economic welfare. As Figure 4a shows, Malaysia recovered its pre-Crisis level of GDP per capita in 2000, as economic growth was sustained, but still, its expansions in the past two years were not strong enough to recoup the losses (Figure 4b). By 2000, foregone output per capita was down to US$ 614 per capita from US$ 646 in the preceding year. The opportunity cost per capita was US$ 650, but the accumulated cost per capita was US$ 719. Still, there were some encouraging trends in the recovery period (Figure 4b). An economic recession in 2001 unfortunately reversed the gains of the previous years, as the country sputtered to a -1.9 per cent growth rate. And the result was that foregone output per capita increased to US$ 891, opportunity cost per capita went up to US$ 922, and accumulated cost per capita became US$ 1,015. What these trends clearly illustrate is that it is important to sustain GDP per capita growth throughout the recovery period. After 2001, economic growth remained slower than the immediate years of the recovery period or the pre-crisis trends. As such, Figure 4b indicates that the costs continued to increase. By 2006, the foregone output per capita reached US$ 1,130 and the opportunity cost per capita was already US$ 1,193. These figures were about 25 per cent of Malaysian GDP per capita in 2006. The accumulated cost per capita as of 2006 stood at US$ 1,434, or at least 30 per cent of GDP per capita.

[Insert Figures 4a and 4b Here]

The estimated figures for 2007 would 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. At the present, however, it is unclear if a flattening in the trends of the costs is taking shape; in fact, the pattern appears to be cyclical – that is, rising as economic growth slows down, flattening out when there is growth and recovery, then rising again as growth eases up again – but at the same time swelling. As Malaysia gains momentum in economic growth in the coming years, flattening in the trends for foregone output and opportunity cost per capita are expected. If dynamic growth is sustained, the cyclical pattern of the costs could be addressed as the amounts are cut down. Nonetheless, the social costs continue to increase in the coming years. As such, only with accelerated GDP per capita growth – faster than the projected rates – and that it is sustained could costs are cut down. Perhaps, because the economic performance of Malaysia is constrained by the strength of global economic performance or at least its major trade partners that it economic growth is contingent. Malaysia thus faces some stumbling blocks to realizing its pre-Crisis performance. The exports sector remains crucial to buoy the economy in the short and medium term. For the long term, Malaysia must deal with the infrastructure requirements to keep the economy in competitive shape. For instance, there is an increasing need to build a workforce to complement the available physical infrastructure supporting investments with productive labor for economic growth.

Philippines

Figure 1 suggests that the Philippine GDP per capita remained relatively steady between 1987 and 1996, a reflection of the boom-and-bust growth that troubled the country much earlier. From 1993, however, the trend suggested an economic turnaround. The Philippines re-entered the international capital markets that year, allowing the domestic economy access to external funds. But for a long time, the Philippines did not have the dynamic growth that distinguished the Asian miracle economies in the pre-Crisis period. As apparent in Figure 2, economic welfare had been in a constant decline over a long period. In fact, stretching the analysis back to the 1970s reveals that the Philippines regained its GDP per capita of 1982 only in 2002, at slightly above the US$ 1,000 mark. In a way, the impact of the Asian Crisis was small because the Philippines was passed over by the capital flows into the region. At the same time, the Philippines had difficulty raising the volume of trade, as it progressively lost competitiveness. In a way earlier crises meant that the Crisis did not produce significant lost opportunities.

Figure 5a shows that GDP per capita fell by a relatively small amount, dropping to US$ 945 in 1998 from US$ 970 in 1997. In fact, the figure in 1998 was comparable to that in 1996, which was US$ 942. The foregone output per capita in 1998 was US$ 51, and the opportunity cost per capita was US$ 54. These figures were 5 per cent of GDP per capita in 1998. That there was a small reduction in economic welfare in 1998 support the contention that the country had the least

damage among the crisis-affected economies. Stronger economic growth in 2000 meant more reductions in the costs (Figure 5b), while a slowing down of growth in 2001 reversed the gains of the previous years. By 2002, foregone output per capita stood at US$ 89; the opportunity cost per capita was US$ 90. These were about 9 per cent of GDP per capita. The accumulated cost per capita stood at US$ 100, which was 10 per cent of GDP per capita. Costs were further cut down as economic growth was sustained since 2002 – albeit at meager rates of economic expansions. By 2006, the foregone output per capita was down to US$ 55 and an opportunity cost per capita of US$ 58, which were less than 5 per cent of GDP per capita and, more importantly, comparable to the 1998 figures. The accumulated cost per capita stood at US$ 77, already 7 per cent of GDP per capita in 2006. It is clear from Figure 5b that the Philippines has started to recoup the costs. Again, because of relatively mild economic growth, the reversal in the trends was delayed and slow.

[Insert Figures 5a and 5b Here]

The forecasts for 2007 suggest that the reductions in the costs would continue, though not large reductions would be had. If the forecasts hold, the estimated 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. These trends are indeed encouraging. As with the other crisis-affected economies, the Philippines has to sustain its current direction of economic expansion, but still it needs achieve dynamic growth if it were to fully recover from the Crisis. Even with these positive developments, there are concerns the country's recent economic performance is becoming highly consumption-driven and too dependent on foreign workers' remittances. Notwithstanding the contribution of workers' remittances to buoying the economy from another balance of payments crisis (as was the case in 2005), there is a budding Dutch disease taking into account that recent economic growths are rather narrow and shallow (see, e.g., Habito and Beja 2006). The country remains vulnerable to global economic performances and to the swings in domestic agriculture production. National elections in 2007 turn out to be respectable, and progress on the remaining reforms agenda are expected to proceed at pace as in the earlier years with the 14th Philippines Congress. What needs to be stressed at this point is that Figures 5a and 5b focus on the costs inflicted by the Crisis. For the Philippines to recoup the lost opportunities from its earlier crises and improve the average economic welfare of Filipinos, the economy certainly needs to produce exceptional rates of GDP per capita growth.

South Korea

South Korea had both a dramatic economic collapse, and then a quick rebound in a span of two years. Such quick turnaround has been said as confirmation of the fundamental strengths

and sound constitution of the South Korean economy (see, e.g., Park and Choi 2004). Still, the Asian Crisis produced large costs. In 1998, Korean GDP per capita fell to US$ 9,307 from the 1997 level of US$ 10,064. The figure was much lower, when compared to the figure for 1996, at US$ 9,707. The foregone output per capita in 1998 was US$ 1,281; the opportunity cost per capita was US$ 1,343. The amounts were 14 per cent of 1998 GDP per capita. As South Korea went on a recovery mode, economic growth jumped to 10 per cent in 1999, and this impressive growth cut down the heavy burdens on economic welfare. Sustained growth into 2002 cut the losses by half. There was some setback in 2001, but there was again a quick rebound in the following year. So by 2002, the foregone output per capita was down to US$ 666, the opportunity cost per capita was US$ 677, and the accumulated cost per capita was decreased to US$ 850. The amounts were between 6 and 7 per cent of GDP per capita. Indeed, recovery periods require strong economic growth when recouping the lost opportunities. Since 2001, however, South Korea experienced a cyclical pattern of growth, perhaps constrained by global economic performances or at least the performances of its major trade partners. At the same time, though, this pattern also point to the challenges in South Korea, especially as the economy navigates reforms with competing domestic interests. As such, Figure 6b shows that the costs remained relatively steady until 2006, and the amounts were: US$ 795 of foregone output per capita, US$ 834 opportunity cost per capita, and US$ 1,117 accumulated cost per capita. Again, the strong economic growths meant continuous reductions on the burdens on average economic welfare.

