Asia's Economic Crisis:
Its Causes And Impact On The Saudi Economy

Abulkalam Abdul Momen

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Abstract

The paper describes in detail the chronological events, the causes and impacts of the Asian crisis on the affected countries, namely Thailand, Indonesia, Malaysia, South Korea and the Philippines. It tries to identify its likely impact on the Saudi economy. It also provides certain policy recommendations to avoid recurrence of such bubble burst.

الأزمة الاقتصادية الآسيوية :
مسبباتها وآثارها على الاقتصاد السعودي

عبد الكلام عبد المؤمن

ملخص

تتناول هذه الورقة بالتفصيل، التسلسل التاريخي للأحداث، من حيث أسباب الأزمة الاقتصادية الآسيوية والآثار المترتبة عليها، على الأقطار المتأثرة بها وهي : تايلندا، أندونيسيا ، ماليزيا، كوريا الجنوبية والفلبين. كما تحاول الورقة تشخيص الآثار المنتظرة أو المرجحة على الاقتصاد السعودي. كما تقدم توصيات سياسة محددة لتجنب تكرار مثل هذه الأحداث التي تبرز للعيان بشكل مفاجيء .

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Introduction

In this world of economic inter-dependence, globalization, super-highway technology, unfettered media coverage, and virtually barrier-free flow of international financial investment, any major economic crisis in one region or economically dominant country invariably will affect other economies. In fact, no country is immune to the effects of the recent Asian turmoil. However, the magnitude of the impact will vary depending on their individual trade, investment and financial relationships. Although Saudi Arabia's trade relationship with the affected countries has been increasing steadily, it does not have a significant investment relationship with the affected countries and therefore, its direct and immediate impact on stock market and exchange rate is likely to be very low.

Aided by high international oil-price in 1996-97, Saudi Arabia has been able to reduce its fiscal deficits, settle government arrears payments to the public sector, maintain low inflation, and generate a surplus in its current account balance for the year. More importantly, it could take corrective measures to strengthen the structure of its economy, particularly in the fiscal and financial sectors. These developments, together with virtually non-existent external debts, stable currency, low inflation, and liberal trade and payment system, place the Saudi economy in a solid position to confront any incoming threats. Therefore, the Asian turmoil will not directly derail its development programs. Nevertheless, its cumulative effects, both direct and indirect, may slow down the current growth, and may increase the nation's budget deficit for 1998 and 1999. In fact, it may reduce the nation's GDP growth rate by 1.0 to 2.2%.

The Saudi economy is still highly dependent on the vagaries of global petroleum price in spite of the fact that its non-oil sector's contribution to the export earnings has increased from a meager 1% in the 1970s to 33% in 1997. Its non-oil export growth has also increased by a spectacular 212% over a ten year period. As the global petroleum price may decline due to indirect effect of the Asian turmoil, coupled with the direct effect of the Iraq's oil-for-food deal, unusually warm weather in the West and huge oil stock, the Saudi economy may face some economic hurdles. Already, the global oil price has recorded a sharp downturn. This is a matter of grave concern as this may reduce its oil revenue by around 5 to 10% causing increasing budget deficit.

Saudi Arabia's exports to the troubled economies account for 14% of the nation's total exports in 1995. However, the average for the period from 1992 to 1995 was 11.8 %. If Singapore and Japan are included, this accounts for 39.2% of the nation's exports. As the bulk of the Saudi exports to the troubled economies comprise intermediate products which are generally essential items, and therefore, in spite of their credit crunch and depreciation of currencies, their decline in import of Saudi products is likely to be of lower magnitude. Nevertheless, it will have a measurable impact unless corrective actions are immediately taken.

This paper is designed to evaluate the impact of the Asian crisis on the Saudi economy in particular. However, it also summarizes the causes of such crisis with a view to understand lessons from the crisis.

Major Causes of the Current Crisis

Although the Malaysian Prime Minister, Mahathir Mohammad, blasted currency trading as immoral and blamed the currency speculators particularly George Soros, (an American investment banker) for the current financial crisis in Asia, the actual causes are numerous. Economic indicators such as rapid GDP growth rate, low inflation rate, excellent sector performance, employment, trade and foreign exchange regimes, accumulated current account deficits, fiscal and monetary policies, external conditions, weaknesses in financial and structural conditions, and more importantly, loss of confidence, are more pronounced. Domestic investors and residents seeking to hedge their foreign currency exposures, and in some cases, international commercial and investment bankers, appeared to have played the most important role in driving the domestic currencies lower. However, the missing link of the turmoil and its spill-over may be the erosion of confidence due to mistrust and lack of transparency in the financial sectors of the involved economies (Sachs, 1997).

Some dominant causes for the crisis are:

- Failure to dampen the over-heating pressures;
- Maintenance of pegged exchange rate regimes far too long that encouraged external borrowing thus leading to excessive exposure to foreign exchange risks in both financial and corporate sectors;
- Lax prudential rules and financial oversight leading to a sharp deterioration in the quality of banks' loan portfolios; and
- Rapid and uncontrolled foreign private borrowing. And once the spiral started,
- Lack of political assertiveness and commitment to take strong and quick measures; and
- Bureaucratic red tape exacerbated pressures on currencies and stock markets.

Although roots of the current crisis lie mainly in the countries that suffered the worst, there is no denying that developments in industrial countries and global financial markets significantly contributed to the build-up of the imbalance that eventually led to the current crisis. For example, weak growths in Japan, wide swings of the yen/dollar exchange rate, relatively low interest rates and accommodating monetary regimes in the advanced economies contributed to the worsening situation. The speculators and foreign investors also played a limited role and they equally suffered and incurred losses. The governments in several countries of both emerging and advanced economies, undertook to provide various guarantees for credits to encourage foreign creditors to lend larger amounts on more attractive terms and correspondingly encouraged domestic borrowers to undertake greater debt and foreign exchange risks. The cumulative effect of all these policies and lop-sided urban-based, capital-intensive development on borrowed technology and unsupervised foreign capital inflows, led to the current bubble burst and the crisis.

Rapid Economic Growth in Asian Countries

The average GDP growth rate in Thailand, Malaysia, Indonesia, and South Korea has been between 7.7 to 8.8% per annum for the period 1990-96 unmatched by other nations of the

world except China (10.5%) and Singapore (8.5%). It varied between 0.7 to 5.3% for the African nations, 4.1 to 6.8% for the developing countries, 0.8 to 2.9% for the advance economies, and 0.7 to 6.5% for the Middle East and European countries for the said period (Table 1 for details). Moreover, their inflation rates were also very low ranging between 2.8% and 9.4% for the same period (Table 2) In addition, their export growth rates varied between 6.3% to 15.4%, much higher than that of major industrial countries which varied between 2.3% and 8.3% during the same period (Table 3).

Table 1. Comparative Analysis of Real GDP Growth Rate of Troubled Countries and Other Selected Regions (1990-96)

Country	1990	1991	1992	1993	1994	1995	1996	Ave 1990-96
Thailand	11.6	8.1	8.2	8.5	8.9	8.7	6.4	8.6
Indonesia	9.0	8.9	7.2	7.3	7.5	8.2	8.0	8.0
Malaysia	9.6	8.6	7.8	8.3	9.2	9.5	8.6	8.8
South Korea	9.5	9.1	5.1	5.8	8.6	8.8	7.1	7.7
Philippines	3.0	-0.6	0.3	2.1	4.4	4.8	5.7	2.8
Singapore	9.0	7.3	6.2	10.4	10.5	8.8	7.0	8.4
China	3.8	9.2	14.2	13.5	12.6	10.5	9.6	10.5
Advanced Countries	2.5	0.8	1.7	0.9	2.9	2.2	2.5	1.9
Developing Countries	4.1	4.9	6.6	6.5	6.8	5.9	6.4	5.9
African Countries	2.3	1.7	0.7	1.0	2.6	2.9	5.3	2.4
Middle East Countries	5.6	3.5	6.5	3.9	0.7	3.5	4.6	4.0
Western Countries	1.1	3.6	3.1	3.6	5.0	1.2	3.5	3.0

Source: Compilation from the World Economic Outlook, Interim Assessment, IMF, December 1997.

