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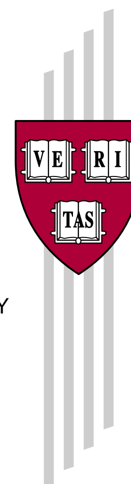

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G-24 Discussion Paper Series

Growth After the Asian Crisis: What Remains of the East Asian Model?

Jomo K.S.

No. 10, March 2001

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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PREFACE

The *G-24 Discussion Paper Series* is a collection of research papers prepared under the UNCTAD Project of Technical Support to the Intergovernmental Group of Twenty-Four on International Monetary Affairs (G-24). The G-24 was established in 1971 with a view to increasing the analytical capacity and the negotiating strength of the developing countries in discussions and negotiations in the international financial institutions. The G-24 is the only formal developing-country grouping within the IMF and the World Bank. Its meetings are open to all developing countries.

The G-24 Project, which is administered by UNCTAD's Macroeconomic and Development Policies Branch, aims at enhancing the understanding of policy makers in developing countries of the complex issues in the international monetary and financial system, and at raising awareness outside developing countries of the need to introduce a development dimension into the discussion of international financial and institutional reform.

The research carried out under the project is coordinated by Professor Dani Rodrik, John F. Kennedy School of Government, Harvard University. The research papers are discussed among experts and policy makers at the meetings of the G-24 Technical Group, and provide inputs to the meetings of the G-24 Ministers and Deputies in their preparations for negotiations and discussions in the framework of the IMF's International Monetary and Financial Committee (formerly Interim Committee) and the Joint IMF/IBRD Development Committee, as well as in other forums. Previously, the research papers for the G-24 were published by UNCTAD in the collection *International Monetary and Financial Issues for the 1990s.* Between 1992 and 1999 more than 80 papers were published in 11 volumes of this collection, covering a wide range of monetary and financial issues of major interest to developing countries. Since the beginning of 2000 the studies are published jointly by UNCTAD and the Center for International Development at Harvard University in the *G-24 Discussion Paper Series.*

The Project of Technical Support to the G-24 receives generous financial support from the International Development Research Centre of Canada and the Governments of Denmark and the Netherlands, as well as contributions from the countries participating in the meetings of the G-24.

GROWTH AFTER THE ASIAN CRISIS: WHAT REMAINS OF THE EAST ASIAN MODEL?

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Abstract

This paper focuses on the prospects for sustained development in the four East Asian economies most adversely affected by the crises of 1997/98. These include all three second-tier South-East Asian newly industrializing countries (NICs) – Indonesia, Malaysia and Thailand – as well as the Republic of Korea, the most adversely affected of the first-generation newly industrialized economies (NIEs). The first section critically examines the East Asian model presented by the World Bank's "East Asian Miracle" (1993). The study emphasizes the variety of East Asian experiences. The three second-tier South-East Asian experiences are shown to be quite distinct from, and inferior to, those of the first-generation NIEs, especially the Republic of Korea and Taiwan Province of China.

The circumstances leading to the onset of the East Asian crises of 1997/98 are then reviewed to assess whether and how the East Asian "models" may have contributed to the crises. Macroeconomic indicators in Malaysia and the three most crisis-affected economies – i.e. Indonesia, the Republic of Korea and Thailand – are reviewed to establish that, despite some misdemeanours, the crises cannot be attributed to macroeconomic profligacy. After reviewing the causes of these crises, the role of international financial liberalization and the reversal of capital inflows are emphasized. Nevertheless, the trend towards further financial liberalization continues. Malaysia is shown to have been less exposed as a result of restrictions on foreign borrowings as well as stricter bank regulations, but more vulnerable owing to the greater role of capital markets compared to the other three economies in the region. The role of the IMF and financial market expectations in exacerbating the crises is also considered.

The emerging discussion begins by asserting that economic recovery in East Asia since 1999 – especially in Malaysia and the Republic of Korea – has been principally due to successful reflationary measures, both fiscal and monetary. The main institutional reforms currently claimed as urgent to protect the four affected economies from future crises and to return them to their previous high growth paths are critically assessed. It is argued that the emphasis by the IMF and the financial media on corporate governance reforms has been misguided and that such reforms are not really necessary for recovery. Instead of the Anglo-American-inspired reforms currently proposed, reforms should create new conditions for further "catching-up" throughout the region. Although the prospects for reform of the international financial system remain dim, a reform agenda in the interests of the South is outlined.

Globalization, including international financial liberalization, has reduced the scope for selective interventions so crucial to the catching-up achieved during the East Asian miracle years. However, the process has been uneven and far from smooth, leaving considerable room for similar initiatives more appropriate to new circumstances. In any case, it is unlikely that globalization will ever succeed in fully transforming all other national economic systems along Anglo-American lines. The emerging hybrid systems have not really advanced late development efforts. There is an urgent need to understand better the full implications of globalization and liberalization in different circumstances so as to identify the remaining scope for national developmental initiatives.

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GROWTH AFTER THE ASIAN CRISIS: WHAT REMAINS OF THE EAST ASIAN MODEL?*

Jomo K.S.

I. Introduction

From the 1980s, and especially in the early and mid-1990s, there was growing international recognition of the sustained rapid economic growth, structural change and industrialization of the East Asian region. There has also been a tendency to see East Asia as much more of an economically integrated region than it actually is, and a corresponding tendency to see economic progress in the region as being similar in origin and nature. Terms such as the "Far East", "Asia-Pacific", "Pacific Asia", "East Asia", "yen bloc", "flying geese", "tigers", "mini-dragons", and so on, have tended to encourage this perception of the region as far more economically integrated and similar than it actually is.

The World Bank (1993) argued that of the eight highly performing (East) Asian economies (HPAEs) identified in its study, *The East Asian Miracle*,[1] three South-East HPAEs – namely Indonesia, Malaysia and Thailand – provided the preferred models for emulation by other developing countries. Yoshihara (1988) had earlier argued that South-East Asian economies were characterized by ersatz capitalism because of the compromised and inferior role of their states, their discriminatory treatment of ethnic Chinese and their failure to develop better technological capabilities. Jomo et al. (1997) criticized the World Bank's claims that the South-East Asian highly performing economies were superior models for emulation, pointing to various differences suggesting the inferiority of South East Asia's economic achievements.

The East Asian currency and financial crises of 1997/8 radically transformed international perceptions and opinion about the East Asian experiences, with earlier praise quickly changing into severe condemnation. This was most obvious with regard to the issue of business government relations, which had previously been characterized as key to the East Asian success story. Instead, these often intimate relations have since been denounced as "crony capitalism" responsible for the onset as well as the severity of the crisis (Backman, 1999; Clifford and Engardio, 2000). Various accounts (Jomo, 1998;

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Furman and Stiglitz, 1998; Radelet and Sachs, 1998a; Krugman, 1999a; Bhagwati, 1998) have since characterized the crises as the consequence of international financial liberalization and related increases in easily reversible international capital flows. These accounts have also emphasized the role of the International Monetary Fund (IMF), particularly its policy prescriptions and conditionalities in exacerbating the crises.

This paper will focus on the four East Asian economies most adversely affected by the crises of 1997/98. These include all three second-tier South-East Asian newly industrializing countries (NICs): Indonesia, Malaysia and Thailand, as well as the Republic of Korea – the most adversely affected first-generation newly industrialized economy. The next section of this paper will critically examine the so-called East Asian model, especially as presented by the World Bank (1993). The third section will then emphasize the variety of East Asian experiences (Perkins, 1994). The second-tier South-East Asian experiences will then be shown to be distinct from and inferior to those of the first-generation newly industrialized economies (NIEs), especially the Republic of Korea and Taiwan Province of China (elaborated in Jomo, 2001b, 2001c). The fourth section will review the circumstances leading to the onset of the East Asian crises of 1997/98, and examine whether and how the East Asian "models" may have contributed to the crises.

The fifth section will begin with a brief review of the reflationary Keynesian policies leading to macroeconomic recovery since 1999. The section will then draw on the preceding analyses to critically assess the main institutional reforms currently being claimed as necessary to protect the four crisis-affected economies from future crises and to return them to their previous high growth paths. This will mainly dwell on discussions of the need for reform of corporate governance as well as the international financial architecture. The sixth section considers the implications of pre-crisis developments and more recent challenges. In particular, it reviews some exchange rate dilemmas, the slowdown of regional foreign direct investment (FDI), limited technological capabilities and new investment promotion strategies. The penultimate section reviews the prospects for sustainable development in the region in light of the foregoing, while the concluding remarks consider the likelihood of convergence – and the viability of distinct development models – in the face of continued globalization and Anglo-American inspired liberalization.

II. The East Asian Miracle[2]

The most important and influential document which attempted to explain the rapid growth, structural change and industrialization of much of East Asia in the last three decades or more has been *The East Asian Miracle* study (EAM) published by the World Bank in 1993. As is now well-known (Wade, 1996), the World Bank did not commission the study on its own volition, and with the East Asian financial crisis since mid-1997 there are many in the Bank who would now wish to disown the study. In fact, it appears that the study was undertaken by the Bank at the behest of Shiratori, the Japanese Executive Director or government representative on the Bank's board. Shiratori had pointed out the region's rapid growth and structural change in sharp contrast to the Bank's poor experience with structural adjustment programmes (SAPs) in Latin America, Africa and other parts of the world, and with the transitions it was trying to engineer in Eastern Europe. The SAPs and transitions had generally turned out to be very problematic, even causing severe recessions in several of these economies and, at best, rather slow and unimpressive growth rates elsewhere. Shiratori suggested that the Bank should learn and draw lessons from the experiences of East Asia where, by the early 1990s, more than half a dozen countries had grown at average rates exceeding 6 per cent per annum for at least a quarter of a century. Shiratori offered the Japanese government funding for such a study, which the Bank then undertook.

In EAM, the World Bank identified eight high-performing Asian economies: Japan; the four first-generation NIEs or NICs, dragons or tigers, namely the Republic of Korea, Taiwan Province of China, Hong Kong (China) and Singapore; and the three second-generation South-East Asian NICs, namely Malaysia, Indonesia and Thailand. Interestingly, China was left out, perhaps because the Chinese experience would upset the Bank's analysis and conclusions in very fundamental ways. EAM recognizes that the likelihood of eight relatively contiguous economies growing so rapidly for such a sustained period of time is less than one in 60,000. Yet, it does not acknowledge the significance of geography – unlike the later 1997 *Emerging Asia* (EA) study led by the Harvard Institute of International Development (HIID) for the Asian Development Bank (ADB).

With the publication and release of EAM, the Bank seemed to be shifting its position from the sort

of neo-liberalism, or the extreme economic liberalism of the 1980s, to acknowledging an important developmental role for the state in the 1990s. EAM appeared to have had something to do with this shift. This impression has been reflected in other Bank activities and publications, especially the *1997 World Development Report* which seemed to advocate effective, rather than minimalist, states (World Bank, 1997).

In EAM, the Bank identified at least six types of state interventions, which it saw as having been very important for East Asian development. It approved of the first four, deemed to be functional interventions, but was more sceptical of the last two, deemed to be strategic interventions. Functional interventions are said to compensate for market failures, and are hence necessary and less distorting of markets, while strategic interventions are considered to be more market-distorting. The two types of strategic interventions considered are in the areas of finance, specifically what it calls directed (i.e. subsidized) credit, and international trade, while the four functional interventions the Bank approved of are:

(i) Ensuring *macroeconomic* discipline and macroeconomic balances;

(ii) Providing physical and social *infrastructure*;

(iii) Providing good *governance* more generally; and

(iv) Raising *savings* and investment rates.

It is very important to compare what has actually happened in East Asia with the way the World Bank has presented this. Beginning with the importance of macroeconomic discipline, there is very little dispute that maintaining macroeconomic balances has been important in East Asia. But what the Bank considers to be the acceptable parameters of macroeconomic discipline may be disputed. One finds, for instance, that inflation was generally kept under 20 per cent in the HPAEs, but it was certainly not always kept below 10 per cent in all the economies. In other words, single-digit inflation was neither a policy priority nor always ensured in some East Asian countries during their high growth periods.