[Insert Figures 6a and 6b Here]

Given the forecasted economic growth of South Korea for 2007, the trends from 2005 are expected to continue. Further reductions in the costs would be expected in 2007. The anticipated figures are: foregone output per capital of US$ 717, opportunity cost per capita of US$ 745, and accumulated cost per capita at US$ 1,074. Investments, consumption, monetary and fiscal policies, and stable won, among others, are expected and contribute to raise confidence in the South Korean economy. A consumer credit problem in 2003 led to a re-examination of the reform programs and steady progress on them has been achieved, contributing to the positive atmosphere today. But it is still important to reignite dynamic growth of the pre-Crisis period in order to recoup the losses. A slow down in exports performance (especially electronics) would disappoint robust economic growth. Indeed, there are indications that in the case of South Korea a full recovery from the Crisis is right around the corner.

Thailand

At the outset, the Asian Crisis was thought to inflict a modest cost on Thailand. Its GDP per capita growth contracted by 2.2 per cent, or a reduction in average income from US$ 2,154 in

1996 to US$ 2,101 in 1997 (Figure 7a). But as the Crisis gained momentum in 1997 and extended in 1998, the serious impacts to Thailand became apparent. In 1998, growth further contracted by 12 per cent. By that time, the foregone output per capita reached US$ 612 and the opportunity cost per capita was US$641, and these were at least 33 per cent of GDP per capita. The accumulated cost by 1998 reached US$ 652, or 35 per cent of GDP per capita. While Thailand registered above average economic growth after the Crisis, it faced difficulties in realizing growth accelerations. Growth tumbled to 1 per cent in 2001 as the global economic slow down affected Thailand, and in turn the costs mounted. For that year, the costs were: a foregone output per capita of US$ 892, an opportunity cost per capita of US$ 922, and an accumulated cost per capita reached US$ 1,040. The latter amount already exceeded 50 per cent of 2001 GDP per capita. The figures for 2002 were even worse, even though Thailand had regained its GDP per capita of 1996 that year. Except perhaps in 2003, when some momentum in economic growth was achieved, growth from 2002 to 2006 remained steady at an average of 4.6 per cent. However, the apparent slow down in growth since 2005 suggested that the costs would consequently rise. As Figure 7b shows, the accumulated cost rose quickly whenever growth slowed down. By 2006, the foregone output per capita reached US$ 1,040 and the opportunity cost per capita was US$ 1,089, both remaining at least 40 per cent of GDP per capita. In that year, also, the accumulated cost per capita stood at US$ 1,345, which was still above 50 per cent of GDP per capita. Interesting to note is that the pattern of cost recovery in Thailand since 2001 closely resembles that of Malaysia. While a flattening in some of the trends could be expected if Thailand maintained decent economic performances in the coming years, the social costs would continue to increase with economic growth not as strong as should be. Yet to date, the prospects for Thailand are not as good as in the previous years. Economic growth is expected to be at its worst in six years but will hopefully improve after 2007.

[Insert Figures 7a and 7b Here]

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. For 2007, the costs as shares of GDP per capita are not significantly different to the preceding years, which mean that the burden on average economic welfare continues to increase. As already pointed out, only with exceptional growth sustained over a long period would significantly cut down costs. Nonetheless, problems remain to constrain a realization of dynamic growth, while developments inside and outside the country impede annual performances. The tsunami of December 2004, for instance, adversely affected the tourism industry that, in turn, affected economic growth. Tourism expectedly went into a lull for most of 2005, but it has now recovered. Political unrest in the southern part of the country contributed to delay the recovery in tourism. While export performances are expected to

be robust, they remain unstable as oil prices remained high and competitiveness were lower. Of course, large public infrastructure projects would contribute to growth as in the past. But recent developments in Thailand raised concerns about the capacity of the economy to regain dynamic growth, particularly the coup d'état in September 2006 sparked fears of a return to the pre-crisis period wherein political conflicts were resolved through military interventions. Compounding the situation was an economic faux pas in December 2006 in which capital controls were introduced but were quickly reversed when they did not work out as planned, thus indicating that the program was not a well thought-out plan. Uncertainties weaken confidence, reduce investments, etc., and in turn weaken prospects for economic growth in Thailand. Credible elections in 2007 would be important to bring confidence back to the country; and hopefully, credible policies would be had to reignite economic growth. At the present, however, it is disappointing that Thailand is losing steam and moving to a lower gear of growth.

The Aggregate Costs of the Asian Crisis

From the discussion above, the costs inflicted by the Asian Crisis on each of the crisis-affected economies have not been recouped as of 2007. While economic expansions in the years following the Crisis resulted in some reductions in these costs, the slower economic performances in recent periods meant that the reductions were not sustained and thus the costs mounted. As the figures show, persistent gaps between the counterfactual scenarios and the actual GDP per capita suggest that the Crisis has had long-lasting effects on the crisis-affected economies. The figures also show that the Philippines and South Korea had succeeded in cutting down on the losses. The experience of the Philippines is expected – as it did not face serious damages like the other four economies – so relatively mild economic growth in the post-Crisis period allowed the country to slowly regain some of its losses from 1997. But the case of South Korea demonstrates clearly the crucial role of robust and sustained economic growth. South Korea rebounded strongly in 1999 and that meant recouping the costs started almost immediately after the Crisis began to subside, although further progress was delayed as economic growth eased up in 2001 and fluctuated into 2006. As for Indonesia, Malaysia, and Thailand, decent economic growth was not sufficient to significantly reduce the costs. As growth slowed in some years, the costs quickly mounted. As of 2006, the standing costs of these three countries remained double the 1998 levels (see Appendix). In the case of Malaysia, the costs were 2.5 times the 1998 figures. While there are indications that the rise in the costs is slowing down in 2007, they assume that economic growth remained steady despite the emerging threats and risks in the region. In short, dynamic growth is crucial for a full recovery to happen.

What the aggregate figures in the Appendix present is that the crisis-affected economies

endured the trauma of the Asian Crisis. For 2007, the projected total social cost for Indonesia would be US$ 95 billion (41 per cent of GDP). Malaysia would be burdened with US$ 39 billion (31 per cent of GDP). For the Philippines, total social cost stood at US$ 7 billion (7 per cent of GDP). South Korea would have a burden of US$ 53 billion (8 per cent of GDP); Thailand would be overloaded with US$ 95 billion (55 per cent of GDP). At the aggregate, therefore, 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 because it had several traumatic experiences from crises prior to 1996. One consequence of the earlier crises to the Philippines was that it did not take off to higher growth trajectories, while another view is that the dismal economic performances were sort of blessings in disguise because the country did not experience the dangerously large capital flows that fueled the Crisis. Nonetheless, it took the Philippines 20 years to regain its 1982 GDP per capital, and costs have mounted over that period.

The conclusion from the above extended analysis is simple: dynamic economic growth is crucial in the post-Crisis period to compensate for the lost opportunities. When subsequent shocks reduce economic performances, the upsets need to be compensated as well with robust economic growth. If growth targets have to be mellowed down to supposedly tolerable levels in the post-Crisis period, it would be difficult to recoup the lost opportunities. Appropriate policies need to be introduced to realize growth accelerations.

5. LOOKING BACK, THEN MOVING AHEAD

The review of the economic performances and incurred losses of the crisis-affected economies must not make governments brood over the past. Retrospective analyses in the previous sections lead to the question: what policies need to be adopted in the here and now? While it is recognized that the past performances and incurred losses cannot govern the policies that need to be adopted today –recommendations need to stand whether or not the costs hare been recouped – it needs to be pointed out that the losses represent the opportunity costs for delayed or misguided actions. The premise in exploring policies is that it is undesirable or objectionable for these economies to relive the painful experiences produced by the Asian Crisis and the difficulties that arose in its fallout. Decisive actions are thus needed from the governments and the international community. There are five broad issues discussed below with the hope of salvaging the past standing of Asian miracle economies and provoking the crisis-affected economies to a consideration of broad-based economic performances.

