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Malaysia’s and Indonesia’s Recovery from the Asian Financial Crisis

Comparison and Causes behind the Recovery

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This paper concentrates on the 1997 Asian financial crisis, and more specifically compares the very different means Indonesia and Malaysia used to handle the crisis. Malaysia was the only country who refused IMF's help during the crisis, and its methods to overcome the crisis are compared to Indonesia's methods which borrowed funds from the IMF. The paper aims to study how Malaysia's policies helped them to distribute wealth more evenly and led to rapid recovery from the crisis.

Indonesia's recovery took longer than Malaysia's, but it has been able to over-grow from its pre-crisis levels in financial indicators, such as GDP growth and foreign direct investment. However, the equal income distribution has been inadequate. When recovering from the crisis, the IMF cut government spending in subsidies and projects, which led to more poverty and unemployment. Alternatively, Malaysia did just the opposite: it boosted the economy, lowered interest rates and improved liquidity.

The US and the IMF had advertised towards open economies for years and one of its cures to the crisis was to open the economies even more to foreign investors, in the hope that the markets would correct themselves. They failed to under-stand that the rapid opening of the Asian markets had led to the crisis at the first place. Malaysia disagreed and imposed governmental control towards capital markets, and increased government involvement in other areas as well. Malaysia's cure seemed to work, since the signs of recovery were already seen quickly after the crisis and its economy was not affected as much as Indonesia's.

The IMF has had a rough path explaining the differences, since the Malaysian policies worked better than Indonesia's and as it was able to recover quicker and distribute its wealth more evenly. Thus, the IMF has been forced to admit some of its mistakes. The IMF's ability to change has been somewhat slow and most of the critiques feel that advances should be made in the organizations openness, transparency and power distribution.

Keywords	Malaysia, Indonesia, International Monetary Fund, Asian financial crisis, inequality, US influence

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1 Introduction

This thesis focuses on the 1997 Asian financial crisis and compares two countries different methods on solving the crisis: Malaysia's and Indonesia's. The research focuses on the different styles of economic methods of these two countries and concentrates especially on the International Monetary Funds (IMF) role as an advisor and lender. The paper tries to answer also to the question how the IMF's lending affected the outcome of Indonesia compared to Malaysia, which did not lend from the IMF, as well as to the question where the IMF policies failed and how they could be improved.

Indonesia was highly affected by the Asian financial crisis starting in 1997, when the Thai baht started to depreciate, weighing down the stock markets and other currencies. The Indonesian rupiah started to depreciate quickly as well, causing huge losses to Indonesian companies and banks. Unable to have financing from foreign investors the government asked financial assistance from the IMF. In return the IMF required to several reform measures to take place; such as closing down a number of banks, cutting down on subsidies and raising of interest rates. During 1997 and 1998 the Indonesian government made four funding programs with the IMF. Nevertheless, even with the financial support the rupiah still kept depreciating and in the same time the general price levels rose, affecting most to the poor, ultimately leading to riots and unstable political environment. (Thee, 2012)

Malaysia also suffered greatly from the financial crisis, when the ringgit, affected by the other Asian currencies, started to devalue in July, leading to a stock market collapse (Ariff & Abubakar, 2007). However, Malaysia refused help from the IMF and its policy measures were somewhat different than Indonesia's. It reduced interest rates to boost the economy and imposed capital controls to prevent the further fall of the ringgit (Nambiar, 2009). Malaysia started slowly to recover already in 1998, while Indonesia continued to struggle (Thee, 2012).

The thesis intends to analyze which factors led to recovery in both of the countries and how they have sustained that recovery throughout time and whether the outcome would have been different if different methods had been used, as well as if the IMF's policies could be improved and what type of measures the organization could take to develop them.

1.1 Aims of the Research and Research Problem

The aim of the research is to compare Indonesia's and Malaysia's economic situations before, during and after the Asian crisis and analyze which factors contributed to the crises. This paper concentrates on the IMF's influence in Indonesia's ways to tackle the crisis and compares those to the different methods used by Malaysia. It analyzes how the IMF lending affected Indonesia and its recovery compared to Malaysia. The aim is to try to find if there is any correlation between the IMF lending with the recovery's speed and stability and also, to determine whether Malaysia could have benefited from lending from the IMF or if Indonesia would have been better without the lending program. With the information now available, the hypothesis of the research is that the IMF's methods did not help Indonesia with the crisis and the recovery could have been more stable without the IMF's arrangements.

Secondly this paper aims to give a clear view of the IMF's rationale behind its policies and to find out why some of its practices were criticized. The research paper also evaluates the criticism and suggests few measures the IMF could do to satisfy its critiques and improve its methods. In addition the paper attempts to shed light on the reasons behind Indonesia's case and see if the critiques would have delivered a different outcome for Indonesia if different methods than the ones recommended by the IMF had been used. The paper could give guidance to governments and for the IMF whether the lending programs are helpful, how helpful they can be and suggests few areas of improvement.

The core research question is: How did the IMF's lending affect Indonesia's recovery from the Asian financial crisis in 1997 compared to Malaysia, which did not accept the IMF's help? And what can governments and the IMF learn from the differences?

1.2 Limitations

Possible problem with the research is that the hypothesis might influence the sources and thus the outcome of the research. However information has been retrieved from a range of different sources, thereby helping the thesis to remain as objective as possible. Another restriction is the countries' different situations at the time and whether it is possible to draw conclusions about cause and effect because of these. It is also difficult to guess what would have happened if Malaysia would have agreed to IMF funding or if Indonesia would not, since there is no way of knowing these counterfactuals.

Other limitations are that data from both countries is not necessarily available. This might make comparison more difficult, since information sources are scarce and not all factors can be regarded as comparable or even appropriate to the research.

1.3 Research Methodology

The thesis will be comprised of secondary research and the information will consist of several books, academic journal articles and online sources to give an overall picture of the problem from different perspectives. The data will be also collected from previous researches on the topic as well as through several databases, Indonesia's and Malaysia's government publications, and World Bank statistics.

1.4 Structure of the Research Paper

The research will consist of three sections: in the first the main events of the Asian financial crisis are introduced and the main reasons behind the crisis are represented as well as the core functions of the IMF and World Bank. The IMF's agenda is to help countries with financial difficulties by lending them money, but to be able to get the funding the countries need to comply with IMF's policies to overcome the crisis. To fully understand the research questions it is quite vital to know why IMF is funding the countries, when and why the IMF was founded and what are its main duties.

The World Banks agenda is only explained briefly, since it is not that critical performer with these types of lending programs, however it is quite intertwined with the IMF, so it is helpful to understand its mandate.

The second part will compare the two countries before, during and after the crisis and the third part will consist of the IMF's reasoning behind the lending conditions and the theory behind it, as well as critique of those conditions and some ideas how to improve its methods in the future.

2 Overview of the Crisis and Key Players

The following subchapters will explain the main characteristics of the IMF and World Bank and briefly introduce the origins and events of the Asian financial crisis, to give an overall picture of the two organizations and the struggles they and the Asian countries faced.

2.1 The International Monetary Fund

The International Monetary Fund (IMF) was founded in 1945. After World War 2 and the 1930's Great Depression there was a need for cooperation between countries to provide advice and resolutions to avoid financial problems and exchange rate difficulties (Bakker, 1997, ss. 11-13). Therefore the IMF was established in the UN conference in Bretton Woods, New Hampshire, United States. Its goals were to reduce foreign exchange restrictions, stabilize exchange rates and lend funds to countries experiencing temporary balance of payments problems (Danaher, 1994, p. 1).

The IMF's founding policies were the work of two economic theorists, John Maynard Keynes and Harry Dexter White. Keynes envisaged the IMF as a world's central bank that could create money on its own authority and as an institution that could lend money to governments while being greatly autonomous, so that no political influence could affect its decision-making. White, however, promoted the idea that the financial assistance should be in provision with the member countries contributions. The result was somewhat compromise of these two ideologies. The IMF finances its loans to member countries by requiring the funding from the reserves of other member countries, while the money lent from the other countries to the IMF can be recalled in short notice making the money reserve quite liquid. Nevertheless, Keynes' theories are more widely noted and the idea behind IMF basic philosophy is often referred to as coming from Keynes. (Bakker, 1997, pp. 11-12)

Today the IMF is an organization of 189 countries. On its own website, the IMF says that its tasks are working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment, advocate sustainable economic growth and reduce poverty around the world. (IMF, 2017)

In the Article 1 in the Articles of Agreement of the International Monetary Fund the purposes of the International Monetary Fund are stated as:

- (i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
- (ii) To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
- (iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
- (iv) To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
- (v) To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
- (vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.
  (Articles of Agreement of the International Monetary Fund, 1994)

The main activities of the IMF are surveillance over the monetary and exchange rate policies of its member countries, issuing policy recommendations to members, supervising the international supply of liquidity, and providing loans to member countries experiencing balance of payments problems. The aim for the additional credit is to help the country in question to rebuild its international reserves, stabilize its currency, continue its ability to pay for imports and restore economic growth. In general, the idea is that If a member country cannot fulfill its financial obligations to other countries because of a shortage of available cash, this country may borrow from the IMF. With these IMF funds, member countries are theoretically able to buy time to fix their economic policies and to restore growth without having to undertake drastic actions, thereby possibly harming the

other member countries. Smaller financial support is often loaned without major conditions, but countries in need of considerable funding should fulfill certain policy conditions to be able to get the credit. This conditionality is to serve two purposes: to ensure that the country getting the funding aims to correct its policies to restore the balance and that it will be able to pay the loan back. (Bakker, 1997, pp. 15-30)

2.2 World Bank

Like the IMF, the World Bank was established after the World War 2 in 1944. Unlike IMF the World Bank provides low-interest loans, credits, and grants to developing countries mainly for development projects. This funding is used for investments in education, health, public administration, infrastructure, financial and private sector development, agriculture, and environmental and natural resource management. Some of their projects are co-financed with governments, commercial banks, export credit agencies, and private sector investors and other multilateral institutions, such as the IMF. (World Bank, 2017)

Thus, the idea of IMF and World Bank funding is different, but together with the IMF the World Bank also provides balance of payments funding, usually through structural adjustment policies or other conditions negotiated by the IMF with the country in question. (Williams, 1994)

2.3 Asian Financial Crisis

In a report made by the World Bank in 1993 it states that “East Asia has a remarkable record of high and sustained economic growth. From 1965 to 1990 the twenty-three economies of East Asia grew faster than all other regions of the world” (World Bank, 1993). This quote describes quite perfectly the widespread view of the Asian economies at the beginning of the 1990s. The East Asian countries were described as “tiger economies”, having long periods of rapid growth and the countries seemed like a good and stable investment. During the 1980-1990s the US dollar was also exchanging at quite low levels and most of the Asian countries pegged their currency to the dollar to be able to have favorable exchange rates (Johnson, 2000, pp. 204-209).

However, in the summer of 1997 some of the foreign investors realized that they had lent vast amounts of money to companies with huge debts and quite low levels of equity. They feared that other investors, especially the huge US hedge funds, would notice the

same. Thus, the investors started to withdraw their money from the area, scared that all the investors would notice the same and the aggregate effect would be enormous, forcing the Asian economies to de-peg their currencies from the dollar and devalue them. However, when a few investors started to withdraw their money, the other investors panicked as well and the scenario described above is precisely what happened (Johnson, 2000, p. 209). In July 1997, with investors pulling money out of the country and currency speculators attacking the currencies, the pressure for the Thai government to keep its currency, baht, pegged to US dollar came too tough for the government to bear and it decided to abandon the peg and allow the baht to float freely. This resulted in the overnight collapse of the baht. This made other Asian currencies vulnerable to changes as well and when investors in the currency markets started to sell their Asian currencies, these started to depreciate too (Mahathir, 1999, pp. 47-50).

The Asian central banks used billions of dollars to support their currencies, but the attempts failed and soon they ran out of funds and needed the IMF's assistance (Stiglitz, 2006, p. 34). In August 1997, the IMF gave its first support package to Asia. However, the aid did not stabilize the markets and in half a year the Thai baht had lost about 55 percent of its value, with Malaysia's ringgit losing 40 percent and Indonesia's rupiah more than 80 percent (Mahathir, 1999, pp. 47-50).

