UCBMUN XXI

Paper Tigers:
The Asian Financial Crisis of 1997

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Committee Overview

Leading up to the Asian financial crisis in 1997, East Asian nations experienced unprecedented economic growth. Malaysia's exports grew 18% per year, Singapore's by 15%, and Hong Kong's by 14%. These nations were seen as extraordinary and dubbed the "Asian Tigers" along with several other nations ("Association"). However, the rapid growth masked the weaknesses inherent in the very factors that that caused the countries to boom.

The growth and pending fall was prompted by government and business missteps. East Asian governments had invested in massive public works projects that cost billions of dollars. Implicit promises to aid failing companies allowed businesses to ignore risky ventures. In addition to failed economic policies, corrupt governments contributed to the fall. Suharto in Indonesia helped more than 300 businesses owned by members in his family. Yet, businesses only furthered the problem. As supposed wealth accumulated, real estate prices started to climb. Banks were more than happy to lend funds to support businesses and individuals. Factories produced so much that prices started to plunge. Companies found themselves with excess capacity and unable to pay back the debt they had taken out in US dollars. The currencies of the Asian economies, which were pegged to the dollar, started to come under question.

After Thailand's Somprasong Land, a property developer, failed to pay $3.1 million in interest on an $80 billion eurobond loan, speculators began to launch attacks against the Thai baht. Currency traders, upon realizing that Thailand's deficit and debt would prompt increased demand for US dollars, began short-shelling the baht. The Thai government, desperate to maintain the baht's value, spent billions of dollars. On May 14, 1997, Thailand's foreign reserve was depleted. There was no other option: the baht would have to float and the economies of all the East Asian nations would soon follow Thailand's destruction.

In the midst of the growing concerns, several countries and international organizations gained power. They became key players in the latter half of the 20th century. Nations such as the United States were seen as sources of support and stability. Some institutions, such as the IMF which was formed to reconstruct the international payment system, were dominated by Western powers; others, such as ASEAN, was formed to promote political and economic cooperation. All found themselves facing pending disaster.

This crisis committee is a true “crisis committee” in every sense of the word, as it will feature representatives from every relevant state and international body. Each representative will have his or her own unique economic situation yet will be tied together by fears of collective economic destruction and anarchy. Undoubtedly, the representatives of the “Asian Tigers” of Southeast Asia and ASEAN will be expressing viewpoints that match their smaller export-based economies. Meanwhile, East Asian giants Japan and South Korea, both of whom had emerged as the regional production leaders in the decades prior, are seeking to challenge the American market. Moreover, a few representatives from the West can be expected in this committee, particularly from the IMF, as they represent the international bodies that oversaw East Asian growth during the crisis. This will be a fast-paced committee, with the situation in East Asia constantly changing economically and politically.

Head Chair Welcome Letter

Dear Delegates,

Welcome to UCBMUN XXI and this year's Asian Financial Crisis: 1997! My name is Victoria Lu, and I am a sophomore intending to study Business Administration and Rhetoric. I was born and raised in the Bay Area. After competing extensively in speech and debate during high school, I decided to try out for UCBMUN—a decision which soon became the best of my college career thus far. Last year, I served as Vice Chair in Colombia: Peace Accords with FARC and am truly excited about serving as Head Chair in this committee. Outside of MUN, I enjoy reading about individuals who destroyed world economies, analyzing group dynamics through research in social psychology, and giving terrible political jokes.

This committee will explore a significant, yet often unaddressed, global economic crisis which documented the first formal use of the term "contagion". As such, we will discuss how the crisis came to be and how to best address the failing economies through the combined efforts of the countries and international bodies involved. It will be your job to navigate the political power struggles between nations and international actors and certain social, political, and economic ramifications. Delegates should expect a fluid and fast-paced committee that simulates the urgency and the conflict associated with the collapse. I suggest delegates research and understand the underlying economic causes of the crisis as well as the long term implications. Knowledge of your country's or body's specific situation and role during the crisis is also recommended.

I'm looking forward to seeing what ideas and solutions each of you will bring to the debate to change the course of history. Feel free to message me if you have any questions!

—Victoria Lu

Crisis Director Welcome Letter

Dear Esteemed Delegates,

The time has come once again for one of the most riveting debate events the west coast has to offer: UCBMUN. Moreover, Asian Contagion: Financial Crisis will prove to be not only a committee that will test the economic and political wit of its delegates, but it will determine how they can collaborate under the most strenuous of circumstances. For those brave delegates participating in this committee, my name is Adam Braver, and I will be your honorary Crisis Director.

To those wanting to know more about myself (because I know that's what you all really want to read about), I am a junior majoring in Political Science with an additionally strong interest in Computer Science. I grew up in the sleepy Southern California surfing town of Ventura, which above anything else has the best fish tacos of any place you will ever visit (and trust me, I've visited a plethora of fish taco places). While in high school, I participated in speech and debate, where I particularly excelled in Extemporaneous Speaking (though I was just shy of your Chair at the State Tournament). My passions include staying fit, keeping up to date with the political world, and training to become the ultimate Pokemon master in Pokemon Go (sad life, I know).