On Economic Growth

Economic policies need to be designed that they do not compromise economic growth. This direction is important because incomes need to expand progressively to enable the people to

have greater command over goods and services. Economic growth must also create jobs. GDP per capita growth can be enhanced if nominal economic growth increases and/or population growth decreases. Accordingly, complementary social programs for the provision of the basic needs and social insurance need to be in place not only to stabilize population growth, but also to contribute to the formation of a productive labor force, a setup needed to bring people to participate in the economy and society. Public goods and services are to be provided and, in fact, to be demanded from governments. It need not mean that governments provide all that is required for economic growth and capabilities formation to take place; but, the essentials must be available. As such, governments have to play the role of enabling agents to make civil society and the private sector productive partners on this endeavor.

Some analyses have suggested that the current levels of investments in the crisis-affected economies are already satisfactory, especially after their elevated levels prior to the Asian Crisis (see, e.g., ADB 2007). It has been established that a lot of these earlier investments only went into speculative activities that created financial bubbles and economic vulnerabilities that culminated in the Asian Crisis. In a way, the current levels reflect the prevailing conditions in the region. But it needs to be stressed that previous flows were facilitated by ignoring the long-term implications of weakened regulations on international flows. Investments today need to be facilitated to boost economic growth to reach their previous heights, although the manner of facilitation needs sound management to encourage capital deepening and avoid unnecessary indebtedness. Investments also need to be facilitated to broaden the industrial capacities and enhance competitiveness.

Economic growth needs to be above the projected normal levels for the crisis-affected economies. The full recovery of the costs inflicted by the Crisis can only be realized if dynamic performances are sustained. Depending on the population growth rate of the country, GDP per capita growth rate needs to be at least 6 per cent (or a nominal annual growth target of about 7 per cent)., which is the low-end average growth rate between 1987 and 1996. Downgrading growth targets in the economic plans so that they conform to the projections of international institutions and rating agencies is unwarranted given that there are sufficient capacities for robust expansion.

But it needs to be pointed out that the realization dynamic growth also produces structural changes, and the transitions to the superior structures need to be facilitated by the governments to avert a deepening of destabilization forces that come along with transformations (see, e.g., Olson 1963). Otherwise, latent social conflicts could materialize in the future to undermine the economy (see e.g., Rodrik 1999). For this reason, democratic environments that recognize meaningful social participation in deciding, say, the direction of the economy is important. At the same time, it also needs to be pointed out that the economic growth strategies of the past are not to be replicated nor

sustained today. The destruction of habitats and the biodiversity as human activities expand, solid waste accumulation and the management of wastes, urban blight because of congestion, resource pollution and toxic contamination, global warming, to highlight some, are important issues that have to be integrated in economic plans and not as token issues included as appendages or after-thoughts. For instance, it is important that environmental strategies include the preservation of the ecological carrying capacities to absorb the stresses are imposed on the ecosystems as economies achieve dynamic performances. And it needs to be pointed out that approaches are available that allow a balance between economic expansions and sustainable environments.

On Opportunism and Hesitation

The misdiagnosis of the causes of the Asian Crisis and the overloading of conditionalities attached to the rescue packages have contributed to the escalation of the crisis (see, e.g., Jomo 1998; Radelet and Sachs 1998; Lane et al. 1999; IMF 2003). To an extent, the interventions have been opportunistic, driven by a longing to introduce reforms that earlier were difficult to bring in or were parried away by the crisis-affected economies. When the interventions had succeeded, the results were short of the desired outcomes, as adjustments were modified when operationalized to fit the domestic circumstances. As long as the Asian miracle economies story worked well, such yearnings to introduce changes in the region were allowed to pass. But the crisis resuscitated that engagement. As noted earlier in the paper, the crisis-affected economies were quickly branded as the principals of crony capitalism, corruption, large inefficiencies, etc. External interventions to force structural changes while the economic environment went increasingly volatile and uncertain undermined the effectiveness of the policy intrusions and became part of the problem.

The initial hesitation of the international institutions to provide support in a crisis situation was understandable to some extent, but the extended reluctance to extend help contributed to intensify the Crisis the way it did. Concerns about moral hazard were valid. After all, the intense capital flows in the region occurred because governments encouraged them with various forms of guarantees and loose or weak regulations. Unrestrained debt accumulation – mainly short-term – and dangerous exposures to risks brewed an economic disaster. In the past, bail-out operations basically benefited those who not only took advantage of the circumstances but also played a part in producing the tragedy. But precisely because of the inaction or delayed actions, the Crisis had produced an outcome that was largely preventable. When they came, they targeted the structural problems of the crisis-affected economies rather than first establish economic stability. The crisis-affected economies could have been steered away from experiencing the impacts of a full-blown crisis if measures were introduced in a timely fashion and appropriate way. The concerns about moral hazard could have been dealt with if guidelines were clear on lender-creditor duties and

responsibilities. On this latter issue, the concerns could be addressed if the creditors shared in the responsibility for the prudent management of international flows. One way this proposal can be achieved is through sound lending policies, some involvement in the disbursement of funds, or some related arrangements. For instance, if the external borrowings were misused, or proof not presented to demonstrate that the funds were used to improve the social conditions of domestic residents, or the borrowed funds could not be traced where they went, the burden of proof would be on the lenders to show that the money was not diverted into private pockets. If lenders pretended not to see that the borrowed funds were misused and benefited elites, or they did not act to redress the situation, the progressive position would be that creditors are accountable for the misallocation of funds. In the past, well-intended rescue efforts ended up bailing-out the private investors and creditors themselves, while in these cases the domestic residents ended up footing the bill in terms of higher taxes, reduced public goods and services, and so on. In these cases, moral hazard concerns are valid. However, they do not expunge the case that an international lender of last resort is, on balance, very important to regain confidence and reestablish economic stability during crises.

On International Flows of Capital and Trade

There is already a large literature on the causes of the Asian Crisis, and there is no need to rehearse them here. An important dimension that needs to be emphasized at this point is that financial liberalization, lax regulations, weak or weakened capacities to manage international flows, the consequent rapid increase in and volatility of capital flows that fuelled speculation and unproductive activities, underpinned the Crisis. Hence, wide-scale – in some contexts, mindless – financial liberalization was identified as one culprit of the Crisis (see, e.g., Jomo 1998; Chang et al. 2001; Jomo 2003). Pundits of financial liberalization point to the benefits of capital mobility; but that has also meant that countries engage the reality of the policy trilemma – the impossibility of simultaneously achieving capital mobility, fixed exchange rates, and autonomous economic policies. However, this interpretation is weak because capital mobility is interpreted to mean that unfettered capital flows are always welfare improving. As the experience in Asia (and elsewhere) suggests, large costs are produced from crises ignited by unregulated capital. Thus, the burden of proof is for advocates of capital mobility to demonstrate that the purported gains of unrestrained international flows not only materialize, but more importantly, accrue to domestic residents.

Lucas (1990) had actually queried why capital was flowing out of developing countries, where capital is most needed. If capital flows out of developing countries as capital flight or even as legitimate capital outflows, and if the capital surges create fragilities, increased risks, and/or reduced effectiveness of economic policies, there is a strong case for intervention. As Epstein et

al. (2003) have noted, capital flow management is warranted. The objective of the intervention is not to revert to economic repression, which had been found to be unsuccessful in engendering financial development and robust economic growth. Rather, intervention is done to regain control of economic policies and the direction of domestic development to enable countries to retain (not only attract) capital into their domestic economies and use the inflows to achieve robust economic growth. For example, capital management techniques can be used to direct capital flows into the productive sectors to bring about sustainable industrialization and propel the economy to higher levels of production. They can be used to affect the volume and composition of capital formation so the economy is insulated from short-term or speculative flows that disrupt congenial economic conditions. Indeed, privatization, deregulation, financial liberalization, and globalization, together with the processes attached with them, require sound institutions for governance and effective mechanisms for administrative controls and regulation for smooth adjustments to occur. As long as the rules are clear and enforcement is fair, capital management techniques contribute to raise the average economic welfares. It would thus be a tragedy if the fear of capital regulation results in a situation wherein capital stopped flowing into Asia.

