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SOUTHEAST ASIAN AFFAIRS 1998

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SOUTHEAST ASIAN AFFAIRS 1998
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FOREWORD

We are pleased to present the twenty-fifth issue of *Southeast Asian Affairs*, a comprehensive annual report on the political and economic trends and developments in Southeast Asia.

Designed to be easily readable yet in-depth, informative and analytical, the annual has come to be a standard reference for scholars, policy-makers, private sector executives and journalists, who seek to understand and keep up to date on the dynamics of Southeast Asian developments.

Completing ASEAN's historic task of uniting all countries in Southeast Asia was the initial problem addressed by regional leaders in 1997, an objective frustrated at the eleventh hour by the renewal of armed violence in Cambodia. The civil war in Cambodia, and other consequences of enlargement, continued to engage ASEAN, but quickly subsided in importance following the devaluation of the Thai baht on 2 July, which triggered the regional financial crisis. These events, together with the smoke-haze problem and the *El Nino*-induced drought, dampened celebration of ASEAN's 30th anniversary. Apart from Cambodia, domestic politics generally remained stable. Governing parties were returned in elections in Singapore and Indonesia, and a change of government in Thailand followed the prescribed democratic process. By year end, however, the economic and social effects of the financial crisis were also pressuring regional governments.

I take this opportunity to thank all the authors who have contributed much to make this publication possible. While the Institute encourages the statement of all points of view in the publication, the authors alone are responsible for the facts and opinions expressed in their articles. Their contributions and interpretations do not necessarily reflect the views of the Institute.

Chia Siow Yue
Director
Institute of Southeast Asian Studies

April 1998

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INTRODUCTION

Nineteen ninety-seven will be remembered as the year of Asia's economic bust. On a fateful first Wednesday in July Thailand unpegged its currency to the U.S. dollar, causing a massive withdrawal of foreign funds and sending the local currency into free fall. By year end the baht had lost around 40 per cent to the U.S. dollar, and the stock market had declined by about the same amount. A similar pattern quickly repeated itself in Indonesia, the Philippines, and Malaysia, and the ripples expanded to the rest of Southeast Asia and beyond. Called in to assist, the International Monetary Fund (IMF) arranged a bailout package of US\$17.2 billion for Thailand, the second largest IMF package ever, followed by a much bigger package of US\$43 billion for Indonesia (then a US\$57 billion package for South Korea). After a decade of exceptionally high growth, dubbed the Asian Miracle by the World Bank and others, the economic crisis of the second half of 1997 was quite unexpected.

Debate over the origins of the crisis focused on whether it was caused by weaknesses in the fundamentals of the ASEAN economies, or risks associated with open capital and financial markets. Declining competitiveness, weak financial sectors, and a lack of good governance in both the public and private sectors all contributed to the crisis. Such factors were evident in Thailand, though not uniformly apparent, initially, in other Southeast Asian countries. But the massive inflow of foreign capital in preceding years and the volatility of international financial markets were also part of the problem. Distinguishing this crisis from others preceding it, the massive debts run up in the region were mainly private, not government.

With no agreement on the causes of the crisis, it is hardly surprising that experts differed over solutions. The IMF approach, which focused on stabilizing currencies by reforming financial institutions, maintaining high interest rates, and enforcing government austerity, was accepted by many in the region; but it was criticized by those who believe that such contractionary policies would aggravate liquidity problems for the private sector. Reform of international financial markets was high on the agenda of some. Southeast Asian countries did, however, agree that as the crisis was a region-wide phenomenon, it required a regional solution. ASEAN gave unprecedented attention to financial matters, and committed the organization to long-term involvement in this area through initiatives such as the establishment of a mutual surveillance system.

ASEAN faced other challenges in 1997. The inclusion of Myanmar was controversial in the eyes of those who opposed that country's record on human rights. Renewed armed conflict in Cambodia was seen as a reflection of ASEAN's failure to ensure peace in the region. And the massive smoke-haze

caused by fires in Indonesia — some deliberately lit to clear jungles for plantations — focused attention on shortcomings in ASEAN's environmental record. At a time when ASEAN was looking to celebrate thirty years of achievement, it faced arguably its toughest year ever.

The regional economic crisis also had an impact on domestic politics in the region, no country more so than Thailand. At the beginning of the year the excesses of the boom decade were brought to public attention by a 20,000-strong encampment in Bangkok of the rural and urban destitute, known as the Assembly of the Poor. Many of their concerns were taken over by an independent, elected Constitution Drafting Assembly, which spent the first half of the year canvassing public views and drafting a new Constitution. At first the government was wary, but by the time the draft was ready in August the financial crisis had already struck, making it impossible to reject an agenda that promised more open, accountable, effective, and less corrupt government. Prime Minister Chavalit Yongchaiyudh's ineffective handling of the economic crisis also contributed to his resignation and eventual replacement by Chuan Leekpai, whose record of probity and strong economic team were greeted warmly by an otherwise stunned public.

Chavalit's coalition performed poorly on a number of fronts, but it did strengthen Thailand's regional diplomacy — building on a solid foundation, achieved in spite of frequent changes in foreign ministers and domestic political turbulence in immediately preceding years. The financial crisis forced Chuan to look to the United States for assistance, and brought Thailand back to a more traditional balancing of regional and great power interests.

As with Thailand, Malaysia and Indonesia also felt the full impact of the financial crisis. In almost domino-like fashion, after the steep depreciation of the baht, currency speculators focused their attention on the Malaysian ringgit and Indonesian rupiah. Sharp falls in both currencies sparked a rout on the two stock markets which, in turn, had a direct effect on the stock market in neighbouring Singapore. The Singapore dollar, however, was less affected by the turmoil in the financial markets, providing evidence of the underlying strength of the Singapore economy.