With the boring introductions out of the way, I truly wish to express what I expect out of this committee. Your Chair and I spent a lot of time thinking over not only what would make for an exciting Crisis Committee, but what our delegates would gain the most out of. As more scholars by the day are arguing how the world is entering "The Age of the Pacific" so too do we believe it is central to understand the challenges that many Asian states have faced to achieve their statuses. I firmly believe that the Asian Financial Crisis was not only an economic turning point for world markets, but also a political one for many Asian states. There were countless spontaneous events during the crisis, which also makes it ripe for a Crisis Committee. I will ensure that exciting crisis updates will tie in with the flow of the committee, and in return expect you all to represent your positions to the best of your abilities. Whether this committee will simply result in economic recovery for all your respective states or something far more sinister is ultimately up to you. I look forward to meeting you all at UCBMUN XXI!

Best,

Adam Braver

Post-World War II and the Cold War:

The end of World War II did not bring the end of strife in Asia. Instead, nationalistic feelings started to develop. Southeast Asian nations began to fight back against imperialist powers. Events such as the Indonesian struggle against the Netherlands (1945-1950) and the Vietnamese war against France (1946-1954) highlighted the call for independence. This only incited fear in the United States at the onset of the Cold War, as their European allies were perceived as weak due to the lost territory. The region soon became home to a proxy war between the United States and Soviet Union during the Cold War (1947-1991) before the fall of the latter in 1989. The Korean War (1950-1953) and Vietnam War (1955-1975) were such examples. Furthermore, even beyond simply being battlegrounds for the two superpowers at the time, Southeast Asian nations fought in bloody civil wars. These conflicts were essential in shaping many decisions that are to be described later in this guide. Though the wars for independence and general violent backdrop won't be analyzed too deeply, delegates should keep in mind the numerous challenges and complications the Southeast Asian region faced following World War II.

1945: The Creation of the International Monetary Fund

Following the end of World War II, people recognized the need for an institution that could take care of international finances and cooperation. From July 1 to July 22, 1944, 730 delegates from 44 allied nations met in New Hampshire, United States in what would be known as the Bretton Woods Conference. The subject at hand: regulation and stability of the post-war international economy. The United States's motion to create an international institution was accepted. Thus, the International Monetary Fund (IMF) was born on December 27, 1945, tasked with maintaining international monetary relations and expanding world trade. The organization functioned like a bank. It would provide short-term financial assistance to countries experiencing deficits. Longer term problems would be resolved by the affected country by adjusting the exchange rate

Above: At the Geneva Convention
(Source: BBC News)

("History of the International Monetary Fund").

The IMF would soon rise in popularity and importance. Since 1956, lending operations for member countries became the primary function of the IMF. The IMF gained its income from gold reserves, loan repayments, and requested financial resources from shareholders. Between 1968 and 1973, the Bretton Woods system of having currencies pegged to the U.S. dollar while having the U.S. dollar pegged to gold began to dissolve. Beginning March 1973, IMF members were allowed to decide any type of exchange arrangement and let their currencies float freely in the market. The IMF would come to play major roles in combatting the oil shocks of the 1970s, alleviating Mexico's crisis in 1982, and transitioning previously central planning economies under the Soviet Union to market economies in the 1990s ("About the IMF History"). Membership increased to 172 countries. With the onset of the Asian Financial Crisis, the IMF is sure to play a large role in combatting and alleviating the consequences.

<u>1944: The Creation of the World Bank</u>

At the same conference that created the IMF, the World Bank (originally called the International Bank for Reconstruction and Development) was formed. Its initial aim was to help European countries recover after World War II by giving loans to governments to rebuild infrastructure such as railways, roads, and ports. The organization's first loan was to France in 1947, intended for reconstruction. However, the World Bank soon expanded its focus and started giving loans to countries in other regions of the world such as Latin America, Africa, and Asia. At the same time the World Bank expanded the number of loans offered, its technical assistance work, which provided countries with resources and training to use these loans effectively, became increasingly popular. In the 1970s, the Bank shifted its focus to eliminating poverty. New projects, relating to food production, rural and urban development, and nutrition, were taken on to serve the poor directly. The bank initiated loans in order to facilitate these projects. In the 1980s, the Bank continued improving social development, addressing issues such as education and good governance ("History").

However, the Bank, as well as the IMF, are not perfect institutions. They often faced accusations of hypocrisy of not following their own mandates during projects. They also were often accused of lending money with strings attached. Debtor governments would have to open up their economics to foreign corporations, which were mostly from advanced Western nations. These corporations, in turn, would be able to take advantage of the workers and natural resources. As such, many individuals in the Third World view the actions of IMF and World Bank as attempts to recolonize their countries.

1966: The Rise of Asian Development Bank

Prior to the 1960s, the Asian region was one of the poorest in the world. In the early 1960s, a new idea formed: a multi-lateral institution should be created to address economic issues. The passing of a resolution at the first Ministerial Conference on Asian Economic Cooperation, hosted by the United Nations, helped transform the concept to reality.

On December 19, 1966, the Asian Development Bank (ADB) opened in Mania, the Philippines' capital. Its primary objective was to address poverty in the region and improve living standards. To do so, the Asian Development Bank promoted investment in the region in public and private capital and finance development projects, and provided technical assistance when needed ("The ASEAN Declaration"). It would also cooperate with the United Nations, and specifically the Economic Commission for Asia and the Far East, when deemed appropriate.

