# ASIAN FINANCIAL CRISIS 1997: SPECIAL REFERENCE TO THE 4 ASIAN DRAGONS

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***Abstract:*** This paper focuses on the 1997 Asian Financial Crisis and the major factors causing the crisis, involving the role of the International Monetary Fund and main emphasis in done in the studying the impact on the 4 Asian Dragons. Some issues faced by the crisis, which are discussed, are still prevalent today in various economies in the world. The speculative attack on the Korean won, Hong Kong Dollar, Taiwan Dollar and Singapore Dollar. Increasing interest rates, market failures, the labor market in Taiwan, the issues the general public faced and corruption in the governments are discussed in this paper. Even though this crisis has been overcome and the affected economies have moved on, there are still some nations which are facing similar problems in their economy which would help them to use this as a base and reform their structures to benefit in the long run.

***IndexTerms*** **- Financial Crisis, Asian Dragons, IMF, speculative attack, reforms.**

## I. Introduction

The crisis was a global phenomenon engulfing most parts of South-East Asia and then the rest of the world beginning in July 1997. The crisis had its roots in Thailand; it was when the Thai baht was unpegged from the U.S. Dollar due to lack of foreign currency and slowly started to spread in other nations in the region as well. Indonesia, Thailand and South Korea were the most affected countries. The crisis caused the interest rates to rise by a maximum of 180% when the crisis was at its peak. It was the intervention of the IMF helping to stabilize the currencies and formulate new policies. The crisis happened at a period when Asia was the model of economic planning and development in the world and was a promising area for the investors to maximize their returns. This paper mainly focuses on the Four Asian Dragons (Taiwan, Hong Kong, Singapore, and South Korea) since these were and still are among the largest economies in the Pacific-Rim region.

## II. Literature Review

*The East Asian Economic Crisis: A Brief Overview of The Facts, The Issues And The Future* (Rosser, 1998)

The authors, Mark Beeson and Andrew Rosser in their paper analyze the facts and issues in the Asian Financial Crisis, plagued in the 1990s. Due to the crisis, major conglomerates defaulted on their loan payments, investors were withdrawing their investments, unemployment has risen and there has been a lot of political instability. It discusses the issues in South Korea, the company Hanbo Steel; the speculation of Thai baht, Indonesian rupiah depreciation, stock market crashes and involvement of the IMF. Currency rates of all countries within 1998 lost their value by almost 71%, the highest recorded in Indonesia, except in Hong Kong, which was stable. The external financing of these countries also fell to a greater extent, interest rates rose, people couldn't borrow money and there would be drainage of the economy. The general people were hit as well since the consumer confidence and spending substantially fell. One example stated is of Thailand, from 1997-1998, the car sales fell by 51%. Inflation rose, consumer prices changed drastically. It also discusses the implication on Australia, the AUD association with the East Asian region and its declining levels. Since the country majorly trades with East Asia, the crisis affected its Balance of Trade figures and the Australian deficit broke the record, pressuring its currency.

*Will Bank Bailouts Bust Budgets? Fiscalization of the East Asian Financial Crisis*(Rosengard, 2004)

This paper discusses the state of East Asia seven years after the crisis happened. Even though the region was back to normal financially and was stable, the long-run impact of the crisis wasn't clear in terms of fiscal issues. Recapitalization bonds were issued to finance the bank bailouts. The author mainly focuses on Thailand and Indonesia because these countries were hit the hardest in the region. Thailand before the crisis had the reputation of being as a model for other countries for sustainable development. It was among the world's fastest-growing economies in 1996. The issue the country was facing was weak tax administration and the lack of a consolidated budget reflecting the unfunded pension programs further increasing the burden. While Indonesia had a sound macroeconomic management and had rapid economic development and diversification. The critical issues present were large liabilities consisting of off-budget accounts, losses of various PSUs; even though both countries were economically stable and sound. Post-crisis, Thailand has maintained fiscal discipline in budget expenditures and stabilized the government debt. Following the same lines, Thailand too adopted prudent policies and made progress in managing its debt.

