REPORT 1: SURVEY OF THE ASIAN CRISIS AND ITS IMPLICATIONS

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EXECUTIVE SUMMARY

Serious institutional weaknesses and errors in macroeconomic policy resulted in the Asian financial crisis which impacted heavily on economies' growth and poverty rates. Although donors have invested heavily in identifying and addressing the crisis' causes, the failure of most South East Asian economies to return to pre-crisis growth rates suggests this is far from complete.

Causes of the Crisis

In the lead up to the crisis, weakly enforced bank and corporate standards and close relationships between banks and corporations meant lending often was excessive, of poor quality and increasingly funded purchases of local shares and property. Relatively high local interest rates and currencies fixed at US dollar values encouraged local banks and corporates to borrow heavily from foreign banks, usually over a short term. Widening trade deficits increased international expectations that regional US dollar exchange rate pegs were making regional exports too expensive and so would have to fall. By the time of the crisis, bank and corporate balance sheets were high in domestic and foreign debt, making them vulnerable to this shift in market sentiment.

Although the crisis did not directly affect Vietnam, Lao PDR, Myanmar and Cambodia due to their closed capital accounts, regional contagion over 1997-8 depreciated their currencies. Also, poor governance of state owned banks and corporations increased the level of non-performing loans from the mid 1990s and increased budget deficits.

Impact of the Crisis

By mid-1997, investors began losing confidence in their investments in the region, aggressively selling local currencies in volumes that overwhelmed local authorities' efforts to prevent them falling. This currency crisis soon became a banking crisis. First, sharply lower currencies increased the domestic currency value of foreign debts banks and companies owed. Second, local market confidence also fell, bursting local share market and real estate bubbles, slashing the value of collateral that backed many bank loans. Together, these two forces crippled many bank and corporate balance sheets, dramatically reducing investment and employment, reducing aggregate demand, GDP, over the following months. Poverty rates consequently jumped, although to levels still well below late 1980s rates. Elsewhere in ASEAN, currencies also fell but not enough to prevent a large decline in their export sales which reduced growth.

Policy Responses

Under multilateral donor financed assistance programmes, early policy responses focused on raising interest rates and cutting government spending to stop sharply higher import prices (due to lower currencies) feeding into broader inflation. The

second priority was identifying the level of financial distress in the banking and corporate sectors and financing programmes to restore banks' capital levels and restructure corporates' non-performing debt. To increase market confidence in these economies and improve the sustainability of a recovery, donors also included extensive economic governance programs and reforms as conditions to assistance packages.

Role of Donors

The international financial institutions were central to devising and implementing the reform programmes across crisis-affected Asia. Bilateral donors also played a significant role which the international financial institutions helped coordinate. Over the past five years, the international financial institutions have identified important lessons from their programmes, conceding that lifting interest rates soon after the crisis may have worsened the fall in spending and employment. They also recognise programmes could have focused earlier on restructuring debts to restore investment growth and some economic reforms proved too ambitious for overstretched bureaucracies to implement.

Unfinished Agenda

Five years after the crisis, growth across developing ASEAN is lower than before the crisis, despite the benefits of lower real exchange rates, exceptional demand for regional electronics exports and booming US export demand over the period. In 1999-00, rising exports and consumer demand saw growth recover. However, investment, which along with exports accounts for most of ASEAN's long term growth, is yet to recover. This suggests donors and governments need to renew efforts to restore the viability of banks and corporations, the key participants in investment activity. Within the other developing ASEAN economies, laying the preconditions for sustainable private sector growth and building effective economic institutions remain priorities.

AFTER THE ASIAN CRISIS

Five years after the start of the Asian financial crisis, the Indonesian, Thai, Philippine and newly developing ASEAN economies are yet to regain their pre-crisis growth rates. This is a disappointing outcome compared with East Asian economies' reasonably rapid recovery from past economic setbacks, particularly given the high level of international assistance these economies have received in the past five years. Partly, this reflects the severe damage the crisis caused to bank and corporate balance sheets.

Several negative factors converged to produce the Asian crisis, causing serious medium term damage to these economies. Institutional failure played a pivotal role in exposing East Asian economies to the international shocks which precipitated the crisis; lack of political will and human capital resources hindered particularly South East Asian economies in addressing these failures. The success of donor programs hinges on working with committed governments to reform key economic institutions so markets can work in these societies' interests.

OVERVIEW: THE CRISIS AND ITS IMPACTS

The immediate events

The 'Asian Crisis' broke in the second half of calendar 1997. The collapse of a Thai bank in mid 1997 severely damaged foreign and domestic investor confidence in the economy, leading them to sell their Thai assets and buy US dollars, plunging the value of the Thai baht. Over the next few months, similar fears spread to investors in Indonesia, Republic of Korea and Malaysia, again plunging their currencies in a matter of weeks. In all cases, the rapid outflow of investment from these economies was a sharp turnaround from the large inflows of investment through the early and mid 1990s.

Falling currencies severely weakened these economies. Many banks had borrowed in US dollars and on-lent these funds to domestic firms. In some cases, firms had also borrowed directly from abroad. In most cases, these loans were not hedged, meaning their domestic value was not protected against foreign currency movements. The plunge in the value of these countries' currencies against the US dollar meant these loans' value were suddenly far higher in domestic currency terms. Overnight, many banks' and firms' liabilities exceeded their assets, making them insolvent. Domestic depositors with these banks realised this and rushed to withdraw their savings, creating a serious bank shortage of cash across the regional banking sector and hastening the loss of confidence in the domestic financial system.

National governments and the International Financial Institutions, the IMF, World Bank and ADB, quickly intervened to stabilise currency values, now at much lower levels, and provided money to banking systems to reduce fears banks had run out of deposits. Authorities also pushed interest rates higher to try to keep remaining foreign investors' funds in the economy. However, higher interest rates, plunges in domestic asset prices and rising unemployment from the growing number of insolvent firms depressed demand across the economy, leading to a severe contraction in output, GDP.

Higher unemployment and falling incomes, along with cutbacks in public spending on health and education and subsidies on some key food items, pushed up poverty rates.

Although the crisis most affected Thailand, the Republic of Korea, Indonesia and Malaysia, the crisis also negatively affected the Philippines and other developing ASEAN economies including Burma, Vietnam, Laos and Cambodia.

Short term recovery and longer term impacts

The acute phase of the crisis spanned calendar 1997 and calendar 1998. Through 1999 and 2000, large declines in exchange rates lifted exports, driving a recovery in output. However, the decline in the exchange rate was a one-off boost to exports that was exhausted by 2000. A slowing in 2001 of US demand for regional exports also slowed export growth, ending the brief recovery. Since the second half of 2002, a moderate economic rebound began across the region. However, without investment, sustained growth is not possible. Serious problems in the economy centring on the banking and corporate sectors have prevented an investment revival and a return to pre-crisis growth rates; 2002 per capita incomes are lower than their 1997 levels in Indonesia, about the same in Malaysia and Thailand and only marginally higher in the Philippines.

CAUSES OF 1997 CRISIS

Summary

A banking and currency crisis combined to produce the Asian financial crisis:

Poor quality, often excessive, bank lending and corporate borrowing in the early to mid 1990s increased exposure to foreign borrowings and the risks of a banking crisis in many East Asian economies.

Poor bank and corporate behaviour reflected serious institutional weaknesses, including poor government supervision of bank and corporate activities, weak or poorly enforced rules on financial reporting and a lack of penalties for poor borrowing, especially under bankruptcy legislation. Weakly regulated share markets also contributed to poor financial practices.

In the mid 1990s, a deterioration in trade balances placed downward pressure on regional exchange rates, leading investors to believe authorities would need to lower the value of their currencies against the US dollar. As concerns grew about the quality of bank and corporate balance sheets, investors began to sell these economies' assets, adding to downward pressure on the currency and eventually forcing authorities to stop supporting these currencies and abandon their currency pegs.

The sharp decline in the value of currencies fed back on bank and corporate balance sheets, forcing up the domestic value of foreign debts and forcing many more banks into insolvency.

Factor 1: Weak Banks and Financial Systems

Prior to the crisis, banks' balance sheets were extremely exposed to foreign exchange movements and over-heated local property and share markets while many corporations carried excessively high debt to equity ratios (Asian Development Bank, 2001).

Exchange rates fixed to the US dollar in conjunction with high local interest rates also gave local borrowers a strong incentive to borrow abroad (Figures 1.1, 1.2).[1] With authorities maintaining virtually fixed exchange rates in terms of US dollars, local borrowers saw foreign borrowing as a relatively risk free source of cheap money; most saw no need to insure (through hedging) against foreign currency movements. For their part foreign bankers also apparently believed these US dollar exchange rates would hold, reducing the risk borrowers could not repay loans. See Report 1 Annex I for figures and tables.

New regulations opening many regional capital markets (allowing foreign money to flow in) allowed domestic East Asian banks to undertake much of this foreign borrowing. By mid-1997, domestic banks handled 77 per cent of all foreign bank borrowing inflows to Malaysia, 86 per cent to Thailand and 69 per cent to the Philippines; in Indonesia firms borrowed more overseas than banks (Asian Development Bank, 2001). Regulators then allowed these banks to lend the proceeds of their foreign borrowing, usually in local currency, to domestic firms or investors. Hence, local banks took all the risk local currencies may depreciate and had no hedge insurance to protect them. By 1996, Malaysian, Thai, Indonesian and Korean banks' foreign currency liabilities considerably exceeded their foreign currency assets (Corsetti, et al, 1998).

Even more dangerously, across the most crisis-affected countries, banks' foreign borrowings were short term, less than 12 months, exposing them to a sudden change in foreign lenders' sentiment. By 1996, short term foreign liabilities made up over 50 per cent of all regional banks' liabilities; this reached 67 per cent in the ROK and 61 per cent in Thailand (Asian Development Bank, 2001).

The ratio of Asia 5 economies' short term foreign liabilities to available foreign reserves increased rapidly to dangerously high levels (Figure 1.3). The International Monetary Fund, IMF, considers this ratio a key vulnerability variable. By 1997, the ROK had accumulated short term foreign debt obligations worth over twice its foreign exchange reserves, Indonesia's were 60 per cent higher than their foreign exchange reserves and Thailand's were 50 per cent higher (East Asian Analytical Unit, 1999). These high ratios made the Asia 5 economies vulnerable to a sudden change in foreign creditors' sentiment.

Risky bank lending also made banks vulnerable on the domestic side of their business. Compared to North America, Europe and Australia, bank lending dominates share market financing of corporates in most East Asian economies, exposing banks more to the business cycle (Figure 1.4). Furthermore, often contrary to prudential regulations, authorities also permitted banks to lend a large proportion of their total loans to local borrowers to purchase real estate, causing a speculative bubble and low occupancy rates. In the years before the crisis, banks also lent heavily to locals to

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[1] The inflow of funds into East Asia increased the demand for these economies' currencies. To maintain their pegged currencies value, authorities bought the foreign currency, building up reserves and sold domestic currencies, increasing their supply. Normally, this increase in money supply would increase inflation, so to prevent this the authorities mopped up the extra money supply by selling government bonds, in the process raising interest rates.

purchase shares; along with major foreign purchases of local shares, or portfolio inflows, this drove a boom in regional stock exchanges (Figures 1.1 and 1.5) (IMF, 1997). Companies also borrowed heavily to invest in industrial capacity, especially for export, but from 1995 high exchange rates undermined their competitiveness, again causing their capacity utilisation to drop, undermining their ability to repay loans. Hence bank lending quality deteriorated in the lead up to the crisis and bad lending decisions undermined the quality of investment; in the 1990s the income earned from each invested dollar started falling sharply (Table 1.1). In 1996, for example, 20 of the largest 30 Korean conglomerates of companies had a rate of return on their investments below the cost of funds (East Asian Analytical Unit, 1999). See Report 1 Annex II.i for a detailed account of these issues.

Prior to the crisis, few East Asian economies allowed foreign financial institutions to compete freely with local banks, finance firms, securities companies or insurers. Protected from international competition, many local financial institutions were small and inadequately capitalised, had weak risk management strategies, employed inefficient and in some cases non-transparent loan assessment procedures and used antiquated transactions technology. Most local financial institutions undertook relationship based lending, based on often poorly valued collateral which later proved hard to secure through the courts, rather than the cash flow expectations of potential borrowers. Regional banks' lack of exposure to international competition and lack of experience in open capital market environments contributed significantly to their risky external borrowing and domestic lending prior to the crisis.

Factor 2: Corporate Governance and Prudential Weakness

Institutional failures contributed to corporates, banks and investors undertaking such risky borrowing, lending and investment strategies and prudential authorities failing to identify sooner deteriorating risk factors in their economies. Institutional weakness in designing and implementing financial market regulations, corporate governance regimes and prudential controls were major areas of failure.

A decade of high growth, excessive domestic and foreign investor optimism, poor prudential supervision, ineffective bankruptcy laws and weak corporate governance encouraged many private firms to imprudently manage financial risk. Many regional governments failed to enforce appropriate bank (prudential) regulations in rapidly growing and increasingly open financial systems, thus sanctioning poor decisions on credit allocation. Implicit government guarantees for banks and large corporates created moral hazard for undercapitalised banks and excessively leveraged firms.[2] In this environment, the major exchange rate depreciations and foreign capital outflows in mid and late 1997 caused a vicious cycle of non-performing loans, corporate failures, shrinking bank liquidity, ultimately threatening financial system stability.

In most regional economies, corporate accounting and audit standards fell well short of international best practice. Major locally owned conglomerates often included a deposit taking bank, which authorities permitted to make loans to other conglomerate firms, often for poor projects (East Asian Analytical Unit, 1999). As well, intra-conglomerate related party transactions concealed such firms' true financial status,

[2] Moral hazard exists when firms or individuals believe they will not be forced to bear the consequences of their decisions.

even though some group firms were listed on local stock exchanges (Economic Analytical Unit, 2002). Weak shareholder protection legislation and the dominance of family owned firms with close relationships between majority owners and their managers, often the same people, made it difficult for shareholders to scrutinise firms' financial dealings. Prudential authorities did not enforce disclosure of corporate or financial institution activities. Banks typically had low capital reserves with which to protect depositors from bad lending decisions. Weak prudential regulatory institutions, bankruptcy laws and commercial courts' which routinely failed to apply corporate codes and laws, increased tolerance of illegal business practices and a weak credit culture (Claessens et al, 2000). Close connections between governments and major corporates reinforced this unhealthy business environment, giving corporates the impression governments would bail them out if they became overleveraged and made poor borrowing and investment decisions.

In many East Asian economies, local banks' and corporates' high unhedged exposure to foreign borrowing, poor local lending policies, risky investment strategies and a lack of timely and reliable information on bank and corporate activities contributed to the major reversal in international capital market sentiment in 1997.

See Report 1 Annex II.ii, II.iii for the role of poor financial sequencing and moral hazard in the crisis.

Factor 3: Macro-Economic Mismanagement

In the four years preceding the crisis, a series of adverse macroeconomic shocks and poor domestic policy responses weakened key East Asian economies' fundamentals, exposing them to a sudden change in market sentiment in 1997. From 1993, the 'Asian Miracle' myth, high local interest rates, the strong Japanese yen and more open local capital markets drove a massive increase in foreign capital inflows to the region (Figure 1.1). Particularly worrying was the massive build up of volatile foreign bank lending to the five economies the crisis affected worst; Indonesia, Thailand, the Republic of Korea, ROK, the Philippines and Malaysia, or the Asia 5.

As most South East Asian governments and the ROK effectively pegged their currencies to the US dollar, throughout the 1990s until 1997, nominal US dollar exchange rates stayed relatively constant. Hence these often speculative capital inflows caused inflationary pressures and drove a real estate and capital investment bubble. Most regional governments responded by raising interest rates, which encouraged more foreign bank borrowing (Figure 1.2).

In the early 1990s, regional economies' real exchange rates were kept low by the high Japanese yen, but from late 1995, their real exchange rates sharply appreciated as the yen depreciated dramatically (Figure 1.6). This was a key trigger for the crisis as the price of regional exports to foreign buyers rose, reducing East Asian exporters' ability to compete on international markets (CEIC, 2002). Most of the Asia 5 economies also suffered a worsening terms of trade, a fall in the world price of their exports compared with their imports, due to declines in semiconductor prices.[3] By 1996, deteriorating

[3] When an economy's exchange rate remains flexible, as in the case of Australia, a depreciation in the currency of a major importer like Japan and a worsening terms of trade usually would causes a drop in the value of the economy's currency, helping it to maintain international competitiveness.

export competitiveness and the weak electronic components market sharply reduced regional export growth, particularly in Thailand, Malaysia, the ROK and the Philippines (Figure 1.7).

East Asian economies' deteriorating export performance worsened their trade and current account deficits.[4] In the lead up to the crisis, most Asia 5 economies had deficits over 5 per cent of GDP (Figure 1.8).[5] In particular, Malaysian and Thai current account deficits reached dangerously high levels of 9 per cent of GDP in 1995 and 1996 (CEIC, 2002). By contrast, the crisis spared other East Asian economies with more moderate deficits and China which had a current account surplus

CRISIS HITS IN OPEN FINANCIAL MARKET ENVIRONMENT

In the decade before the crisis, East Asian governments sequentially opened their economies to international capital markets, permitting their banks and corporates to borrow, lend and invest abroad, foreigners to buy local shares and locals to buy foreign shares, often with few restrictions. However, few East Asian economies had put in place the necessary prudential controls and institutional framework to protect their economies from the occasional inevitable volatility in international capital flows.

International banks and investors only will lend and invest abroad if they believe the risk adjusted return they will receive there is higher than returns they can obtain at home. However, by the time of the crisis, these economies exhibited deteriorating competitiveness due to poor macroeconomic settings, increasingly risky bank and corporate balance sheets and high foreign debt to foreign reserve ratios, so offered a declining risk adjusted return for foreign creditors, shareholders and direct investors. Because international capital markets are highly liquid and the cost of undertaking transactions is low, the volume of net inflows can change suddenly, rapidly moving financial variables like exchange and interest rates. In 1999, the annual value of international capital flows was over 70 times the value of international trade flows and was rising rapidly each year (East Asian Analytical Unit, 1999).