Another needed intervention takes the form of trade management techniques, which must complement capital management techniques. Beyond the issues associated with trade access and facilitation, trade coordination among countries is important to avert domestic disintegrations and social dislocations. The crisis-affected economies have had a strong focus on export-oriented growth, yet there was no clear program on how to push industries to higher levels of production (see, e.g., Jomo 1997; Jomo 2001; Jomo 2003), except perhaps in the case of South Korea (see, e.g., Amsden 1989). Crowding out effects have started to manifest today in the global exports market (especially in electronics), putting the sustainability of the old strategies to doubt. As pointed out by Krugman (1994), among others, intensive production can produce growth despite structural inefficiencies or defects, but it cannot go on forever.

Hence, trade management techniques can be used to administer production to facilitate industrial deepening and propel the economy to higher levels of industrialization. As such, sound industrial policies and planning are crucial. They need to be flexible also, to allow for adjustments as circumstances change. Still, trade management techniques have to be implemented in a way that allow for steady progressions from low to higher levels of industrialization. Production must also be progressively upgraded on the industrial ladder, gradually reducing reliance on imported inputs and capital goods, embarking on technological adaptations and introducing innovations, deliberately enhancing international competitiveness, etc. It needs to be pointed out, too, that a competitive exchange rate is important for efficient allocation of resources to support industrial

production. Similarly, countries need to strategize when entering into trade arrangements. Just like in the case of capital, the burden of proof is to demonstrate that the purported gains of free trade not only materialize and exceed the costs, but more importantly, the gains from trade accrue to the domestic residents. As long as the modes of interventions and the conditions under which industrial-facilitation are clear, trade management techniques contribute to raise average economic welfares. In a similar fashion, it would be a tragedy if the uneasiness with strategic domestic interventions resulted in a situation wherein economies end up closing their borders to trade or introducing protectionist policies, thereby adversely affecting global economic performance.

On the Role of Governments

The way reforms have been executed created opportunities that undermined economies in the end. As this situation continued, it became difficult to direct, say, investments into productive domestic endeavors that support industrialization, enlarge aggregate outputs, and create more jobs. Capital flows became increasingly short-term and/or going into speculative and non-productive domestic activities that fueled financial and asset bubbles, encouraged risky investments, and contributed to produce the Asian Crisis. The costs were large when the Crisis erupted. It needs to be stressed that even when the indicators suggested robust performances were to be maintained, the increasingly large amounts of capital flows generated complacency, raised risks, and enlarged the imbalances. Some of the inflows ended up as unrecorded transactions as large volumes could not be absorbed by the domestic economy and they too became difficult to control. Governments backed up the situation with guarantees, consequently encouraging more risky, unproductive, and unrecorded activities. Governments concluded that withdrawing from active management of the economy was on the right direction: the least they intervened, the more correct the policies were.

There is a need to rethink the direction of policies if governments in the crisis-affected economies want to remain relevant, to rethink active economic management and sound execution of reforms. Beja (2007b), for example, argued that unsuccessful governments face larger pressures to remove themselves from further participation in the economy. In turn, the governments become weaker, more ineffective, or worse, become failures.[9] Weak governments find it hard to regain the stabilities of their economies or secure basic needs of their peoples. Weakening governments in turn find it increasingly difficult to maintain the same level of effectiveness they once enjoyed. Governments that allow external forces to undermine their autonomy and capacities find that they degenerate quickly. In the end, years of economic progress are wiped out overnight. Governments that casually wait for the market or events to unfold to produce for them the stabilities and securities they needed 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. Thus, they are responsible for the injustices and miseries that their peoples experience. As the Asian Crisis and its fallout illustrated, the governments of the crisis-affected economies had difficulty in guaranteeing the securities of their people and societies.

Of course, the issues that continue to trouble developing countries, such as unsustainable current account deficits, unsound fiscal deficits, spiraling prices, uncompetitive foreign exchange rates, unattractive interest rates, unfavorable environments for investments, among others, remain important and must beaddressed. These issues continue to challenge the crisis-affected economies today, as they try to find the right mix of policies to realize dynamic growth. Accompanying the concerns on macro-organizational fundamentals are issues like institutional capacities to negotiate internal and external challenges to policy-making and to economic growth, sound implementation of programs, to list some items. In the context where privatization, deregulation, and financial liberalization have been introduced, it is imperative that governments introduce the compensating measures to catch up with changing contexts to remain effective, ease adaptation, facilitate smooth adjustments, and secure and stabilize economies.

Strong governments mean effective governance, in which governments are at the center of economic management and policy-making. They effectively respond to domestic challenges. They see the challenges and act on them in a timely manner to avoid any economic derailment. Strong governments negotiate ingeniously the external demands imposed by globalization. They facilitate cooperative relations with the private sector and civil society rather than obstruct broad-based initiatives. They plan for the long-term rather than immediate political gains. They also pace the progress of reforms such that adequate regulatory institutions and supervisory mechanisms are in place. They ensure to put in place clear rules for capital and trade management with the domestic economy interest in mind. In short, governments that maintain their autonomy and continuously improve capacities to the changing conditions are strong governments that in the end succeed in steering economies to higher growth trajectories and raising the average economic welfare of the people.

To an extent, therefore, it is important to challenge the governments of the crisis-affected economies to take decisive actions to stabilize economies and secure their peoples. Government interventions are thus not only expected but must also be demanded. It is important for strong governments to consider legitimate social concerns, such as aspirations for balanced and healthy economies, peaceful societies, clean environments, and so on. It is also important to rethink how reforms had been done in the past, the costs of misguided policies and wrong implementation, the consequences of lost autonomies and capacities. Likewise, it is important to rethink pro-active

engagements that lead to the identification of the legitimate alternatives.

On international Cooperation

The above points are some of the institutional underpinnings to create a strong domestic economy. It follows that the international community must contribute to create the institutional underpinnings for a strong external economy. Efforts that enhance transparency of international flows, mechanisms to monitor the regional dimensions of vulnerabilities, and so on, are on the right direction. At the global level, there is a need to foster international economic cooperation. The Asian Crisis clearly illustrated how a shock in one country can snowball into a serious crisis in the region and elsewhere if no solid cooperation to address the problem happens right away. When there are large unrecorded transactions, funds move from developing countries to haven locations elsewhere, and the latter in a way benefit from the misery of the former. Recipients of the unrecorded transactions must take steps to redress the situation starting with their institutional policies that attract such flows. The increased trade across countries – even intra-regional trade – means that global production are increasingly becoming interconnected and this has important implications on domestic performances. An export slump, for instance, can translate into reduced economic performances in developing countries.

The international community must work to design the international rules of the game, including the mechanisms for engagements to reduce uncertainties, to create a stable international economy and secure international polity. The international community must take up responsibility in regulating activities within their domestic economies to avert unfavorable developments. They also need to coordinate economic policies so that international flows do not again cause havoc elsewhere. In the event of a crisis, the international community needs take up the challenge to forge quick resolutions, working on rescue, recovery, and rehabilitation in the affected countries. Quick action is important to avert the crisis from transforming into a more virulent form like what happened in the case of the Asian Crisis. Quick response is likewise expected in order that the lost opportunities are minimized.

6. CONCLUSION

This paper presents a review of the economic performances of Indonesia, Malaysia, Philippines, South Korea, and Thailand in the decade following the 1997 Asian Crisis, and showed that these crisis-affected economies have been performing unsatisfactory relative to their previous decade's performances. The full recovery from the Asian Crisis requires long-term dynamic performances to compensate for the lost opportunities in 1997, perhaps an annual GDP per capita growth of at least 6 per cent. If economic growth mellowed down to supposedly pragmatic levels, it would be difficult to recoup the losses. Downgrading the economic growth targets in economic plans to

conform to the projections announced by international institutions and rating agencies is unwarranted given sufficient capacities for robust expansions. Such aversion to rapid growth is symptomatic of callousness to the unsatisfactory circumstances of the majority.

