THE IMPACT OF THE ASIAN FINANCIAL CRISIS WITH SPECIAL REFERENCE TO SARAWAK ECONOMY AND A CASE STUDY ON HOTEL AND CONSTRUCTION MATERIAL PRODUCING SECTORS IN KUCHING

Rakayah Hamdan

Kota Samarahan
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The Impact Of The Asian Financial Crisis With Special Reference To Sarawak Economy And A Case Study On Hotel And Construction Material Producing Sectors In Kuching

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Rakayah Hamdan

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Faculty of Economics and Business
Universiti Malaysia Sarawak

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I certify that I have supervised and read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Corporate Master in Business Administration.

Dr. Rokiah Alavi
Supervisor

This research paper was submitted to the Faculty of Economics and Business, UNIMAS and is accepted as partial fulfilment of the requirements for the degree of Corporate Master in Business Administration.

Assoc. Prof. Dr. Shazali Abu Mansor
Dean, FEB
UNIMAS
DECLARATION AND COPYRIGHT PAGE

Name: Rakayah Bt. Hamdan
Matric Number: 00 - 02 - 0463

I hereby declare that this research is the result of my own investigations, except where otherwise stated. Other sources are acknowledged by footnotes giving explicit references and a bibliography is appended.

Signature: [Signature]
Date: 15/4/02

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ACKNOWLEDGEMENTS

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Lastly, I would like to express my thanks to my husband, Abdul Gani Mohamad and my three children’s; Muhd. Haziq, Muhd Hamiz and Nur ‘Izzah who had undoubtedly sacrificed the precious time, given me courage and endless moral support in pursuing my Corporate Master in Business Administration.
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Abstract

The financial crisis that hit East Asia in July 1997 was the worst financial crisis since the global economic crisis in the 1930s. The 1997 financial crisis came as a surprise as East Asia was just pronounced as “miracle economies” by the World Bank (1993). The crisis is said to have left negative implication on the economies of Asia including Malaysia. In general, the impact of the crisis can be viewed from two main aspects: macro and micro level. This paper is an attempt to study the impact of the financial crisis with special reference to Sarawak. In order to analyse the situation in a wider perspective the national and state level impact of the crisis were examined. At macro level the variables such as economic growth, unemployment, inflation, stock market, interest rate and etc were looked into. As for micro level the studies on the impact of the financial crisis on hotel and construction material producing sectors in Kuching were chosen. The areas of concern at micro level are the company’s profit, turnover, occupancy rate, retrenchment etc. The filed work was carried out between January–February 2002. Interviews with those involved in the Construction and Hotel Sectors were also conducted. Detailed analysis of the financial statements and audited accounts for the period prior to financial crisis (1996), during the height of the crisis (July 1997 - 1998) and the recovery period (1999 – 2001) were examined. In Sarawak, although the economy did not contracted adversely, the impact of the financial crisis was nevertheless felt. In the both sectors understudy, the impact of the crisis adversely felt in 1998. Some policy recommendation will also be discussed.
Abstrak

PART I

1.0 INTRODUCTION

1.1 Background Study

The financial crisis in late 1997 was an adverse economic event for Sarawak. Its fast growing economy was suddenly faced with the prospects of slowing down or even contracting. The national economy was severely affected. Other countries in the region especially Indonesia and Thailand were in even worse situation. Korea far away and far more advanced and having less similar features with the Asean countries was also caught in this economic meltdown. There was very little to cheer about on the economic front. The severe downturn caused considerable hardship on the part of the people of the countries that were caught in the economic meltdown. Sarawak was not spared. The people of Sarawak – who were used to high growth rate, stable prices, almost full employment and fast improving standard of living were adversely affected by the financial crisis. What was the actual situation? How did Sarawak fare compared with the rest of the country or the other countries? These are some of the questions that the paper sets out to answer.