Similarly, when considering other macroeconomic balances such as the fiscal balance and the current account of the balance of payments, one finds that the balances were not always strictly maintained in the way the Fund and the Bank now seem to require of much of the developing world. Malaysia and Thailand have had relatively high current account deficits throughout the 1990s, while other countries with much lower deficits were not spared the recent currency attacks and massive depreciation.

On physical and social infrastructure, until the 1980s, the Bank would probably have gone along with what the East Asians have done. However, since the 1980s, the Bank has increasingly seemed to recommend privatization and private provision of physical infrastructure. With the exception of Hong Kong (China), most physical infrastructure in East Asia has been provided by governments until fairly recently, when there have been the beginnings of privatization in the provision of physical infrastructure, which has become the basis for powerful private monopolies associated with "crony capitalism".

The role of government has been extremely important in providing so-called social infrastructure and services in East Asia. In some of its other documents, the Bank seems to acknowledge this, but nonetheless it recommends a more modest role for government in the provision of social infrastructure. For instance, the Bank recommends universal and free primary education, but does not recommend the subsidization of education beyond the primary level, when the "user/consumer" (student) should bear the full costs of education as far as the World Bank is concerned. This would have had very serious consequences in terms of human resource development, if one contrasts that recommendation with the actual experience of East Asia. To give some sense of how important government support for education has been beyond the primary level, in the Republic of Korea today over 40 per cent of young people attend universities. Thailand has a percentage of close to 20 per cent, Indonesia has 10 per cent, and most of the first-generation East Asian NIEs have well over 25 per cent, generally over 30 per cent.

The notion of good governance is somewhat ambiguous and often used rather tautologically. When things are going well, it is assumed that there must be good governance, and conversely if things are not going well. So one does not really have much of an explanation of good economic performance by simply invoking good governance, although it is widely touted these days, sometimes *ad nauseum*. There have, however, been important efforts to try to understand the factors contributing to good governance. In this regard, the *1997 World Development Report* has been important and useful. It seems from the East Asian experience that what was called "strong government" (in Gunnar Myrdal's sense) has been an important notion, though one often misunderstood and wrongly associated with authoritarian government.

What is called "embedded autonomy" has become a useful way to try to understand what the conditions of good governance are. Here, embeddedness refers to the institutional capacity and capability of the governments concerned to effectively provide the coordination necessary for rapid capital accumulation and economic transformation. Autonomy is primarily understood to be from "vested interests", "special interest groups", "distribution coalitions" and "rent seekers" who, in more favourable or conducive circumstances, would be able to influence public policy to their own advantage. Embedded autonomy is therefore considered to have been very crucial in ensuring that regimes in East Asia could effectively serve as developmental states.

The role of the state in encouraging savings and promoting investments is also generally accepted. However, much of East Asia's large savings is actually comprised of corporate or firm savings, rather than just household savings. Household savings in East Asia are not spectacularly higher than in the rest of the world, except in Malaysia and Singapore. The difference in Malaysia and Singapore is due to the mandatory or forced savings schemes introduced in the late colonial period and the relatively high proportion of the working class or wage owners as a proportion of the labour force. The latter is particularly true in the case of Singapore, but is also not insignificant in the case of Malaysia. The significance of coerced savings should be noted because of the popular view that the high savings and investment rates in the region exist because East Asians are culturally, if not congenitally, thrifty.

The large contribution of high corporate savings implies that firms have often been able to enjoy very high profit rates due to government interventions, subsidies, tax breaks and other incentives for particular types of investments favoured by the governments, enabling the firms concerned to enjoy higher "rents". But more important is that attractive conditions (e.g. tax incentives and other inducements), largely created by governments, have induced high rates of reinvestment of the huge profits of firms. How have such high rates of reinvestment been secured? In some East Asian countries they have been assured by the very strict controls on foreign exchange outflows. Capital flight was made very difficult in certain East Asian economies, especially in the Republic of Korea and Taiwan Province of China, during their high growth periods. High levels of reinvestment have also been successfully induced by structuring laws so that reinvestment of profits is subject to little or no tax, or by offering other incentives to undertake state-favoured investments.

In pursuing these supposedly functional interventions, the East Asian governments were not just market-conforming, but instead played important roles, which have been more than simply market-augmenting, as suggested by EAM. On the more controversial, so-called strategic interventions in finance and international trade, the Bank almost grudgingly concedes that financial interventions have been important and successful in East Asia, particularly in North East Asia – i.e. in Japan, the Republic of Korea and Taiwan Province of China. However, the Bank implies that nobody else is capable of successfully pursuing the types of policies that the North East Asians successfully implemented, because state capabilities in North East Asia have been almost unique and are non-replicable.

Creating the conditions for attracting investment, both domestic private investment as well as foreign investment, has had much more to do with reforming incentives and governance more generally to attract particular types of investments to generate specific sources of economic growth, rather than liberalizing financial markets as such. South-East Asian governments, notably Singapore and Malaysia, have especially sought to attract FDI into areas where indigenous industrial capabilities were not expected to become internationally competitive. Venture capital markets, rather than the usual stock markets, tend to be more supportive of developing new industrial and technological capabilities.

Attracting FDI should, however, be distinguished from capital account liberalization. Chile, which has been very FDI-friendly, has imposed fairly onerous obstacles on easy exit, probably limiting capital inflows, especially of a short-term nature. Capital account liberalization has come under renewed consideration, following the East Asian financial crisis, since mid-1997, precipitated by an eventually successful currency attack on the overvalued Thai baht, and greatly exacerbated by herd-like panicky withdrawals from the entire South-East Asian region, inducing currency and stock market collapses (Jomo, 1998). Those who control financial assets usually enjoy disproportionate political influence in most contemporary economies, and especially in developing ones. Hence, liberalizing financial markets alone, without sufficient inducements for a not easily reversed and sustained net inflow of portfolio investments, may well cause greater outflows rather than inflows.

Why did the Bank give a positive evaluation of financial interventions in North East Asia despite their clear violation of market norms? A few analysts might suggest that the evidence offers no other possible conclusion, but most observers would dispute this, especially given the ongoing problems of the beleaguered Japanese financial system. Another explanation is the influence and unorthodox neoclassical analysis of Joseph Stiglitz, the principal author of this part of EAM. The more cynical might point out that the study was funded by the Japanese Ministry of Finance, and it is hardly likely that the World Bank would bite the hand which feeds it by negatively evaluating the Ministry's record. There has been significant historical rivalry between the Finance Ministry and the bureaucratically weaker Ministry of International Trade and Industry (MITI). Hence, some observers suggest that it is not surprising that the Bank study did not criticize the role of the Ministry of Finance of Japan, but was less sympathetic to MITI and international trade-related industrial policy.

The evaluation in EAM of the record of Japan's MITI and its counterparts elsewhere in the region is more predictable, arguing that government interventions have been trade-distorting and, more importantly, generally unsuccessful in East Asia, with some minor exceptions. However, contrary to the impression given by the study, the governments of Japan, the Republic of Korea and Taiwan Province of China did pursue import substituting industrialization policies from the 1950s, but soon also pursued export-orientation so as to ensure that their industries quickly became internationally competitive by requiring a rapid switch from import substitution to export-orientation.

In many cases, infant industries were generally provided with effective protection conditional on export promotion, which had the effect of forcing the firms and industries concerned to quickly become internationally competitive. By giving firms protection for certain periods, depending on the product, and by also requiring that they begin exporting certain shares of output within similarly specified periods, strict discipline was imposed on the firms in return for the temporary trade protection they enjoyed. Quantitatively, such policies forced firms to push down their own production costs as quickly as possible, for example by trying to achieve greater economies of scale and accelerating progress up learning curves. Requiring exports has also meant that producers had to achieve international quality standards quickly, which technologically imposed pressures on progress in terms of products as well as processes. With strict discipline imposed, but also some flexibility in enforcement, many firms managed to rapidly achieve international competitiveness.

Thus, the East Asian miracle was characterized as principally due to export-led growth. But, while exports tend to rise with trade liberalization in the short term, imports also tend to rise strongly, especially if the domestic currency appreciates in real terms. Thus, trade liberalization is inclined to limit or only weakly supplement domestic effective demand. Hence, while increased international trade may enhance growth, the added stimulus tends to be much less than presumed by proponents of trade liberalization. Despite efficiency gains from trade liberalization, increased exports do not necessarily ensure stronger domestic economic growth.

EAM and its supporting studies have implied and argued that South East Asia began to take off after it reversed such trade interventions. Hence, the mid-1980s are portrayed by the Bank as a period of economic liberalization and deregulation leading to economic recovery and rapid growth and industrialization. The facts are more complicated (Jomo et al., 1997; Jomo 2001b). There certainly was some deregulation during this period, but there also was some new private sector-oriented regulation, more appropriate to the new industrial policy priorities of the governments of Indonesia, Malaysia, Singapore and Thailand.

Given international trends and pressures in recent years, trade liberalization has become increasingly irresistible, and hence inevitable. But by pro-actively accelerating the apparently inevitable, some advantage may be regained by deliberate sequencing and timing of trade liberalization. Unfortunately, many trade policy instruments have been excluded by recent trends in international trade governance and are no longer available as options for governments. For example, local content requirements were phased out with the conclusion of the Uruguay Round of negotiations under the General Agreement on Tariffs and Trade (GATT). However, despite considerable diminution, there still remains some scope for trade policy initiatives in support of industrial policy.

It is instructive to consider some of the important differences among the East Asian economies, particularly whether all of East Asia has been proceeding inexorably in the same basic direction in a similar manner. Although the Bank does not really

extol an East Asian model as such, the Bank study has often been read as offering one, or perhaps two variants. However, more generally, as suggested earlier, there has been much talk about East Asia in the singular, as constituting a flock of "flying geese" or even a "yen bloc". Many observers even speak of generic East Asian models, approaches or ways of doing things. In response to the financial crisis since mid-1997, as sentiment on East Asia has turned sour, there have been similar broad-brushed sweeping generalizations about East Asian "crony capitalism".

III. East Asian differences

While many lessons may certainly be drawn from the East Asian experience, they are far from constituting a single model. Some of the major differences in East Asia are themselves very instructive. In the case of the role of FDI, one finds tremendous contrasts, especially between South East Asia and the rest of East Asia. In the case of Singapore, FDI has constituted about a quarter of gross domestic capital formation. In the case of Malaysia, the proportion has been about 15 per cent. At the other end of the spectrum, in the case of Japan and the Republic of Korea, the percentage has long been below 2 per cent. Some of the other countries fall between these two extremes, with very few near the mean for developing countries of around 5 per cent. Those most successful in developing industrial capacities and capabilities in East Asia – namely Japan, the Republic of Korea and Taiwan Province of China – have hardly depended on FDI, which has only played a relatively small role.

The far greater importance of FDI in South East Asia has been due to a variety of reasons, which have not been entirely economic. One of the reasons for the major role of FDI in Singapore and Malaysia is political. After Singapore seceded from Malaysia in 1965, the Lee Kuan Yew government decided that to ensure its own survival, it would be best to attract foreign investment in massive quantities to Singapore, so that the major foreign powers would quickly develop a stake in the survival of the Singapore regime. Of course, this preference was subsequently justified in terms of improving access to the technology frontier. In other words, political considerations have been a very important reason for attracting, even privileging, foreign investment in Singapore.

In the case of Malaysia, the country has long had ethnic rivalries and an ethnic affirmative action policy. This may have incited some policy makers to try to limit ethnic Chinese control over the economy by encouraging FDI so as to reduce proportionately such control. Again, one finds a political motivation for the important role of FDI in Malaysia. Singapore and Malaysia are exceptions, which need to be explained politically, rather than simply by economic considerations.

Clearly, there is considerable diversity in the role and performance of public investments, including state-owned enterprises (SOEs), in East Asia, including within South East Asia. In Japan, Hong Kong (China) and the Republic of Korea, state-owned enterprises are hardly important today, but historically were so in Japan at the end of the nineteenth century and in the twentieth century before the Second World War. Conversely, however, more recently one finds that state-owned enterprises have been extremely important in Singapore and Taiwan Province of China; this is partly explained by political factors, but there are also economic considerations. Very importantly, the performance of these enterprises has also been quite impressive.