*The Asian Financial Crisis and ASEAN's Concept of Security* (RYU)

This research discusses that how the crisis affected and changed the ASEAN's concept and approach towards regional security. It transformed itself from being non-interfering to being more interactive allowing more intervention into the domestic affairs by member states. The paper discusses the events of the Asian Financial Crisis majorly the currency depreciation and the crashing of Asian stock markets; the Traditional concept of ASEAN's security, based on the principle of non-interference, being more consulting in solving regional problems to create stability around it. It was after the crisis that provoked the ASEAN to review its concept. It became more open and started to pay more attention towards the local issues and seeing economic problems as potential threats to stability. Since each nation independently tried to tackle the situation and sometimes led to more issues, the ASEAN decided to let go the policy of non-interference. It fostered a great sense of unity amongst the member countries. It further analyses the foundation of ASEAN and how its identity got evolved in these years. It mostly has undermined owing to being more interactive which contradicts the original purpose of the organization. But it has led to the creation of more trust and coordination among the member states. It is at the crossroad to be like the European Union. The Financial Crisis was not just economic in nature, it also played a huge role in shaping the ASEAN into what it is today and what it will be in the future.

*Financial Contagion In The East Asian Crisis: With Special Reference To The Republic Of Korea* (Song)

The crisis is discussed with special reference to South Korea. It discusses that how stock market crashes in Taiwan and Hong Kong worsened the investment environment in Korea, how it was reduced to a country solely surviving on foreign loans from being the fastest growing economy at that time. Through an empirical examination of contagion, the crisis is discussed. The focus is emphasized on the stock prices in the affected nations, how much is the coordination with them. Through the tests, it was analyzed that it was due to the worsening situation in the Hong Kong stock market plunged Korea and a lot of equity investment was withdrawn from the country. The crisis in ASEAN countries was not contagious in the developed countries like Korea and Hong Kong. It rules out a possibility that the spreading of crisis from Thailand prompted investors to reduce their holdings in other nations to balance their portfolios. This made the banks in Korea to go to the Bank of Korea for assistance, which further led them to approach the IMF. The author believes that it was due to overreaction by the investors in Korea and assumption that the markets in South East Asia and Korea are coordinated deepened the crisis in the country and worsened the situation.

*Asian Financial Corporation: The Problem of Legitimacy in Global Financial Governance* (Sohn, 2005)

The article discusses that how global financial governance is linked with Asian financial governance and about legitimacy in global financial governance. Until the developed western nations put aside their issues, Asian countries don't plan to put their part in global solutions to various problems. It tells that after the crisis, how G20, Financial Stability Forum, Asian Bond Fund and Bilateral Swap Arrangement came into the picture. The crisis changed the perception of various countries towards the global financial governance. There was distrust in the solutions IMF proposed i.e increasing interest rates and the legitimacy of the policies of G7 were questioned. It prompted the South Korean Prime Minister Kim Jong Pil to propose an independent Asian Monetary Fund. There were signs showing that the G7 engaged intensively with the rest of the world, involving bank governors from other nations as well.

*A Good Look at the Thai Financial Crisis in 1997-98*(Laplamwanit, A Good Look at the Thai Financial Crisis in 1997-98, 1999)

In the 1990s, Thai economy had received massive volumes of capital inflow from various parts of the world because of its accommodating economic policies, goal, healthy-looking conditions and recession in European countries being a major factor behind this. The fixing of the exchange rate to a group of world dominant currencies which majorly include US dollars, the Thai economy enjoyed a long period of nominal exchange rate stability as baht was in a very stable position which hardly fluctuated between 24.91-25.59 baht per dollar. The hard efforts which Thai government did in keeping inflation rate low between 3.36% and 5.7% with fiscal balances in a surplus position. Though Thailand became one of the best investing economies in the world as many channeled their large sum of capital out of Japan which had undergone a lengthy period of stagflation and low-interest rates.

## III. TIMELINE OF THE CRISIS

- 1996- 1997
    - Late 1996- early 1997: Thai stock market falls due to speculative attacks
    - Early 1997- Korean conglomerates like Kia Motors face bankruptcy
    - May 1997-Thailand spends billions of Dollars of its foreign reserves to protect its currency from speculative attacks
- July 1997
    - Devaluation of the baht by 20%.
    - Abandoning the pegging of Thai Baht against US Dollar.
    - IMF ensures one billion Dollars plus to Philippines to help it reduce the pressure on the peso.
- August 1997
    - Package worth 17.2 billion Dollars ready for Thailand.
    - Hong Kong Dollar under speculative attack.
    - Indonesia abandons trading band and allows the currency to float freely.
- October 1997
    - Hong Kong Dollar attacked and interest rated rose by 280% in the country.
    - Hong Kong stock index falls by 10.8%, wiping of shares worth 29.3 billion Dollars,
    - Sovereign credit rating of Korea is downgraded
    - Thailand agrees to adapt tough economic measures proposed by the IMF in return for a 17 billion Dollars loan from various Asian countries.
- November 1997
    - Indonesia finalizes a funding deal with the IMF, which is negotiated three times Indonesia being unwilling to meet all terms.
    - The crisis is described as "few small glitches on the road" by then President Clinton at the APEC Summit in Vancouver. Western stock markets fall.
    - The Bank of Korea abandons the efforts to bring up the value of the won, the result of which it fall below 1000 against the US Dollar.
    - South Korea requests IMF for aid.