The paper also presented results that as of 2007 the crisis-affected economies have not recouped the losses produced by the Crisis. While these economies have already exceeded their 1996 GDP per capita, they have done so only after some years of significant lost opportunities. For 2007, the projected total social cost for Indonesia is US$ 95 billion (41 per cent of GDP) or a per capita social burden of US$ 418. Malaysia is still 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. And Thailand is overloaded with US$ 95 billion (55 per cent of GDP) or a per capital social cost of US$ 1,444.

Finally, the paper invited decisive policy actions from each of the governments of the crisis-affected economies to realize dynamic performances and recoup the costs. These actions need to ensure economic stabilities and preserve political securities. While reforms have already been introduced in the post-Crisis period, challenges remain and new issues arise on how to raise economic growth to levels that characterized the Asian miracle economies performances prior to the Crisis, addressing the regulatory and supervisory constraints to secure the domestic economy, allowing for meaningful changes in the international financial architecture to secure the external economy, to name a few. It is important to put in the missing instruments for the present context while maintaining the useful components of the past arrangements. Accordingly, together with the dynamic growth and sound government interventions for positive structural transformations in the domestic economy, the complementary actions of capital and trade management techniques, the corresponding international cooperation and policy coordination, and improvements in the rules of the game to construct a balance between the domestic and external economies that generate broad-based economic outcomes.

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Figure 1: GDP per Capita (in 2000 prices), Normalized at 1996 = 100

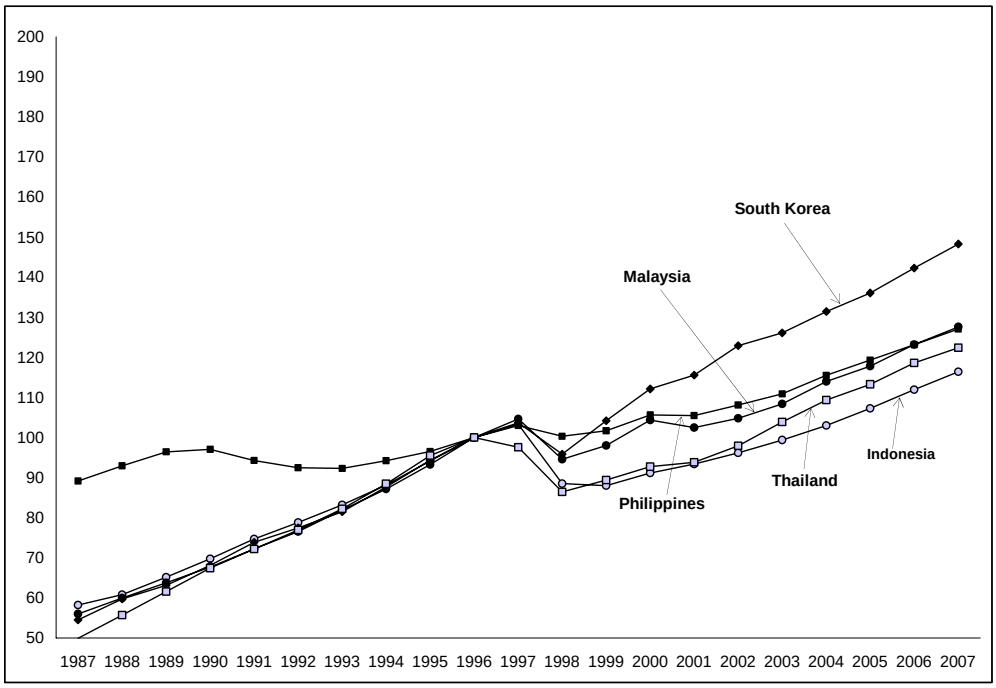


Figure 2: GDP per Capita (in 2000 prices), Rotated at 1996 = 100

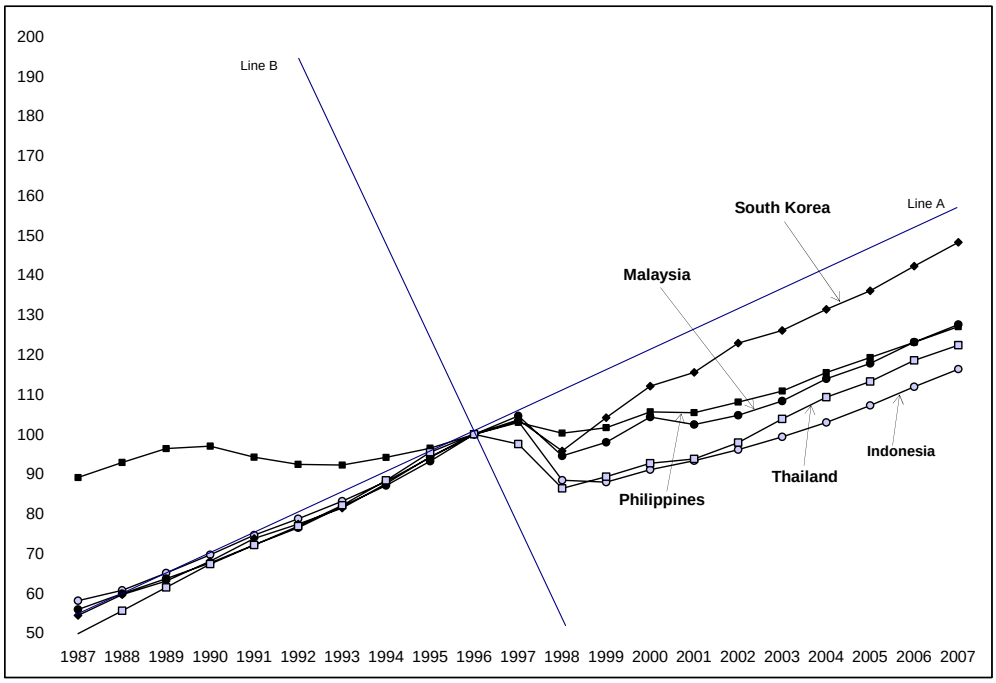


Figure 3a: GDP per capita and Counterfactual, Indonesia (in 2000 prices)

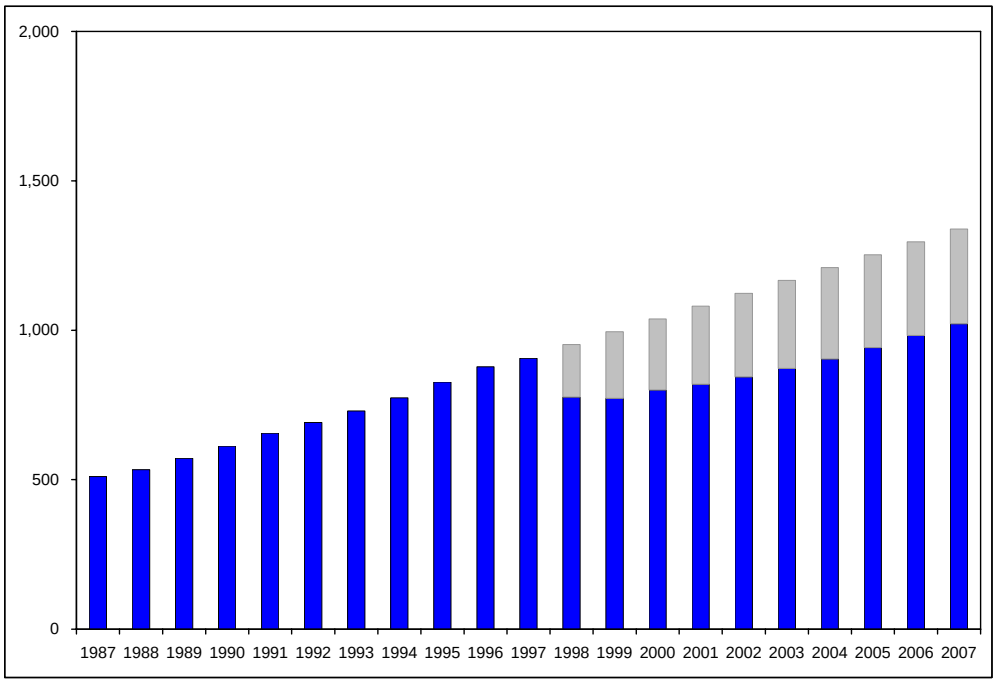


Figure 3b: Costs per capita, Indonesia (in 2000 prices)