In the case of Singapore, for instance, the single largest foreign investor – i.e. the biggest Singaporean firm investing abroad – has been the Government Investment Corporation. For quite a number of years in the 1990s, the average rate of return for its investments was higher than for all major financial investment firms in the City of London as well as on Wall Street. Such SOE success poses a challenge for those who insist that state-owned enterprises are bound to fail because of property rights and principal-agent arguments.

There is also tremendous diversity in the role of industrial and technology policies in East Asia. One extreme, of course, is Hong Kong (China), where there is relatively little industrial policy, although more than most opponents of industrial policy care to admit. It is far more detailed and sophisticated in Japan and the Republic of Korea at the other end of the spectrum. In the Republic of Korea, industrial policy is largely oriented towards the *chaebol*s, whereas in Taiwan Province of China, much more emphasis is given to medium-sized and relatively smaller enterprises. There have also been different orientations, emphases and instruments in industrial policy in the region. For example, the role of trade policy has been very important in almost all economies in the region except Hong Kong (China) and Singapore, while financial policy has been important in all the countries, including Singapore, but

again with the exception of Hong Kong (China). Since the latter's reversion to China in mid-1997, there have been many indications of the possible introduction of an industrial policy for the territory, presumably in line with its new status and China's envisaged role for the de-industrialized financial centre. There have also been very important differences in the role of technology policy in the region.

As noted earlier, the World Bank recommends that the rest of the developing world emulate South East rather than North East Asia. There are very important differences between North East Asia and South East Asia underlying the Bank's recommendations. These differences oblige us to recognize the achievement of the first-tier East Asian NIEs (including Singapore) – rather than the transformation of the second-tier South-East Asian NICs – as far more impressive and superior in terms of economic performance.

Despite the much greater resource wealth of South East Asia, one finds that growth performance has been superior in North East Asia over the long term. Over the period studied by the Bank – i.e. from the 1960s until the early 1990s – the average growth rate in the former was in the region of about 8 per cent, compared to about 6 per cent for the latter. A 2 per cent difference, compounded over a period of a quarter century or more, adds up to a lot. Very importantly also, population growth, except in Hong Kong (China) owing to immigration from China and perhaps Singapore, has been much lower in the former compared to the latter. The immigration into Hong Kong (China) and Singapore involves a very high proportion of people in the labour force, thus raising the average labour utilization rate. Political factors have also ensured far more equitable distribution of economic welfare than would otherwise have been the case in the first-tier NIEs, whereas such considerations have been less influential in the second-tier South-East Asian NICs, except perhaps for Malaysia due to its ethnic "social contact".

Hence, the improvements in per capita income and economic welfare have been much more significant in North East Asia, compared to South East Asia (with the exception of Singapore), despite the relative resource wealth of the latter. In other words, what South East Asia has achieved has been less impressive in some critical ways. Drawing from this contrast, one could argue that resource wealth is not a blessing but a curse insofar as it postpones the imperative to industrialize.

As noted earlier, North East Asia has generally had a much more sophisticated and effective industrial policy compared to South East Asia. This accounts, in no small way, for the very important differences in industrial and technological capabilities between North East and South East Asia. Also, industrialization in the latter is still primarily driven by FDI, whereas industrialization in the former is primarily an indigenous phenomenon.

It is now generally recognized that Japan and the first-generation NIEs began to industrialize in the very specific economic and political conditions of a particular cold war historical conjuncture. North East Asia grew rapidly in the immediate post-war period under a "security umbrella" provided by the Americans, especially after the cold war began. Besides subsidizing military expenditure and providing generous aid, the Americans were anxious for them to "succeed" economically in order to be show-cased as attractive alternatives to those under communist rule or influence. Hence, the Americans were quite happy to tolerate trade, finance, investment, intellectual property and other policies violating *laissez-faire* market or neo-liberal economic norms that they are now strongly opposed to, especially following the end of the cold war. These favourable conditions are simply not available to others, and hence their experiences are said to be almost impossible to emulate.

In arguing why other developing countries should not imitate the first-generation East Asian NIEs, it is now often argued that their state capabilities are almost unique and virtually impossible for any other regimes to emulate. The more cultural explanations suggest that this has something to do with the East Asian Confucian legacy of meritocracy. However, it is important to remember that the supposedly Confucian Kuomintang government of Taiwan was the same regime driven out of mainland China by the communists because of its incredible incompetence and corruption. One could say the same of the Rhee regime in South Korea in the 1950s, as well as of the Chun, Roh and Kim Young Sam regimes in the 1980s and 1990s. Japan has hardly been scandal-free in recent years, and most observers would trace recently disclosed abuses to the nature of post-war Japanese political economy. The superior policy-making and implementation capabilities of the North-East Asian decision makers was, at least until recently, widely acknowledged, but this, in itself, does not prove the existence of thoroughly competent and incorruptible policy makers.

There is also the claim that East Asia cannot be emulated owing to its very different initial conditions. Such differences are real, but often exaggerated. There is no doubt that Japan and the first-tier East Asian NIEs are now distinguished by high levels of education. However, the level of literacy in South Korea in 1950 was lower than the literacy rate in contemporary Ethiopia (which has one of the lowest rates in Africa today); thus the level of education achieved by contemporary Koreans reflects the tremendous investments consecrated to developing human resources in East Asia in the post-war period, as the region then was generally not very advanced despite, or perhaps even because of, its (elitist) Confucian legacy. But by the end of the 1960s, literacy rates had gone up greatly for the first-generation East Asian NIEs after enormous resources had been poured into education in the preceding two decades.

In discussing initial conditions, some fortuitous circumstances must also be considered. Japan, South Korea and Taiwan Province of China all had relatively virtuous American-sponsored land reforms shortly after the end of the war (Hsiao, 1996). In Japan, there also was significant redistribution of other non-land assets, most notably of the pre-war and wartime *zaibatsu* industrial conglomerates. Much of the motivation for such re-distributive reforms was, of course, anti-communist, i.e. to undermine and minimize support for the communists by those desiring asset redistribution.

The implications of asset redistribution in Japan were considerable. Ironically, the Americans were not uninfluenced by the left, partly because of the nature of the wartime anti-Axis alliance and the nature of the most influential scholarships available (Tsuru, 1993). During the post-war American occupation of Japan, it was widely presumed that the *zaibatsu* "military industrial complex" had been responsible for the militarization of pre-war Japan. So the Americans decided to dismantle the *zaibatsu*, and forcibly broke family control over them, selling off the assets in interesting ways with important consequences. To ensure popular acceptance of this policy, preference was first given to employees, and then to local communities – thus developing worker and community stakes in the companies and the basis for what is now called a stakeholder economy. Thus, the stakeholder economy was created by deliberately re-distributive policies that have had many consequences now considered to be peculiarly Japanese. Similarly, many now acknowledge the influence of the "human relations" school of industrial relations on the post-war development of guaranteed life-long employment and the seniority wage system, both of which have effectively developed a strong employee commitment to the fate of their firm. There are numerous other ostensibly typically Japanese features, many of which were not inherited from the Edo period or even developed autochthonously during the Meiji period; quite a few are actually relatively recent innovations, with rather virtuous consequences.

There are important lessons to be drawn from East Asia, but clearly there is no single East Asian model as such, and most certainly not one that can accommodate all the different experiences of South East Asia. Considering the historicity of the development experiences, it does not make much sense for any other country to think in terms of trying to emulate any particular economy in the South East region or, for that matter, East Asia more generally. There are many reasons why most will find it impossible to imitate any other country even if they wanted to. But even in drawing lessons, it will be important to recognize the distinctive nature of the South-East Asian experiences.

A. *South East Asia's ersatzness*

There is considerable evidence that the three South-East Asian economies of Indonesia, Malaysia and Thailand have some common characteristics and policies that distinguish them from the other high-growth economies of East Asian (Jomo et al., 1997). Most importantly, the region's high growth economies have relied heavily on FDI to develop most of their internationally competitive industrial capabilities; government interventions have also been more compromised by considerations besides economic growth and late industrialization, especially redistribution and rent capture. Consequently, industrial policy has also varied in nature, quality and effectiveness. Yet, it will be shown that the South-East Asian economies would not have achieved so much without selective government interventions, including industrial policy.

The conditions contributing to, and the nature of, industrialization in Indonesia, Malaysia, Singapore and Thailand have been quite distinct (Jomo. et al, 1997; Jomo, 2001b). The inclusion of these economies as four of the eight HPAEs identified by the World Bank (1993) has encouraged comparison with the record of Japan and the three of the other four first-generation or first-tier East Asian newly indus-

trializing economies (NIEs): Hong Kong (China), the Republic of Korea and Taiwan Province of China. Comparisons with other countries in South East Asia and elsewhere are also shown in some chapters below.

South-East Asian industrialization has been far more dominated by foreign capital (Jomo et al., 1997; Jomo, 2001b), and has, as a consequence, fewer industrial and technological capabilities that may be considered indigenous or under national control. The efficacy of industrial policy has thus emerged as the primary determinant of the ability of different national economies to take advantage of transnational capital's relocation of productive capacities in the region. The distinct nature of the South-East Asian economies and experiences (Jomo et al., 1997; Jomo, 2001b) offers valuable insights into various industrial policy instruments, the circumstances in which these may work, as well as the importance of relatively uncompromised, competent and effective state capacities in ensuring desirable industrial policy outcomes.

South-East Asia's development experiences have been almost as diverse as those of the other four HPAEs identified by the World Bank (1993). South-East Asian high-performing economies have generally been less successful in developing indigenous industrial and technological capabilities for various reasons (Jomo et al., 1997); this seems to be partly due to the greater reliance on FDI in the region for political as well as other reasons. South East Asia's industrialization is also less impressive in other respects, probably as a result of its greater natural resource wealth and consequently weaker imperative to industrialize (ADB, 1997).

Industrial policy has been less elaborate, efficient and effective in the three South-East Asian second-tier NICs – Indonesia, Malaysia and Thailand, as compared to Japan and the first-tier East Asian NIEs, except for Hong Kong (China) but including Singapore. This is partly because state intervention in South East Asia has been far more abused, and hence, often seriously compromised by politically influential business interests. Yet, it would be a mistake to "throw the baby out with the bath water" by condemning all industrial policy in the region. Despite various abuses and other weaknesses in implementation, some industrial policy has been crucial to South East Asia's rapid economic growth, structural change and late industrialization (Jomo et al., 1997).

Before the currency and financial crises of 1997/98, the South-East Asian second-tier NICs were being celebrated by the World Bank and others as the new models for other developing countries to emulate. In its influential 1993 publication, *The East Asian Miracle*, the Bank argued that the eight HPAEs – Hong Kong (China), Japan, Republic of Korea, Singapore, Taiwan Province of China; Indonesia, Malaysia and Thailand – had achieved sustained and equitable export-led high growth and rapid industrialization.

The Bank and others suggested that owing to the first five HPAEs' various exceptional characteristics, the last three South-East HPAEs were the most appropriate examples for other developing countries to follow. Implicit in this recommendation was the claim that the achievements of Indonesia, Malaysia and Thailand were similar to and comparable with the other HPAEs in terms of growth, structural change and industrialization. Their industrialization records have been significantly different from and inferior to those of the other HPAEs, especially Japan, the Republic of Korea, Singapore and Taiwan Province of China (Jomo et al., 1997; Jomo, 2001b).

Closer examination suggests that the experiences of Indonesia, Malaysia and Thailand, as well as Hong Kong (China) and Singapore, more closely approximated the neo-classical, export-led, growth model than those of Japan, the Republic of Korea and Taiwan Province of China. The latter appear to have promoted exports very actively while also protecting domestic markets, at least temporarily, to develop domestic industrial and technological capabilities in order to compete internationally. This strategy of temporary effective protection conditional upon export promotion (EPconEP) can hardly be equated with trade liberalization. Recent criticisms (Baer et al., 1999) of attempts by an earlier generation (for example, Ian Little, Jagdish Bhagwati, Anne Krueger) to accommodate the North-East Asian EPconEP experience within their fundamentalist free trade advocacy paradigm, have exposed the intellectual sophistry of neo-classical trade economists in trying to explain away the North-East Asian success in requiring export promotion as a condition for temporary (national) market protection.