- December 1997
  - Rescue package worth 58.2 million Dollars for Korea sanctioned by the IMF.
  - Korean won is allowed to float and private debt worth $22 billion are renegotiated post talks with the US Federal Reserve.
  - Thai government closes 56 insolvent financial companies as a part of IMF's restructuring plan. 30,000 people lose their jobs.
  - World Bank released a $3 billion emergency loan to South Korea, as a part of the $10 billion support package.
  - In return of the package, South Korea agrees for financial reforms and open up its domestic financial market.

## IV. Major causes of the crisis

For decades, Asia was seen as a model of economic growth that developing Countries used to mimic. The basic indicator like real per capita income rose by an average of 5% per annum, the life expectancy, literacy rate, and standard of living of Asian people vastly improved. In almost all Asian countries, the export sector was a backbone of the economy. Growth continued at a great pace during the early 1990s, which was the result of notable inflows of capital from countries like from Europe and Japan.But, signs of weakness started to show in the mid-1990. In most of the Asian nations, signs go overtrading became evident; there were the high amount of short-term debts, huge leveraging of top companies and a fall in export levels.In 1997, the currency crisis in Thailand rapidly developed into a financial and economic crisis in other nations of the region. Asset prices and currency rated dropped between 30-40% in most countries. Banks and companies faced various financial issues. By the end of the year, there were requests by Thailand, Indonesia, and Korea to the IMF for assistance. By 1998, even countries like Hong Kong and Singapore, which had a sound economy, entered the economic recession.

**Domestic Financial Vulnerability:** The Asian countries witnessed a good amount of capital inflows in 1990's resulting in a significant rise in GDP of the countries like Korea and Malaysia. Most of these capital inflows for investment booms were routed through poorly regulated institutions. Liberalizations of domestic businesses were not done under a appropriate supervision and under regulations. Furthermore, this created a variety of problems like lack of competition in financial markets, concentration of ownership. The amalgamation of inefficient financial sectors with strong capital inflows and credit booms resulted in two related but different sets of problems: inefficiency of resulting investment, and financial weakness of an overleveraged corporate. Some reasons to believe the rise in lending was not efficiently used as the investments routed though weak channels were concentrated in sectors having already excessive capacity in parts via government directions and towards non-trading sectors. A turnaround of asset prices before the crash, however, characterizes the financial panics followed by speculative booms. Another important aspect of this credit boom was a rise in financial fragility with a rise in bank lending by highly priced properties, any slowdown in growth, and the rise in interest rates resulted in large bankruptcy. Inefficiency in capitalizing turned as immediate pressure on the solvency of the banking system. The large size of the banking industry and industrial debt in relation to GDP magnifies the economic significance of financial distress.

## V. Involvement of the IMF

The IMF intervened to provide support to three majorly hit countries, Korea, Indonesia, and Thailand. Some of the strategies the IMF used to combat the crisis are:

1. **Finance**: Support and rescue packages with worth more than $85 billion were sanctioned to help the affected countries stabilize their currency and help the bankrupt institutions.
2. **Macroeconomic policies**: Tightening of the monetary policies, interest rate changes, exchange rate changes, and fiscal policy changes were implemented. It was held firm in Indonesia and Korea, but in Thailand, fiscal tightening was implemented to reverse the increased deficit.
3. **Structural reforms**: These were the measures to address the problems both in the financial and corporate sector.

Though IMF has been credited with solving the crisis, it has been accused to make the crisis even worse. It gave loans to the affected countries on the condition to adopt adjustment policies and cut on spending, even though the countries were not facing the budget deficit and further deepened the economic slowdown by starving the economy.