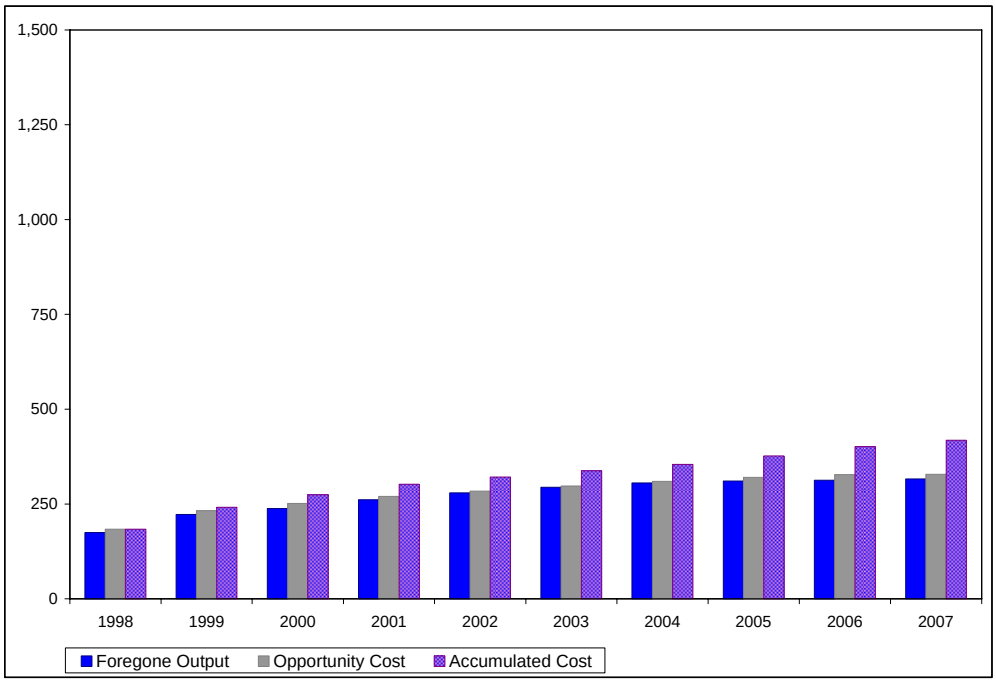


Figure 4a: GDP per capita and Counterfactual, Malaysia (in 2000 prices)

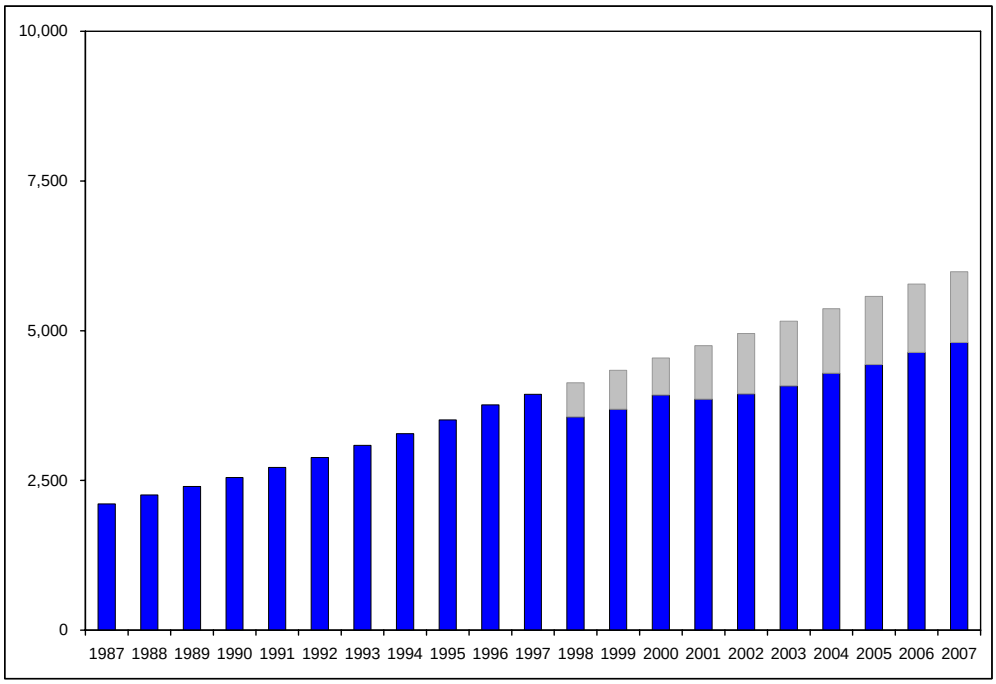


Figure 4b: Costs per capita, Malaysia (in 2000 prices)

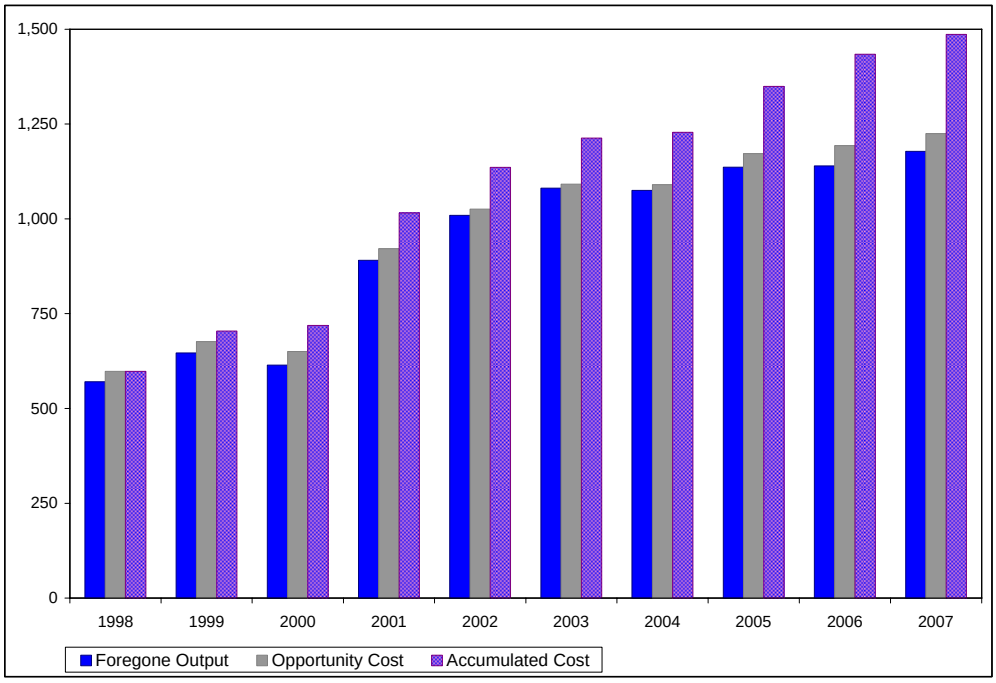


Figure 5a: GDP per capita and Counterfactual, Philippines (in 2000 prices)