For the remainder of the 1960s, the ADB mainly focused on food production and rural development. In the 1970s, when the world experienced its first oil price shock, the organization increased support for energy projects in member countries. Co-financing operations, in which ADB manages the funds of other organizations, provided additional resources for ADB's programs. The organization issued its first bond – worth $16.7 million – in Japan in 1970. In 1974, ADB began to provide low-interest loans to its poorest members. In 1982, its first field office opened in Bangladesh. Soon, ADB began working with nongovernment organizations to help disadvantaged groups.

Entering the 1990s, policies on involuntary resettlement and indigenous peoples were put into place. Environmental protection also became a pertinent issue. Membership expanded with the end of the Cold War with the addition of several Central Asian countries. In 1995, ADB became the first multilateral organization to have a board-approved governance policy to ensure that development assistance fully benefits the poor ("ADB History").

1967: The Rise of ASEAN

The Association of Southeast Asian Nations (ASEAN) has its origins in the Association of Southeast Asia (ASA), which was formed in July 31, 1961 by Malaya, Thailand, and the Philippines. However, ASA failed to maintain relevance due to its inability to obtain support from other Southeast Asian nations. The breakdown of relations between Malaya and the Philippines over the creation of the Federation of Malaysia in 1963 also contributed to its demise.

In May 1967, the idea of fixing ASA was replaced by the idea of creating a new group entirely, using ASA as a foundation. In August 8, 1967, non-communist nations including Indonesia, Malaysia, the Philippines, Singapore, and Thailand would become the first members of ASEAN with the signing of the ASEAN Declaration (also known as the Bangkok Declaration). As set forth by the declaration, the goals of ASEAN were to:

1. To accelerate the economic growth, social progress and cultural development in the region through joint endeavours in the spirit of equality and partnership in order to strengthen the foundation for a prosperous and peaceful community of South-East Asian Nations;
2. To promote regional peace and stability through abiding respect for justice and the rule of law in the relationship among countries of the region and adherence to the principles of the United Nations Charter;
3. To promote active collaboration and mutual assistance on matters of common interest in the economic, social, cultural, technical, scientific and administrative fields;
4. To provide assistance to each other in the form of training and research facilities in the educational, professional, technical and administrative spheres;
5. To collaborate more effectively for the greater utilization of their agriculture and industries, the expansion of their trade, including the study of the problems of international commodity trade, the improvement of their transportation and communications facilities and the raising of the living standards of their peoples;
6. To promote South-East Asian studies;
7. To maintain close and beneficial cooperation with existing international and regional organizations with similar aims and purposes, and explore all avenues for even closer cooperation among themselves.

(“The ASEAN Declaration”)

Some of ASEAN's first projects included increasing food production, promoting tourism, and enhancing cooperation in mass media. Plans to liberalize trade among members were also put into place. ASEAN quickly became a potent organization in the region and in the world. ASEAN earned respect for quelling tensions between its members such as Indonesia, Malaysia, and Singapore. The most important diplomatic initiatives in Asia came from ASEAN, not from China or Japan. The ASEAN Regional Forum, East Asia's only regional dialogue for security, was established along with regular summits between Asian and European leaders.

Soon, ASEAN began to expand: Brunei joined in January 7, 1984, Vietnam on July 28, 1995, and Laos and Myanmar on July 21, 1997. Cambodia was scheduled to join with Laos and Myanmar but delayed due to political instability. The decision to incorporate these new members generated controversy. The Cold War was still ongoing, and the first six members hoped to end the ideological split in the region. The barriers fell with the admission of Vietnam, which was previously considered a bitter enemy. Myanmar's military junta posed a threat to ASEAN's relationship with the United States and the European Union ("Expanding ASEAN"). Yet, withholding membership from Myanmar would break ASEAN's policy of ignoring each country's internal affairs.

By the onset of the Asian Financial Crisis, ASEAN was officially composed of nine member nations, ranging from Thailand's new democracy to Vietnam's one-party state.

1970s: The Rising Influence of the Federal Reserve

The United States: 1970s. The Federal Reserve was created in 1913 to ensure liquidity in the financial system during periods of panic. Yet, during the 1970s, disaster was on the horizon. The Fed, eager to avoid another Great Depression, had consistently implemented expansionary monetary policies. The result was rising inflation coupled with increased unemployment. Arthur Burns, Chairman of the Federal Reserve from 1970 to 1978, relayed a warning in his final speech: central bankers needed to curb inflation – an action which should have started in 1964. However, the Fed simply didn't have the power due to restrictions imposed by the federal government. Politicians knew that raising interest rates could very well lead to a depression, which was something that no representative would ever vote for.

Paul Volker, the following chairman of the Fed, took it upon himself to do what his predecessor couldn't: lower inflation.

