

# Free the causes and consequences of the asian financial crisis of 1997 argumentat...

[Economics](#), [Currency](#)



While there seems to be nothing to unhinge the economic development, whether in a global or regional context, now that military conflicts are history. Countries engage in mutually profitable trade relationships and enter into trade blocs, conduct strategic planning, develop their respective economies; however, a miscalculation on the part of one country can precipitate the entire region into economic crisis that inflicts all types of damage on the productive capacity, exports, and social welfare. The Asian Financial Crisis of 1997 was one of such regional disturbances that did serious economic damage to countries like China, Japan, Indonesia, and Malaysia. The reason were many ranging from currency speculation to the inability of governments to tackle economic problems successfully. However, pegging the exchange rate of local currencies to the US dollar and the banking sector were the chief driving forces of the crisis. The outflow of loans and investment capital in the years prior to the crisis took their toll on the regional economies setting the stage for the economic calamity. The point is that the outflow of capital and exchange rate pegging along with other reasons caused the Asian financial crisis of 1997 that sent the rate of exports falling down, as it did GDP, stimulated poverty, income differences, and affected healthcare and educations services.

### **The Causal Factors of the Asian Crisis**

Nanto (1998) noted that a number of structural causes in combination provoked the financial crisis in the Asian region. Increasing external liabilities for borrowing states, debt issues in the private sector and the unsatisfactory quality of loan, balance-of-payments issues, economic performance growing feeble, the close alignment between the American dollar and national

currencies, currency speculation, the absence of confidence in the governmental capacity of handling issues successfully, and technological changes occurring in fiscal markets are believed the chief reasons. The crisis started in currency markets. What caused unstable exchange rate were issues in the banking sector of Asian countries (Nanto 1998). Seeing that the banking sector is where the crisis began, bank lending and borrowing deserve considering arguably the single most important cause of the Asian crisis of 1997.

Nanto (1998) suggested that the financial troubles in Asia originated for the most part in the doubtful lending and borrowing practices of financial companies and banks in the turbulent Asian economies. Rather than rely on the emission of stock and bonds in order to raise capital, Asian firms, in their wisdom, give preference to bank borrowing. International borrowing implies two different kinds of risk. One of these is if the debt is sovereign or private, the other is in the maturity distribution of accounts. As far as the distribution is concerned, plenty of businesses and banks in the turbulent Asian economies are reported to have received short-dated loans for longer-term projects nearly two decades ago. Analysts are much of the opinion that the Asian Tigers may owe the crisis to these borrowings.

King (2001, p. 438) noted that Japanese commercial banks provoked the Asian crisis. In reaction to emerging issues in South Korea and Thailand, these banks decreased their exposure in the Asian region. Stock market bubble in the insular state in 1990 coupled with the collapse of the real estate market did a lot to weaken banks in Japan. The Japanese banks that were the single largest lenders of loans in Asia change their orientation from

the states in question to overseas commercial banks who also withdrew their loans. The outflux of capital launched a devaluation in Thailand in mid-1997, yet in Korea it would not start until later that year in view of the fact that the regimes of exchange rate differed in both states. The circulation of private capital is critical for developing countries. East Asia alone drew upwards of 200 billion dollars in the period between 1994 and 1996 (King 2001, p. 439). MacIntyre (1999, p. 143) claimed that the economic crisis was largely due to an unlooked-for and deep loss of confidence by foreign and local investors (cited in Walton n. d.). The loss of confidence entailed capital drain, which precipitated Asian economies into the notorious crisis (Walton n. d.). Winters (1999, p. 82) noted that, in the early 1990s, Asian economies embraced the policy of liberalization or open door policy, which allowed the flow of money from all corners of the world at a never-before-seen rate (cited in Walton n. d.). Nixon and Walters (1999, p. 498) suggested that the flow of net private capital had jumped from 37.9 to 97.1 billion dollars in the Philippines, Malaysia, South Korea, Thailand, and Indonesia in the period between 1994 and 1996. By comparison, around the end of 1997, the net outflow stood at 11.9 billion dollars in these five states. The figure stands for the turnaround of 109 billion dollars amounting to an estimated 10% of GDP in the years before the crisis in all of the countries (cited in Walton n. d.).