In looking for the answers above, the regional situation would also be examined. The impact of the crisis on the life or livelihood - jobs, businesses and so on would be examined. In the crisis it is conceivable that every sector of the economy will be adversely affected. At least this is conventional economic interpretation or wisdom. By examining the various sectors it might be possible to draw a conclusion that may or may not conform to conventional economic interpretation. All these issues are of interest to those who want to understand the events that unfolded in late 1997 and others that surfaced consequently. To study these events can serve two-pronged purposes: understanding the problems and to be forewarned.
1.2 Objectives of the Study

1.2.1 To study the impact of the financial crisis on Sarawak’s economy as a whole. The study also looks at Indonesia, Korea, and Thailand in order to give it a regional or wider perspective.

1.2.2 To study the impact of the financial crisis on the Hotel Industry and Construction material producing Sector in Kuching. By doing so in some way the study might be able to shed some light on the impact of the crisis on life and or the livelihood of the people of Sarawak.

1.3 Significance and Limitation of the Study

The Southeast Asian countries - Indonesia, Malaysia and Thailand, and Korea in East Asia have achieved sustained high economic growth rate for the past three or four decades. Suddenly in the second half of 1997 these countries were struck by the Asian financial crisis. The financial crisis that started in Thailand with the flotation of the Thai baht on 2nd July 1997 quickly spread to other countries in the region. Indonesia and Malaysia soon found their currencies under pressure. Korea was next - although far away, more advanced and having less common features with Indonesia, Malaysia or Thailand. The depreciation of their currencies continued to worsen. What started as currency problem in the form of exchange rate instability soon affected other aspects of the economy. Immediately their stock markets declined drastically. Confidence was badly affected. Other problems soon emerged: banking troubles, collapse of property value, corporate and personal bankruptcies. The positive changes in the economy and improvement in the life of the people were abruptly threatened by the financial crisis.

In this respect, Sarawak like the region or the rest of the countries it achieved high growth rate, averaging more than 8 per cent for a period of ten years before the crisis. Even though isolated from the rest of the country Sarawak was similarly

affected...
affected by the financial crisis. Its fast growing economy was suddenly faced with the prospects of drastic economic slowdown. People of Sarawak were confronted with numerous economic problems: jobs were threatened, many businesses adversely affected. The level of confidence took a tumble. Indebtedness increased. Subsequently this was translated into business and personal bankruptcies as the impact of the financial started to take effect. The financial crisis definitely had an impact on development and aspirations of the state and its people.

The study is significant in two respects. Firstly, very little has been written on the subject of the impact of financial crisis on Sarawak economy. Although the economic crisis drew widespread interest, the attention has been largely on regional or national basis. It is somewhat more distinguishable as an economic entity compared with the rest of the country in Malaysia, although it has always been lumped together with other states when the subject is dealt with. Thus, this study hopefully would shed some light on a state economy that has its own distinguishable features. Secondly, many of the writings on the subject of the Asian financial crisis were written when the crisis first struck or immediately after the event. However, this paper is written four years after the onset of the crisis. Many new data, analyses or trends have emerged. Therefore, it is hoped that the paper would offer a new perspective of the crisis.

### 1.4 Sources Of Data and Methodology

This study has its limitations. One is the availability and the quality of data. Data on the national economy is easily available. However, at state level some data might not be available, and the accuracy of the available data might be an area of concern as well. This is definitely a constraint of this study. Thus, the study would rely heavily on published or audited reports. To produce primary data would be time consuming, if there were enough willing respondents for any questionnaire to start with. Thus, shortage of reference material is the main problem in doing this research.
1.5 Organisation Of The Data

This paper is made out of five parts as follows. Part I, provides the brief overview on the impact of the financial crisis in the region and particularly in Sarawak. It follows by stating the objectives and significance of the study. The limitations are outlined to indicate some of the problems encountered in conducting the study.

