LESSONS FOR INDIAN ECONOMY FROM THE RECENT SOUTH ASIAN FINANCIAL CRISIS

Meenakshi Rishi, Ph.D.,
Department of Economics, College of Business Administration,
Ohio Northern University, Ada,
OH 45810.

Kishore G. Kulkarni, Ph.D.,
Department of Economics, Campus Box 77,
Metropolitan State College of Denver, P. O. Box 173362,
Denver, CO 80217-3362.

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Introduction:

To some world economy observers the South-Asian economic crisis of 1997 took place as a surprise. There are also some other thinkers who believe that the price of mismanagement of resources is to be paid sooner or later. In case of some South Asian countries like Indonesia, Thailand and Malaysia the financial crisis has severely damaged economic progress and has eroded the gains from economic miracle that occurred in 1980s. There is however some doubt about the miracle itself (see Ryan (1999)). The main questions to be answered in all this fiasco are as follows: Are there any statistical signs that one can observe in the pre-crisis era? Can other economies (especially India) learn any lessons from this financial crisis? Are there any steps policy makers can take to avoid financial crisis?

We shall use the data of Indonesia, Malaysia, the Philippines, S. Korea and Thailand to observe any trouble signs before the onset of their financial crisis. It is important to investigate such economic indicators as total debt service paid in recent years, the commitments of repayment, interest paid on loans the duration on loans from abroad and the balance of payment changes in recent years. What is more important is to realize the exact sequence of events that led to crises in these countries. Are there any common events that afflicted all crisis ridden countries? Can India learn from the old mistakes of these countries? These are some other questions this paper intends to answer by comparing the economic situation in India with these five countries.

The paper is organized in the following manner: Section 1 uses the data of above mentioned economies and analyzes the trend in their economic indicators. Section 2 is devoted to Indian economy's relevant data and carry out the comparison of economic situation in India and the above mentioned countries. Section 3 summarizes the finding and carries out the conclusion.

Section 1: Financial Crisis in South Asian Countries

As mentioned before, we have selected 5 countries that were beset by the financial crisis in 1997 to observe the external debt related statistics. However before we look at their data it is necessary to summarize the general reasons for the financial crisis to get started. In 1980s all of these countries experienced a solid economic growth, measured in terms of any economic indicator e.g., decreased unemployment, general prosperity measured as the increase in real output, increase in standard of living measured by per capita income etc. The improved prosperity made expectational adjustment for investors all over the world as new capital investments started pouring in from all corners of the world. The capital inflows were matched by increased imports and increasing exports.

There was hardly anything thought to be going wrong in this scenario. Nonetheless, in early 1990s the exports could not keep up with the imports and all countries started running into the current account deficit. Most of the capital investments of 1980s started maturing with interest, dividends capital gains etc and countries that were finding it tough to finance their increased imports found it difficult to repay the capital gains. The prosperity of 1980s was therefore replaced by economic hardship created by capital inflows and increased imports. Until crisis situation was clearly envisioned in 1997, no one predicated that growth of 1980s was immizerising. Another important point about the recent crisis in Southeast Asia is that this took place even when countries had a balance of payment surplus, there was overall strength in the economies and unlike Mexican and other Latin American countries' cases this crisis was a crisis in abundance rather than shortage of financial capital. Several authors have recently attempted to summarize the exact causes of the Southeast Asian crisis. Talele (1999) claims that, "from 1980 to 1996 this region’s share of world output increased 17% to 25%”. Former Prime Minister of Singapore Mr. Lee Kuan Yew predicted a boom of 20 to 30 year sto this region in 1995. From 1994 to 1996 the U.S. exports to this region surged by 37%. The US exported to South Korea more than to Germany in 1995. All these developments go to show that this region was one of the most attractive places to invest for any financial investor. Nonetheless some things never change. As Talele points out even in 1928 Tassing’s feelings were appropriately summarized by his writings as follows:

“Loans from the creditor country begin with a modest amount, then increase and proceed to a crescendo. They are likely to be made in exceptionally large amounts towards the culminating stage of a period of activity and speculative upswing continues. With the advent of crisis, they are at once cut down sharply, even cease entirely. The interest payments on the old loans are no longer offset by any new loans; they become instantly a net charge to be met by the borrowing country. A sudden reversal takes place in the debtor country’s international balance sheet; it feels the consequences abruptly, in an immediate need of increased remittances from creditor country, in a strain on its banks, high rates of discounts (interest) and falling prices. And this train of events may ensue not only once but the final outcome, when this period of irregular movements has run its course, is also that the debtor country has more to remit on its interest account than to receive on principal account and that remittance is effected by an excess of merchandise exports over imports”. (See Taussig (1928, page 130, International Economics)).

Thus destabilizing capital inflows and outflows can occur that make the financial crisis inevitable. Ryan (1999) claims that crisis affected countries were not substantially (economically) weaker than non-crisis affected countries of Asia. There was no economic miracle in the first place hence in his opinion the crisis was completely explained by other than economic events. In fact he criticizes Krugman (1979) hypothesis which faults the money financed budget deficits for reserve depletion and eventual collapse of exchange peg. He also points out that some of the Southeast Asian countries tried to be models of fiscal prudence in anticipation of overheating due to capital inflows.

In a related explanation of the crisis Krugman (1995) summarizes his position as follows: "The newly industrializing countries of Asia, like the Soviet Union of the 1950s have achieved rapid growth in large part through an astonishing mobilization of resources. Once one accounts for the role of rapidly growing inputs in these countries' growth, one finds little left to explain" (page 6). Thus in his renewed position, Krugman claims that the tremendous increase in inputs is the main reason for rapid growth and the crisis is the result of diminishing returns to these inputs. Ryan shows that there is a little evidence to this hypothesis of Krugman in case of South Asian economic crisis.

At the outset of the crisis the trade deficit deepened, foreign debt burden increased the chain reaction began that culminated in the loss of investor confidence in these countries. The Mexican crisis of 1994 was not very different than the chain of events that made explosion in South-east Asia. In fact as Ryan puts it, an article in The Australian explained the similarities between Mexican situation and South-east Asian situation as early as in 1996. "A massive current account deficit, a crippling foreign debt burden and excessive monetary growth encouraged speculators to attack its currency. This is a description of Mexico before its financial meltdown in December 1994 but could now sum up several fast growing Asian economies. Thanks to economic woes and political turmoil, the currencies of Thailand, Malaysia and Indonesia have all been attacked this year" (The Australian, September 4, 1996, page 39). Soon after this warning, the crisis of July 1997 ensued.

Assuming this idea of the above quotation the Australian, we plan on carrying out a survey of the relevant data of debt ridden countries and India. The main idea is to find out if there are any red signals for the Indian economy in terms of debt trap. We therefore carry out the comparison of four countries Thailand, South Korea, Philippines and Malaysia and compare their numbers with the India's economy data in terms of the external borrowing, balance of payment deficit and the debt burden. We also would investigate if the debt of Indian economy is of short term or long term nature and if the debt is generated from several sources or from only few.

Section 2: India's Case in Comparison With Other Debt Affected Countries

To date the Indian economy has successfully escaped the financial crisis thanks- as some would argue -to the strict financial control, a responsible monetary policy, stable even if increasing trade imbalance. Nonetheless the trend of Structural Adjustment Programme started in 1991 and continued with increased capital inflow as well as increased imports leading to the increase in deficit in trade balance are worrisome points for some economists such as Parchure (1998). As Parchure mentions "Any country which is internationally indebted and whose current account is in deficit is already in crisis. If, in addition, the government of that country has tacitly or explicitly promised her citizens and /or international investors to maintain the external value of her currency, the crisis can be precipitous" (Parchure in the reading list, page 15) Moreover according to Parchure all the balance of foreign reserves with the Reserve Bank of India is illusionary since it is only the borrowed money from outside and does not constitute the real earnings of the country. Thus for him the crisis is looming around Indian economy's neck and to get out of that like Kulkarni (1997) he suggests the devaluation of Indian rupee to the degree that the rupee will be determined slowly by the market forces rather than the policy authorities in New Delhi.