## VI. Effect on the four Asian dragons

### VI.I SINGAPORE

The financial crisis effect Singapore in numerous ways. Various important elements like currency, assets markets, economic growth were badly hit the below given explanation will help in better understanding.

1. **Currency Contagion**: After surviving against various currency attacks Thai baht was freed in July 1997 from its peg to the US Dollar. Baht fell by 15% after this and by 80% by the end of the year. Singapore Dollar was also found in a same trend from a high of S$1.43/ US $ it went way down to S$1.75/US $ on January 7, 1998 in a span of 6 months, Singapore Dollar declined by 18.23%. Although Singapore Dollar depreciated against the US currency and other major currencies but a great appreciation against the regional currencies was noticed. As a result, Singapore's real and nominal exchange rates were relatively stable both before and during the crisis.
2. **Falling Asset Prices**: The stock market and the real estate market in Singapore were badly hit by the crisis. The stock market opened with the Straits Times Index (ST Index) in 2,055.44 on January 1997.But later in September 1988 a sudden drop of 856.43 decline of some 60 per cent. The property market witnessed the private property price index falling from 270.0 in the first quarter of 1997 to near 163.7 in the fourth quarter of 1998, a drop of about 40 per cent over a one-year period. The decline could have been higher had the government not taken drastic measures in May 1996 to cool the private residential property market, which was in a great trouble.

### VI.II SOUTH KOREA

Korea already had witnessed the macroeconomic variable deterioration in 1995 and 1996. Wide increase in current account deficit, debt-equity ratios, and fall in stock markets by almost 36% were some of the impacts. The Korean won was spared from its collapse, though other currencies didn't survive the impact. The crisis in the country further burdened the liabilities in the banking system of the country. This created the confusion that which banks were solvent or not. Due to this, foreign lenders refused to renew the loans that could have been rolled over in stable times. It created a dilemma for the international investors who withdrew their investments to prevent further losses. In order to increase the gold reserves, the general public went on to melt down their jewelry amounting to $2 billion. The Korean community in the US also sent special remittances to their home country, which still didn't complete the deficit. By 1998, 2 million workers lost their jobs and the unemployment rate was at 9 percent. Increase in school dropout rates, hoarding of currency and setting up shelters for white-collar employed people were common.

### VI.III HONG KONG

Hong Kong, a country with reserves of about US$90 billion in 1997 and well managed financial sector from years still faced great variation in currency and stock market because of the crisis of 1997.Interest rate rose in the protection of Hong Kong (Dollar which is pegged to the US Dollar under a currency board) the People's Republic of China took a decision of using exchange reserves for defending the Hong Kong Dollar and by committing to not devalue the Yuan. Floatation of the New Taiwan Dollar further intensified the attacks on the Hong Kong Dollar. In October 1997 interest rates rose to 280% in overnight and quarterly interbank rate reached around 20%. Hang Seng (limited is a Hong Kong-based banking and financial services company) Index fell by 23% over four days. This plague then reached to global markets. The Dow Jones industrial average lost by 554 points in October the biggest drop in the points in its history. In Countries like Brazil, Argentina, Mexico equity markets also saw their biggest single-day losses. Various other effects that could be seen were the failure of local investment bank investment holdings lead to a fall of 8.7% in the stock market index in January 1998. Hong Kong Dollar was further affected by a sharp fall of Indonesian rupiah. The three-month interbank rate reached 17% by January 1998. Fluctuations like the weakness of the yen furthered pushed down the Hong Kong Dollar, which resulted in the drop in stock price.

### VI.IV TAIWAN

The crisis struck at a time when Taiwan was on the verge of recovery from a similar prior crisis. The country was unaffected till early 1998, but as the recession went, the situation deteriorated, the country being export-oriented. The labor market fell, initially at a small rate but as the first quarter of 1998 came, things became worse mainly due to the economic conditions, which recovered later. Besides, the exports of the country with ASEAN nations and Japan fell. But, Taiwan was still at a better position in terms of its exchange rates as compared to other nations in the region. But the regional affects soon affected the Taiwanese economy and its exchange rate depreciated by 8%. The stock market was still performing better than other Asian markets in 1997 but due to the fall of the currency, foreign investors became vary due to low return on investment. Interest rates rose to 15.4%.Though Taiwan had a healthy economy, it was the intervention of foreign exchange market by the Central Bank make the situation worse. The traditional industry of plastic, machinery and textiles were affected and faced a strong competition with Korean exports due to the massive depreciation of the Korean won.

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