Starting in Thailand in June 1997, foreign and local investors and creditors lost confidence the Thai Government could maintain a baht exchange rate which looked unrealistically high. A run on the baht saw Thailand lose most of its foreign reserves within a few days, the Government stopped defending the peg and the currency collapsed. Over the ensuing months the other Asia 5 currencies followed (Figure 1.6). See Report 1 Annex II.iv for a detailed description of these events.

Throughout this period, the lack of reliable information on the true state of economies' foreign exchange reserves and their bank and corporate balance sheets made market participants very sensitive to the actions of other investors who may be better informed. This created an avalanche of selling and placed tremendous downward pressure on regional currency values (Krugman, 1998). Once contagion took hold in 1997, the high short term debt to foreign exchange ratios of several Asia

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[4] The trade balance, exports minus imports, forms the major part of a country's current account, which also includes income earned from abroad less income paid abroad on investments and the balance of funds repatriated into and out of the country.

[5] Experts disagree as to when a current account balance reaches dangerous levels, although in 1996, United States Treasury Secretary Summers suggested this occurs when the CA reaches 5 per cent of GDP.

5 economies made creditors nervous they would not be able to recover their funds. This precipitated a ‘rush to the door’ with foreign creditors refusing to roll over short term bank loans, making dramatic inroads into domestic liquidity (Figure 1.1). The US$150 billion contraction in Asia 5 liquidity after 1996 explains much of the severity of the Asian crisis. In the ensuing credit crunch, even viable firms found it impossible to obtain working capital or export credits, let alone investment capital. Production, domestic consumption exports and imports all contracted. Asset prices, particularly in the bubble real estate and stock markets fell sharply (Figure 1.5).

The large drop in exchange rates also fed back into the economy through bank and corporate balance sheets, as a large share of liabilities were valued in foreign currencies (Goldstein, 1998). Debts owed to foreigners suddenly doubled in domestic value, dramatically increasing banks’ and firms’ debt servicing burdens. This undermined firms’ ability to repay loans, dramatically increasing banks’ non performing loan ratios and corporate insolvency (Figure 1.9).

See Report 1 Annex II.v for an alternative view on the cause of the crisis, known as the ‘Non-Fundamental’ view.

IMMEDIATE IMPACT OF THE CRISIS

With banks and corporates across the region becoming insolvent, production and employment declined sharply, reducing GDP growth and even levels in the Asia 5 and other regional economies (Figure 1.10). In 1998, as net external demand increased, the drop in domestic demand far exceeded the drop in total real GDP; for example, domestic demand fell 18 per cent in Thailand and 17 per cent in Indonesia (IMF, 1999).

The sharp depreciation in exchange rates dramatically increased inflation, as import prices rose. In 1998, aided by a massive increase in money supply, Indonesian inflation reached close to 60 per cent, but due to tight money supply was only 10 per cent in the Philippines, 8 per cent in Thailand and about 5 per cent in Malaysia (CEIC, 2002). In Lao PDR, inflation hit 90 per cent, again due mainly to lax macroeconomic policy. However, in 1999, tight monetary policy and slowing demand across the region slowed inflation, which fell to 20 per cent in Indonesia and low levels in other regional economies (CEIC, 2002).

Unemployment also rose sharply following the crisis, increasing poverty. By the end of 1998, unemployment rates peaked at 13 per cent in the Philippines, 8 per cent in the ROK and close to 6 per cent in Thailand and have continued to rise in Indonesia to over 8 per cent by 2001 (Asian Development Bank, 2000). However, official unemployment rates did not capture the full impact on the labour markets as many workers returned to rural areas, dropping out of the formal labour market and official statistics.

The crisis also significantly reduced earnings adjusted for inflation (real earnings). In 1997-8, real earnings per worker declined by 27 per cent in Indonesia, 21 per cent in Thailand and 10 per cent in the ROK. In most cases, declines in urban incomes exceeded falls in rural incomes. For example, in Indonesia, the crisis impacted most heavily on Java given its greater exposure to manufacturing (Knowles et al, 1999).

Falling output, employment and earnings and rising prices significantly reduced living standards, poverty and equity. In 1998, average living standards measured as real (inflation adjusted) per capita GDP fell 16 per cent in Indonesia, 12 per cent in Thailand, 10 per cent in Malaysia and 8 per cent in the ROK, but only 3 per cent in the Philippines. Regional economies less directly affected by the crisis registered more modest declines in real per capita GDP (Barro, 2001). By 1999, only the ROK had regained its pre-crisis real per capita GDP level (Asian Development Bank, 2000). Household measures suggest even greater falls in living standards; between 1997 and 1998, real per capita household income fell 24 per cent in Indonesia and 12 per cent in the Philippines (Knowles et al, 1999). The living standards of the poor were hit more than others, with food prices rising by more than non-food prices and food subsidies removed in some economies including Indonesia as part of IMF conditions (World Bank, 1999).

Reflecting these trends and mostly inadequate social safety nets, poverty rates increased across the region. Given their rapid growth, economies had little reason to plan for downside risks and governments were ill prepared to manage the impact of the crisis, with coverage of existing social protection systems generally inadequate (World Bank, 1999). Most households had few formal mechanisms for risk management, relying largely on savings and links to family and communities (World Bank, 1999).

In Indonesia, the share of people living on less than US$2 per day rose from 50 per cent in 1996 to over 65 per cent in 1998; in Thailand, the share of people living on under US$2 per day rose from 28 per cent to 34 per cent (World Bank, 1999) (Figure 1.11). In the ROK, the poverty rate more than doubled from 3 to 7.5 per cent (Knowles et al, 1999). Income inequality also increased in some economies following the crisis. The income share of the rich rose from 20.5 per cent to 22.5 per cent in Thailand, from 22 to 24.5 per cent in the ROK and 39.3 to 42.9 per cent in the Philippines. By contrast, Indonesia saw some minor improvement in income distribution, as rural areas were less affected than urban areas (Knowles et al, 1999).

In many economies the rural sector provided a buffer against the rise in urban poverty, absorbing many urban workers. This is because few farmers had accessed bank loans and agricultural exports benefited from exchange rate depreciation (Knowles et al, 1999; World Bank, 1999).[6]

Burma, Vietnam, Cambodia and Laos did not suffer the same type of domestic problems Indonesia, Thailand and Malaysia experienced. However, the crisis did affect these economies, reducing their exports and growth, and forcing them to devalue their currencies. Also, the crisis increased the urgency of reforms, including privatisation of state banks, reform of state owned enterprises and in some cases reigning in of the budget deficit (see Annex III for the crisis' impact on developing ASEAN economies).

POST CRISIS POLICY DEVELOPMENTS AND THE ROLE OF DONORS

In the wake of the crisis, developing East Asian economies, particularly Thailand and Indonesia, embarked on widespread financial and corporate sector restructuring and

[6] Most agricultural exporters export at a given international price, usually measured in US dollars. When their domestic currency depreciates, the local currency earnings from their exports increases by the same amount, increasing their incomes. As few agricultural exporters rely on imported inputs they are not exposed to rise domestic prices of imports.

reform. These reforms were designed to underpin investment and growth and reduce vulnerability to future crises. The international financial institutions, the IMF, World Bank and Asian Development Bank and bilateral donors played a significant role in guiding the process. Together, multilateral donors committed close to US$60 billion to programs in Indonesia, Thailand and the ROK and bilateral donors a further US$54.7 billion (Tables 1.2, 1.3).

See Report 1 Annex IV for a description of bilateral donor responses.

GOVERNMENT AND DONOR POLICY RESPONSES

Responding to the crisis, from early 1998 regional governments adopted policies to recapitalise their banking sectors, restructure their corporate balance sheets and review economic governance systems and institutions. Many governments also increased their exposure to world trade and foreign direct investment. In Thailand, Indonesia, the ROK and the Philippines (the IMF 4 economies) IMF stand-by programs ensured the Fund played a key role in guiding the restructuring and liberalising process. Elsewhere, including in Malaysia, Vietnam, and Cambodia, IMF influence was less, although policies governments adopted often resembled IMF packages. Because most analysts believed improved macroeconomic outcomes depended on market confidence, IMF packages gave high priority to structural reforms, formulated in collaboration with local authorities, the World Bank and Asian Development Bank (IMF, 2002).

i Macroeconomic Response and Reforms

Policy makers and the Fund initially gave policy priority to halting the cycle of capital outflow, falling currencies and rising inflation (IMF, 1999). The IMF recommended governments adopt floating exchange rate regimes to replace their pegs and tighten monetary and fiscal policies to support their newly floating currencies, contain inflation and restore financial market confidence (IMF, 1999). [7] However, as regional economies' recessions deepened unexpectedly and currencies stabilised, from early 1998 the Fund endorsed governments reducing interest rates and running budget deficits in an effort to stimulate demand and restore economic growth (IMF, 1999).

The IMF provided advice on consolidating regional economies' long-term fiscal outlook so they could meet the significant outlays required to recapitalise their banking sectors (IMF, 1999).[8] Indonesia reduced subsidies to industries and energy and agricultural product consumers. Amongst donors, the IMF continues to carry responsibility for Indonesian macroeconomic policies (World Bank, 2001).

[7] In early 1998, Indonesian officials vacillated over whether to support the currency through higher interest rates or add liquidity to the banking sector, lowering rates; this indecision lead to a large sell-off in the currency which aggravated inflation (IMF, 1999). By May 1998, the weak currency and higher inflation cycle was well underway. At mid-year, the Government announced a new set of policies, including higher interest rates and a tough structural reform program and by October, the currency strengthened, financial markets stabilised and inflation moderated (IMF, 1999). In 1999, the Malaysian government adopted a pegged exchange rate against the US dollar, locking in a competitively low exchange rate at that time and imposed capital controls (IMF, 1999).

[8] Every year, the costs of the banking sector recapitalisation absorb around 2 per cent of GDP in Thailand and Indonesia (IMF, 1999).

Governments also agreed to privatise state owned enterprises and sell assets nationalised as part of bank and corporate sector restructuring. Sale of Indonesian Government equity in nationalised banks continues provide significant revenue for the national budget and Thailand also launched a significant privatisation program, though the current government has only recently resumed this after several years of stalled progress.[9]

Several governments also reformed their central banking legislation and restructured their central banks. The Indonesia Government introduced a new Central Bank Act and some governments, including Thailand's moved to an inflation target to rebuild central bank credibility (Economic Analytical Unit, 2000).

In the other developing ASEANs, macroeconomic development priorities included regaining macroeconomic stability and boosting revenues to reduce budgets' reliance on donor inflows. In Cambodia, reducing defence and civil service expenditure, improving revenue collection and governance and reducing smuggling were priorities (World Bank, 2000b). In Lao PDR, donors focused on reducing inflation by reigning in fast growing credit growth and reducing budget expenditures (IMF, 2002b). Stopping central bank financed credits to the state owned enterprise sector was central to this policy and improving basic economic data reporting also was a priority (IMF, 2002b). By 2000, tighter macroeconomic settings had contained money growth, stabilising the currency. In Myanmar, authorities focused on reducing the deficit by improving tax implementation and their measures of inflation and GDP (IMF, 1999b).

ii. Liquidity Support

In late 1997, with confidence in their banking sectors falling rapidly, Indonesia, Thailand and the ROK issued government backed guarantees of bank deposits to staunch further runs on bank deposits. In August 1997, Thai authorities guaranteed all deposit-taking institutions other than the 58 finance companies previously suspended. The Government also suspended several banks' operations pending a review of their viability (Scott, 2002). The Indonesian Government closed 16 banks in November 1997 and subsequently guaranteed deposits up to IDR20 million per depositor per bank. By this time private banks had already lost 12 per cent of their rupiah deposits and 20 per cent of their foreign currency deposits. As deposits continued to leak following the announcement, by January 1998, the Government was forced to extend the guarantee to all deposits. The Government also nationalised several failed banks implicitly guaranteeing their deposits, further raising community confidence in the banking system (Scott, 2002).

In hindsight, donors acknowledge they should have acted more quickly in advising the Indonesian Government to guarantee deposits (IMF, 1999). Instead the central bank issued large loans to private banks to ensure they could repay depositors; many of these funds were subsequently converted to foreign exchange and repatriated and little has been repaid, adding significantly to Indonesia's fiscal burden. In Thailand, donors should have advised against suspending private banks as this encouraged some debtors to those banks to cease repayments, adding to the strategic debtor problem

[9] In 1998-9, the IMF projected privatisation would fund 15.8 per cent of the fiscal deficit in Indonesia.

(Scott, 2002).[10] The IMF and World Bank continue to support governments in devising new deposit insurance schemes.

II. Bank Sector Restructuring

Throughout 1998, due to currency devaluations, collapsing real estate markets, macroeconomic contraction and subsequent falls in local employment, income and demand, an increasing share of loans crisis affected economy banks advanced to corporates became non performing loans (Figure 1.9). Over 1997 and 1998, with international financial institution assistance, regional governments established a range of new institutions to manage bank and corporate sector restructuring. Under the IMF Extended Arrangement, and with World Bank and Asian Development Bank technical assistance and loans, governments adopted policies to restore confidence in their financial systems. See Report 1 Annex II.vi for more details.

The Indonesian, Korean and Thai governments passed legislation allowing them to consolidate their banking industries and liquidate insolvent banks which failed to meet minimum capital adequacy ratios.[11] The Thai Government nationalised, merged and sold seven mostly small and medium sized banks and 70 finance companies. The Thai Financial Restructuring Authority, FRA, reviewed these financial institutions' rehabilitation plans and where necessary oversaw their liquidation (Economic Analytical Unit 2000b). The World Bank provided a loan to fund in-depth assessments of the non-suspended finance companies and their rehabilitation (World Bank, 2000c). With World Bank and IMF technical assistance, the Indonesian Bank Restructuring Authority, IBRA appraised banks' capital adequacy and restructured the industry, closing or nationalising 35 banks; the Government also merged insolvent state owned banks into one large bank. See Report 1 Annex II.vii for a detailed account of bank recapitalisation in Indonesia.

These agencies also recapitalised banks with weak capital adequacy ratios but which exceeded agreed minimum levels, usually 2-4 per cent and carried a high proportion of non performing loans. IBRA recapitalised nine banks, effectively nationalising them and the Thai Financial Restructuring Authority seven, five of which were state owned banks. The Korean Government also recapitalised, nationalised and merged seven major banks. These government cash injections became bank equity, significantly increasing government ownership of banks across the region (Figure 1.12). Governments typically recapitalised banks by purchasing their non performing loans off from them at a discount, usually 40 to 50 per cent of their face value paying for them with long-term government bonds. This rebuilt banks' capital adequacy ratios and provided them a source of interest income (IMF, 1999).

At huge cost, the Indonesian, Thai, Korean and Malaysian governments' asset management companies purchased banks' nonperforming loans and managed them,

[10] The strategic debtor problem occurs where debtors who may be able to service their debts categorise themselves as distressed to exploit perceived broad state guarantees given to creditors and debtors in a financial crisis.

[11] Capital adequacy ratios, CARS, are the ratio of unimpaired bank capital (net of bad loans) to total deposits. The international CARs norm for solvent banks is 8 per cent, but many East Asian banks had CARs well below this prior to the crisis, and many of the worst affected banks had severely negative CARs.

restructuring loans, selling them or collateral backing them. In Indonesia, IBRA also acts as the Government's asset management company, managing the assets of closed banks and non performing loans purchased from recapitalised banks. In 2001, Thailand belatedly established the Thai Asset Management Company but it mainly buys state owned banks' non performing loans. The ROK and Malaysia established successful asset management companies in 1998. The cost of these banking system bailouts was enormous. In Indonesia, bank recapitalisation and deposit insurance cost taxpayers around 75 to 80 per cent of GDP, while Thai and Korean bank recapitalisation and deposit guarantees each cost around 40 to 45 per cent of GDP (Economic Analytical Unit, 1999). Analysis indicates the interest costs of these bailouts has reduced Indonesian and Thai GDP by about 2 percentage points since 1999 (World Bank, 2002b).

The international financial institutions assumed responsibilities for different restructuring tasks. In Indonesia, under the joint World Bank, IMF and ADB extended arrangement, the World Bank continues to concentrate on state banks and IBRA-related matters, whereas the IMF focuses on the central bank and private bank restructuring. In Thailand, the World Bank and Asian Development Bank focus on financial sector reforms and institution building.

Vietnam also suffered a crisis in its banking system after the 1997. Resembling problems experienced in the Chinese banking system this crisis was due to the high non performing loans state owned enterprises owed to state banks. Some state banks also borrowed abroad illegally and on-lent to state owned enterprises. The Government closed and merged seven banks and in 2002 finalised plans to restructure most other state owned commercial banks. With World Bank technical assistance, international accounting firms audited banks on the basis of international auditing and accounting standards, finding many irregularities and confirming high non-performing loan levels (IMF, 2002c).

Cambodia's aid program also focused on repairing the state owned banks and creating a two-tier banking system, separating central bank functions from commercial banking and allowing foreign bank entry (World Bank, 2000b). The IMF program is close to liquidating non-viable banks and is re-licensing viable banks (IMF, 2002d). The IMF completed technical assistance to improve bank supervision in July 2002.

In Lao PDR, repairing the weak state-owned banking sector also is a priority, as it also lent heavily to state owned enterprises and government investment projects (IMF, 2000e). With IMF, World Bank and Asian Development Bank assistance, the Government is recapitalising deeply insolvent state owned commercial banks conditional on improved financial performance, loan classification and accounting. The Government also is phasing out directed lending and increasing pressure for state owned enterprises to repay past loans (IMF, 2002b).