In the literature review section (Part II), few areas are covered. Firstly, the definition and concept of financial crisis was examined. Secondly, the causes and the impact were looked at from two perspectives – in general terms and in relation to the region. The impact of the crisis on individual countries was discussed as well. This is intended to give a regional perspective on the subject. Special emphasis was given to the impact of the crisis on Malaysia and Sarawak. This will allow the paper to relate the impact of the financial crisis at national and state level.

Part III, discussed on the research methodology, the period covered for the purpose of the study and how the selection of the firms being made. This paper then follow by the evaluating the impact of the crisis in Part IV at micro level which focused on hotel industry and construction material producing sector in Kuching. The choice of sectors – although rather dissimilar in nature hopefully would be useful in highlighting the impact of the crisis on livelihood, business and economic activities in Kuching or in Sarawak.

The subsequent section (Part V) outlines the conclusion and the policy recommendation with some implication to the state.
PART II

2.0 LITERATURE REVIEW

2.1 Background: Economic Performance and Financial Crisis

Despite the achievement of the high performing Asian economies, they were unexpectedly engulfed in financial turmoil in the second half of 1997. The performance of the miracle economies was impressive in the first half of the 1990s despite a relative moderation in growth in 1995 and 1996 in Hong Kong, and in 1996 in South Korea, Singapore, Taiwan and Thailand. The financial crisis ironically occurred when the economy was growing strongly and the fundamentals in terms of conventional economics were deemed to be sound.

Generally the high growth rates of the Southeast Asia and East Asia countries have been achieved since the sixties. In Southeast Asia - Singapore, Malaysia, Thailand and Indonesia went through a long period of sustained high economic growth rate. In East Asia - Taiwan, Korea, Hong Kong also experienced similar sustained high growth rate.

‘From 1945 to 1997 the Asian economic miracle fueled the greatest expansion of wealth, for the largest number of persons in the history of mankind. Prognosticators spoke confidently of the advent of an ‘Asian Century’. By 2020 Asians were expected to produce 40 per cent of the world’s GDP while the US and the European shares would recede to 18 per cent percent and 14 percent respectively’ (Jackson, 2000: 16).

These countries were known by many complimentary names for their economic achievement. The World Bank among many others lumped these countries as miracle economies.

The financial crisis that had far-reaching effects on the miracle economies came rather unexpectedly. Its initial major symptom was the drastic depreciation in the value of the currencies. Other problems soon followed. Very few people however saw the financial crisis looming in the economic horizon. One reason for this situation is the fact that there were no obvious signs that
could be easily interpreted as severe symptoms of a financial crisis.

2.2 Financial Crisis: Definition, Causes And Impact

2.2.1 Definition

The definition of a financial crisis is diverse. Thus even among economists they could not find a universally accepted definition of financial crisis. It signifies different things to different people. Currency crisis, financial crisis and economic crisis all have some common features. But that does not mean they are the same economic phenomena despite some similarities in features. One definition of financial crisis describes it as “a sharp, brief, ultracyclical deterioration of all or most of a group of financial indicators - short-term interest rates, asset (stock, real estate, land) prices, commercial insolvencies and failures of financial institutions.” (Kindleberger, 1996: 3). However this particular definition specifically excludes foreign-exchange difficulties as a necessary feature.’ (op cit).

Kindleberger also quoted Michael Bordo a monetarist who defined financial crisis in terms of ‘a change in expectations, fear of insolvency of some financial institution, attempts to convert real or illiquid assets into money’ (op cit). On some points Goldsmith and Bordo concurred it seems. (Krugman, 2000: 94) in his description of the ‘vicious circle of financial crisis’ that affected the Asian countries indirectly provides a definition. The set of factors of the financial crisis were divided into three subsets - (a) loss of confidence, (b) plunging currency, rising interest rates, slumping economy, and (c) financial problems for companies, banks, households. (Krugman 2000: 94) Each subset affects and reinforces another. This description or definition seems to sum up the situation in respect of the Asian crisis. The definition of financial crisis is definitely varied. People have different perception of the phenomena, even though there are common strains that they normally agree upon.
2.2.2 Causes