Table 2. Inflation Rate of Affected Countries (1990-97)

Country	1990	1991	1992	1993	1994	1995	1996	1997	Ave 1990-97	1998*
Thailand	6.0	5.7	4.1	3.4	5.1	5.8	5.9	6.3	5.3	40
Indonesia	7.8	9.4	7.5	9.7	8.5	9.4	7.9	8.3	8.6	50
Malaysia	2.8	2.6	4.7	3.5	3.7	3.4	3.5	3.7	3.5	12
South Korea	8.6	9.3	6.2	4.8	6.3	4.5	4.9	4.3	6.1	25
Philippines	12.7	18.7	8.9	7.6	9.0	8.1	8.4	5.2	9.8	13
Singapore	3.5	3.4	2.3	2.3	3.1	1.7	1.4	2.1	2.5	
China	2.1	2.7	5.4	13.0	21.7	14.8	6.1	1.5	8.4	
Developing Countries	67.9	36.1	38.5	46.6	51.0	22.7	13.3	9.0	35.6	
Major Ind. Countries	4.8	4.3	3.2	2.8	2.2	2.3	2.2	2.0	2.9	

Source: World Economic Outlook, Interim Assessment, International Monetary Fund, Interim Assessment, December 1997.
*IMF estimates for 1998

Table 3. Comparative Export Growth Rate For Asian and Industrial Countries

(Annual Growth Rate %)

Year / Country	1990	1991	1992	1993	1994	1995	1996	1997*
Industrial Countries	6.8	5.1	4.4	2.3	8.3	7.3	4.7	6.6
Asian Countries	6.3	12.5	11.4	11.9	12.8	15.4	7.2	8.8

Source: World Economic Outlook, IMF, May 1997. * estimated

Such unparalleled and successful economic performance created great confidence in the East Asian economies. For example, the US-based credit rating agency; Moody's Investment, forecasted tough times for the Western nations due to their falling competitiveness and advised investors to invest in Asian nations. They rated South Korea in the first category (A1), Thailand and Malaysia in second category (A2), China and Hong Kong in the third category (A3) while Germany, UK, USA, Switzerland, Spain and Italy in the fourth category (Aa1). Table 4 shows these data.

Table 4. Comparative Analysis of Moody's Investment Risk Rating of Some Selected Countries

Country	Rating*	Country	Rating*
South Korea	**A1**	**Latin American Countries**	**B to Baa**
Thailand, Malaysia	**A2**	**Columbia, Venezuela**	**Ba1**
China, Hong Kong	**A3**	**India**	**Ba2**
Germany, UK, USA, Switzerland, Spain, Italy	**Aa**	**Philippines**	**Ba3**
Singapore	**Aa2**	**Czechoslovakia**	**Baa2**
Taiwan	**Aa3**	**Indonesia**	**Baa3**
Australia	**Aaa**		

Source: "Moody's Positive on Asia, Broadly Negative on West", by Luiselta Mudie, the Asia Business Journal, June 1-15, 1994. * Investment grade rating begins at Baa3.

As prospects were bright and risk was relatively low, and also due to myriad incentives offered by the Asian leadership, foreign investors and financial corporations directed their resources to the Asian economies. International Banks alone advanced $736 billion to the East Asian economies of which $261.7 billion only was directed to the affected countries (Table 5). Their external debt went up to $493 billion (Fig. 1) and foreign liabilities and private sector credit rose very sharply. For example, foreign liabilities of local banks in Thailand increased from 6.4% in 1990 to 24.5% in 1995 and growth rate of private sector credit rose from 20% in 1992 to 30% in 1994, more than twice of the growth rate of nominal GDP (Table 6). Moreover, instead of long-run direct foreign investment, most of these nations received short-term credits that resulted in current account imbalances. Such mounting current account deficits and short-term loans forced their many financial institutions, corporations and banks to declare bankruptcy. Soon, private borrowing became a public issue.

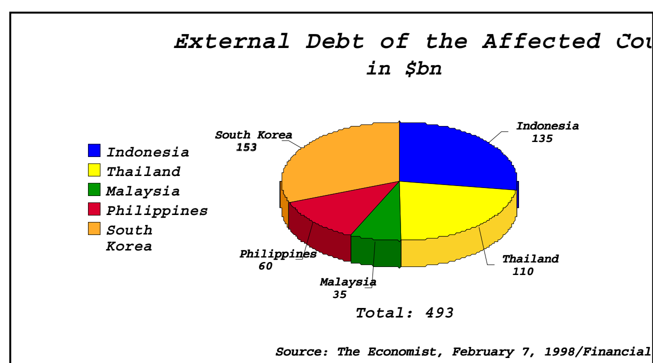

Figure 1.

Table 5. International Bank Lending to East Asia (Billion US $)

Country	US Banks	Japanese Banks	EU Banks	Total Int'l Lending*
Thailand	5.0	37.5	19.2	70.2
Indonesia	5.3	22.0	21.0	55.5
Malaysia	2.3	8.2	9.2	22.2
Philippines	3.9	1.6	6.3	13.3
Korea	9.4	24.3	33.8	100.5
Sub-Total	25.9	93.6	89.5	261.7
Singapore	5.7	58.8	102.9	189.3
China	2.7	17.8	26.0	55.0
Hong Kong	8.7	87.5	86.2	207.2
Vietnam	0.2	0.2	1.0	1.5
Taiwan	3.2	2.7	12.7	22.4
TOTAL:	46.4	260.6	318.3	736.6

Source: World Economic Outlook, Interim Assessment, December 1997, IMF, Washington, D.C.

Table 6. Foreign Liabilities of Banks in Asian Affected Countries
(% OF GDP)

Country	1990	1991	1992	1993	1994	1995	1996
Indonesia	11.0	8.6	10.3	10.9	10.9	9.6	8.5
Thailand	6.4	6.0	6.9	11.7	20.3	24.3	23.3
Malaysia	7.3	9.0	13.0	19.5	8.8	6.5	-
Korea	6.5	7.7	7.6	6.9	8.0	10.1	12.8
Philippines	14.9	11.5	12.9	10.9	12.3	13.9	21.9
China	3.5	4.6	4.0	5.4	7.1	6.4	5.6
Singapore	3.9	33.6	35.3	34.8	35.6	35.2	36.4

Source: World Economic Outlook, Interim Assessment, International Monetary Fund, December 1997

Macroeconomic Management and Exchange Rate Regimes

The second set of factors that led to the build-up of the Asian crisis refers to shortcomings of their macroeconomic and exchange rate policy management, particularly in the context of the pegged or relatively fixed exchange rate maintained by most of these countries. For example, the Thai currency was unrealistically pegged to hard currencies, and local interest rates were high. Due to the peg, businessmen were able to borrow huge amounts of foreign currency denominated funds at unrealistically cheaper rates. For example, relatively high domestic interest rates and other incentive package doubled Thailand's foreign exchange reserves between 1992 and 1996 and at the same time, commercial banks' foreign liability increased from $5 billion to $46 billion. There were also clear signs of asset price inflation, including real estate markets. The interrelated problems of overheating, excessive credit growth and large capital inflows were not effectively pursued upon on a timely manner by the leadership (Vatikiotis, 1998).

Financial and Other Structural Weaknesses

The third set of factors that led to the Asian crisis pertains to: (a) lack of transparency, (b) poor corporate governance and inadequacies in the regulation and supervision of financial institutions, (c) limited experience in pricing and managing risk, (d) lack of commercial orientation, (e) lax internal control, and (f) imprudent lending practices. In addition, continuous denial of the seriousness of the problems aggravated the situation. In fact, currency markets quite often dance to the statements made by politicians and other responsible decision-makers and rumors of all sorts generally put fire on the currency markets. In non-transparent economies, rumors crop up quite often and generally they are pretty wild.

In Korea, large corporate conglomerates (*chaebol*) are heavily dependent on debt as opposed to equity finance. The vulnerability of the banking sector was increased not only by large exposures to *chaebol* but also by politically influenced lending. Large amounts of short-term foreign currency were taken by Korean financial institutions to provide finance for Korean enterprises at home and abroad, little of which had been hedged. Due to such irregularities, at the end of 1996, banks' non-performing loans and net of reserves, were already equivalent to 70% of their equity. True asset quality may have been much worse (IMF, 1997, p 13). As the global market was flooded with excessive supply of computer chips, the stock market price of Korean chips plummeted and many factories declared bankruptcies. Such bankruptcies severely weakened the financial system. At the same time, steep declines in stock prices cut the value of banks' equity and further reduced their net worth.

In Thailand, inefficiencies in financial systems stemming partly from constraints in competition, contributed to relatively high lending rates. This, together with exchange-rate policies, encouraged borrowers to seek funds abroad.

Structural weaknesses outside the financial system

- In Korea - lack of market discipline contributed to excessive and unproductive investment. Prime example of crony capitalism and government intervention is Sammi Steel, Korea's biggest specialty steel-maker. Banks were forced to lend credit to Sammi Steel until it closed down.
- In Indonesia - trade restrictions, import monopolies and corrupt political contacts and cronyism especially in public sector expenditure, impeded economic efficiency and competitiveness.
- In Thailand - political uncertainty, lax and delayed implementation of necessary policy measures aggravated the problems. Poor portfolio management based on inadequate data created shocks. For example, in the case of Finance One, Thailand's largest finance company, nearly two-thirds of the Company's loans were in three problem areas, i.e. property, hire purchase, and stock margin lending. As interest rates rose and the economy slowed down, Finance One's non-performing loans doubled in 1996 and then re-doubled in early 1997. US investors who brought $600m bonds issued in April 1997 were forced to liquidate, as they became junk bond overnight. In fact, lack of transparency, inadequate and often times, distorted disclosure of information and data deficiencies across Asian nations particularly with regard to extra-budgetary fiscal transactions and quasi-fiscal activities and poor governance of regulations, contributed to the current shock and speculative activity. Special mention may be made to the denial of existence of insolvency problems in Finance One until it collapsed, and the Thai government's false disclosure of over $30 billion foreign reserves. In reality, it was worth $1.14 billion only (Financial Times, February 12, 1998).

