

3.7 The Nepotism Between Politicians and Enterprises

In many East Asian countries, very close relationships exist between politicians and enterprises. Engaging in this sort of nepotism provides the enterprises in question with substantial preferential treatment being offered by the government. In concrete terms, the enterprises may be provided with mortgage-free loans from the state-owned financial institutions at preferential interest rates. If the enterprises fail in their investment of these funds, and fall into financial difficulties, the relevant institutions would inevitably find themselves becoming part of the subsequent financial crisis.

These arguments seem plausible, but they cannot provide the whole picture of the Asian financial crisis, either completely or systematically. In some sense, they seem to be consistent with an old Chinese saying, “the blind who touches an elephant”, meaning that their impression of the financial crisis is merely partial, incomplete. Nevertheless, no one explanation can provide the answers to the underlying causes of the financial crisis in East Asia.

4. THE IMPACTS OF THE FINANCIAL CRISIS IN EAST ASIA

4.1 The Initial Impacts of the Financial Crisis on Financial Markets

There are two important indicators, which reflect the initial impacts of the financial crisis on East Asian economies during the period June 30, 1997 to December 31, 1997. One is the change in exchange rates and the other the change in stock prices. Table 1.1 shows that among the ten countries, Thailand, Indonesia, Malaysia, the Philippines, Singapore, Hong Kong, China, Taiwan, Korea and Japan, the worst reactions in each of these indicators were demonstrated by just four of them, Indonesia, Korea, Thailand and Malaysia. In terms of depreciation of currency against the U.S. dollar, in Indonesia the depreciation was 52.3%, in Korea 47.8%, in Thailand 46.1%, in Malaysia 34.9%, and in the Philippines 34.3%. Regarding the change in

stock prices, Korea dropped by 49.5%, Malaysia by 44.8%, Indonesia by 44.6%, the Philippines by 33.5% and Thailand by 29.3%.

Since the Hong Kong currency was linked to the U.S. dollar, there was no significant change in its exchange rate, but stock prices there dropped by 29.4%. In China, the RMB was purposely unchanged while the stock prices dropped by 4.4%, the lowest movement amongst the ten countries affected. The Japanese Yen depreciated by 12%, while its stock prices declined by 25.9%. Taiwan was not affected as dramatically from the impact of the crisis during 1997; the Taiwan currency depreciated by 14.8%, and stock prices dropped by 9.3%. In Singapore, the currency depreciation was 14.7%, and its stock prices dropped by 23%. Comparatively speaking, China, Hong Kong, Taiwan, Singapore and Japan suffered least from the financial crisis, whilst Indonesia, Korea, Thailand, Malaysia and the Philippines suffered significantly more during the initial stage of the financial crisis.

Table 1.1 Impacts of the Crisis on Financial Markets

(1) On Exchange Rates

Country	Initial Level		Rate of Change in Exchange Rate (currency units / US\$1) Unit %		
	June 30, 1997 (currency unit/ US\$1)	Dec 31, 1997 / June 30, 1997	June 30, 1998 / June 30, 1997	June 30, 1999 / June 30, 1997	Jan 5, 2000 / June 30, 1997
Taiwan	27.81	-14.8	-19.0	-13.9	-9.41
Hong Kong	7.75	0.0	0.0	-0.1	-0.38
Singapore	1.43	-14.7	-15.4	-15.9	-13.86
Korea	888.00	-47.8	-35.3	-23.3	-21.76
Thailand	24.70	-46.1	-38.7	-29.9	-33.60
Malaysia	2.52	-34.9	-39.0	-33.7	-35.68
Indonesia	2,432.00	-52.3	-83.6	-64.6	-66.21
Philippines	26.38	-34.3	-37.3	-30.6	-34.38
China	8.28	0.0	0.0	0.2	0.00
Japan	114.6	-12.0	-18.3	-5.5	-24.60

(2) On Stock Prices

Country	Initial Level	Rate or Change in Stock Prices (Index)%			
	June 30, 1997 level/index	Dec 31, 1997 / June 30, 1997	June 30, 1998 / June 30, 1997	June 30, 1999 / June 30, 1997	Jan 5, 2000 / June 30, 1997
Taiwan	9030.28	-9.3	-16.4	-6.2	-2.0
Hong Kong	15196.79	-29.4	-43.8	11.0	4.2
Singapore	1987.96	-23.0	-46.3	9.1	20.2
Korea	745.4	-49.5	-60.0	18.5	32.3
Thailand	527.28	-29.3	-49.3	-1.06	17.7
Malaysia	1077.30	-44.8	-57.7	-24.7	-24.3
Indonesia	724.56	-44.6	-38.5	-8.6	-6.5
Philippines	2809.21	-33.5	-40.9	1.4	-26.2
China	1306.78	-4.4	-25.5	-4.6	14.6
Japan	20604.96	-25.9	-23.2	-14.9	-10.1

Note: Negative signs of exchange rate indicate depreciation.