The huge depreciation of the currencies affected the investors in the stock market as well. The Kuala Lumpur Stock Exchange lost 63 percent of its value in just one year. The credit agencies then started to lower their country ratings of the suffering economies, thus making the remaining investors alarmed, which resulted in a massive drop of stock prices. (Mahathir, 1999, pp. 51-52)

The currency crisis and the plummeting stock prices resulted in an economic crisis throughout the whole of Asia, having several consequences for various countries. The IMF responded to the financial crisis by funding the crisis countries so that they could sustain the exchange rates. The total bailout package for the Asian countries was $95 billion. The idea was that if the market believed there was enough money in the reserves, there would be no point attacking the currency and the confidence would be restored while at the same time the companies that had foreign debt could now easily obtain dollars and pay back the loans. However, the wealthy people inside those countries now saw an opportunity for escape and converted their money into dollars at a favorable exchange rate and then moved the money abroad. (Stiglitz, 2002, pp. 95-96)

In return for the aid the IMF insisted that the governments should implement several conditions such as austerity measures, tax increases, high interest rates and the sales of indebted firms, mostly to foreign investors. The IMF thought these measures would restore the economic health to the "Asian tigers" and by extension strengthen their, and the world's, faith in an open American-style capitalism (Johnson, 2000, p. 211). However, the conditions and high interest rates made the local companies incapable of paying back their loans and interests, leading to massive bankruptcies and eventually to a banking crisis (Stiglitz, 2006, p. 34).

2.3.1 The Influence of the United States

During the 1980s the Japanese trade was really beginning to have a negative impact on the American economy, so in 1985 the US and Japan made an agreement, called the Plaza Accord, to manipulate the exchange rates so that Japanese yen would increase in value and make the US dollar cheaper. Thus making US exports more affordable in the market. The Plaza Accord's aim was to decrease the US trade deficit with Japan, and the US government hoped that the regime would correct the trade imbalance by itself. However, the agreement only affected the prices of the goods, and no action was taken to end Japanese barriers against imports or to reduce the amount of Japanese goods coming to the US. Also, Japan's reaction to the high yen value was to minimize the costs with excessive mass production and lowering the interest rates, so that it would be able to continue its export-oriented growth. This resulted in industrial overcapacity and helped create the Asian bubble. By 1995 Japan still had a huge surplus of savings, which it invested in the US Treasury Bonds, allowing the US to gain more debt and keep its interest rates low, even though at the same time some of the Japanese banks were struggling to finance themselves. Thus, the situation started becoming more difficult and between 1995 and 1997 the Japan and the US agreed to reverse the Plaza Accord, allowing the yen gradually to decrease to 60 percent against the dollar. (Johnson, 2000, pp. 202-204)

However, during the 1990s when the Plaza Accord was still in place, many East Asian economies had pegged their currencies to the low dollar, with different types of fixed float regimes. This meant that as long as the dollar was low their price levels were also low, which gave the East Asian countries an advantageous position compared to other coun-

tries, and to Japan. But when the dollar became more expensive, the Asian exports suddenly came more expensive as well. These pegged currencies also gave the impression that the currencies were quite safe from exchange fluctuations, thus making the banks more eager to lend money even with higher risk. (Johnson, 2000, pp. 204-206)

With this advantageous situation, the East Asian countries experienced rapid growth through their exports, and in 1996 half of the global foreign investment went to Asia. This "hot money" however, was not especially needed in most of the Asian economies since in most cases the countries had high savings rates by themselves. (Johnson, 2000, pp. 204-206)

Additional US influence on the East Asian economies was the US's persistence of opening up the countries to free trade and free capital movement. Around 1992-1997 the US government had used its influence and pressured the Asian governments towards looser capital markets. However, this left the governments more defenseless to market movements, especially since many of the countries did not have legal and institutional systems needed for regulating the higher exposure to market volatilities. Another huge influence, especially for the smaller East Asian countries, was the founding of Asia-Pacific Economic Cooperation forum (APEC) in 1989. The US started to support the APEC especially in 1993 to improve the Asian economies ability to handle the foreign money offered to them. APEC became one of the leaders in promoting globalization to "the tiger economies" of Asia. American theorists declared that opening up to markets was necessary and beneficial to the economies so they would not be left behind with the growth. In the APEC meetings in 1994 and 1995 all the members agreed on opening their economies and to invest into the Pacific by 2020. In November 1997, with the Asian financial crisis already in place, the US still pushed for rapid removals of tariffs and barriers in fifteen different economic sectors. By November 1998, the meeting had a different tone, when Malaysia had reimposed capital controls, and the US Vice President Al Gore openly denounced Malaysia's Prime Minister Mahathir, and encouraged the Malaysians to overthrown him. Finally, Japan announced that it would stop making any further market-opening measures at this moment and accused the US of endangering the Asia's fragile economies by pushing the market openings to countries who were too weak to handle its mass. (Johnson, 2000, pp. 207-210)

The US also used its influence to undermine the Asian economies collaboration. When the crisis started, the Japanese suggested establishing Asian Monetary Fund, so that

they could help the suffering countries. The US, however, blocked the idea and did not want anything to challenge the IMF's and the USA's control, especially when they knew that the Japanese had often disagreed with the IMF policies, and probably would not have insisted on similar conditions to the lending countries. (Stiglitz, 2002, pp. 112-113)

2.4 Summary of Chapter 2

The Asian financial crisis started in July 1997 when the Thai government was forced to depeg the baht, and led it float freely. The currency plummeted in just one night and affected the other East Asian countries as well. One by one they were forced to de-peg their currencies, which ultimately led to major downturn on stock prices and the real economy. As the IMF had been established to help economies with balance of payment problems, most of the East Asian countries turned to it for help. The IMF loaned several countries billions of dollars, however the loans were conditional to several policies that should be implemented in order to receive the loan. For instance the IMF insisted the governments to reduce spending, increase taxes, higher the interest rates and sell the indebted firms.

There were several reasons behind the crisis, but one of the biggest ones was the USA's insistence to quickly open up the Asian markets to foreign investors during the 1990s. The East Asian countries were by then called the "Asian tigers" with their rapid export-led growth, but with the growth came the vulnerability to outside threats that the countries were ill-equipped for. So when investors were fleeing from the market the countries had little chance to protect and stabilize themselves, leading to universal crisis.

3 Indonesia

The following subchapters are describing briefly the political history of Indonesia from 1945 onward and its prospects before the crisis, the evolution of the crisis and the mechanisms used to overcome it, followed by description of the developments after the crisis, the current situation and future outlooks for the country.

3.1 General Suharto's era

To be able to get clear understanding of the governments politics, it is important to know few historical facts. Indonesia announced independence in 1945 and from then on was

led by President Sukarno, with support of the Indonesian Communist Party (PKI). However, Sukarno had problems combining the ethnically diverse nation, and several strikes and mass movements of workers and farmers had occurred in 1957 and 1964-1965. The uprisings were severely alarming and threatened the banks, companies and plantations owned by the Dutch, British and US. This and the USA's anticommunist ideology during the Cold War-era, led to US cutting off the foreign aid to President Sukarno, while in the same time made some strategic alliances with the Indonesian military forces. From the mid-1950s the US had trained and equipped Indonesian officers and soldiers and now started to help Indonesia to overthrow Sukarno and supplied approximately $64 million to Indonesian generals for military aid. The anticommunist idea or riots were not the only factors making the country a desirable ally, Indonesia had also vast natural resources, with tactically significant sea routes from Asia to Europe. (Winters, 2011a, pp. 154-160)

The President Suharto's era started when in the night of 30th September 1965, six high ranking military generals were killed. The PKI claimed that the conflicts inside the military led to the killings, but military officials declared that the murders were designed by the PKI. The killings were a good excuse for the US backed General Suharto take power and "save" the country from communism and overthrow Sukarno. Later it has been revealed that the US officials, with selected Indonesian army officials, constructed the assassinations to excuse the coup and to gain power. (Winters, 2011a, pp. 154-160)

Even though Suharto's presidency did not start peacefully, and his reign has not been declared as the most democratic one, with strong nepotistic character, ruling with military power and intimidation, he did manage to make the country more united than before. During Suharto's presidency Indonesia's per capita income increased from $75 in 1966 to almost $1200 in 1996. As well as economic growth, he also brought political stability to the country and Indonesia was major contributor in the creation of Association of Southeast Asian Nations (ASEAN) in 1967. (Johnson, 2000, p. 79)

3.2 Before the Crisis

Like the other "tigers" Indonesia had experienced rapid growth in the 1980s and 1990s. By then Indonesia had changed from the 1960s agricultural community to manufacturing and service economy. Indonesia focused on food, tobacco and textiles manufacturing, which were also its biggest exports with oil. The reducing oil prices, however, pushed

the country to evolve its manufacturing sector, and it was the fastest growing sector between 1980 to 1996 (Elias & Noone, 2011). The middle class was growing and becoming more influential in the country and the super-rich were getting even richer (Aspinall, 2015).

During the 1990s the unemployment rate was low, around 3 to 5 percent, and GDP growth had been stable for years, fluctuating from 7 to 9 percent (World Bank, 2017). In the early 1997 Indonesia's economic future looked promising and different businesses had grown with the fast expansion. Its fiscal deficits were between 1 to 2 percent of GDP and foreign reserves were considered to be sufficient to cover imports and short-term debts (Habir, 1999, pp. 197-198).

3.3 The Crisis

When the Thai baht collapsed in July 1997, it did not have immediate influence in Indonesia, but after a few months the investors lost their confidence also in the rupiah and the economy began to struggle. (Habir, 1999, pp. 197-198)

When the rupiah started to devalue, businesses started to face difficulties in paying back their loans. The banks now had vast amounts of bad debt on their hands and found themselves struggling as well. Foreign and domestic investors started to sell their shares of Indonesian companies and invested their money offshore. The government was struggling to have efficient foreign reserves and as a result it decided to let the rupiah float freely instead of the previous managed float. In August 1997, the value of the rupiah started to plummet (Habir, 1999, pp. 198-199) and the rupiah devalued from 2300 to 3000 per dollar. Also at the same time, the Indonesian companies with dollar liabilities started selling rupiahs and buying dollars, and equities lost almost immediately 55 percent of their value (Johnson, 2000, p. 211).

What made Indonesia more vulnerable was the fact that their businesses had a lot of debt in foreign currencies. Before the crisis, borrowing from abroad seemed a cheap alternative because the interest rates were often lower than in Indonesia. By then Indonesia had also a very good history of handling its exchange rates at the preferred rate and the foreign-exchange reserves seemed sufficient to defend the rupiah against exchange rate fluctuations. Based on this the people assumed that this would continue in the future as well, thus not being well prepared for the crisis. (Habir, 1999, p. 198)

Unable to pay the foreign debts anymore, many companies and banks went bankrupt. This made the Indonesian banks seem untrustworthy and the foreign banks started to refuse letters of credits, which led to further difficulties for companies trying to access credit. Same time the diminishing exports and imports had also negative effects on the companies. (Habir, 1999, p. 199)

The government had decided to take actions to reduce the money supply, and adjusted their interest rates higher, hoping that this would prevent further depreciation and attract foreign investors. However, this backfired, since the domestic borrowing now became more expensive and the companies could not afford even domestic loans. Indonesia then turned to the IMF for help and the first loan agreement was agreed in October 1997 (Habir, 1999, p. 199). The $43 billion loan was a three-year policy reform program that included adjustments to the financial sector, tightening fiscal policy and undertaking structural adjustments (Emmerson, 1999, p. 323).

The Indonesian government was accused that it did not commit enough to these reforms and was lacking any actual strategy to implement the policies. Meanwhile the country's economy kept stagnating. By January 1998, the rupiah had depreciated 85 percent since the end of the free-floating regime. Stock markets had also reduced to half of their previous value and companies were laying off thousands of workers while inflation was increasing. (Habir, 1999, p. 199)

During the same month, the IMF and Indonesia made another agreement with fifty specific reforms, including breaking down monopolies and cutting government expenditure, so that they would be able to continue with the $43 billion funding package. However, the reforms did not work and President Suharto was again accused of neglecting the promises made to the IMF. In April 1998, the IMF and Indonesian government confirmed yet another arrangement, listing 117 activities the government had to complete by specific deadline not to lose access to the aid package. Between October and April, only 7 percent of the promised funds had been disbursed so far. (Emmerson, 1999, p. 324)

The IMF had provided access to $23 billion to support the exchange rate and bailout creditors, but the smaller sums planned to help the poor had been less accessible. In order to cut back on government expenditure, the IMF ordered the food and fuel subsidies to be stopped on May 4, 1998 (Stiglitz, 2002, p. 119). This resulted in a 70 percent

increase in fuel prices overnight. Other effects that the government deductions had, was that the vast amount of government projects were stopped and especially construction firms suffered when they suddenly lost major contracts (Winters, 2011a, pp. 174-175). The country was now in deep economic and political crisis and from February till April 1998 several riots across the country erupted. Especially students rioted against the wealthy Chinese minority, and Suharto's family's businesses and buildings. During May over a thousand people were killed in these riots (Habir, 1999, p. 199). Since the citizens were rioting against Suharto and the IMF policies, it came clear even to the US and IMF that Suharto needed to be replaced. There has been some evidence that the military, still highly influenced by the US, also took part in starting some of the riots, to replace President Suharto and secure its own position. Also, the US had long ago changed their views from the Cold War, and Suharto was no longer seen as important asset. The military of course hoped that the wider audience would not see their involvement and the acts would look like concerned citizens rioting against Suharto (Johnson, 2000, pp. 80-83). In the end, President Suharto was forced to resign on 21 May 1998, and was replaced by his vice president Habibie (Habir, 1999, p. 199).

