East Asia’s recovery in 1999 and 2000 has been no less dramatic, though much less publicized, than its deep economic reversals in 1997 and 1998.

Triggered by the collapse of Thailand’s baht in July 1997, four economies that had high positive GDP growth in 1996 experienced negative growth between 5 percent and 12 percent in 1997 and 1998. Asset values in these “crisis” countries—Thailand, Korea, Malaysia, and Indonesia—plummeted by about 75 percent due to the combined effects of currency depreciation and deflated equity and property valuations. Averaging over the four economies, an asset worth $100 in June of 1997 was worth only $25 a year later.

To place these reversals in historic context, recall that the U.S. financial shocks of 1929–1932, 1962, and 1987 witnessed declines in the Standard and Poor’s index of 87 percent, 28 percent, and 34 percent respectively.

By the second quarter of 2000, the turnaround of the East Asian economies has been extraordinary. Korea, Thailand, and Malaysia currently have growth rates equal to or above those of 1996. Indonesia’s growth—about 5 percent at an annual rate—is surprisingly high as well as profoundly shaky because of myriad problems and uncertainties which bedevil it: civil and military unrest in Timor, Atjeh, and

A slightly edited version was published in The Weekly Standard on June 5, 2000 under the same title.
Ambon, and the continuingly ambiguous position of Indonesia’s military establishment.

Other indicators of the recovery’s strength abound. Capital inflows have resumed, mainly in the form of direct investment, rather than debt. Korea, for example, which was almost closed to foreign direct investment prior to the turmoil of 1997, received $15.5 billion FDI in 1999, five times the level in 1996. The current accounts of the four economies are now positive, their foreign exchange reserves are above those held in 1996 (except for Indonesia), and their currencies, whose exchange rates are now flexible rather than artificially pegged, have regained 50 percent or more of their pre-crisis values.

The abundant evidence of recovery is all the more impressive because the Japanese economy—long viewed by much of the conventional unwisdom in the U.S. and the International Monetary Fund as the essential engine for East Asia’s recovery—continues to stagnate.

Asia’s other major economy, China, continues to register significant growth, although beset by problems which are largely independent of the 1997–1998 crises.

Although the East Asian economic picture is roseate, this doesn’t mean that there are not serious soft spots, nor that business cycles have been repealed. Indonesia’s serious as well as still unfolding problems have already been mentioned. Korea’s large and amorphous chaebols still require reform, as well as explicit non-preference in their access to credit or other benefactions. Nevertheless, the upward trajectory of the Asian economies is likely to endure because of five lessons—four tactical and one strategic—which appear to have been learned from the debacles of 1997–1998:

- First, as a form of foreign capital inflow, direct investment is far preferable to debt.
- Second, when foreign borrowing is resorted to, the repayment period should not be shorter than the yield from the uses to which loans are put (don’t borrow short and lend long—a pervasive practice leading to the 1997 crisis).
- Third, don’t borrow in foreign (“hard”) currency and then re-lend or invest for purposes whose yields do not generate foreign
currency (at least, don’t engage in this practice without ample foreign exchange reserves).

• Fourth, don’t peg domestic currency to the U.S. dollar (unless fiscal and monetary policies and institutions are strong enough to support the peg).

Finally, in charting development strategy, eschew what used to be referred to as the “Japan development model,” which predicated resource allocations not on the basis of market criteria of costs and returns, but instead on non-market based preferment for particular firms or industries.

Postaudit

This is an abbreviated version of the same story as presented in the previous chapter, so my assessment of it is also the same.