Besides more modest growth as well as industrialization, the South-East HPAEs (including Singapore) were much more reliant upon FDI compared to Japan, the Republic of Korea and Taiwan Province of China. The much greater South-East Asian dependence on FDI raises disturbing questions about the actual nature of industrial and technological capacities and capabilities in these economies,

especially in their most dynamic and export-oriented sectors. This, in turn, raises concerns about the sustainability of their growth and industrialization processes, especially if they are later deemed less attractive as sites for further FDI, for example as more attractive alternative locations become available.

B. South-East Asian weaknesses

In recent years, there has been growing recognition of major structural and systemic differences among the eight HPAEs studied by the World Bank (1993). Of these, Indonesia, Malaysia and Thailand have been increasingly grouped as second-tier or second-generation South-East Asian NICs, with characteristics quite different from the others, and of course, even among themselves. It has been argued that industrial policy or selective state intervention has, for various reasons, been of much poorer quality and less effective in these economies. Instead, there have been other state interventions motivated by less developmental considerations, especially in Indonesia and Malaysia (Jomo et al., 1997). It appears that such interventions bear some of the responsibility for the vulnerability of the second-tier South-East Asian NICs to the factors that precipitated the mid-1997 financial crisis in the region.

A longer-term view of the crisis would, of course, have to recognize the vulnerability of existing financial systems to such "exogenous" shocks. The central banks in the region clearly fell short of the new challenges faced (Hamilton-Hart and Jomo, 2001). National-level central banking faced a new situation with the new international monetary system that emerged after abandonment by the United States of the Bretton Woods framework in 1971. Further international financial liberalization from the 1980s on added to the new problems for the national monetary authorities precisely when the role of government in economic affairs was coming under greater pressures for economic liberalization. The failure of institutional and regulatory reform to rise to new challenges posed by the changing international as well as domestic situations has to be acknowledged.

It would be erroneous to view the crises as due to "crony capitalism" or to some similar failure of the policy and institutional framework supporting the accelerated development of industrial capacities and capabilities in the region. Yet, it would be equally fallacious to regard the concerned economies as innocent bystanders bearing no responsibility whatsoever for what was happening. Instead, the region's vulnerability to crisis was due to inappropriate and even irresponsible earlier policies, with important adverse macroeconomic implications.

While official efforts to accelerate industrial technological progress in Indonesia, Malaysia and Thailand have increased, at least since the late 1980s, the South-East Asian trio remained well behind the Republic of Korea, Taiwan Province of China and Singapore. Domestic political priorities have often neglected technology policies, while policy initiatives have also been constrained by the weak commitments of the governments concerned. The dominant position of foreign firms in the most dynamic manufacturing sectors has also served as a major deterrent to more pro-active technology development efforts. All too often, technology policies have not been sensitive enough to sector- or industry-specific conditions. More worryingly, the scope for discretionary policies has become more constrained as global regulatory frameworks are increasingly defined by international organizations with enforcement capacities, as well as effectively coordinated and articulated investor demands. Nonetheless, there still is much scope and potential for informed technology policies in the region.

With accelerated globalization and economic integration in the past decade, the international investment environment, especially in the East Asian region, has changed considerably. Taking into consideration the fresh constraints imposed by new international regulations and commitments, as well as the more sophisticated industries in some of these economies, investment policy reform was already occurring before the 1997/98 crises. However, the crises and its aftermath, including the conditionalities imposed by IMF on Indonesia and Thailand for emergency credit facilities, have also introduced new constraints. Attracting new "green-field" investments to restore and sustain growth as well as structural change is all the more urgent as so much recent FDI in the region has involved mergers and acquisitions.

Most accounts of the East Asian miracle have emphasized the key contributions of educational efforts in raising the quality of human resources throughout the region. However, once again, the actual South-East Asian record in this regard has fallen well short of the other HPAEs (Booth, 1999). With the exception of Singapore, educational achievements in South-East Asia, including in the South-East Asian trio, have been grossly inferior to those in the

other HPAEs. While the region's earlier achievements in extending primary and lower secondary schooling have probably contributed to rapid its growth and labour-intensive industrialization, these limited educational gains may well serve as fetters to further progress. (Ironically, the country with the highest share of tertiary education in the region – the Philippines – has not had a particularly impressive economic growth record for a complex variety of reasons.) There is now considerable cause for concern that rapid structural change, industrialization and productivity gains may not be achievable in the future owing to the region's poor educational efforts. Such findings and comparisons compel a reconsideration of the facile World Bank policy recommendation that governments should concentrate on enhancing human resources, but only subsidize primary schooling.

Comparing the South-East Asian trio with the Republic of Korea and Taiwan Province of China, it is now quite clear that the latter two economies not only achieved far more in terms of growth, industrialization and structural change, but that income inequality in them has been significantly lower as well (Jomo, 1999). While their better economic performance was probably due to more effective government interventions, especially selective industrial policy, lower inequality was probably due to significant asset (especially land) redistribution before the high growth period, i.e. more equitable "initial conditions". However, there is also troubling evidence that economic liberalization in recent years may well have exacerbated inequalities in both East Asian groups.

Evidence from other developing countries (Ganuza et al., 2000) suggests that more equitable growth has been achieved elsewhere with policy mixes combining three elements: first, avoiding a macroeconomic mix of real exchange rate appreciation and high domestic interest rates; second, developing and maintaining flexible systems of well targeted export incentives; third, having appropriate prudential financial regulation as well as capital controls to contain the negative consequences of capital flow surges.

IV. The East Asian débâcle

Although there has been considerable work critical of the East Asian record and potential, none actually anticipated the East Asian *débâcle* of 1997/98 (Krugman, 1994). Although some of the weaknesses identified in the literature did make the region economically vulnerable, none of the critical writing seriously addressed one crucial implication of the greater role of foreign capital in South East Asia, in particular with regard to international financial liberalization, which became more pronounced in the 1990s. As previously noted (Jomo, 1998), dominance of manufacturing activities – especially the most technologically sophisticated and dynamic ones – by foreign transnationals subordinated domestic industrial capital in the region, allowing finance capital, both domestic and foreign, to become more influential.

In fact, financial capital developed a complex symbiotic relationship with politically influential *rentiers*, now dubbed "cronies" in the aftermath of 1997/98. Although threatened by the full implications of international financial liberalization, South-East Asian financial interests were quick to identify and secure new possibilities of capturing rents from arbitrage as well as other opportunities offered by gradual international financial integration. In these and other ways (Gomez and Jomo, 1999; Khan, 2000), transnational dominance of South-East Asian industrialization facilitated the ascendance and consolidation of financial interests and politically influential *rentiers*.

This increasingly powerful alliance was primarily responsible for promoting financial liberalization in the region, both externally and internally. However, insofar as the interests of domestic financial capital did not entirely coincide with international finance capital, the process of international financial liberalization was partial. The processes were also necessarily uneven, considering the variety of different interests involved and their varying lobbying strengths in different parts of the region.

History too was not irrelevant. For example, the banking crisis in Malaysia in the late 1980s served to ensure a prudential regulatory framework which checked the process from becoming as in Thailand, where caution was thrown to the wind as early external liberalization measures succeeded in securing capital inflows. Yet, in both countries such flows were wanted to finance current account deficits, principally due to service account deficits (mainly for imported financial services as well as investment income payments abroad) and growing imports for consumption, speculative activity in regional stock markets, and output of non-tradeables, mainly in the property (real estate) sector. There is little evidence that such capital inflows contributed significantly to accelerating the pace of economic growth, especially of the tradeable sectors of the economy. Instead, it is

likely that they contributed greatly to the asset price bubbles, whose inevitable deflation was accelerated by the advent of the crisis, with its devastating economic, social and political consequences.

A. *Crisis and contagion*

After months of international speculative attacks on the Thai baht, the Bank of Thailand let its currency float from 2 July 1997, allowing it to drop suddenly. By mid-July 1997, the currencies of Indonesia, Malaysia and the Philippines had also fallen precipitously after being floated, with their stock market price indices following suit. In the following months, currencies and stock markets throughout the region came under pressure as easily reversible short-term capital inflows took flight in herd-like fashion. In November 1997, despite the Republic of Korea's rather different economic structure, the won too had collapsed after withdrawal of official support. Most other economies in East Asia were also under considerable pressure, either directly (e.g. the attack on the Hong Kong dollar) or indirectly (e.g. due to the desire to maintain competitive cost advantage against the devalued currencies of South-East Asian exporters).

Contrary to the impression conveyed mainly by the business media as well as by IMF, there is still no consensus on how to understand and characterize the crisis. One manifestation of this has been the debates between IMF and its various critics over the appropriateness of its negotiated programmes in Indonesia, the Republic of Korea, and Thailand. While policy debates have understandably captured the most attention, especially with the public at large, the East Asian crises have also challenged previously accepted international economic theories.

However, contrary to the popular impression promoted by the Western-dominated financial media of "crony capitalism" as the main culprit, most serious analysts now agree that the crisis began essentially as a currency crisis of a new type, different from those previously identified with either fiscal profligacy or macroeconomic in-discipline. A growing number also seem to agree that the crisis started off as a currency crisis and quickly became a more generalized financial crisis, before impacting on the real economy because of reduced liquidity in the financial system and the consequences of inappropriate official policy and ill-informed herd-like market responses.[3]

B. *From miracle to débâcle*

Rapid economic growth and structural change, mainly associated with export-led industrialization in the region, can generally be traced back to the mid-1980s. Then, devaluation of the currencies of all three South-East HPAEs as well as selective deregulation of onerous rules helped to create attractive conditions for the relocation of production facilities in these countries and elsewhere in South East Asia and China. This was especially attractive for Japan and the first-tier or first-generation NIEs – Hong Kong (China), the Republic of Korea, Singapore and Taiwan Province of China – most of which experienced currency appreciations, tight labour markets and higher production costs. This sustained export-oriented industrialization well into the 1990s, and was accompanied by the growth of other manufacturing, services and construction activities.

High growth was sustained for about a decade, during much of which fiscal surpluses were maintained, monetary expansion was not excessive and inflation was generally under control (see Appendix table 1). Table 1 shows various summary macroeconomic indicators for the 1990s, with greater attention to the period from 1996. Prior to 1997, the savings and investment rates were high and rising in all three South-East Asian economies. Foreign savings supplemented high domestic savings in all four economies, especially in Thailand and Malaysia. Unemployment was low, while fiscal balances generally remained positive up to 1997/98.

This is not to suggest, however, that the fundamentals were all alright in East Asia (Rasiah, 2001). As table 1 shows, the incremental capital-output ratio (ICOR) rose in all three South-East Asian economies during the 1990s before 1997, with increase greatest in Thailand and least in Indonesia. The rising ICOR suggests declining returns to new investments before the crisis. Export-led growth had been followed by a construction and property boom, fuelled by financial systems favouring such "short-termist" investments – involving loans with collateral, which bankers like – over more productive, but also seemingly more risky investments in manufacturing and agriculture. The exaggerated expansion of investment in such non-tradeables exacerbated their current account deficits. Although widespread in East Asia, for various reasons, the property-finance nexus was particularly strong in Thailand, which made it much more vulnerable to the inevitable bursting of the bubble (Jomo, 1998; Pasuk and Baker, 2000).