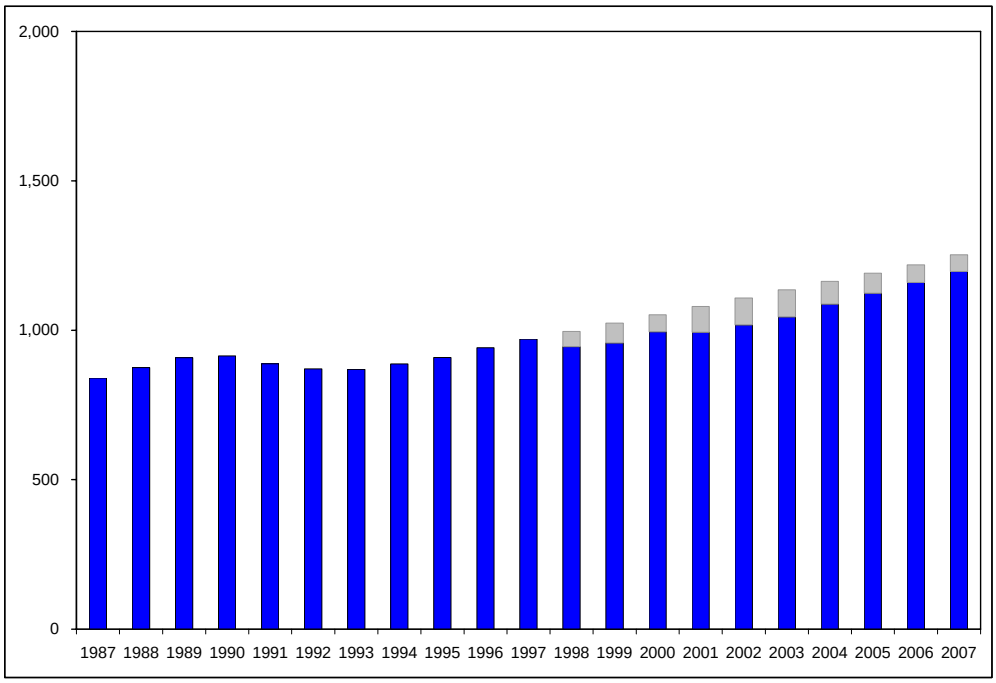


Figure 5b: Costs per capita, Philippines (in 2000 prices)

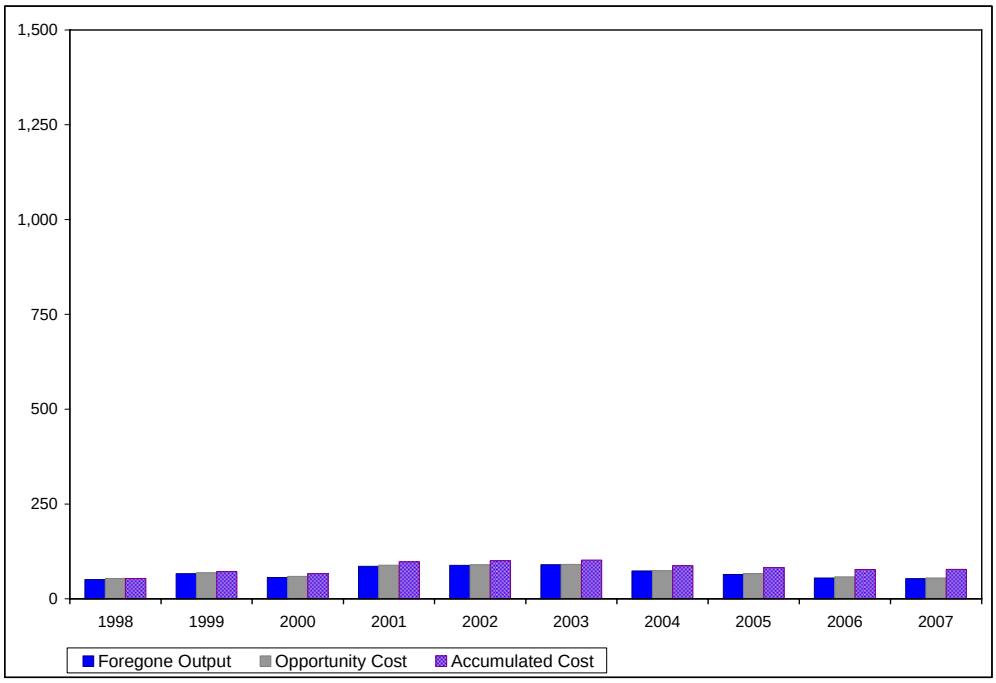


Figure 6a: GDP per capita and Counterfactual, South Korea (in 2000 prices)

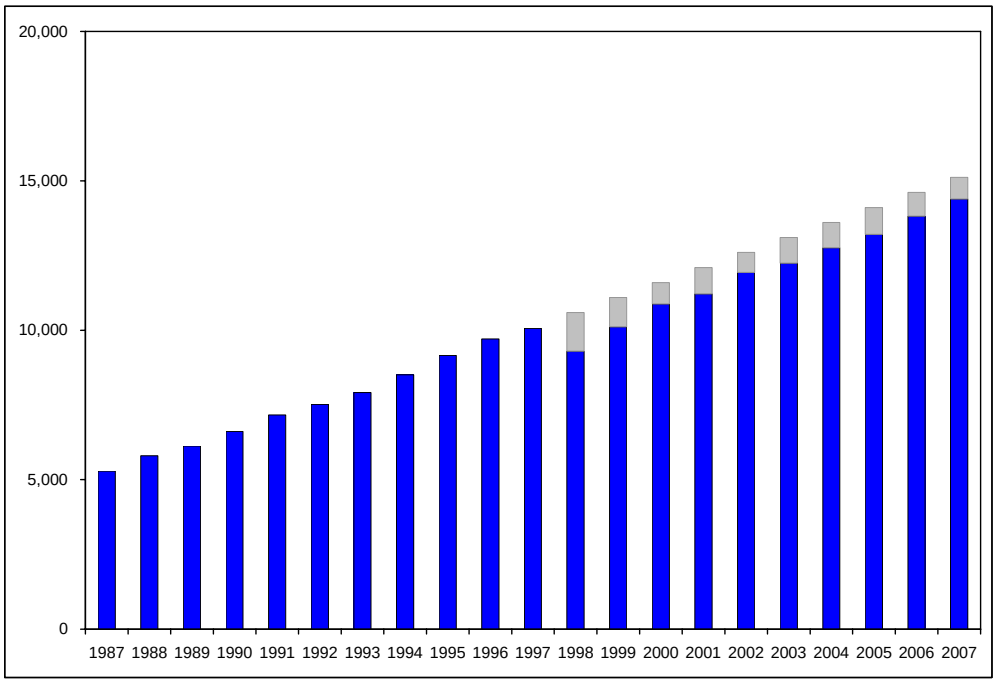


Figure 6b: Costs per capita, South Korea (in 2000 prices)

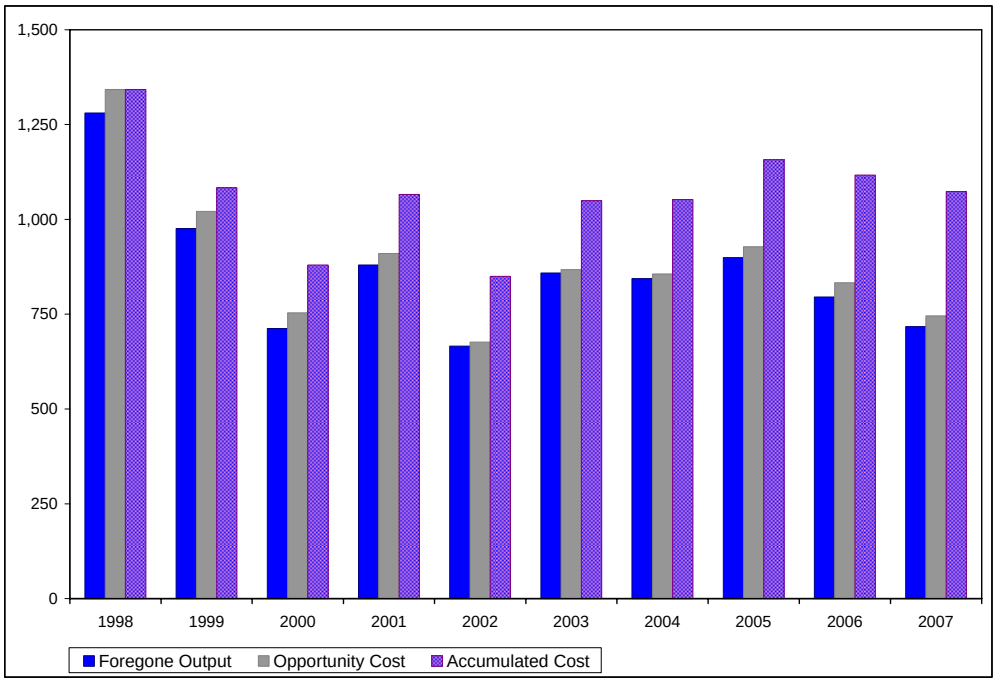


Figure 7a: GDP per capita and Counterfactual, Thailand (in 2000 prices)