There are numerous causes of financial crisis as there are events that can trigger the phenomenon. The causes can either be immediate (‘causa proxima’) while others are indirect or external in nature (‘causa remota’). While the problem is normally manifested as financial in nature, however its causes or consequences are varied and are not usually confined to finance. “A wide spectrum of opinions has since emerged to explain the causes of the crisis”(Ruzita Amin & Rokiah Alavi 1997: 1) thus the causes or consequences are complex. As a result no one explanation or solution would adequately unravel the complexity nor solve the problem of financial crisis. The key domestic factors that led to the crisis were as follows:

(i) Currency Speculators (Hedge Funds)

Definitely this was the case with the recent crisis in Asia. It is commonly agreed that the flotation of the Thai baht on 2 July is the trigger event. Instead of stabilizing the depreciation of the baht continued its downward spiral from 25.72 to 52.55 per US dollar. Currency speculators came into the picture and pushing the currency down. Neighbouring currencies also suffered but from unanticipated depreciation as there were no deliberate flotation by Indonesia, Malaysia or Korea for example. Investors and nationals alike started to worry about or lose confidence in the value of their currencies they are holding. They started to dispose of their local currency for ‘hard’ foreign currency. This put more pressure on the currencies that were already having problem.

Of the rather abstract or non-quantifiable causes of the financial crisis, the role of currency speculators has been the most contentious. There have been numerous allegations of their complicity in forcing currencies to depreciate. In the process speculators denied that they were in any way responsible for the exchange rate problems faced by the Asian economies. “But the 1990s have been a great age for financial speculation” (Krugman, 1999: 137). It was a known fact that in Singapore where the ringgit, rupiah and baht were actively traded the
volume of daily currency trading increased from US$80 billion to more than US$200 billion during the height of Asian currency fluctuation. It does not take much imagination to deduce that the substantial increase involved the affected currencies and traders were busy ‘investing’ or betting on the fluctuation or movements in those currencies. Currency speculation is a complex subject no doubt.

“The best brains in the world have been attracted to the financial markets and the combination of computer capacity with efficient market theory has produced an explosive growth in new financial instruments and new types of arbitrage. The dangers that they may pose to the financial system have been ignored because markets are supposed to be self-correcting, but that is an illusion. The innovative instruments and techniques are not properly understood either by the regulators or the practitioners; therefore they pose a threat to stability” (Soros, 1999: 190)

Currency speculation at the moment is a largely unregulated industry. It is shrouded in secrecy and involved few prominent players, and the currency trading desks of (major) banks. Probably their influence on currency – for better or for worse could be summed as formidable.

“One of the most bizarre aspects of the economic crisis of the last few years has been the prominent part played by “hedge funds,” investment institutions that are able to take temporary control of assets far in excess of their owners’ wealth. Without question hedge funds, in both their success and their failure, have rocked world markets; and in at least a few cases, the evil speculator has staged a comeback” (Krugman, 1999a: 118)

“Hedge funds don’t hedge. Indeed, they do more or less the opposite. What hedge funds do, by contrast, is precisely to try to make the most of market fluctuations. The way they do this is typically to go short in some assets – that is, promise to deliver them at a fixed price at some future date – and go long in others. Profits come if the shorted assets fall in price (so that they can be delivered cheaply) or the purchased assets rise, or both. (ibid 119). Hedge funds with good reputations have been able to take positions as much as a hundred times as large as their owners’ capital; that

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capital; that
means that a 1 percent rise in the price of their assets, or
decline in the price of their liabilities, doubles that capital.”

Officials in Kuala Lumpur¹, Hong Kong², Bangkok³ or Seoul
and Taipei⁴ might have a point after all when they accused
speculators for the currency crisis. Speculators did set off the
fluctuation of the British pound in 1992, or French franc and
Italian lira in 1993 and were known to make substantial profits
from the subsequent currency movements. Their combined
might, definitely could move the smaller Asian currencies. Thus
the speculators could be apportioned some of the blame for the
currency crisis. But the consequential problems were not
intended. Even speculators understood there is not much profit
to be made from impoverished economies.

