Chapter Two

ASIA’S ECONOMIC TURMOIL AND THE VARIED RECORD OF RECOVERY

THE “CRISIS” COUNTRIES: KOREA, THAILAND, MALAYSIA, AND INDONESIA

The East Asian economic crisis, triggered by the collapse of the Thai baht in July 1997, is essentially over, as is the generalized fear of more severe global financial repercussions from it. Postmortem controversy continues in financial and academic circles over the extent to which the original crisis was due to the operation of “free” global markets, or instead to distortions created in these markets by mistaken policies and the lack of legal and financial institutions to redress them. Those who advocate the former of these two positions place primary responsibility for the original crisis on such phenomena as the sometimes “irrational exuberance” of markets and their susceptibility to “overshooting,” and to the malady of “contagion.” Those who identify with the second position—that bad policies rather than free markets are to blame—place primary emphasis on excessive short-term lending, pegged exchange rates, and the “moral hazards” created by a tacit belief that governments or multilateral agencies will provide a safety net if circumstances sour. This controversy is not likely to be resolved in the near future.

In any event, the earlier sense of economic crisis has been replaced by a situation characterized by widely differing economic performance among the East Asian countries and correspondingly differing problems and prospects. A brief overview of this situation requires distinguishing between four quite different sets of countries and economic circumstances: namely, the mid-1997 “crisis” countries (Korea,
Thailand, Indonesia, and Malaysia), Japan, China, and the smaller, less affected and more resilient economies (Taiwan, Singapore, and Hong Kong).

In the crisis countries between mid-1997 and the end of 1998, the combined effects of currency depreciation and deflated property and equity markets caused asset values to plummet by about 75 percent. An approximate averaging over all of the four Asian crisis economies and currencies indicates that, as a general order of magnitude, an asset in these countries worth $100 in June of 1997 was worth only $25 a year later.

One way of measuring the depth of Asia’s economic turmoil is to compare it with historic market crashes in the United States. In the period from 1929 to 1932, the Standard & Poor’s Index decreased by about 87 percent, in 1962 by about 28 percent, and in 1987 by about 34 percent.

By the middle of 1999 (the time of this writing), Korea and Thailand were no longer in crisis, although they had not completed the recovery and restructuring process. Both countries had reversed the negative GDP growth of the two preceding years and realized positive economic growth. Their current accounts were in surplus, foreign exchange reserves increased, and foreign direct investment resumed—substantially in Korea and modestly in Thailand. In Indonesia and Malaysia, progress was discernible, but more limited than in Korea and Thailand. Currency and other asset values rose substantially in Malaysia (at least temporarily buoyed by capital controls). Indonesia’s economic prospects were deeply mired in the country’s political uncertainties, although there was a modest resumption of foreign direct investment.

In sum, while the record thus far and prospects of continued recovery are stronger in Korea and Thailand than in Malaysia and Indonesia, in general, the region’s crisis is behind it. Moreover, while recovery in the four crisis countries was previously thought to depend on Japan’s recovery, their recovery is well ahead of that of Japan. Our forecasts for Korea and Indonesia, summarized in Chapters Three and Four, reflect this judgment.
JAPAN

The serious economic problems besetting Japan predate and transcend the mid-1997 financial crisis elsewhere in East Asia; indeed, Japan’s economic problems have been only marginally affected by that crisis. As will be discussed more fully in succeeding chapters, Japan’s economic problems are structural rather than cyclical. They are reflected by an annualized GDP growth rate in the 1990s of about 1 percent, compared with a growth rate in the 1980s nearly four times larger.

Nevertheless, Japan maintains a high level of per-capita GDP—between $43,000 and $23,000 currently—depending, respectively, on whether nominal or real purchasing-power-parity rates are used to convert Japanese yen into U.S. dollars. Also, Japan maintains the largest current account surplus (estimated at more than $120 billion in 1999), and the largest foreign exchange reserves (over $225 billion) of any economy in the world.

Japan’s efforts to reform and restructure its economy will be assessed more fully later in this report. That assessment is reflected in the forecasts for the Japanese economy summarized in Chapters Three and Four. In effect, the high per-capita GDP and large foreign exchange reserves provide a form of protection and insulation for Japan that enables it to pursue a very gradual—some might even say leisurely—pace of economic reform, and to avoid the painful restructuring that would be necessary to enhance the economy’s performance.

CHINA

China, like Japan, has thus far been only marginally affected by the financial crisis elsewhere in Asia. Nevertheless, the economic picture presented by China is mixed and decidedly different from the situations prevailing elsewhere in Asia.

On the positive side, and despite a wide range of sometimes fuzzy statistics, China maintains a high rate of GDP growth—probably less than its reported rate of 7 to 7.8 percent, but probably in the range of 5 to 6 percent per annum. Also on the positive side, China’s current account is substantially in surplus (nearly $30 billion in the most re-
cent 12-month period), and the foreign direct investment (FDI) it receives from abroad (an annual rate of $30–35 billion) is the largest among the emerging market countries. Even though exports and FDI are below peak levels, they remain large and strong. China’s foreign exchange reserves, at over $150 billion, are second only to those of Japan among the world’s economies. Another positive indication for China’s future is the largely completed “buy out” by the government of the Chinese Army’s commercial enterprises with a view toward their early privatization.

Yet, China also displays a nearly equal array of negative indicators, including its thousands of inefficient and loss-incurring state-owned enterprises (SOEs) whose continuing deficits impose an enormous burden on the banking system that finances their deficits. As a result, the Chinese economy is riven by a pervasive misallocation of credit between the favored but nonperforming state sector and the disfavored-but-generally-more-efficient nonstate sector. The government’s overarching fear of increased urban unemployment and possible social unrest impedes the pace and prospects for reform of the SOEs.

TAIWAN, SINGAPORE, HONG KONG

Finally, the smaller and more resilient economies of Taiwan, Singapore, and Hong Kong provide still another part of the East Asian mosaic, differing from the rest of the region as well as displaying differences among themselves.

Each of these cases is different—for example, Taiwan and Singapore have maintained a flexible exchange rate system, while Hong Kong has a fixed-peg currency board. Since the mid-1997 crisis in East Asia, Hong Kong’s asset bubble in property and equity markets has popped, which in turn has resulted in negative growth for the economy as a whole. Singapore and Taiwan have been less affected, and both maintained or resumed positive growth rates by the middle of 1999, while Hong Kong showed distinct signs of moving in this direction.