In Myanmar, non-performing loans are thought to be rising, although little has been done to address this. The large loses the state owned enterprises generate suggest non-performing loans may be higher than the state estimates. However, the central bank has increased its emphasis on prudential supervision (IMF, 1999b).

iv. Corporate Sector Restructuring

As the crisis severely damaged the regional corporate sector, policies aimed at assisting firms restructure debt have assumed high priority. For example, in 1999, analysts estimated around 70 to 80 per cent of Indonesia's corporate sector was technically insolvent and carried debts of about US$120 billion or 85 per cent of gross domestic product (World Bank, 2000a). Corporate insolvency is a critical drag on economic growth; first, banks and capital markets rarely will lend to or invest in insolvent firms, which therefore cannot invest. Second, if original managers continue to operate insolvent firms they have an incentive to asset strip and little reason to maintain assets. Hence productive assets can fall into disrepair and be wasted; this undermines medium to long term economic growth. Third, if legal systems do not force corporates to repay or restructure debts, more viable borrowers have incentives too cease debt repayments, further boosting non-performing debt levels; this increases the cost and difficulty of recapitalising insolvent banks and selling nationalised banks, undermining banking sector reform. Finally, banking systems cannot recover until corporate debts are restructured or written off as they have few viable clients to which to lend.

To expedite and manage corporate debt restructuring, crisis affected governments established agencies including Indonesia's Jakarta Initiative Task Force, Thailand's Corporate Debt Restructuring Advisory Committee and the ROK's Financial Supervisory Agency. These institutions employ US Chapter 11 style debt work-outs, allowing firms with a sound business plan to survive, though preferably under new ownership and management, hopefully maintaining employment and economic activity and delivering creditors higher pay backs than if debtor firms were liquidated. These agencies were charged with speeding up the debt and corporate restructuring processes, relieving pressure on inadequate legal systems and reducing costs for creditors and debtors.[12] Creditors and debtors who participate in these workout schemes do so in the hope of retrieving more value from non performing loans and saving viable businesses (Nam et al, 1999). Ultimately, the threat of bankruptcy courts liquidating uncooperative firms should encourage debtors to participate in debt work-outs.

However, especially in Indonesia, Thailand and the Philippines, weak and non-transparent courts provide little threat to well connected recalcitrant debtors, impeding corporate restructuring efforts (Economic Analytical Unit, 2002). In many cases, powerful well-connected corporate owners seek to influence courts and governments and manipulate the debt restructuring process, preventing or challenging adverse court findings. Authorities and creditors are concerned these new debt work-out mechanisms can not handle the large backlog of insolvency cases in an efficient manner, as rules are vague and judges' discretion great (IMF, 2002a).

In many regional economies, workouts aim to minimise formal bankruptcies so firms can be rescued and debts restructured. Frequently corporate restructuring is shallow, merely restructuring debts, writing off debts and giving interest rate discounts and holidays rather than requiring firms to sell off non-core assets, change management

[12] These agencies classified corporate debts by quality, determining which corporates could be restructured and which should be liquidated. In Indonesia, IBRA negotiates debt restructuring where debtors owe banks under its control.

and acquire new capital and owners. Without robust insolvency laws and courts, creditors often have to agree to such terms. Shallow debt restructuring also is in the short term interests of many domestic banks who are struggling to retain minium capital adequacy levels to survive, as it allows them to present doubtful loans as performing. However, such work-outs have not protected creditors' rights or resulted in potentially healthy corporates; in Indonesia and Thailand many inadequately restructured companies' loans are becoming non-performing again (Markels, 2001). The impact of shallow debt restructuring on corporate governance also is undesirable as depositors and taxpayers are bailing out non-viable firms and managers responsible for bad decision making, many of whom retain their assets and positions. This creates an environment of moral hazard, where corporates and managers believe they will not be held accountable for poor future commercial decisions.

Donors continue to address this weakness in corporate restructuring, strengthening the authority of debt rescheduling agencies and their ability to foreclose on non-cooperative debtors. In April 2000, for example, debt restructuring delays saw the Indonesian Government and World Bank initiate time-bound processes under Jakarta Initiative Task Force, improving incentives and sanctions applying to debtor participation.[13] Reforms included establishing the Financial Sector Policy Committee on which all relevant ministers sit. Instead of relying on debtors to volunteer for debt workouts, the Committee oversees corporate and bank restructuring and refers major cases to the Jakarta Initiative Task Force for action. The Committee also can refer uncooperative debtors to the Attorney General's office to initiate bankruptcy proceedings.[14] Where necessary the task force assists debt restructuring on IBRA's behalf. Government tax incentives for debt forgiveness, debt for asset and equity swaps and easier requirements for banks to swap non-performing debts for equity also assist the task force's debt restructuring program (IMF, 1999). These new government initiatives have markedly improved the progress of Jakarta Initiative Task Force. The World Bank is supporting this process under its Extended Arrangement, which assists IBRA's two asset management units and supports the Jakarta Initiative (World Bank, 2001). The Bank's Private Sector Development Strategy also supports the Indonesian Government's corporate restructuring efforts through technical assistance, lending, trust funds and analytical and advisory services (World Bank, 2002a).

In Vietnam, the World Bank is leading state owned enterprise reform. In March 2001, the Government adopted a five year plan aiming to improve state owned enterprise profitability through equitisation, divestiture and liquidation (IMF, 2002c). However, donors report serious vested interest resistance to some measures, slowing reforms (IMF, 2002c).

With donor assistance the Myanmar Government started privatising state owned enterprises in 1995, by offering them for lease, joint ventures with foreign investors and outright sale. However, the pace of divestiture is slow, as unrealistic asset prices have limited foreign and domestic investor interest (IMF, 1999b).

[13] Under the early form of the JITF, progress was very slow; it attracted only 25 companies by November 1998, in its first two months of operation.

[14] The Financial Sector Policy Committee also can act on the Jakarta Initiative Task Force's recommendation to impose other sanctions against recalcitrant debtors, including publishing the names of non-cooperative debtors and requesting relevant government agencies to revoke or refuse to extend licences, concessions and other facilities previously held by uncooperative parties.

Also with donor assistance, governments embarked upon a parallel set of economic governance reforms to corporate governance legislation, bankruptcy laws and court and regulatory system strength.

v. Economic Governance Reforms

Repairing bank and corporate sector balance sheets without addressing weak supervisory and regulatory frameworks exposes economies to the risk of future financial crises (IMF, 1999). Hence, with donor guidance, governments adopted a wide range of structural and regulatory reforms and reviewed their role in the economy, especially in allocating credit (IMF, 1999, East Asian Analytical Unit, 1999, Economic Analytical Unit, 2002).

First, governments reviewed and strengthened their supervision of the financial sector. Most governments introduced and set timetables for enforcing international standards for capital adequacy ratios for banks, 8 per cent, and established prompt corrective action mechanisms for cautioning and eventually closing banks which do not meet these standards. Governments also tightened the definition of non performing loans to meet international standards and increased the frequency banks had to report key financial and performance indicators (East Asia Analytical Unit, 1999).

Second, many East Asian governments committed to improve the timeliness and standard of corporate information available to banks and investors, through more stringent reporting requirements and upgraded company laws and accounting standards. Third, governments tightened other aspects of corporate governance, including minority shareholder rights and introduced tighter listing rules for companies to protect investors' savings (Economic Analytical Unit, 2002). However, compliance with new prudential supervision and corporate governance regimes is uneven, with under resourced enforcement agencies and weak compliance incentives often preventing a faster move to a rules based disclosure culture.

Finally, to increase the speed and fairness of corporate debt workouts and insolvency proceedings, Indonesia, Thailand and the ROK strengthened their bankruptcy legislation and courts following the crisis. Indonesia's 1998 bankruptcy law allowed unsecured creditors to proceed against defaulting debtors in the commercial courts (Asian Development Bank, 2001).[15] In 2000, after strong resistance in the parliament, the Thai Government also finally introduced new bankruptcy laws strengthening creditor rights. However, in Thailand and particularly Indonesia, controversial and non-transparent court decisions have prevented effective implementation of new legislation, slowing corporate restructuring (Asian Development Bank, 2002).[16]

[15] The court can declare a firm bankrupt if at least two creditors request it or if default occurs on a single loan. In 2000, the Government also passed the *Company Bankruptcy and Debt Restructuring and/or Rehabilitation Act*, modelled on Chapter 11 provision of the US bankruptcy law. In 2000, the Government increased sanctions on uncooperative debtors and empowered the Attorney General to deal directly with cases, improving incentives for debtor participation (World Bank, 2000a).

[16] The new Bankruptcy Court initially won creditors' confidence with landmark rulings against the largest and most notorious Thai corporate debtor, Thai Petrochemical Industry. However, in 2001, the court allowed an appeal against a previous ruling in this case, precipitating a flood of similar appeals, further slowing restructuring (Chittmittrapap, 2001). Most cases can take up to ten years, so creditors receive little net value from collateral, even if eventually it is realised. Insolvent firms have an automatic stay on debt repayments, protecting them from foreclosure for five years while they

Hence, most creditors have opted for financially rehabilitating insolvent companies. Several regional governments also sought to improve their court systems by strengthening judges' training in commercial matters, anti-corruption measures and augmenting resources. The World Bank provides most donor support in this area. However, progress has been slow.[17]

Economic governance programs have attracted a large share of international financial institutions' loans under Fund standby programs. The World Bank provided US$1.5 billion in assistance to the Indonesian Government for economic governance reforms under the Policy Reform Program. This program aims to rebuild an efficient banking sector, re-establish effective financial services, restructure unviable corporations, reduce corruption and increase public and private sector transparency and efficiency (World Bank, 2002d). Under its Indonesian Private Sector Development Strategy, the Bank is directly implementing a range of free-standing programs and advisory activities (World Bank 2002d). The Bank also established a Partnership for Governance Reform, bringing together government, civil society, the private sector and donors (World Bank, 2001). The Bank is heavily involved in training officials preparing for decentralising government functions to the provinces (World Bank, 2001).

Since 1998, the World Bank has supported the Cambodian private sector's development by helping draft new commercial laws and promoting other legal reforms through the Legal Reform Unit (World Bank 2000b). In conjunction with the World Bank Institute, the Cambodian Economics and Finance Institute trains civil servants (World Bank 2000b). A Governance Action Plan also aims to improve civil service administration, reduce corruption, reduce civil service numbers, raise the salaries and qualifications of remaining officials and (IMF, 2002d).

In Lao PDR, the international financial institutions are boosting fiscal authorities' capacity and strengthening the legal framework to support private sector development and state owned enterprise reform (IMF, 2002b). The IMF notes the Lao Government requires further technical assistance to improve officials' capacities, especially in banking and fiscal areas (IMF 2000e).

See Report 1 Annex II.viii for donor responses to improve international financial architecture.

vi. Market Access Measures

Since the crisis, regional governments have further reduced barriers to trade and international investment in key sectors. Stand-by programs for Indonesia and Thailand included provisions for freer international trade and investment. Indonesia reduced agricultural tariffs and abolished several monopoly trading entities,

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restructure. In 1999, creditors gained the right to claim repayment for new loans to a debtor business, enabling restructuring firms to gain finance (Economic Analytical Unit, 2002).

[17] In Indonesia, despite forming a new commercial court and training judges, courts have declared only a handful of companies bankrupt and refused to rule in favour of creditors in many high profile, clear cut cases (Asian Development Bank, 2001). Under their Partnership for Governance Reforms, the World Bank and United Nations Development Program focuses on judicial and legal reform, working with the Indonesian Law Reform Commission. This partnership is largely Indonesian managed and donor funded (Department for International Development, 2002).

significantly liberalising trade. The Philippines also unilaterally reduced trade barriers in the wake of the crisis, as its depreciated currency increased natural protection for many sectors.

Letters of Intent also included provisions to open banking to foreign investment. This sector remained underdeveloped in many regional economies, contributing significantly to the crisis. Regional governments also increasingly recognised they needed foreign expertise and capital to assist with corporate and financial sector restructuring.

Most governments also are reducing their involvement in the economy, especially in agricultural marketing, utilities, industrial production and in some cases financial services. Such withdrawal is desirable to increase effective competition and, in the case of the banking system, to reduce the potential for a new round of bad debts. Governments also recognise the need for stronger anti-trust laws to combat anti-competitive practices. The IMF standby program conditions in Indonesia and the ROK dismantled state-sponsored monopolies and pressured governments to curb the market power of large conglomerates that reduced market access to smaller new entrants and distorted bank lending and sharemarket operation (IMF, 1999).

In Vietnam, donors also include trade liberalisation in assistance programs. Authorities are focussing first on removing non-tariff barriers, particularly quantitative restrictions on steel, vegetable oil and construction glass (IMF, 2002c). Vietnam also is implementing outstanding commitments under ASEAN Free Trade Agreement and eliminating some state trading monopolies. These reforms are having some success; the IMF estimates that by early 2003, Vietnam will improve from 9 to 6 its rating under the Fund's 10-point scale of trade restrictiveness (IMF, 2002c).

vii. Poverty Reduction Programs

In the wake of the crisis, the incidence of poverty increased in the worst affected economies. With donor assistance most governments adopted programs designed to alleviate some of the more immediate impacts on the most vulnerable groups. These included using public works to generate employment, providing subsidies for food and social services, distributing food, cash transfers or loans directly to the poor and introducing or enforcing legislation on severance pay and unemployment insurance (World Bank, 1999). Unemployment and severance pay is limited in the region; the ROK is the only low and middle income economy with a formal unemployment insurance system. World Bank interventions include short-term programs to alleviate immediate consumption shortfalls and long-term governance and institutional reform programs to reduce poverty over time (World Bank, 2002c).

The World Bank adopts two groups of programs to reduce poverty. The first group includes social policies targeting health, education and nutrition; the second focuses on generating employment and income and building social safety nets. To inform their policies regarding the first group, the Bank undertakes Public Expenditure Reviews in each borrowing country, identifying which social budget expenditures need protecting or expanding and which social groups should receive these expenditures (World Bank, 2002c). As part of this, the Bank reviews all fiscal areas spending areas to enhance social spending. Under the second group of programs, the Bank for example developed the Thai Social Investment Project which supports low income health insurance schemes, develops small and medium scale community and municipal projects, funds job creation through existing labour intensive government programs and expands training for the unemployed (World Bank, 2002c).

In Indonesia, the World Bank expanded labour intensive public works programs and undertook various activities aimed at improving access to basic health and education (World Bank, 2002a,b). In 1999, the World Bank extended the Indonesian Government an US$600 million Social Safety Net Adjustment Loan to provide budgetary assistance to improve the country's social safety net operations (World Bank, 2002c). The Bank assisted the Government redistribute revenue from fuel subsidies to pro-poor programs (World Bank, 2001). The Bank also lent US$300 million for maintaining poor children's access to education via scholarships and special assistance funds for primary and junior secondary schools, benefiting an estimated 25 million students (World Bank, 2002c).

In April 2002, World Bank issued the Vietnam Poverty Reduction Strategy Paper based on wide NGO and local community participation (IMF, 2002c). Donors and government are working on development targets in nine main areas including health, education and social protection. The IMF is costing these policies and the Bank is providing analytical support by monitoring processes and outcomes (IMF, 2002c).

In Cambodia, the main thrust of poverty alleviation policies is to regain economic growth and redeploy budget expenditures. The budget now spends less on the military and the civil service and more on rural and social development and supporting small-scale enterprises (World Bank, 2000b).

In Lao PDR, the Poverty Reduction Strategy Paper includes policies designed to boost growth to 7 per cent by 2003, restrain credit advances to state owned enterprises, contain inflation that undermines living standards and improve tax revenues collection to fund social spending. Supported by IMF technical assistance Lao taxation authorities boosted revenue collection through their Large Taxpayer Unit initiative; this helped control inflation and fund social spending increases (IMF, 2000e).

SUITABILITY OF DONOR RESPONSES

Donor, particularly international financial institution, responses to the Asian financial crisis have generated considerable controversy. International donors' contribution to resolving the crisis include macro-economic stabilisation, assisting in bank and corporate restructuring, strengthening economic, prudential and legal institutions, introducing other necessary structural reforms and addressing crisis created increases in poverty. However, critics maintain international financial institution responses were too heavily oriented to long term structural reforms and too little to addressing and resolving the immediate economic impacts of the crisis.

Macroeconomic Stabilisation

Due to the severity of the Asian crisis and criticism of the Fund's role, an IMF review carefully appraised its efforts to stabilise affected economies (IMF, 1999). While concluding the Fund's role generally was appropriate, this review did identify several areas where mistakes occurred. The Fund believes its decision to require members on standby programs to maintain high interest rates soon after the crisis was appropriate, arguing that lowering rates would have caused further currency depreciation, exacerbating inflation and increasing foreign debt obligations. In Indonesia, where the central bank dramatically increased liquidity and lowered interest rates inflation surged, reaching 60 per cent by 1998 (IMF, 1999).

However, the IMF acknowledges it failed to stem the decline in market confidence early in its programs; capital outflows continued to exceed the large official financing packages developed for Indonesia, Thailand and the ROK (IMF, 1999). The alternatives would have been to offer more funds, although the Fund believes this would have increased the moral hazard problem as well as strained resources. Instead, the IMF argues private sector investors should have been involved in negotiations earlier to ensure they did not withdraw funds too quickly (IMF, 1999)

The Fund also concedes the programs' initial fiscal targets and conditions were too tight, as they assumed the crisis would cause only a moderate regional economic slowdown. The Fund eased these fiscal targets as it became clear the region was entering a severe contraction. Fiscal expansion began in early 1998, only two months after the start of programs in Indonesia and the ROK (IMF, 1999).

See Report 1 Annex II.ix for a brief account of the lessons the IMF drew from its response to the financial crisis.

Dealing with Non-Performing Loans

In the wake of the crisis, a high proportion of East Asian bank loans became non performing, threatening the systemic stability of regional financial systems and hence the economic stability and growth of affected economies (Figure 1.9). Donors increasingly recognised crisis affected economies had to deal with corporates' non-performing loans before they could return to growth. Banks saddled with bad loans cannot lend and insolvent corporate sectors cannot invest or employ new workers; this scenario precludes growth and ensures increasing poverty. Progressively, donors increased support for debt restructuring agencies and ensured governments applied greater conditionality when recapitalising banks. In Indonesia, subsequent IMF Letters of Intent included targets for IBRA and Jakarta Initiative debt restructuring and bank asset sales. In Vietnam, reform of the largest state owned commercial bank required demonstrated improvements in lending performance as a condition to receiving finance (IMF, 2002c).

