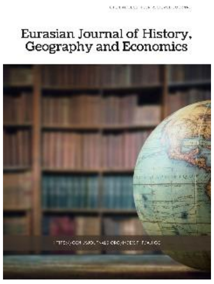

Impact of the East Asian Crisis on Thailand's Economy and China's Overcoming Strategies: An Analysis of Economic Sectors, Growth, and Policy Implications

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ABSTRACT

The study studied the impact of East Asian crisis that happened in the late 90's to one of the countries in the region, Thailand and how another country, China managed to overcome that crisis. Nearly all Thai economic sectors were exposed to the East Asian crisis. Thailand's GDP growth, inflation, budget, and trade accounts exposed its flaws as one of the fastest-growing countries of the 1980s. CML boosts investment and economic growth. CML's key downsides include financial instability, volatility, and foreign investor dependency. Results can inform some policy suggestions. They are export promotion, business restructuring, and financial reforms. Fiscal and monetary policies like strong government expenditure, low interest rates, and lower taxes stimulate demand and growth.

Keywords: East Asian crisis, Thailand economy, China's economic strategies, GDP growth, inflation, budget analysis, trade accounts, Capital Market Liberalization, financial instability, investment and economic growth, export promotion, financial reforms, fiscal policies, monetary policies

1. Introduction

The financial crisis that happened in 1997-1998 years, also called the East Asian financial crisis, caused millions of people in the region to return to poverty and brought down the economies of East Asian countries. Up to the present day, people still argue about the impact of Capital Market Liberalization (CML) on the economies of East Asian countries in that period. Understanding the causes and ways to overcome this crisis will help economists to prevent future crises. One of the countries that suffered the most during that crisis was Thailand. The objective of this essay is to examine the impact of the East Asian crisis on Thailand, the role of CML in the crisis, and how China managed to survive it.

2. Economic Characteristics of Thailand

To better understand the impact of the East Asian crisis on Thailand, the overview is divided into 3 periods: the pre-crisis period (1994-1996), the crisis period (1997-1998), and the post-crisis period (1999-2000).

According to the data obtained from WDI (World Development Indicator), during the pre-crisis period annual GDP growth of the country constituted 8-8.1% and declined to 5.7% in 1996(Appendix A). The inflation rates were constant at 5-5.8% (Appendix B). Starting from the late 1980s, Thailand's exports shifted from agricultural products to technological ones. The main exporting products were technical products such as electronics, electrical goods, automobile parts, and computer products (Phongpaichit, 1996). The exports of goods and services rose sharply from $56 billion in 1994 to $70.3 in 1995 and $71.4 in 1996 (Appendix D). The imports also saw a great rise from $63 billion in 1994 to $81.6 billion in 1995 and $82.8 billion in 1996(Appendix C).

The East Asian crisis had a significant impact on the key indicators of Thailand's economy. Particularly, the GDP growth showed a rapid decline of -2.6% in 1997, which was less than 8.5% compared to the rate of the previous year (5.7%). The crisis hit GDP growth most in 1998 with a rate of -7.6% (Appendix A). The inflation remained unchanged in the first year of the crisis (1997) at the rate of 5.6%. However, in 1998, the inflation rate was up to 8% (Appendix B). Similarly, the exports were not affected by the crisis in 1997 and increased to the point of $72.44 billion. Then, Exports dropped to $65.86 billion in 1998(Appendix D). The imports were affected by the crisis more than other indicators. High inflation rates made imports very expensive. In 1997, the value of imports was equal to $70.3 billion, while this value fell to $48 billion in 1998. To sum up, in 2 years, imports decreased by more than 40% (Appendix C).

Nearly all sectors of Thailand's economy instantly began to recover in the post-crisis period. In particular, the GDP growth rate grew to 4.5-4.6%, while the inflation rate fell from 8% to 0.3% in 1999 and 1.6% in 2000(Appendix A; B). Exports rose from $65.86 billion to $71.5 billion in 1999 and to nearly $82 billion in 2000(Appendix D). The imports also witnessed a sharp rise in the post-crisis period. Its value rose from $48 billion to $56 billion in 1999 and $71.36 billion in 2000(Appendix C).