Table 1

EAST ASIA FOUR: MACROECONOMIC INDICATORS, 1990–1999

	Unemployment rate					*Savings/GDP*				
	1990	*1996*	*1997*	*1998*	*1999*	*1990–95*	*1996*	*1997*	*1998*	*1999*
Indonesia	n.a.	4.1	4.6	5.5	6.3	31.0	26.2	26.4	26.1	23.7
Malaysia	6.0	2.5	2.4	3.2	3.0	36.6	37.1	37.3	39.6	38.0
Rep. of Korea	2.4	3.0	2.6	6.8	6.3	35.6	33.7	33.3	33.8	33.5
Thailand	4.9	1.1	0.9	3.5	4.1	34.4	33.0	32.5	34.9	31.0

	Investment/GDP					*(Savings-investment)/GDP*				
	1990–95	*1996*	*1997*	*1998*	*1999*	*1990–95*	*1996*	*1997*	*1998*	*1999*
Indonesia	31.3	29.6	28.7	22.1	19.3	-0.3	-3.4	-2.3	4.0	4.4
Malaysia	37.5	42.5	43.1	26.8	22.3	-0.9	-5.4	-5.8	12.8	15.7
Rep. of Korea	36.8	36.8	35.1	29.8	28.0	-1.2	-3.1	-1.8	4.1	5.5
Thailand	41.0	41.1	33.3	22.2	21.0	-5.6	-8.1	-0.9	12.8	10.0

	Incremental capital-output ratios					
	1987–89	*1990–92*	*1993–95*	*1997*	*1998*	*1999*
Indonesia	4.0	3.9	4.4	1.7	0.4	1.8
Malaysia	3.6	4.4	5.0	3.9	28.2	4.3
Rep. of Korea	3.5	5.1	5.1	4.2	-15.1	3.2
Thailand	2.9	4.6	5.2	12.9	-11.5	14.5

	Fiscal balance/GDP				
	1990–95	*1996*	*1997*	*1998*	*1999*
Indonesia	0.2	1.4	1.3	-2.6	-3.4
Malaysia	-0.4	0.7	2.4	-1.8	-3.2
Rep. of Korea	0.2	0.5	-1.4	-4.2	-2.9
Thailand	3.2	2.4	-0.9	-3.4	-3.0

Source: Radelet and Sachs (1998: table 11); ADB (1999); Bank of Thailand, Bank Indonesia, Bank of Korea, Bank Negara Malaysia.

Financial liberalization from the 1980s had major ramifications in the region, as foreign savings supplemented the already high domestic savings rates in the region to further accelerate the rate of capital accumulation, albeit in increasingly unproductive activities, owing to the foreign domination of most internationally competitive industries in the region. Consequently, several related macroeconomic concerns had emerged by the mid-1990s from the rapid growth of the previous decade.

First, the savings-investment gap had historically been financed by heavy reliance on FDI as well as public sector foreign borrowings, with the latter declining rapidly from the mid-1980s. Both FDI and foreign debt, in turn, caused investment income outflows abroad.[4] In the 1990s, the current account deficit[5] was increasingly financed by short-term capital inflows, as in 1993 and 1995/96, with disastrous consequences later with the subsequent reversal of such flows. Many recent confidence restoration

measures seek to induce such short-term inflows once again, but they cannot be relied upon to address the underlying problem in the medium to long term. Although always in the minority, foreign portfolio investments increasingly influenced the stock markets in the region in the 1990s. With incomplete information exacerbated by limited transparency, their regional presence, the biased nature of fund managers' incentives and remuneration and the short-termism of their investment horizons, foreign financial institutions were much more prone to herd behaviour, and thus contributed most decisively to regional contagion.

Second, there was an explosion of private sector debt in the 1990s, especially from abroad, not least because of the efforts of "debt-pushers" keen to secure higher returns from the fast-growing region.[6] Commercial banks' foreign liabilities also increased quickly as the ratio of loans to GNP rose rapidly during the period.

Overinvestment of investible funds, especially from abroad, in non-tradeables only made things worse, especially on the current account. Only a small proportion of commercial banks and other lending agencies went to manufacturing and other productive activities. This share is likely to have been even smaller with foreign borrowings, most of which was collateralized with assets such as real property and stock.[7]

Thus, much of the inflow of foreign savings actually contributed to asset price inflation, mainly involving real estate and share prices. Insofar as such investments did not increase the production of tradeables, they actually exacerbated the current account deficit, rather than alleviated it – as they were thought to be doing. This, in turn, worsened the problem of "currency mismatch", with borrowings in US dollars invested in activities not generating foreign exchange.

As a high proportion of these foreign borrowings were short-term in nature and deployed to finance medium- to long-term projects, a "term mismatch" problem also arose. According to the Bank for International Settlements (BIS) (*Asian Wall Street Journal*, 6 January 1998), well over half of the foreign borrowings by commercial banks were short-term in nature: in Malaysia 56 per cent, in Thailand 66 per cent, in Indonesia 59 per cent, and in the Republic of Korea 68 per cent.

More generally, the foreign exchange risks of investments generally increased, raising the vulnerability of these economies to the maintenance of currency pegs to the US dollar.[8] The pegs encouraged a great deal of un-hedged borrowing by an influential constituency with a strong stake in defending the pegs regardless of their adverse consequences for the economy. Owing to foreign domination of export-oriented industries in South East Asia, unlike in North East Asia, there was no strong domestic export-oriented industrial community to lobby for floating or depreciation of the South-East Asian currencies despite the obvious adverse consequences of the pegs for international cost competitiveness. Instead, after pegging their currencies to the US dollar, from the early 1990s and especially from the mid-1990s, most South-East Asian central banks resisted downward adjustments to their exchange rates, which would have reduced, if not averted some of the more disruptive consequences of the 1997/98 currency collapses.[9] Yet, it is also now generally agreed that the 1997/98 East Asian crises saw tremendous "overshooting" in exchange rate adjustments well in excess of expected "corrections".

It is generally agreed that the affected South-East Asian economies were characterized by the following key fundamentals:

(i) viability of domestic financial systems;[10]
(ii) domestic output and export responsiveness to nominal devaluations;[11]
(iii) sustainability of current account deficits;[12]
(iv) high savings rates and robust public finances.

C. *Consequences of financial liberalization*

In Kaminsky and Reinhart's (1996) study of 71 balance-of-payments (BoP) crises and 25 banking crises during the period 1970–1995, there were only three banking crises associated with the 25 BoP crises during 1970–1979. However, there were 22 banking crises which coincided with 46 BoP crises over 1980–1995, which the authors attribute to the 1980s financial liberalization, with a private lending boom culminating in a banking crisis, and then a currency one. Montes (1998) attributes the South-East Asian currency crisis to the "twin liberalizations" of domestic financial systems and opening of the capital account. Financial liberalization induced new behaviour in financial systems, notably:

(i) domestic financial institutions had greater flexibility in offering interest rates to secure funds domestically and in bidding for foreign funds;

(ii) they became less reliant on lending to the government;

(iii) regulations, such as credit allocation rules and ceilings, were reduced;

(iv) greater domestic competition meant that ascendance depended on expanding lending portfolios, often at the expense of prudence.

Looking at 57 countries during the 1970–1996 period, Carleton et al. (2000) find that inflationary macroeconomic policies and small foreign reserves stocks reliably predicted currency collapses. They argue that since the probability of Indonesia, Malaysia, the Republic of Korea and Thailand experiencing a currency collapse in 1997 was about 20 per cent, and all four currencies (and economies) collapsed – rather than just one, as expected – financial contagion is a better explanation than weak domestic fundamentals.

Clearly, investor panic was the principal cause of the Asian financial crisis (McKibbin, 1998; Montes, 1998). The tightening of macroeconomic policies in response to the panic served to exacerbate rather than check the crisis. Economic disasters are not necessarily punishment for economic sins, and while "cronyism" is wrong, it was not the cause of the East Asian crises. And as the recent East Asian crisis has demonstrated, even sound macroeconomic fundamentals cannot guarantee immunity from contagion and crisis.

One of the most cited crisis explanations suggests that it stemmed from the banking sector as a result of imprudent expansion and diversification of domestic financial markets, fuelled by short-term private borrowings. While this may have been true of Thailand, it was certainly less so of Indonesia, Malaysia, the Philippines and the Republic of Korea (in order of decreasing relevance). Instead, the significance of contagion cannot be exaggerated, as "the differences raise questions about how sensitive the currency knockdowns (and the associated divestment from these economies) are to economic fundamentals" (Montes, 1998: 3).

Although financial systems in the region are quite varied and are hardly clones of the Japanese "main bank" system (as is often wrongly alleged), they had nevertheless become prone to similar asset price "bubbles", albeit for somewhat different reasons. Arguably, the more bank-based systems of Indonesia, the Republic of Korea and Thailand had a stronger nexus of this kind compared to, say, Malaysia's much more market-oriented financial system. Rapid growth, on the basis of export-oriented industrialization from the late 1980s, gave rise to accelerated financial expansion, which contributed to asset price bubbles (including property booms), both in more market-oriented or "Anglo-American" Malaysia as well as in the other more bank-oriented economies badly hit by the crises.[13]

Little has been achieved by insisting that the crisis should not have happened since East Asian economic fundamentals were fine, even if that were completely true. In some instances, such official denials exacerbated the problem as the authorities did not seem to be responding to ostensible problems in ways deemed appropriate by market opinion makers. Unfortunately, as East Asia has painfully learnt, financial markets are driven by sentiments as much as by fundamentals. Hence, although much more serious current account deficits in 1995, for instance, did not result in a crisis, it does not mean that an economy can maintain such deficits indefinitely without being vulnerable to speculative attack or loss of confidence.

One cannot, for example, liberalize the capital account, and then complain when short-term portfolio investors suddenly withdraw following their whims and fancies. Capital controls can make it difficult and/or costly to rapidly withdraw capital from an economy. Many governments treat FDI very differently from portfolio investments. Some authorities are trying to distinguish between speculative investments by hedge funds that are clearly short-termist from, say, pension funds with more medium-term orientations.

In the early and mid-1990s, some South-East Asian economies had become excessively reliant on such short-term capital inflows to finance their current account deficits. This problem was exacerbated by excessive imports to manufactures more non-exportables, such as buildings, infrastructure and heavily protected import substitutes. Ostensibly, prudent financial institutions often preferred to lend for real property and stock purchases, and thus secure assets with rising values as collateral, rather than to provide credit for more productive ends.

While foreign banks were more than happy to lend US dollars at higher interest rates than available in their home economies, East Asian businesses were keen to borrow at lower interest rates than were available domestically. The sustained dollar pegs of the South-East Asian currencies may have induced

some moral hazard by discouraging borrowers from hedging their loans, but there is little systematic evidence of the extent of this problem. In any case, the existence of well-developed swap markets allowed South-East Asian companies to tap into foreign capital markets, at low cost, by swapping away the currency risk.

Hence, many such loans remained unhedged as South-East Asian currencies had been pegged to the US dollar since the 1970s, despite the official fictions of exchange rates moving with the baskets of the currencies of their major foreign trading partners. The growth in foreign banking in the region in the 1990s led to lending competition reminiscent of the loans to third world governments in the late 1970s (which led to the debt crisis of the 1980s). However, the new belief in international policy-making circles before the crisis was that such accumulation of private sector debt did not matter as long as public sector debt was reined in.

Meanwhile, portfolio investors moved into newly emerging stock markets in East Asia with encouragement from the International Finance Corporation (IFC), an arm of the World Bank. In Malaysia, for example, they came in a big way in 1993, only to withdraw even more suddenly in early 1994, leaving most retail stockholders in the lurch. The government introduced some capital control measures, only to withdraw them later in 1994. Unfortunately, policy makers did not learn the lessons from that experience as the new unsustainable stock market build-up from 1995 sent stock prices soaring once again despite declining price-earnings ratios.

Thus, the East Asian currency and financial crises since mid-1997 have been partly caused by financial liberalization and the consequent undermining of monetary and financial governance. The "managed pegs" of the region's currencies to the US dollar and the encouragement of foreign capital inflows – into the recently opened-up stock markets as well as in the form of borrowings, often on a short-term basis[14] – financed the current account deficits. They also ensured that foreign savings supplemented the already high domestic savings rate to raise investment rates in the region, contributing to a spiralling inflationary bubble of share and real property prices. The peg not only encouraged unhedged borrowings and portfolio investments from abroad, but also became a target for currency speculators as regional currencies appreciated with the US dollar from mid-1995, in spite of declining export competitiveness and growth.