Structural Reforms

International financial institutions introduced many structural reforms as a condition of financing under standby programs, forming a key element of regional economies' efforts to resolving crisis related corporate and financial sector problems. First, for authorities to understand and measure the scale of their debt problem, new bank prudential and accounting standards were needed. Second, restructuring non-performing debts in a fair and consistent way required new bankruptcy laws and commercially trained courts. Third, for new investment to occur, financing alternatives to the banking sector were needed, including transparent and efficient share and debt markets. Achieving this objective required far reaching corporate governance reforms, including stronger shareholder rights, new listing rules and upgraded corporate reporting, accounting and auditing standards. Fourth, authorities needed to break the nexus between government and business, which in many cases granted credit cheaply to favoured firms and sectors, generating bad loans particularly in state owned banks. This required reforming and privatising state owned enterprises and banks, reducing government officials' influence on the banking system, as occurred in the ROK and ensuring better market access for new domestic and foreign firms.

The IMF argues that including structural reforms in standby programs was appropriate. First, had programs been offered without conditions, large official financing packages could have created moral hazard, signalling to governments the international community would continue to bail out weak banking sectors. Second, if financing packages had not been linked to credible structural reforms, the Fund believes financial markets would have continued to sell down currencies, aggravating balance sheet weaknesses and inflation. Third, failure to rectify domestic credit allocation mechanisms would have increased the risks of another crisis (IMF, 1999).

Structural reforms required in Fund Letters of Intent introduced international best practice approaches to regional banking and corporate sectors. For example, new bank supervision standards included for Indonesia, Thailand and the ROK were based on the Basle Core Principles. Debt restructuring was based on the London Approach which emphasises creditor cooperation, maintaining firm credit facilities and out-of-court solutions; accounting and corporate governance reforms were based on international accounting and auditing standards (IMF, 1999).

However, the IMF acknowledges its reform program did not focus early enough on non performing loans and corporate restructuring, which only featured in subsequent Letters of Intent as the linkages were better understood (IMF 1999). The Fund also concedes it could have required better prioritising and sequencing of reforms, acknowledging some of these issues only emerged as major constraints as programs unfolded (IMF, 1999). The Thai, Indonesian and ROK corporate sectors feature large inter-connected conglomerates owned by politically well connected families which were able to influence their treatment. Particularly in Indonesia and Thailand, too many original corporate and bank owners retained ownership of their assets and ensured taxpayers paid the cost for recapitalising banks.

Critics of the IMF maintain its Letters of Intent with Thailand and particularly Indonesia included overly ambitious and only tangentially relevant structural reform programs (IMF, 1999). For example, analysts now agree that financing conditions like abolishing the Indonesian clove and plywood monopolies were of low priority compared to key financial and corporate restructuring programs. Wide ranging structural reform conditionality required the Indonesian governments to expend large amounts of political capital and over burdened and under resourced and skilled bureaucracies to implement efficiently many reform programs concurrently; delivery capacity was often lacking. As programs advanced, donors focused increasing resources on building the necessary institutional capacity, though because of the long term nature of such programs, they have had mixed results. See Report 1 Annex II.x for an account of World Bank lessons from the crisis.

To ensure programs were co-ordinated and duplication minimised, the international financial institutions agreed to allocate responsibility for different types of structural reforms (DeFontenay, 2002). The IMF was responsible for macroeconomic stabilisation and central bank reform, the World Bank focused on commercial bank reform and the ADB on other institutional development. However, in some cases the lines of responsibility differed. Also, the delegation of institutional reform and capacity building between the ADB and the World Bank has been ad hoc (DeFontenay, 2002).

In the other developing ASEANs, aid co-ordination also has been vital. In Cambodia, the Council for the Development of Cambodia lacks resources and is not able fulfil this role, hence the UNDP takes a lead role in program coordination (World Bank 2000b). In Lao PDR, the World Bank and ADB focus on poverty reduction programs with the Fund focussing on fiscal reforms; coordination between the three institutions has been close (IMF, 2002b).

POST CRISIS ECONOMIC DEVELOPMENTS

To what extent have these policies and donor responses returned crisis affected economies to pre-crisis growth levels? While these economies resumed growth over 1999-2000, sharp improvements in trade balances and stronger consumer spending drove most of the recovery (Figure 1.13). New investment, the variable which received most policy maker and donor attention contributed little to growth (Figures 1.13 and 1.14). Mainly due to a failure to deal with corporate restructuring, overall bank lending is still contracting in all major regional economies (Figure 1.13). By 1999-2000, real GDP growth reached 10 per cent in the ROK, which has done most to resolve non performing loans and corporate debt, but was only 6 per cent in Malaysia, 4 per cent in Thailand and Indonesia and 3 per cent in the Philippines (Figure 1.10).

By 1999, four favourable factors drove a return to growth in crisis affected East Asia. First, macroeconomic stimulus governments applied in late 1998 started to kick in. Second real effective exchange rates remained low making East Asian export prices very competitive, and most export credit mechanisms functioned again. Third, an electronics and IT investment boom produced strong demand for Asian electronics exports, benefiting Malaysia, the ROK and Thailand. Finally, the United States economy boomed generally, and with the US dollar at an all time high, it sucked in increasing volumes of regional exports. Exports, particularly to the United States, accounted for a large share of Thai and Indonesian growth in 1999 and 2000 (Figure 1.13, 1.14).

Furthermore, as economies recovered, more confident consumers resumed spending. Banks contributed to the consumer spending boom by expanding credit card coverage and providing mortgages and loans for durables. In the current environment of weak corporate solvency and credit demand banks preferred to increase household lending to resuming corporate lending.

As a result of declining bank lending, investment remains weak, contributing only marginally to growth and preventing a sustained return to pre-crisis growth rates (Figures 1.13, 1.14 and 1.15). The ratio of investment to GDP remains 10 percentage points below pre-crisis levels in Thailand, Indonesia, Malaysia and the ROK and by about 7 percentage points in the Philippines (Figure 1.16). Stalling investment is a serious concern as investment in new capital equipment, technology and social and economic infrastructure is the major source of economic growth. Without investment in new productive capacity, increases in other components of demand, including exports and consumption, soon reach their limits. Firms cannot produce ever-increasing export volumes and meet expanding domestic demand without investing.

The Asian financial crisis was foremost a crisis of capital accumulation; in each economy the mechanisms for allocating domestic and foreign savings to productive local investment projects broke down; this mechanism has not yet been fully repaired and hence regional growth has not recovered. Apart from the ROK, Asian crisis economies failed to grow as strongly out of the crisis as other currency-crisis affected economies. According to a detailed analysis of currency crisis, the Asian financial crisis lowered average annual Indonesian, Malaysian, ROK, Philippine and Thai growth rates by 3 percentage points compared with a drop of 2 per cent in other currency crisis economies (Barro, 2001).

Foreign investment inflows to the region also remain low, further undermining new investment. This not only reflects depressed domestic demand but also international investor concerns about the investment environment. Weak and non transparent corporate economic governance, poorly implemented bankruptcy legislation, inadequate legal enforcement of contracts, lack of credible disclosure regimes and uneven listing rules enforcement all deter portfolio and direct investors. While most regional economies, with the exception of Indonesia, Vietnam, Laos and Myanmar, are making progress in improving the formal corporate and legal environment, implementing these reforms is proving a long and difficult process (Economic Analytical Unit, 2002).

UNFINISHED AGENDA

The failure of investment to recover suggests much remains to be done to overcome structural problems in Asian-crisis affected economies. Slowing regional growth is due to governments trying to grow out of economic problems without addressing their fundamental causes, particularly in corporate and financial sectors (IMF, 2002a).

Banking Sector Reform

Since the crisis, most regional economies have undertaken significant banking and related insolvency law reform and recapitalising, but despite this bank lending continues to contract, undermining growth. Most governments have recapitalised their banking sectors in line with international standards of 8 per cent capital adequacy. However, as growth slowed in 2001, in several economies, the decline in non-performing loans slowed and even reversed, as new non performing loans emerged. Also, many regional banks remain undercapitalised due to regulations allowing unrealised losses to remain on banks' balance sheets. A recent Indonesian central bank survey found many restructured loans failed to meet regulatory requirements (IMF, 2002a). Thailand suffers similar problems; as well, its state banks are again under political pressure to lend to preferred firms and small and medium enterprises, risking new non-performing loans.

The sale of nationalised and recapitalised banks generally has been slow and confronts much political resistance (IMF, 2002a). In Indonesia, Indonesian Bank Restructuring Agency finally sold a 51 per cent stake in Bank Central Asia in early 2002 and expects to sell shares in Bank Niaga and Bank Mandiri soon, but is well behind its original schedule. The ROK Government has committed to selling most of its controlling stakes in previously private banks by 2005 (IMF, 2002a). The Thai Government sold several nationalised banks to foreign banks in 1998, but has since back-tracked from this policy due to a political backlash. Vietnam and Lao PDR have yet to seriously tackle bank privatisation. By maintaining extensive government bank ownership, economies risk new rounds of state-directed lending, creating moral hazard and future financial crises.

Finally, bank supervision standards are yet to materially improve (IMF, 2002a). In Thailand, a long delayed Financial Institutions Act still is being debated in Parliament in 2002. Indonesia still plans to introduce a new Financial Sector Supervisory Institution, but to date the Government has done little to establish its legal framework or operational modalities (IMF, 2002a). Malaysia and the ROK have significantly strengthened their prudential controls and enforcement. However, Vietnam, Myanmar, Lao PDR and Cambodia have made little progress in this area to date, and start from a low base.

Corporate Sector Restructuring

In general, economies have made less progress in corporate sector restructuring than in financial sector reform; corporate debt levels remain unsustainably high (IMF, 2002a). For example, Thailand's corporate debt to equity (leveraging) ratios fell from 4 in 1997 to close to 3 by 1998, but rose again to 4 in 2000 before falling again to slightly above 3 by the end of 2001 (IMF, 2002a). Typical developed country leveraging levels are 0.6. Thailand's Corporate Debt Restructuring advisory Committee initially made good progress in out-of-court debt restructuring. However, setbacks in high profile bankruptcy cases emboldened strategic and recalcitrant debtors and by mid-2001 almost half Thailand's non performing loans remained unresolved. Most of these had to be referred to the weak court system, adding to delays (IMF, 2002a). The transfer of assets to the newly formed Thai Asset Management Company is nearly complete, but will not necessarily expedite corporate restructuring (Markels, 2001).

In 2000 and early 2001, the Jakarta Initiative Task Force made some progress, restructuring US$15 billion in debts in out-of-court settlements, or 25 per cent of non-performing loans by value. However, in the last year, courts' clear bias in favour of debtors has increased debtor recalcitrance to enter debt work-outs and slowed the Jakarta Initiative Task Force's and IBRA's capacity to restructure or sell assets under their control (IMF, 2002a). Despite considerable donor focus on boosting courts' capacity, court-led insolvency proceedings are progressing even more slowly than out-of-court workouts (IMF, 2002a).

Institution Building and Governance

Regional governments continue to confront urgent economic governance issues, including the need to strengthen the public sector, particularly expenditure, taxation and provincial government administration and improve the expertise and transparency of the legal system (IMF, 2002a). East Asian governance indicators remain well below those of developed OECD economies (Figure 1.17). Disturbingly, despite increased government rhetoric and donor efforts, East Asian corruption and rule of law indicators appear to have deteriorated since the crisis (Figure 1.18). However, the World Bank acknowledges awareness of transparency and legal issues may have increased since the crisis, in part explaining worsening reported indicators (Kaufman et al, 2002). Indonesia, Laos and Vietnam, continue to feature poor rule of law and government effectiveness despite concerted donor efforts (Figure 1.17). Some regional economies including Thailand and Malaysia feature better rule of law and government effectiveness ratings suggesting scope for regional learning (Kaufman et al, 2002).

Finally, many regional governments recognise they must develop or strengthen the commercial, legal and regulatory frameworks essential for modern market economies, including laws protecting creditors and shareholders, requiring corporate transparency, enforcing competition, implementing prudential controls and guaranteeing central bank independence. More importantly in many cases, governments need to create the institutions capable of enforcing these commercial laws and regulations in a transparent and efficient way (IMF, 1999, Economic Analytical Unit, 2002).

PRIORITIES BY ECONOMY

Reform and assistance priorities vary across the region depending on economies' level of development, residual crisis impacts and government institutional effectiveness. In the Philippines, key reform priorities include improving the efficiency of public sector taxation and procurement, general civil service reform and judicial reform. Tax revenues are too low to fund institutional capacity building, essential social services or urgently needed infrastructure (IMF, 2002a). Procurement and the court system often are not transparent and the middle and lower echelons of the civil service are over staffed, underpaid and under skilled.

Thailand suffers similar problems and as well management of its burgeoning public debt is becoming a critical concern. Thai spending on education and technological uptake lags that of many regional economies at similar income levels (IMF, 2002a).

In Vietnam, public administration transparency and fiscal administration also are issues of concern and planned state owned enterprise equitisation reform has slipped, hampering efforts to move to a market based economy (IMF, 2002a). In Cambodia, some important structural reforms are running well behind schedule, including civil service reforms to address pay levels and inappropriate incentives encouraging absenteeism, corruption and underperformance (IMF, 2002a). Legal and judicial reforms also lag plans (IMF, 2002). In Lao PDR, restructuring state owned enterprises the military owns and state banks and increasing public service administrative and macroeconomic management capacity remain serious challenges (IMF, 1999).

CONCLUSION

The Asia 5 economies have made much progress since 1997 in overcoming some of the structural weaknesses which precipitated the crisis. However, economies like Indonesia and Thailand still have failed to repair much of serious economic damage the crisis inflicted on their corporate and financial sectors. Hence investment is unlikely to recover strongly, growth is set to stay 2 to 3 percentage points below pre crisis levels and this will not generate enough new employment to make inroads into poverty. Hence, donors and regional governments have no choice but to directly tackle and resolve the key constraints to investment recovery. This involves redoubling efforts to force corporates to undertake deep corporate restructuring to reduce corporate debt ratios to more normal, less risky levels and resolve the unresolved backlog of insolvent companies and bad debts. As well as immediate support for debt work-out agencies, reforms to increase corporate disclosure, shareholder scrutiny, the effectiveness and impartiality of the commercial courts and increased foreign investment and trade competition all will assist in this process. In Indonesia, Thailand, Vietnam Lao PDR, Myanmar and Cambodia banking systems also still require restructuring, privatisation, increasing competition and stronger prudential controls to ensure they can allocate funds efficiently to productive new investments. Donor efforts in all these areas remain crucial to growth returning to post crisis levels.

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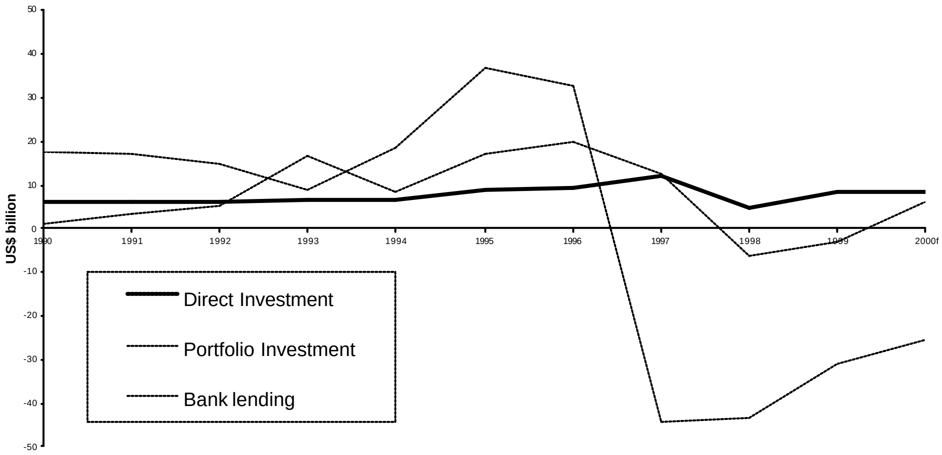
REPORT 1 ANNEX I GRAPHS AND TABLES

Figure 1.1

Bank Lending Dominated Capital Inflows to Asia-5 Economies

Bank Lending, Portfolio (Sharemarket) and Direct Investment Inflows to Asia-5 Economies, 1990-99

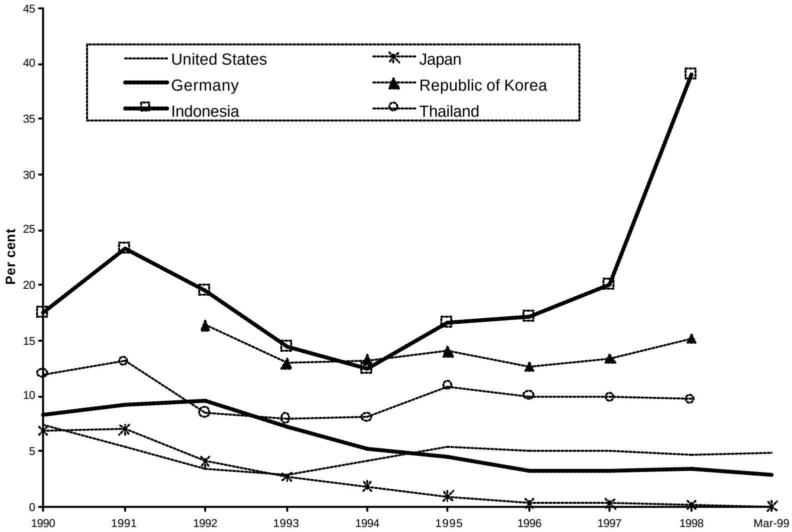


Note: Asia 5 Economies are Indonesia, Thailand, the Republic of Korea, Malaysia and the Philippines.
Source: East Asian Analytical Unit, 1999.