Based on the Council data, the claims of the American banks in the Asian economies dropped from 45.2 to 41.9 billion dollars in the period between December 1996 and June 30, 1997. The American banks seemed cognizant of the lending environment in Asia that was growing too risky and decided on decreasing their exposure in the region (Nanto 1998). The outflow of capital

implies that plenty of lucrative economic projects come to a standstill falling under the budget knife. Naturally, banks do not want their funds used in an unstable country, and neither do foreign investors not wanting to put their money into a country with questionable investment climate. It is difficult for a state to endure the loss of money after conducting a thorough economic planning, building specific spending articles into the budget, and tailoring the national development to a certain amount of allocations.

The pegging of the exchange rate of the Asian currencies to the US dollars or a basket of dollar-dominated currencies was one of the chief structural factors contributing to the crisis. The governments were in no position to adapt the fixed exchange currency values sufficiently to the changing economic situation. The fluctuation of exchange rates was allowed by the governments only within narrow bands. Troubles started to emerge in 1996 and 1997 when the official value of Asian currencies swerved from the fundamental market values and the dollar rose in value or appreciated, speaking in economic parlance. Some of the states under analysis found it difficult to balance international accounts while Asian countries were having the value of their national currencies pulled up by the US dollar. The situation caused exports to become more expensive to non-dollar buying parties. Conversely, imports from non-dollar regions became more affordable (Nanto 1998).

What it means is that countries not using dollars in their trade transactions partially lost the capacity of purchasing goods in Asian countries mass-producing a wide range of commodities. The partial loss of a consumer market, though temporary, spells the shrinking of revenue, a possible market

reorientation, and the rollback of economic productive activities that, by itself, means the reduction of jobs and worse budget replenishment, as the taxpaying capacity is on the decline. In the crisis days, money a country under-receives hits particularly painfully at the industries or social categories that require subsidies or dotation during financial instability. The crisis produced a number of traditional concomitant issues exacerbating the crisis. Hence, the pegged exchange rate is the second most important cause of the crisis that had plenty of unpleasant consequences for the Asian Tigers with the rates aligned to the dollar. Nanto (1998) went on to note that the weakened Japanese yen was decreasing the competitive ability of products manufactured in non-dollar countries in comparison with the ones produced in Japan. The subsequent increasing deficits in their trade put a downward pressure on the exchange rates whose maintenance required the larger extent of intervention on the part of the government.

### **The Consequences of the Crisis**

Narine (2002, p. 179) suggested that the Asian crisis of 1997 led to the collapse of multiple regional currencies, economic disruption, and political instability, which particularly held true for Indonesia, a big member of the politico-economic organization known as ASEAN, the Association of Southeast Asian Nations. Griffith-Jones (1998, p. 10) noted that the crisis undid the history of high growth providing room for recession continuing well into 1998. The crisis assumed the shape of a negative growth. Exports is an important economic variable indicating the depth of the crisis. Hai and Zhong (1999, p. 10) noted that the pegged exchange rate along with the

economic crisis throw Chinese exports into a sharp fall in 1998. While the country did stimulate its exports to the North American and European markets, losses it incurred on the Asian market exceeded gains. The yearly growth level of overall exports went from being close to 0% in 1998 to becoming minus 10% in the first two months of 1999. International Monetary Fund. Research Department (2014, p. 76) stated that, as per informal estimates, Japanese exports fell by 15% at the time of the crisis. As such, it could reflect the decline of real GDP growth in the region of 0.3% taking into account that exports to emerging markets were estimated at 2% of GDP in 1997 (International Monetary Fund. Research Department 2014, p. 76). The reduction in GDP was one of the first naturally expected outcomes. At the time of writing, the economy of Thailand was predicted to decrease by 8% showing the signs of stagnation at the rate of 0.5%. For much of the 1990s, it added 8% to its growth, which means that the crisis whittled down the entire previous growth. The GDP of Korea was expected to drop by as much as 4% from 5.5%. In the years preceding the crisis, Indonesia gained a comfortable momentum in terms of growth placed at close to 5% heading into the millennium, yet the crisis caused the contraction of 12% in the financial year of 1998-1999. In Malaysia, another ASEAN member, the growth of GDP was predicted to become half as much as it was before the crisis when it reached the mark of 8% (Griffith-Jones 1998, p. 10).