The financial crisis harmed several different aspects of the economy as well. At the peak of the financial crisis, the rupiah traded 15000 to one US dollar (Johnson, 2000, p. 211). In 1998 Indonesia's GDP fell by 13,1 percent and three years after the crisis the GDP was still 7,5 percent lower than what it was before the crisis (Stiglitz, 2002, p. 97). 75 percent of the firms were in distress during the crisis and almost 15 percent of working men in 1997 had lost their jobs by August 1998 (Stiglitz, 2002, pp. 97,117). Over a thousand, mostly Chinese, shopkeepers had lost their lives in the riots and in a few months the number of people living under the poverty line had increased from 27 million to over a hundred million, which was about half of the population (Johnson, 2000, pp. 74, 211-212).

Mohamad Mahathir describes the situation well in his book *A New Deal for Asia* when he quotes the former US Secretary of State Dr Henry A. Kissinger from the *International Herald Tribune* on October 1998 "In Indonesia – a rich country with vast resources and economy praised by the World Bank in 1997 for its efficient management – the IMF demanded the closing of 15 banks, the ending of monopolies on food and heating oil and the end of subsidies… The ending of subsidies raised fool and fuel prices, causing riots aimed at the Chinese minority who controls much of the economy. As a result, as much as $60 billion of Chinese money fled Indonesia… A currency crisis had turned into an

economic disaster… by April (1998) the explosion swept away the Suharto regime. A currency crisis, having been transmuted into an economic crisis, had become a crisis of political institutions. Any real economic reform stands suspended". (Mahathir, 1999, p. 104)

In Indonesia's case, it was easy to see that the much advertised liberalization of the foreign exchange markets, before the banking system was strengthened, turned out to be a disaster for Indonesia and instead of growth it brought instability. (Stiglitz, 2006, p. 54)

3.3.1 IMF Reforms

One of the IMF's reform plans starting from October 1997 was to keep interest rates high and decrease public spending, hoping to achieve a budget surplus to one percent of GDP. Critics have said that these actions led to a long-term recession, instead of a just brief loss of confidence of the rupiah. The high interest rates made already struggling companies even more difficult to receive loans and government austerity measures caused project halts and unemployment. (Emmerson, 1999, p. 330)

The IMF also insisted on closing several banks, resulting in the closure of 16 small private banks (Emmerson, 1999, p. 330). In addition, the IMF warned that other banks might need to be closed down as well (Stiglitz, 2002, p. 117). During this time, the government did not have any deposit insurance at place (Johnson, 2000, p. 211), but trying to avoid the panic, the Indonesian government announced that the depositors with accounts less than Rp 20 million, at that time equivalent to $6500, could retrieve their money from one of the three state banks. These accounts were around 49 percent of all deposits. Investors with larger sums might also collect their money back after the banks' assets had been sold (Emmerson, 1999, p. 330). Even though the IMF's wish was to reassure investors that the banking sector was now adequately reformed, the markets saw this as a worrying sign and started to withdraw their savings from all banks (Emmerson, 1999, p. 330). The only banks that were not much affected were the state banks, since people started to deposit their money from other banks to government banks, hoping that the government would guarantee their savings in case of bankruptcy. Thus the private banks struggled even more (Stiglitz, 2002, p. 117). In addition, the larger banks now feared that the government would close even more banks and they stopped lending to the smaller banks. The private banks then started to increase their interest rates more in hope of

luring investors, which finally set the lending to almost a complete halt. Much later the IMF has admitted, that the closing of the banks had been untactful (Emmerson, 1999, p. 330).

3.3.2 Chinese Minority

The wealth in Indonesia had been quite concentrated to the Chinese minority and to a few wealthier families, often relatives of President Suharto. Because of the riots against the ethnic Chinese minority, thousands of them fled from Indonesia. Even though the Chinese represented only 3,5 percent of the population before the crisis they represented close to three-quarters of the country's wealth. The fleeing Chinese took with them approximately $85 billion in cash (Johnson, 2000, pp. 83-84) and nearly $200 billion in overall possessions (Winters, 2011a, p. 178). This amount of capital, of course, made the liquidity of the Indonesian banks even more scarce and affected their ability to pay back their loans (Johnson, 2000, pp. 83-84).

What made matters worse, was that while the Chinese were fleeing the country, at the same time the Fund was injecting tens of billions of dollars to the banking sector trying to stabilize the situation. This gave time for the Chinese to move their assets outside of the country and they often even used that money to speculate against their own currency. (Winters, 2011a, p. 178)

3.3.3 Criticism towards Indonesian Government

Indonesia had been criticized, that among the reasons why it suffered so greatly from the financial crisis were its inadequate microeconomic policies, unsustainable investment in property, excessive foreign borrowing and unsound banks. Also, the country was accused of corruption and the country's President Suharto has been accused of favoring his relatives and friends during his long presidency. These factors were said to influence the trust of the investors resulting in the financial crisis. However, these issues were present in Indonesia long before the financial crisis, so the disappearance of trust solely because of these factors seems unlikely. (Habir, 1999, p. 198)

The IMF itself accused Indonesia several times during and after the crisis of "crony capitalism" and blamed the Asian-type economic model of not being effective, even though it had just months before referred to Indonesia and other East-Asian countries as miracle economies and Asian tigers. (Johnson, 2000, p. 80)

3.4 After the Crisis

By November 1998 the Fund had provided nearly a billion dollars to the economy every month and there were some signs of recovery. Inflation had been stopped and rupiah had settled around 7500 per dollar, still three times weaker than in July 1997. (Emmerson, 1999, p. 330)

After a long term under Suharto's power the country held democratic national elections in 1999, with free competition among parties and policies. However, power is still quite concentrated to certain wealthy and authoritative families and there is no single party truly representing the poorest. (Winters, 2011a, pp. 179-180)

By the 2000s Indonesia's real GDP per capita was growing at a yearly 5,4 percent rate and poverty has decreased to around 11 percent. From then growth has been able to create a stronger middle class, being currently the fastest growing segment of the population, and around 18 percent of the population is now economically secure. (World Bank, 2016)

Nevertheless Indonesians, and critics of the IMF, have blamed the organization for the country's suffering. The IMF used tens of billions of dollars to bail out foreign lenders, while at the same time there was not "enough" money to support the food subsidies for the poorest of the people. Even after unemployment and poverty had skyrocketed the IMF did nothing to change its course. The Indonesians blamed the IMF for its current misery. The common opinion was that the IMF should be held responsible and forgive the debt. When the tsunami hit Indonesia in 2004, the IMF finally gave in a bit and around $3 billion of debt due in 2005 was postponed for a year. (Stiglitz, 2006, p. 243)

3.4.1 Inequality

Surprisingly, since Indonesia's first democratic elections were held the inequality has increased. The politicians are mostly from the more prestigious families and the working class has no political party of its own. For example, even though labor unions are becoming more influential in Indonesia, there is no social democratic party linked to these unions (Aspinall, 2015). The government does not have any program, nor has it ever proposed a program to accomplish some wealth redistribution to the poorest citizens or to the whole society. Politicians often target their political promises and benefits directly

to their voters by introducing smaller programs benefitting only a selected target group. Often these are one-off deals rather than long-lasting policies (Aspinall, 2015).

However, there are some indicators that redistribution is becoming more important to voters, and the political field is aiming to find some health care, educational and other social welfare policies. Especially in health care, many local governments have begun new social welfare policies and a new universal healthcare insurance scheme has been introduced nationally. The current president Joko Widodo won the election in 2014. During his campaign he targeted the poorer voters and promised them healthcare, education and other social service improvements. One of his policies is a program to give cash disbursements to poor families and the aim is to eventually reach one-third of the population. (Aspinall, 2015)

One factor contributing to inequality is the relatively slow growth of income for the poorest Indonesians, who have benefitted less from economic growth than the average (Aspinall, 2015). There are some signs of promise as well when it comes to poverty reduction; in 2002 18,2 percent of the population was poor and in 2015 the percentage was around 11 percent. Nevertheless according to World Banks poverty standards, there are still around 40 percent of people living under 2 dollars per day (Priasto, 2015).

At the same time, Indonesia’s super-rich are gathering more power and wealth around them. In 2010, their combined net worth was about $177 billion and the richest one hundredth of one percent of Indonesia’s population, 43 000 people, has total wealth equal to 25 percent of the country’s GDP. The share of the extremely rich becomes more significant when considering that in the same year only 40 Indonesians had combined wealth equal to 10,3 percent of GDP and 21 of those 40 individuals are billionaires (Winters, 2011b).

The growing concentration of wealth can be seen elsewhere in the world as well, but one key factor to explain this trend in Indonesia was the sharp rise in prices and production of key commodities like coal and palm oil in the 2000s. Only the wealthy entrepreneurs with political connections benefitted from this boom (Aspinall, 2015).

3.5 Summary of Chapter 3

In Indonesia the financial crisis truly exploded and it evolved to a nationwide economic and political chaos. Many companies went bankrupted, thousands of people lost their jobs, and poverty rates expanded. The IMF tried methods such as high interest rates, government austerity measures and closing of several banks to stabilize the economy with little success. The IMF accused Indonesia of poor implementation of its remedies and corruption, while the Indonesians blamed the IMF of poor advice and inability to attend the needs of the poorest citizens.

Later the IMF has admitted that it failed in some of its policies, and especially closing down the weak banks lead to more illiquid market, almost stopping completely all lending. Nevertheless, the Indonesian economy gradually recovered and has been able to reach promising growth rates once again, while concerns about the income inequality and poverty still remain.

4 Malaysia

Malaysia is the only country in East Asia that rejected the IMF's help during the financial crisis. This makes the country an interesting comparison to others. Like in the Indonesia's case, the following subchapters will also analyze the events and policies before, during and after the crisis.

4.1 Before the Crisis

Malaysia had evolved from the 1950s tin and rubber exporter to industrialized economy. It had more than doubled its manufacturing output between 1970s and 1990s and decreased its dependence on oil, palm oil and rubber exports. The government had clear mission to industrialize the country and concentrated on exporting electrical and electronic products (Yusoff;Hasan;& Jalil, 2000). By 1990s Malaysia had been praised globally as one of the miracle economies in East Asia. Its growth rates were high, inflation was only 3-4 percent per year and the unemployment rates were low (Ariff & Abubakar, 2007).

However, there were some worrying signs as well, such as Malaysia having some substantial deficit in their balance of payments in 1995, but by 1996 it was almost half of that and in the early 1997 it had decreased more. Also, some of Malaysia's infrastructure and

development projects were considered large, but by historical comparison they were seen as manageable. Overall, Malaysia was considered as one of the tiger economies and investors were highly interested of the country. (Mahathir, 1999, pp. 55-56)

4.2 The Crisis

When the Thai currency started to weaken in July 1997, Malaysia's currency ringgit, started to struggle as well. The central bank of Malaysia, Bank Negara Malaysia, tried to defend the foreign exchange rate for about a week but finally was also forced to float the ringgit on July 14, 1997. By that time, the bank had already lost about $1,5 billion in the process. The ringgits value shrank almost fifty percent, falling from 2,42 to the US dollar in April 1997 to an all-time low 4,7 by January 1998. The financial crisis also affected the stock markets: between July 1997 and January 1998, approximately $225 billion in share values was lost. (Ariff & Abubakar, 2007)

The currency collapse also led the property bubble to burst, making investors unconfident about Malaysia's future. Money started to flow out of the country and as a result, the banking sector began to struggle since the number of nonperforming loans started to increase. By December 1997 the capital outflows had almost doubled to 4,08 percent from June's pre-crisis levels of 2,18 percent. A year after the onset of crisis, in July 1998, the percentage was already 11,45. The high increase in nonperforming loans affected the banks so that they cut back on borrowing and financing. (Ariff & Abubakar, 2007)

After a while the real sector also began to struggle. The stock price and ringgit depreciation started to affect the domestic demand and domestic-concentrated industries, such as construction and services. Also, the private and foreign direct investments slowed down especially during 1998 because of market uncertainties. By now many of the businesses were bankrupt or downsizing and inflation and unemployment was rising. (Ariff & Abubakar, 2007)

The IMF offered its help to Malaysia, as it had offered it to every Asian country struggling with the crisis. However, Malaysia refused the help. One of the reasons for the refusal was that the government had little faith in the IMF's policies and other reason was that during the 1980s and 1990s Malaysia had grown its exports in manufacturing and oil, which gave it more confidence to be able to tackle the crisis on its own. In the 1970s the share of manufacturers in total exports was 6,5 percent, but by 1995 it was 40,5 percent

and at the same time the share of manufacturers in GDP rose from 1970s 13,4 percent to 35,7 percent by 1995 (Yusoff et al., 2000). Also, Malaysia's government owned oil and gas company, Petronas, gave it more security to tackle the crisis on its own. When Petronas was established in the 1970s the government ensured that the major proceeds of the company did not fall into the arms of foreign players, and instead stayed inside the country (Stiglitz, 2006, pp. 32-34, 143). Malaysia had also high palm oil exports, and even when the price volatilities of petroleum oil affected the economy, palm oil exports secured constant revenue to the country (Yusoff et al., 2000).