Figure 1. 2

Asian Interest Rates Higher than Industrial Economy Rates

Asian, US and German Short Term Interest Rates, 1990-99



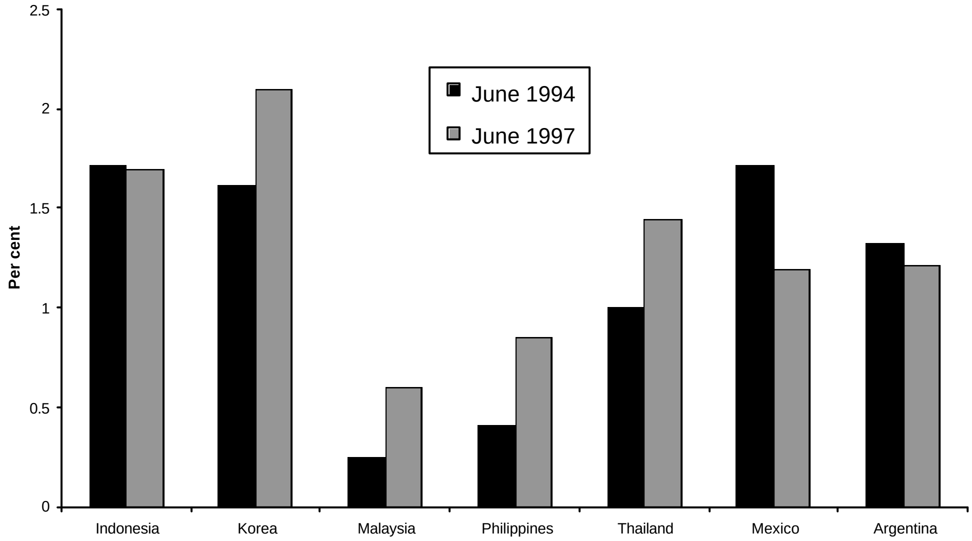
Note: Interest rates are three month certificates of deposit for the United States, Korea, Japan and Indonesia; three month interbank deposits for Germany; and for Thailand, three to six month commercial bank time deposits.

Source: International Monetary Fund, 1998b; and CEIC, 1999.

Figure 1.3

Service Short Term Debt Dangerously High

Ratio of Short Term Debt to Reserves in Financial Crisis Economies

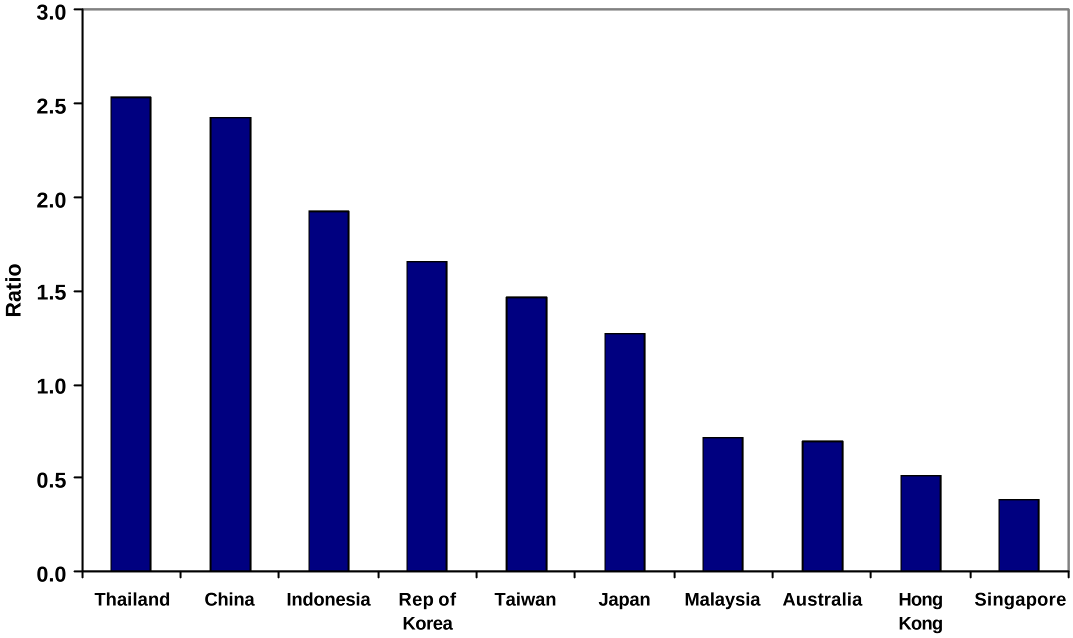


Source: East Asia Analytical Unit, 1999

Figure 1.4

Bank Financing Dominates

Ratio of Bank Debt to Share Market Capitalisation, 2000



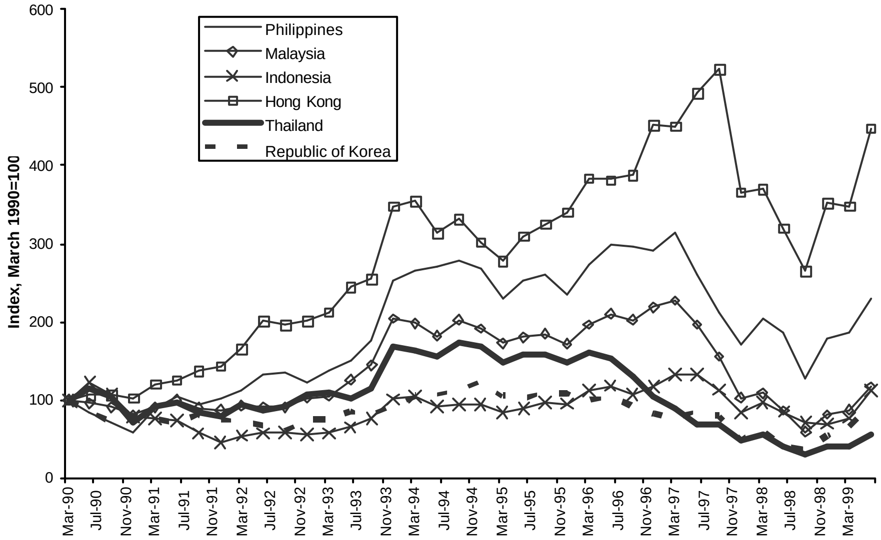
Source: CEIC, 2001.

Note: The ratio of bank debt to share market capitalisation is used here as a proxy for companies' average debt to equity ratios, due to inadequate or inconsistent data for the latter in these economies. For reasons including the listing of foreign companies on share markets and the use of borrowings from non-bank domestic or foreign financial institutions, the two could deviate markedly. However, the approximate rank order of the economies concerned is not expected to differ much from the above

Figure 1.5

Domestic Lending and Foreign Inflows Fuelled Stock Boom

Regional Stock Market Indices (1990 =100)



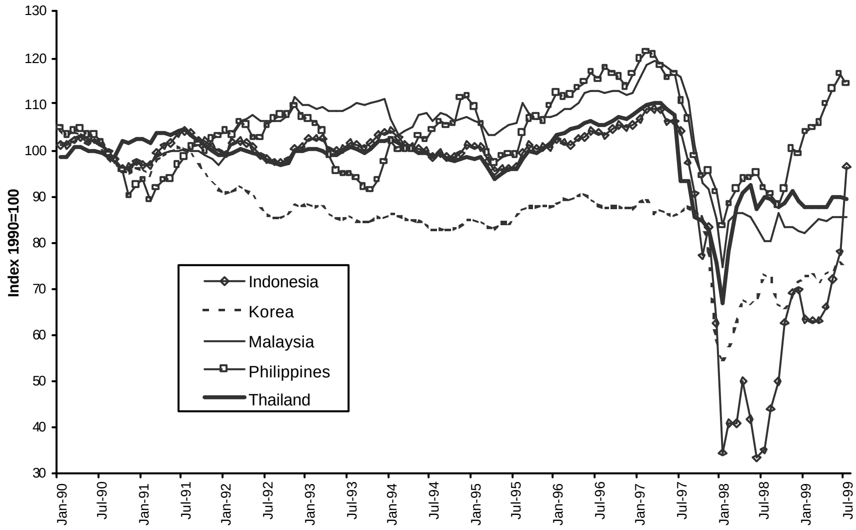
Note: These indexes are rebased versions of the flagship index for each country.

Source: CEIC, 2002.

Figure 1. 6

Crisis Economies Currencies Appreciated Sharply after 1995

Asia-5 Real Effective Exchange Rates, 1990-99

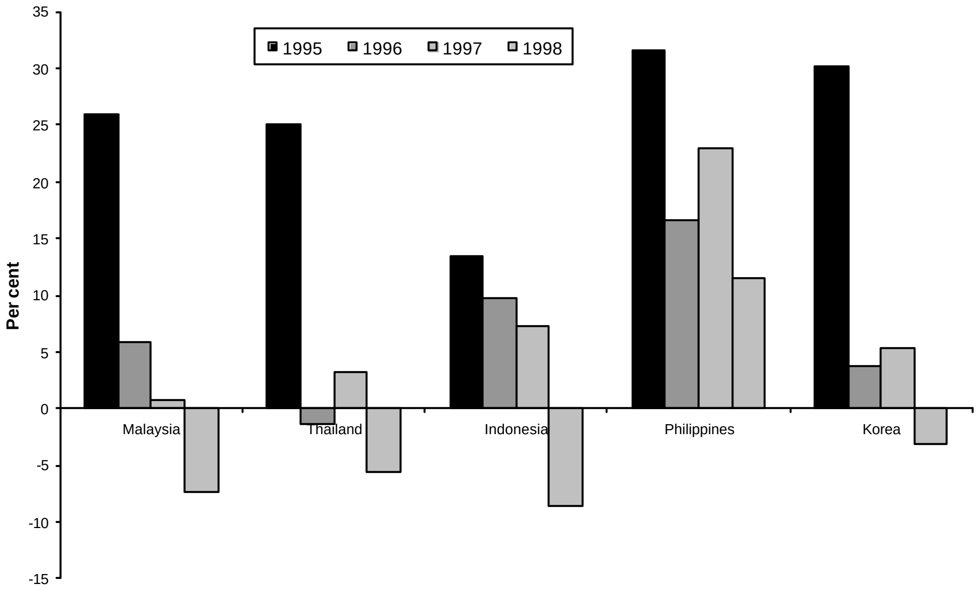


Source: JP Morgan; 1999, Economic Analytical Unit, 1999.

Figure 1.7

Asia-5 Export Growth Drops Sharply after 1995

Growth in US$ Exports, 1995-98

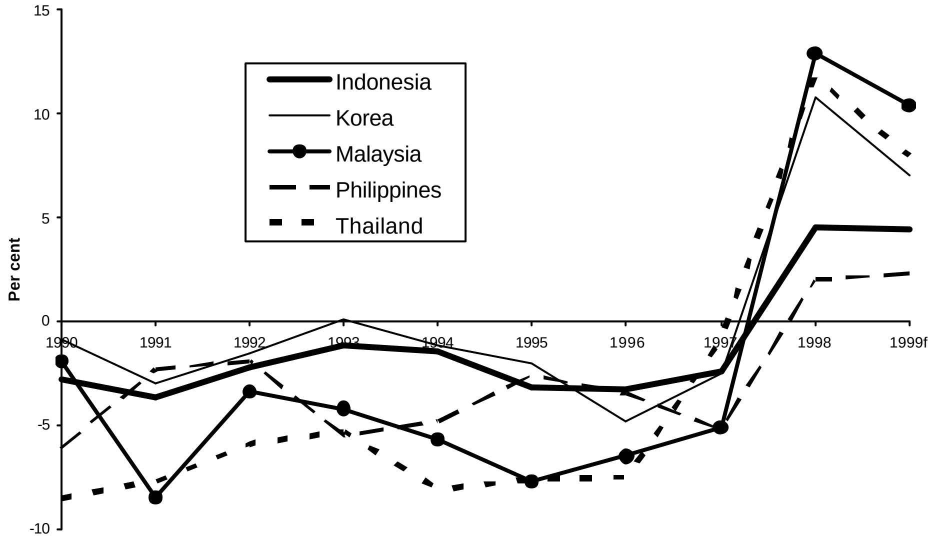


Source: International Monetary Fund, 1998a and 1999a.

Figure 1.8

Current Accounts Deficits High before the Crisis

Current Account Balances of Asia 5 Economies as a Proportion of GDP, 1990-99



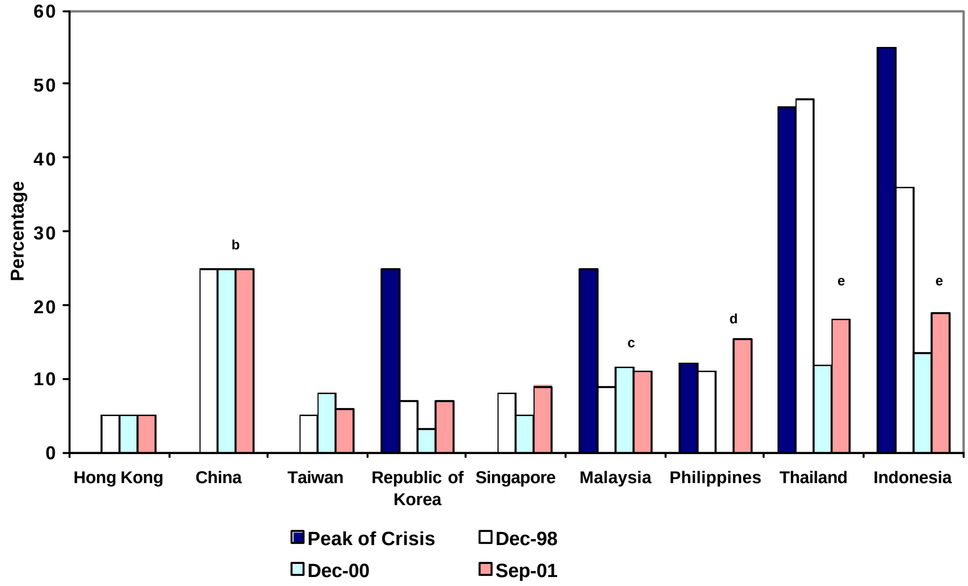
Note: Asia-5 economies are Indonesia, Malaysia, the Philippines, Thailand and Korea. A negative figure represents a current account deficit.

Source: East Asia Analytical Unit, 1999.

Figure 1.9

Loans Rapidly Became Non Performing

Share of Non-performing in Total Loans in East Asian Banking Systems[a]



Notes: a Sharp drops in non performing loan levels reflect asset management companies (usually government funded) buying out non-performing loans.

b Estimates of non-performing loans are as high as 50 per cent.

c December 2001.

d September 2000.

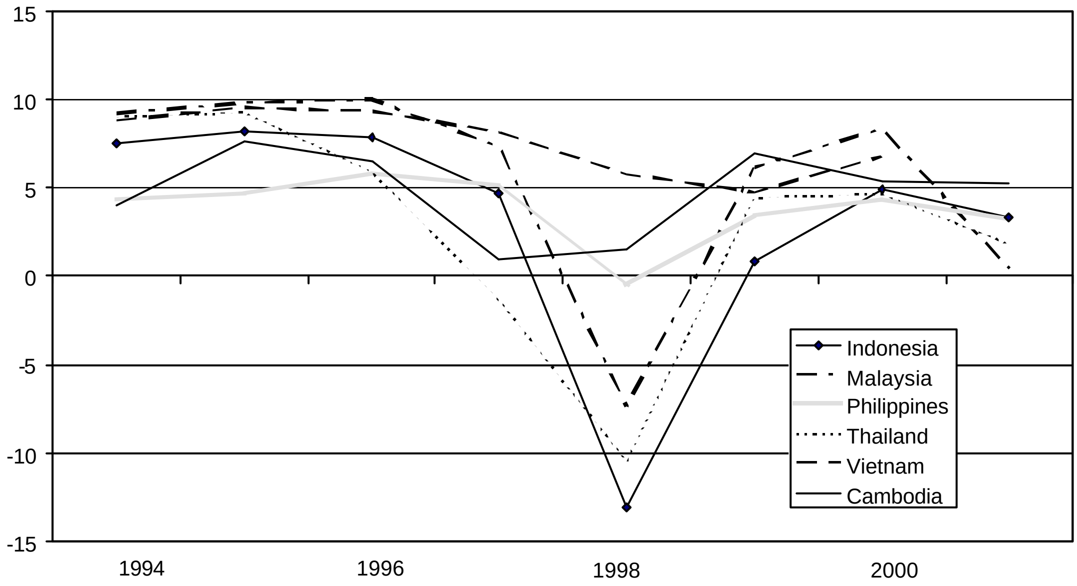
e November 2001.

Source: Hawkins and Turner, 1998; CEIC Database, 2002.

Figure 1.10

Post Crisis Growth Contracts Dramatically

Real GDP Growth in Major East Asian Economies, 1993-2000

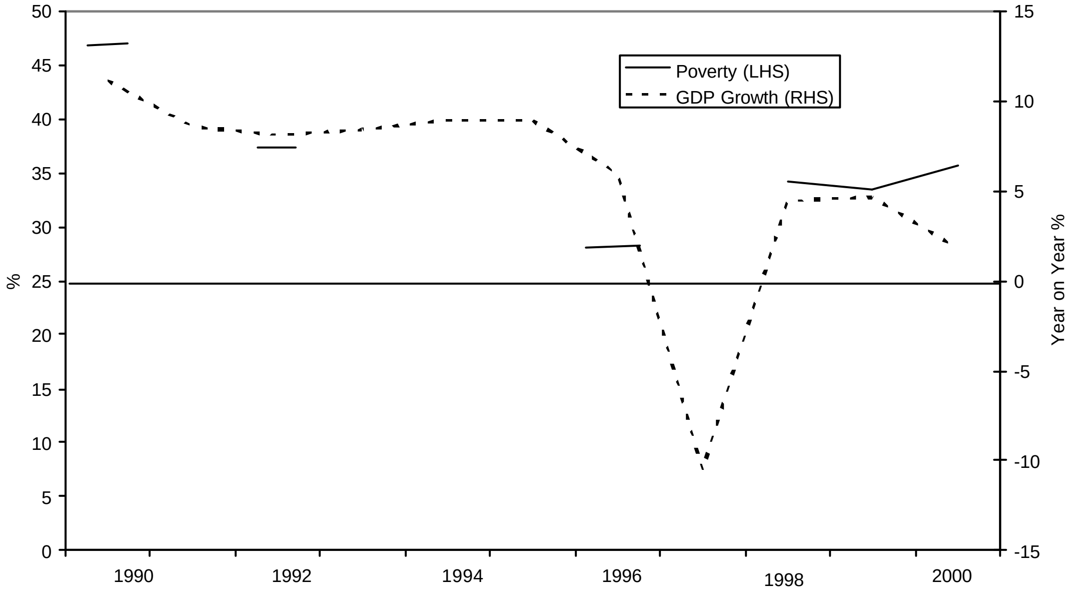


Source, CEIC, 2002.

