

**The impact of the Asian Financial Crisis  
on Southeast Asia**

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The Asian financial crisis which broke out on 2 July 1997 with the floating of the Thai baht has been described by the Japanese Ministry of Finance as a problem of plunging currencies caused by sudden movements of short-term capital. Optimists regard the crisis as a problem of short-term adjustment of the Asian economies to the demands of financial globalisation which include trade and capital liberalisation, privatisation and free capital movements. Pessimists view the crisis as a symptom of deeper malaise affecting Asian economies in general in that financial globalisation has developed rapidly beyond their ability to adapt. They claim that fundamental restructuring of Asian economies will be required before they will be able to experience levels of growth comparable to those before the crisis.

The issue in question relates to the impact of an economic downturn upon the political stability of governments and upon security relations between states in Southeast Asia. As a general principle, it has been averred that trade and finance constitute "powerful moderators" for peace and their development provided an important support for the peace of the 19<sup>th</sup> century.<sup>1</sup> In particular, Asia-Pacific governments have framed their goals in terms of the rapid development of these moderators which may have contributed to peace in the region. The strong identification with trade, finance and economic success as a criterion for government performance has been a characteristic of the "East Asian" economic model that was so highly praised until recently.<sup>2</sup> For China economic performance substituted for ideology as a basis for party legitimacy and as a means of ensuring national unity after a devastating period of political turmoil. In the case of Japan economic performance and development has provided an alternative to nationalism as a focus for the country's energies in the post-war era. In multi-ethnic countries such as Singapore, Malaysia and Indonesia economic performance has been regarded as a means of strengthening social and political stability as well as a basis for regime legitimacy. Conceivably, any serious downturn in the economic fortunes of these governments may have alarming repercussions for political and social

stability. Populations and electorates that have become socialised by their leaders into the culture of economic betterment and advancement may react in unpredictable ways should their expectations be denied or frustrated. Governments may resort to the inculcation and exploitation of nationalism or may be tempted by foreign adventures to justify their positions and to deflect the blame for performance failure. These concerns are indeed serious.

An examination of the issues requires an analytical effort to separate cause from consequence and to identify to the extent possible the impact of the financial crisis upon pre-existing trends. Before the outbreak of the crisis certain trends were identified as troubling and potentially destabilising and their influence may not be properly assigned to the financial crisis alone. Beijing's relationship with Taiwan, the South China Sea and the Korean Peninsula are all disturbing issues for ASEAN even when economic growth rates were at their height. These problems may be exacerbated by the financial crisis which may not be regarded as a cause but as an opportunity to pursue objectives previously decided. Other potentially troubling issues may have arisen as a direct result of impaired government authority that may be linked to the crisis. The question posed by this paper is the extent to which the crisis has provided an opportunity for actors to pursue strategies of aggrandisement, or has exacerbated existing security trends in the ASEAN region.

### **The Asian financial crisis-current trends**

If the Asian financial crisis was a harbinger of an economic downturn on the scale of the great depression of the 1930s the impact upon inter-state relations would no doubt be disruptive. The difficulty is that there are contrary signals and various views and no clear trend exists that would justify these pessimistic conclusions. The financial crisis had a devastating initial impact as currencies plunged but since then they have stabilised and economies in the

main are showing signs of improvement, or at least further deterioration has been arrested. Pessimists include Dibb, Hale and Prince who argue that the financial crisis should not be regarded as a short-term problem and claim that the crisis is a “defining event in the post-Cold War international order.” They add that the changes required to Asian financial institutions are “so fundamental that any ‘quick fix’ is unlikely.”<sup>3</sup> Paul Krugman argues that “none of the vulnerabilities that made the great Asian crisis of 1997-98 possible has disappeared” and opines that Asia’s long-term prospects were “far less promising than they had seemed only two years ago.” Krugman admits that Asia’s situation has improved but argues that the improvement has been partial at best and that Asia has not emerged from this crisis with any “clear idea about how to avoid the next one.”<sup>4</sup>

Somewhat buoyant views of Asia’s recovery have been recently expressed based upon the signs of increasing economic activity, the termination of currency volatility and the rebounding of regional stock markets. The Asian Development Bank in its *Asian Development Outlook* declared that Asian economies had “stabilised” and that in Korea and Thailand especially “the bitter economic medicine was beginning to work” as the emphasis moved from “crisis management to accelerating recovery.”<sup>5</sup> First Deputy Managing Director of the IMF Stanley Fischer on 17 June 1999 claimed that the “regional outlook had improved markedly in the last months” and that the economies of Korea, Thailand, Malaysia and Indonesia “are probably past the turning point.” The positive indicators which justified Fischer’s optimism include a recovery in exports, the return of foreign capital, both financial and FDI, and expansionary domestic policies.<sup>6</sup>

The IMF’s *World Economic Outlook* of May 1999 predicts that average growth rates for the ASEAN economies will improve over 1999-2000 and claims that “activity in the Asian crisis economies is close to trough.” The report concedes that “new negative forces are contributing to a second phase of the slowdown in the global business cycle” which may cause “further slowdowns in

domestic demand.” The US economy has absorbed Asia’s export surges as the market of last resort but is expected to slow in the immediate future as trade deficits increase to record levels. This may place negative pressure upon the ASEAN economies in the future, but all things being equal and on the basis of current trends the IMF predictions for the ASEAN crisis economies [Indonesia, Malaysia, Thailand, the Philippines] are as follows:<sup>7</sup>

**Table 1**

IMF growth projections for ASEAN-4 Indonesia, Malaysia, Thailand, Philippines			
1997	1998	1999	2000
3.8%	-9.4%	-1.1%	3.0%

Source; *World Economic Outlook*, IMF, May 1999

**Table 2**

IMF growth projections for 4 ASEAN economies				
	1997	1998	1999	2000
Indonesia	4.6%	-13.7%	-4.0%	2.5%
Malaysia	7.7%	-6.8%	0.9%	2.0%
Philippines	5.2%	-0.5%	2.0%	3.0%
Thailand	0.4%	-8.0%	1.0%	3.0%

Source; *World Economic Outlook*, IMF, May 1999

With currency stabilisation and revitalised stock markets in every affected ASEAN country the feeling has been created that the worst is over. To the extent that the financial crisis was a crisis of confidence for investors who

were driven by the "herd instinct" in withdrawing funds from the region this may be the case. Nonetheless, deeper issues of economic restructuring have been raised by the crisis, which have been noted by both the pessimists and optimists. Both share common concerns in their views of the financial crisis and it depends upon whether a glass of water is considered half full or half empty. Optimists in the IMF and international agencies point to the measures which have been adopted in varying degree to reduce the impact of the worst features of the crisis. They admit that this is only the first stage of stabilisation and that subsequent steps are required to ensure further recovery. IMF Director Michel Camdessus points to the need to renovate the financial systems in the affected countries in way which would ensure transparency as the "golden rule" of the new international financial system.<sup>8</sup> Pessimists, however, doubt whether the Asian countries will be able to move to the next stage which would require restructuring not only of their financial systems but political systems as well as business behaviour and culture.