Even though Malaysia had refused the IMF's help, during the early stages of the crisis its approach to the downturn was very similar to the IMF's actions in other countries. Malaysia's government announced that it would cut its operating expenses by 18 percent and cancel or postpone several infrastructure projects. It also increased interest rates, trying to lure in investors looking for higher profit. To strengthen the country's balance of payments account, exports were encouraged by different tax incentives, and imports were discouraged by increasing taxes. However, the government expenditure cuts and decreasing demand led to the rise of unemployment. The employment had been growing steadily at 4,9 and 4,6 percent in 1996 and 1997, but in 1998 it declined by 3 percent. Inflation also rose, reaching 6,2 percent in June 1998. The increased unemployment and cost of food developed a new group of poor who could not afford everyday necessities, education or health care. (Ariff & Abubakar, 2007)

Since the high interests and low liquidity made it difficult for the domestic companies to gain debt and make profit, the government soon started to look for other means to boost the economy. Share prices had started to decrease as well, thus making loan payments even harder for the companies. Domestic companies were close to bankruptcy and cheap enough for foreign investors to acquire them at a bargain (Mahathir, 1999, pp. 106-109). The policies currently in use were seen as short-term and ineffective so the government decided to change its tactics and established the National Economic Action Council in January 1998, whose main tasks were to develop a response plan for the crisis. The National Economic Recovery Plan was then introduced comprising more long-term and unique methods, such as easing of fiscal and monetary policies and lowering of interest rates. The government also proposed a RM 7 billion stimulus package and a specialized fund aimed at key industries to gain loans at reasonable costs (Ariff & Abubakar, 2007).

In September 1998, the Malaysian government also decided to internalize its countries assets by returning to a fixed exchange rate regime and calling back overseas deposits of the ringgit. Also, it implemented new regulations to make the stockbrokers' work more transparent and to avoid the effects of short selling in stock trading. Stock purchases in Malaysia had to be held for at least a year before they could be sold again (Mahathir, 1999, pp. 106-109). These methods were introduced as short term, while advertising that the government was not opposing any long term foreign investments (Stiglitz, 2002, p. 123). Critics however were concerned that after this mandatory one year period there would be massive outflow of money at one time. In response, the government revised its policy and introduced afterwards an exit tax with variable rates depending on the length of the stay and when the money was put in. The longer you kept the money after the one year, the less tax you needed to pay (Ariff & Abubakar, 2007).

Additionally, to increase the transparency the government ordered that instead of having a lot of shares registered in the name of a few nominee companies, the Kuala Lumpur Stock Exchange (KLSE) now required the shares to be registered in the names of the beneficiary owners. This stopped the operation of illegal share markets and the stock prices immediately started to recover. (Mahathir, 1999, pp. 106-109)

Since the ringgit was now called back and made unconvertable internationally it was basically valueless outside Malaysia. The offshore money, mostly removed from the country during 1997 and 1998 (Ariff & Abubakar, 2007), was now forced to re-enter the country, thereby solving the liquidity crisis. The economy started to recover quickly when money reserves rose and the balance of payments was in surplus. Interest rates could now be lowered to more reasonable levels since both the share and currency markets were more under control (Mahathir, 1999, pp. 109-110).

Malaysia also understood the importance of effective bankruptcy laws. The government organized additional courts and actively took a role in restructuring the firms' financials, so that companies could reorganize their assets. The methods were highly effective and in two years a large fraction of the distressed firms' financials were resolved. (Stiglitz, 2002, pp. 117-118)

Even though the economy was struggling, the country's exports increased during 1998 due to the palm oil and manufactured goods exports. The total exports grew 29,8 percent

in nominal ringgit terms. However, if measured in US dollars exports declined by 2 percent. Compared to other countries suffering from the crisis, this was still quite remarkable, and the almost doubling of palm oil prices during that time enabled the 64,4 percent growth of palm oil exports. At the same time, the economic stagnation slowed down demand for imports, and in 1998 the imports grew only 3 percent. These factors made the balance of trade surplus of RM 46,7 billion possible in 1998. (Mahani, 2000)

In early days of the crisis, the IMF had expressed its concerns about the Malaysian banking sector and its weaknesses. Malaysian banks had quite a high level of nonperforming loans – around 15 percent. However the central bank had already imposed strong regulations on banks to have adequate money supplies for these losses. Also, compared to other East Asian countries, and especially Indonesia, Malaysia had quite strong regulations towards banks and their foreign exchange lending and borrowing. They also had limits for the amount foreign debt companies were able to have in order to still receive loan from banks. (Stiglitz, 2002, p. 123)

4.3 After the Crisis

After the financial crisis, Malaysia has had more steady GDP growth than before. Malaysia was able to stop the GDP decline quite early and had positive growth already in 1999. Recently it has been growing at approximately 5,2 percent per annum. The inflation is now in low levels, being 2,1 percent in 2015, and the unemployment level has stayed low. (World Bank, 2017)

Even though the country seems to be operating quite well and is relatively high in the world's competitiveness score, some concerns remain. The ringgit is currently trading at its lowest levels since the crisis and related to this in October 2015 Malaysia's parliament member Wong Chen stated his concern about the economic future of Malaysia: "The biggest worrying factor is the domestic confidence level has plummeted due to the goods and services tax (GST) and also due to the fact that politically it's not very stable," The consumer confidence level had dropped to an all time low since 2005, when the first market survey about consumer confidence were conducted. The government introduced the new GST of 6 percent in April 2015, to gather some revenue, but consumers have reduced their spending because of the higher prices. At the same time, consumers have a high level of personal debt. Household debt is around 88 percent of GDP, and Wong fears that the tax increases may result in payment problems for those loans. "Even

though there's no default, what it requires is constant wage growth, and it needs a growing economy and that's not happening." However, Wong does emphasize that the Malaysian banking sector is doing remarkably better than during the crisis, and it is not burdened by the debt. Wong is also worried about the expected increase in the US Federal Reserve's interest rate which has led to an outflow of money. He is also concerned about the price drops of its major commodity exports, crude and palm oil, severely affecting the country's outlook. (Shaffer, 2015)

The government, however, sees the future brighter. The economy is growing more slowly, but it is still growing at decent pace. Also in October 2015, Minister for International trade and industry, Mustapa Mohamed, said that oil with other commodities accounts for just over 20 percent of exports, while manufacturing accounted for 50 percent and that the market has overreacted to the reduction of the oil prices. The country's trade balance looks healthy and the government's budget is on track. (Shaffer, 2015)

One of the key factors to help Malaysia's future outlooks in growth and stability is its efficiency as a steel and plastics producer. In addition, investments in the high-tech sector has helped it to become one of the major producers in computers, computer chips and electronic industries. Even though Malaysia has invited foreign investment, it has made sure that the firms have transferred technology and trained local workers so that the country would gain from these investments. One good example is the government owned oil and gas company Petronas, where foreign investors were prevented from exploiting Malaysia's natural resources, but instead helped to teach the Malaysians and develop the industry, while ensuring that most of the value of the resources stayed in Malaysia. Today Petronas is a major oil and gas company and it is also helping other developing countries by teaching them to develop in the industry. (Stiglitz, 2006, pp. 32-34)

4.4 Summary of Chapter 4

Malaysia was the only country in Asia who refused the IMF's help and decided to overcome the crisis on its own. As described above Malaysia's approach to stabilize the economy was very different than IMF's. Instead of increasing the interest rates, Malaysia lowered them. Instead of cutting back on government expenditure, it increased funding to specific important industries and used funds to stimulate the economy. It also in-

creased regulations to financial sector and called back its currency from offshore, increasing the liquidity in the country. It also helped firms to deal with bankruptcies in an effective way and regulated foreign investments, and at the same time repegged its currency back to the dollar, making the exchange rate more stable. All these methods helped the country to revive already in 1999 and diminish the damages of the crisis. The country has since then once again de-pegged its currency and has been able to increase its GDP while keeping its inflation, unemployment and poverty rates down.

5 Comparison

The previous chapters have discussed the situation in Asia in general and, more specifically, the two countries, Indonesia and Malaysia. To be able to compare the countries better, the thesis focuses on eight different economic parameters, which are GDP, exchange rate, inflation, foreign direct investment, competitiveness, unemployment, poverty and inequality. The aim is to conclude the differences in their recovery speed, stability and growth to help understand and compare the countries.

5.1 GDP and Growth

Before the crisis, Indonesia had quite stable GDP growth rates in the 1990s, fluctuating from 7,2 to 9 percent. The crisis can be seen in 1997s rates already, when growth was only 4 percent. However, the crisis really hit in 1998 when Indonesia's GDP fell by 13,1 percent. Since then GDP has gradually grown, first 0,8 percent in 1999 and 4,9 percent in 2000, but it still has not achieved the pre-crisis levels of over 7 percent growth. From 1999 to 2015 the average GDP growth rate has been 5,0 percent. (World Bank, 2017)

In Malaysia, GDP growth levels before the crisis were fluctuating between 8,8 and 10 percent. In 1997, the growth rate was still 7 percent, however in 1998 it declined by 7,4 percent. During 1999 and 2000 it grew by 6,1 and 8,9 percent. Since then the growth has been fluctuating more, but it is on average 5,2 percent per year (1999-2015). (World Bank, 2017)

When comparing the GDP growth, also represented in the Figure 1, it is easy to see that Malaysia seemed to recover more quickly from the crisis, since its GDP started to rise steeply already in 1999. However, in the long run the evidence is not so clear, since the countries growth rates are very similar and Malaysia has had more fluctuations in its GDP.

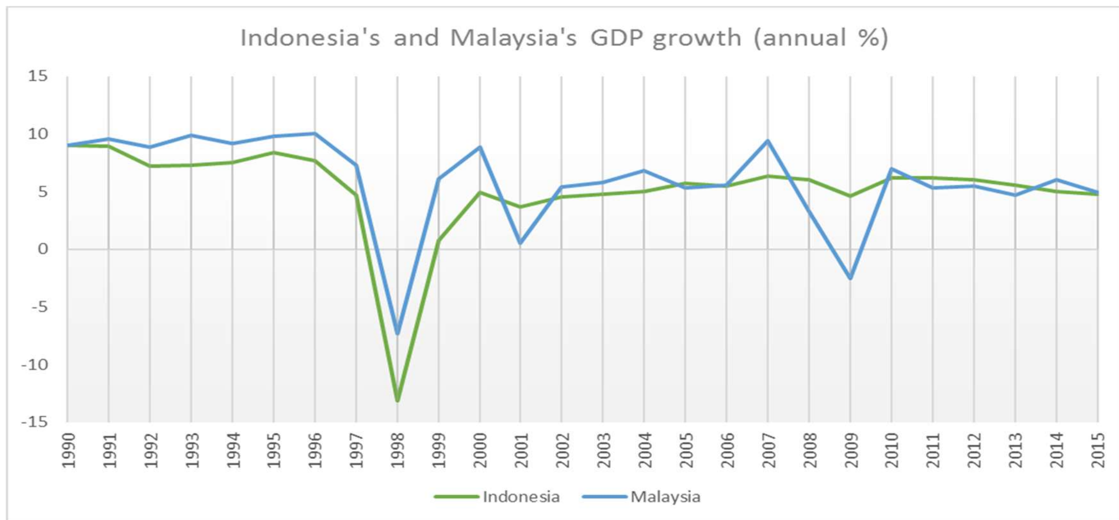

Figure 1: Indonesia's and Malaysia's annual GDP growth in percentages. Source: World Bank, 2017

5.2 Exchange rate

In Indonesia, the rupiah started to plummet in August 1997 and by January 1998 it had depreciated 85 percent from its summer rates (Habir, 1999, p. 199). The rupiah devalued from 2300 per dollar to an all time low of 16600 by June 1998. The rupiah gradually recovered, but it has recently devalued near to the crisis levels of 13000-14000 per dollar (Trading Economics, 2017).