Figure 1.11

Strong Growth Reduces Poverty in Thailand

Real GDP Growth and Headcount of People Living on less than US$2 per day, 1990-2000

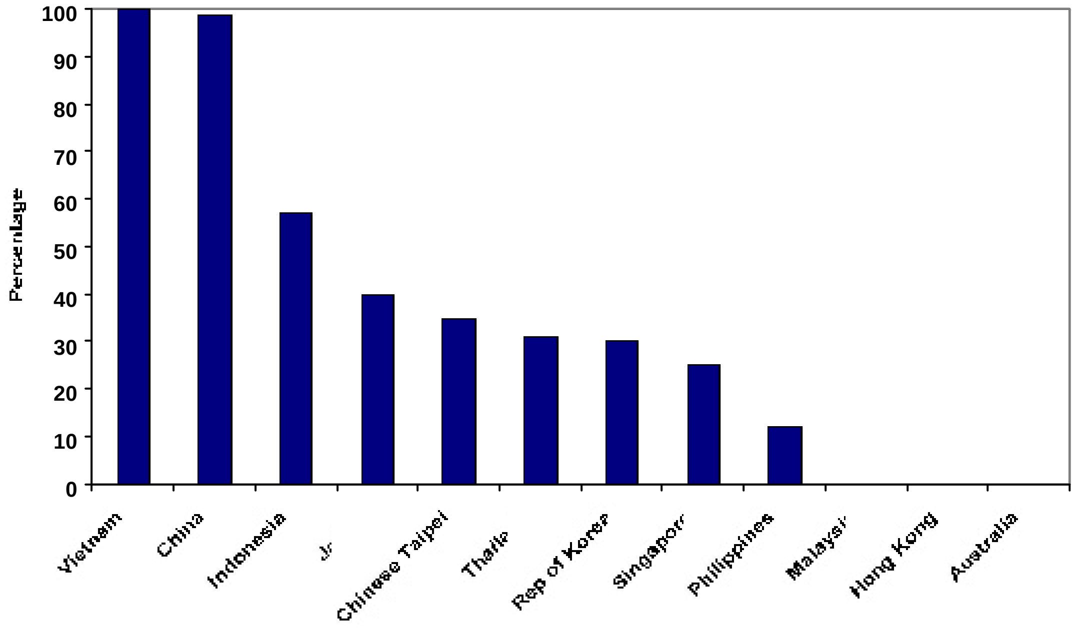


Source: CEIC, 2002, World Bank, 2002.

Figure 1.12

Post-Crisis State Bank Ownership High

Share of Bank Sector Equity Governments Hold, 2000

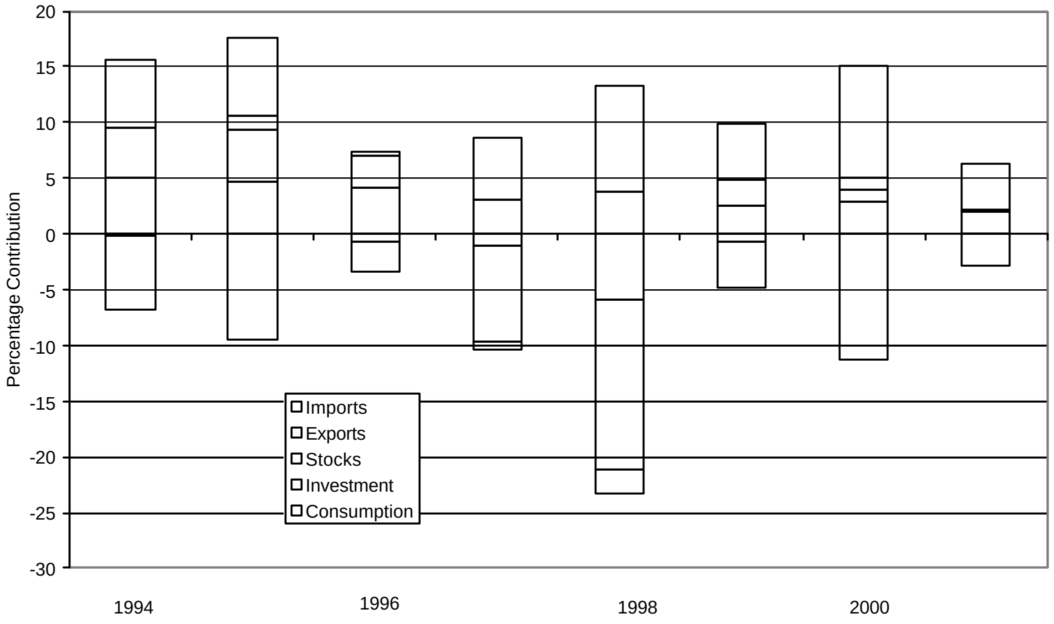


Source: Economic Analytical Unit, 2002.

Figure 1.13

Exports Up but Investment Not Recovering

Contributions to Thai Real GDP, Annual, 1993-2000



Source: CEIC, 2002

Figure 1.14

Post Crisis Investment Falls Undermine Growth

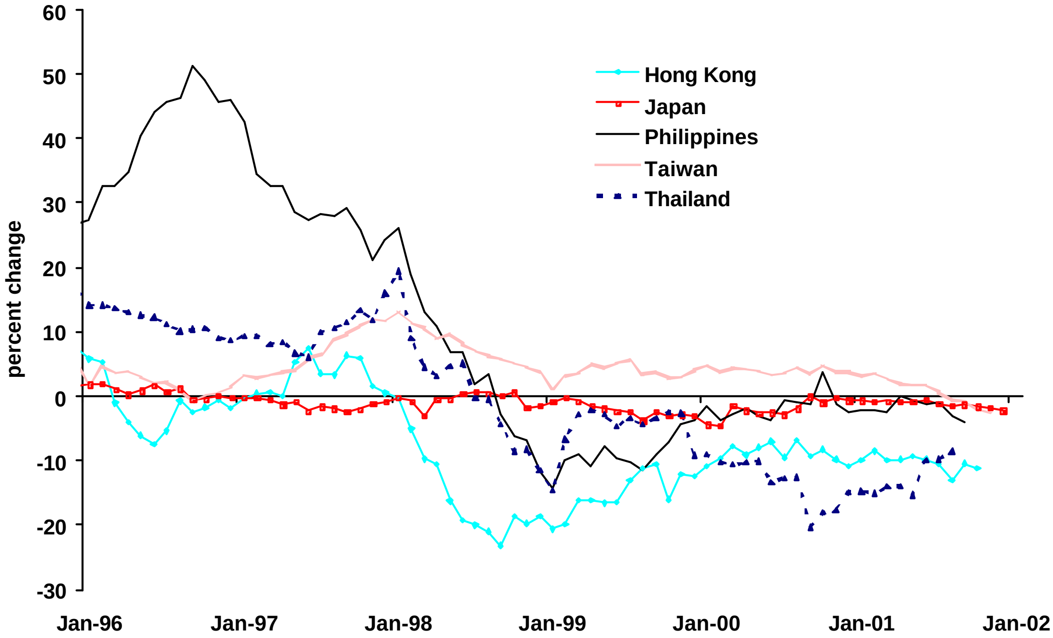
Contributions to Indonesian Real GDP, Annual, 1993-2000

Source: CEIC, 2002

Figure 1.15

Bank Lending Still Contracting

Year-ended Per Cent Change in Volume of Bank Lending, Selected Economies, 1996-2002

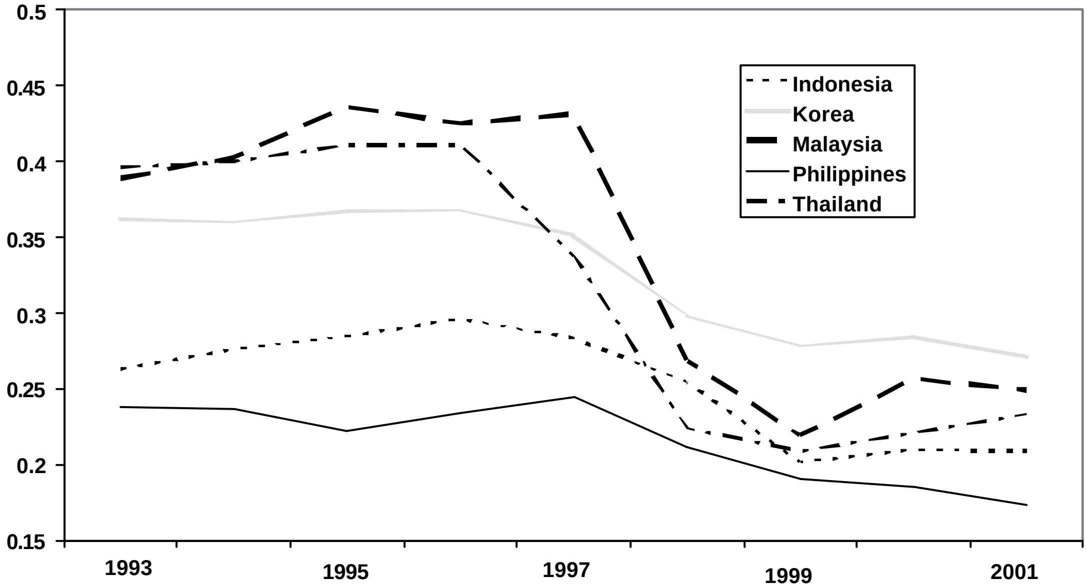


Source: CEIC, 2002.

Figure 1.16

Investment Recovering Slowly

Investment to GDP Ratios Major East Asian Economies, 1993-2001

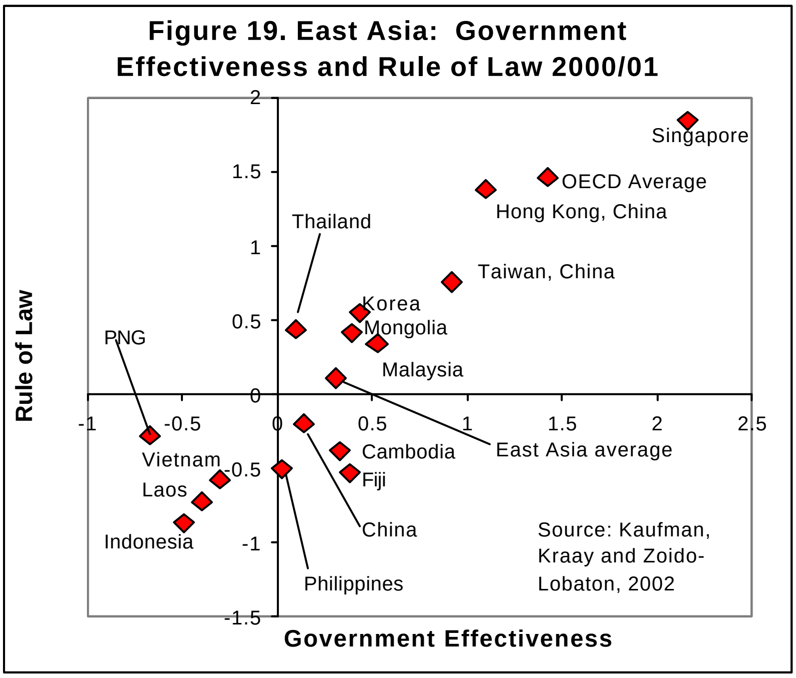


Source: CEIC, 2002

Figure 1.17

East Asian Governance Still Lagging

East Asian Government and Rule of Law Effectiveness, 2000-01

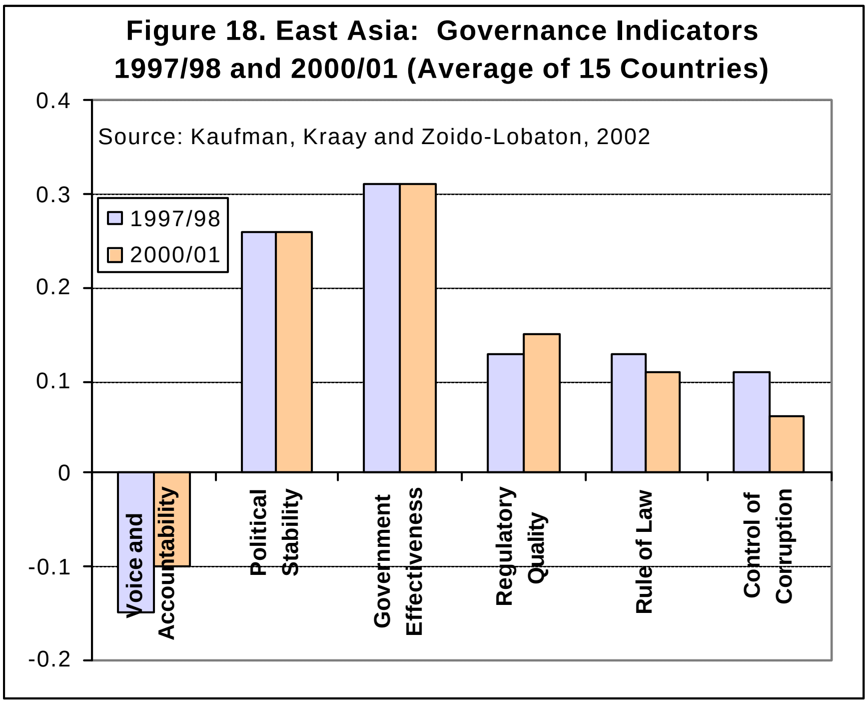


Source: Kaufman et al, 2002

Figure 1.18

Corruption and Rule of Law Deteriorating

East Asian Governance Indicators, Average of 15 East Asian Economies



Source: Kaufman et al, 2002

Table 1.1

Investment Decreasingly Productive Before Crisis

Ratio of Private Investment to Change in National Output[a], Selected Economies, 1994-2000

	1994	1995	1996	1997	1998[b]	1999	2000
East Asia ex Japan	4.1	4.5	5.0	5.7	Na	4.9	4.3
China	3.7	4.3	4.5	4.7	5.2	5.6	4.9
Hong Kong	5.7	8.3	7.7	7.5	Na	9.5	2.9
Indonesia	3.8	3.7	4.1	6.9	Na	Na	4.7
Japan	28.5	18.0	8.5	16.1	Na	36.1	17.8
Republic of Korea	4.7	4.5	5.8	7.2	Na	2.8	3.4
Malaysia	4.6	4.9	4.7	6.4	Na	4.2	3.6
Philippines	5.6	5.3	4.5	5.4	Na	6.8	5.6
Singapore	3.2	4.6	5.0	5.6	Na	6.1	3.5
Taiwan	3.8	4.2	4.3	4.1	6.0	4.9	4.7
Thailand	4.9	4.8	7.4	Na	Na	4.6	4.5

Notes: [a] A higher ratio means investment is less efficient, as one dollar of investment is associated with less output in the same year, possibly suggesting investment is less productive. This is referred to as the incremental capital output ratio.

[b] years where recessions occur, or when output declines due to other factors, such as in 2001, distort the ratio as it rises to very high levels. These have been omitted.

[c] year to September data.

Source: Economic Analytical Unit estimates using CEIC data.

Table 1.2

Official Financing Sources

	In US$ Billions	% Annual GDP
Indonesia		
IMF	10.1	5
ADB and World Bank	8.0	4
Other	18.0	9
Total Package	36.1	17
Thailand		
IMF	4.0	3
ADB and World Bank	2.7	2
Other	10.5	7
Total Package	17.2	

Source: IMF, 1999

Table 1.3

Commitments of the International Community to the Asian Crisis

	IMF	Multilateral	Bilateral	Total
Indonesia	11.2	10.0	21.1	42.3
Korea	21.1	14.2	23.1	58.4
Thailand	4.0	2.7	10.5	17.2

Source: IMF, 2001

Table 1.4

IMF Packages Promoted Financial Market and Prudential Reform

Financial Restructuring Measures Agreed with IMF

Thailand		Korea		Indonesia	
Measures	Dates	Measures	Dates	Measures	Dates
Suspension of 58 insolvent finance companies	8/97	New legislation governing supervision, deposit insurance, closure of financial institutions and allocation of losses and equity write-downs	12/97	Closure of 16 insolvent banks; conditional liquidity support to others	11/97
Tightened loan classification and bank licensing rules	11/97	Closure of 10 (of 14 suspended) merchant banks	1/98	Placement of weak regional development banks under Bank Indonesia supervision.	12/97
Guidelines for assessing owners, board members and managers of financial institutions	12/97	Submission of rehabilitation plans by remaining merchant banks; recapitalisation plans required of commercial banks whose 1997 capital adequacy ratios fell below 8 per cent (based on full provisioning)	2/98	Establishment of Indonesia Bank Restructuring Agency; external guarantees to all creditors and depositors of all locally incorporated banks; compensation to small depositors from closed banks	1/98
Amendment of bankruptcy laws; stronger loan classification and	3/98	Establishment of units at Ministry of Finance and Economy under	3-4/98	Transfer of 54 weak banks to Indonesia Bank Restructuring Agency;	2/98

provisioning rules to meet international standards by 2000		Financial Supervisory Board to coordinate and monitor bank restructuring and provision of public funds		new loan classification and provisioning rules based on international standards	
Preparation for restructuring and privatisation plan for intervened banks; review of banking supervision laws	6/98	Initiation of consultations with banking community and outside experts on strengthening prudential regulations (regulations issued 8 November 1998)	4/98	Merger of two state-owned banks; legislation enabling state bank privatisation and removing limits on private ownership of banks; establishment of new asset resolution entity	6/98
Memoranda of understanding with financial institutions on implementing stricter loan classification and provisioning rules	8-9/98	Legislation to allow full write-down of existing shareholders' equity	6/98	Portfolio, systems, and financial review of Indonesia Bank Restructuring Agency and major non-Indonesia Bank Restructuring Agency banks by internationally recognised audit firms	8/98
Revision of Bank of Thailand laws; completion of amendments to foreclosure laws	10/98			Preparation of restructuring plan for Indonesia Bank Restructuring Agency banks.	10/98
Completion of disposal of assets of 56 (of 58 suspended) finance companies; new prudential regulations; stronger rules governing disclosure, auditing and accounting practices; and new deposit insurance scheme	12/98			Preparation of state banks for privatisation. Introduction of deposit insurance scheme	2001
Development of plans for privatising					

institutions undergoing state intervention

Source: Goldstein, 1998, p. 25.