(ii) Short-term capital invested into the stock market.

The period prior to the crisis also witnessed large inflows of
short-term foreign capital into the miracle economies. Major
foreign pension funds, insurance companies and other investors
were investing in the various bourses, and lending to banks and
large corporations in these countries. There was profit to be
made from investment in the booming stock market (and loan to
banks which channeled it to local borrowers). And investments
and loans in these countries looked secure. Loan and investment
made in those countries were safe as repatriation policy was

¹ Dr. Mahathir Mohammad Prime Minister called Soros a moron and Soros
returned the insult by calling him a loose cannon and a menace to his country
² “In the view of Hong Kong officials, the hedge funds weren’t just betting on these
events: like Soros in 1992, they were doing their best to make them happen. The sales
of Hong Kong dollars were ostentatious, carried out in large blocks, regularly timed,
so as to make sure that everyone in the market noticed. Again without naming names,
Hong Kong officials also claim that the hedge funds paid reporters and editors to run
stories suggesting that the HK dollar or the Chinese renminbi, or both, were on the
verge of devaluation. In other words, they were deliberately trying to start a run on
the currency.” (Krugman, 1999b)
³ The planned address by Soros in Bangkok was cancelled because of threats of
protests. He was blamed by many Thais for the exchange rate problems which caused
the financial crisis in Thailand.
⁴ Taiwan instituted administrative measures in November 1997 to prevent Soros from
attacking the NT dollar. Foreign currency deals were limited to $5 million tranches
and no trade was allowed if it involved Soros or any funds associated with him.
generally liberal and the exchange rate has been stable for a long period. Although some short-term foreign investment were liquidated before the fateful July 1997, it was the ensuing panic caused by the currency crisis that prompted further liquidation either to realize profit or cut losses. The torrent of repatriation caused further pressure to the already embattled currencies. The inflow of foreign capital was earlier seen as sign of confidence in the strength of and boosted the local economy. Now it has the reverse effect when investors liquidated their investments and repatriated the proceeds. The purchase of foreign currency to repatriate the proceeds caused further depreciation of the local currencies and with it confidence also deteriorated. Thus short-term foreign capital changed from boon to bane in the countries facing financial crisis.

Table 1: Private Debt and related indicators for four Southeast and East Asian economies.

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<td>Total private debt (US$ bill)</td>
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<td>Short-term debt (US$ bill)</td>
<td>17.18</td>
<td>18.82</td>
<td>21.13</td>
<td>27.54</td>
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<td>Reserves (US$ bill)</td>
<td>10.4</td>
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<td>Short-term to total debt(%)</td>
<td>60.5</td>
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<td>61.8</td>
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<td>S.debt to reserves ratio</td>
<td>1.65</td>
<td>1.67</td>
<td>1.75</td>
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<td>Total private debt (US$ bill)</td>
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Source: Financial Times

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<tr>
<td>Total private debt (US$ bill)</td>
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<tr>
<td>Short-term debt (US$ bill)</td>
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<tr>
<td>Reserves (US$ bill)</td>
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<tr>
<td>Short-term to total debt(%)</td>
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<tr>
<td>S.debt to reserves ratio</td>
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Source: Financial Times
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<th>Reserves (US$ bill)</th>
<th>Short-term to total debt(%)</th>
<th>S.debt to reserves ratio</th>
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<tr>
<td>Malaysia</td>
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<tr>
<td>Total private debt</td>
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<td>Short-term debt</td>
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<td>7.38</td>
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<td>Reserves (US$ bill)</td>
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<td>27.2</td>
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<td>Short-term to total debt(%)</td>
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<td>S.debt to reserves ratio</td>
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<td>Thailand</td>
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<td>Total private debt</td>
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<td>Short-term debt</td>
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<td>Reserves (US$ bill)</td>
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<td>Short-term to total debt(%)</td>
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<td>S.debt to reserves ratio</td>
<td>0.78</td>
<td>0.87</td>
<td>1.05</td>
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</table>