In a survey of Asian business executives of South Korea, Australia, Indonesia, Taiwan, Malaysia, Singapore, Japan, Thailand, Hong Kong, and the Philippines, the majority (54.2%) respondents say that the absence of democratic freedom in South Asia

contributed to the economic turmoil (Far Eastern Economic Review, Feb. 19, 1998). In addition to internal growth and structural weaknesses as described, a few external factors also contributed to the massive inflow of capital and the subsequent turmoil in the Asian region. These are summarized below.

Low Economic Performance in Advanced Economies

Weak economic performance in many industrial countries including the US, Japan and Western Europe up to the mid-1990s, led to accommodative monetary policies, abundant liquidity, low interest rates, and decline in asset yields. These, in turn, contributed to rises in stock markets most notably in the US. Decline in asset yields in industrial countries make emerging Asian markets an increasingly attractive investment opportunity. There may also have been a shift in preferences in favor of Asian market assets in particular, following the Mexican crisis of 1994-95.

Table 7. Current Account Balance of Asian Troubled Countries (1990-96)
(% OF GDP)

Country	1990	1991	1992	1993	1994	1995	1996	1997
Thailand	**-8.3**	**-7.7**	**-5.6**	**-5.0**	**-5.6**	**-8.0**	**-7.9**	**-3.9**
Indonesia	**-2.8**	**-3.4**	**-2.2**	**-1.5**	**-1.7**	**-3.3**	**-3.3**	**-2.9**
Malaysia	**-2.1**	**-8.8**	**-3.3**	**-4.8**	**-7.8**	**-10.0**	**-4.9**	**-5.8**
Philippines	**-6.1**	**-2.3**	**-1.6**	**-5.5**	**-4.6**	**-4.4**	**-4.7**	**-4.5**
South Korea	**-0.9**	**-3.0**	**-1.5**	**0.1**	**-1.2**	**-2.0**	**-4.9**	**-2.9**
Singapore	**3.3**	**11.2**	**11.3**	**7.4**	**17.1**	**16.9**	**15.0**	**14.0**
China	**3.4**	**3.5**	**1.5**	**-2.7**	**1.4**	**0.9**	**2.5**	
Hong Kong	**8.9**	**7.1**	**5.7**	**7.4**	**1.6**	**-1.3**	**-1.5**	

Source: World Economic Outlook, Interim Assessment, International Monetary Fund, December 1997.

Decline in Competitiveness

Exchange rates of most of the affected countries, i.e. Korea, Thailand, Indonesia, Malaysia and the Philippines, were pegged to the US dollar. When the dollar weakened in 1994 and early 1995 reaching an all time low against the Japanese yen in particular, these countries generally gained competitiveness as their currencies depreciated. Conversely, when the decline in dollar was reversed over the two years beginning in mid-

1995, these countries suffered substantial losses in competitiveness with adverse effects

on net exports and growth. Since Japan is their largest trading partner, changes in yen/dollar exchange rate badly affected not only their current account but also their capital account and the balance of payments. Apart from country-specific factors, slowing of export revenues in most East Asian countries forced import growth rates from 11-12% in 1994-95 to 8% in 1996. In addition, there was tightening in global financial conditions resulting from the sudden rise in Japanese bond yields and the sharp rebound in the yen. This reduced the attractiveness of borrowing in Japan to finance investments in high-yielding markets elsewhere, including Thailand. International investors, commercial banks, investment banks and hedge funds appear to have played a role alongside domestic investors in taking short positions against Thailand's *baht,* which they viewed as one-way bet, given the exchange rate peg and relatively low funding costs. In the face of continuous large scale capital outflow, on July 2, 1997, Thailand had to abandon its exchange rate peg and consequently, the *baht* depreciated by 18% and the spillover effects spread out in the neighboring current account-deficient countries like the Philippines, Malaysia and Indonesia.

Regulatory Laws to Reduce Risk of Foreign Investment

Many advanced countries designed and instituted regulations, provisions and insurance policies that reduced risk of foreign investment. For example, US investors may hedge their political risk of foreign investment through purchasing 'Political Risk Insurance' at a very low premium. Moreover, the Mexican experience showed that in case of bank failures, the IMF or the US government would extend their help to guarantee safe repatriation of capital funds. These policies, myriad guarantees offered by Asian leaders, and the internal strength of the Asian economies attracted huge foreign capital inflows some of which were channeled into unproductive sectors as well.

Financial Crisis and Its Effects

The Asian financial crisis affected many nations in varying degrees. Most hard hit are Thailand, Indonesia and South Korea. As financial market weakened and to reduce the outflow of capital, the Thai currency *baht* was allowed to float and overnight it depreciated. To hedge their foreign currency exposures, the domestic investors, residents, international bankers and financial speculators of Southeast Asia rushed for purchase of stable currencies, predominantly the US dollar. This created pressure on the Philippines' *peso,* Malaysia's *ringgit* and Indonesia's *rupiah* which depreciated by 30% by mid-October, 1997. Their neighboring countries, i.e. Singapore, Hong Kong, Taiwan, China and Korea increased their interest rates to keep their currency from falling. In spite of this, Taiwan's *dollar* depreciated by 6%, and Hong Kong's *SAR* by 23% (Table 8). However, spillover effects beyond the Asian region remained fairly limited, except Eastern Europe, Mexico and Russia. In fact, global financial markets remained buoyant.

Table 8. The Asian Crisis: Chronology of Events

Country	Date on which Currency was allowed to float	Immediate Market Reaction: Depreciation	Mid October, 1997 Depreciation
Thailand	***baht*: July 2, 1997**	**10%**	**30%**
Philippines	***Peso*: July 11, 1997**	**Interest rate increased**	**20%**
Malaysia	***Ringgit*: July 21, 1997**	**10%**	**20%**
Indonesia	***Rupiah*: August 14, 1997**	**15%**	**30%**
South Korea	***Won*: November, 1997 Parliament refused**	**Interest rate increased**	**55% on Jan, 1998**
Spillover Effects			
Singapore	***Dollar*: under attack on August 3, 1997**	**Interest rate increased**	**Depreciated by 16% and banks earnings down by 30%**
Hong Kong	***SAR*: equity price down**	**Interest rate increased**	**Depreciation by 23%**
Taiwan, China	***Dollar* & *Yuan*: under attack**	**Interest rate increased**	**Depreciation by 6%**
Russia, Mexico	***Rubble* & P*eso*: under attack**	**Interest rate increased**	**Depreciation by 7%**
US	***Dollar*: appreciated**	**Equity price down 27% on Oct 27, 1997**	**market regained and buoyant**

Source: Far Eastern Economic Review; February 7, 1998; The Financial Times, February 12-16, 1998 issues and the IMF World Economic Outlook, December 1997.

The Asian Turmoil and Its Direct Impact on Affected Economies

Due to the turmoil, the currencies of the affected nations dramatically depreciated and their stock market prices crumbled. Many banks, financial institutions, and companies were closed down. Their receipt of foreign credits and loans declined in 1997 by $80 billion. Large-scale layoffs resulted due to scaling down of projects and closing of factories. Chaos, street demonstrations and riots broke out in many cities.

Thailand. Its annual GDP growth rate which was fairly high and varied between 6.4% to 11.6% during 1990-96 was projected to decline to 3.5% in 1998 (IMF, December, 1997) as the government would maintain austerity program to have a budget surplus of 1%. Fifty six banks and financial institutions including Finance One, Thailand's largest financial company, were closed down and interest rate rose to 24%. The *baht* declined by 50% and its GDP reduced $186 billion in 1996 to $97 billion. Its stock market price tumbled by 86.2% and its average growth of exports and imports that were 14.5% and 13.7% during 1980-96 would decline to 7.9% and 0.2% respectively in

1998 as per IMF forecast. The IMF agreed to provide a bail out package of $17.2 billion.

Indonesia. Indonesia has been hard hit most in the recent crisis and its GDP reduced from $226 billion in 1996 to $51 billion (The Economist, Feb. 7, 1998). Its annual GDP growth rate had been projected to decline to 2% in 1998 from an average of 8% during 1990-96 (IMF, December 1997). It has an external debt of $135 billion of which 59% are short-term loans. Its bank interest rates increased to 40 to 50%. Due to the credit crunch, many manufacturing plants have been closed down owing to the scarcity of raw materials/imports.