II.i Factors Explaining Poor Lending Quality

four broad development objectives. USAID helped the Philippines through a major stock-market fraud and political scandal, aided development of a new Securities Regulation Code, and supported the reorganization of the Philippine Securities and Exchange Commission.

Thailand

Because there is no USAID Mission in Thailand, all Thailand activities are implemented through USAID's regional programs. USAID mainly concentrates on technical assistance to protect vulnerable populations along its borders from infectious diseases and improve the environmental regulatory framework. First, many of these funds were invested in the property and construction sector; in Malaysia, for example, banking system loans to property comprised 42.6 per cent of total credits by 1996, compared with 21 per cent for manufacturing, boosting property values by 25 per cent over the year (Corsetti et al, 1998). As money channeled into these sectors, the returns on these investments declined.

Second, throughout crisis affected Asia, banks faced little competition in attracting funds because shallow, poorly regulated and hence volatile share and bond markets meant savers had few investment alternatives (Figure 1.7). This reduced the pressure on banks to work hard at offering depositors the best returns by lending the funds to the best projects.

Third, banks often lent to firms that they partly owned or under direction from the government. State owned banks in Thailand and Indonesia lent large amounts to well-connected business conglomerates (Economic Analytical Unit, 2002). In Thailand, the state lent large amounts to troubled finance companies; in the first quarter of 1997, the Bank of Thailand’s Financial Institutions Development Fund lent US$8 billion to finance companies, 17.5 per cent of which went to Finance One, the largest finance company in the country (Corsetti et al, 1998).

Fourth, regulatory authorities did not pay close attention to the quality of bank lending and knew little about their foreign borrowing exposures (IMF , 1997). Bank supervision laws were weak, out of date and poorly enforced. Authorities had little idea of the extent of loans not being repaid and the level of risk that many banks and corporations faced. Capital adequacy ratios commonly were low, so banks were soon exposed to loans turning bad.

II.ii Sequencing Financial Market Liberalisation

Across crisis-affected Asia, poorly sequenced financial market reforms contributed to the crisis. Governments did not ensure domestic institutions for monitoring bank and corporate behaviour were strong enough prior to opening their economies to capital flows. Nor were financial markets well enough developed, often lacking liquidity and institutional support (Economic Analytical Unit, 2002). This increased the risk that borrowers would use foreign loans poorly.

Poor sequencing also adversely affected the scale and nature of capital inflows. For example, in 1991, Indonesia reintroduced controls on domestic banks' foreign borrowing because of concerns about excessive foreign debt build up, but continued to liberalise corporates' borrowing abroad. By 1997, the non-bank private sector accounted for 68 per cent of Indonesia's foreign debt. In 1994, Korean authorities liberalised restrictions on financial institutions and corporates' short term foreign borrowing but retained controls on long term borrowing. Subsequently, the term structure of the ROK's foreign debt shortened significantly. As part of Thailand's financial liberalisation, authorities provided tax concessions on short term foreign borrowing, again encouraging a dangerous shortening of foreign borrowing maturity and established the Bangkok International Banking Facility which became a funnel for foreign borrowings into the Thai economy (Radelet et al, 1998; and East Asia Analytical Unit, 1998).

II.iii Role of Moral Hazard

Moral hazard played an important role in causing the crisis. Weak regulation and close links between private and public institutions meant banks and firms acted as if they would not be held accountable for their actions. Hence, banks and corporations faced only weak incentives to lend and invest soundly. Within the banking sector, banks held the view that the government would assist in covering any losses, reducing their incentive to improve their prudential practices. This belief also may have made foreign banks more willing to lend to them.

Within the corporate sector, political pressure to maintain high levels of growth meant state credit or subsidies went to favoured firms or industries; if loans turned bad, firms had reasonable grounds to assume the government would protect them (IMF , 1997). Also, close connections between policy makers and powerful families who own the majority of large corporations created an expectation of shared responsibility should things go wrong (Pomerleano, 1998).

Macroeconomic policy also contributed to the moral hazard problem. Foreign investors believed local governments would maintain their exchange rate pegs, encouraging them to invest in higher yielding local assets to considerable gain.

In the words of Paul Krugman, weak institutional safeguards against moral hazard meant investors continued to 'play a game of heads I win, tails, the taxpayer loses' (Krugman, 1998).

II.iv Exchange Rate Movements During the Crisis

In June 1997, the Thai government announced it would cease supporting Finance One, the country's largest finance company, signaling to investors their expectations of returns were too optimistic and causing them to quickly exit the regional market, economy by economy. After floating on July 2, the Thai baht depreciated 20 per cent by August 5, when authorities announced a package for revamping the troubled finance company sector. In September, currency contagion spread through the region, lowering the Malaysian ringgit to 26 per cent below its January 1996 level, the Indonesian rupiah 37 per cent and the Thai baht 42 per cent. By contrast, the Korean won initially depreciated more slowly, by 14 per cent, as authorities allowed a gradual adjustment to the peg. However, in November 1998, the won plunged a further 25 per cent (Corsetti et al, 1999).

II.v The Non-Fundamental View of the Crisis

Some analysts of the crisis believe exposure to volatile financial markets caused the crisis more than fundamental domestic economic weaknesses. In particular, they believe panic rather than reason drove the sudden exit of short term money which depressed regional exchange rates, damaging otherwise sound bank and corporate balance sheets. Whilst some of these critics acknowledge ASEAN institutions and regulations needed improving, they believe this did not warrant the extreme reaction of financial markets (Sachs et al, 1998).

This school of thought believes the crisis' major policy implication is to address weak international financial architecture and dissuade developing countries from opening to capital flows. They also believe more should have been done at the outset of the crisis to co-ordinate international donors and borrowers in rescheduling debt and currency structures to avoid a panic (Corsetti et al 1998).

Key references on this theme include Sachs and Radelet, 1998 and Krugman, 1998.

II.vi New Institutions for Dealing with Financial Sector Restructuring

Dealing with bank and corporate bad debts required new institutions, most of which arose out of arrangements agreed under International Monetary Fund, IMF , packages, drawing on World Bank and Asian Development Bank funding and input (Table 1.4) (IMF , 1999).

In Thailand, authorities handed the Bank of Thailand primary responsibility for the crisis management. Its Financial Institutions Development Fund provided financial and managerial assistance to banks in distress. The Thai Government also established the Financial Sector Restructuring Authority, FRA, as an independent state agency for rehabilitating or liquidating the 58 finance companies suspended in 1997. In mid-1998, the government established the Corporate Debt Restructuring Advisory Committee to enable viable debtors to continue business operations and promote fair debt repayment to creditors (Scott, 2002; Economic Analytical Unit, 2000b). Subsequently, in 2001, the Government established the Thai Asset Management Corporation to buy non performing loans from state banks.

In hindsight, donors to Thailand recognise that granting two agencies responsibility for resolving the finance companies reduced incentives for maximising assets' sales price. Also, the Bank of Thailand had a conflict of interest in both supervising and resolving distressed banks, creating an incentive to delay declaring banks insolvent (Scott, 2002).

In Indonesia, authorities established the Indonesia Bank Restructuring Agency, IBRA, in January 1998 as the agency responsible for crisis management, including restructuring the corporate and financial sectors. With World Bank assistance, the Jakarta Initiative Task Force also was established in 1998 to assist debt workouts (Scott, 2002). However, IBRA's operating parameters were not established until a year after its formation, reducing the effectiveness of its early efforts and the President continued to hold final say in IBRA-related decisions, undermining its autonomy. Also, transferring bank supervision from Bank Indonesia to IBRA strained the relationship between these institutions, making effective crisis management difficult (Scott, 2002).

II.vii Indonesia's Bank Recapitalisation Programme

During 1998, IBRA used World Bank funds and IMF assistance to employ international accounting firms to assess the capital adequacy of all private banks. Banks were classified according to their capital adequacy and in May 1999, IBRA unveiled its recapitalisation plan for private banks. This involved IBRA issuing government bonds to undercapitalised banks in return for government equity. At the same time, non performing loans were transferred to IBRA. IBRA initially issued Rp158 trillion (US$18.3 billion) of bonds in return for equity in 11 private banks and 12 regional development banks, raising their capital adequacy ratios to 4 per cent. By mid 1999, negative net interest rate spreads and deteriorating non performing loans increased the amount of capital required to recapitalise banks by 17 per cent, to around 40 per cent of GDP. In April 1998, eight nationalised banks were merged into Bank Danamon, with a CAR of 32.5 per cent (Economic Analytical Unit, 2000a).

With World Bank assistance, the second leg of Indonesian recapitalisation targeted large state banks, which accounted for more than 80 per cent of total bank deposits. These were amongst the worst performers in the banking system, reflecting weak management and sustained lending to government connected companies for non-viable projects. These plans stipulated banks close unnecessary branches, adopt new approaches for credit approval and risk management and shed non-core or unprofitable business activities. IBRA merged four state banks under its initial surveillance into Bank Mandiri, which required Rupiah 178 trillion in recapitalisation (Economic Analytical Unit, 2000a).

II.viii Post Crisis Reforms to International Financial Architecture

While domestic policy failures were the main cause of the Asian financial crisis, the crisis highlighted the increasing interdependence of the world financial system and the benefits of strong international financial architecture. Since the crisis, the international community has developed recommendations to improve such architecture (Taskforce on International Financial Reform, 1998).

In 1999, the IMF and World Bank commenced the Review of Standards and Codes, ROSCs, to identify weaknesses which could contribute to economic and financial vulnerability in member economies. The review aims to propose ways to foster market efficiency and discipline and contribute to a more robust and less crisis prone global economy. In a key outcome, this process developed a range of standards for regulatory, corporate governance and macroeconomic data systems to help member countries identify vulnerability and guide policy reform, known as ROSCs. The ROSCs program aims to increase transparency about global economic governance standards for markets and encourage governments to adhere to core international codes.

Under a five year program, the IMF and World Bank are employing independent expert teams to gather detailed data on around 180 member economies' compliance with international standards in 11 key areas. These include statistical data dissemination and transparency; corporate governance; accounting; auditing; insolvency and creditor rights; fiscal transparency; transparency in monetary and financial policies; banking supervision; securities regulation and supervision; insurance supervision; and payments and settlements.

By April 2001, the IMF and World Bank had completed 110 ROSCs modules for 43 economies; 76 of these are on the IMF web site, www.imf.org. Australia was a leader in advancing the concept of the ROSCs program and has already has reported on all 11 modules. Hong Kong also has reported on banking supervision, data dissemination, monetary and financial policy and fiscal transparency; and Japan and the Republic of Korea have reported on fiscal transparency. Malaysia, the Philippines, the Republic of Korea and Indonesia have volunteered for several early ROSC assessments (Metzen-Quemarez, 2001; Parkinson, 2001; International Monetary Fund, 2001).

Also in 1999, the Financial Stability Forum, FSF, was convened to promote international financial stability through information exchange and international co-operation in financial supervision and surveillance. The FSF regularly brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors and committees of central bank experts. The FSF seeks to co-ordinate the efforts of these various bodies in order to promote international financial stability, improve the functioning of markets and reduce systemic risk (Economic Analytical Unit, 1999).

In 2000, responding to the Asian financial crisis the FSF, endorsed recommendations addressing concerns about the role highly leveraged institutions, HLIs, known as hedge funds, play in international financial markets. These included strengthened risk management practices by HLIs and their counterparties, enhanced regulatory oversight of HLI credit providers, enhanced HLI disclosure, improvements on market infrastructure and guidelines on sound practices for foreign exchange trading. Through 2001 and since, the FSF has monitored progress in implementing these recommendations, noting generally good progress (Financial Stability Forum, 2002).

The FSF also has coordinated other agencies, including the IMF to develop recommendations for developing effective deposit schemes, identifying financial sectors at risk of instability under the Financial Sector Assessment Plan, enhancing securities regulators' information exchange and better involving the private sector in combating financial crisis and financial market volatility (Financial Stability Forum, 2002). The IMF believes it should have involved the private sector sooner in restoring confidence and stemming the outflow of private capital at the crisis' outset (International Monetary Fund, 1999).

II.ix **IMF** *Lessons from Assistance Programmes*

The IMF has carefully appraised its efforts to assist crisis affected countries, conceding its programs' initial fiscal objectives, based partly on the assumption of moderate economic slowdowns, were too tight. These were adjusted as it became clear the region was entering a severe contraction and in all three economies on International Monetary Fund packages, fiscal expansion began in early 1998, only two months after the start of the programs in Indonesia and Korea (International Monetary Fund, 1999).

While the IMF maintains far reaching structural reforms were needed to restore financial market confidence, it concedes programs did not focus early enough on financial and corporate sector issues, which came only later as the linkages were better understood (IMF 1999). The Fund also concedes that more could have been done to better prioritise and sequence reforms, acknowledging that some of these issues were only resolved as the programs unfolded (International Monetary Fund, 1999).

II.x World Bank Lessons from Assistance Programmes

The World Bank, which carried prime carriage for many of the key structural reforms, also revised its approach as programs evolved. First, given the need for institution building and sustainable poverty reduction, the Bank narrowed its focus in Indonesia and Thailand to governance reforms. Second, it now takes risk management more seriously when administering projects, acknowledging the often fluid political and institutional recipient environment. In Indonesia, for example, it describes three broad outcome scenarios, budgeting differing outlays under each (World Bank, 2001). Third, it now adopts a catalytic approach to developing projects, supporting only those that enjoy strong government and institutional support and extends funds only to those showing promise. Fourth, it makes greater effort in fostering local level support and undertakes more detailed 'bottom-up' planning (World Bank, 2001). Fifth, the Bank now seeks formal stakeholders and target group feedback and includes local representatives when designing projects. Finally, the Bank ensures it is more transparent to government and civil society groups.

REPORT I ANNEX III - THE OTHER DEVELOPING ASEANS

With low levels of industrialisation and financial sector development, Vietnam, Lao PDR, Myanmar and Cambodia were less exposed to sharp increase in foreign-currency borrowing undertaken elsewhere in East Asia, though Vietnam did suffer somewhat from this trend. Nevertheless, these economies' are closely integrated with regional markets and generally suffer from weak macroeconomic policies and institutions making them vulnerable to the regional currency shock. Also, in Vietnam, Laos and Myanmar, the dominant state owned enterprise and banking systems often generated commercially unsound lending and high non performing loans levels, which are slowing new investment and growth. Unlike in the Asia 5 economies, few banks or corporates in these four economies had borrowed abroad, so balance sheets were less vulnerable to the looming currency crisis.

In Vietnam, real GDP grew on average 8.8 per cent between 1993-7, starting to make inroads into poverty (Figure 1.11). However, crisis-related contagion and slowing reforms lead to a run on the Vietnamese dong, which from mid 1997 to 1998 depreciated by 17 per cent and reduced real GDP growth, largely due to declining export growth, which slowed from 20 per cent in 1997 to under 4 per cent in 1998 and a sharp drop in FDI to under 4 per cent of GDP (IMF 2002c). After averaging 4.5 per cent of GDP in 1993-7, investment slumped in 1998, also reducing real GDP growth (IMF, 2002c). The dominant state enterprise sector incurred substantial non-performing loans with the state owned banking sector in the lead up to the crisis, reducing banks' capacity to extend new loans (IMF, 2002c).

Cambodia's real GDP grew by 6 per cent between 1991-8, but was unevenly spread, driven mainly by donor-funded construction and urban services; agriculture output, which employs 80 per cent of the population, grew only 2 per cent per year (World Bank, 2000b). Moreover, the government fiscal position was weak, with the budget deficit running close to 7 per cent of GDP in the lead-up to the crisis and current account deficit reached a high 16 per cent of GDP (World Bank, 2000b). While donor inflows and foreign direct investment financed most of the current account deficit, authorities were forced to devalue the currency in the lead up to the crisis (World Bank, 2000b).

Around the time of the crisis, Cambodia's economic performance deteriorated sharply with construction and tourism hit hardest; real GDP grew by only 1.0 and close to zero in 1997 and 1998 (World Bank, 2000b). However, a drop in donor assistance and investment due to political upheaval caused slowing growth rather than the direct effect of the crisis. Foreign direct investment plunged by 45 per cent and domestic investment fell from 20 per cent of GDP to around 16 per cent by 1997 (World Bank 2002b). The Government also reduced budget expenditure, reducing the deficit to around 4 per cent of GDP.

Due to the closed nature of the Myanmar economy, the crisis had a limited impact on it. Real GDP fell from about 7 per cent in 1995/6 to 6.4 per cent and 5.7 per cent in 1996/7 and 1997/8; slowing reform also contributed to this decline (IMF, 1999b). The collapse of the Thai baht depreciated the Myanmar kyat's market exchange rate, boosting inflation from 22 per cent in 1995/6 to 49 per cent by 19998/9 (IMF, 1999b). Also in 1998/99, foreign direct investment fell by one-third from 1997/98 and foreign reserves reached low levels.