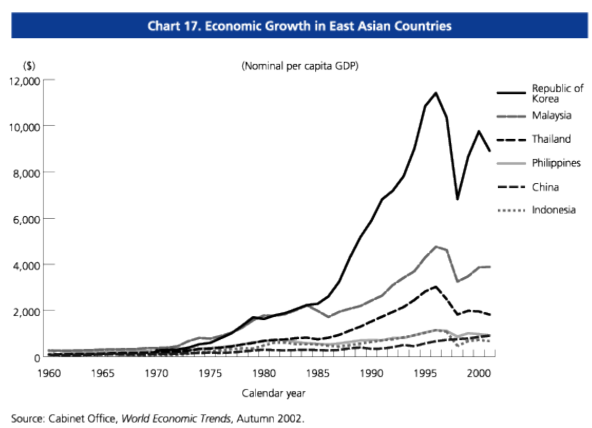
Knowing that he wouldn't be able to convince the government and the rest of the board to raise interest rates, he instead targeted the money supply. He restricted money supply, which in turn, made the interest rates skyrocket. The U.S. was soon experiencing up to 21% interest rates, up from 8% in June of 1981. The recession that began in 1981 was the longest in post-war history, yet inflation gradually began to fall. The faith in the dollar – and the U.S. Fed – was restored. Volker, though villainized, changed the course of the Fed. The organization gained a tremendous amount of power never before witnessed in U.S. history ("Money for Nothing).

The next years would contain mild recessions in a period of growth. In October 1987, the U.S. experienced a stock market crash, and the Fed began raising interest rates in response. After the August 1990 Gulf War in Mexico, inflation was curbed, and the Fed began stimulative monetary policy to address the rising unemployment rate in 1992, which peaked at 7.8%. Beginning late 1993, the Fed began to preempt rising inflation, which then set the stage for economic expansion (Goodfriend 7).

The United States, though failing to experience the same rapid growth as Southeast Asia, is sure to play a significant role in the 1997 Asian Financial Crisis. It not only is a large trading partner with many of the more prominent nations in Asia, but also has the incentive to keep the region stable. However, the U.S. still faces its own problems, such as maintaining its credibility in the face of low inflation rates. In addition, rising productivity growth will also complicate the Fed's goal to stabilize the U.S. market – and the international market.

<u>1960s – 1990s: The Economic Rise of East Asia</u>

In the 1960s, prospects for many East and Southeast Asian nations began to shift. Ten countries specifically were facing



Above: Explosive Growth in East Asian Countries

change: People's Republic of China, Hong Kong, Indonesia, Korea, Malaysia, Papua New Guinea, the Philippines, Singapore, Taiwan, and Thailand. Most of them grew an average of over 5.5% per year in per capita terms between 1965 and 1990. Such growth was unprecedented in human history, excluding Europe immediately following World War II. Four of these nations, known as the "Asian Tigers", experienced the most dramatic economic growth. They were Hong Kong, Singapore, South Korea, and Taiwan.

Many people have tried to explain and justify this growth. A poorer nation, compared to a richer one, had more potential to experience rapid growth. These developing nations were also home to educated citizens. The Four Tigers had an average 1.5 years of secondary schooling; this was more than the average years of school in many developing regions. In some cases, such as in Malaysia, foreign investment allowed for further grov Government savings—the Four Tigers had the highest government savings in the world at 5.6% of GDP—may have added to the reserve available for later investment. Yet, none of these variables, though viable, played the most significant role in facilitating growth.

Rather, openness to international trade, including lowering tariffs and export taxes, allowed the largely agricultural Asian nations to become export powerhouses. Basic exported products such as textiles quickly shifted to high technology products such as automobiles, semi-conductors and consumer electronics. The increase in wealth triggered an investment boom in real-estate, infrastructure, and industrial assets. Starting in the second half of the 1980s, prices of commercial and residential real-estate soared, leading to development never seen before in Asia. Construction increased exponentially, financed by heavy borrowing from banks.

Governmental policies fed the expansion. Governments encouraged private businesses to invest in specific sectors of the economy in accordance with "national goals" and "industrialization strategy". In Malaysia for example, the government encouraged the rise of national automobile manufacturer Perusahaan Otomobil Nasional Bhd by protecting it with

Above: Economic growth chart, East Asia

in 1984, sold 72,000 cars out of the total 117,000 cars sold on the market by 1989. Yet, the costs for the Proton, as the car was called, was three times the per capita income in 1987. This did not reflect an efficient company, as many individuals couldn't afford the automobile. Corruption was also rampant in several nations, which contributed to the growth. In Indonesia, President Suharato supported investments in 300 business that were owned by his friends and family.

By the mid-1990s, Southeast Asia was experiencing astounding growth. The traditional high income economies were only growing 0.8% per year. The U.S. was growing at 4.1% per year. In comparison, Asian nations were lauded for their low inflation rates, high national savings rates, and steps toward market liberalization

Inherent Weaknesses

Yet, there were inherent flaws in the growing economies. This level of growth could not have been possible without government support—and promises. Banks received implicit, and sometimes explicit, reassurance from governments that they would not have to bear the full cost of failure (Moreno). As such, domestic banks began to borrow excessively from abroad and loaned money to finance risky projects. Businesses, also insured by the government, were incentivized to take on more risk. The economic growth, in a way, could be considered unnatural and unsustainable.

The problem, however, went even beyond potential default. When Asian banks borrowed from international creditors, they made two critical decisions: 1) they borrowed money in US dollars and 2) they took out short-term loans. These decisions were reasonable at the time. Since local currencies were pegged to the dollar, interest rates on dollar borrowings were lower than rates on borrowings in domestic currency. Taking out short-term loans seemed to be insignificant. Yet, these decisions would soon come to pose dramatic consequences.

Economic Slowdown: Weakening Demand and Excess Capacity

Fractures began to appear in the mid-1990s when the Asian economies began to slow down—which foreshadowed far more than just a dip in a typical business cycle.