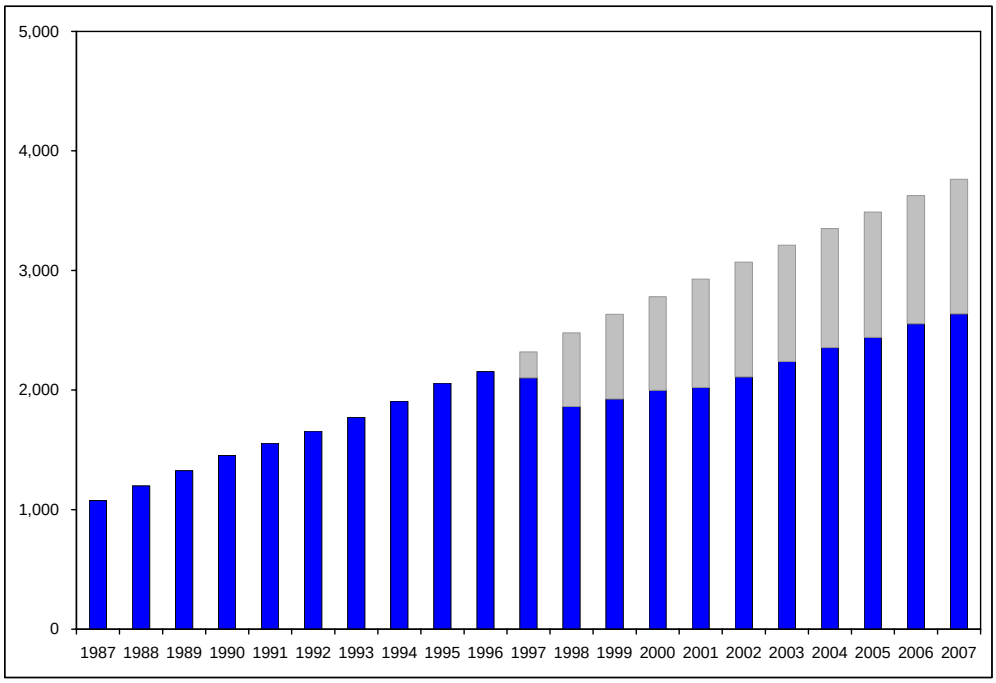
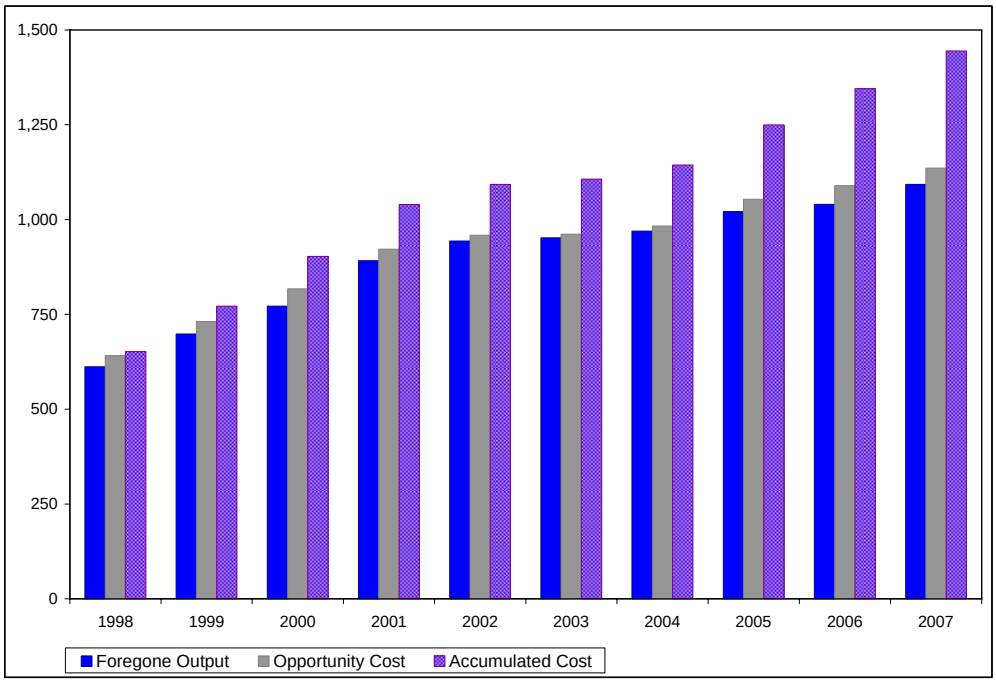


Figure 7b: Costs per capita, Thailand (in 2000 prices)



APPENDIX

Table 1: Total Accounting Costs (in US$ Millions, 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 (in US$ Millions, 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 (in US$ Millions, 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] The oil price shocks of the 1970s, the Latin American debt crisis and the commodities prices slump and oil price crash in the 1980s, European financial debacle of the early 1990s, the reverse Plaza Accord in 1995, among others, brought economic problems to Asia. In the post-World War II period, the region as a whole did not experience a similar drastic economic contraction like that produced by the 1997 Asian Crisis. Bhagwati (2002) even argues that the Crisis was the worst man-made economic crisis the global economy had faced since the 1930s.

[2] Thailand and Indonesia signed a US$ 17.2 billion rescue package in August and US$ 23 billion in October, respectively, while the Philippines had stand-by package.

[3] See Craft (1999), Barro (2001), Cerra and Saxena (2003; 2005), Hutchison and Noy (2005).

[4] Parts of Sections 3 and 4 have appeared in Beja (2007a).

[5] Beja (2007b) presents counterfactual calculations in which the Philippines had reached economic performances comparable to Indonesia, Malaysia, and Thailand.

[6] During the early/mid-1980s, the governments of Indonesia, Malaysia, South Korea, and Thailand embarked on economic reforms and adjustments to produce dynamic 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. Moreover, the economic history of the Philippines points to the fact that the deterioration of governance and capacities started much earlier, in the 1970s. It is still interesting to note that in the 1950s and 1960s, the country 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. In fact, 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.

[7] Knowles, Pernia, and Racelis (1999); Robison, Beeson, Jayasuriya, and Kim (2000); Chang, Palma, and Whittaker (2001); and Chu and Hill (2001) are earlier discussions on the costs of the Crisis. As expected, the earlier studies presented preliminary estimates because of the difficulty in filtering out the dramatic changes that were unfolding in the late 1990s or still apparent in the early 2000s.

[8] The (further) reduced form of $y_t = \alpha + \beta \text{ time} + e_t$ is also estimated. The geometric mean of the two sets of results are obtained and used as the estimate of the counterfactual performances. The geometric mean ensures that the trend has zero as the lower-bound rate of growth.

[9] Chang (1999) highlighted that a relentless attack against government interventions has occurred since the 1970s, attacking the notion that the government can have a positive role in the economy, among others.