To avert capital outflow, it allowed its currency, the *rupiah,* to float and it depreciated up to 80%. Indonesia's financial crisis resulted in the closing of 16 banks and wide-scale looting of Chinese stores. Its stock market price plummeted by 80.2%. Racial riots erupted in 40 towns and many were killed. Because of the precarious conditions, Indonesia's dominant Chinese business group started migrating abroad and the country lost about $1 billion capital in a short time due to the Chinese exodus (Far Eastern Economic Review, Feb. 19, 1998). IMF extended a bail out package of $43 billion to stabilize Indonesia's financial market.

South Korea. Korea is the world's 11th largest economy and Saudi Arabia's third largest trade partner. Its GDP was $485 billion in 1996. It plummeted to $272 billion due to the crisis, and its annual GDP growth rate that varied between 5.1% to 9.5% during 1990-96 was expected to be only 2.5% in 1998. It has an external debt burden of $153 billion of which 68% are short-term loans. In 1996, exchange rate was 804.5 *won* per dollar and it declined to 1780 in January 1998, a 55% depreciation. Korea's 14 merchant banks have been suspended, and 26 large conglomerates or *chaebol* have been closed down including Sammi Steel, Korea's biggest specialty steel makers and Kia Motors, nation's third largest car-makers. Its Hanbo Steel collapsed under $6 billion in bad debts. Due to over capacity, Korea's largest export, computer memory chips collapsed as earnings of chipmakers fell by 90%. Its stock market has seen a slide of 56%. To avert a crisis, Korea negotiated a $57 billion IMF bail out package. Its commercial bank interest rate ceiling went up to 40%.

Malaysia. Malaysia's total external debt is $35 billion of which only 6% are non-performing loans. Moreover, large proportions of its loans are in local currency, a hedge against external debt burden. Since 56% of its debt are short-term loans and 35% are invested in property, to control escalation of turmoil, it announced an emergency economic package that includes public sector expenditure cut and slowing of infrastructure spending. Such action resulted in large-scale layoffs. Its currency, the *ringgit* devalued by 44%. Due to devaluation, its GDP declined from $92 billion in 1996 to $72 billion. While its GDP growth rates were steady and varied between 7.6% to 9.6% during 1990-96, it was expected to be only 2.5% in 1998, a sharp decline. Its average export and import growth rates that were 11% and 10.3% during 1980-96 were proejcted to decline significantly in 1998 due to the turmoil. Its stock market index declined by 6%. However, Malaysia expects to stabilize its financial markets through reforms and mergers and without an IMF bail out.

Philippines. Known as the 'sick man of Asia', the Philippines' economy recorded improvement as it has been implementing an IMF-sponsored stabilization program for the last five years. While neighbors' growth rates are sharply declining due to the turmoil, its GDP growth rate of 5.1% in 1997 far exceeded that of IMF's projection of 4% per annum. Its annual GDP growth rates that varied between -0.6% in 1991 and 5.7% in 1996 is projected to stabilize at 3.8% in 1998. However, the recent crisis forced its currency, the *peso* to decline by 34%, and its stock market price slipped by 57.9%. It raised its interest rate to 14%. The Philippines has asked for $2.7 billion IMF loans to avert its $3 billion current deficit. Table 9 summarizes the impacts of the crisis on the affected countries.

Spill over Effects on Major Trading Partners

The world's growth of imports is highest in East Asia, nearly 30% and naturally, it would affect global trade. Direct effects of the crisis on major trading partners such as Singapore, Hong Kong, Japan, China, United States, and the European countries in particular, would vary between 0.4% to 1% of their GDP (IMF, December, 1997). Japan is the largest trading partner of the region and its banks extended $93.6 billion or 44.8% to the affected countries. Next are the European banks that extended $89.6 billion or 42.9% to the affected countries while the US banks' lending exposure is only 12.4% of the total. However, in the entire East Asian region, out of a total external lending of $736 billion, European banks' lending is the highest (43.3%), followed by Japan (35.4%) and the US (6%). Any default in payment may affect these external lending institutions. Already Hong Kong's largest investment firm, Peregrine collapsed due to the Asian crisis.

The Asian turmoil has substantially reduced the growth prospects of the affected countries and further contraction of their spending will reduce their imports, while depreciation of their currencies may enhance their competitiveness and boost their exports.

While the ratio of trade to GDP for Japan and the US is below 10%, it is about 23% and 33% for New Zealand and Australia respectively. This means that the impact on their economy is likely to be higher. Already, tourist revenue for Australia has declined by 12%.

Nearly half of US manufacturers are bracing for deteriorating sales this year because of the Asian turmoil and the US bilateral deficit with Asia could rise as high as $90 billion. US farm exports would decline by $2.1 billion in 1998 as the financial crisis curbs the demand for imported food (Financial Times, Feb 24, 1998). The US government, therefore, has allocated $2.1 million in export credit guarantee to prop up demand.

Japan. Japan's banks are riddled with bad loans amounting to $632 billion. Its government is determined to renew confidence in the sick Japanese financial system, and it has allocated billions to help sort out Japan's financial system and declared massive tax cuts to enhance consumer demand. These actions appreciated the yen against the US

dollar from its lowest of 131.7 yen to a dollar to 125.7. Without Japanese and US help, the Asian economies may take longer to rebound.

Table 9. Impact on Affected Countries

Country	Devaluation	Short-term Loan (%)	GDP in 1996 US $bn	GDP* in 1997 US $bn	External Debt in US $bn	International Financing $bn	Bank Interest Rate 1997	% Change of Stock MKT Price from Dec.96	Current Account in Latest 12 Months $bn	Foreign Reserves, $bn		IMF Package $bn
										Latest	A Year ago	
Thailand	**50%**	**66%**	**186**	**97**	**110**	**70.2**	**24.0**	**- 68.2**	**- 8.6**	**27.0**	**37.7**	**17.2**
Indonesia	**80%**	**59%**	**226**	**51**	**135**	**55.5**	**30.5**	**- 80.2**	**- 6.8**	**18.9**	**15.7**	**43.0**
Malaysia	**44%**	**56%**	**92**	**71**	**35**	**22.2**	**10.13**	**- 65.1**	**- 6.3**	**21.7**	**27.0**	**-**
Philippines	**34%**	**62%**	**84**	**68**	**60**	**38.0**	**13.93**	**- 57.9**	**- 3.8**	**8.8**	**9.7**	**2.7***
S. Korea	**55%**	**68%**	**485**	**272**	**153**	**100.5**	**21.50**	**- 55.9**	**- 8.9**	**20.4**	**34.0**	**57.0**

Source: World Economic Outlook, Interim Assessment, IMF, December 1997, and the Economist, February 7, 1998.

Singapore. As more than 17% of Singapore's bank loans went to the troubled economies and one-third of all Singaporean exports go to Southeast Asian countries, Singapore's economy is directly linked to the turmoil. Singapore's major banks reported earnings on the average 30% lower in 1997 as the banks are making full provisions for their $1.22 billion non-performing loans to the troubled countries (Wall Street Journal, Feb 20, 1998). Because of the turmoil, its currency, the *Singapore dollar* has plunged 16% since July 1 and tourist revenue expected to drop from 21% to 12% in 1998. Moreover, its estimated growth rate for 1998 is between 1% to 4% much lower than its 7.6% growth rate in 1997.

China. Despite China's repeated assurance that it has no plan to devalue its currency, the *yuan*, the market exchange rate has gone down by 6% from its official rate of Yn 8.28 to Yn 8.8 per US dollar. With a staggering official figure of $200 billion bad bank loans, China risks being Asia's next casualty. If Chinese banks start imploding under the weight of their loans to money losing state industries, the economy is sure to take a massive hit. This may force Beijing to devalue its *yuan* to pump up its exports (Arab News, March 8, 1998). Such devaluation could deliver a huge shock to the recovery. The good news is that Beijing has $134 billion foreign reserves to maintain the *yuan's* stability.

There is more good news. The US and the European economies are now robust. The dollar value is appreciating and consumer confidence level is very high in the US. This should generate more exports from the troubled Asian economies and a quicker recovery.

Saudi Arabia's Trade With Asia

The Kingdom has a growing trade with Asia and its exports to Thailand, Indonesia, Malaysia, Philippines, and South Korea which has been increasing at a rate of 10.3% per annum since 1992 while its imports from the said countries have declined over the years. In 1992, its exports to the aforementioned five countries was $5198 million and it increased to $6976 million in 1995, i.e. 14% of the Kingdom's total exports. However, its imports declined from $1822 million in 1992 to $1820 million in 1996, leaving a comfortable surplus for the Kingdom (Table 10).