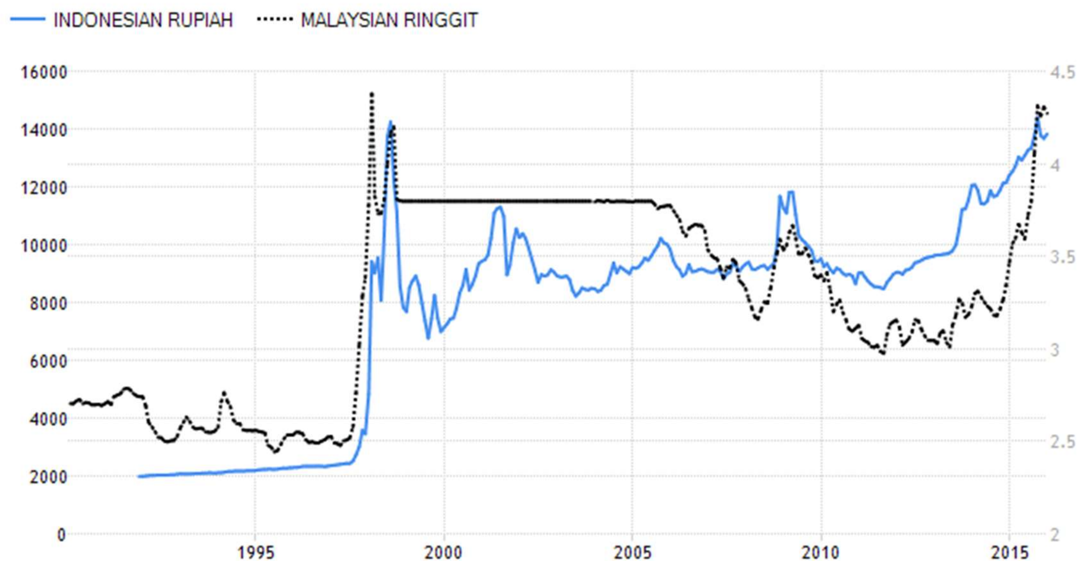

Figure 2: The Indonesian rupiahs and Malaysian ringgits exchange rates from 1990-2017. Rupiahs exchange rate on the left and Malaysia's rate on the right. Source: Trading Economics, 2017

The Malaysian ringgits value shrank almost 50 percent in less than a year, starting from April 1997 at 2,4 per dollar, reaching to the all-time low of 4,7 in January 1998 (Ariff & Abubakar, 2007). From January onwards the exchange rate settled somewhat, and in October 1998 the government pegged the currency at a fixed rate of 3,8 per dollar, making the rate unsuitable for comparison. In 2005, the currency was allowed to float freely again, and the rate slightly dropped until 2013 when it started to rise again. The ringgit is currently trading at around 4,4 (Bank Negara Malaysia, 2017).

The exchange rates' shifts can also be seen in Figure 2, where ringgits' and rupiahs' rates are expressed in the same graph. From the figure the comparison is easy to see, and the ringgits peg is very noticeable. Because of the peg, the currencies cannot really be compared immediately after the financial crisis, but in the last decade the differences are more noticeable. However, currently the rupiah and ringgit are both changing at very low rates, close to the numbers during the crisis. Especially the ringgits exchange rate has dropped quickly in a few years.

5.3 Inflation and Consumer Prices

The countries consumer price inflations are represented in Figure 3. There you can see that Indonesia's consumer price inflation had been on average about 8,5 percent per year. In 1996 and 1997 the inflation was still at a reasonable level at 8,0 and 6,2 percent respectively, but in 1998 inflation really boomed to 58 percent (World Bank, 2017). By November that year, inflation started to settle and by then the rupiah was exchanging at 7500 per dollar, three times weaker than in summer 1997 (Emmerson, 1999, p. 330). Also noticeable, in 1998, was that when the government reduced the subsidies, the price of fuel increased 70 percent over one night (Winters, 2011a, pp. 174-175). In 1999, inflation started to lower and was 20 percent, and in 2000 it was already around 3,7 percent. During the 2000s inflation has been fluctuating between 3,7 to 13,1 percent, averaging around 7 percent per year. In 2015, the inflation rate was 6,4 percent (World Bank, 2017).

In Malaysia, inflation on consumer prices had been around 3 to 4 percent per year before the crisis. In 1998 inflation rose to over 5 percent (World Bank, 2017) and during the same year inflation was at its highest in 6,2 percent in June 1998 (Ariff & Abubakar,

2007). In 1999 inflation came back to a more reasonable 2,7 percent and has been ranging from 0,6 – 3,6 percent per year, except for 2008 when inflation once again rose over 5 percent. In 2015 the inflation rate was 2,1 percent (World Bank, 2017).

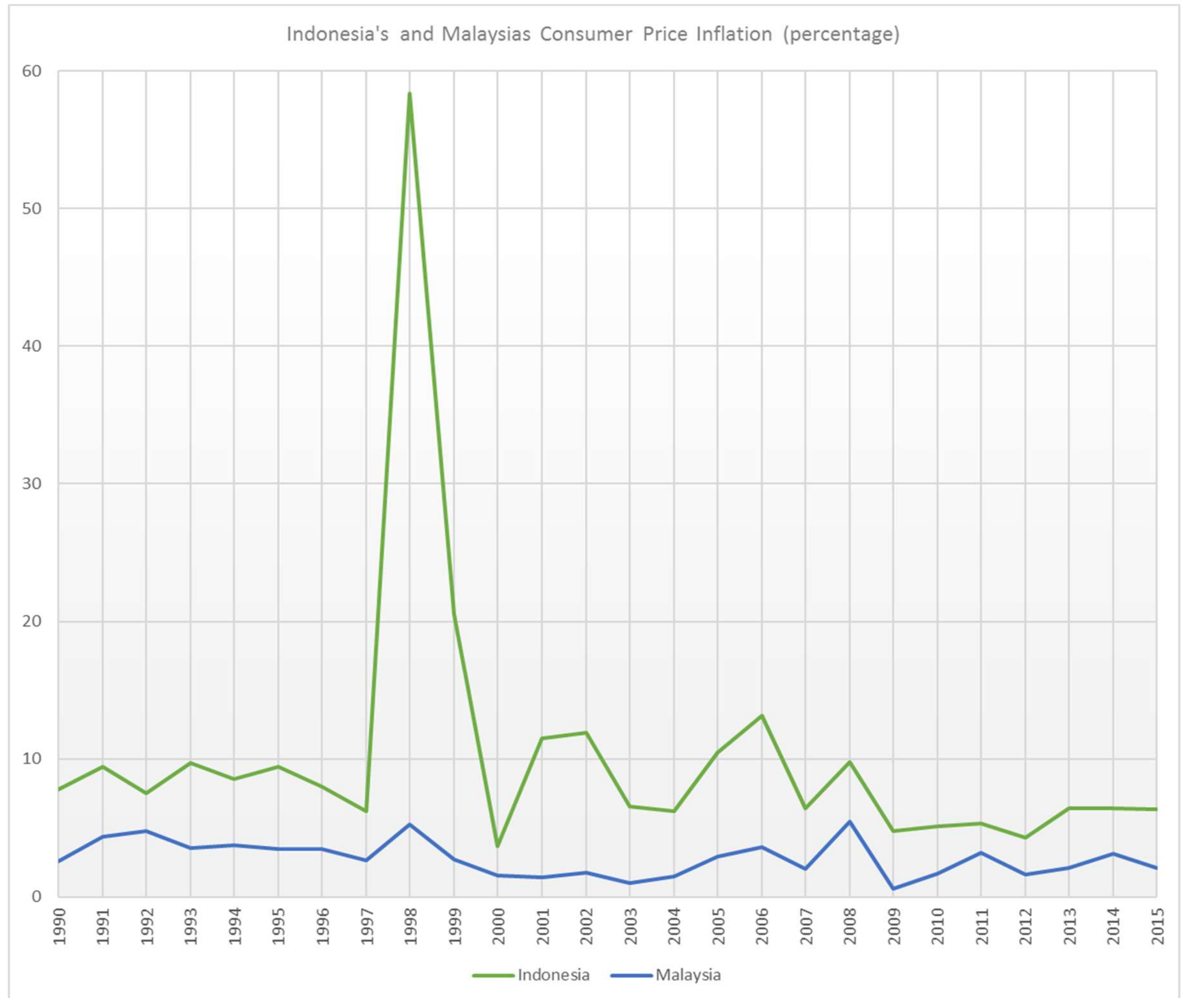

Figure 3: Indonesia's and Malaysia's inflation in consumer prices in percentages 1990-2015. Source: World Bank 2017

Malaysia's inflation stabilized more quickly after the financial crisis and was already at pre-crisis levels in 1999, and has been at quite stable levels since, and even a little lower than before the crisis. Indonesia's recovery to pre-crisis levels took one year longer and its inflation has been fluctuating a lot. In 2009 its inflation seemed to stabilize and has been around 4-6 percent since.

5.4 Foreign Direct Investment

Since the IMF had encouraged both countries to open their economies to foreign investment, foreign direct investment (FDI) is an interesting indicator to follow. Both countries FDI's are illustrated in the Figure 4. Malaysia has had somewhat steadier growth in its investments than Indonesia.

Figure 4: Foreign direct investment in Malaysia and Indonesia, net inflows (BoP, current US$). Source: World Bank, 2017

Especially Indonesia had significant increase of investments a few years before the crisis, growing to around 6,2 billion US dollars in 1996. The financial crisis has clearly decreased the amount of foreign investments even to negative, meaning there were more capital outflows than inflows. By 2000 foreign investments had dropped to -4,55 billion US dollars. Since then, there has been quite rapid growth and especially between 2009 and 2014 the growth rates have been fast, peaking at $25 billion in 2014. In 2015 growth steadied and FDI of the country was around $20 billion. (World Bank, 2017)

In Malaysia, foreign investment fluctuations have been more moderate. The crisis is still seen with a drop in 1998, changing from 1997 $5,1 billion to $2,2 billion. However, in the next year the FDI was up again at $3,9 billion (World Bank, 2017). Nevertheless, there is a bigger drop in the net inflows again in 2001. The Central Bank of Malaysia explains this as due to a slowdown in the global economy and with a one huge private sector

acquisition by a Malaysian company financed with long-term debt securities (Bank Negara Malaysia, 2002). Since then inward FDI has been growing, except in year 2009 with the global financial crisis, following with higher peaks in 2010 and 2011. Currently FDI seems to be more stabilized and has been around 10-11 billion US dollars in recent years (World Bank, 2017).

When comparing the two countries, it is clear that Indonesia has been able to lure more foreign investment in the recent decade at least. However, the fluctuations also seem to be bigger, indicating that FDI growth might not be as stable as in Malaysia. Malaysia's government had also a more strict approach to the crisis and controlled the capital flows more, which has led to more stable outcome, eliminating the high peaks as well as the downturns.

5.5 Competitiveness

One simple way to compare the countries is to examine its competitiveness placement in the World Competitiveness Yearbook. It is an annual report published by the International Institute for Management Development (IMD), which compares countries by measuring different aspects of competitiveness, through statistical economic indicators as well as surveys. (IMD, 2017)

In Figure 5, the World competitiveness rankings are presented. Malaysia is currently in 19th place and Indonesia 48th. The performances of the countries in 1997 were ranked as Malaysia 14th and Indonesia 38th. In 1998 the rankings had dropped, Malaysia being 19th and Indonesia 40th. 2000 and 2002 Malaysia's ranking was 27 and 26, but by 2004 it had climbed back to 16th place. During more recent years, its rating has been fluctuating around 15th. Indonesia had been constantly descending the whole early 2000's, being 60th by 2006. However, it has recently experienced more growth and has climbed back up to 48th. (IMD, 2017)

Even though the competitiveness gives some indication of the countries' current status, it is good to recognize that the performance of other countries highly influences the ranks. Even if the country in question would not have made any changes its placement can still drop because other countries have outperformed it. Nevertheless, it seemed like Malaysia was able to improve its ranking more quickly after the financial crisis, while Indonesia was still struggling in 2006. Currently Malaysia is five places behind its 1997 rating and

Indonesia ten places, but if comparing the 2015 numbers Malaysia was at the same ranking than before financial crisis, while Indonesia was only four places behind its pre-crisis level. (IMD, 2017)

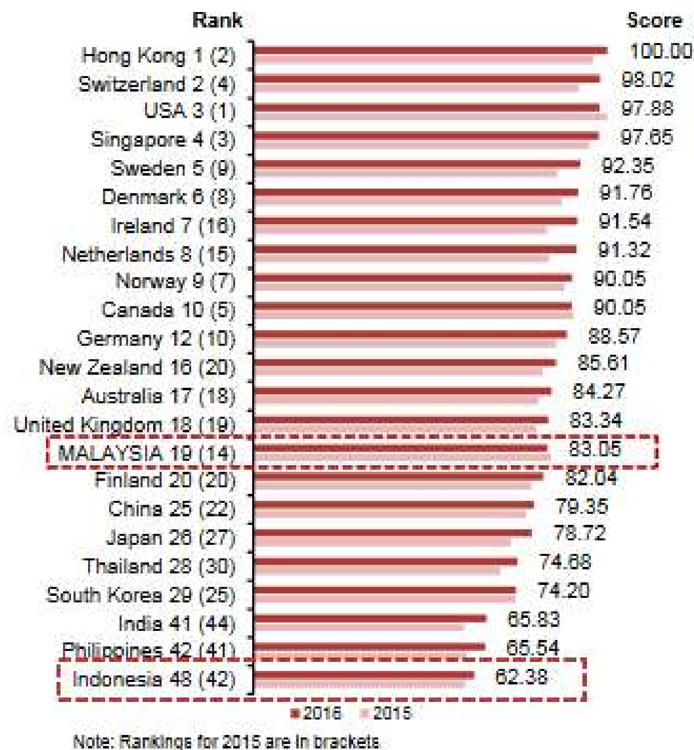

Figure 5: World Competitiveness Scoreboard 2016 and 2015. 2015 numbers are on the brackets. Source: World Bank, 2016

5.6 Unemployment

In Indonesia, the unemployment rate had been fluctuating somewhere around 3-5 percent of the total workforce in the 1990s. In 1998 the rate was 5,5 percent and continued to grow as high as 11,2 percent by 2005 (World Bank, 2017). Especially noticeable is that almost 15 percent of working men in 1997 had lost their jobs by August 1998 and male unemployment grew ten times bigger (Stiglitz, 2002, p. 97). Since then unemployment has gradually decreased and was around 6 percent in 2014 (World Bank, 2017).