Decisions made during the previous years had led to risky and downright terrible investments. Financing so many investments led to excess capacity, which posed a significant problem. In Thailand, there were an estimated 365,000 unoccupied units in Bangkok. In South Korea, investment in semi-conductor factories surged in 1994 and 1995 to address the shortage of chips. However, by 1996, the shortage was gone, and South Korea found itself with facilities able to manufacture a product that now sold for 90% of its previous value.

Not only were the prices down around the world, but also exports as a whole, which funneled Asia's growth, began to slow perilously. So many companies were producing the same items that the supply far outpaced the demand. Japan, once East Asia's economic powerhouse, found itself in a precarious position: by 1996, it had experienced zero growth for five years. A consumption tax passed in April 1997 pushed Japan into another recession. Japanese imports fell along with its economy. This contributed to the export crisis in East Asia, as nations could no longer rely upon Japan to buy their goods.

At the same time nations were struggling to export goods, investments in infrastructure, real estate, and more required massive amounts of foreign products. Southeast Asian countries were purchasing equipment from America, Europe, and Japan. Airlines such as Boeing and Airbus and semi-conductor equipment companies such as Lam Materials and Applied Materials received huge orders from Asia. Wireless telecommunications companies such as Motorola and Nokia and electric power generation equipment companies were also huge suppliers. Soon, many nations saw that their balance of payments shifted strongly into the red during the mid-1990s (Hill). In 1995, Indonesia was running a current account deficit that was equal to 3.5% of its GDP. Malaysia's was 5.9%; Thailand's was 8.1%. If the local currencies that were pegged to the dollar were deemed at risk, economic meltdown would result.

The Beginning of the End: Thailand

Thailand was marketed as the regional financial hub in the 1990s; it was a model developing country. It averaged over 8% real GDP growth since the late 1980s and consistently reported a balanced budget. Those who ran the financial markets and economy were considered professionals. But, this glory didn't last long. At the beginning of 1996, the Thai government forcasted strong export growth at 18%. However, Thailand's traditional exports, consisting of footwear, garments, and seafood, faced increasing competition from other countries. Higher labor costs and the strong value of the Thai baht began to limit growth ("The Asian Currency Crisis").

On February 5th, 1997, the Asian meltdown began. Somprasong Land, a Thai property developer, announced that it failed to make a $3.1 million interest payment on a $80 billion Eurobond loan. The company effectively entered into default. The stock market dropped 2.7% after the news (the stock market had already declined 45% since its high in early 1996), but that was only the beginning. It soon came to light that other property developers were also on the edge of default. Financial institutions, including the country's largest, Finance One, found themselves in trouble. This is when the consequences of 1) taking out loans in US dollars and 2) taking out short-term debt struck. In theory, Finance One and other banks were able to borrow in US dollars at a low interest rate and lend in Thai bahts at high interest rates. But, when the Thai property market began to slow down in 1996 and 1997, property developers could no longer pay back their loans. If the property developers could no longer afford to pay back their loans, financial intuitions could no longer pay back their creditors. In 1996, Finance One's non-performing loans doubled, and the loans doubled once again in the first quarter of 1997.

In February 1997, the government suspended the trading of Finance One shares. The central bank in Thailand tried to arrange for the company to be acquired by a small Thai bank. The plan failed, and when trading resumed, Finance One's shares plunged by 70% in a single day. The bad loans in the Thai property market were only increasing daily, exceeding over $30 billion. Finance One soon went bankrupt, and other financial institutions were at the brink of experiencing the same fate.

In the midst of Thailand's woe, currency traders saw an opportunity. For the previous 13 years, the baht had been pegged to the US dollar at an exchange rate of approximately $1 = Bt25. However, as property developers and banks defaulted, the peg became increasingly hard to defend. Currency traders, after recognizing the growing current account deficit and dollar denominated debt burden, realized that banks would need to exchange Thai baht for US dollars in order to pay back their debts. The demand for US dollars would rise sharply, and the demand for the Thai baht would fall. In late 1996 and early 1997, there were several attempts to devaluate the baht. Traders began speculative attacks and short selling the baht.

In May 1997, short sellers were all over the Thai baht. Fast forward to present day, May 14, 1997. The government decided to use $5 billion of its foreign exchange reserves (which were recorded in US dollars) to purchase Thai baht and maintain the peg. Its reserves now stand at a two-year low of $33 billion ("Timeline"). If the speculative attacks continue and result in a currency devaluation, the result will be disastrous. With all debts denominated in US dollars and most loans due within a

Above: Nations experiencing economic crisis year, banks will struggle even more to pay their international creditors back. If Thailand sinks, investors will likely pull out money from other Asian countries out of fear. The country is on the brink of economic collapse, and Thailand—and the world—has no idea what to do. The Asian Financial crisis is about to begin.

Social Implications: Poverty and Unemployment

The Asian Financial Crisis's potential consequences reach further than mere economic stagnation; there are dire social consequences. Crippling inflation may result. Further price increases can even mark the onset of hyperinflation. If inflation were to occur, prices for everyday food and needed supplies would skyrocket. Food shortages, which would only be heightened by natural disasters the region, are sure to become more common as individuals buy and hoard in panic. Worse yet, many countries in Southeast Asia do not have the distribution systems in place to counter the potential food shortage. Poor and remote areas face the greatest threat.