Indonesia as the country most affected by the crisis has improved somewhat and though the rupiah fell to 15,000 per US dollar in June 1998, then stabilised at 7,500 in August, it rose to 6,300 in July 1999. The Indonesian government in its eighth letter of intent to the IMF in July 1999 claimed that consumer demand was recovering and that agricultural incomes were increasing and that in general "market sentiment had improved markedly." The government and IMF increased their estimates of Indonesia's growth prospects for 1999-2000 from 0-2% to 1.5-2.5%, which demonstrated marginally enhanced optimism for the Indonesian economy.<sup>9</sup> The World Bank, however, expects the economy to shrink by 1% over 1999-2000 before it may improve depending on whether or not the government adheres to the reform program.<sup>10</sup> To deal with the bad debt problem the Habibie government on 13 March 1999 initiated a bank restructuring and capitalisation plan that included the closure of 38 banks and the nationalisation of an additional seven. The government intends to channel \$30-35 billion to recapitalise some 80

private and state banks to salvage the financial system, but unless it deals with politically well connected banks the effort will be in vain.<sup>11</sup> FDI for Indonesia has dropped 90% over January-June 1999 [from \$5.1 billion to \$560 million] which shows that the problem of investor confidence remains. Structural reform involving banking restructuring and a solution to the bad debt problem cannot be postponed and will require effective implementation for the long-term economic stability of Indonesia.

Thailand's situation has improved in comparison with the worst period of the crisis as investor confidence has returned to some extent. Investment nearly doubled over January-June 1998 [\$3.3 billion] in comparison with the period January-June 1997 [\$1.8 billion].<sup>12</sup> To deal with the bad debt problem in Thailand a hotly-contested bankruptcy bill was passed by the parliament in April 1999 over the objections of business groups that pleaded for leniency. The bankruptcy law has been regarded as the one of the most crucial reform measures and "as the key to economic recovery."<sup>13</sup> It will permit creditors to recover debts directly from borrowers and will reduce the reliance upon taxpayers' money to bail out financial institutions. If successful the new law is expected to strengthen investor confidence in Thailand.<sup>14</sup>

### **Consequences of the financial crisis**

Those who claim that the crisis is likely to manifest a negative impact upon Southeast Asia' make the assumption that the key factor in Asia-Pacific stability is a regional cohesion that arises from economic growth. The assumption is that economic development has been a force for stability in the Asia-Pacific region and has created patterns of interdependence that have reduced considerably the likelihood of conflict. Remove this basic and important factor and the region may slide into an era of uncertainty and instability. Long-standing rivalries may resurface, national leaderships may lose sight of the incentives of interdependence to assert territorial claims or to

exploit the weaknesses of neighbours to gain particular advantages. This assumption will be tested in the following sections.

First, the positions of the major external actors will be analysed to identify whether or to what extent their behaviour towards the region betrays an attempt to exploit vulnerabilities and weaknesses as revealed by the crisis. The major actor here is China but the US-Japan relationship will also be included. Secondly, major areas of tension in Northeast Asia will be examined as to whether the crisis has exacerbated tensions in conflict zones in a way which could detrimentally affect Southeast Asia. Thirdly, the impact of the crisis upon the political stability of governments will be analysed where such instability could undermine regional security. Finally, an attempt will be made to identify the impact of the crisis upon inter-state ASEAN relations to test the assumption that deterioration would be the result of an economic crisis.

### *External actors-the role of China*

In terms of external actors the most significant factor is the role of China whose position relative to the region may have been strengthened by the crisis. Dobb, Hale and Prince assert that the impact of the financial crisis could be “a shift in the regional balance of power that favours China” as ASEAN becomes weakened and preoccupied with its own economic problems. They claim that the financial crisis assists China in its ambition to become “the leading regional power” and that its status and influence in the region will grow. This argument relies upon the unequal and disparate impact of the financial crisis which devastated several ASEAN countries but which left China in a position of relative strength. ASEAN countries would be compelled to reduce defence budgets placing themselves in a position of weakness *vis-à-vis* China which would continue with current levels of defence spending. In terms of China’s role two issues will be examined – Taiwan and the South China Sea.



The worst case scenario for the ASEAN region is a clash between Beijing and Taiwan which could result in military action in the Taiwan Straits or a naval blockade of Taiwan. On 2 August 1999 China test fired the Dongfeng 31 missile which has the capability to strike the west coast of the US with a range of 8,000 kms with a single nuclear warhead, which was an expected development in view of the pattern of Chinese BM development.<sup>15</sup> If China would be able to target the US mainland the effect could be that the US would be effectively deterred from assisting Taiwan in the event of a conflict. With its BM program China may achieve the capability to deter a US conventional response in the event of a crisis in the Taiwan Straits. In this situation countries along the periphery of China could be compelled to acknowledge Chinese supremacy while those with alliance relationships with the US would be placed in a agonising dilemma. ASEAN indeed may be split between those countries willing to oblige China and those which may find alternatives. Mainland countries such as Myanmar, Thailand would accommodate China more easily than would Vietnam which has land and sea territorial disputes with Beijing. The maritime sections of ASEAN, Indonesia, Malaysia and the Philippines would face the dilemma of resisting China's claims in the South China Sea, and so turning China into an enemy, or surrendering their own claims into which much has been invested. Without the prospect of US support, however, even the maritime countries would be tempted to acquiesce in Chinese suzerainty over the South China Sea.