In 1995, the Kingdom's trade surplus with the affected five countries was $5060 million or 4% of the nation's GDP. It was $13196 million or 10.5% of the Kingdom's GDP for the affected group (inclusive of Singapore and Japan). Due to the crisis, this surplus will reduce.

The Asian region is the predominant consumer of Saudi hydrocarbon products and their share of imports of Saudi crude oil and refined oil in 1996 was 46.1% and 64.3% respectively (Table 11). Due to devaluation, foreign exchange crunch and their current turmoil, their total imports may decline which may create excess supply of oil in the world market forcing the oil price to go down. It must be reminded that the current oil price decline is not all due to the Asian crisis but also due to unusually warm winter in

North America, Iraq's oil deal, the additional 10% expansion of OPEC quota, and over pumping by a few OPEC members.

Table 10. Saudi Arabia's Exports (E) and Imports (M) to the Affected Countries ($million)

Country	1992	1993	1994	1995	1996	Ave. Prop. of Total E&M (1992-95)
Thailand	**276 (326)**	**283 (277)**	**231 (204)**	**429 (285)**	**--- (325)**	**0.7 (1.0)**
Indonesia	**763 (349)**	**353 (349)**	**489 (265)**	**499 (385)**	**--- (411)**	**1.1 (1.2)**
Malaysia	**99 (220)**	**129 (191)**	**105 (193)**	**159 (274)**	**--- (241)**	**0.3 (0.8)**
Philippines	**654 (39)**	**572 (52)**	**711 (58)**	**976 (91)**	**--- (59)**	**1.6 (0.2)**
South Korea	**3405 (888)**	**3182 (752)**	**3466 (661)**	**4914 (881)**	**--- (784)**	**8.1 (2.9)**
Sub-Total ***Trade Surplus***	**5198 (1822)** ***3375***	**4519 (1621)** ***2898***	**5002 (1381)** ***3621***	**6976 (1916)** ***5060***	**--- (1820)**	**11.8 (6.1)**
Japan	**8211 (4691)**	**7141 (3554)**	**659 (2739)**	**8092 (2483)**	**--- (1950)**	**16.3 (10.9)**
Singapore	**2631 (227)**	**2099 (162)**	**2063 (118)**	**2659 (132)**	**--- (102)**	**5.1 (0.5)**
Sub-Total ***Trade Surplus***	**16040 (6740)** ***9,300***	**13748 (5336)** ***8413***	**13857 (4231)** ***9626***	**17728 (4531)** ***13196***	**--- (3873)**	**39.2 (17.5)**
Total Exports Imports	**50196 (33,228)**	**42339 (28,164)**	**42557 (23320)**	**49974 (28050)**	**------ (27728)**	

Source: *Thirty-third Annual Report*, Research & Statistics Department, Saudi Arabian Monetary Agency, 1997. N.B. Import figures are in parentheses; Trade surplus in italic.

Asian capital investment in the Kingdom or the Kingdom's financial or investment exposure in the affected countries is very negligible and therefore, would not affect the Kingdom's capital investment. Further, there has not been any direct spill over effects on the Saudi financial or stock market due to the turmoil. Rather, the Saudi stock market is up by 27.9% in 1997 while stock prices in Asian market tumbled. A bigger impact on the Saudi economy would be on the trade sector, especially the oil and petroleum sectors.

Table 11. Exports of Crude and Refined Oil Products to
Asia and Fareast, 1990-96

Year	Crude Oil (in Million Barrels)	Total Exports of KSA (In million barrels)	% Share	Refined Oil (In million barrels)	Total Exports of KSA (in Million barrels)	% Share
1990	**593.10**	**1642.42**	**36.11**	**274.67**	**478.98**	**57.34**
1991	**861.78**	**2382.11**	**36.18**	**255.13**	**450.23**	**56.67**
1992	**958.19**	**2408.98**	**39.78**	**264.53**	**473.88**	**55.82**
1993	**986.40**	**2296.92**	**42.94**	**246.87**	**516.05**	**47.84**
1994	**957.36**	**2275.27**	**42.08**	**281.42**	**498.18**	**56.49**
1995	**1006.31**	**2296.13**	**43.83**	**323.92**	**482.38**	**67.15**
1996	**1031.49**	**2236.01**	**46.13**	**350.95**	**546.07**	**64.27**

Source: Petroleum Statistical Bulletin 1997, Ministry of Petroleum & Minerals Resources, Kingdom of Saudi Arabia.

Brief on the Kingdom's Current Economy

The Kingdom's nominal GDP growth (oil and non-oil) nearly doubled from 4.5% in 1995 to 8.5% in 1996. This was due to the sharp rise in the growth rate of the oil sector from 5.9% in 1995 to 17% in 1996 reflecting mainly the increase in oil prices during the year. The average price of Arabian light, which had increased by 8.7% in 1995, went up by 19% in 1996. However, in 1997, the oil prices declined by 5% and so the growth rate declined from 8.5% of 1996 to 7.1% in 1997. Due to aforementioned myriad reasons (Iraq's oil deal, warm weather, increased quota, the Asian turmoil) oil price would likely decline further in 1998. The overall growth rate in the non-oil sector in nominal terms was 3.7% in 1996, i.e. same as in 1995. The Saudi economy made all round progress in 1996 and 1997 as well. Economic growth picked up, fiscal consolidation continued and the current account balance of payments recorded 8.3% growth in surplus. Surplus increased from $214 million in 1996 to $232 million in 1997. The Kingdom's exports increased by a remarkable 17.4% in 1995 from $42,557 million

in 1994 to $49,974 million in 1995, and its import bill declined by 1.1% in 1996, from $28,050 million in 1995 to $27,728 million in 1996. Balance of trade surplus increased from $19,238 million in 1994 to $21,924 million in 1995, a growth rate of 14%. Its inflation rate in 1997 was a meager 0.5%, one of the lowest as per international standards and its financial sector and stock market showed positive developments. To meet its Five-Year-Plan target growth (its sixth), the country approved an expansionary budget of $52.3 billion for fiscal year 1998. Its total budget's revenue is estimated at $47.5 billion. The gap of $4.8 billion deficit will be financed through public borrowing.

The Kingdom's Exports and Imports to the Affected Countries

The affected Asian countries import Saudi products mostly for their intermediate consumption, i.e. as inputs for final products. Table 12 shows that almost 99% of the imports by Indonesia and the Philippines are for their intermediate consumption whereas in the cases of Malaysia, South Korea and Thailand, it varies between 76% to 96%. Due to depreciation of these countries' currency and more importantly, due to shortage of foreign currency, their total imports are likely to be reduced**.** This may affect the Kingdom's exports. The reassuring news is that since their imports are mainly for intermediate consumption, the magnitude of decrease may not be very high.

In the case of imports into the Kingdom from these affected countries, the utilization varies widely. Based on 1995-96 import data, products for intermediate consumption varied between 4% and 64% and final consumption between 25% and 92%. Since currencies have been devalued substantially, the Kingdom can import them at a relatively cheaper price. This may encourage higher consumption in the Kingdom and may reduce its trade surplus.

Table 12. Kingdom's Exports by Utilization of Items to Affected Countries*
(in million US$) FOR 1994-95

Country	Final Consumption		Intermediate Consumption		Fixed Assets Capital		Country Total	
	1994	1995	1994	1995	1994	1995	1994	1995
Malaysia	4 (3.8%)	36 (22.6%)	100 (96%)	121 (76%)	1	2	105	159
Indon	Negligible	1	489 (99%)	497 (99%)	Negligible	Negligible	489	499
Thailand	13 (5.6%)	57 (13.3%)	218 (94%)	371 (86.5%)	"	"	232	429
Philippines	2 (0.2%)	3 (0.3%)	716 (99.7%)	973 (99.7%)	"	"	718	976
South Korea	249 (7.2%)	188 (3.8%)	3218 (93%)	4726 (96.2%)	"	"	3467	4914
NATIONAL TOTAL	1787 (4.2%)	1966 (3.9%)	40575 (95.3%)	47750 (95.5%)	196 (0.5%)	259 (0.5%)	42558	49975

Source: Exports of Saudi Arabia 1995, Foreign Trade Statistics, Central Dept. of Statistics, Kingdom of Saudi Arabia.
* Percentages are in parentheses.