Currency: Taiwan - NT\$; Hong Kong - HK\$; Singapore - S\$; Korea - Won; Thailand - Baht;
Malaysia - Ringgit; Indonesia - Rupiah; Philippines - Peso; China - Renminbi (RMB);
Japan - Yen.

Sources: Datastream and the Economist.

4.2 Impacts of the Crisis on Economic Activities***4.2.1 On economic growth***

The impacts of the financial crisis on economic growth can be seen from Tables 1.2 and 1.3. In 1996, prior to the outbreak of the financial crisis, all ten of these East Asian countries performed well. Even the countries which were most affected by the subsequent financial crisis were demonstrating extremely high growth, for instance, Indonesia's growth rate was 8.0%, in Korea it was 7.1%, in Thailand, 6.7%, and in Malaysia, 8.2%. The initial impact on growth in 1997 was not serious. In comparison to the 1996 figures, there was a definite decline, but only Thailand had a negative growth rate of -0.4%. The remaining countries still managed to maintain positive growth rates. In Indonesia, the growth rate was 4.7%, in Korea 5.5%, and in Malaysia 7.8%.

Table 1.2 Main Economic Indicators of East Asia

(Unit: %)

	Economic Growth Rate				Industrial Growth Rate			Inflation Rate			Unemployment Rate		
	1996	1997	1998	1999	1997	1998	1999	1997	1998	1999	1997	1998	1999
Taiwan	5.7	6.8	4.8	5.5	7.0	3.8	10.9(Dec)	0.9	1.7	0.1	2.7	2.7	3.1(Nov)
Hong Kong	5.0	5.3	-5.1	1.7	-0.8	-8.6	-6.3(Q3)	5.7	2.6	-3.3	2.2	4.6	6.1(Nov)
Singapore	7.0	7.8	1.5	5.5	4.3	-0.5	7.0(Dec)	2.0	-0.3	0.4	1.8	3.2	3.7(Sep)
Korea	7.1	5.5	-6.8	9.2	7.7	-7.1	24.1(Dec)	4.5	7.5	0.8	2.6	6.8	6.4
Thailand	6.7	-0.4	-8.0	4.2	-0.7	-10.0	15.3(Dec)	5.6	8.1	0.3	3.5	5.3	5.6(May)
Malaysia	8.2	7.8	-6.7	4.9	10.7	-11.2	23.1(Nov)	2.6	5.3	2.1	2.5	3.9	1.3(Jun)
Indonesia	8.0	4.7	-13.7	-0.1	13.1	-.-	20.2(Q2)	10.0	77.6	28.4	4.7	5.5	6.4(Feb)
Philippines	6.8	5.8	-0.5	3.0	5.2	-0.5	-11.7(Nov)	5.1	9.7	7.3	8.7	10.05	9.4(Oct)
China	9.5	8.8	7.8	7.2	10.9	8.8	8.8(Dec)	0.8	-2.6	-0.9	3.1	3.1	-.-
Japan	3.5	0.9	-2.8	0.6	1.2	-7.1	5.1(Dec)	2.0	0.2	-0.3	3.4	4.1	4.6(Dec)

Note: Economic growth rate in 1999 is estimated; inflation rate is the rate of change in consumer price index.

Source: The Council for Economic Planning and Development, International Economic Situation Weekly, April 15, 1999, and July 8, 1999.

Although the financial crisis had taken place in 1997, the most serious impact on economic growth throughout the region was not felt until 1998, when most of the East Asian countries experienced negative growth. Korea, for example, dropped by 6.8%, Thailand by 8%, Indonesia by 13.7%, Malaysia by 6.7%, Hong Kong by 5.1%, the Philippines by 0.5%, and Japan by 2.8%; only Taiwan, China, and Singapore maintained positive growth rates. Obviously, almost all the East Asian countries were plunged into serious recession in their economic activities.

4.2.2 *On exports*

Prior to the financial crisis, all ten of the East Asian countries had high growth in terms of exports, although in comparison to 1995, export growth rates showed a general tendency towards decline in 1996. Of the average export growth rates, in 1996, only Thailand's export growth rate was higher than its recent average growth rate throughout the whole period (1994-1996). In 1997, the growth rates of the four dragons' exports were higher than in 1996, while the growth rates of the four tigers' exports, with the