To make some comparisons with the debt affected countries, consider table 1 that lists the debt service paid (and for some years debt service due) in each of the five above mentioned countries and India for the period of 1980-1996. Clearly for Indonesia this figure has increased tremendously after 1987 since it almost doubled in 7 years from 1987 to 1994 and reached to $21.45 billion in 1996. While Malaysian, Philippino, S.Korean figures were less reason for an alarm, the Thai case is again quite serious since the figures almost doubled in 1992-1994 period and reached to high $8.652 billion in 1996. Indian case is somewhat worrisome in this respect. India's debt service paid had increased substantially in 1986, stayed at high number (approximately $5.6 billion) in 1987 and 1988 and then increased much faster upto 1995.

In 1996 the total debt service paid reached to $12.66 billion. One question is if the country is paying higher and higher amounts of its debt service, is it an encouraging sign or is it a danger signal? The answer is is somewhat "both". If higher debt service paid is paid then it shows the increasing capacity of the country to repay all her loans. It also means the world believes in the country and therefore there is a greater supply of loans moving to her. Hence in some way it is a sign of increased confidence of the world in the country. But on the other hand increased debt service also means that the country is required to pay a greater amount to the rest of the world hence it is a sign of weakness that higher and higher amounts are needed to be borrowed from the rest of the world. In case of India the increased debt service payments can be taken a s a sign of greater strength rather than weakness because after 1991 the outside world has a more optimistic view of the Indian economy thanks to the openness initiative started in 1991. In conclusion one can observe from Table 1 that the debt service paid by India is more in tune with the figures of Indonesia rather than with those of Malaysia, S. Korea and the Philippines.

Table 2 reports the total debt stocks of the countries as a percentage of their respective GNP (or GDP). Clearly lower is this percentage greater is the chance that economy will be in comfortable shape to repay any or all of her debt to the world. As a percentage of her GDP India has been successful in keeping this percentage low right from the first year observed in this data series. In fact the highest figure of 36.3 was reached only in 1993 but then it declined significantly to 25.6 in next three years. It appears that the debt affected counties data show that this percentage is kind of crucial in terms of predicting economic illness. Observe that all countries have a greater increase in this figure when economic crisis started looming in their region, except in case of S. Korea. In case of Indonesia the percentage of GNP in debt stock increased to 73% in 1987 (from 52% in 1986), the highest number and then stayed at a high number throughout the data period. Similarly in Malaysia this percentage increased to 84 percent in 1986 and rarely went below 60%. In case of the Philippines again 1986 was the critical year. This percentage increased to 96 in 1986 and stayed very high up to 1993 even though it moderately went down in next three years. In case of Thailand there is a steady increase in this percentage reaching to 50% in 1996 from 25% in 1980. Table 2 therefore shows that the common element in all the debt affected countries is that the very high percentage of GNP in total debt stock is a dangerous sign of crisis appearing in the future.

Even if India has not experienced a very high percentage of GNP in total debt stock in recent years, she has seen it reach to as high as 36% in 1993. Nonetheless the overall performance of Indian economy in this respect is satisfactory. Table 3 shows two ratios: short term debt to the total debt of the country and short term debt to the export earnings of the country. In either cases the higher values of these ratios indicates a sign of danger for the economy. Clearly long term debt is preferred to a short term loan since in the long term the borrower gets more time to adjust his/her repayment capability and as a consequence the long term loan typically have a smaller risk of default. Similarly greater are the export earnings in comparison to the short term loans borrowed, greater is the ability of the country to repay her debt. As can be seen in table 3 Indonesian economy has done a miserable job of keeping these ratios low. These ratios not only increased in the data period but also reached to their highest figures in the years just before the crisis erupted in Indonesia. The ratio of short term debt to the export earnings reached to 50% in 1996—a fact that should have been clearly worrisome for any observer. In case of Malaysia the situation is not as grave as in case of Indonesia however. Both these ratios in Malaysia became higher before crisis but the numbers were not as frightening. Still it appears that these ratios are a good indicator of the crisis to come. Thailand's situation re-enforced the same fact. It shows a tremendous increase in these ratios from 19913 onwards. It however had high figures for the short term debt as the ratio of export earnings in 1980s which subsided in late 1980s but re-emerged in early 1990s.