The Kingdom's Major Items of Imports and Exports and Their Likely Impact. Major items of imports into Saudi Arabia from the affected countries are polyester fabrics, automobiles, tv sets, electric appliances and parts of air-conditioners, plywood, wood, cooking oil, rice, water pumps and boilers, clothes, dresses, exercise books, tires, blankets, banana, cigarettes, auto-parts, furniture, and shoes. Imports of these items in the future will be cheaper due to devaluation of currencies and such imports are likely to go up. Since 53% of the Saudi imports from the affected countries are intermediate products, it is probable that the price competitiveness and profitability margin of a few Saudi industrial products will improve due to the Asian crisis. One of the major drawbacks of Saudi industrial units is their low profitability margin and high cost of raw materials, a large proportion of which are imported from abroad (Bashir, 1998). For example, Saudi furniture-product companies are likely to benefit as they can import their raw materials, wood and plywood, at cost-effective prices and thus their competitiveness may further be enhanced. However, locally manufactured shoes and exercise books which are already less competitive, will face stiffer competition.

It may be mentioned that as the imports from the Asian affected countries are relatively small (only 6.1% of the total imports), its impact will also be small. Due again to currency devaluation and also due to their additional efforts to export in order to earn hard currency, such imports may increase. However, there could be some tradeoff between European and the Asian imports. Asian imports may replace some European goods in the Saudi market in the next 12 to 18 months. .

Major Saudi export items to Asian countries are crude oil, propane, lubricating oils, kerosene, ethylene glycol, polyethylene, other acrylic derivatives, gasoline, fuel oils, wheat, cement, fertilizers, steel bars and rods, etc. Most of these items are intermediate products and therefore, it is likely that their demand may not go down dramatically. Since construction works have been reduced in the affected countries, the export of cement, steel bars and rods may be affected most. Out of the total Saudi exports to the Asian region in 1995, about 14% of the total are exported to the affected countries (Indonesia, Malaysia, Thailand, Philippines and South Korea) and another 22% are exported to Japan and Singapore, totaling 36% of the total exports. Due to the crisis, exports from Japan and Singapore to the region will decline and hence, sum total impact on the Saudi economy could be measurable. Out of this 36%, if there were an overall decline of 10%, then in terms of annual exports, it would be a decline of $1,773 million or 3.6% of total national exports, about 1.4% of the annual GDP of the Kingdom. A scenario of likely impacts is presented in Table 13 under various assumptions.

Table 13. The Asian Crisis: Various Scenarios of Direct Impact on The Saudi Economy

Scenario	Assumption	Likely Impact on Export and GDP
Optimistic	**Troubled economies' imports decline by 10%**	**Total Saudi exports to the troubled economies reduce by $698 million or 0.6% of GDP**
	If Singapore and Japan are included and their imports decline is 5%	**Then total export reduction will be $1,237 million or 1% of GDP**
Moderate	**Troubled economies' imports decline by 15%**	**Total Saudi exports to the troubled economies will reduce by $1,047 million or 0.8% of GDP**
	If Singapore and Japan are included and their imports decline is 10%	**Then total reduction of exports will be $2,122 million or 1.7% of GDP**
Pessimistic	**Troubled economies' imports decline by 25%**	**Total exports to the troubled economies will reduce by $1,744 million or 1.4% of GDP**
	If Singapore and Japan are included and their import reduction is 10%	**Then total reduction of exports will be $2,819 or 2.2% of GDP**

N.B. Import of industrial intermediate products are exempt from tariff in Saudi Arabia. However, a tariff rate varying between 12 to 20% are imposed on importation of final products. Therefore, to avoid tariff, some final products may have been falsely imported under the category of classification of intermediate products.

Hydrocarbon and Mineral Products. The affected countries of Asia mainly import mineral or hydrocarbon products from the Kingdom and their rate of imports has been steadily increasing for many years. The Kingdom's total exports of crude oil to Asia and East Asia in 1990 were 593.10 million barrels and they sharply increased to 1,031.49 million barrels in 1996, a 9.7% annual increase. During the same period, Saudi exports of refined oil to the region also increased from 274.67 million barrels to 350.95 million barrels, a 4.2% growth rate. The Kingdom exported 46.1% of its crude oil and 64.3% of its refined oils to Asia and the Far East in 1996 (See Table 10). Most of these exports, however, went to Japan, India, Singapore and China. The oil import demand of the directly affected countries comprises 4% of the global oil and they mainly import it from the Kingdom.

Because of the credit crunch and current account imbalances, the affected countries have cut back their expenditures and adopted austerity programs. Their total productivity is likely to go down by 1 to 3%. Japan's and Singapore's economies supply one quarter of their requirements and those will also be affected. If the direct and indirect impacts cause a 5% decline in their regular purchase, this will amount to a decrease of 51.6 million barrels of crude oil and 17.5 million barrels of refined oil. It is to be mentioned that the Asian countries import their hydrocarbon requirements from the Kingdom and therefore, any decline will badly affect the Kingdom's revenue.

To avert a Gulf crisis, the UN Secretary General Kofi Annan recently signed an agreement with the government of Iraq. As per oil agreement, it would allow Iraq to pump from $2 billion to $5.3 billion worth of oil for humanitarian purposes every six months. However, Iraq may not be able to pump all that quantity due to its dilapidated pumping facilities. Already, as some OPEC members have been over-producing their additional 10% raised quota of 27.5 million barrels a day, the international oil price has gone down significantly. In fact, crude oil price dropped to a 46 months low after the deal with Iraq and it created further gloom for the oil stocks. For example, at the London's International Petroleum Exchange, the North Sea benchmark Brent Blend for April delivery ended the day at $14.17 a barrel, down 48 cents. In New York, sweet, light crude for April delivery closed at $15.46 a barrel, down 79 cents (Wall Street Journal, Feb 24, 1998). Excess supply is causing prices to tumble. Venezuela which has been producing excess of 900,000 barrels a day over its quota of 2.5 million/day, brushed aside any attempts by others in OPEC to persuade it to relent. Reportedly, three OPEC members, i.e. Venezuela, Qatar, and Nigeria are producing 1.3m barrels a day over their quota (Editorial, Financial Times, Feb 10, 1998). Such excessive supply plus decline in Saudi oil demand by Asian countries, is likely to have stronger indirect impacts on the economy. This may increase the Kingdom's deficit to a significant level.

Petrochemicals. The Saudi Arabian Basic Industries Corporation (SABIC) has been exporting a large number of petrochemical products, namely ethanol, methanol, ethylene, propane, ethylene glycol, urea, caustic soda, benzene, butane, bars and rods, polyester chips, propylene, styrene, polyethylene, polypropylene, polyvinyl chloride, cement and cement clinkers etc. to the affected countries. SABIC plans to increase its total output by 5 million tons to 28 million tons by the year 2000. Its total turnover in 1996 was $5,556 million. The strength of Saudi petrochemicals is based on its access to cheap and abundant feedstock and a range of government incentives including concessionary finance and 10-year tax holidays. The problem is that there has already been an over-capacity of global petrochemical supply and the Asian downturn can only add to the difficulties that loom for the global industry as the twin pressures of excess capacity and softer demand start to bite in 1998. The current turmoil would provide Asian producers who are faced with falling domestic demand, even greater incentive to export thus, creating more supply in the global market. This may reduce SABIC's high profitability margin.

Japan and Singapore. Out of the total Saudi exports to Asia, Japan and Singapore occupy a very important role. The Kingdom's exports to Japan and Singapore

occupy one-fifth (21.4%) of its total exports on average. One-third of the Kingdom's exports go to Japan, Singapore and the affected countries and it generates about 56% of its trade surplus. If there is any slow down of imports from the said countries due to the turmoil, the Kingdom's exports will suffer significantly and its surplus may reduce dramatically.

Trade statistics for Japan and Singapore so far available, indicate that the Asian shock wave will have strong impact on their economies. Japan's exports to the rest of Asia plunged last month and the country recorded its first deficit to the region for eight years. Japan's sales to Asia were 9.4 % lower in January 1998, the sharpest monthly drop recorded since 1986 (Duane, Financial Times, Feb 20, 1998)

Impact on the Saudi Industrial Products: Winners and Losers

As discussed earlier, exports of petrochemical products will suffer due to the turmoil. Since Saudi export data is not available at this stage for the affected countries item-wise and country-wise, it is difficult to evaluate the magnitude of impact on each product.

Many Asian countries import substantial amounts of ethane, propane, ethylene, methanol, ethylene glycol, natural gas, steel billets, bars and rods, urea, styrene, cement and cement clinkers, sulfur, various lubricating oils, butane, polyvinyl chloride, soda lye, etc. These products are mostly intermediate products and their demand is derived demand. So two opposing forces will work. Firstly, due to the credit crunch and devaluation, their demand from the affected countries will go down. Secondly, affected countries' exports of final products may go up due to devaluation and aggressive marketing efforts. On the other hand, this may increase the demand for raw materials or intermediate products. Thirdly, it is also possible that the affected countries instead of importing from abroad, would try to meet their cut-down needs from within. The sum total of these initiatives may be a decline in their net imports from non-ASEAN countries. It is, therefore, advisable to take proactive initiatives to enhance or at least to maintain the current level of exports of the aforementioned items. Otherwise, there is likelihood that these manufacturing products will face stiffer competition, decline in exports and may become losers due to the turmoil.

