2012 International Conference on Economics Marketing and Management
IPEDR Vol.28 (2012) © (2012) IACSIT Press, Singapore

Economic Development and Crisis Policy Responses in Southeast Asia (Comparative study of Asian Crisis 1997 and Global Financial Crisis 2008 in Malaysia, Thailand and the Philippines)

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Abstract. This paper mainly describes how the economic formation affects the countries' capability cope with economic crisis. During the Asian Crisis of 1997, all countries (in some sense except Malaysia) accepted the IMF's neo-liberal recipes, while in the Global Financial Crisis of 2008, all of them turned to the more Keynesian approach, allocating moneys to improving the demand side of their economies. This paper also answers some speculations that these countries will do better in coping with crisis in 2008, as they experienced crisis in 1997.

Keywords: Financial Crisis, Southeast Asia, Public Policy

1. Introduction

This paper mainly describes how the economic formation affects the countries' capability cope with economic crisis. It also elaborates the diversity of economic structures in those countries, yet regarding coping with financial crisis, they took the quite similar approaches. During the Asian Crisis of 1997, all countries (in some sense except Malaysia) accepted the IMF's neo-liberal recipes, while in the Global Financial Crisis of 2008, all of them turned to the more Keynesian approach, allocating moneys to improving the demand side of their economies. This paper also answers some speculations that these countries will do better in coping with crisis in 2008, as they experienced crisis in 1997. Did the countries learn from the Asian crisis of 1997? Some sceptical analysts may answer: No. However, most of the facts prove that the countries do have better economies after the1997 crisis, although that does not necessarily mean they are free from the suffering that was created by the Global Financial Crisis of 2008.

There are eleven countries in the region. I choose three of them which are: Malaysia, The Philippines and Thailand. The reasons I chose these three are because the countries have similarities in the sense that all of them are anti-communist countries (three countries in Southeast Asia that are currently communist: Laos, Vietnam, and Burma) yet they have structural differences. Thailand has a strong history of monarchy and was never colonized; The Philippines was colonized by three different countries (Spain, the US and Japan); and Malaysia is a British' Commonwealth country (Neher and Marlay, 1995). I believe those aspects have played and continue to play a very vital role in the economic construction of the countries.

2. Perspectives on Financial Crisis

In many parts of this article, Krugman used both Keynes and Minsky's ideas as his point of departure yet not for his final destination. After giving long and thorough critiques on Washington Consensus (free market and sound money policies), Krugman said that those policies are probably "the best policy for developing countries to follow" (Krugman, 1995). Unlike Keynes and Minsky, Krugman did not gave a strong alternative solutions on free market mechanism at the end of his article, opens up a discussion for any possible solutions (for instance Asian model), including free market.

The main argument Krugman pointed out is that the rapid economic growth (measured by massive capital inflow) in developing countries in the 1990's was not derived directly from the implementation of Washington Consensus (free market and sound money policies). Instead, there are three reasons why the phenomenon happened. First of all, there was a 'speculative bubble' happening at that time period as a result of massive dissemination of Washington Consensus, especially among investors. They became enthusiastic to invest their money in developing countries as the Consensus provided a favourable view about the prospect of doing so. Secondly, the political elites in these countries were convinced by the Consensus' agents to implement the policy. The leaders of developing countries exposed to the Consensus through, what Krugman called, "self-reinforcing process" (Krugman, 1995). As the result of those two reasons, finally, there were immediate pay-offs (capital inflow) given to developing countries that implement free market and sound money policies.

However, Krugman emphasized, the growth was superficial because it was only measured by the amount of capital inflow into developing countries' capital market. The growth did not reflect the actual economic improvement of developing countries. Three fundamental economic aspects which were not changed by the implementation of the Washington Consensus at that time were: real exchange rate (which was actually increased), growth rate (which did not go hand-in-hand with capital inflow) and inequality (the fact that the Gini index in developing countries was still large during that time period). These facts prove that Washington Consensus did not provide a stable and fundamental solution for the economy of developing countries.