Table 1.3 Main Economic Indicators of East Asia

	Growth Rate (Real GDP), %		Trade Balance US\$ bill (Dec)		Foreign Exchange Reserves US\$ bill (Dec)		Growth Rate of Exports (%)	
	1998	1999	1998	1999	1998	1999	1998	1999
Taiwan	4.8	5.4	5.9	11.0	90.3	103.5(Nov)	-9.4	-.
Hong Kong	-5.1	1.5	-10.59	-5.6	89.6	92.1(Nov)	-7.4	-1.2
Singapore	1.5	5.5	8.4	3.6	74.6	75.1(Oct)	-12.1	0.7
Korea	-6.8	9.2	40.3	24.8	52.0	69.6(Nov)	-2.8	9.0
Thailand	-8.6	4.2	12.1	8.9	28.8	32.1(Nov)	-5.1	6.7
Malaysia	-6.7	4.9	13.9	18.5(Nov)	25.6	29.8(Nov)	-6.9	12.6
Indonesia	-13.7	0.5	21.4	24.0(Nov)	22.7	26.2(Aug)	-8.3	-3.1
Philippines	-0.5	3.0	-0.2	4.5(Nov)	9.2	12.7(Sep)	16.9	18.9
China	7.8	7.2	45.0	29.1	145.2	156.0(Oct)	-.	-.
Japan	-2.8	0.7	107.39	98.37	215.5	272.0(Nov)	-7.8	-.

Source: The Economist (Jan 1999 – Jan 2000).

exception of Indonesia, were much lower than in 1996. China's export growth rate in 1997 was higher than in 1996. Export growth rate in Japan declined by 8.7% in 1996, further declining in 1997 by 0.1%.

It was not until 1998 that the greatest impact of the financial crisis was experienced. Among the ten East Asian countries, only China and the Philippines maintained positive growth in exports and all the remaining countries had negative export growth rates, implying that the currency depreciations in East Asia during 1997 were not helpful in improving the balance of trade within these countries. Accordingly, the argument follows that although the depreciation of a country's currency is a necessary condition for the increase in its exports, it is not a sufficient condition.⁴

Table 1.4 The Impact of the Financial Crisis on Exports

	(Unit %)							
Country	1994	1995	1996	1990~1993	1994~1996	1997	1998	1999
Taiwan	9.4	20.0	3.8	9.2	10.1	5.3	-9.4	7.2
Hong Kong	11.9	14.8	4.0	15.6	10.2	4.2	-7.4	-1.2
Singapore	30.8	22.2	2.9	17.8	16.8	3.4	-12.1	0.7
Korea	16.8	30.3	5.3	12.6	17.5	7.3	-2.8	9.0
Thailand	22.7	25.1	18.9	18.9	15.5	-1.3	-5.1	6.7
Malaysia	24.7	26.0	6.7	19.8	19.1	-7.2	-6.9	12.6
Indonesia	8.8	13.4	10.4	12.7	10.9	11.6	-8.3	-3.1
Philippines	19.9	31.6	17.5	14.8	23.0	12.2	4.7	18.9
China	33.1	22.9	17.9	19.4	24.6	20.9	0.7	10.0
Japan	9.7	11.6	-8.7	8.4	4.2	-0.1	-7.8	8.0

Note: Growth rate (US\$).

Sources: Ross H. McLeod and Ross Gamant (eds.), *East Asia in Crisis*, p. 23.

The Directorate-General of Budget, Accounting and Statistics, Executive Yuan, 1999.

⁴ In the second half of 1997, due to the effects of the financial crisis, all of the currencies of the East Asian countries, with the exception of China and Hong Kong, were greatly depreciated. Theoretically, this should have led to an increase in exports during 1998, and yet all of them saw a corresponding decrease in their exports, whilst their growth rates became negative.

Table 1.4 is also useful in verifying the fact that the depreciation of the RMB in 1994 did not harm the expansion of exports in Southeast Asia. In 1994 and 1995, all the East Asian countries had very high export growth rates. Only in 1996 did the export growth rates in all ten of the East Asian countries begin to show a decline.

4.2.3 On inflation and unemployment

Two sensitive economic indicators reflected the impact of the financial crisis. The inflation rate and the unemployment rate have risen. The former resulted from depreciation, while the latter was due to the sluggishness of the economies. Inflation rates have risen amongst two of the four dragons, Taiwan and Korea, while Hong Kong and Singapore have decreased their inflation rates. Since the Hong Kong dollar is linked to the U.S. dollar, it depreciated less, as did the Singapore dollar. The four tigers have different profiles because their currencies have been greatly depreciated, so all of them have a correspondingly high inflation rate.

Unemployment relates closely to economic recession, and as 1998 was the most serious year of the recession, with the exceptions of Taiwan and China, all the East Asian countries have seen an increase in their unemployment rates. These countries have also seen a reduction in industrial productivity and economic growth.

5. EXTERNAL DEBT AND FINANCIAL CRISIS

The relationship between external debt and economic growth is somewhat complicated. Whether external debt is good or bad for economic growth depends largely upon how we make use of it. For a developing country, usually lacking in capital, external debt plays a key role in the promotion of economic development and during the last thirty years, for example, many East Asian economies have benefited greatly from external debt. Conversely, many of the East Asian countries worst hit by the financial crisis were those