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The East Asian Model of Economic Development and Developing Countries

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Abstract

One can argue that the Asian financial crisis of 1997 - 1998 and the rapid economic growth of eight East Asian countries economies, often called the East Asian miracle is now seen as one of the most significant economic events in recent world history. This paper focuses the East Asian tiger's successful economic stories that became a role model for many developing countries. This paper will discuss the WB and IMF's role in the East Asian financial crisis and the paper analyses the steps taken and mistakes done to reach a solution by International Monetary Found (IMF). IMF provides temporary financial assistance to help countries to handle the situation. The paper focuses on the issue that did IMF play crucial roles or worsen the crisis. The first section of the paper will set a brief historical background about the existence of East Asian crisis, and consequences. Also, in this part being a role model to other developing countries will be discussed. The second section of the paper examines the role of the International financial Institutions (IFIs) such as IMF and IBRD analysis. The third and final part of the paper focuses the aftermath of the East Asian financial crisis from liberalizes market to standardize the market.

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Keywords: Financial Crisis, developing countries, WB, IMF;

1. Introduction

The East Asian financial crisis started in 1997, Thailand money, which is called Thai baht, was floated and spread rapidly as domino affect to other Asian countries. The crisis first started in Thailand and spread to South Korea, Indonesia, the Philippines and Malaysia. Those countries end up with heavy economic recession and currency depreciation. There were several aspects that led those countries into serious financial crisis between 1997-1998. One of the most crucial catalyzer on East Asian financial crisis was difficulty in international financial system;

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Asian countries started to adopt international financial market and become the place for Foreign Direct Investment and this integration lead to crisis.

In those East Asian countries financial liberalization created serious capital flows that result with huge bank loans and finally they end up with foreign debt. In another word, based on speeding their economic development East Asian countries take opportunity of foreign capital and as a result they accumulate foreign debt. Repayment of foreign debt was not easy for those Asian countries. And also, it led to overtake value of foreign exchange assets. The Asian countries responded to this issue with reducing liquid foreign exchange reserves in order to protect their own currencies. The currencies of those country lost values in front of US dollar.

One can say that East Asian countries wanted to join foreign capital to speed economic growth. International capital markets that create new opportunities for East Asian countries to attract foreign capital. Joining foreign capital, East Asian countries needed to take credit so, they have accumulated foreign debt. With huge amount of foreign debt the East Asian countries could not get more loans. Also, capital outflow occurred from those countries by international foreign investors. East Asian countries left with foreign capitals fleas, which hit them economic crises. With the government interfere International Monetary Fund and World Bank asked some economic reforms to gain new aid from Bretton Woods's institutions. It shows that globalization, international financial system, role of IMF, WB and government policies really played crucial role on this crisis.

The discussion of the research paper is divided into sections. Section I provides a brief background to the East Asian financial crisis. This section discusses the East Asian economic development up to the crisis 1997-1998. Section II provides information about the role of International Institutions Bretton Woods Institutions. For the better understanding it needs to be answer that "Is it solving or worsening the East Asian crisis?" Section III draws some important lessons from the East Asian financial crisis to other developing countries. Section IV is the conclusion of the research paper. This section provides summary and conclusion the discussion.

2. Section I: The Background of the East Asian Financial Crisis

The main aim to understand that how do East Asian countries grow rapidly? What caused to the economic crisis? What is their growth model? In those countries before crisis their economy was booming and rapid Gross Domestic Product growth -real GDP- was very fast. They were called miracle economy. The real GDP was growing very rapidly because of this growth over a long period of time; even they were growing 8-10 percent. Table 1 illustrates that China, Hon Kong, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan and Thailand's average annual percentage growth in GDP, the GDP growth rate, 1996 GDP per head (at PPP US$) % annual average between 1970-96. According to Table 1, since 1960, rapid economic growth rate occurred in those countries. So, those countries attract most of foreign and private capital inflows into those countries. The table shows that real average rate before East Asian financial crisis in 1997, average growth rate of real GDP.