According to Knowles, Pernia, and Racelis (1999, p. 7), the levels of unemployment rose, the highest recorded in Korea. Sigit (1998) stated that, in Indonesia, the rate increased from 4.7% to 5.4% in the timeframe between August 1997 and 1998 (cited in Knowles, Pernia, and Racelis 1999,

p. 7). Moon, Lee, and Yoo (1999) noted that, during 1998, the portion of the economically active population fell by 1% in Korea since the rate of participation in the workforce went from 62. 2% to 60. 5% (cited in Knowles, Pernia, and Racelis 1999, p. 7). Sigit (1998) asserted that the number of individuals working under 35 hours on a weekly basis went 3. 3% up reaching 39. 1% (cited in Knowles, Pernia, and Racelis 1999, p. 7). The better part of countries demonstrated the reduction of real earnings related to inflation rather than the decrease in the amount of nominal salaries (Knowles, Pernia, and Racelis 1999, p. 7).

Economic activeness reflects social welfare and the purchasing capacity that determines the success of entrepreneurial activities, the taxpaying capacity, people's economic sustainability of self-sufficiency and other essential aspects. Obviously, the Asian crisis affected all of these. More than that, according to Knowles, Pernia, and Racelis (1999, p. 16), income disproportions rose in the course of the crisis in countries like the Philippines, Korea, and Thailand. In Thailand, the share of expenditure of the top-earning urban social group increased from 20. 5% to 22. 5%. David (1999) reported that poverty percentage increased from 11. 4% in 1996 to 12. 9% in the country over a three-year period (cited in Knowles, Pernia, and Racelis 1999, p. 19). Atinc and Walton (1998) stated that the 12% GDP decrease led to the rise of poverty level from 11. 3% to 14. 1% in the months between January 1996 and March 1999 (cited in Knowles, Pernia, and Racelis 1999, p. 19). Sigit (1998) reported the rate to have been higher in urban regions being half again as much after rising from 5% to 8. 3% (cited in Knowles, Pernia, and Racelis 1999, p. 19). In the years before the crisis, Indonesia enjoyed the



status of one of the most successful industrialized states of the East Asian region in part thanks to the reduction of poverty to 15%. The expected rate was 50% of the 200 million population or a threefold increase (Griffith-Jones 1998, p. 10).

Knowles, Pernia, and Racelis (1999, pp. 22-23) opined that the Asian crisis had a direct adverse impact on human development. Education budgets saw a reduction in the majority of crisis-hit Asian states with the exception of Malaysia. While personnel on the payroll remained untouched, teaching materials, training, equipment, and building maintenance all suffered from a decrease in allocations. According to Brooker Group (1999), in the 1997-1998 fiscal year, education budget of Thailand fell by 6% from 214 to 202 billion baht, as against 1996-1998 (cited in Knowles, Pernia, and Racelis 1999, p. 23). As for healthcare, all Asian states but Malaysia experienced a decline in public health budgets. As with the education sector, while the workforce was left working for the most part, state spending on medications fell abruptly resulting in the acute deficits of drugs at times (Knowles, Pernia, and Racelis 1999, p. 28).

## **Conclusions**

The Asian financial crisis of 1997 was a regional economic disturbance caused largely by the policy of local economies to align currencies to the USA dollar. Another reason was the outflow or flight of capital, with banks withholding loans and changing partnership orientation and investors refusing to invest in the economies as much as they did earlier in the 1990s. The open-door policy first bringing enormous funds into the country did not

allow the region to secure foreign funds in required volume. Near-catastrophic were the consequences of the crisis. Exports and GDP fell in China, Japan, and most ASEAN countries. The gap between the poor and the rich widened while poverty increased rendering all preventive efforts made before useless. Economic activeness was on the decrease while unemployment was hitting new highs. Education and healthcare sectors were subject to budget revision. Although most employees remained working, the quality of services did not benefit from budgetary cuts. Overall, the crisis had tremendous consequences for social welfare, the economy, and productivity.

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