Source: World Bank, Global Development Finance (Various issues)
(Quoted in Rao, Bhanoji 2001: 61)
(iii) Excessive External borrowing

Short-term foreign debt was another factor in the financial crisis. *(Table 1)* It was increasing tremendously prior to the crisis. Thailand, Indonesia and Korea were heavily exposed. In the case of Thailand its short-term debt was actually alarmingly high – at more than 145 per cent of its foreign reserves in 1997. Indonesia was saddled with more than 171 per cent. The magnitude of the short-term debt should be caused enough for alarm, especially in terms of ability to repay the loan on maturity and its possible effect on currency exchange rate. The short-term debt was incurred largely by the private sector. Banks and large corporations alike took the easily available loans. The banks used the foreign loans to lend to local borrowers. The foreign loans contributed to the expansion of money supply and credit, thus further ‘fueling the flames’ of the boom and speculative investment. (Kindleberger, 1996: 44). This easily available loan raised the question of ‘moral hazard’, an issue mentioned earlier. The lender extended the loan because it is considered to be profitable and safe; the borrower took the loan because it is available to finance projects that might not be undertaken in the first place. Who is at fault and how is the blame apportioned in this case? But when borrowers for whatever reasons have problems servicing their debts, banks and lenders would be faced with numerous problems of delinquent loans. This happened in all the severely impacted countries such as Korea, Indonesia and Thailand. [Malaysia was relatively less affected in this case] To illustrate the situation, the case of Thailand might be cited.

'Tens of billions of dollars of cheap capital poured into Thailand following the 1993 liberalisation of the foreign exchange regime. Most of it flowed into speculative investment such as the stock market and property development, causing severe asset price inflation, and predictably a property bubble. The Nation summed up the situation aptly in a 1998 New Year special report:

*[financial institutions and corporations] went on a borrowing binge that built up foreign debts to US$70 billion, half of which accounted for loans with short-term maturity. The foreign loans came with low interest rates of 6-7 per cent. Thai corporate sensed they could make easy...*
profits, borrowing cheaply from overseas and making money from the interest rate differentials. Who cared about profits from actual operations...?

Foreign lenders lent financial institutions and corporate easy money because Thailand was an economic tiger, a model of the newly-emerging industrialized economy. At $90 billion in total external debts, including public debts, Thailand’s debt service burden was running at about half of gross domestic product...

The financial and economic system was in need of more foreign debts to refinance old debts, which had been misallocated into the speculative property and stock markets. With the deteriorating macro-economic conditions, foreign investors began to lose confidence. That was how the trouble started (Laird 2000 pp 95&96)...

What happened in Thailand would hold true in other countries in this case and especially so in Indonesia. The situation amounted to reckless borrowing and just as reckless lending. The massive and mounting external debt either helped trigger off the financial crisis and definitely worsened it. This happened during the crisis, and many banks and lenders were forced to make massive write offs. Many Japanese banks were in this position owing to their exposure Southeast Asian countries caught in the financial turmoil. For the same reason Hong Kong based Perigrines Securities went under because of its unusually high exposure in Indonesia. It was possible that the short-term debt situation contributed to the severity of the financial crisis, if it was not one of the major causes of the financial crisis.

(iv) Other Factors.

Of course other factors could have contributed to the crisis apart from the abstract notions such as crony capitalism, moral hazard or currency speculators and conspiracy theory. These are more tangible. One was weakness in the financial system in the affected countries. Numerous forms of weaknesses in the merchant and commercial banks and other financial institutions actually existed in these countries. Inadequate supervision, poor management or lack of corporate governance in the finance