Krugman criticized two policies which is known as the backbone of Washington Consensus, free market and sound money policies. In relation to explaining Keynes and Minsky's influence in Krugman's "*Dutch Tulips and Emerging Market"* article, for the sake of brevity and possible deeper inquiry, this essay will only focus on one aspect of the Consensus, the free market policy.

In the early parts of the article, Krugman demonstrated how the free market ideology, empirically, has not been proven to be able to encourage growth and bring about prosperity. The Free market idea basically believes that protectionist policy is bad for economic growth because it will reduce competition, creates rent-seekers, and discourages innovations. The World Bank showed data which support this argument but Krugman said that those data are collected by subjective criteria. The real situation in developing countries, as explained earlier, was not as ideal as the ideology and the data had shown.

Sixty years before this debate, Keynes have already mentioned about the failure of free market to provide real and stable economic welfare. Intrinsically, market can "boom" (when businessmen sale exceeds their cost) and also "slump" (when businessmen cost exceeds their sale) at the same degree of possibility (Keynes, 1930). Free market's belief of businessmen sale will always equal to income of society and assuming that businessmen can sell everything they produce (full-employment equilibrium) is totally incorrect. The only way to solve the problem is by, obviously, increasing the sales (demand side) because working on the supply side, such as restricting output and cutting wages, will only cause decrease in demand, industries stop producing and, eventually, severe unemployment. The government must intervene with the market and create policies which can lift up demand aggregate such as reducing interest rate, increasing public spending on infrastructure or giving stimulus package.

In his article, Krugman did not give the readers detail clarification about why free market was not empirically proven to provide welfare. Krugman might assume that the readers are familiar with Keynes' argument.

One can easily see both Keynes and Minsky influences in Krugman's 'speculative bubble' argument. In *General Theory,* Keynes explicitly mentioned about the psychological factor that could affect market (Hodgson, 2007). This psychological aspect will lead actors to speculate, bring about the disequilibria of the market, and then blow up the "bubble." In addition, Minsky's main argument of market instability also provides the conceptual basis for "speculative bubble" phenomenon, especially when Minsky explains the link between aggregate investment and the aggregate profits (Fazzari, 1999).

Nowadays, one would automatically analyze the financial aspect when a crisis occurs. In Southeast Asia, for example, one of the most important agreements of the 14th ASEAN Summit (February the 24th – 26th 2009) was the agreement to integrate the stock market (by 2010) of country members (starting with Indonesia, Malaysia, Singapore, Thailand and the Philippines) which will be called "ASEAN Linkage Stock Market." This agreement was taken as a reaction to the current global crisis. The leaders believe that by integrating their stock market, the liquidity and the transaction value of country members bonds will increase. In line with Krugman argument, this movement is part of the strategy to attract investors to invest their money in the region. This is one of the realizations of Minsky's "financial capitalism as the new stage of capitalism" concept.

Last but not least, there is one argument in Krugman's *Dutch Tulips* that was novel, not covered by either Keynes or Minsky's, the role of political elites' behaviour in relation to a country's economy. Developing countries' political leaders and their [American-trained] "technocrats", together with Washington Consensus advocates, built interlocking social grouping which tend to coverage on a conventional wisdom (Krugman, 1995). This political-economic aspect is very important in analyzing global economy because regime types of developing countries that embraced the idea of Washington Consensus were extremely varied. Take the example of Indonesia (absolute authoritarianism) and the Philippines (democratic) in 1990-1997. How those different regime types could embrace the same idea at that time period? Krugman noticed the phenomena but did not elaborate this question deeply in *Dutch Tulips*, while, both Keynes and Minsky did not touch this aspect in their theoretical construction.

3. Policy Responses

Ariff and Abubakar (in Montes and Chu 1999) and Hwang (2003) elaborate many responses policies regarding 1997 crisis in Malaysia, a couple of which are: a). Denial and hesitation, the Malaysian government denied that there was a crisis in the first place; b). Tight fiscal and monetary policies, and restructuring the banking system; c). Government proposed to use regional currencies instead of the US dollars in inter-ASEAN bilateral trade; and d). Financing the recovery programs with the total cost of all measures was RM62 billion; While in 2008 crisis there are four main categories of the Malaysian government's policy responses: a). RM7 billion stimulus package; b). Implementing liberalization policies; c). Attract FDIs; and d). Social Safety Net policies.