3. Capital Market Liberalization

The early steps of CML in Thailand appeared in 1985. By 1994, openness in the capital market reached the point where there were no restrictions on current account transactions using foreign currencies (Panahi, 2016). Thailand became a very favored country for foreign investments. A number of restrictions were eliminated in the following areas: current account transactions, portfolio investments, foreign direct investments, and foreign exchange systems (Alba, Hernandez, and Klingebiel, 2022).

Quick credit growth and huge private capital inflows were a result of CML. These factors caused excessive rates of debt and asset price bubbles. As a result, the dependence on foreign currencies increased dramatically. Moreover, over the period 1990-1998, the economy of Thailand became more dependent on foreign capital. The proportion of foreign debt to the total debt in Thailand rose from 89.1% in 1988 to 94.1% in 1997. Consequently, the share of short-term debts, which are potentially more volatile, grew, as a result of huge capital inflows. The net FDI (Foreign Direct Investment) decreased, while portfolio investments increased in value (Alba, Hernandez, and Klingebiel, 2022).

Even though there are plenty of theoretical studies on the CML and its impact on Thailand during the East Asian crises, very few empirical research were conducted up to the present day. To answer the question "Was CML a good choice for East Asian countries during the 1997-1998 crisis?" the multivariable linear regression analysis was utilized. Here, the impact of FDI (Appendix I), current account balance (Appendix J), and portfolio investments (Appendix K) on GDP growth was examined. The choice of independent variables can be explained by the fact that, together, they represent the capital market of the country. The data on variables are obtained from WDI. The equation of the model looks as follows:

$GDP = \beta_0 + \beta_1 * FDI + \beta_2 * CAB + \beta_3 * PI + u$;

Where:

GDP=annual GDP growth rate (%)

FDI=net foreign direct investment (current US$, in billions)

CAB=current account balance (current US$, in billions)

PI=portfolio investment (current US$, in billions)

β_0 = intercept, constant number in the model, when independent variable is 0, value of the dependent variable

β_1 ; β_2 ; β_3 = coefficient that demonstrates change of the GDP, when the independent variable changes by 1 unit

u = error term

The results of the regression analysis are below:

VARIABLES	(1) GDP
FDI	2.798***
	(0.622)
CAB	0.0108
	(0.0268)
PI	1.082*
	(0.547)
Constant	15.19***
	(2.616)
Observations	11
R-squared	0.751

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

According to the results, the equation of the model looks as follows:

$$GDP = 15.19 + 2.78 * FDI + 0.0108 * CAB + 1.082 * PI$$

It is seen that all variables positively influence GDP growth. R-squared is equal to 0.751, meaning that 75.1% of all variations in GDP growth during that period can be explained by this model. In particular, a $1 billion increase in FDI results in a 2.798% increase in GDP growth. A $1 billion increase in CAB results in a 0.011% increase in the dependent variable. A $1 billion increase in PI leads to a 1.082% increase in GDP growth.

All these variables, being positively linked with the economic growth of the country, were negatively influenced during the East Asian crisis. Therefore, it can be concluded that CML is one of the reasons why Thailand’s and other East Asian countries’ economies suffered during the crisis. In other words, the more a country’s market liberalized, the more vulnerable its economy is in front of international crises.

4. China

When talking about the East Asian crisis, China deserves special attention. It must be highlighted that China, despite being economically and regionally similar to other countries of East Asia, suffered from the crisis considerably less than them (Knowles, Pernia and Racelis, 1999). During the crisis period, the GDP growth of China was equal to 7.7-7.8% (Appendix E). As for the inflation rates, this parameter, unlike the inflation in East-Asian countries, went down to -1.4% in 1999(Appendix F). The imports and exports of China also were not affected by the crisis (Appendix G; H).

There are several reasons behind this anomaly. The first reason is that China made it impossible to convert its national currency (RMB) for capital account transactions. Large transactions were only possible after the approval of the government and all big debt liabilities were denominated in national currency (Knowles, Pernia, and Racelis, 1999). Also, the government set limitations on foreign participation in China's equity market. This high currency control makes China less vulnerable to external activities and immediate banking collapses (Sharma, 2002).