Perceiving the East Asian region as much more integrated than it actually is, the panicky investment decisions of fund managers were typically "herd-like",[15] causing "contagion" throughout the region. The very nature and magnitude of hedge fund operations[16] tended to exacerbate these phenomena, with disastrous snowballing consequences for the region. Other international, regional and, increasingly, local currency speculators and hedgers also contributed by reacting in their own perceived self-interest to supposed market trends, rather than as part of some grand conspiracy.

With the currency collapses, the assets acquired by portfolio and other investors in the region depreciated correspondingly in value, precipitating an even greater sell-out and panic, causing herd behaviour and contagion to spread across national borders to the rest of the region. Meanwhile, liberalizing the capital account essentially guaranteed residents and non-residents ease of exit, as well as fewer limitations on nationals holding foreign assets, thus inadvertently facilitating capital flight.

Thus, financial liberalization allowed lucrative opportunities for taking advantage of falling currencies, thus accelerating and exacerbating the volatility of regional currency and share markets. All this, together with injudicious official responses, transformed the inevitable "correction" of overvalued currencies in the region into collapse of the currencies and the stock markets of the region as panic set in, aggravated by "herd" behaviour and "contagion".

D. Crises of a new type

It seems fair to say that no one fully anticipated the crisis in East Asia, mainly because it was a crisis of a new type. Some observers argued that there were important parallels with the Mexican tequila crisis of 1995, while others emphasized the differences (Kregel, 1998). There were, of course, sceptics who regarded the claims of an East Asian economic miracle as somewhat exaggerated, albeit for different reasons: for example, because they had not achieved much productivity growth and would eventually run up against diminishing returns (Krugman, 1994). But these were different criticisms of the East Asian miracle and certainly did not anticipate, let alone predict, the East Asian *débâcle* of 1997/98.

It is now clear that the East Asian crisis differed from conventional currency crisis scenarios in at least several important ways (Krugman, 1998c):[17]

(i) the absence of the usual sources of currency stress, whether fiscal deficits or macroeconomic in-discipline;[18]

(ii) the governments did not have any incentive to abandon their pegged exchange rates, for instance to reduce unemployment;

(iii) the pronounced boom-bust cycles in asset prices (real property and stock markets) preceded the currency crisis, especially in Thailand, where the crisis began;

(iv) financial intermediaries have been key players in all the economies involved;

(v) the severity of the crisis in the absence of strong adverse shocks;

(vi) the rapid spread of the initial crisis in Thailand, even to economies with few links or similarities to the first victims.

Very importantly then, the traditional indices of vulnerability did not signal a crisis, as the source of the problem was not to be found in the governments per se or even in national income accounts. The (mainly private) financial intermediaries were "not part of the governments' visible liabilities until after the fact". Other issues also need to be taken into account for an adequate analysis of the East Asian crisis:

(i) the financial crises had very severe adverse effects on growth by *disrupting* the productive contribution of *financial intermediation*;

(ii) the East Asian crises not only involved *excessive* investments, but also *unwise investments*;

(iii) the huge real currency depreciations caused large *declines in output*, and seemed to do little to promote exports;

(iv) *other* kinds of *market failure* – for example, herd behaviour – need to be taken into account.

Furman and Stiglitz (1998: 101) emphasize that economic downturns caused by financial crises are far more severe and have longer lasting effects than those caused by inventory cycles. High leveraging by companies and high lending for asset price (stock or property market) booms enhance financial fragility. Increased insolvencies disrupt the credit mechanism. Large unanticipated interest rate increases may not only precipitate financial crises, but are also likely to cause economic downturns as the value of bank assets and highly indebted firms collapse. Also, such adverse effects are likely to persist well after the interest rate has returned to more normal levels.

Besides asset price bubbles, excessive investments and other problems caused by moral hazard due to implicit government guarantees for weakly regulated financial intermediaries as well as the exchange rate peg, a more comprehensive analysis must also consider the following phenomena:

(i) the implications of the growth in currency trading and speculation for the post-Bretton-Woods international monetary system;

(ii) the reasons for the South-East Asian monetary authorities to defend their quasi-pegs against the strengthening US dollar, despite its obvious adverse consequences for export competitiveness and hence for growth;

(iii) the consequences of financial liberalization, including the creation of conditions which have contributed to the magnitude of the crises;

(iv) the role of herd behaviour in exacerbating the crises;

(v) other factors accounting for the contagion effects.

E. *Reversible capital flows*

Growing attention has been given to the role of reversible capital flows into the East Asian region as the principal cause of the 1997/98 crisis. It is increasingly widely accepted that the national financial systems in the region did not adapt well to international financial liberalization (Jomo, 1998). The bank-based financial systems of most of crisis-hit East Asia were especially vulnerable to the sudden drop in the availability of short-term loans, as international confidence in the region dropped suddenly during 1997. Available foreign exchange reserves were exposed as inadequate to meet financial obligations abroad, requiring governments to seek temporary credit facilities to meet such obligations mainly incurred by their private sectors.

Data from BIS show that the banks were responsible for much of this short-term debt, though, of course, some of it consisted of trade credit and other short-term debt deemed essential to ensuring liquidity in an economy. However, the very rapid growth of short-term bank debt during stock market and property boom periods suggests that much short-term debt was due to factors other than trade credit expansion. In Malaysia, the temporary capital controls introduced in early 1994 by the central bank momentarily dampened the growth of such debt, but

Table 2

LENDING BY BIS REPORTING BANKS TO FOUR EAST ASIAN ECONOMIES BY SECTOR, AS OF END-JUNE 1997

(US$ billion)

	Rep. of Korea	*Thailand*	*Indonesia*	*Malaysia*	*Developing countries*
Total Borrowings	**103.4**	**69.4**	**58.7**	**28.8**	**744.6**
Banks	67.3	26.1	12.4	10.5	275.3
(per cent)	(65.1)	(37.6)	(21.1)	(36.5)	(37.0)
Private non-bank	31.7	41.3	39.7	16.5	352.9
(per cent)	(30.6)	(59.5)	(67.6)	(57.3)	(47.4)
Government	4.4	12.0	6.5	1.9	115.6
(per cent)	(4.3)	(17.3)	(11.1)	(6.6)	(15.5)

Source: Bank for International Settlements.

by 1996 and early 1997 a new short-term borrowing frenzy was quite evident, involving not only the banks but also other large private companies with enough political influence to circumvent central bank guidelines.

As table 2 shows, in Indonesia, Malaysia and Thailand, the non-bank private sector was the major recipient of international bank loans, accounting for more than 50 per cent of total foreign borrowings by the end of June 1997, i.e. well above the developing country average of slightly under half. In contrast, 65 per cent of borrowing in the Republic of Korea was by banks, with only 31 per cent by the non-bank private sector. Government borrowings were low, and lowest in Malaysia and the Republic of Korea, although the data does not allow us to differentiate the state-owned public companies or partially private, but corporatized former fully state-owned enterprises.

Appendix tables 2a, 2b, 2c and 2d show the remarkable growth of (mainly private) foreign debt in the early and mid-1990s, especially in the three most externally indebted economies of Indonesia, the Republic of Korea and Thailand. While FDI grew in all four economies in the 1990s, it was most modest in the Republic of Korea. Profit remittances on FDI were least from the Republic of Korea and Thailand, and highest from Malaysia, reflecting its greater role historically, although FDI in Indonesia was actually higher in 1995/96. Portfolio equity flows into all four economies grew greatly in the mid-1990s.

External debt as a share of export earnings rose from 112 per cent in 1995 to 120 per cent in 1996 in Thailand and from 57 per cent to 74 per cent over the same year in the Republic of Korea, but actually declined in Indonesia and grew more modestly in Malaysia. By 1996, reserves as a share of external debt were only 15 per cent in Indonesia, 30 per cent in the Republic of Korea, 43 per cent in Thailand and 70 per cent in Malaysia. By 1997 this ratio had dropped further to 15 per cent in the Republic of Korea, 29 per cent in Thailand, and 46 per cent in Malaysia, reflecting the reserves lost in futile currency defence efforts. Despite recessions in 1998, reserves picked up in all four economies, mainly due to the effects of currency devaluations on exports and imports. The short-term debt share of total external debt in 1996 stood at 58 per cent in the Republic of Korea, 41 per cent in Thailand, 28 per cent in Malaysia, and 25 per cent in Indonesia.

Table 3 shows that much of lending to developing countries was done by Japanese, German and French BIS-reporting banks, with United States and United Kingdom banks being far less significant. This pattern was quite different from that of lending before the 1980s debt crises, and suggests that Anglo-American banks were generally far more reluctant

Table 3

EXPOSURE OF BIS AREA REPORTING BANKS TO NON-BIS BORROWERS, END-JUNE 1997

(US$ billion)

Total	*1054.9*
Germany	178.2
Japan	172.7
United States	131.0
France	100.2
United Kingdom	77.8
Percentage of private non-bank borrowers	45

Source: Bank for International Settlements.

to lend in the 1990s following their experiences in the 1980s. There is little evidence to suggest that such banks were more averse to lending either to governments or to developing economies. The pattern of lending in the late 1970s and early 1980s suggests the contrary.

From the beginning of the decade, Malaysia sustained a current account deficit. Overinvestment of investible funds in non-tradeables only made things worse. Insofar as such investments – for example, in power generations and telecommunications – did not contribute to export earnings, they aggravated the problem of currency mismatch, with foreign borrowings invested in activities not generating foreign exchange. An additional problem of "term mismatch" also arose, as a high proportion of these foreign borrowings were short-term in nature (table 4), but were deployed to finance medium- to long-term projects.

Foreign capital inflows into East Asia augmented the high domestic savings rate to raise the domestic investment rate as well as East Asian investments abroad in the 1990s. Thus, though there is some evidence that foreign capital inflows may have adversely affected the domestic savings rate indirectly, foreign capital inflows generally supplemented, rather than substituted for, domestic savings (Wong with Jomo, 2001). It is difficult to be conclusive on this point as the nature of foreign capital inflows has changed significantly over time. Hence, even if earlier foreign capital inflows may once have adversely affected domestic savings, it is also possible that the changed composition of foreign capital inflows just before the crisis no longer adversely affected domestic savings.

Increased foreign capital inflows have reduced foreign exchange constraints, allowing the financing of additional imports, but thus also inadvertently

Table 4

MATURITY DISTRIBUTION OF LENDING BY BIS REPORTING BANKS TO SELECTED ASIAN ECONOMIES, 1996

(US$ million)

	All loans			*Under 1 year*			*1–2 years*		
	June 1996	*Dec. 1996*	*June 1997*	*June 1996*	*Dec. 1996*	*June 1997*	*June 1996*	*Dec. 1996*	*June 1997*
Rep. of Korea	88,027	99,953	103,432	62,332	67,506	70,182	3,438	4,107	4,139
Thailand	69,409	70,147	69,382	47,834	45,702	45,567	4,083	4,829	4,592
Indonesia	49,306	55,523	58,726	29,587	34,248	34,661	3,473	3,589	3,541
Malaysia	20,100	22,234	28,820	9,991	11,178	16,268	834	721	615

Source: Bank for International Settlements.

Table 5

EAST ASIAN FOUR: DEBT SERVICE AND SHORT-TERM DEBT, 1980–1996

	Debt service as a proportion of exports (Per cent)			*Short-term debt (US$ billion)*[a]				*Current account deficit plus short-term debt as share of international reserves (Per cent)*[b]			
	1980	*1992*	*1995*	*1992*	*1994*	*1995*	*1996*	*1992*	*1994*	*1995*	*1996*
Indonesia	13.9	32.1	30.9	18.2	14.0	16.2	17.9	191	139	169	138
Malaysia	6.3	6.6	7.8	3.6	7.6	7.5	8.5	29	46	60	55
Rep. of Korea	14.5	6.9	5.8	11.9	31.6	46.6	66.6	133	125	131	127
Thailand	18.9	14.1	10.2	14.7	29.2	41.1	44.0	101	127	152	153

Source: UNCTAD (1997: table 14); World Bank (1994: tables 20 and 23; 1997: table 17).

a Year-end figures.

b As a percentage of reserves, measured by dividing the current account deficit plus short-term debt by international reserves (1992 figures computed from World Bank data).

encouraging current account deficits. Finally, foreign capital inflows have most certainly adversely affected factor payment outflows, export and import propensities, the terms of trade and capital flight, and thus the balance of payments. These results suggest caution in determining the extent to which foreign capital inflows should be encouraged. Furthermore, the South-East Asian trio's heavy dependence on FDI in gross domestic capital formation, especially for manufacturing investments, has probably also limited the development of domestic entrepreneurship, as well as many other indigenous economic capabilities, by requiring greater reliance on foreign capabilities, usually associated with some types of FDI (Jomo et al., 1997).