Asian countries also import items like chewing gums, diapers, animal fertilizers, paint thinners, sheep leather, craft paper, honey, dates, granite articles, vacuum pumps, wheat, etc. Their total imports of these final consumption goods are relatively low. A decline in their demand may marginally affect these manufacturing products.

The Kingdom's non-oil exports to the affected countries varied between 4% to 54% during the period 1994-95 (Table 14). Malaysia, Indonesia and Thailand are the major consumers of non-oil products among the affected countries and their importation of non-oil products varied between 28% to 36% in 1995. If their imports of non-oil products from the Kingdom go down by 25%, it would mean $67.5 million or 0.1% of

total exports.

Table 14. The Kingdom's Non-Oil and Oil Exports to
the Affected Countries, 1994-95 ($ million)

Country	1994			1995		
	Non-oil	**Oil**	**Total**	**Non-oil**	**Oil**	**Total**
Thailand	**126 (54%)**	**106 (46%)**	**232**	**120 (28%)**	**308 (72%)**	**428**
Indonesia	**121 (25%)**	**368 (75%)**	**489**	**150 (30%)**	**349 (70%)**	**499**
Malaysia	**45 (43%)**	**60 (57%)**	**105**	**56 (35%)**	**103 (65%)**	**159**
Philippines	**58 (8%)**	**653 (92%)**	**711**	**67 (7%)**	**908 (93%)**	**975**
South Korea	**125 (4%)**	**3342 (96%)**	**3467**	**226 (5%)**	**4689 (95%)**	**4915**
Sub-Total	**475 (9%)**	**4529 (91%)**	**5004**	**620 (9%)**	**6356 (91%)**	**6976**

Source: Exports of Saudi Arabia, Foreign Trade Statistics, 1994 and 1995, Department of Central Statistics, Kingdom of Saudi Arabia. N.B. Percentages are in parentheses.

Major imports of the Kingdom from the affected countries have been enumerated. It has also been mentioned that many consumer goods, e.g., blankets, economy cars and autos, clothes, suits, dresses, tires for bus, truck and cars, tuna fish, note books, colored TV sets, radios, video equipment and magnetic tapes, bananas, cigarettes, bed spreads, shoes and sport shoes, will be cheaper to import and therefore, their imports may go up. This may help reduce the Kingdom's trade surplus further. Moreover, local products like blankets, bed spreads, note books, shoes, etc. will find stiffer price competition. Products like wood, wooden boards, plywood, polyester fabrics and fibers, parts of air conditioners, synthetic fibers, and nylon yarns are used as intermediate products for manufacturing furniture, clothes, uniforms, drapers, blankets, air conditioners, etc. The manufacturers of these products may be able to import their required raw materials at cheaper prices due to the turmoil and thus can enhance their competitiveness. It is obvious therefor that there will be both winners and losers among the local manufacturers.

An Empirical Estimation of Overall Impact on the Saudi Economy

Impacts of the turmoil on the Saudi economy would be on a number of fronts. It will have some direct impact on its trade. However, perhaps more importantly, the indirect effect will be more damaging and lasting. Direct impact will depend on a number of factors: firstly, the Kingdom's bilateral trade relationship with the troubled region and secondly, in terms of the region's trade proportion to the Kingdom's annual

GDP. Thirdly, indirect impact may include those countries that are likely to be directly or indirectly affected by the turmoil such as Japan, Singapore, China and the US. The impact will also depend on the Kingdom's nature of the products sold to the region. If the region's import items are essential items, the impact will be low and vice versa. The extent and the durability of impact will also depend on the countries' adaptability to reform measures and the international help package that comes its way.

In the initial year, the shock would be relatively mild as the affected countries will try to maintain their imports by drawing down on the reserves. However, full impact would be felt in 1998 and thereafter. The indirect effect will worsen when Saudi Arabia's other major trading partners get affected due to the turmoil such as Japan, Singapore, US and European countries The indirect effect mostly would be through the decline in global oil price and petrochemical products and it could be substantial.

Saudi Arabia's average share of export and import with the affected countries is 11.8% and 6% respectively for the period 1992-96 (Table 15). The affected countries' ratio of trade to the Kingdom's GDP is only 5.8%, which amounts to $788 million of the nation's GDP. This low ratio suggests that the direct impact of the turmoil would be low on the GDP.

Table 15. Comparative Analysis of Kingdom's Share of Trade With Asian Countries

Country	Average* 1 % of Export	Average* 2 % of Imports	Ratio of GDP* 3 to Trade
Thailand	**0.7**	**1.0**	**0.5**
Indonesia	**1.1**	**1.2**	**0.6**
Malaysia	**0.3**	**0.8**	**0.3**
Philippines	**1.6**	**0.2**	**0.7**
South Korea	**8.1**	**2.8**	**3.7**
Troubled Countries together	**11.8**	**6.0**	**5.8**
Japan	**16.3**	**10.9**	**9.0**
Singapore	**5.1**	**0.5**	**2.1**
Combined	**33.2**	**17.4**	**16.9**

Source: Compilation from *Foreign Trade Statistics,* Kingdom of Saudi Arabia.
*Note 1: Average ratios of exports of individual countries/total national exports, 1992-95.
*Note 1: Average ratios of imports of individual countries/total national imports, 1992-96.
*Note 3: Individual countries total exports & imports/GDP for years 1992-95.

However, if Japan and Singapore are included, then the combined ratio of their trade to GDP is 16.9%, i.e. one-sixth of the nation's annual GDP and then the shares of exports and imports will go up to 33.2% and 17.4% respectively. An overall 10% decline in their imports will reduce the Saudi exports by $1,744 million or 1.4% of the GDP. In addition, there would be an indirect multiplier effect and the magnitude of it may be 0.5 assuming IMF general model of trade. Except Indonesia where recovery efforts are still

mugged with uncertainty and politics, the other affected ones have taken measures to recover and they are likely to recover within two to three years' time.

Data Limitation of the Study. Export data, item-wise and country-wise, of the affected countries, are unavailable at this stage and therefore, a general model is designed to empirically evaluate the impact of the crisis. To avoid tariff and custom duties, some final products may be imported and recorded as intermediate products in the Kingdom. This led to somewhat weak conclusions. It therefore becomes difficult to pinpoint item-wise or industry-wise impacts. Under the circumstances, the recording of export and import data be preferably under the International Standard Industrial Classification code on a country-wise and item-wise basis. It is also necessary to enforce strict adherence to product utilization classification for correct evaluation and analysis.

How to Lessen the Impacts on the Kingdom

Taking policy options to counteract decline in their import from the Kingdom may reduce the impact of the Asian crisis. Affected countries generally import intermediate products from the Kingdom. Because of the temporary credit crunch and cash shortage, they are finding difficulty to import. If these countries are allowed to have extended credit on a soft term basis to import their requirements from the Kingdom, the impact could be lessened. The US and the Australian governments have already extended such credit guarantee to the affected countries. The Kingdom may extend similar options to them. It may be mentioned that this Asian Tigers' crisis will not last for long and they will recover within two to three years' time. Moreover, when they rebound, they are likely to be stronger and more financially sound. Therefore, extension of credit will not be a loss in the long run.

Being assured of return, Prince Alwaleed Bin Talal Bin Abdulaziz, an astute Saudi investor, reportedly bought $150.5 million worth of convertible bonds of the South Korean conglomerates, Daewoo ($100 million) and Hyundai ($50.5 million). He may once again prove himself to be a superb investor. The Kingdom may safely follow his suit in extending credit to the troubled countries.

Secondly, to stop erosion of gasoline price, an emergency OPEC meeting may be arranged to evaluate the situation and an appeal could be made to take corrective actions to maintain global stable price of oil.

Thirdly, exporters of the Kingdom may consider widening their market and explore new markets in the East European and Centrally Independent States (former USSR) countries. Setting up of turn-key or joint venture projects abroad could be an option to explore new markets. In addition, more aggressive and creative marketing techniques may be adopted to increase Saudi exports.

Fourthly, product price and quality competitiveness are effective tools to market a product. The Kingdom may consider adopting Total Quality Management (TQM)

techniques to reduce wastage, production cost, and improve quality performance.