In Malaysia, the unemployment rate had been steadily decreasing before the crisis, and in 1996 and 1997 it was 2,5 and 2,4 percent respectively. The increase of unemployment was not as high as in Indonesia, increasing to over 3 percent. The unemployment rate

has been close to three percent during the 2000s, closing in at 2,9 percent in 2014. (World Bank, 2017)

When comparing Malaysia's and Indonesia's unemployment numbers, it is quite obvious that Malaysia's unemployment was not heavily influenced by the crisis compared to Indonesia, especially in the long-term. The gap between the highest rate in 2005 (11,2 percent) and the 1996 number is 6,8 percent. However, in Malaysia the same gap is only 1,2 percent, comparing the highest unemployment rate after the crisis (2009; 3,7 percent) to the 1996 numbers (World Bank, 2017). Indicating that Malaysia succeeded on limiting the effects of the crisis to the unemployment, while Indonesia struggled in this area.

5.7 Poverty

When looking at Indonesia's poverty rates, it is vital to know that the country altered a bit the way of counting poverty in 1996, by growing the line of poverty little. Even though this did not hugely impact on the numbers, the previous to 1996 numbers might be slightly smaller than what they would have been if calculated by the new standards. Nowadays Indonesia's national poverty line is set at consumption outlays of Rp 302,735 ($25) per month per person, around 82 cents a day (Priasto, 2015). When looking at Indonesia's official statistics, according to these standards, before the crisis, in the 1990s, the poverty had been fluctuating somewhere between 11,3-17,5 percent. And according to the new standard in 1996 it was 17,5 percent. During the crisis, the poverty peaked to as high as 24,2 percent in 1998. In 1999, poverty started to decrease slightly to 23,4 percent and has been shrinking since, reducing to pre-crisis levels 17,4 percent by 2003 and being around 11 percent in 2015 (BPS - Statistics Indonesia, 2017). However, if a World Bank poverty indicator would be used, meaning people living with less than $2 a day, then still 40 percent of the population would still be considered as poor (Priasto, 2015). When calculating with this method, the number of people living under the poverty line during the crisis reached close to 50 percent – over one hundred million people (Johnson, 2000, pp. 74, 211-212). Many Indonesians are also living near the poverty line and can be easily fluctuating in and out of poverty. A good indicator of this is that 55 percent of households classified as poor in 2014 were not poor a year earlier (Priasto, 2015).

In Malaysia, poverty had been steadily reducing during the 1990s before the crisis, from 16,5 percent in 1990 to 6,1 by 1997. After that the financial crisis affected the poverty

rates and by 1999 7,5 percent of the population was living under the poverty line (Economic Planning Unit, 2017). Thereafter poverty started reducing again and was under the pre-crisis levels at 5,5 by 2000 (Abhayaratne, 2004). The 2014 numbers indicate that poverty is diminishing and only 0,6 percent are currently living in poverty (Economic Planning Unit, 2017).

The poverty ratios are difficult to compare, since Indonesia's poverty rates were much higher in the first place. However, it seems like Malaysia has been able to reduce poverty close to a minimum and Indonesia is still struggling to reduce its poverty. Even when looking at Indonesia's national poverty standards, they returned to pre-crisis levels in 2003, 3 years after Malaysia. Malaysia recovered relatively quickly by being already at lower levels than before the crisis by 2000.

5.8 Inequality and Gini coefficient

The Gini coefficient is a widely-used measure of inequality. Countries are given points, where 0 represents complete equality and 100 (or 1) represents complete inequality. Usually the Gini coefficient is measured with consumption, but in Malaysia it is counted with income (World Bank, 2016). This makes the comparison a little bit trickier, but since inequality in Indonesia is a widely acknowledged concern, it remains an important topic to include in this thesis.

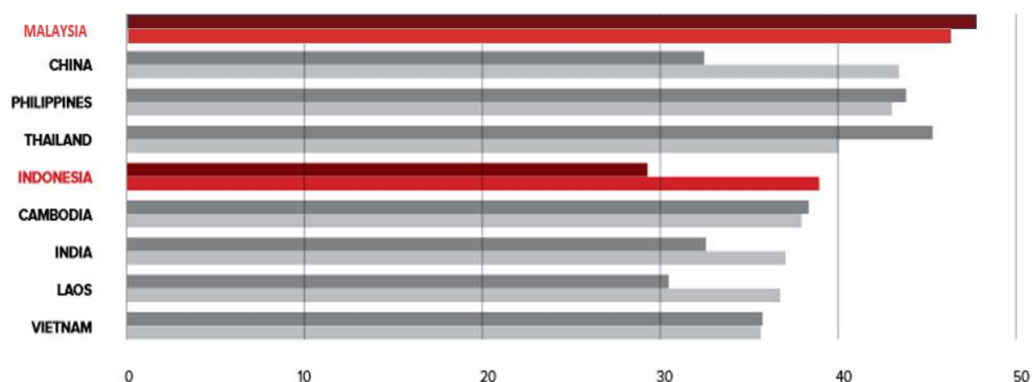

Figure 6: The Gini coefficients in East Asia. 1990s (dark) and 2000s (light). Consumption Ginis for all countries except Malaysia, which uses income. The periods for countries are: Indonesia 1990-2011; Malaysia 1992-2009, Source: World Bank, 2016

Figure 6 presents the Gini ratios of East Asian countries. The Malaysian Gini is not so comparable in this graph, since the calculation method is different. However it does give indication that Malaysia's Gini has not changed as much as Indonesia's during the 1990s

and 2000s and unlike Indonesia Malaysia's Gini has reduced during the years. Indonesia's inequality on the other hand seems to have increased quite a lot during recent decades, increasing around 10 points. (World Bank, 2016)

Looking closer at Indonesia's Gini ratios, which are also displayed in Figure 7, it is noticeable that during the 1980s inequality was somewhat stable, but by the 1990s bigger fluctuations in the ratio can be seen. The Asian financial crisis then again lowered the ratio, since the richest, who had more to lose in the crisis, where hit hardest and also recovered relatively slowly from the crisis, making the Gini ratio decrease to 30 by 2000. Nevertheless, from year 2000 onward, the gap between the poor and rich started to widen again to 37 by the next financial crisis. However, the global financial crisis did not affect Indonesia so much and it was able to sustain growth, keeping the Gini higher as well: by 2011 it had reached 41, where it has been steady since. (World Bank, 2016)

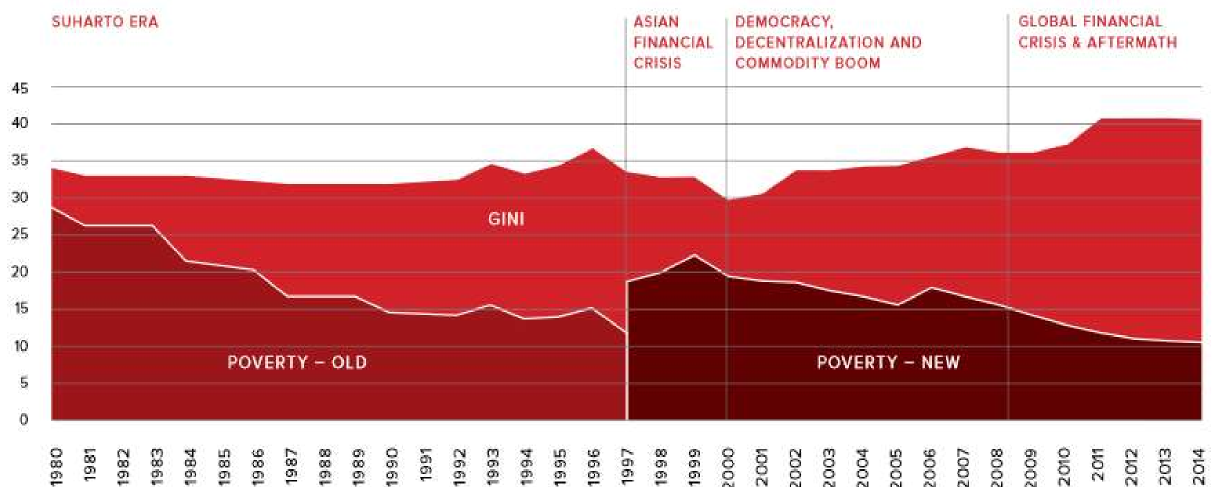

Figure 7: Gini coefficient (points) of Indonesia and poverty rate (percent) 1980-2014. Note: The national poverty line was changed in 1998, and the 1996 rate is calculated under both the new and old methodologies. Source: World Bank, 2016

In Malaysia, inequality has been dropping rapidly especially during the past decade. The effect of the financial crisis can also be seen in Figure 8, when inequality has dropped remarkably. After the crisis, the Gini started to rise again, and was at its peak of around 46 points in 2004. Since then the Gini has reduced substantially, and 2014 it was around 40 points, reducing 6 points in ten years. (Economic Planning Unit, 2017)

Figure 8: Gini coefficient of Malaysia, 1989-2014. Source: Economic Planning Unit, 2017

The countries' Gini ratios explain how differently the countries have reacted to growth. Previously explained GDP growth numbers were quite similar for both, thus the Gini's suggest that while Malaysia has been able to spread its growth better to the whole nation, in Indonesia the wealth is more concentrated in fewer hands.

5.9 Summary of Chapter 5

When comparing Malaysia's and Indonesia's different indicators, it seems that in financial and economic parameters the countries are currently quite alike, even though Indonesia might have taken longer to overcome the crisis. But when comparing the social factors Malaysia has been able to improve its citizen's well-being and distribute the country's wealth better.

Malaysia recovered quicker when comparing in GDP, inflation and competitiveness ranking, nevertheless, Indonesia has recently outperformed Malaysia in FDI growth and currently the countries have very similar GDP growth rates and exchange rates. Exchange rates are difficult to compare immediately after the crisis, because of the rupiahs peg, but after the 2005 de-peg the rupiahs value has reduced quicker. Malaysia's unemployment rate was not as much influenced by the crisis than Indonesia's and Malaysia has been able to reduce poverty close to minimum while Indonesia is still struggling quite a bit to distribute the nation's wealth to the poorest as well. This can also be seen at the inequality ratio, which has been steadily reducing in Malaysia, while at the same time it is growing in Indonesia.

6 IMF Critique

The IMF has received a lot of criticism with its way of handling crises, not just with Asian financial crisis, but with other financial crises as well. There are several factors that especially influenced the East Asian countries, such as the lack of accountability and transparency in the IMF, the huge number of conditions to be able to receive the loan and the amount of influence the US has through the IMF. The largest targets of criticism are introduced in this chapter and the impact these factors has had to Asia and other lending countries.

6.1 Opening up the Markets

During the 1980s and 1990s the IMF and the US Treasury had pushed the Asian countries toward capital account liberalization, arguing it would help the region grow faster, even though most of the countries in East Asia had no specific need for additional capital, since their savings rates were quite high. The fast liberalization of capital markets made the countries more vulnerable to outside threats and market fluctuations. However, the IMF continued to argue that the liberalization and market forces would make the market work more efficiently and this would enable more growth. Other argument towards the globalization policy was that instead bringing vulnerability to the market, the markets could actually be less risky since investments could be distributed wider. Nevertheless, the assumption was proven void in Asia when the opening up led to massive capital outflows and several countries on the verge of bankruptcy. With the 2008 global financial crisis fresh in mind, it is easy to understand how the globalization brought instability to several countries, as the economic changes in one region easily affects the whole global economy. (Stiglitz, 2002, pp. 90-101)

The Asian countries repeatedly got criticisms especially from the US for being too closed and that the state is intervening too much, not allowing free markets to function properly. Even after the crisis already started, in September 1997, in the annual meeting of IMF and World Bank, the IMF officials advised, and pressured, the Asian countries to liberalize their capital markets. Even though most of the countries' officials were concerned that the foreign investors and hot money could deepen the problem, they were afraid to resist in fear that the IMF would withdraw its funding if they did so. Malaysia was the only country that refused the IMF's help and acted differently (Stiglitz, 2002, pp. 92-93). Instead of liberalization it tightened its control over the capital market and the government

took active role to regulate the financial sector (Mahathir, 1999, pp. 106-110). Indonesia, on the other hand, unable to re-impose capital control methods, lost several billions of dollars when investors hustled their capital offshore (Johnson, 2000, pp. 83-84).