The second reason is that China, compared to the East Asian countries, had much fewer short-term foreign debts, and FDI, with its long maturity periods and bearable rates, was considered the main capital inflow. This allowed China’s economy to be less exposed to foreign currency (Sharma, 2002).

Another reason for China’s stability during the East Asian crisis is that China’s economy was very diversified, and its sizes were very large. Exports constituted a less share of national GDP compared to East Asian nations. Consequently, the economy of China was less dependent on international trade (Sharma, 2002).

5. Conclusion

To sum up, it can be said that nearly all sectors of Thailand’s economy were highly vulnerable to the East Asian crisis. The economic characteristics of Thailand such as GDP growth, inflation, budget, and trade accounts showed all the weaknesses of Thailand’s economy that were one the fastest growing economies of the 1980s world. CML increases investment opportunities and enables economies to grow at a faster rate. However, the main drawbacks of CML are financial instability, volatility, and dependence on foreign investment. Based on the findings, some policy suggestions can be made. They are the promotion of exports, corporate restructuring, and reforms in the banking system. Moreover, fiscal and monetary policies like high government spending, low-interest rates, and reduced taxes would be useful in boosting demand and economic growth.

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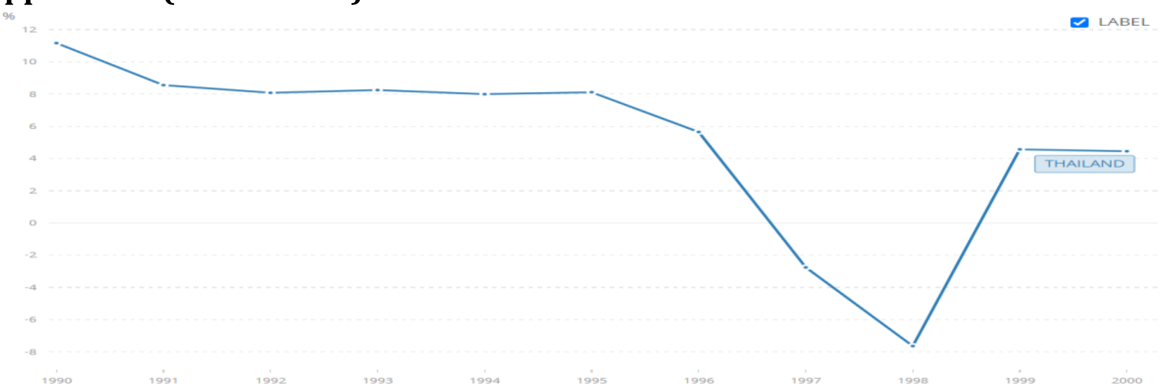
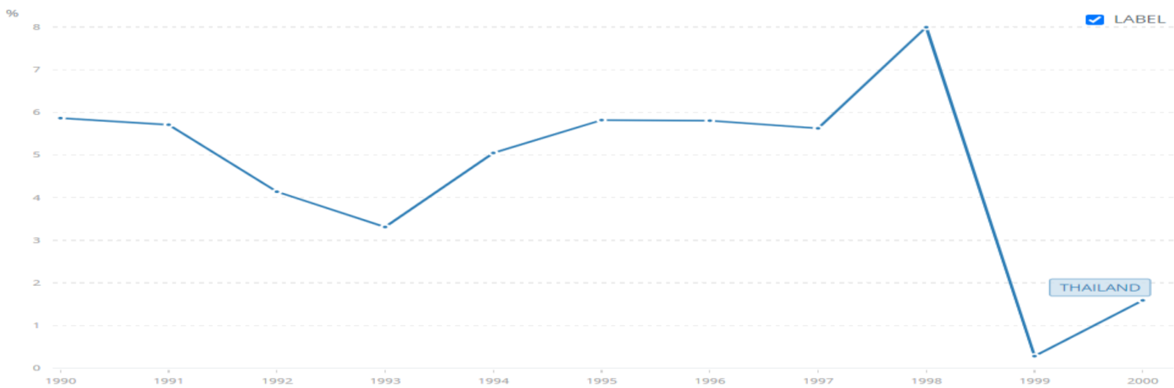
7. Appendices (World Bank)