Lessons from the Asian Crisis

Gustav Ranis recently highlighted the phenomenon that productivity increases in Taiwan's industry being substantially higher than Korea's over several decades. Taiwan's economy is alive and well and this offers important lessons for its neighbors (Financial Times, Feb 19, 1998). The Taiwanese economy has continued to perform remarkably well and confidence has remained high despite the absence of the IMF. Although it has been touched by contagion, its growth rate has remained fairly steady at more than 6%, with inflation in 1997 less than 1%. Its stock market actually rose by 8% in 1997. In contrast, Korea went downhill. The reason, Ranis explained is that Taiwan faced the onslaught of Asian crisis with foreign exchange reserves of $86 billion, against Korea's $17 billion. But a deeper answer relates to the sharply differentiated pattern of development over the past 40 years in these two miracle countries. While booming exports plus extremely high savings and growth rates, have been the hallmark of four decades of spectacular growth in both cases, Korea's investment rate was considerably higher at 38% compared with Taiwan's 21%. This has been fueled by much larger inflows of foreign capital, mostly of portfolio variety. Agriculture contributed much less to the national savings of Korea. Taiwan's agricultural labor productivity grew at twice the rate of Korea in the 1960s and 1970s, bolstered by decentralized farmers' association that spread innovation into non-agricultural activities in rural areas. In contrast, Korea's development concentrated in big cities and shaped by import of capital-intensive foreign technology. The consequence is an oligopolistic industrial structure, in which *chaebols* manipulate the government and the banks. In Taiwan, by contrast, industrialization was from the outset much more decentralized and rural-oriented. Small and medium-sized companies dominate its economy. Directed credit and crony capitalism is by no means absent in Taiwan, but it is much less pronounced. In general, the allocation of resources is left more to the market. Foreign capital is accessed cautiously and direct foreign investment (DFI) outweighs the more footloose portfolio kind of Thailand, Korea and Indonesia. Consequently, Taiwan's reliance on foreign savings is much less at 10% of total investment in sharp contrast to Korea's 60%. Manufacturing debt/equity ratios are estimated at 87% in Taiwan and at a massive 300% in Korea. All these features stood the Taiwanese in good stead as turmoil began to engulf Asia. Currency speculators did not find any scope to meddle with Taiwan's financial markets.

In Taiwan, as in Hong Kong and Singapore, high rates of growth have been achieved not via Japanese-style *keiretsu* and cronyism, but as the result of a rational risk-taking investment allocation. Saudi Arabia and the GCC countries may design their industrial policy on the lessons of the Asian crisis by encouraging non-oligopolistic market structure, avoiding short-term excessive private sector borrowing and by allocating resources on the basis of economic analysis and market needs. They may also encourage transparency, enforce effective application of banking control, avoid denial of problems, and excessive and unproductive investment and accumulation of non-performing loans. They may like to reduce their data deficiencies as well.

The lessons of the Asian crisis may be summarized as follows:

- Importance of the composition of foreign borrowing.
- Unsupervised rapid expansion of bank and non-bank credit harbor crisis.
- Current account deficit financing helps investment but creates instability.
- Promoting liberalization of capital market without achieving financial maturity could be a disaster.
- Lack of transparency and overshooting of equity price spread contagion.

Conclusion and Recommendations

As accidents can not be foretold, the recent financial crisis in Asia could not be forecasted beforehand as well. Neither the IMF nor the international financial investors nor speculators nor the affected governments, could foretell the timing of the crisis, the collapse of the markets nor the nature and depth of its severity. However, there have been symptoms of financial difficulties such as 'overheating' of the economy, massive inflow of foreign private capital forcing unsustainable external imbalances and insolvency or deterioration of banks' portfolios. Some ineffective measures were taken to dampen the overheating, but given the spectacular and steady growth rates in the region, it was natural not to put too much importance on the difficulties. Moreover, private borrowing did not warrant serious public attention until it became a public issue. Although excessive current account deficits, pegging of currencies against the dollar, and speculative motives are being postulated as the main causes of the crisis, it is not that simple. The causes of the crisis are complex and still unfolding. The fundamentals of the affected economies were reasonably good; public confidence was high and market upbeat was positive, but it did crash. The spillover effects spread not only within the region but globally at a time when advanced economies were enjoying historic upswings. Because of the crisis, the global real growth rate projection had to be lowered by 0.75 to 1% globally (IMF, December 1997).

The Asian crisis is a reminder that in this age of super-highway technology, free flow of capital movements, institutional and aggressive global investors, and unfettered media coverage, the global economy is highly interdependent. Fiscal, monetary and other policy actions inside one country/ region are likely to affect the global or other economies and therefore, policies across nations should be synchronized. Concerted efforts are needed both by industrial and emerging nations to lessen the damages of such burst bubbles.

Three of the major causes of the crisis and loss of investors' confidence are: (a) poor governance, (b) too much influence of conglomerates in credit lending, and (c) lack of transparency. Therefore, public and corporate governance need to strengthen credit lending decisions and it is necessary to enhance transparency and accountability to maintain investors' confidence. Strict international financial standard should be adopted.

The following policy options may be adopted:.

- Reduce incentive for excessive borrowing through macro policy mix.
- Rationalize explicit and implicit guarantees.
- Supervise and regulate overall risk especially capital investment.
- Place limit on sectoral investment to evade excess capacity build up.
- Improve transparency, corporate governance, and rationalize currency pegging.

The Saudi government has followed a low-interest, capital-intensive, medium/large investment policy unlike Taiwan for its rapid industrialization to overcome its oil dependency. Because of its sustained and prudent policy, its non-oil export earnings have increased from a mere 1% in the 1970s to 33% in 1997 and its industrial export growth recorded a remarkable 212% increase over a period of 10 years, from 1986 to 1996. It has been justifiably maintaining a prudent policy of pegged exchange rate and interest rate regime against the US dollar mostly due to its petroleum price that is traded in dollar denomination. Its public debt and deficit are growing fast and therefore need serious attention.

The crisis of Asia highlights the risk of relying on short-term foreign capital inflows to finance investment. It also shows why emerging countries should not open fully to foreign portfolio investment until their capital markets attain sufficient depth, and their financial intermediation process achieves maturity and strength. This also shows that unsupervised borrowing of foreign capital by private companies/individuals may become a public problem without adequate control and safeguard. Therefore, it is well advised that these issues be cautiously analyzed before opening up of the Saudi economy. Recent government's decision to open up its stock market to foreign capital (SAMA , 1997) has allowed foreigners to invest through a closed country fund, the Al Saif Fund which is listed on the London Stock Exchange on a controlled basis. It is therefore an appropriate one.

Addendum: New Developments in the Kingdom

This paper was written in December 1997 and some editing was completed until the beginning of March 1998. Since then, new developments have occurred in the Kingdom. With the global economic slowdown especially due to a 35% fall in the Brent crude oil prices**,** the Kingdom's GDP growth in 1998 went down by negative 10.8% (current prices) from a positive 7.1% in 1997, 8.7% in 1996 and 6.2% in 1995. Moreover, the economy witnessed a current account deficit of $13.1 billion against a surplus of $254 million in 1997. Low oil prices forced a budget deficit of $12.3 billion against a projected deficit of $4.8 billion leading to a rise in the internal debt levels. The overall government debt level is now estimated at over 90% of GDP (Consulting Center for Finance and Investment [CCFI], 1999). The government also projected a budget deficit of $11.7 billion in 1999. However, to reduce budget deficit, the government has taken a number of bold and prudent actions that include:

- Increase of gasoline price by 50% from 60 *halala* to 90 *halala*
- Imposition of embarkation fee of $13.3 per passenger
- Increasing emphasis on privatization

- Across the board reduction of a 10% public expenditure
- Go slow policy on defense purchases.

Due to the slowdown in the economy, the stock market fell by 30% in 1998 and the cement sector is facing low internal demand to an overproduction of 7 million tons. It is therefore, contemplating consolidation. The cement and industrial sectors are the worst affected with a fall of more than 40% stock price (CCFI, 1999). The SABIC, the petrochemical giant of the Kingdom, announced a 62% decline in their profit margin in 1998 because of global price decline. However, still it made more than $1.03 billion profit that shows its resiliency.

In the area of trade, both exports and imports have been declining as predicted since the Asian crisis. Preliminary estimates show that the exports have declined by 36% from $59.5 billion in 1997 to $37.9 billion in 1998 and imports by 0.6% from $26.2 billion to $26 billion in the period. Naturally the trade surplus has dwindled significantly as shown in Table 16.

Table 16. Exports and Imports of Saudi Arabia, 1995-99 (in million US$)

Year	**1995**	**1996**	**1997**	**1998**	**1999***
Exports	**49974**	**60565**	**59527**	**37891**	**38453**
Imports	**28050**	**27728**	**26154**	**26000**	**25000**
Surplus	**21924 (44%)**	**32837 (54%)**	**33373 (56%)**	**11891 (31%)**	**13453 (35%)**

Source: Trade Statistics, Ministry of Finance and National Economy, 1999. N.B. These are estimated figures.

Two local banks, the United Saudi Bank (USB) and the Saudi American Bank (SAMBA) already announced a $1.3 billion merger move. In a survey of business executives of the leading companies of the Kingdom, 80% of the respondents felt that their revenue growth would flatten or decline (CCFI, 1999).

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