The collapse of the currencies could also trigger another consequence: unemployment. Millions will be laid off if the private sector cannot pay back the massive amounts of debt. Specifically, the manufacturing, banking, and service sectors, which had undergone years of growth, are at the edge of bankruptcy. Moreover, the notion that workers in these sectors can return to their villages if they lose their city jobs is downright inaccurate.

Above: Protests in Thailand, Asian Financial Crisis

In the past, when the wage sector of the workforce was small, this might have been possible. Yet, the transformation of many of these Asian nations means that rural areas no longer function as a "shock-absorber" for the unemployed (Sherlock). Moreover, improved technology in agriculture requires less manpower. At the best of times, there are no opportunities for a worker returning to a village. In most cases, obtaining city jobs led to an improved standard of living; without these jobs, the combination of inflation and unemployment can lead to widespread poverty.

There are only a few options: surviving on the streets, depending on family or friends, or seeking work in regional towns. Indeed, in order to survive, crime is surely going to skyrocket. Prostitution rings and drug peddling will be on the rise. Even within the home, families are under stress, leading to increases in divorce and domestic violence.

Social Implications: Human Capital

In addition to poverty and unemployment, the crisis poses a threat to human development, particularly in education and health. Parents are struggling to find jobs or find themselves with decreasing wages; children must find work to generate more income. Students will have to shift their focus from school to work. This will impact the least subsidized areas of education, such as secondary schooling, the most. Moreover, the perceived benefits of education are likely to dim, as parents no longer see how a quality education can lead to a stable life.

Health care is also likely to be impacted as individuals switch over to self-treatment and traditional healers. Government budgets for vaccines and other health programs are likely to be cut. Private hospitals are will face a shortage of patients as well as a shortage of medicine and equipment (Pernia & Knowles).

Social Implications: Vulnerable Groups

Yet, not all groups will be affected equally. Women, children, youth, and seniors will be more at risk due to their secondary status in society. Factory workers and constructions workers will face massive lay-offs due to slowing demand and excess capacity. White collar and financial service workers will also see lay-offs, but are equipped with the education to find new jobs. Farmers, now unable to migrate to cities in search for jobs, may face consequences if natural disasters or food shortages are to occur. At the same time, farmers may be able to weather the upcoming storm by cultivating their crops and selling any extra.

The poor will struggle with preventing themselves from sinking deeper into poverty. For the middle class, their relative affluence will come to an end. For all people, crisis is brewing on the horizon.

Political Implications: Revolution and Revolt

The obvious link between economic crisis and political revolt is that economic distress will decrease support for political incumbents. Disaffected interest groups, protests, riots, and social violence may result. Countries may transition to – and away – from democracy. South Korea and

Above: Potential political riots in Indonesia?

Thailand, two countries which already have robust democracies, may merely see a new elected official. More authoritarian governments, such as that in Indonesia, may find themselves grappling with maintaining control as protestors take to the streets and demand more freedom and liberalization. At this point, authoritarian leaders will have to make a choice: should force be used?

Leaders not only face trouble brewing within their own countries, but also have to cope with certain international crises. Borrowing funds from the IMF and Federal Reserve, which are both dominated by advanced Western nations, will subject East Asia to rules they may not agree with. ASEAN, formed with the intention to preserve regional stability and growth, may change its attitude of nonintervention to actively promoting cooperation and interdependence between member states.

Country Analysis: South Korea

South Korea had long been a country where the government played a proactive role in the economy. In the 1960s following the aftermath of the Korean War, the South Korean economy underwent tremendous change. The government worked closely with the banking sector, and the banks lent out money at negative real interest rates. The primarily agricultural economy transformed into the world's largest producer of ships and computer memory chips; exports grew from $33 million in 1960 to $130 billion in 1997 ("The Asian Currency Crisis"). However, though South Korea was the world's 11th largest economy and was a member of the Organization of Economic Cooperation and Development, it faced serious problems. Trouble was brewing in Asia, and Korea was not immune.

In 1993, President Kim Young-Sam, a populist politician, took office during a mild recession. He supported Korea's giant diversified conglomerates, known as chaebols, as they grew their positions in the semi-conductor and automobile industries. Fueled by easy money, chaebols diversified into areas where they had little expertise. The top five conglomerates were involved in an average of 140 different businesses each. The top four accounted for half of the country's exports yet made minimal profits.

President Young-Sam also encouraged the building of new factories. Investments surged as a temporary global shortage of Dynamic Random Access Memory chips (DRAMs) in 1994-1995 led to sharp price increases in the product. In order to finance these investments, chaebols built up massive debts that were equivalent, on average, to four times their equity. Much of this debt was short-term and had to be paid back within a year.

However, from 1995-1996, economic conditions in the country worsened. Shortages for the semiconductors disappeared, and as the prices fell, the manufacturers' earnings fell by 90%. Export growth fell sharply due to the slowing demand. Industrial production growth rates had halved relative to 1995. The financial conditions of the chaebols and the banks that had lent money to them were in crisis. The stock market fell 36% in 1995 and 1996. The problem of how to pay back the debt loomed. Bankruptcy seemed a real and terrifying possibility.