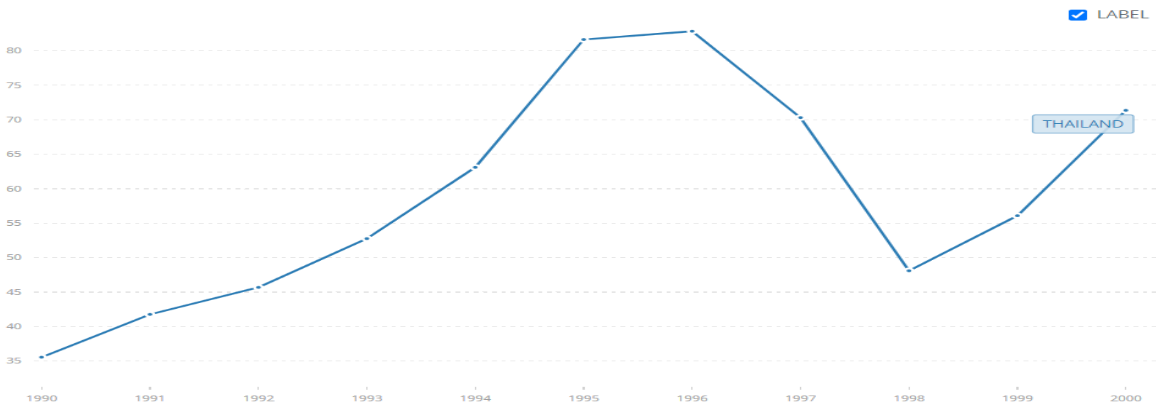
A)

GDP growth (annual %) – Thailand



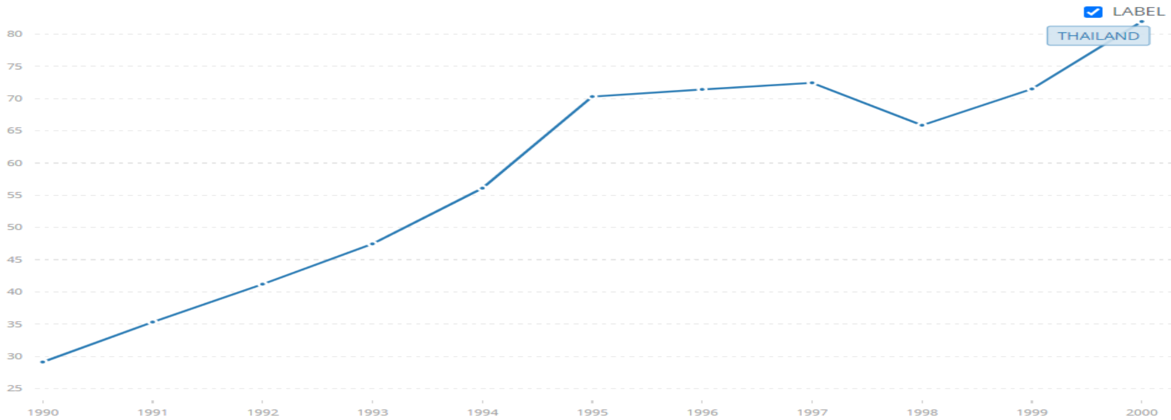
B)