After mid-1995 the South-East Asian currency pegs to the US dollar – which had enhanced the region's competitiveness as the dollar declined for a decade after the 1985 Plaza accord – became a growing liability as the yen began to depreciate once again. The overvalued currencies became attractive targets for speculative attacks, resulting in the futile but costly defence of the Thai baht and Malaysian ringgit, and the rapid regional spread of herd panic, termed contagion. The resulting precipitous asset price collapses – as the share and property market bubbles burst – undermined the East Asian four's heavily exposed banking systems, for some (e.g. Malaysia), for the second time in little over a decade, undermining financial system liquidity, and causing economic recession.

Undoubtedly, international financial liberalization succeeded in temporarily generating massive net capital inflows into East Asia, unlike many other developing and transitional economies, some of which experienced net outflows. But it also exacerbated systemic instability and reduced the scope for the developmental government interventions responsible for the region's economic miracle. In South East Asia, FDI domination (well above the average for developing countries) of internationally competitive manufacturing had weakened domestic industrialists, inadvertently enhancing the dominance of finance capital and its influence over economic policy making.

As noted earlier, three major indicators began to cause concern from the mid-1990s on. The current account of the balance of payments and the savings-investment gap were recording large imbalances in the South-East Asian economies, especially Malaysia and Thailand. However, as table 5 shows, the short-term foreign debt and current account deficits as proportions of international reserves in Malaysia were better than in Indonesia, the Republic of Korea and Thailand, thereby averting the need for IMF emergency credit. Domestic credit expansion had also soared in all four countries by the mid-1990s. Prior to the crisis, there had been a steady

trend towards financial liberalization in East Asia, dating back to the mid-1980s. This had included bank liberalization, considerable promotion of the region's "newly emerging" stock markets and greater capital account convertibility. Thus, East Asia succeeded in attracting a great deal of capital inflow.[19]

F. Financial liberalization

An explosion of international financial flows followed the substitution of the Bretton Woods system of fixed exchange rates with the prevailing system of flexible exchange rates. Strong speculative motives have been ascribed to most of the international capital flow not associated with FDI. Much recent FDI, especially into East Asia in the wake of the crisis, has been for the purpose of mergers and acquisitions, rather than to add new economic capacity through green-field investments.

The demise of fixed exchange rate regimes has also encouraged capital account liberalization. Recent financial developments have resulted in a proliferation of financial instruments, enabling investors to diversify their financial asset holdings. These trends gathered steam with international financial liberalization in the wake of the international debt crisis of the 1980s, and picked up further momentum in the 1990s. The volume of foreign exchange spot transactions had grown to well over a trillion US dollars daily, or more than 67 times the total value of the international trade in goods by 1995, or more than 40 times the value of all international trade (including "invisibles" or services). The daily foreign exchange market in 1997 was estimated at US$ 1,250 billion. In a world economy where foreign exchange spot transactions are now worth more than 70 times the total value of international commodity trade transactions, the financial sector has become increasingly divorced from the real economy.

Viewed from an historical perspective then, such currency trading is hardly natural, inevitable or even desirable. For most of human history, including that of capitalism, it has not been "integral to global trade in goods and services", as claimed by then United States Treasury Secretary Robert Rubin. In fact, as is well known, various critics have offered various alternatives to the present system. With the recent proliferation of new financial instruments and markets, the financial sector has an even greater capacity to inflict damage on the real economy. Ever since Keynes advocated "throwing sand" into the financial system to check the potentially disastrous consequences of unfettered liberalization, Keynesians, and others, have been wary of the financial liberalization advocated by ideological neo-liberals and their often naïve allies.

Furthermore, it is important to emphasize that many of the promised benefits of international financial liberalization have not been realized (Eatwell, 1997):

(i) First, liberalization was expected to move financial resources from capital-rich to capital-poor countries.[20] Instead, such net flows of finance – and of real resources – over time have been very modest, and if anything, going to the capital-rich.[21] Of course, most net flows to the "capital-poor" were mainly to the most attractive "emerging markets", especially in East Asia before 1998. The rush to convertibility and capital control deregulation in most transitional economies has resulted in many (e.g. the Russian Federation) becoming significant net capital exporters![22] Such flows arguably contributed to asset price bubbles and, eventually, to financial panic, and thus to currency and stock market collapses.

(ii) Second, while liberalization was expected to enhance options and returns for savers and to lower the cost of funds to borrowers, savers have benefited most from higher real interest rates.[23] Instead, it is claimed that the lower cost of funds in the late 1970s is attributable to the exceptional circumstances caused by financial repression, enhanced liquidity due to the availability of petroleum revenues and high inflation.

(iii) Third, the new financial derivatives – expected to improve risk management – have actually generated new systemic risks, especially vulnerable to sudden changes in sentiment.[24] While some of the new instruments have undoubtedly reduced some of the older sources of volatility and instability, their creation and operations have introduced new sources of systemic vulnerability.

(iv) Fourth, improved macroeconomic performance – with greater investment and growth expected from better allocative efficiency – has not been realized. Instead, overall macroeconomic performance has been worse than during the post-war "golden age" before financial liberalization.[25]

(v) Fifth, financial liberalization has introduced a persistent deflationary bias in economic policy as governments try to gain credibility in financial markets to avert destabilizing capital outflows, instead of the "healthy discipline" on governments expected to improve macroeconomic stability.

More generally, financial liberalization has introduced further constraints on the role of the state. Governments have reduced options in both monetary and fiscal policies. Besides such macroeconomic policy limitations, the room for discretionary state interventions – for example, in the form of selective industrial promotion so crucial to late industrialization – has been much reduced. Thus, financial liberalization has greatly weakened government capacity to become a developmental state. If one recognizes the desirability of preserving the limited but still significant scope for monetary independence, liberalization should not be allowed to frustrate the sound development of the financial system and its effective deployment for development purposes.[26] The scope for monetary independence partly depends on the soundness of macroeconomic management as well as political will.

Financial markets seem to function in such a way as to impose their own "expectations" on the real economy, thus defining their own "fundamentals" and logic, which in turn become self-fulfilling prophecies. In other words, they do not just process information in order to efficiently allocate resources. Since financial markets operate like beauty contests and the real economy has no automatic tendency to converge to full-employment growth, the presumed analytical assumptions of other market participants become imposed on the economy.

The threat of instability in the now massive capital market forces both governments and private investors to pursue risk-averse strategies, resulting in low growth and employment creation. A deflationary bias in government policy and the private sector emerges in response to the costly risks of violating the rules of the game. This is exacerbated by the high costs of debt due to high real interest rates owing to efforts to maintain financial stability in a potentially volatile world. Thus, "long-term price stability" supersedes "a high and stable level of employment" as the macroeconomic policy priority.

A successfully liberalized financial system, prioritizing flexibility, or the possibility of easy exit tend to become necessarily fragile, as reflected in:

(i) *liquidity crises*, reducing real output;

(ii) private sector risk aversion, encouraging *short-termism*;[27]

(iii) public sector risk aversion, resulting in a *deflationary* policy bias;

(iv) persistent pressure for ever greater flexibility, increasing the *ease of exit*.

The benefits that the reduction of financial controls has brought to "emerging markets" must be weighed against the increased instability resulting from enhanced ease and speed of exit. While increased flows of (real) FDI generally require agreement to unrestricted profit repatriation, this is quite different from the "instant exit" conditions demanded by financial markets.[28]

There is considerable evidence that in the longer term economic development has been associated with developmental states. The post-war golden age – which saw high levels of output and employment as well as short-run efficiency – was based on the premise of active macroeconomic management under the Bretton Woods system. Post-war European reconstruction was achieved with tight capital controls. Similarly, Japan, the Republic of Korea and Taiwan Province of China all began late industrialization and achieved rapid capital accumulation with the aid of capital controls.

The adverse consequences of financial disintermediation and of grossly undervalued currencies for economic development also deserve special attention, particularly as the crisis threatens the future of growth and structural change in the region, not only directly, but also as a consequence of policy responses. The typically deflationary policies favoured by the international financial community as well as others may well throw out the baby of economic development with the bath water of financial crisis.

Some dangers associated with financial liberalization have now become quite evident, but most are not sufficiently recognized, let alone debated and addressed. Most initiatives in this regard cannot be undertaken unilaterally without great cost, as market reactions to Malaysian Prime Minister Mahathir's critical remarks in the second half of 1997 showed. The very few options available for unilateral initiatives need to be carefully considered, and only implemented if deemed desirable. Selectively invoking instances of bad or incompetent policy-making or implementation does not justify leaving things to lib-

eralized markets that render systematic policy-making impossible. Instead, it emphasizes the importance of creating an environment and developing the capability for good and competent policy to be effective.

Many policies need to be actively pursued through multilateral initiatives, for which governments need the support of neighbours and others. Given the power of the dominant ideology that infuses the prevailing international system, it is virtually impossible to assert control over the financial system without a fundamental change in priorities and thinking by the governments of the major economic powers. The currencies of a small number of major governments – Germany, Japan, the United Kingdom and the United States – were involved in over three quarters of currency transactions in 1995; hence, they have the capacity and capability to monitor and control transborder capital flows by acting in concert.

G. The role of IMF

Critical consideration of the causes and consequences of the East Asian crises requires close and careful attention to the nature and implications of IMF "rescue" programmes and conditionalities, as well as policies favoured by the international, as distinct from the domestic, financial communities and others affected. IMF prescriptions and conventional policy-making wisdom urged bank closures, government spending cuts and higher interest rates in the wake of the crisis. Such contractionary measures transformed what had started as a currency crisis, and then become a full-blown financial one, into a crisis of the real economy. Thus, Indonesia, Malaysia and the Republic of Korea – that had previously enjoyed massive capital inflows in the form of short-term bank loans or portfolio investments – went into recession during 1998, following Thailand, which went into recession in 1997.

Not only did IMF underestimate the severity of the collapse in all the East Asian economies, it also under-estimated the speed and strength of recovery (IMF, 1997, 1998; Lane et al., 1999). This suggests that IMF not only did not understand the causes of the crisis but was also incapable of designing optimal policies in response. There is still considerable doubt as to whether IMF actually recognized the novel elements of the crisis and their implications ("old medicines for a new disease"), especially at the outset. The apparent failure of IMF to anticipate the current crisis in its generally glowing recent reports on the region and also to effectively check, let alone reverse, the situation despite interventions in Indonesia, the Republic of Korea and Thailand – certainly did not inspire much confidence. And although the Philippines had long been under IMF programmes and supervision, it was not spared the contagion.[29]

There is considerable international scepticism about IMF's role in, and prescriptions for, the East Asian crisis. Most economists now agree that the early IMF programmes for Indonesia, the Republic of Korea and Thailand were ill-conceived, although there is little agreement over why IMF made such mistakes. Perhaps partly out of force of habit in dealing with situations in Latin America, Africa, Eastern Europe and elsewhere, where fiscal deficits had been part of the problem, IMF insisted on the same prescription of deflationary policies in its early policy responses to the East Asian crisis.

Thus, many of its programmes were effectively contractionary in consequence, although this was sometimes disguised by poorly conceived measures to provide social safety nets for the poor. Hence, what started of as currency and financial crises, led – partly due to IMF-recommended or imposed policy responses – to economic recessions in much of the region in 1998. The accounts, of course, vary with the different countries involved.[30]

The early IMF policy prescription to raise domestic interest rates[31] not only failed to stem capital flight, but instead exacerbated the impact of the crisis, with financial pain caused by currency depreciation, stock market collapse and rising interest rates. But even if higher interest rates succeeded in doing so, such capital flight can only be temporarily checked, and even so, at great and permanent cost to productive investments in the real economy. And when inflows are eventually reversed in the precipitous manner experienced by East Asia from the second half of 1997, much collateral damage is inevitable.