Since the outbreak of the crisis there have been disturbing reports about China's activity in the South China Sea which may be related to an effort to exploit the weakness of the Philippines and ASEAN's own preoccupation with domestic affairs. In November 1998 two new Chinese structures were identified in Mischief reef in addition to the four that had been discovered in 1995. The Chinese insisted that the original structures that had been built earlier were simply being upgraded and that there was no change of position.<sup>16</sup> Philippine Defence Secretary Orlando Mercado claimed that the structures

represented a "creeping invasion" of the Philippine sea zone area and called upon the international community for a response.<sup>17</sup> ASEAN, however, failed to respond and when President Estrada attempted to raise the issue at the Hanoi informal ASEAN summit of December 1998 he was rebuffed.<sup>18</sup> Certainly from the Philippine perspective the Chinese action was linked to the financial crisis as the ASEAN countries sense of gratitude towards China for refusing to devalue the yuan seemingly overrode any obligation to the Philippines over this issue. The Philippines has sought alternatives other than ASEAN to manage China in which case it has been able to compensate for its vulnerability before China and ASEAN's preoccupation with the financial crisis.

In February 1998 the Philippines signed a Visiting Forces Agreement [VFA] with the US which was strongly supported by Estrada who as a senator voted against the renewal of the American base in Subic Bay in 1991. The VFA would allow the conduct of training exercises between the US and Filipino navies and was ratified by the Philippine Senate on 27 May 1999, because of alarm over Chinese behaviour despite vociferous opposition. The Philippines also announced that joint naval exercises will be conducted with South Korea, Malaysia and Vietnam which pointed to the possibility of a common response to China's moves. A Philippine concern to demonstrate resistance to China may have been behind the ramming and sinking of a Chinese fishing vessel by a Philippine patrol boat on 24 May. In this case a Chinese probe to test Philippine responses may have provoked the country to resort to firm measures.

The idea of an ascendant Chinese regional power, however, is based upon linear projections and comparisons with the developed world that could be misleading. If the financial crisis proves to be a long-term problem it would affect China as much as or even more than the ASEAN countries. In China a delayed effect may be likely as the currency has been only partially convertible and the economy has been cushioned somewhat from the effects of the financial crisis. China's exports over the first quarter 1999 declined by 7.9% though the economy reportedly grew by 8.3% because of heavy expenditure on

infrastructure projects that can not be sustained over the long term.<sup>19</sup> China faces a bad debt problem of immense proportions of which estimates vary from 20% to 60% of GDP according to the *Economist*.<sup>20</sup> The state-owned banks continue to channel funds into under performing state owned enterprises [SOEs] which increases their debt and imposes a growing burden on the economy.<sup>21</sup> As the ASEAN countries recover from the crisis and their currencies adjust to more realistic levels their exports are expected to increase. The ASEAN countries may be better positioned to overcome the worst effects of the crisis which could strike China at a later time. China has earned the gratitude of the region by refusing to devalue the currency but reports indicate that a decline in exports and a weakened economy are prompting Chinese economists to raise the issue of currency devaluation.<sup>22</sup> Devaluation of China's currency could throw the region into turmoil and would certainly raise the prospect of a round of competitive devaluations that would be destabilising. More significant would be the impact of declining growth rates on China's social and political stability and the prospect of the fragmentation of the country. As the Communist Party struggles to maintain unity China might drift towards another period of "warlordism" in which provincial party groups assume greater control over their affairs to the detriment of central authority. In this situation Beijing may resort to foreign adventures to contain centrifugal tendencies and maintain unity, but should the fragmentation become uncontrollable its ability for a prolonged external confrontation would be undermined.

### ***Northeast Asian areas of tension***

According to Dibb, Hale and Prince South Korea's economy has been considerably weakened relative to that of the North, and the South may be less able to fund its defence budget and to maintain the military balance with the North. The concern is that Kim Dae Jung's "sunshine policy" of engaging the

North could threaten the party leadership which would take the opportunity presented by the South's relative economic decline to resort to provocative measures. In June 1998 a Northern submarine was captured on an infiltration mission in the south which stimulated criticism of the "sunshine policy" amongst conservative circles in Seoul. Should conflict break out in the Korean Peninsula there would be repercussions for other areas of tension in the Asia-Pacific region and ASEAN would be affected. In the context of the financial crisis the North unexpectedly test-fired its two-stage Taepodong 1 missile over Japan on 31 August 1998 which alarmed both South Koreans and Japanese. This event prompted greater co-operation between Japan and South Korea in which case diplomacy may strengthen the South in relation to the North and may compensate for the impact of relative economic decline.

During his subsequent visit to Japan in October 1998 Kim Dae Jung promised to lift the ban on Japanese cultural imports which had been introduced in 1978. The ban was rescinded as from July 1999 as a product of an agreement with the IMF demonstrating how the financial crisis promoted co-operation between these countries.<sup>23</sup> The crisis also strengthened those groups in South Korea which seek to co-operate with neighbours to manage the problem of the North and has impaired the case for an independent and hard line response. Japan and South Korea held their first naval exercise in history in August 1999 which involved three Japanese destroyers and two Korean naval vessels as well as ASW patrol aircraft and helicopters.<sup>24</sup> As a consequence of the crisis the South has become more dependent upon external support and more willing to resort to co-operative strategies.

A second area of tension has been the US-Japan alliance where it has been asserted that the financial crisis has undermined a "congruity of national interests and perspectives on key regional and global issues." According to this view diverging perspectives on the origins of the crisis and necessary remedies to deal with its consequences means that "American and Japanese strategic harmony on major issues cannot be taken for granted." Alliance cohesion has

suffered because the US blamed the flaws of the "East Asian" model for the outbreak of the financial crisis while the Japanese were inclined to regard globalisation as the problem.<sup>25</sup> This view of US-Japan relations exaggerates the impact of the crisis as the undoubted differences between the US Treasury and the Japanese Ministry of Finance do not necessarily translate into misunderstanding over various strategic issues that the two countries face. US and Japanese positions on North Korea are closer than ever since the launching of the Taepodong missile in 1998 while similar areas of convergence have been in evidence in relation to China. When Jiang Zemin visited Tokyo in November 1998 he irritated the Japanese because of his hectoring behaviour, his demand for an apology for Japan's past behaviour, and his refusal to sign the joint communiqué. This visit stimulated much criticism of China in Japan and may pave the way for greater co-operation with the US in the context of the defence guidelines.