In addition, the market liberalization made companies vulnerable to outside bargain-hunters. During the crisis, many companies struggled to pay the high interest rates and the liberalizations gave the opportunity to foreign companies to buy these firms at a bargain. The IMF even promoted it by saying that the firms needed knowledge and reforms from the foreign managers to be able to gain stable growth again. The struggling companies were usually bought by foreigners, often even financed by the same foreign banks that had denied loans for the domestic players. However, the foreigners did not necessarily even make any grand adjustments and just waited till the economy started to recover and then sold the assets at a higher price (Stiglitz, 2002, pp. 129-130). Many Asians call this “vulture capitalism” and suspect that the IMF gave them deliberately faulty advice, so that the major American companies could buy their assets at bargain prices. Countries like Indonesia have been long dependent and highly influenced by the US, so when the pressure from the US side to globalize their nations began, it was quite impossible for them to say no. In the end, the companies and assets, built with their own labor were now taken by the same government which forced them to open up their markets (Johnson, 2000, pp. 226-227).

The US policy to boost countries to open up their markets, weakened the East Asian countries’ power and the US seemed to be happy to reinsure itself against any competitors. The US also led a campaign against Asian style economies and advertised that the US style capitalism, with little government intervention is the one and best policy in the world. However, since the opening of the markets had severe consequences the US lost some credibility and in the same context betrayed its Cold War supporters. The other countries had also seen how Malaysia tackled the crisis quicker and with less consequences than other countries. This gave the US style capitalism even less creditability, since government control and intervention was key factors to overcome the crisis. (Johnson, 2000, pp. 213-214)

The IMF has conceded later that the rapid capital market liberalization was indeed harmful and dangerous to the Asian economies (Stiglitz, 2002, p. 90), and in 2003 they acknowledged that for many developing countries the capital market liberalization had

not led to more growth, just more instability. The Washington consensus type of globalization idea is based on a theory that assumes perfect information, perfect competition and perfect risk markets. This is an ideology that does not meet reality, especially when talking about developing countries (Stiglitz, 2006, pp. 16, 28).

6.2 The US Influence

One of the reasons behind the IMF's rigid policies is argued to be the structure of the organization and its voting system. Rich countries dominate decision-making in the IMF, because the amount of money a country pays into the IMF's reserves determines the volume of their voting rights (Ker, 2002). This gives minor authority to the poorer countries and the political power is in the hands of the biggest shareholders, such as the US with 16,5 percent of votes, followed by China, Japan, Germany, France and Great Britain (IMF, 2017). The voting rights have also been distributed when the IMF was established, and only slight changes have been made since, with the US being the only country with a veto power (Stiglitz, 2006, pp. 12-13). The interests of the lower income countries are often diminished and the interests of bankers, investors and corporations from the more developed countries are put above the needs of the world's poor majority, especially when US-based internationally operating firms are considered (Ker, 2002).

Furthermore, during the Cold War, the US had keen interactions with East Asian countries and it wanted to “protect” the countries from communism as well as advertised the benefits of opening up their markets, especially to export consumer goods to the US market. During the time many US manufacturers outsourced their facilities to Asia. The Asian countries of course welcomed the revenue gathered from exports and expected it to continue, and it did so as long the Cold War continued. However, over time this produced overinvestments and excess capacity in East Asia and large trade deficits for the US. The East Asian economies were now built solely to export sales, instead of domestic demand. When the exports were mainly concentrated on the US market, the countries came highly dependent on the US. This worked so long as the US economy remained massively larger than the East-Asian economies, but in the end, there were too many factories manufacturing too many goods to too few people. (Johnson, 2000, pp. 193-197)

The fast growing Asia was also becoming a substantial competitor to the western world and especially to the US. So, the US and IMF offering help to Asia was not seen as an

entirely unselfish act. On the contrary, the IMF has been said to have used the Asian crisis to advance its own strategic interests and forcing Asia into submission, to make the threat more controllable (Mahathir, 1999, p. 60). The fact that the US blocked Japan's offer to the help the Asian countries in need supports this fact. In November 1997 Japan and Taiwan offered $100 billion to help create an Asian Monetary Fund, so that they could assist the countries in need and stimulate their economies, but the US Treasury and the IMF rejected the idea (Stiglitz, 2002, pp. 112-113). Since the IMF had a monopoly in this type of "market" it did not appreciate the competition. The US also having the only veto power in the IMF could not risk losing some of its power by having a competitor (Johnson, 2000, p. 211). The US was afraid that Japan and possibly China would challenge the Americans with their own fund and this would disperse the control, especially since the Japanese had often disagreed with the IMF's policies and would not have demanded such harsh conditions as the IMF. The help was thus rejected and the idea was killed. However, eventually the Japanese did help by donating $30 billion under the Miyazawa Initiative and three years after the crisis the East Asian countries did create the Chang Mai Initiative, a more modest version of the Asian Monetary Fund (Stiglitz, 2002, pp. 112-113). In addition, China also offered Indonesia its help, in the form of cash and medical supplies, as well as the opportunity not to devalue the renminbi, so it would not compete with Indonesia's exports. However, Indonesia, already receiving aid from IMF had to turn down the help (Johnson, 2000, p. 84).

6.3 Closing the Weak Banks

The IMF focused on shutting down weak banks in Asia and in Indonesia. Even though the banks had made some risky investments, closing down the banks made companies' access to credit even more difficult. The IMF urged the banks to either shut down or quickly adjust their capital adequacy ratio to better levels. The capital adequacy ratio means that the banks are required to have certain amounts of capital in reserve compared to their outstanding loans. During a recession, the banks might have more non-performing loans, so they would fail to meet this ratio. To correct the ratio the banks can either increase capital reserves or reduce the loans. When banks now needed to quickly correct the ratio, they started to call back the loans. But as each bank starts to do this, the firms have more difficulty accessing capital and credit and they start to cut back on their production and other expenses, in the end affecting other firms and their employees as well. (Stiglitz, 2002, pp. 116-117)

The shutting down of 16 weak banks in Indonesia almost completely stopped the lending between the banks and to companies. The trust to Indonesian financial sector nearly disappeared and investors started to withdraw their money out of the country even faster. This made the private banks to increase their interests more to lure in investors and soon practically no one was able to receive or ask for credit. (Emmerson, 1999, p. 330)

The IMF later admitted that the closing down of the banks was not tactful, and perhaps they had learnt something from the error or simply did not want to use the same methods themselves, since the advice given to the Asian countries was completely different from the approach the US took during the 2008 global financial crisis. During the 2008 crisis the US banks had also lend too much money compared what they had on their reserves. In 2007, when the signs of the crisis were already in the air, the central government provided liquidity to the banks and the US central bank, Federal Reserve System (Fed), started to decrease the interest rates. The US government bailed-out several banks and bought huge number of nonperforming loans from the banks as well as gave them cash funds to encourage lending, so that the markets would resume liquidity. (The Financial Crisis Inquiry Commission, 2011)

6.4 Bankruptcies

One of the problems was that when businesses went to bankrupt, there was a long period of time before the real owners of the firm could be announced. The businesses were in a limbo-like state, when the old owners had filed for bankruptcy they did not own the firms anymore but the creditors were not clearly aligned either so there could be long periods of time when the company and its remaining assets did not belong to anyone. Many Asian countries did not have the legal framework to address efficiently the bankruptcy issue and this gave the opportunity to the old owners or managers to exploit the situation and embezzle the remained assets. In Malaysia, the government actively took a role in restructuring the firms' financials, and in two years a large fraction of the distressed companies' financials were resolved. The IMF however did not see the role of a government to be important in financial restructuring and completely neglected this part of the crisis in Indonesia, and many other countries. (Stiglitz, 2002, pp. 117-118)

The IMF's agenda not to involve the government to the bankruptcies is once again seen as an odd approach, when considering the active role the US government took during the global financial crisis in US. The Fed actively helped several bankrupted

companies and even purchased part of them or helped banks or other companies to acquire them. The Fed was also willing to provide overnight cash loans or US Treasury bills for companies with collateral, so that companies would be still able to receive loans. As housing bubble was one of the key issues during the crisis, the government encouraged banks to adjust interest rates of the mortgages, spread loan payments over longer period of time or simply write down the mortgage debts. All in all, the US government had over 20 emergency programs and used trillions of dollars to stabilize the financial system and rescue specific firms. (The Financial Crisis Inquiry Commission, 2011)

6.5 Bailing out Lenders

Critics argue that the bailout packages really do not help the country in question, but instead help the lenders. The IMF's plan was to quickly refinance the reserves so that international creditors could be reimbursed. IMF programs also might influence the lenders' behavior. When crises have occurred, the IMF has loaned money to the countries via bailout packages, but the money is not used to boost the countries' economies or increase social welfare, it is often used to bailout the Western banks. It provides money to the government so that they can pay back to their foreign creditors, thus reducing the nonpayment risk for the lender, and while doing so incentivizing the lenders to take higher risks. The lenders are then bailed out, without having to bear the consequences of their poor investment, and the country, with its taxpayers, are left with the bill to pay back the loan to the IMF. Even worse, if the lenders assume that the bailout is likely to happen, they might lend even more knowing that their investment will be rescued. (Stiglitz, 2006, pp. 35, 217)

Nonetheless, if considered from the lender banks perspective, those policies worked quite well in Asia and most of the countries restored their reserves relatively quickly and paid back the IMF loans in a few years. (Stiglitz, 2006, pp. 35, 217) Unfortunately, Indonesia was not one of the lucky countries who were able to pay back the loan in a few years. Nevertheless, it did manage to pay back the loan ten years after the crisis in 2006, four years before the scheduled repayment time (IMF, 2006). The amount that the Indonesia taxpayers suffered from the loan is difficult to interpret, but most noticeable factor are the government expenditure cuts that the country had to make to be able to pay back the loan, which clearly ultimately affected the unemployment rate and poverty. The IMF also hoped to achieve budget surplus by keeping the interest rates high, and as said

before, this resulted to an inability for companies to pay back the loans, decrease in all loan activities and ultimately led to a banking crisis (Emmerson, 1999, p. 330). Malaysia on the other hand tried to revive the whole economy, and keep the markets liquid so that no bailouts would be necessary, while in the same time regulated its banking sector. The government helped bankrupted companies to disburse their remaining assets relatively quickly, enabling the lenders to receive their share of the remaining assets and thus making the economic atmosphere more stable. (Stiglitz, 2002, pp. 117-118)

6.6 Lack of Country Specific Reforms

The IMF is also blamed for its lack of responsiveness to making country specific reforms. The format to all countries seeking funding is usually the same; high interest rates, balanced budgets and adjustments of current external payments. These measures do not recognize the countries' cultures and economic differences. The countries might be forced to open up the markets and national control is completely lost. This has led to bankruptcies and suffering of the domestic companies, and might have caused the recovery to take more time than necessary. The IMF has considered the theory and method more important than the actual results of those theories. Especially before the crisis it had promoted the openness of economies to all the East Asian countries, thereby making the developing countries more vulnerable to outside threats. Later the IMF itself admitted making some mistakes with the East Asian countries, leaving them unnecessarily vulnerable to foreign threats. (Mahathir, 1999, pp. 100-102)

The IMF also used the same methods as it had used in Latin America, even though the situation was completely different. In Latin America, the governments had loose monetary policies and government spending was high, which led to huge deficits and high inflation. In Asia, the governments had surpluses and inflation was low. It was the companies that were suffering from high debts. So, the economies would have needed stimulation, instead the IMF insisted on austerity measures and when they raised interest rates the companies suffered, unable to pay their debts, leaving the whole economy staggering. The difference between Malaysia and Indonesia regarding this matter is easy to see. Malaysian government actively made efforts to stimulate the whole economy and recovered relatively quick, while Indonesia was in deeper recession and struggled longer. (Stiglitz, 2002, pp. 104-105)

6.7 Accountability and Transparency

One major concern for the IMF is that even though it is funded with taxpayer money, it is not held accountable for its actions to anyone. It is also criticized for not allowing the participation of members of the affected government in the decision-making process. The loan agreements and the policies implemented usually consist of the same political principles and they are not altered to every country's specific needs. The IMF works with a group of bankers and finance ministers with set policies, dictating the terms of the loans without consulting the countries' agencies, such as health, education and environment departments. Since the countries are in huge need of outside financing they have no reasonable pressure to affect those decisions. (Stiglitz, 2002, pp. 220-228)

The IMF has been focused on economic policies and inflation, rather than wages, unemployment or poverty, since those areas are closer to the World Bank's mandate. However, without looking at the economy as a whole, their policies have often led to more unemployment and poverty, as they did in Indonesia. Nevertheless, in recent decades they have at least officially announced that poverty reduction is also one of their priorities (Stiglitz, 2006, p. 14). Malaysia on the other hand concentrated on aiding important industries and used funds to reduce unemployment (Ariff & Abubakar, 2007).