Table 1: average annual percentage growth in GDP

	GDP Growth Rate					
	1996 GDP per head (at PPP US$)	% annual average 1970-96	1994	1995	1996	1997
China	3,120	9.1	12.66	10.55	9.54	8.80
Hong Kong	25,400	7.5	5.51	3.85	5.03	5.29
Indonesia	4,280	6.8	7.54	8.22	7.98	4.65
Malaysia	9,703	7.4	9.24	9.46	8.58	7.81
Philippines	3,060	3.6	4.38	4.77	5.76	5.10
Singapore	25,650	8.2	10.05	8.75	7.32	7.55
South Korea	12,410	8.4	8.58	8.94	7.10	5.47
Taiwan	17,720	8.3	6.54	6.0	5.67	6.81
Thailand	8,370	7.5	8.94	8.84	5.52	-0.43

Source: The World Bank; IMF (1998)

What cause this rapid growth in real GDP? First of all those countries shifted from import substitution to export substitution it created greater growth through increase foreign direct investment, greater technological developments. On the export promoting governments were active in giving supporting big corporations like LG, Hyundai, Samsung etc. those big corporations were giving massive government support to export goods to outside the country. Whole country became factory; all countries were become like big corporation for export. In those countries government controlled Unions, very cheap wage, also government insuring cheap labor especially female workers were producing goods. The governments in those countries were providing infrastructure such as road, electricity, good education, so all of those developments led to greater inflow of foreign direct investment (FDI) that even contributed greater growth in exports and incomes. Also, Asian countries got foreign aids from West and had greater access to the Western markets. Now, one can say that shift export oriented strategy, role of good governance, providing good education, technological advances, control trade union activities, foreign aid especially United states of America was giving too much money in order to discourage communism as a Cold War Containment policy.

In the East Asian countries market forces which focusing on export oriented. In those countries both market emphasizes export and government support. They were market friendly and by emphasize a private sector, big cooperation most importantly production for export. The governments were crucial role by control trade union, provision, education, law and order, construct enforcement and land reforming, provision of credit (intervene Bank sector), government give direct to bank to give credit to big companies. According to Stiglitz (2000) economy was growing with the good government policies but he criticizes globalization, international financial system, and IMF's failure of predictions and the IMF tried shock therapy it might be successful in the long run but Stiglitz argues that gradual therapy was better in short run and lead faster growth in long run. Besides this "the success of the East Asian miracles (all associated with great success in global markets) are often used by promoters of globalization to bolster their case" (Stiglitz, 2000). Target of the international institution's role in globalization caused by the structural adjustment and liberalization imposed by the International Monetary Fund and World Bank under the so- called 'Washington consensus'.

> "According to Stiglitz (1996) economic growth pattern and various government policies led East Asian countries rapid development it is possible. There are many conditions affects states

> development process. Economic growth can happen with investment, if states invest more they grow faster. According to them not all countries can develop economically. East Asian state successfully achieve development by successful market economy, private investment but three conditions are necessary; credible policy environment, competitive economy and focus on public sector."

With amazing economic growth, suddenly crises came in East Asian countries with financial globalization, foreign capital and as a result they accumulate foreign debt that they cannot repay easily and they are pushed toward default. In order to receive financial assistance, East Asian countries like all developing countries turn to the IMF and World Bank and implement economic reforms.

The important issues on East Asian financial crisis was that how they are given credit to each other, how the development unsustainable, 'crony capitalism' -which means that influence of government and businessmen-. In East Asian countries big corporations getting money from each other, whether investment sufficient or no it was ambiguous, massive corruption was exist, they were capital fly, crony capitalism led to crisis of confidence in the economies which stated first in Thailand and then other Asian countries drive into financial crisis, capitalism based on corruption, they were taking money out of the economy of the region. Production and export were down. East Asian countries were in serious debt. Before 1997 Asian financial crisis capital was inside the countries after massive Foreign Direct Investment. Because of the crisis, which really had domino effects that collapsing people's attention through, those countries and investors draw out the investment money. There was rapid flow out to those countries. The both GDP and export collapsed, unemployment up, inflation up, output not growing, inflation rising, serious balance of payment problem as a result of this crises was unexpectedly came.

3. Section II: The role of International Institutions Bretton Woods Institutions

Since the financial crises of East Asia, many countries have received International Monetary Fund and World Bank for assistance. As a result of economic crisis those countries went to Bretton Woods institutions for help and support as customary Bretton Woods institutions they worked together and they put many conditionality's before they could get support they need to implement conditionality. Like open market, privatization, deregulation of interest rate, pre condition to getting them, support devaluation of currency there are variation for example, 2 TL per 1 $ and later 4 TL per 1$ if you want to reduce to value, now it needs devaluation of currency. Devaluation has two effects; country's goods cheap like tourism, devalue your country do your export cheap. Balance of payment problem occur if you earn 100$ but you spend 200$ there is balance of payment problem. In order to solve the balance of payment problem it needs to be cut your expenditure, instead of spending 200$ it must be balanced what comes in what goes. Or one can increase the income or do part timework to increase the incomes.