The debt problem started to escalate in January 1997 when Hanbo, one of the chaebols, collapsed under a $6 billion debt load. Its decision to build the world's fifth largest steel mill proved to be its undoing. Costs had escalated from Won 2,700bn to Won 5,700bn while steel demand was slowing. Soon, allegations surfaced that the government had been bribed by Hanbo to pressure the banks into lending money. To make matters worse, more chaebols went bankrupt. Sammi Steel fell in March and Jinro Group followed in April (Gidwani). Leading into the committee present day (May 1997), another five chaebols are on the verge of bankruptcy.

Political instability is sure to come. The country's presidential elections are coming up in late 1997, and political instability poses as serious a problem as banking sector instability. The threat of regime change is looming, and the people of South Korea remain in a precarious position.

Country Analysis: Indonesia

Indonesia obtained its independence in the late 1940s and sustained unity through centralized economic policies and authoritarian rule. Economic policies during the 1970s and 1980s were designed to favor the indigenous Indonesians, also known as the pribumi. These policies allowed President Suharto to secure power.

Until the fall of oil prices in 1982, oil provided a relatively stable income for Indonesia. The presence of oil reduced the need for foreign investment, but with the deregulation of the financial industry, the credit market opened up to foreign traders in the 1990s. However, because of the weak banking regulations, the Indonesian central bank could not supervise risky lending practices easily. Yet, the Indonesian rupiah was not initially affected by the pressure on other currencies in early 1997 because it didn't have such a large current account deficit and dollar-denominated debt (Head, 42). In fact, if it weren't for the maelstrom that hit Thailand, Indonesia may have remained unscathed.

However, if the crisis does spread to Indonesia, the country may well be the hardest hit. Indonesians have long bet on the stability of their currency. The foreign exchange market for its currency was small, trading at merely $5 billion of the $1 trillion total. The Indonesian central bank had allowed the rupiah to float within a range of 8 percent for years. The stable exchange rate of the rupiah, coupled with Indonesian banks offering relatively high interest rates to attract depositors, led to an inflow of dollars into the country. This surplus of money allowed banks and companies to invest recklessly. Like in Thailand and South Korea, there was a drastic increase in property development and excess capacity. During this period of growth, businesses seldom took out hedges to protect themselves from sudden devaluation. Many had more than half of their foreign debt unhedged. This would lead to dire consequences since many companies had most of their loans in dollar denominated debt.

Moreover, the Indonesian government, in addition to the economy, may have the most to lose. President Suharto and his New Order regime based their legitimacy on bringing sustained improvements to Indonesia's lower classes and meeting the aspirations of the expanding middle class. Even before the onset of the crisis, many Indonesians were beginning to argue for institutions that would reduce the power of the elite, which included the President and the Army. Yet, President Suharto shows no sign of stepping down and is unwilling to discuss his successor or how a transition government would work (Sherlock). Rumblings of protests are beginning, and it remains to be seen if a revolution will result.

Country Analysis: Japan

Japan faced an interesting governmental transition at the turn of the 1990s with the falling influence of the Liberal Democratic Party (LDP). The LDP was formed in 1955 and maintained control in Japan until 1993. The country became the most extreme example of the world's limited number of "uncommon democracies" as it had all the formal institutions of democracy, yet with a single political party enjoying decades of uninterrupted power.

The LDP had sustained roughly 2:1 majorities over the opposition parties. It was a unique amalgamation of big business, small business, and agriculture; it excluded organized labor. As such, the Japanese government supported rapid technological growth and pursuit of export markets while providing assistance for economically distressed geographical areas. A large reason why the LDP was able to stay in power for so long was due to the booming economy. Jobs were plentiful and unemployment was low. From 1952 until 1990, Japan's GDP grew at double the rate of other OECD countries.

It was only until the economic downturn in 1990-1991 that the regime started slipping. Following 1990, the LDP faced a Japanese growth rate of merely 0.5% per year (Pempel 231). The usual counter-cyclical macroeconomic policies didn't seem to work and interest rates neared zero. The economy had become fragile due to nonperforming loans in the banking sector due to declining land prices and excessive borrowing. Other reasons for the downtown included inappropriate fiscal policy, overinvestment in the late 1980s and early 1990s, and fall of total productivity. In April 1997, the central government tried to take action. The consumption tax was raised from 3% to 5% as scheduled. However, the reaction was only negative (Ito 1).

As such, Japan's first priority at the eve of the Asian Financial Crisis was to restore a robust financial sector. With the entire region facing economic slowdown, Japan, though perhaps not in the best position to aid other nations, can still attempt to regain stability. Domestic and international issues will both be considered.

Country Analysis: China

The Third Plenary Session of the 11th Central Committee of the Communist Party in December 1978 was considered the defining shift of the People's Republic of China's history. After years of suffering under Mao's Great Leap Forward, farmers were allowed to return to their land and sell their produce in local markets. Under Deng Xiaoping, collective farming was soon replaced. China's reputation of being one of the poorest countries in the world quickly changed.

A year later, the Law on Chinese Foreign Equity Joint Ventures was introduced, allowing foreign capital to enter the country. This helped boost GDP from an average of 6% per year between 1953-1978 to 9.6% starting in 1978. As the economy improved, the rate of urbanization increased. More and more famers began moving from their land to cities. China ascended to its role of global exporter. The Shanghai stock exchange, which had been closed for 40 years, reopened in December 1990 (Hirst).