### *Indonesia's political stability*

The fall of Suharto and the disturbances that have afflicted Indonesia can in part be related to the financial crisis but it would be erroneous to blame the crisis for all of Indonesia's woes. Suharto had unwittingly prepared the ground for a domestic conflict when he promoted deregulation of the economy in a series of packages beginning in 1983, as well as the trade liberalisation programs under AFTA and APEC. Deregulation and liberalisation were implemented in a political system that was dominated by Suharto's family circle which extended their monopolies and privileges throughout much of the economy. The economic policies to which Suharto had committed himself at the behest of his US trained economic advisors were in conflict with the feudal system of rule that he had established and which he had sworn to defend. The contradiction was revealed when the contagion of financial crisis spread to Indonesia and the rupiah began to drop in value. The reform measures that

the IMF had demanded to lift the country out of crisis would have swept aside Suharto's system of rule and the privileged role of his family. Those measures included the termination of fuel subsidies, the elimination of monopolies and cartels such as those related to clove marketing, cement, paper and plywood, all of which were controlled by family-related business groups. When in response to IMF demands Suharto on 4 May 1998 announced the removal of fuel subsidies student riots were triggered in Jakarta which eventually resulted in his resignation on 21 May.

For the ASEAN countries the most troubling issue has been the stability of Indonesia since the fall of Suharto and the prospect of social and political disintegration. Indonesia's situation after the Jakarta riots of May 1998 appeared disturbing and ominous predictions of chaos circulated within the country. Conflict erupted in East Timor and Aceh and it seemed likely that these two provinces would separate from the republic with the result that the country would fragment. Muslim leader and currently Chairman of the People's consultative Assembly [MPR] Amien Rais warned that "it is possible that what happened to Yugoslavia could also happen to Indonesia."<sup>26</sup> International agencies claimed that the crisis was leading to a massive increase of poverty as the prices of imported rice and fuel increased dramatically and beyond the reach of most families.<sup>27</sup> 15 prominent Indonesian economists in a common declaration warned of the impending collapse of the economy as they stated that economic policy was being managed within the context of the same corrupt political system.<sup>28</sup>

Since 1998 the situation has stabilised somewhat for various reasons. Suharto's appointee to the presidency, the irrepressible Habibie, made the initial step towards a democratic transition by holding parliamentary elections on 7 June 1999, thereby defusing the accumulated hostility of the student protestors and urban population. Megawati Sukarnoputri's party the PDI-Perjuangan [Indonesian Democracy Party-Struggle] won a reported 35.4% of the vote, well ahead of the government party Golkar with 19%. Moreover, to deal

with unrest and rebellion in the provinces two important items of legislation have been passed by the MPR in April 1999. First was the autonomy law which devolved greater powers to Indonesia's 306 districts and cities. Under this legislation the central government will be responsible for defence, foreign affairs, monetary policy while districts will be able to develop their own relations with external investors. The second was the revenue law which provided for the sharing of resources and finance between the Jakarta government and the provinces.<sup>29</sup> The regional autonomy law is yet to be implemented but the current interpretation is that the provinces will be required to give only 20% of their revenue to the central government, which excludes revenue earned from oil and natural gas.<sup>30</sup> Amien Rais, however, declared that the autonomy legislation did not go far enough and called for federalism as a solution.<sup>31</sup> Indeed, Indonesia will be compelled to go further than the autonomy legislation in order to ensure stability and may have to explore variations of the federalist concept despite the opposition that it arouses within Jakarta.

Most important for the future was the election by the MPR of Abdurrahman Wahid as Indonesia's fourth President on 20 October 1999. As Chairman of the Traditionalist Muslim association Nahdlatul Ulama Wahid had widespread respect as a renowned Muslim leader, despite his often erratic political behaviour. Wahid's commitment to democracy was unquestioned and he attempted to reconcile Islam with democracy thereby endearing himself to Indonesia's liberals. In March 1991 he established *Forum Demokrasi* with a group of prominent liberals who sought to counter Suharto's effort to cultivate Muslim support through the Indonesian Muslim Intellectual's Association [*Ikatan Cendekiawan Muslim Indonesia* or ICMI], which was chaired by Habibie.<sup>32</sup> Indeed Wahid often warned that Suharto's effort to promote ICMI could stimulate Islamic radicalism and a revival of the *Masyumi* Islamic modernist party, which had been banned by Sukarno in 1960. Wahid could

appeal to Muslim liberals and democratic constituencies, an appeal which was strengthened when he appointed Megawati as vice president.

Wahid's first major contribution to stability was to prepare Indonesia to for an independent East Timor which had opted for secession in the referendum of 30 August 1999. The concern was that the loss of East Timor would stimulate other provinces, particularly Aceh, to secede in which case the very real fear of Indonesia's fragmentation arose. Wahid has attempted to manage the problem of secessionist pressure by curbing the power of the military and subordinating it to civilian control. Indeed, elements within the military had reportedly supported the East Timor militia in its attacks upon the pro-independence East Timorese. The conflicts in Maluku and Lombok that broke out in January 2000 could similarly be traced to disgruntled military forces.<sup>33</sup> If greater control over the military could be established within the political context of democratisation perhaps the major factor in Indonesia's instability may be removed. From this perspective, far from being Indonesia's unifying force, the Indonesian military has acted blindly as a force promoting its disintegration. If the military had not acted so brutally in Aceh, where it had become regularly associated with atrocities, the desire for secession would not have become so intense in that province.