Largely unrelated to the crisis, Myanmar suffers other serious economic problems on which donors continue to focus. The public sector has run up large fiscal deficits, stimulating rapid money growth and creating inflation (IMF, 1999b). The central bank does not use monetary policy to target low inflation and high growth but simply lends to the public sector the money it needs (that is, prints money) increasing inflation (IMF, 1999b). Four large state owned banks undertake mainly state directed lending, lowering lending quality and also exacerbating inflation. However, several smaller private banks are growing rapidly (IMF, 1999b).

In Lao PDR, real GDP growth averaged 7 per cent in the years prior to the crisis but has faltered since, again mainly due to poor macroeconomic policy. In 1996, the current account balance reached 17 per cent of GDP, largely funded by donor and FDI inflows and the Government operated a large fiscal deficit (East Asia Analytical Unit, 1997). In 1998, partly financed by central bank monetary expansion the, banking sector expanded credit by over 100 per cent, mainly to fund government irrigation investment. This boosted inflation to over 140 per cent in 1998 (IMF, 2000b). By 1999, this sharp rise in lending boosted non-performing loans to around 70 per cent of total loans threatening their viability (IMF, 2002b).

US Aid Programme

Indonesia

The USAID program in Indonesia focuses on promoting economic recovery and growth and facilitating Indonesia's decentralization process, concentrating on local service delivery and budget planning in sectors such as natural-resource management and health. USAID uses private sector partnerships, resource city exchanges between U.S. and Indonesian local governments, and development partnerships with private companies, linkages with regional universities in meeting these objectives. USAID claims to have assisted in providing path-breaking support to Indonesians working to reform a corrupt and lethargic legal system. USAID also claims to have been instrumental in building the capacity and tripling the pace of public and private sector debt restructuring.

Budget Summary Table

(in thousands of dollars)

Category	FY 2000 Actual	FY 2001 Actual
Child Survival and Disease Programs Fund	18,950	19,580
Child Survival and Health Programs Fund	0	0
Development Assistance	53,050	51,483
Economic Support Fund	22,500	49,890
PL 480 Title II	18,110	12,233
Total Program Funds	112,610	133,186

Philippines

The USAID Philippines programme aims to improve the investment climate by helping reduce corruption and poor governance as one of

Cambodia

USAID runs a substantial economic support fund in Cambodia. A public defender's program now makes legal aid available to the poor in 83% of the country's courts, and 23 of Cambodia's 24 provinces and municipalities monitor human rights.

Budget Summary Table

(In Thousands of Dollars)

Category	FY 2000 Actual	FY 2001 Actual
Child Survival and Disease Programs Fund	3,550	9,420
Child Survival and Health Programs Fund	0	0
Development Assistance	0	0
Economic Support Fund	10,000	14,967
PL 480 Title II	7,071	2,422
Total Program Funds	20,621	26,809

Vietnam

USAID provides assistance to Vietnam to enhance the environment for trade and investment. The objectives of this program are to strengthen the Vietnamese private sector, and to help the government deepen trade and investment related reforms consistent with its commitments in the Bilateral Trade Agreement. Successful implementation of these reforms will also help Vietnam meet some of the requirements for accession into the World Trade Organization (WTO).

USAID provided critical technical assistance to the Government of Vietnam to develop the Bilateral Trade Agreement with the USG. The Agreement was signed in July, 2000, and awaits ratification by both sides in 2001. USAID will provide further assistance to help the Government of Vietnam implement the reforms and legislation required under the terms of the BTA.

Laos

USAID's programmes focus on developing activities to replace opium farming and reducing HIV.

Japanese Aid Programme

Indonesia

Japan announced in FY1998 that it would continue to provide assistance to Indonesia in its efforts to overcome economic difficulties and to provide support for measures for the socially disadvantaged and the unemployed. Japan's priority assistance areas include HIV/AIDS, the environment and education. Amongst economic assistance, priorities include providing assistance for sound macroeconomic management, promotion of supporting industries and agriculture. Little mention is made of governance or financial and corporate restructuring; natural disasters receive more attention.

Laos

Japan was Laos's top bilateral aid donor in 1997. Once again, Japan does not emphasise economic reform or restructuring, with its main priorities including human resources development, addressing Basic human needs, agriculture and forestry and industrial infrastructure.

Philippines

The Philippines is the third largest recipient of bilateral aid from Japan. Authorities stress the need to strengthen economic infrastructure for sustainable growth, including by removing impediments to growth. The program also stresses improving administrative capacity and institution building especially in local government areas. Finally, it stresses the need to develop capital market financing, especially for small and medium enterprises.

Thailand

Thailand is the fourth largest recipient of bilateral aid from Japan based on cumulative net disbursements up to 1998.Japan maintains a High-Level Mission on Economic and Technical Cooperation to Thailand, giving priority to assisting the Thai government meet its emphasis on human-centred development, with an emphasis on education and the HIV/AIDS sectors. The program recognises that there remains a need to support implementation of economic structural reforms that will bring economic recovery to the country. However, the programmes' economic priorities concentrate little on institution building and good governance initiatives.

Viet Nam

Viet Nam is currently the 13th largest recipient of bilateral aid from Japan based on cumulative net disbursements up to 1998. Japan undertook a High-Level Mission on Economic and Technical Cooperation sent to Viet Nam in October 1994 the program currently gives priority to human resource and institution building, with a special emphasis on support for the transition to a market economy. This include assisting with legal codification, taxation systems and financial systems. Japan provides cooperation in administration, market economy and legislation and vocational training and related fields. Developing education and infrastructure also comprise key economic priorities.

Japan believes medium term priorities include promoting institutional reform in the fiscal and monetary areas, reform of state-owned enterprises and private sector development and building a legal system oriented towards the market economy and promoting development of human resources.

Canada's Aid Programme

Canada's Asian aid programme emphasises environment and democracy and governance outcomes.

Philippines

The Philippines aid program emphasises the need to promote governance, build sound public institutions and promote private sector development.

A list of current projects include -

Good Governance, Democracy and Human Rights

Local Government Support Program (LGSP) - Phase II

Policy Training and Technical Assistance Facility (PTTAF) - Phase II

Philippines-Canada Environmental and Economic Management (PCEEM) Project

NCRFW Institutional Strengthening Project - Phase II

Private Sector Development

Promoting Participation in Sustainable Enterprise (PPSE) Project

Socio-Economic Development Through Cooperatives in the Philippines (SEDCOP) Project

Business Advisory Project (BAP)

Thailand

The Thai aid programmes also emphasises good governance and private sector development that comprise two out of the programmes' five main goals.

Recent projects include the *Enterprise Thailand Canada* project, which assists Canadian and Thai firms to enter into joint ventures and similar business partnerships; *the Human Resources Development (HRD) Policy and Institutional Linkages* project, which supports linkages in key sectors between Thai and Canadian institutions, agencies and private sector firms for technology transfer and human resources development purposes.

Upcoming projects include the new *Golden Jubilee Training and Visits Fund*, which will support professional exchanges, scholarships, short-term training and technical missions.

Viet Nam

Developing the private sector and establishing good institutional and public governance comprise one-half of the Vietnam aid programme.

Recent projects include the *Policy Implementation Assistance Project* (PIAP),1994-99, promoting economic and administrative reform in Vietnam, and strengthening policy planning and formulation capabilities of key organizations. Activities include short and long term technical assistance, seminars, workshops, training programs, study tours, practical attachments, and research assistance.

The *Vietnam Canada Financial Management Project*, 1995-00, improved the institutional framework for the development and implementation of economic reforms in Vietnam and strengthened the capacity of the Ministry of Finance to formulate and co-ordinate financial management policy.

The *Vietnam-Canada Short-term Retraining Fund*, 1995-00, helped Vietnam acquire the technical and management skills needed for enhanced socio-economic development and transformation to a market economy. Funds are provided for training and practical attachments in Canada and technical assistance in Vietnam for the benefit of Vietnamese decision-makers.

UK Aid Programme

Indonesia

DFID's aid programmes focuses on Governance reform, pro-poor growth and budgetary management and forest management. Current projects include support for the Community Recovery Programme developed and maintained by Indonesian civil society as a response to the crisis; supporting the ILO program to develop accountable trade unions that promote better living conditions; and encouraging the National Poverty Dialogue comprising community led workshops that seek to influence policy.

In Governance, DFID works closely with the World Bank and UNDP in running the Partnership for Governance that works with government, parliamentarians and civil society to build a broad constituency for reform, and provides expertise and advice. Through the Partnership, DFID assists design of initiatives targeting civil service reform and legal and judicial reform. Commitments to governance totalled STL6.7 million in 2000-03.

Cambodia

DFID mainly works through multilateral agencies, focusing on health, education, urban poverty, governance, civil society and mine action.

In health, DFID works with WHO to reduce HIV/AIDS, malaria and boost community awareness programmes. DFID also assist the Ministry of Health to strengthen policy environment for delivering healthcare services. In education, DFID provides institutional and policy support to improve teaching at primary and secondary levels. To reduce urban poverty, the DFID works with the UNDP to assist poor people in Phnom Penh through various schemes including employment training schemes. In the field of governance, DFID supports the UN Trust Fund in holding elections. Also, the program aims to strengthen the civil service to make it more responsive and accountable to the public.

Vietnam

In Vietnam, DFID works through partnerships with the World Bank and to a lesser extent the Asian Development Bank. The DFID assisted with an Interim Poverty Reduction Strategy Paper and co-financed with other bilateral donors the Poverty Reduction Strategy Credit.

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REPORT 1 ANNEX V DATA

Poverty Indicators

	$1 –a-day			$2-a-day			
	Mean Consump. (month)	Headcount (%)	Number of Poor ('000)	Headcount (%)	Number of Poor ('000)	Gini Coefficient	Population (Mill.)
Korea							
1990	301.09	0.0	0.00	0.3	0.13	29.88	42.87
1991	330.38	0.0	0.00	0.3	0.13	29.85	43.27
1992	362.09	0.0	0.00	0.3	0.11	29.85	43.66
1993	383.03	0.0	0.00	0.0	0.00	29.36	44.06
1994	411.09	0.0	0.00	0.0	0.00	29.36	44.45
1995	440.03	0.0	0.00	0.0	0.00	29.11	45.00
1996	480.46	0.0	0.00	0.0	0.00	29.71	45.55
1997	483.84	0.0	0.00	0.0	0.00	28.97	45.99
1998	400.86	0.0	0.00	0.0	0.00	29.42	46.43
1999	450.06	0.1	0.05	0.2	0.09	30.00	46.86
2000	466.60	0.1	0.05	0.2	0.09	30.00	47.23
2001	483.11	0.1	0.05	0.2	0.10	30.00	47.56
2002	500.31	0.1	0.05	0.2	0.10	30.00	47.87
2003	518.12	0.1	0.05	0.1	0.05	30.00	48.17
Thailand							
1988	90.4	17.9	9.6	54.1	29.0	43.8	53.69
1990	102.9	12.5	7.0	47.0	26.1	43.8	55.60
1992	129.8	6.0	3.5	37.5	21.5	46.2	57.34
1996	143.9	2.2	1.3	28.2	16.9	43.4	60.00
1998	121.7	3.3	2.0	34.2	20.9	40.6	60.33
1999	123.7	3.0	1.8	33.4	20.7	40.7	61.81
2000	125.4	5.2	3.2	35.6	22.2	43.2	62.31
2001	127.3	4.5	2.9	34.2	21.5	42.8	62.84

2002	130.3	3.8	2.4	32.3	20.4	42.4	63.35
2003	134.0	3.1	2.0	30.0	19.1	42.0	63.87
Vietnam							
1990	41.7	50.8	33.6	87.0	57.6	35.0	66.20
1993	48.9	39.8	28.0	81.6	57.4	35.0	70.35
1996	62.1	25.4	19.1	70.8	53.2	35.5	74.30
1998	70.5	15.0	11.6	63.9	49.7	35.4	77.73
1999	73.5	12.6	9.9	61.1	48.2	35.1	78.89
2000	80.2	9.6	7.6	55.2	44.2	35.3	80.00
2001	82.2	8.9	7.2	53.7	43.6	35.5	81.06
2002	84.6	8.2	6.8	51.8	42.5	35.8	82.06
2003	88.1	7.3	6.1	49.5	41.1	36.3	83.07

	$1 –a-day			$2-a-day			
	Mean Consump. (month)	Headcount (%)	Number of Poor (Mill.)	Headcount (%)	Number of Poor ('000)	Gini Coefficient	Population (Mill.)
Cambodia							
1990	48.29	48.3	4.4	83.7	7.7	41.6	9.15
1996	57.77	36.7	4.0	76.9	8.4	41.6	10.97
1997	56.97	38.4	4.2	78.0	8.5	41.6	10.90
1998	57.45	37.7	4.2	77.7	8.7	41.5	11.15
1999	57.28	37.7	4.3	77.8	8.9	41.5	11.40
2000	59.00	35.6	4.1	76.5	8.9	41.4	11.63
2001	60.37	33.5	4.0	75.5	8.9	41.5	11.86
2002	61.46	32.4	3.9	74.7	9.0	41.5	12.07
2002	63.43	30.2	3.7	73.1	9.0	41.6	12.29
China							
1990	57.05	31.3	357.8	69.9	799.5		1143.33
1993	67.36	29.4	348.4	62.9	745.3		1185.17
1996	84.24	17.2	210.1	50.7	620.1		1223.89
1998	88.45	17.1	213.5	50.8	633.5		1248.10
1999	93.07	17.4	218.7	49.6	624.4		1259.39
2000	99.95	15.3	194.2	46.2	587.2		1270.12
2001	107.24	13.8	176.6	43.6	558.5		1280.28
2002	113.87	12.7	163.6	41.6	536.3		1290.52
2003	120.90	11.7	151.1	39.5	514.3		1300.85
Indonesia							
1984	49.80	36.7	58.7	80.0	128.12	30.30	160.08
1987	55.63	25.7	43.4	74.2	125.39	33.08	168.99
1990	61.58	20.6	36.7	71.1	126.69	28.90	178.23
1993	68.54	14.8	27.8	61.6	115.53	31.69	187.71
1996	86.62	7.8	15.4	50.5	99.58	36.45	197.16

1999	66.82	12.0	24.9	65.1	135.00	0.31	207.44
2000	72.60	8.3	17.5	58.9	124.00	0.31	210.49
2001	73.85	7.8	16.7	57.8	123.23	0.31	213.23
2002	75.20	7.1	15.4	56.4	121.80	0.31	216.00
2003	76.59	6.5	14.2	54.9	120.09	0.31	218.81
Laos							
1990	39.16	53.0	2.2	89.6	3.72	32.65	4.15
1992	41.35	48.8	2.1	88.1	3.87	32.65	4.40
1996	48.27	41.3	2.0	83.1	3.83	36.51	4.90
1997	50.35	38.4	1.9	81.3	4.08	36.47	5.02
1998	49.57	39.5	2.0	81.8	4.21	36.47	5.15
1999	51.54	36.7	1.9	80.5	4.25	36.47	5.27
2000	52.95	34.6	1.9	79.7	4.30	36.47	5.40
2001	55.09	31.8	1.8	77.7	4.30	36.47	5.53
2002	57.50	28.8	1.6	76.0	4.30	36.47	5.66
2003	60.21	25.6	1.5	74.0	4.29	36.47	5.80

Real GDP Growth

	Actual						Projection	
	1996	1997	1998	1999	2000	2001	2002	2003
East Asia	8.3	6.4	-0.4	6.9	7.5	4.9	5.3	5.9
East Asia 5	7.1	4.2	-8.1	6.8	7.1	2.7	3.7	4.9
Indonesia	7.8	4.7	-13.1	0.8	4.9	3.3	3.5	4.0
Korea	6.8	5.0	-6.7	10.9	9.3	3.0	4.2	5.6
Malaysia	10.0	7.3	-7.4	6.1	8.3	0.4	3.0	6.0
Philippines	5.8	5.2	-0.6	3.4	4.0	3.4	4.0	4.5
Thailand	5.9	-1.4	-10.8	4.2	4.3	1.8	3.0	3.5
Transition								
China	9.6	8.8	7.8	7.1	8.0	7.3	7.0	7.0
Vietnam [1/]	9.3	8.2	4.0	4.5	5.5	4.8	5.2	7.0
Small Economies								
Cambodia	7.0	3.7	1.8	5.0	5.0	5.3	4.5	6.0
Lao PDR	6.8	7.0	4.0	7.3	5.7	6.4	6.5	7.0
Mongolia	2.4	4.0	3.5	3.3	1.1	1.1	3.0	5.0
Fiji	3.1	-0.9	1.4	9.7	-2.8	-1	3.5	3.5
Marshall Islands	-16.6	-10.1	0.8	-0.2	0.7	0.6		
Micronesia, Fed. Sts.	-2.4	-5.2	-2.3	1.1	2.5	0.9		
Papua New Guinea	7.7	-4.9	-2.8	7.6	-1.3	-3.5	0.8	1.5
Samoa	7.3	0.8	2.5	3.1	7.3	10		
Solomon Islands	3.5	-2.3	1.1	-1.3	-11	-9		
Tonga	-0.4	0.2	1.6	3.1	6.2	3		
Vanuatu	2.5	1.5	2.2	-2.5	3.7	-0.5		
East Asia NIEs	5.9	6.5	0.9	4.8	8.0	-1.3	2.4	4.2
Hong Kong (SAR)	4.5	5.0	-5.3	3.0	10.5	0.1	1.8	4.3

Singapore	7.6	8.5	0.1	5.9	9.9	-2.2	3.8	5.8
Taiwan (China)	6.1	6.7	4.6	5.4	6.0	-1.9	2.3	3.7
Japan	3.5	1.8	-1.1	0.8	1.5	-0.4	-1.2	1.7
Memo: East Asia - All	5.0	3.4	-0.7	2.8	3.6	1.0	0.8	3.0

Source: World Bank for EA5, Transition Economies, Small Countries. Consensus Forecasts (3/11/02) for Hong Kong (SAR), Singapore, Taiwan (China). World Bank DEC Prospects Group Update March 2002 for Japan.
Note: 1/ Differs from government data of 5.8 for 1998, 4.8 for 1999, and 6.7 for 2000

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