Montes and Chu (1999) and Peleggi (2007) explained that there were two main policy responses that Philippines' government took regarding 1997 crisis: a). Restore investor confidence in the economy by stabilizing the exchange rate and protect the soundness of the banking sectors; b). Kept domestic interest rates low and finance a higher budget deficit to pump the prime economy. While in 2008 crisis, there are three objectives of economic policy in The Philippines, which are: a). Ensuring sustainable growth which base on improving the agriculture and fiscal by improving revenue collection through better tax administration; b). Saving and creating jobs; c). Protecting the most vulnerable by imposing the labor and social protection policies (Hoontrakul, 2008; Phongpaichit, 2008)

Montes and Chu (1999), Ravenhill (2000), and Srinivasan (2006) explained that there are two major aspects of Thai government response on the Asian crisis of 1997: a). The Thai government obtained a rescue package of US$17.2 billion from the IMF in August 1997; b). Thailand implemented a financial restructuring package by increased the power of the Bank of Thailand (BoT) including giving it more authority to order commercial banks or finance companies without having to go to shareholders' meetings. Hoontrakul (2008) and Tarachai (2008) explained that there are five policy implications that Thailand has to be aware of regarding the global financial crisis of 2008: a). Protecting the unsophisticated *retail* depositor against bank failures; b). The International Accounting Standard Board (IASB) amended IAS 39 as its commitment to enhance market confidence in a coordinated and timely manner; c). Blocking the vicious circle of financial liquidity; and d). Fiscal stimulus measures

4. Conclusion

The studied countries are actually in the same 'ideological group' in Southeast Asia as the other group (socialist) in which Cambodia, Myanmar, Laos and Vietnam belong to. Nevertheless, the economic structures of these three countries are still very different from each other. They have their own colonialist histories: Malaysia colonized by British (Commonwealth), Philippines colonized by Spain and then the US, while Thailand had never been colonized. In policy areas, Malaysia has a long history with strong government interventions in the economy which is in the very opposite direction of the Philippines's economy, which has been very liberal since the post Marcos' era. Interestingly, these structural differences do not play very important roles in determining their policy actions during the crises (Rodan and Richardson, 2001).

There are two main differences between the Asian Crisis of 1997 and the Global Financial Crisis of 2008. First, the 1997 crisis was triggered by the fall of Southeast Asian currencies (the reason why it also commonly called a 'monetary crisis'), while the 2008 crisis was caused by the fall of property prices. Second, the epicenter of the 1997 crisis was on the peripheral of the global economy, while 2008's occurred in the core (the US). Yet there is one similarity to the crises, which is the 'speculative bubble' that prior to the crises rapidly lead the economy to slump. In addition, the global the financial system, on which all economies in the world depend, has remained weak/unstable (Minsky, 2008 and Tymoigne, 2006).

The macro economy of Southeast Asian counties had been robust prior to the 2008 crisis (Hui 2008). All of the countries studied have strong and relatively stable financial and banking systems. Given their sound fundamental financial system, compared to other regions in the world, Eastern Europe for instance, they are not suffering so much from the 2008 crisis. It means that they actually learned from the previous crisis, in which the government improved the financial system so that it is not vulnerable to crisis. Moreover, in the Philippines, it also was not impacted so much by the Asian crisis of 1997 as it had already been improving its economy from the domestic 1986 crises. However, that does not mean that it was free from being struck by the crisis of 2008 but at least endogenously it is improving.

All of the countries (in some extent except Malaysia) accepted IMF recipes in order to recover from the crisis of 1997. The trajectory of policies taken were mainly to more widely open markets internationally. This choice made sense at that time because the dominant (patron) element of the global market was strong, so it could absorb and (theoretically) lift up the peripheral economies which came into it. However, this strategy lost it *raison d'etre* when it came to the 2008 crisis because the core of the global economy is broken; therefore, if one economy comes in to this spot the economy will also brake. This is the reason why the more Keynesian approaches, such as bailing out banks, stimulus packages, and creating jobs, are more popular these days particularly in the countries studied.

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