Wahid succeeded in removing Wiranto as a military figure through characteristic if often times confusing manoeuvre. First in October 1999 Wiranto was moved from the position of Armed Forces Commander to co-ordinating minister for Political and Security Affairs, thereby losing operational command over troops. Wahid appointed a civilian defence minister by placing Professor Juwono Sudarsono in that position while Wiranto's replacement was Admiral Widodo, the first naval officer to hold this post. The military's representation in parliament, currently 38 members, will be eliminated but it will continue in the MPR. On 31 January 2000 Wahid announced that Wiranto would be removed from the co-ordinating minister's position and after back tracking on his demand eventually had him replaced on



14 February by the Home Affairs Minister Surjadi Sudirja. In February 2000 Wahid appointed Agus Wirahdikusuma as Strategic Reserve [KOSTRAD] commander and Djamari Chaniago as Chief of the Armed Forces General Staff.<sup>34</sup> Both had replaced officers who were linked to Wiranto and so strengthened the President's hold over the military. Many more steps will be required before the military can be fully controlled but Wahid has made an ambitious start.

Indonesia, indeed, may have veered away from the edge of collapse and the situation appears less alarming than was the case in 1998. The outbreak of chaos has been prevented somewhat by the above developments while the anticipated social explosion based on the poverty figures released by the Indonesian government did not materialise. Indeed, the World Bank subsequently claimed that the government and international aid agencies had deliberately exaggerated poverty figures in order to obtain increased funding.<sup>35</sup> The prospect of collapse and disintegration seems to have receded and the problem for the country is the management of a democratic transition that would provide sufficient stability to allow the military to disengage from politics. As part of the process of democratisation Indonesia's problem of separatism may be resolved once a more acceptable relationship is negotiated between central government and provinces. Indeed, if this were the outcome then the financial crisis would have contributed to Indonesia's political development by bringing about the necessary conditions for a political change that could no longer be postponed.

### *Inter-state ASEAN relations*

Dibb, Hale and Prince have predicted that Thailand's economic collapse will undermine its "ambition to be the predominant regional power" in relation to Vietnam and as well as the desire to serve as a model of development for Cambodia and Myanmar. In reality the impact of the crisis upon Thailand's

relations with neighbours has been negligible and it was no more capable of becoming the predominant regional power after the crisis than it could before the crisis. The financial crisis has provided the opportunity for Thailand's democratic government to implement plans to reduce the size of the military or to curtail finance for unnecessary prestige military projects. One example of the latter was the purchase of the helicopter carrier *Chakri Naruebet* by which the Thai navy had attempted to seek a more prominent role. The carrier spends most of its time in port as maintenance budgets have been slashed because of the financial crisis. Training exercises have been reduced to one every two months so the carrier is virtually non-operational.<sup>36</sup> As another consequence of the financial crisis the Thai army will be reduced in size from its current strength of 250,000. According to the new army chief Surayudh Chukanont, staff numbers would be reduced, divisions would be downsized and the number of generals [currently 1,800 of which 600 have no specific responsibilities] will be cut.<sup>37</sup>

Thailand has had periodical territorial and fishing disputes with neighbours over but there is no evidence that these have been intensified as a result of the crisis. Thai and Burmese naval vessels have regularly clashed the latest incident occurring over disputed maritime territory near Ranong in January 1999. In the past such clashes sometimes escalated into major political conflicts involving heads of governments as was the case in 1995. Thai relations with Myanmar deteriorated in 1995 when the Myanmar generals accused Thailand of assisting the Karen rebels, which resulted in the closure of two land border checkpoints. Moreover, in August 1995 there was the murder of five Burmese fishermen working for a Thai fishing trawler, which further exacerbated relations and prompted Myanmar to close a third border checkpoint.<sup>38</sup> Tensions again developed over the Moei river area of the border in January 1998 as the Burmese threatened to drive out Thai troops from a disputed zone but by February the local Thai-Burmese border committee reached an agreement to disengage.<sup>39</sup> By the same token Thailand and

Myanmar were less inclined to escalate the naval clashes of January 1999 probably in recognition of the futility. The Thai side raised with the Myanmarese the desire to negotiate the maritime border and its demarcation as well as the establishment of joint patrols to police the disputed area.<sup>40</sup> In a related case, Thai-Malaysian relations over Muslim separatism in southern Thailand have similarly improved during the financial crisis. Previously, Malaysia was reluctant to co-operate with Thailand to suppress the small Pattani United Liberation Organisation [PULO] that sought to detach the four Muslim provinces from Thailand. A change of attitude in Kuala Lumpur, however, eliminated the sanctuary that the separatists had exploited in northern Malaysia.<sup>41</sup>

In Malaysia the financial crisis contributed to the generational conflict between Prime Minister Mahathir and his designated successor Anwar Ibrahim who attempted to develop an alternative strategy to manage its economic effects. As finance minister Anwar was more willing to abide by IMF prescriptions for higher interest rates and reduced government spending to limit the current account deficit and to strengthen the currency. In December 1997 he cancelled several major government projects which Mahathir has been publicly advocating and precipitated a clash over economic policy which the prime minister could not ignore. This conflict with its lurid allegations of sexual impropriety is unlikely to have serious strategic repercussions for the region but it may contribute to a change of behaviour within ASEAN. Previously the convention within ASEAN was to avoid commenting upon the politics of members in deference to Article 2 (c) of the Treaty of Amity and Co-operation of February 1976 according to which non interference in the internal affairs of members was sanctioned. Anwar Ibrahim's arrest on 2 September 1998 became a *cause célèbre* within ASEAN liberal circles in which case the non interference principle was challenged. President Estrada of the Philippines openly criticised the detention of Anwar while Habibie under the influence of his liberal advisers cancelled a visit to Malaysia to meet Mahathir.<sup>42</sup> One

result was that Malaysia postponed a meeting with the Philippine government dealing with joint maritime patrols but a termination of such co-operation was unlikely.<sup>43</sup> As ASEAN public opinion evolves and responds to democratisation similar incidents can be expected in the future.

