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## **The 1997 Asian Financial Crisis: Ten Years On**

*Shiping Tang\**

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THE 1997 Asian financial crisis was undoubtedly one of the most dramatic events in post-Cold War East Asia. While there is no doubt that the crisis was a watershed, it might perhaps be timely to ask, on its tenth anniversary, how deep an impact it has had on the region.

### **The Damage and The Corrections**

The most obvious impact of the crisis has been the severe damage inflicted on several regional economies, most notably Indonesia and Thailand. By most estimates, Indonesia's economic development was pushed back for at least a decade. The economic upheaval triggered by the crisis eventually led to the collapse of Suharto's "New Order" and the democratization of Indonesia. Thailand was also moving toward a mature democracy when it promulgated a new Constitution in October 1997, until the military coup in September 2006 brought the country back to military rule.

The 1997 crisis eroded the International Monetary Fund's moral authority in managing international financial crises and prescribing remedies. Before 1997, the IMF's authority in dictating policy changes to developing countries in need of financial assistance had gone unquestioned even though the Fund had already mishandled a few previous crises. IMF's clumsy handling of the 1997 crisis and its severe consequences finally drove home the point that the IMF did not have all the right answers; neither did the so-called "neoclassical/Washington Consensus" work all the time.

The IMF's handling of the crisis also made regional economies realize that they needed a regional mechanism that could react to an impending crisis in a timely fashion; it was out of this recognition that the Chiang Mai Initiative (CMI) was hatched. Today, CMI has evolved from the initial bilateral reserve swap system to a multilateral arrangement, called "Emergency Currency Reserve". Under the initial bilateral reserve swap system, a state could decline to contribute to a rescue mission on another state. Under the new "Emergency Currency Reserve" arrangement, rescuing missions are deemed as

collective action. This evolution should be considered a major progress because it contributed to the integration of East Asian economies.

The 1997 crisis fundamentally weakened the legitimacy of what is known as “crony capitalism”, as epitomized by the *chaebols* in South Korea. The lack of transparency in and oversight over the dealings between private business and banks (state-controlled or not) made an economy extremely vulnerable to external shocks. Today, most regional economies have firmly rejected this practice and many have spent much of the past decade to bolster the independence of their banks and to clean up the bad loans within their banking systems.

An important but often overlooked consequence of the 1997 crisis is the acceleration of the integration of Hong Kong into China. Hong Kong returned to China’s sovereignty on July 1, 1997; the Asian financial crisis struck the next day, dragging Hong Kong into its longest recession in history. It was during this long recession that residents of Hong Kong began to appreciate their dependence on China -- perhaps for the first time. For thirty years after 1949, China was closed to the outside world and Hong Kong essentially monopolized China’s international trade with the Western world and profited enormously. After China’s opening and economic reforms, however, Hong Kong’s monopoly was gradually eroded. Hong Kong today has to compete for business opportunities against other Chinese cities, especially Shanghai, Shenzhen, Guangzhou, Tianjin and Dalian. Residents of Hong Kong today now have to compete for jobs like never before. Someday, Hong Kong may become, for better or worse, just another major Chinese city, though hopefully a good one.

### **The Constants**

The 1997 crisis did not change everything, of course.

Perhaps the biggest surprise is that the “ASEAN plus Three or 10+3” grouping, the most touted initiative in East Asian regionalism, has come into existence. Indeed, it will come into existence sooner or later even if there had been no 1997 crisis. Actually, the financial crisis did not create the “10+3”: The ever-increasing interdependence within these East Asian economies has been a factor, and will almost inevitably lead to a pan-East Asian bloc. The 1997 crisis had merely accelerated the coming of the “10+3”. East Asia was already feeling a sense of urgency that it was rapidly falling behind the European Union (EU) and the North American Free Trade Agreement (NAFTA) in regional integration. East Asia also realized that this lag was weakening the region’s overall competitiveness. Indeed, the inability to deal with the financial crisis was instrumental in propelling East Asian states into action.

The 1997 crisis has neither significantly affected the central role of ASEAN in pushing East Asian regional integration, despite many pundits eagerly waiting to hand a death sentence on ASEAN shortly after the crisis. Today, ASEAN remains in the driver's seat in pushing East Asian regionalism. A key reason is that Japan and China, the two major powers in the region, do not get along too well and thus have to devolve the leadership role to ASEAN. In the long run, though, a genuine and robust reconciliation between Japan and China is a must if East Asia is to have an integrated future.

Moreover, ASEAN has remained in the driver's seat in pushing East Asian regionalism, despite the inability of Indonesia -- ASEAN's "first among equals" before 1997 -- to exercise leadership after it was hard-hit by the crisis. Maybe ASEAN as an institution has indeed gained its own life, independent of Indonesia's leadership.

And contrary to conventional wisdom, the 1997 crisis had also not destroyed the East Asian economic development model. The core of the East Asian model is not crony capitalism, but state-guided economic development with a market economy. While today's East Asian economies believe in strong governance and transparency, they remain committed to the core principle of a developmental state. One can even argue that post-crisis, East Asian states became more convinced in the necessity of a strong state in managing the road toward economic success.

Finally, the 1997 crisis has had very little effect on the long-term growth of the Chinese economy, although it might have brought about sooner China's sterling economic growth.

### **The Fog: East Asian Identity**

The one area in which the impact of the 1997 crisis is hard to judge is the "East Asian identity." While the 1997 crisis gave the East Asian states a sense of solidarity, it is difficult to argue that East Asia has a stronger common identity today. If a full-fledged East Asian Community depends on the emergence of a common East Asian identity, then the region has a long way to go.

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\* *Shiping Tang is Senior Fellow with the S. Rajaratnam School of International Studies (RSIS), Nanyang Technological University.*