The cases of the Philippines and S. Korea stand differently than the cases of Indonesia, Thailand and Malaysia in this respect. The data for S. Korea for years 1995 and 1996 do not exist, but up to 1994 surprisingly it shows a decline in the ratios of short term loans as a ratio of total debt and export earnings. In case of the Philippines these ratios are admirably very low. These two countries suffered from mild economic crises despite these ratios of short-term debts. In case of India the short-term debt as a ratio of total debt is extremely low which is a good sign. But observe the tremendous increase in the ratio of short-term debt as a percentage of export earnings in 1995. This may be the result of new initiatives created by the government to enter into commercial borrowing, allowing international financial institutions to enter in financial market ands the wave of selling short term bonds to the non-resident Indians (NRIs). In any case the increased ratio of short term debt to the export earnings should cause some concern to the economic observers of the Indian economy.

If a country borrows debt from others it is beneficial to at least borrow the debt that can be classified as the "concessional" debt that may have fewer strings attached to its repayment. Hence a higher percentage of concessional debt in the total debt is seems as a beneficial sign for country's external debt. A greater share of concessional debt also provides a country a better management of its economic situation. Table 4 indicates that India has done a stupendous job of acquiring more debt in terms of concessional debt than any other country we studied up to the year 1994. Clearly higher are the numbers in Table 4, better it is for the economy to manage the external debt. While in cases of Indonesia and Thailand there is a slow reduction in concessional debt, in cases of Malaysia and S. Korea these ratios have stayed pretty steady. In case of the Philippines this ratio of concessional debt has steadily increased. But Indian case is most impressive of all, at least until 1994. In the last two years of data series however, the Indian situation has considerably weakened. While this may cause some concern to some observers we think that this decline in is attributed to the higher increase in total external debt in the country (denominator) rather than actual decline in concessional debt (numerator). Given the political situation in the country in the last two years and the Indian stubborn actions in terms of nuclear blasts etc. the concessional debt in the future can be interesting area of observation for India. Obviously a sustained decline in this ratios is a danger sign of loss of confidence by the rest of the world in the economy.

It is seen as a beneficial thing for a borrower to borrow from as many sources as possible rather than borrow from only one lender. Hence debt coming from multilateral sources is much better than the debt coming from only few sources. This indicates that more lenders re willing to lend a country and there is a greater confidence in her ability to repay. In this respect India has done an impressive job in attracting debt from multilateral sources in the given time period and compared to debt affected countries.

Table 5 reports the multilateral debt as a percentage of total external debt of the country. Higher percentage is seen as a better sign. India's percentage has steadily increased even in the latest years of 1993 onwards. Hence it is clear that India is able to attract debt from multilateral sources. The case can not be repeated for Malaysia, Indonesia, S. Korea, or Thailand. They all have a very low percentage of multilateral debt as a percentage of their total external debt. India seems to have done very good job in this respect.

Another important criterion for well management of economy's external debt is to get the loans of long term rather than short term nature. Hence we observed the average terms of new commitments that economies have made over the period of time. In Table 6 one sees the maturity periods of the external borrowing in years for all the debt affected countries and India. Again India seems to be in a comfortably different position than the debt affected countries. Especially in 1980s the Indian average term of new commitments is much higher (some times two to three times better) than the remaining five countries. Indonesian, Malaysian, the Philippino, and Thai average term of new commitments is somewhat same at the 15-21 years. Hence their borrowing comes with the time limitations of that duration. In case of S0 Korea the debt commitments are even shorter than 15 years, especially after 1990. One striking observation is that when country's new commitments become shorter and shorter for their repayment, the crisis looms around the corner. Yet, using this criterion, the Indian average time commitment for debt repayment is observed to be becoming less long term in recent years. Even if there is a room to catch up with the low figures of 11-15 years of the rest of the debt affected countries, Indian economy unfortunately is borrowing at a shorter duration in 1996 than in whole decade of 1980s.