Indonesian-Singapore relations have been affected by political events since the fall of Suharto and it would be surprising if it were otherwise. Singapore's role as a trader has been resented and envied in the region since colonial times and, moreover, the enmity expressed towards the business success of the local Chinese has been directed towards predominantly Chinese Singapore as well. Indonesian Chinese have utilised the investment services of Singapore's banking system and have funnelled their funds into offshore Singapore accounts. They travelled to Singapore for medical treatment, which they claimed was at a lamentably low standard in their own country, they sent their children to Singapore for education, and would invest in Singapore property. Singapore felt protected by Suharto with whom Lee Kuan Yew had developed a personal relationship as the Javanese leader ensured that popular resentments against Singapore were controlled and suppressed. Lee Kuan Yew's ill-timed remarks in February 1998 that markets were disturbed by Habibie's selection as vice president threatened to provoke and stimulate that animosity.<sup>44</sup>

According to reports Habibie was annoyed by the Singaporean leader's comments which prompted him to call the Singaporeans "real racists" for allegedly not allowing Malays to become military officers in the Singapore Armed Forces.<sup>45</sup> Co-operatives Minister Adi Sasono proposed that Singapore conclude an extradition treaty with Indonesia to ensure the return of so-called "economic criminals" or Indonesian Chinese who had fled to Singapore with their money.<sup>46</sup> To establish better ties with the Habibie government Singapore offered Indonesia \$5 billion as part of a trade guarantee plan and \$12 million in humanitarian aid as well. Habibie, however, declared that he had expected more from Singapore which was a prevalent view within Indonesia.<sup>47</sup> It was

reported in Singapore that at least three ministers in Habibie's cabinet pushed for a hard line against Singapore over the extradition treaty and other contentious issues.<sup>48</sup> Since Abdurrahman Wahid's elevation to the presidency, however, clashes with Singapore have not been in evidence. Wahid has no particular animus against Singapore and has been more critical of the ICMI Muslims that Habibie included in his cabinet. Nonetheless in Singapore there is the concern Indonesian hostility may be only below the surface and may erupt again in the future.

An economic downturn may have the effect of creating refugee flows from areas of high unemployment to less populous areas with relatively higher standards of living that could overwhelm host governments. Refugee movements from countries suffering high unemployment are the great concern of governments in the developed world and no less so for the ASEAN region where the disparity in GDP per capita between neighbouring countries may reach that between developed and developing world countries. Refugee flows from Aceh to Malaysia were stimulated by the financial crisis and became an issue to be negotiated by the heads of government. When Acehnese began to flee to Malaysia in increased numbers the Malaysian government pressed for their deportation as demanded by Indonesia. The Jakarta government insisted that these refugees were linked to the Aceh Sumatra National Liberation Front [ASNLF] and prevailed upon the Malaysian government to deny them sanctuary.<sup>49</sup> After the Acehnese rioted in three detention camps and forced an embarrassing entry into the local UNHCR office the Malaysian government was not inclined to disagree with the Jakarta government and in March 1998 announced their deportation.<sup>50</sup> In another case Thai Foreign Minister Surin Pitsuwan complained of a huge flow of Myanmarese refugees into Thailand which he said amounted to "interference."<sup>51</sup> Nonetheless, refugees have not become critical issues for the ASEAN governments yet though all governments are concerned about the economic stability of China with the understanding

that should it falter massive and unprecedented levels of refugee flows would be stimulated. This is indeed a real concern.

### *Mixed impact*

The impact of the crisis is unclear but there is no identifiable slide towards a critical instability. Negative trends identified have existed even before the outbreak of the crisis and the process of analytical separation would in some cases be fruitless. In terms of the four points raised for analysis there has been major concern in the case of two – China and Indonesia – but to a qualified degree. China's position in relation to the region may have been strengthened in the short-term but with few real gains for Beijing. The Taiwan issue is largely independent of the financial crisis as both Beijing and Taiwan have been relatively less affected. China's encroachment into the South China Sea began well before the outbreak of the crisis as shown by the Mischief Reef incident of 1995. The attempt to exploit Philippine vulnerability in 1998 may have been related to the financial crisis but Manila has sought to strengthen its relationship with the US as a result. Moreover, China itself may face the delayed effect of the financial crisis which could immobilise its government and render it less capable of offensive action. In this case China as well as the affected ASEAN countries may become preoccupied by internal affairs and like Indonesia may face the prospect of social chaos.

Secondly, Northeast Asia has shown signs of tensions created by North Korea's BM program but there have been positive trends as Japan and South Korea co-operate more closely. Thirdly, Indonesia's political stability has been troubling the region but a wholesale collapse into chaos is unlikely as the country adjusts to its new situation. Indonesia's political transition along the path of democratisation has been an inevitable but delayed journey and has been hastened by the financial crisis. Finally, in terms of inter-state relations the cases of Thailand, Malaysian and Indonesia-Singapore were examined.

In Thailand's case there has been no evidence of deterioration in relations with neighbours but in Indonesia-Singapore relations there has been some concern about a revival of suppressed animosities and conflicts.

Economic interdependence has not been the only force that has created regional cohesion and it would be fallacious to assume that reduced levels of economic growth as a product of crisis would automatically result in tensions or conflict. The national leaderships of the countries concerned are aware of the dangers of heightened tensions and conflict and in no case can an eruption of imperialist ambitions, or the desire for conquest be identified. The crisis if anything has had the effect of making leaders acutely conscious of vulnerability and fragility as regional political systems are in the main brittle and friable. The ability of these still developing political and social structures to withstand the fragmentary forces released by economic deterioration is indeed limited. This awareness of weakness is a factor stimulating the development of security interdependence which may accompany and can be strengthened by economic interdependence but sometimes may develop independently. The early history of ASEAN has illustrated that crisis may compel governments to pursue institutional strategies to ensure security in the absence of significant economic interdependence.

### **Impact upon Asia-Pacific institutionalism**

The last decade has been significant for the development of institutional structures in the Asia-Pacific region which have brought greater stability and predictability to inter-state relations. Institutions offer governments a more acceptable path for the pursuit of their interests and allow them the opportunity to co-ordinate actions with other states. As Robert Keohane has explained institutions affect the costs associated with independent actions that governments may be tempted to pursue which may be destabilising for others.<sup>52</sup> In this sense institutions are communication channels which provide

governments with responses to possible actions undertaken. They may steer and direct the policy-making process towards actions that are more acceptable to others and less likely to provoke conflict or to raise tensions. In the Asia-Pacific region institutions have had considerable impact upon inter-state relations and facilitated the development of norms of consultation as a first step towards the wider dissemination of norms of accommodation. APEC which was promulgated in November 1989 faces an uncertain future in terms of trade and investment liberalisation but it has acted as a forum where the US, Chinese and Japanese leaders can meet. The ASEAN Regional Forum [ARF] first met in July 1994 and has been criticised for inactivity but it has at least communicated to China the views of other governments over the South China Sea. In the view of ASEAN officials the ARF has influenced China's behaviour in a more positive direction over this issue.<sup>53</sup> ASEAN has emerged as a meaningful conflict resolution vehicle in Southeast Asia providing a political context for the accommodation of Thailand, Vietnam and Cambodia after the ravages of the Cambodian conflict over 1979-89.