As the Asian Financial Crisis brewed, China faced the global economy from a position of relative strength. Since 1978, China experienced almost two decades of growth (Chow, 127). Its social welfare and education system had drastically changed, leading to a more educated workforce. Coupled with the China's massive population, China's future seems bright. Unlike Japan and South Korea, China had an outward-looking policy grounded in foreign direct investment. It had a major trade surplus, especially with the U.S. (Kirton). Thus, China has a huge opportunity to take advantage of the chaos caused by the crisis and seek a larger role in regional and global affairs. However, because of its open economy, China is not completely safeguarded from the potential consequences.

Vocabulary:

- *Currency Speculation*: Currency speculation involves buying, selling and holding currencies in order to make a profit from favorable fluctuations in exchange rates ("Understanding"). This can result in what is called a speculative attack, in which usually have these following steps:

  1. Borrow the pegged currency from a domestic bank
  2. Convert it to the reserve currency
  3. Buy short-term interest-paying government bonds of the reserve country. If the traders anticipate correctly, the central bank is forced to devalue the domestic currency
  4. Traders will sell their bonds in the reserve currency
  5. Convert them back into the domestic currency
  6. Repay their domestic loans

  ("Speculative")
- *Short Selling:* Short selling is the sale of a security that is not owned by the seller, but instead borrowed by the seller. Short selling is motivated by the belief that a security's price will decline, enabling it to be bought back at a lower price to make a profit ("Short Selling").
- *Contagion:* A financial contagion is the spread of market changes or disturbances from one regional market to another. Contagion can refer to the diffusion of either

economic booms or economic crises throughout a geographic region ("Contagion"). This is possible due to increasing global interdependence and is not limited to merely one region of the world.

- *Exchange rates:* A fixed exchange rate, which was utilized by Thailand's government prior to the crisis, is when the central government sets and maintains the price of its currency. This is usually in relation to a major world currency. In order to keep this value, the government would buy and sell its foreign currency on the exchange market. Floating exchange rates, however, are determined by the private market. Governments still take action to adjust the value of the currency, but significantly less than they would have if the currencies were pegged.
- *Other terms to keep in mind:* Devaluation, foreign reserves, economic policies (Classical vs. Keynesian), hedging

Potential Issues to be Addressed:

Committee present day: May 14, 1997. Thailand just spent billions of dollars from its foreign reserves in order to keep the baht from sinking. The most important takeaway from this background guide should be that there are multiple parties, situations, and causes for the meltdown. This guide should introduce basic information regarding different countries and organizations while highlighting social and political consequences if the crisis is not stopped.

Finance ministers, or those of the associated position, are meeting together to discuss what to do about the upcoming crisis. Representatives from international financial institutions are also present to lend their thoughts and support but face the complication that Asia's financial crisis is like none other seen in history. Traditional strings for loans such as reduced government spending may not work in this scenario. We would recommend delegates decide how to approach the financial meltdown and address social and political consequences (e.g. poverty, crime, political revolt).

Delegates should also keep in mind their country's or organization's issues they wish to bring to the table. Complications will arise as each nation or organization has its own agenda and goals. Some, like China, will be seeking more power in the region; some, like Japan, may be seeking to restore their relevance. In the process, delegates may find that their interests align with either objectives set by the agenda or with those of other characters.

Character List:

Please note that the following individuals may not have reflected the actual participants of the crises discussions; rather, this list was created with the purpose of facilitating discussion that would take into the account the many stakeholders involved.

1. Indonesia: Marie Muhammad, Minister of Finance
2. Philippines: Roberto de Ocampo, Secretary of Finance
3. Singapore: Richard Hu Tsu Tau, Minister of Finance
4. Thailand: Tarrin Nimmanahaeminda, Minister of Finance
5. South Korea: Lim Chang-yuel, Finance Minister
6. Malaysia, Anwar Ibrahim, Finance Minister
7. Japan: Hiroshi Mitsuzuka, Minister of Finance
8. China: Liu Zhongli (刘仲藜), Finance Minister
9. Hong Kong: Donald Tsang, Financial Secretary
10. Taiwan: Paul Chiu（邱正雄）, Minister of Finance
11. Myanmar: Than Shwe: Prime Minister of Burma
12. Brunei: Hassanal Bolkiah, Minister of Finance
13. Laos: Bob Bobworks, Important Dude of Money
14. Vietnam: Nguyen Sinh Hung; Finance Minister Nguyen
15. Mongolia: Jambin Jargalsaikhan, Ministry of Finance
16. Cambodia: Keat Chhon, Minister of Economy and Finance
17. Federal Reserve, Alan Greenspan
18. IMF: Michel Camdessus, Managing Director of IMF
19. Asian Development Bank: Mitsuo Sato, President and Chairman
20. World Bank: James D. Wolfensohn, President

Conclusion:

This guide should only serve as an outline of your research and contains elements that I thought would be relevant for all delegates. However, we expect all delegates to perform additional research. Along the way, delegates may come up with questions about the information, the functioning of the committee, or even their role within the committee. If so, please do not hesitate to contact us.

The intention of this committee is not to follow history blindly, but to see how delegates integrate their own objectives within the overarching goal of the committee: to address the financial crisis. Given the complexity of the crisis, there will not be a single correct answer, and we look forward to seeing agreements, arguments, peaceful resolutions, wars, backstabbing, and whatever else may result. Welcome to Paper Tigers: 1997 Asian Financial Crisis.

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