Inflation, consumer prices (annual %) – Thailand



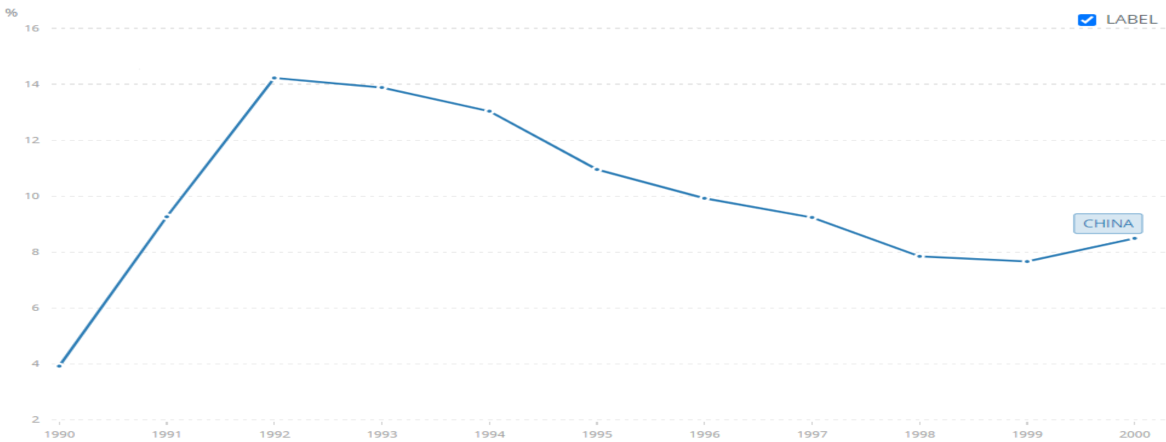
C)

Imports of goods and services (current US$) – Thailand



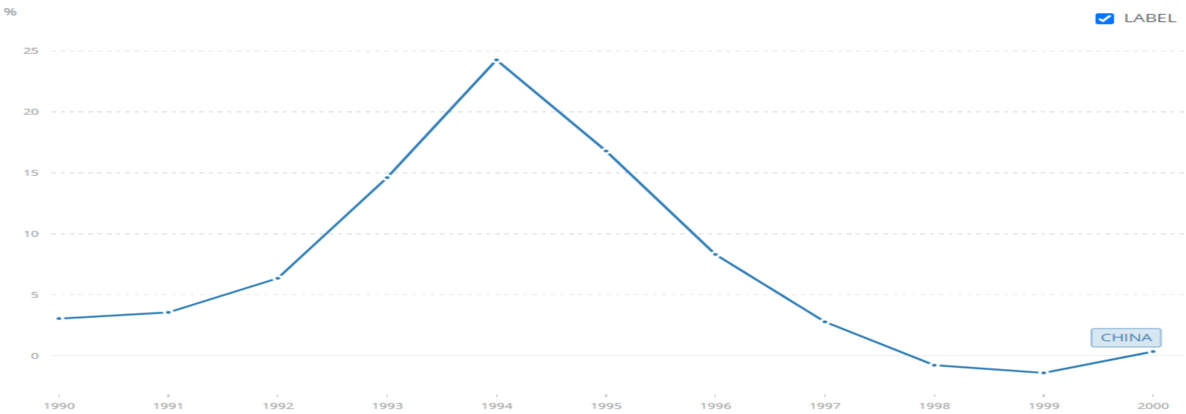
D)

Exports of goods and services (current US$) – Thailand



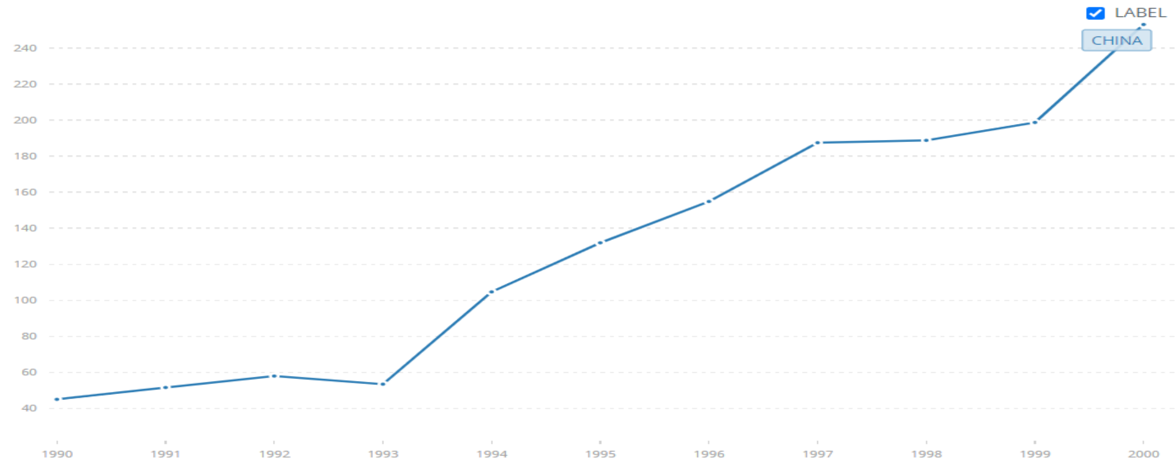
E)