Asia-Pacific institutions may be expected to contain the worst effects of the financial crisis for regional security and without them some of the dire predictions expressed may have been closer to reality. There is the concern, however, that the financial crisis may have exposed the weaknesses of Asia-Pacific institutionalism in which case the cushioning effect may be less in evidence than anticipated. Governments may be less willing to consider concessions in terms of tariff reductions and market entry and may be compelled by domestic pressure groups to become more protectionist. Concealed protectionism may come to influence government behaviour and may have an impact upon policies of accommodation in other areas that affect security relations. The concern is that a rupture in economic interdependence may imperil security relations as well.

In terms of tariff reductions APEC has become stalled over the Early Voluntary Sectoral Liberalisation [EVSL] plan at the November 1998 Kuala



Lumpur APEC meeting of heads of governments. Under the EVSL agreement the 21 APEC governments were expected to subject nine economic sectors to accelerated tariff reductions but faced resistance from Japan which refused to open up two sectors – forestry and fish products. The Kuala Lumpur meeting decided to refer eight products to the WTO negotiations which were scheduled for November 1999. Tariff reductions over another six sectors, oil seeds, food, rubber, fertiliser, aircraft and automobiles were similarly deadlocked. At the Auckland meeting ministerial meeting of July 1999 Japan and South Korea both resisted pressure to open up two sectors –oil seed and food– with the result that ministers referred this issue to the WTO as well.

Progress under APEC has slowed and if this trend continues the institution may lose credibility amongst governments. A gulf has emerged between APEC business leaders who have been pressing for faster tariff reductions and governments which are accountable to a larger constituency and varied domestic interests. It is difficult to separate analytically the effect of the currency crisis upon this organisation as it may be argued that tariff reductions would have faced eventual resistance from Japan and South Korea in any case. Nonetheless, the financial crisis probably has made the Japanese and South Korean governments more responsive to domestic interests and protectionist sentiment though this cannot be proved with any degree of certainty. Moreover, within APEC there has been criticism of the US and the anti-dumping measures which have been levied against Japanese steel exports to the US as well as the demand for punitive tariffs on New Zealand's exports of mutton. Particularly within Japan these measures have been regarded as concealed protectionism and undermines the US insistence upon free trade and tariff reductions in negotiations with the Japanese. As Asian economies take advantage of lower exchange rates for their currencies to export their way out of the financial crisis protectionist sentiment may be kindled in Congress.

ASEAN economic co-operation has been vigorously promoted by member governments as a response to the crisis though some governments appear less

willing to meet AFTA targets. Malaysia's Special Functions Minister Tun Daim Zainuddin thought that the AFTA deadline should be delayed to allow the country to recover and to allow time for the exchange rate and capital controls introduced in September 1998 to have effect.<sup>54</sup> Singapore proposed that the deadline for AFTA be brought forward as Prime Minister Goh Chok Tong explained, "to send a powerful signal to international investors of the determination of the ASEAN countries to open their economies to trade and investments."<sup>55</sup> The Thai government called for the removal of all tariffs and demanded the abolition of the sensitive list to demonstrate the effectiveness of AFTA in a time of crisis.<sup>56</sup> The Hanoi ASEAN summit of December 1998 agreed to bring forward the AFTA deadline from 2003 to 2002 and to expand the liberalisation of services beyond previously agreed areas. The Indonesian government continues with its pre-Habibie commitments to AFTA deadlines and officials say that they have received no instructions to the contrary from the political leadership.<sup>57</sup> There have been indications that business groups in Indonesia would prefer a postponement of tariff reduction commitments until after the economy recovers but so far government policy has not been affected by such sentiment.

If the financial crisis continues economic co-operation in APEC and ASEAN may be affected in the way outlined above but security institutionalism may be strengthened as a consequence. As governments become aware of the negative impact of the economic downturn they seek assurances from neighbours in relation to worst case scenarios and to maintain the benefits of a stable and predictable environment. Consultation within institutional frameworks becomes more important for this reason in which case the pressure arises to expand the functions of institutions already established or to create new variants. Japanese Foreign Minister Masahiko Komura has proposed a Northeast Asia forum that would embrace the six regional actors and which would focus upon security issues.<sup>58</sup> The idea of a Northeast Asia forum had been raised previously in second track circles but the public proposal by a

foreign minister was indicative of a greater need for institutional structures in a time of uncertainty.

## **Conclusions**

This study has examined the impact of the financial crisis in the following stages. First, there is the issue of the extent and duration of the crisis given the view that the Asian economies may improve and undertake the necessary process of self correction in which case the impact upon Southeast Asia would be slight. Secondly, there is the assumption that an economic crisis would result in a deterioration of the strategic environment around Southeast Asia and the eruption of dormant animosities and conflicts. This causal connection is not automatic. A concern for vulnerability and an awareness of the consequences of instability is likely to prompt governments to strengthen institutional structures, and to contain the effects of an economic downturn. Already in the Asia-Pacific region patterns of consultation and institution-building have been formed which will probably be boosted by governments that seek to avert the dangers of an economic collapse. For these reasons an Asia-Pacific economic downturn is likely to contribute to the development of institutionalism and security interdependence as a necessary complement to the economic interdependence that has developed over the past decade.