After the Asian financial crisis, the IMF and US Treasury blamed the Asians for "crony capitalism" and announced the need for more transparency, especially, in the banking sector. When the developing countries indicated that one of the problems in tracing the money flows was bank secrecy in offshore Western banks, the tone of the US changed and the transparency issue was not discussed much anymore (Stiglitz, 2006, pp. 208-209). However, during the crisis Malaysia did make several improvements to increase the transparency in the financial sector and stock markets (Mahathir, 1999, pp. 106-109), which might indicate that some of the criticism was accurate and the banks could have been more transparent. Also, in Indonesia there has been clear evidence that during the Suharto's era corruption and nepotism were not unknown characteristics and some fault behind the crisis may lie on the country's unwillingness to reform (Habir, 1999, p. 198). Nevertheless, the crisis can hardly be blamed solely on corruption and lack of transparency, since these elements were there long before the crisis, and some of the blame can be shifted to the US as well since it failed to advice the countries on the importance of monitoring the banks when it advertised the benefits of free markets. (Johnson, 2000, pp. 207-210)

6.8 Conditionality

One concern with the IMF and the World Bank is that as a return of providing loans, they insist that the countries fulfill several conditions and usually in a very tight schedule. A country may need to change its legislation quickly to be able to bankrupt firms or banks, change financial systems or reform social security schemes. The enormous number of conditions has often distracted governments from more vital tasks, and the time to structure the economy in the long run or attacking the actual problems has been minimized (Stiglitz, 2006, pp. 14-15). In Indonesia, the IMF insisted on 117 activities that the government had to implement by specific deadline in order to receive the funding (Emmerson, 1999, p. 324).

The IMF and World Bank have later admitted that they might have gone overboard with the number of conditions in some cases, and during the 2000s they have started to reduce the amount of conditions. Conditionality also weakens the countries' democracy, when decisions are taken out of the hands of the politicians, usually democratically voted members of the community, and turned over to a third party. (Stiglitz, 2006, pp. 14-15, 56).

6.9 Summary of Chapter 6

The general criticism toward IMF has concentrated on the concentrated power the US has within the organization and its inability to communicate with the lending countries. It is blamed for lacking transparency and there is no authority who it would be accountable for. Its methods seem to be more concerned about bailing out the foreign lenders than actually supporting the citizens of the lending countries, and the vast amount of conditions it has insisted on to receive the loan.

It major difficulties in Asia were the insistence of closing down several banks and the inability to understand the importance of bankruptcy laws and the role of the government with the procedures. The IMF also failed to understand that its promotion towards capital market liberalization was one of the biggest reasons that led to the huge extent of the crisis. Malaysia's method to boost the economy and increase government intervention in several areas gives an exceptional possibility for comparing the different set of policies.

Since Malaysia recovered from the crisis relatively fast and was able to keep its unemployment and poverty rates down, the Malaysian view of tackling the crisis seemed to be quite successful in a lot of areas, and made the IMF's policies rather questionable.

7 Developing the IMF

The previous chapters have been focusing the reasons behind the crisis and the different implementations the countries used to survive the crisis, as well as critique towards IMF. The IMF has admitted some of its faults, and has already made some small changes, which will be explained in this chapter in more detail. However, there is still room for improvement. The following subchapters will introduce few ideas how the IMF could develop its current strategies and gives focus points to the areas that are recognized as weaknesses in the IMF.

7.1 IMF Admitting Its Faults and Changes

There have been some questions to reform or change the IMF. In 1999, while the Asian financial crisis was still in progress, some of the countries pleaded in the World Economic Forum to change the IMF and reform it, making it more attuned to the economies' conditions and the reality of poverty. However, the US blocked all these suggestions (Johnson, 2000, p. 226).

Nevertheless, since then the IMF has admitted that not all its policies have been successful. In March 2003, the IMF admitted in its report that globalization may actually increase the risk of financial crisis in the developing countries since countries get more vulnerable to outside fluctuations. The importance of safety nets and controllable financial integration should be implemented in its policies (Prasad;Rogoff;Wei;& Kose, 2003). It has also admitted that the rapid market liberalization was harmful to the Asian economies and instead of growth led to instability (Stiglitz, 2002, p. 90). In addition, the IMF and the World Bank have acknowledged that in some cases they have made too many conditions to their loan programs and since 2000 they have tried to reduce them (Stiglitz, 2006, pp. 14-15). The IMF has also declared that more country specific policies should be implemented with its policies. However since the general policies have stayed the same, the measures to accomplish this have been quite moderate (Shah, 2013).

To silence the criticism towards the voting right, the IMF divided 3 percent of the developed countries votes to the less developed countries in 2012. It hoped that, this would

ease the pressure from the critiques and developing countries about their possibilities to affect to the decision-making. Nonetheless this has not settled the critiques, and more transparency and accountability is demanded. (Shah, 2013)

7.2 Understanding Cultural Differences

Even though the IMF has reported that it tries to make more country specific policies and involve the countries more to its decision, little evidence and actual restructuring of IMF's actions are not well seen. One of examples is the IMF's involvement with the recent Greek crisis. Together with the European Union (EU) they pushed austerity measures which led to protests and political shifts. The Greeks are opposing the measures taken by the IMF and EU, but the IMF has not been able to really negotiate with the Greeks and adjust its methods. (Mody, 2017)

The US has often also undermined the Asian style of leading and the high government intervention. That is one of the reasons it promoted the free capital movement and globalization policies. However, when countries with different backgrounds and cultures are pushed to one mold the outcome seldom is victorious in a long run. That is why the IMF's agenda to force countries to the US way of thinking or impose controversial regulations to countries with different legal, economic and political systems should be diminished. The IMF has already used billions of dollars to attempt to repair damages that the US globalization agenda has caused and when trying to repair the problem it often makes the countries even more distressed. In this context Malaysia was able to undermine the US policies and rather increased the faith to the Asian style economics than the US style capitalism. (Johnson, 2000, pp. 225-226)

7.3 Bailouts for Lenders

As discussed earlier the bailouts are enabling the lenders to make more riskier decisions and receive their money even when the country is in bankruptcy. As creditors refuse to default on their bad investment decisions, the entire country can be affected. The alternative could be that the lenders simply default the bad loans and suffer the consequences. The problem in East Asia's case was that few of the countries had sufficient legal frameworks to address bankruptcies. The IMF has tried to impose some creditor-friendly bankruptcy laws to the developing countries that had asked for its funding. However, the ability to make a single right law for bankruptcies for different countries and situations has failed. Nevertheless, if bankruptcies are prolonged, the companies may

remain in ambiguous stage too long, where no one actually owns the company, making it easy for the management to strip the assets during that time (Stiglitz, 2006, pp. 231-233). The importance of well-established bankruptcy laws is a major factor in the lending and banking community and Malaysia gave a good example of resolving the legal issue quickly and relatively effectively with the government establishing immediate procedures to address the matter (Stiglitz, 2002, pp. 117-118). Based on this, the IMF should concentrate more, not to the lenders, but rather to the economy as a whole and ensure the countries legal framework are in a state that can tackle problems such as bankruptcies (Stiglitz, 2006, pp. 231-233).

7.4 Keynesian Ideology

Even though the IMF is partly built on the ideas of John Maynard Keynes, the IMF has lost some of the Keynesian objectives somewhere along the line. Keynes suggested that governments' solutions to recover from recessions should be increasing their spending, and lowering taxes and interest rates. The IMF's conditions, however, are often just the opposite. Basically, everywhere the IMF has tried to implement its ideas, they have failed, such as in Asia and Latin America. Especially the high interest rates, set to stabilize the exchange rate, pose a problem, since higher interest rates lead to a higher debt burden, forcing countries to borrow more and more to be able to pay the interest payments. The high interest rates usually do not stabilize the exchange rate either, making them useless in the first place (Stiglitz, 2006, p. 235). The IMF could recall the Keynesian lessons and instead of austerity and high interests they could try to find ways to stimulate the affected economies, as Malaysia did during the crisis.

7.5 Summary of Chapter 7

The IMF has admitted some of its mistakes with prior crises and has made some adjustments since. However, the actual development has been quite modest. It could still improve their understanding of different countries cultures and change their policies accordingly. Their current policies have not been successful and still they have done little to change them. They have gone far from the original Keynesian ideas, which promote lowering the interest rates, increasing government expenditure and reducing taxes. In addition the funds it provides to the countries are often used to bail out the foreign lenders, who have done bad investment decision rather than actually helping the countries' economies or citizens. The other root would be to help countries to improve the legal framework needed and let the investors to bear their responsibilities as well.

8 Conclusion

To conclude the Asian financial crisis had severe effects on the Asian economies, and many countries struggled quite long to recover from the crisis. The influence the US had cannot be undermined, while their endorsement towards the open economies and US style capitalism was one of the most influential factors that made the countries so vulnerable.

When comparing Indonesia and Malaysia, it seems that Malaysia might have recovered from the crisis a bit faster, but currently are quite equal when it comes to financial performance, such as GDP growth, exchange rate, inflation and FDI, but when comparing more social aspects, such as employment, poverty and inequality, Malaysia has really outperformed Indonesia.

Malaysia was able to achieve GDP growth faster than Indonesia, but currently their growth rates are quite similar and Indonesia has been more successful in luring in foreign direct investment, which indicates that Indonesia might also succeed in growing in the future. However the Malaysian government succeeded to keep its country more stable and inflation in reasonable levels. Indonesia's high inflation during the crisis harmed especially the poor and it is obvious that Malaysia has been more successful to distribute the wealth more evenly to all its citizens. Especially descriptive is the Gini coefficient, which Malaysia has been able to reduce every year, while in the same time Indonesia is in different path, growing the gap between the rich and poor. The nations poverty ratios are also in different scale, even though Indonesia's poverty numbers were higher in the first place, it has not succeeded to lower the ratio much and the poverty soared during the crisis. Malaysia has been able to spread its income more equally and the poverty has been reduced to quite minimum levels. One factor that might explain the high number of poverty in Indonesia is the fast-growing unemployment rates during the crisis, and the countries inability to reduce them quickly. The Malaysia's unemployment rate on the other hand was not highly influenced by the crisis, and the unemployment was at quite stable levels during the whole crisis. The government's attempts to stimulate the economy succeeded in this matter and the citizens were not so devastated during and after the crisis.

Nevertheless, the comparable factors were quite difficult to determine, and not all data from both countries were available, which also reduced the ability to analyze the countries differences. In addition, it is difficult to say if Indonesia would have resulted in any different if it would have refused the IMF's help. Some evidence suggests that, especially the closing of the banks was harmful, but if Indonesia would not have been influenced by the IMF it is impossible to say what would have been its national measures to overcome the crisis. However, if Indonesia could have been able to use the same methods than Malaysia to overcome the crisis, the poverty and unemployment levels might have been different. IMF reduced government spending and while doing so it cut off the subsidies for the poorest and cancelled several projects, making the unemployment and poverty rates soar. Malaysia did just the opposite, funding critical industries and made efforts to keep interest rates and inflation down.

Also, the IMF's idea that the free markets would correct themselves and that there was no reason for government intervention led the country to face more instability and capital flowed out of the country. The Malaysia took another approach and government took control over the capital market, to reduce the money escaping offshore and remain its liquidity. Eventually, even the IMF had to admit that the rapid freeing of the markets was harmful to the East Asian countries and the opening up should have been made more moderately, while ensuring the legal framework would be sufficient enough to tolerate market volatilities.

The IMF has admitted that not all of its policies have been successful and it has made some efforts to change. The poverty reduction has now come part of its agenda, it is making efforts to reduce the conditionality and make more country specific policies. Nevertheless, improvements can still be made, the developing countries are still underrepresented in the IMF, and the policies can be rigid and intolerant towards the lending countries cultures and situation. The strategies often help the foreign lenders more than the countries citizens. When comparing the way the crisis in developed countries are handled to the policies used in developing countries, it is difficult to see the reasoning behind those strategies. One way the IMF could help ease the criticism, would be more openness, transparency and co-operation with the affected countries.

Overall, the Malaysia's governments interventions and stimulating the economy seemed to stabilize the economy quicker and better than the remedies IMF offered to Indonesia. Much have been learned from the East Asia's, and the more recent global crisis, and as

any organization the IMF has developed during the years. The situation in every country and with every crisis is a bit different so the cure should be changing as well and Malaysia was one of those few who could show us the alternative path and succeeded in it.

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