Just like average time of borrowing is crucial also important is the interest rate paid on the new borrowings.

Table 7 records the interest rates paid by these countries on the new commitments from official creditors as well as private creditors. Indian economy seems far away from (and looks in much better shape than) in terms of the comparison. While India in 1996 has paid average interest of 4.5% to official creditors, 5.5% to the private creditors and 4.8% to all creditors taken together, other countries have paid much higher interest rates in the same time period. Indonesian economy has paid as high an interest rate as 12.4% to private creditors in 1980 and has been able to secure credit from official creditors at 4.9% in 1988 and in 1993. The Malaysian economy has been able to borrow at the lowest rate of 3.4% from official creditors in 1995 but has also paid as high as 14.1% to the private creditors in 1980. In case of the Philippines the smallest interest paid is to the official creditors at 4.6% in 1988 but it also had to borrow at 14.5% from private creditors in 1981. S. Korea paid smallest interest rate to the private creditors at 5.6% in 1993 and its highest interest payment was to the private creditors at 14.1% in 1980. Thailand's highest interest rate paid was to private creditors at 13.8% in 19080 and its lowest was at 3.6% to official creditors in 1991. Indian economy's lowest interest rate was available in 1980 at 2.10% from official sources and highest was 15.5% from private creditors in 1980. However the recent years performance of the Indian economy is very encouraging compared to the debt affected countries.

Table 8 shows the ratio of interest payments to export earnings, and in case of India this ratio is much higher than other countries especially in recent years. This can be taken as a disturbing thing for economic observers. The higher ratio obviously means the economy is paying more interest than other economies. Table 8 indicates that India has consistently paid more interest than other debt-affected economies. Malaysia has done an impressive job since in 1995 and 1996 its ratio of interest payment to export earning is no greater than 2%. The only economy as bad as India is probably the Philippines which had this ratio as high as 30% in 1982. While India's ratio has never reached greater than 18.2% (in 1990) it has not reached below 4.2%. One relieving fact is that the ratio of interest payment to the export earnings for India has gotten lower in very recent years of the data series. In fact from 1990 it has steadily declined and 8.5% in 1996 was its lowest number after 1990.

We present the data in Table 9 as the summary of the arguments so far. Table 9 reports the present value of external debt as the ratio of export earnings and percentage of GNP. In this analysis the Indian economy's performance at best is mixed. For time period of 1992-1994, Indian economy's figures were not as impressive as those of remaining five debt affected economies. Her shares of external debt as a percentage of export earnings as well as GNP were greater than all other countries. However in 1994-1996 period, (excluding S. Korea whose data were not available) India's shares were more impressive than only Indonesia and the Philippines. Hence Thailand and Malaysia have done better in terms of managing their external debt in comparison to their export earnings and their GNPs than India after 1992. Hence as a policy step India should manage her external debt much better than she has been to make it a less threatening scenario. This leads us to the summary and conclusion section of this study.

Summary and Conclusion:

We began this study to compare Indian economy's performance with that of other debt affected South East Asian economies. The comparison was supposed to have given us an answer to the question of proximity of financial crisis for the Indian economy if at all such a crisis was brewing. Our analysis points out that the debt affected countries had a sustained balance of trade deficit that got out of hand in years before crisis hit them. Second, the short term borrowing to finance the trade deficit was another bad step these countries took, and the increased financial flows were mismanaged by them in terms of allowing the domestic money supply to grow leading to the severe devaluation of the domestic currencies. The confidence problem is another reason for the crisis in South East Asia. The comparison of statistic show that while India is no where close to having a financial crisis to hit her, there are some concerns such as the interest payments a s a proportion of export earnings are going. In summary, we think that in comparison to the crisis affected countries India's economy is managed well.