CHAPTER 6

CONCLUSION

The crisis has demonstrated the extent to which East Asian economies are sensitive to changes and shocks in the international environments and to financial sector weaknesses. It revealed, among other things, the importance of complementing sound macro-economic policies with adequate structural reform especially in the financial sector. On the onset of the crisis there was wide international scepticism on the policies imposed by IMF. Malaysia even though adopted some of the policy prescription suggested by IMF but at a later point opted to some its own set of policies for example by imposing capital controls and pegging its exchange rate. With the benefit of hindsight, IMF's policy advice to these countries during the emergency was not flawless. Nevertheless corrections and adjustments to policies were made accordingly, and the strategies adopted were successful to some extent if not fully in restoring financial market confidence and stability, and in achieving a resumption of economic growth, in most cases by late 1998.

Despite the policy reforms undertaken which has been encouraging in these countries, the road to completing financial and corporate restructuring in the region is still long. In the financial sector, particularly for Indonesia

and Thailand, a significant proportion on non-performing assets remain

be resolved. Although privatization of the nationalized banks

divestment of state ownership in the banking sector have been underta

a lot more have to be done particularly in Indonesia, and Thailand.

In the corporate sector, debt equity ratios have declined most notabl

Korea. However in the other countries operational restructuring still

behind balance sheet restructuring. Creditors still find difficult to enf

their claims through the courts, leading to a limited number of compl

cases of court-led restructuring. The weakness in the bankruptcy regi

also impedes restructuring via out-of-court processes.

Reforms to strengthened bank prudential supervision and regulation,

changes in the legal and regulatory framework for the corporate sector

been impressive but these are no guarantees for sound financial

corporate governance. Strict compliance and effective enforcement

equally important big challenges facing all these countries. Effe

enforcement requires tackling broad governance issues, including a

such as transparency, accountability and responsiveness of governr

effectiveness and efficiency of the legal and judicial system; the rule o

and control of corruption; and political stability.

Despite efforts to tackle problems in all these areas over the past few

in the affected countries, a recent study by the World Bank (Kaufman

2002) reveals that there is still much ground to be covered. Among the countries concerned only South Korea enacted the required levels of change in its financial system since the crisis. This has restored confidence in the countries banking sector to lend for new economic activity, giving South Korea the reputation of having undertaken the deepest structural reforms in the region. Malaysia has made some reasonable progress in its financial sector reforms. Thailand is much slower and Indonesia has still a long distance to travel. The World Economic Forum's competitiveness survey ranks many Southeast Asian countries near the bottom, largely due to poor economic governance and lack of transparency. Indonesia and Thailand earned especially poor marks in terms of corruption, tax evasion, and organised crime. It is important that these countries improve economic governance to ensure continued and sustainable growth.

As regard to social sector policy, initiatives in these countries have differed significantly since the social impact during the crisis was heterogeneous in terms of who was affected and in the way people responded. What the crisis did was actually to work as a magnifying glass to make the social problems that existed before the crisis more visible. The Malaysian and Korean economy had less social repercussions because social safety nets were comparatively more structured then Indonesia and Thailand. The policy focus for all these countries will be a long-term strategic vision on

fostering human development and enhancing social safety nets for the poor.

Even though policy reforms adopted by these countries were generally similar in approach but some have progressed faster then the other. Since the crisis Korea and Malaysia have advanced the most in their recovery followed closely by Thailand but lagging quite far behind is Indonesia where current economic activity remains significantly below pre-crisis levels. Thailand is sacrificing growth as a result of the decision to spread the much-needed financial reform over many years. This makes it difficult for banks to raise capital and that translates to the system not having enough to lend for economic activity. Indonesia has been seen to be less able to achieve complete recovery, which has been partly due to the high levels of domestic and foreign debt that limits the Governments options for stimulating the economy. Private investment is constrained by concerns of security, political stability, the rule of law and corruption as well as the slow pace of privatisation, bank reform and corporate restructuring. This validates the view that however sound economic policies maybe but equally important are the other non-economic elements for a nation to achieve overall progress.

As much as sound economic policies revived the economies after their collapse in 1997 it also goes to show these countries cannot avoid the

impact of a global downturn (the second external shock) which began in mid 2001. This led to a drop in growth rates. A slowing world economy and decelerating world trade growth hurt the demand of exports of these countries. Exports played a key role in reviving the economies in the aftermath of the 1997 financial crisis, but now are leading the economic downturn. This vulnerability has arisen because of the policy on depending on certain economies for trade and investment. It only shows that countries which are more linked to the external world become more vulnerable when there is global slowdown. In other words, the countries concerned should now adopt a gradual policy shift towards inducing growth by stimulating domestic demand. China has been able to demonstrate to us how she has survived through the most turbulent times of global economic slowdown. However some economists are worried that the government's policy of stimulating domestic consumption may turn some of these countries into a Latin America type disaster. Latin American style economic disasters have a common cause: populist policies aimed at pacifying the electorate by stoking domestic demand and creating a situation of easy credit that ultimately leads to runaway consumption. These policies are a sort of exaggeration of Keynesian economics to the extreme.

It is interesting to note even currency depreciation did not lead to increase in exports during the later part of the crisis through the desired J-curve

effect because high inflation did not allow real exchange rates to depreciate very much. Like wise during the post crisis period i.e. in 2001, falling exchange rates did not help stimulate exports because this happened in scenario where there was global slowdown which reduced the demand for the countries exports. This implies that government that use devaluation policies to stimulate growth must do so in the right environment. It also suggest that It is imperative that these economies further diversify their exports and reduce the reliance on a few major world economies for their export revenues. However this may not be achieved in the short term. For this period, the US and Japanese economy which are significant engines of growth will determine the recovery of these countries.

To stimulate growth during this period of slump in the real economic sector, these economies have shifted to a less restrictive monetary policy and an expansive fiscal policy. However, whether this adjustment of macroeconomic policy already provides an adequate basis for transition to a long-term path of growth remains uncertain. If the governments continue to pursue high deficit budgets to generate domestic demand this will eventually lead to higher government debt resulting a burden to the economy. Whilst an expansionary monetary policy may stimulate investment and demand because of low interest rates but this may be offsetted by a decline in foreign portfolio investment. Nevertheless the

governments have been successful in maintaining low rates of inflation and unemployment. On the investment front, these countries cannot afford to depend on direct foreign investment as it use to do because it is loosing its competitive advantage to more attractive destinations like China and Vietnam.

Finally and to conclude, with the right economic policies, strong international support and favorable global conditions, these countries can in due course emerge from this slowdown and once again resume their role as pacesetter and be example to the rest of the world.