As an IMF conditionality country needs to devalue their currency to aim to sell your good cheaper so, they were not selling, devaluation currency to attract to promote export, one of the conditions to promote and reduce import, you buy expensive. Liberalization of interest rate or deregulation interest rate, before government was controlling interest rate, they were having credit very cheap, IMF asked deregulate interest rate, so credit were coming expensive before it was cheap, but when IMF conditionality is on the issue, credit become high, before government interest rate were fixed, interest rata was cheap, because many people looked for credit, you increase price and IMF hit them with high interest rate. When you deregulate foreign investors cannot got foreign and domestic investors cant got credit due to high interest rate cause by deregulation which one of IMF's conditionality is high investment rate, reduce production, reduce employment and incomes. Because of the deregulation "credit squeeze", investment was reduce when people do not invest its reduce production, reduce employment opportunities further making economic crisis worsen. All of those conditionality, they had to put these conditionality's because of crisis IMF put those conditionality's to make economy become fresh, situation worsen but economy quickly recovered. Another issue is the institutions open up their economy, IMF said open up their economy, some country implemented the IMF conditionality but some countries did not implemented. Such as Malaysia did not implement capital liberalization, they try to allow Foreign Direct Investment or capital moved the economy they impose controls.

4. Section III: Lessons From The East Asian Financial Crisis To Other Developing Countries

The promoting economic stability is internationally and regionally significantly difficult. Especially, remain economic stability harder for developing countries than developed countries. As Stephan Haggard (1990) stated that focus on the macroeconomics polices of developing countries and examines why some of them more successful to promote macroeconomic policies. The society-centric approach and state-centric approach in order to analyze middle-income East Asian states policy outcomes because both approaches combine their macroeconomic policies. The middle-income developing countries inflation and stabilization differ between developing countries and advanced countries.

East Asian Tigers rapid growth and their financial crisis had big impact on the other countries. The Asian financial crisis had over but there are several lessons which not to repeat. Wade implement that all developing countries need to protect themselves and they must consider impact of the Asian crisis, which witnessed by whole world. Wade also explains the reason of Asian financial crisis that the experience of capital inflows, loss of export competitiveness and rise of domestic credit which led them into serious crisis. So, what are the lessons for other developing countries? One of the lesson it is important shift from inward to outward looking policies. East Asian economic experience of China; late 1970s the ‘household responsibility system’ that encourage farmers to increased agricultural productivity and this system led to rural – urban migration. China is most successful country in 1984, the ‘enterprise responsibility system’ means that enterprise encouraged to sell outside to the world markets. Later on China had ‘open door policy’ which liberalize foreign direct investment. In 1970 to 1990 income had double growth. Simply, for economical growth the country needs to be orient their economy outside, export orientation and recent experience of China illustrate that export orientated policies lead to rapid growth. Second lesson is outward / export orientation policy result uncertainties it make an economy vulnerable to contagion in economics. Because of financial crisis in other countries, other countries economy can be affected. Thirdly, the role of foreign direct investment can help increase investments, production, employment, incomes and technology but they must be handle properly. The government must provide infrastructure, law and order as well as good macro economic policies. Fourth lessons; developing countries must have access to developed markets if they want to growth effectively. The role of international institutions Bretton Woods some of their policy conditionality’s like devaluation, deregulations.

Section IV: Conclusion

The economic and political developments affect most developing countries like East Asian countries. Most developing countries used liberal trade policies till World War 1; they were exporting agricultural goods and importing manufacturing goods. Until 1980 policy of protectionism was the dominant and agricultural goods dominate their GDP. During 20th Century, the politics changed shift from export-oriented interests to import-competing manufacturers. So, state had development policy it led rapid industrialization also government put trade barriers and policies for investment. East Asian countries by late 1970s had balance of payments problem led those countries to ask for International Monetary Fund and World Bank for loan. Also, financial crisis forced governments to have reform and especially IMF and WB forced them to have reform like neoliberal development strategies. The East Asian model is export-oriented strategy, manufacturing growth rapid, export grew rapidly and the rate of per capita growth occurred. There are different scholars ideas about role of the state. Neoliberal explains East Asian success due to market friendly development strategy. On the other side state oriented interpretation stated that East Asian success because of state led industrial policies. As below discusses there are different emphasizes about the role of market or the state led East Asian economic success.

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