GDP growth (annual %) – China



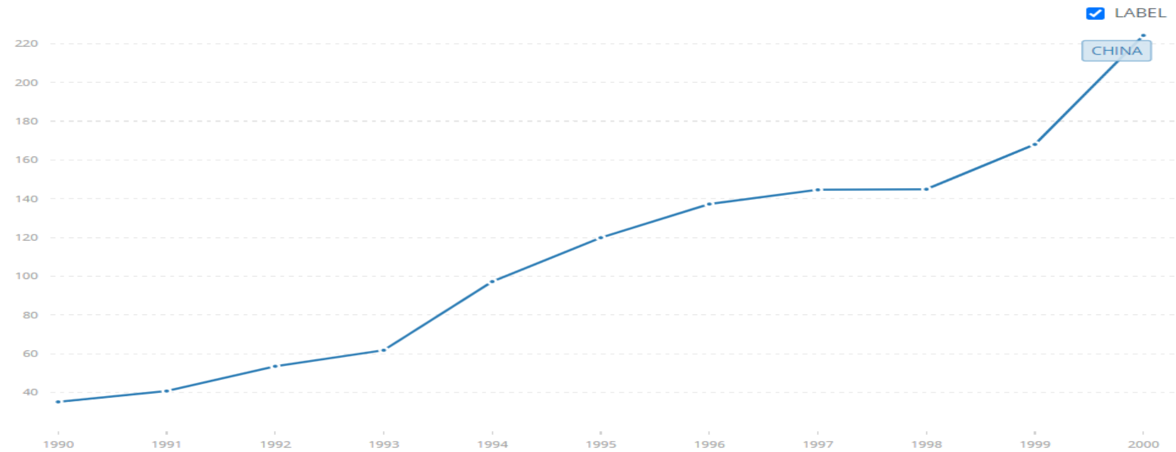
F)

Inflation, consumer prices (annual %) – China



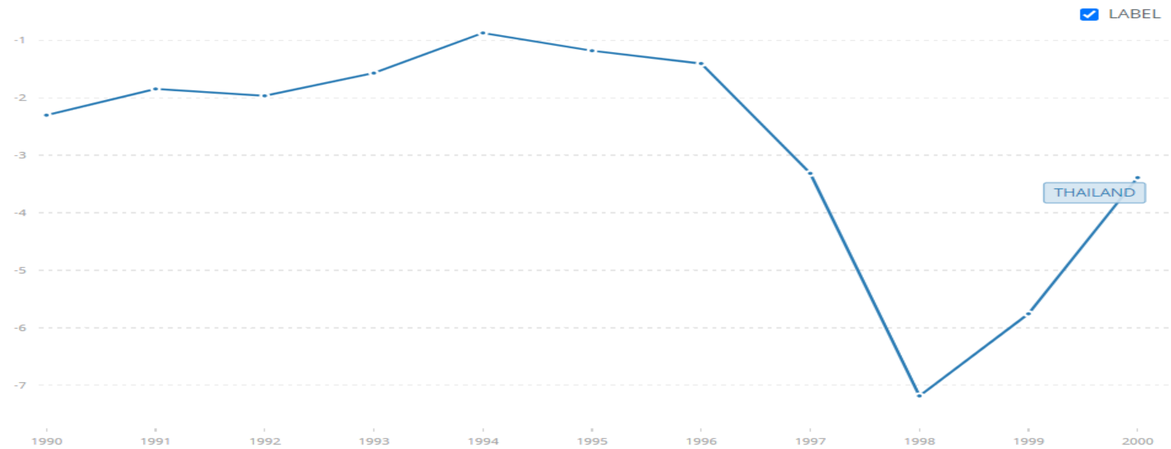
G)