## Endnotes

- <sup>1</sup> See Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time*, Beacon Hill Press, New York, 1957.
- <sup>2</sup> On the East Asian economic model see F. Gerald Adams and Shinichi Ichimura [Editors], *East Asian Development: Will the East Asian Growth Miracle Survive?* Praeger, Westport, Connecticut, 1998, Ross H. McLeod, Ross Garnaut, *East Asia in Crisis: From Being a Miracle to Needing One?* Routledge, London, 1998.
- <sup>3</sup> Paul Dibb, David D. Hale and Peter Prince, "The Strategic Implications of Asia's Economic Crisis", *Survival*, vol. 40, no. 2, summer 1998.
- <sup>4</sup> Paul Krugman, "Recovery? Don't Bet on It", *Time*, 21 June 1999. See also Clyde Prestowitz, "The Coming Asian Crisis", *Far Eastern Economic Review*, 19 August 1999.
- <sup>5</sup> See *Asian Development Outlook 1999*, Asian Development Bank, Oxford University Press, 19 April 1999 pp. 6, 7, 24; also *International Herald Tribune*, 20 April 1999.
- <sup>6</sup> Stanley Fischer, *The Asian Crisis: The Return of Growth*, speech delivered to the Asia Society, Hong Kong dated 17 June 1999. [<http://www.imf.org/external/np/speeches/1999/061799.HTM> accessed 9 August 1999]
- <sup>7</sup> *World Economic Outlook, May 1999*, International Monetary Fund, Washington DC.
- <sup>8</sup> Michel Camdessus, *Governments and Economic Development in a Globalised World*, remarks at the 32<sup>nd</sup> International General Meeting of the Pacific Basin Economic Council, Hong Kong, 17 May 1999. [<http://www.imf.org/external/np/speeches/1999/051799.HTM> accessed 9 August 1999]
- <sup>9</sup> *Indonesian Observer*, 24 July 1999.
- <sup>10</sup> *Jakarta Post*, 11 March 1999.
- <sup>11</sup> *Jakarta Post*, 25 February 1999.
- <sup>12</sup> *International Herald Tribune*, 7 October 1998.
- <sup>13</sup> *Euromoney*, April 1999.
- <sup>14</sup> The IMF has claimed that Thailand may be recovering on the basis of first quarter growth which was a reported 0.9%. Thailand's Deputy Prime Minister and Commerce Minister Supachai Panitchpakdi declared that the "the IMF is confident that Thai GDP will expand more than 1%". See *International Herald Tribune*, 19 August 1999, *Bangkok Post*, 7 July 1999.
- <sup>15</sup> *International Herald Tribune*, 3 August 1999.
- <sup>16</sup> *Straits Times*, 6 November 1998.
- <sup>17</sup> *Straits Times*, 10 November 1998
- <sup>18</sup> *Straits Times*, 23 December 1998
- <sup>19</sup> *International Herald Tribune*, 13 April 1999.
- <sup>20</sup> *Economist*, 14 February 1998
- <sup>21</sup> *Far Eastern Economic Review*, 10 December 1998.
- <sup>22</sup> *International Herald Tribune*, 24-25 July 1999.
- <sup>23</sup> *International Herald Tribune*, 1 July 1999.
- <sup>24</sup> *Japan Times*, 6 August 1999.
- <sup>25</sup> Christopher B. Johnstone, "Strained Alliance: US-Japan Diplomacy in the Asian Financial Crisis", *Survival*, summer 1999.
- <sup>26</sup> *Jakarta Post*, 4 June 1998
- <sup>27</sup> The UN Food and Agriculture Organisation and the World Food Program predicted in April 1998 that over 7 million people could starve in Indonesia unless the international community took action. *Straits Times*, 21 April 1998.
- <sup>28</sup> The "Declaration for Saving the Indonesian Economy" was signed by Anwar Nasution, Sjahrir, Mari Pangestu, Thee Kian Wie, Rizal Ramli, Faisal Basri, Didik J. Rachbani, Arier Arryman, Umar Juoro, Rozy Munir, Revrison Baswir, Angito Abimanyu, Ari Kuncoro, Chatab Basri, Sri Mulyani. See *Jakarta Post*, 7 August 1998.
- <sup>29</sup> *Far Eastern Economic Review*, 13 May 1999.

- <sup>30</sup> *Jakarta Post*, 17 February 2000.
- <sup>31</sup> *Straits Times*, 29 April 1999.
- <sup>32</sup> On Abdurrahman Wahid's political background see Douglas E. Ramage, *Politics in Indonesia*, Routledge, 1995
- <sup>33</sup> Amien Rais and Abdurrahman Wahid have both accused the military of provoking these disturbances. See *Straits Times*, 27 January, 2 February 1999, *Antara*, 21 January 2000.
- <sup>34</sup> *Jakarta Post*, 29 February 2000
- <sup>35</sup> *Japan Times*, 26 January 1999.
- <sup>36</sup> *Bangkok Post*, 1 June 1999.
- <sup>37</sup> *Straits Times*, 17 March 1999.
- <sup>38</sup> *Bangkok Post*, 30 May, 29 September 1995.
- <sup>39</sup> *Bangkok Post*, 1 February 1998.
- <sup>40</sup> *Bangkok Post*, 24 January 1999.
- <sup>41</sup> *Far Eastern Economic Review*, 12 February 1998.
- <sup>42</sup> *Straits Times*, 6 October 1998.
- <sup>43</sup> *Straits Times*, 20 October 1998.
- <sup>44</sup> Ben Dolven, John McBeth. "Distant Neighbours", *Far Eastern Economic Review*, 9 July 1999.
- <sup>45</sup> *Straits Times*, 10 February 1999.
- <sup>46</sup> *Straits Times*, 24 December 1998.
- <sup>47</sup> *Straits Times*, 7 August 1998.
- <sup>48</sup> *Straits Times*, 24 February 1999. Bilateral trade statistics have been unpublished by Singapore as Indonesia has complained about smuggling.
- <sup>49</sup> *Straits Times*, 30 March 1998.
- <sup>50</sup> *Straits Times*, 2 April 1998.
- <sup>51</sup> *Straits Times*, 30 July 1999.
- <sup>52</sup> Robert O. Keohane, *International Institutions and State Power*, Westview Press, Boulder Colorado, 1989, p.5.
- <sup>53</sup> Interview source, Ministry of Foreign Affairs, Bangkok, Thailand, 30 July 1999
- <sup>54</sup> *Straits Times*, 6 September 1998.
- <sup>55</sup> *Straits Times*, 13 August 1998.
- <sup>56</sup> *Bangkok Post*, 8 December 1998.
- <sup>57</sup> Interview source, Ministry of Industry and Trade, Jakarta, Indonesia, 22 July 1999.
- <sup>58</sup> *Japan Times*, 4 June 1999.