Apart from financial turmoil, there were other notable developments in the three Strait of Malacca states during the year. In Malaysia, the political succession issue came to the fore when Prime Minister Mahathir Mohamad's deputy, Anwar Ibrahim, took over the reins of government for two months while Dr Mahathir was on an extended overseas trip, largely to promote the ambitious Multimedia Super Corridor project. In foreign relations, Malaysia's ties with Singapore took a downturn as a result of remarks which Singapore Senior Minister Lee Kuan Yew made about the crime situation in the southern Malaysian state of Johor.

Senior Minister Lee's remarks were contained in an affidavit as part of a law suit he and other People's Action Party members had filed against a Singaporean opposition politician, Tang Liang Hong, consequent to statements the latter had made in both the run-up and aftermath to the Singapore general

election, which was held on 2 January. The severe set-back which opposition parties experienced in that election led to a debate during the year about the nature of civil society in the island republic, and the desirability of furthering its development.

As with Singapore, Indonesia also held a general election in 1997. And like its smaller neighbour, Indonesia saw its governing party, Golkar, return to power with an enhanced vote and seats. The general election, held on 29 May was, however, overshadowed by other events, notably the financial crisis, but also the increasing incidence of riots and other acts of violence throughout the country, underlying causes of which appeared to be both political and social in nature. The forest fires in Kalimantan and Sumatra added to a generally bleak year for Indonesia. The smoke-haze resulting from those fires blanketed the skies over a number of other Southeast Asian countries, giving further evidence of the centrality of Indonesia in affecting the well-being of the region.

Liberal reforms in the Philippines over recent years served that country well when the full impact of the regional financial crisis struck. Compared with its neighbours the country's currency was less volatile, and its financial, property, and manufacturing sectors remained in reasonable health. Despite encountering legal obstacles to its liberalization programme, the country remained on track for imminent graduation from three decades of IMF tutelage. The economic crisis complicated the plans of President Ramos to ensure a successor of his choosing at elections in May 1998, though all candidates shared a commitment to continued economic reform.

Recent economic growth in the Philippines has reduced internal security problems in that country, but Muslim rebels remain a concern in Mindanao, and as domestic concerns eased those over maritime security in the Spratlys and around Scarborough Shoal increased. In part the problem was addressed by a modest modernization of the armed forces, but the main response was through creative and pragmatic diplomacy — increasing political and security co-operation with ASEAN, China, and the United States.

Perhaps alone among the original ASEAN-6 countries, Brunei, protected by its enormous oil wealth, felt no severe effects from the financial crisis. It worked to strengthen ties with ASEAN neighbours, contributing generous financial assistance, and giving high priority to the East ASEAN Growth Area, to which it belongs together with Indonesia, Malaysia, and the Philippines.

Myanmar and the Indochinese states were not badly affected by the financial crisis, because their financial sectors continued to be relatively closed and underdeveloped. But in all cases currencies were devalued, and further investment from regional neighbours — the main source of foreign investment — was put on hold. This was an unexpected welcome to ASEAN for Myanmar and Laos, who joined in July, hoping that ASEAN membership would be an engine for domestic economic development.

Myanmar became the focus of international attention early in the year, when the United States and the European Union imposed economic sanctions

and launched a major campaign to delay the country's entry into ASEAN. These countries continued their opposition after July, but ASEAN membership conferred added international legitimacy which the ruling State Law and Order Restoration Council (SLORC) badly needed. Domestically, the impact of regional financial woes was exacerbated by a devastating flood that destroyed up to 20 per cent of the rice crop. And political stagnation continued: no progress was made in drafting a new Constitution, and no changes seemed likely from restructuring the SLORC as the State Peace and Development Council.

Vietnam grappled with the problem of revitalizing its *doi moi* reform programme, which had run its course by 1995. The outbreak of local protests in 1997, triggered by such issues as land rights disputes and corruption in the local party and state apparatus, demonstrated the seriousness of the problem. Substantial reforms to both the party and the state are necessary if growth is to be sustained. A younger leadership provides some reason for optimism, but new leaders will find it difficult to gain public support for *doi moi II*.

Cambodia was yet again at the centre of regional and international attention, when the fragile ruling coalition was shattered by Hun Sen's bloody power seizure in July. In retrospect the nature of the 1991 Paris Accords and the outcome of elections in 1993 — which left Prince Ranariddh with a parliamentary majority, but Hun Sen with the post of co-prime minister and with predominant military power — contained the seeds of this disaster. Cambodia's economic and social development has once again been held hostage to political conflict, with no guarantee that Hun Sen's strong-arm tactics portend a move to greater political stability. The international community disapproved Hun Sen's actions, but many countries were willing to acquiesce — intensifying doubts that forthcoming elections will be held as scheduled, or that they will be free and fair if they are.

Aside from its membership of ASEAN, Laos largely escaped international attention for yet another year. It was a busy time for foreign policy, with a succession of ASEAN leaders passing through Vientiane, and various initiatives to strengthen ties with other important countries such as China, the United States, and France. Although affected by economic problems in neighbouring Thailand, government leaders continued a policy of cautious economic reform. National Assembly elections in December set the stage for the future incorporation of younger leaders, but no major policy changes seemed in store.

Southeast Asian Affairs 1998 addresses these issues from a regional perspective in the first three chapters. The rest of the volume consists of ten country studies, and six articles with a more in-depth analysis of critical national issues.

Derek da Cunha
John Funston
Editors
Southeast Asian Affairs 1998