Exports of goods and services (current US$) – China



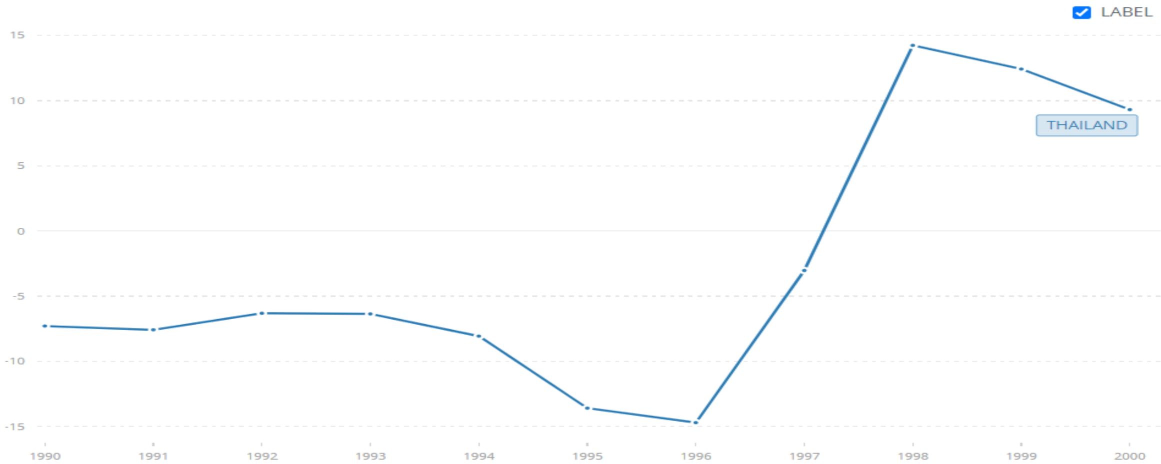
H)

Imports of goods and services (current US$) – China



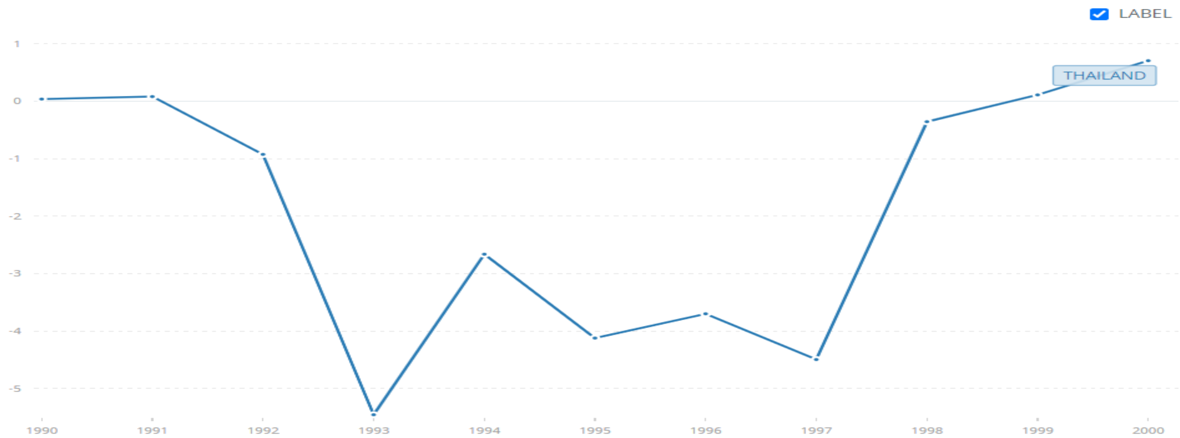
I)

Foreign direct investment, net (BoP, current US$) – Thailand



J)

Current account balance (BoP, current US$) – Thailand



K)

Portfolio Investment, net (BoP, current US$) - Thailand