Despite their sound fiscal balances before the crisis, the East Asian economies were also asked to cut government spending to restore confidence in their currencies, despite the ominous implications for economic recovery. Although all the affected East Asian economies had been running fiscal surpluses in the years preceding the crises (except Indonesia, which had a small deficit in 1996), IMF expected

the governments to slash public expenditure. With the possible exception of Indonesia (which could not raise the financing required), the other crisis-affected economies eventually ignored this advice and began to undertake Keynesian-style reflationary counter-cyclical measures from the second half of 1998, which has been primarily responsible for economic recovery since.

Incredibly, the Fund did not seem to be very cognizant of the subjective elements contributing to the crises, and seemed to approach the crises as if they were solely due to weaknesses in the macroeconomic or financial system. Examining the changing risk premiums on Eurobonds issued by East Asia, Woo (2000b) found evidence of "irrational exuberance", implying that the potential for investor panic also existed. Moreover, although the risk premiums on Thai Eurobonds increased by 10 basis points following the July 1997 devaluation, they jumped by four times as much with the acceptance of the IMF programme for Thailand in August 1997. This suggests that the latter's deflationary macroeconomic policies and abrupt closure of financial institutions had undermined, rather than restored, investor confidence.

Insolvent financial institutions should have been restructured in ways so as to avoid the possibility of triggering bank runs and consequent social instability. By insisting on closing down banks and other financial institutions in Indonesia, the Republic of Korea and Thailand, IMF undermined much of the remaining confidence there, inducing further panic in the process. Anwar Nasution (2000) points out that IMF's way of taking insolvent banks out of the Indonesian financial system in late 1997 exacerbated the country's economic crisis. He argues that the Indonesian government should have taken over the insolvent banks temporarily – rather than have them closed them down suddenly – to sustain credit to solvent borrowers and to retain depositors' confidence. Also, while IMF insisted on greater transparency by the affected host governments and those under their jurisdiction, it continued to operate under considerable secrecy itself.

Such IMF double standards, reflected by its priority in protecting the interests of foreign banks and governments, also compromised its ostensible role as an impartial agent working in the interests of the host economy. The burden of IMF programmes invariably fell on the domestic financial sector and, eventually, on the public at large, which has borne most of the costs of adjustment and reform. The social costs of the public policy responses have been very considerable, usually involving bailouts of much of the financial sector and the corporate sector more generally.

There has been considerable unhappiness in East Asia about how differently IMF had responded to the East Asian crises compared to the earlier Mexican one. It is widely believed that IMF was far more generous in helping Mexico because of the United States' interest in ensuring that the tequila crisis should not be seen as an adverse consequence of Mexico's joining the North American Free Trade Agreement (NAFTA). In contrast, East Asians saw IMF as far less generous and also more demanding with all three countries, which had long seen themselves as allies of the United States and the West.

Liabilities and other commitments to foreign banks have invariably been given priority by the Fund, even though both foreign and domestic banks may have been equally irresponsible or imprudent in their lending practices. As BIS (1998) noted: "In spite of growing strains in South East Asia, overall bank lending to Asian developing countries showed no evidence of abating in the first half of 1997" (Raghavan, 1998). In the year from mid-1996 to mid-1997, the Republic of Korea received US$ 15 billion in new loans, while Indonesia received US$ 9 billion from the banks. Short-term lending continued to dominate, with 70 per cent due within one year, while the share of lending to private non-bank borrowers rose to 45 per cent at the end of June 1997. The banks were also actively acquiring "non-traditional assets" in the region, for instance in higher yielding local money markets and other debt securities. Most of this lending was by Japanese and continental European banks.

Thus, Western and Japanese banks will emerge from the crisis relatively unscathed and stronger than the domestic financial sectors, which have taken the brunt of the cost of adjustment. Some merchant banks and other financial institutions will also be able to make lucrative commissions from marketing sovereign debt, as the short-term private borrowings – which precipitated the crisis – are converted into longer-term government-guaranteed bonds under the terms of IMF programmes. Hence, IMF programmes have been seen as primarily benefiting foreign banks, rather than the East Asian economies or people.

H. The roots of crises: a summary

Financial liberalization reduced monitoring and supervision of banking operations and transactions, including those of a prudential nature. There was also a significant increase in "private banking" as well as increased banking transactions across borders with the proliferation of "international off-shore financial centres" and other international banking facilities competing for business. The growing dollarization of the world economy, including international finance, has also skewed the nature of these developments in important ways.

Liberalization of financial services as well as of investment regulations, including liberalization of the capital account, reduced national oversight and management of financial flows, which created conditions conducive to the East Asian crises following. The scope for national macroeconomic, including monetary, management has been considerably reduced by various aspects of financial liberalization. Options for *rentier* as well as developmental initiatives have also been significantly reduced as a consequence.

The variety of financial regimes in East Asia do not allow for easy generalizations for the entire region. Many observers have compared the economies and regimes which have experienced major economic crises since the second half of 1997 (i.e. Indonesia, Malaysia, the Republic of Korea and Thailand) with the other HPEA economies which have not been so badly affected – namely Hong Kong (China), Japan, Singapore and Taiwan Province of China, as well as China. There is no systematic evidence that the difference lies primarily in the extent of corruption, rent-seeking, government intervention, industrial policy, export-orientation, productivity growth, FDI, or democracy. Although all the economies affected have liberalized their capital accounts, restrictions remain important, especially in China and Taiwan Province of China. In any case, capital account liberalization may only be a necessary, but not sufficient, condition for the new type of crisis experienced. The big difference seems to have been that the East Asian four have had low foreign exchange reserves, unlike the second group of East Asian economies, which have the highest reserves in the world, and hence have been far less vulnerable to currency attack. Unlike Malaysia, the external liabilities of the three most affected economies were well in excess of their foreign exchange reserves.

The extent to which macroeconomic fundamentals went awry among the affected economies varied considerably and, by themselves, cannot explain the financial collapses, although they suggest their greater vulnerability to currency attack and the greater likelihood of panic. The crises have underlined the significance of investor sentiments, and there can be no convincing explanation for what happened, especially herd behaviour, which does not take account of market psychology. Hence, while confidence restoration must necessarily be at the top of the agenda for any recovery programme, institutional and systemic arrangements should also seek to reduce vulnerability to sudden changes in investor sentiment.

Although there have been important precursors to the recent crises in East Asia, the market – which is increasingly being left to its own devices – has neither a memory nor a capacity to develop natural immunity to such cataclysmic shocks. It is therefore left to policy makers to build the necessary institutions and to design the needed institutional framework for sound developmental financial governance.

Thus, the recent South-East Asian *débâcle* can be traced to poorly conceived and sequenced financial liberalization which resulted in attracting massive, but easily reversible, capital inflows into the region. As elsewhere in the region, capital inflows increased substantially with international financial liberalization, especially just before the crisis. Capital inflows tended to raise foreign reserves, domestic credit availability as well as exchange rates.

The combination of increased capital inflows, credit expansion and exchange rate appreciation raised aggregate demand more rapidly than GDP, further increasing the current account deficit. While additional credit availability owing to capital inflows may well have stimulated total spending due to increased domestic investments, such inflows also supported consumption booms (with high import contents) as well as speculative asset (stock or property) price bubbles. Such temporary increases in demand could not be sustained as the consequently greater external deficit was not sustainable. Worse still, capital flight ensued as the bubble began to deflate, and was accelerated by panic induced by regional contagion from the collapse of the Thai baht. Weakened prudential regulation encouraged panic, resulting in massive capital flight.

Increased private sector demand growth resulting from trade and financial liberalization in the absence of strong contributions from the public sector or from abroad has often contributed to import-led consumption booms, adversely affecting domestic private savings rates. Such increased consumption was encouraged by cheaper imported goods due to import liberalization and real exchange rate appreciation in the region before the 1997/98 crises. It was also enhanced by domestic credit expansion owing to increased capital inflows as well as domestic financial liberalization.

The currency crisis, which began in Bangkok, rapidly spread to the rest of the region, with devastating consequences for financial systems and real economies. These external shocks to financial systems, made vulnerable by inappropriate liberalization, in turn precipitated sudden recessions. These abrupt downturns were primarily caused by systemic liquidity shocks as earlier asset price inflations were suddenly reversed and initially gradual reversals rapidly accelerated. Thus, regional contagion from Thailand's baht devaluation caused regional currency and then financial system crises. Panicky investors and lenders quickly withdrew capital from a region that had become reliant on net capital inflows. The asset price bubbles had been built on a financial house of cards, that collapsed with devastating effects for the real economy, not only due to liquidity drying up, but also because of reverse wealth effects.

V. Reforms and recovery

There is considerable debate about the implications of the crises for economic development, particularly over whether the East Asian experience of the last three decades offered different lessons and prescriptions for development from those advocated by the "counter-revolution" against development economics. As is now well known, this neo-liberal reaction has maintained that development economics and its prescriptions constituted bad economics, based on distortions of neo-classical welfare economics, which exaggerated the extent and implications of "market failure" and underestimated the likelihood of "state failure" and its consequences.

Influential economists at the United States Treasury, IMF, the World Bank and elsewhere have cited the East Asian financial crisis to criticize the Bank's 1993 *East Asian Miracle* volume as flawed. In particular, the critics denounce the study's acknowledgement of the success of "directed credit" and what has come to be known as "financial restraint", authored by Joseph Stiglitz, who later publicly dissented on the appropriateness of IMF prescriptions for the East Asian crises, while serving as Chief Economist and Senior Vice-President of the World Bank until late 1999.

The crisis from mid-1997 started not long after Krugman's (1994) claims that East Asian growth was not sustainable because it was based primarily on factor accumulation – eventually subject to diminishing returns, rather than productivity growth ("perspiration rather than inspiration"). Many critics, from across the intellectual spectrum, initially saw the East Asian currency and financial crises as vindication of Krugman's argument, or of some variation thereof. Often, there was more than a touch of neo-liberal triumphalism in hasty pronouncements of the end of the Asian miracle, or in word plays of "miracle or *débâcle*", "tigers or fat cats" and the like.

A. *International reform for the better?*

For the first year after the East Asian crises began in mid-1997, there was limited interest in the West with respect to growing calls from East Asia and elsewhere for reforms to the international monetary and financial systems. An initiative by the Japanese government in the third quarter of 1997 to set up a regional monetary facility with US$ 100 billion to deal with the crisis was opposed by IMF. The opposition was endorsed by the Western powers as well as China, which was suspicious of Japanese intentions to take advantage of the crisis to secure regional leadership.

However, as noted earlier, the situation changed dramatically a year later as the East Asian crisis seemed to be spreading West, via the Russian Federation and Brazil. In the United States, there was a scare on Wall Street after the collapse of the LTCM hedge fund, subsequently rescued thanks to an initiative of the United States Federal Reserve Bank. The second half of 1998 saw much greater Western concern about the international financial system, and the possible damage its vulnerability might cause. Various government leaders began a briefly animated international discussion concerning the need for a new international financial architecture, leading to some initiatives to promote greater international financial stability.

The new challenges at the international level are formidable, considering the powerful vested interests involved, particularly in Europe, Japan and the United States. There have been many misgivings elsewhere about the nature and volatility of the international financial system, renewed and enhanced by each new crisis, especially the recent East Asian crisis, not least because of its new characteristics. Nevertheless, the voice of the developing countries has continued to weaken after the debt crisis of the 1980s began to reverse the gains of the 1970s, associated with the New International Economic Order and related initiatives.

The conditionalities imposed in the aftermath of the debt crisis, the broad range of reforms associated with the World Trade Organization (WTO), and changing transnational economic and political alliances have advanced economic liberalization. Meanwhile, international political developments following the end of the cold war as well as the new constraints on state initiatives have further undermined the capacity for effective collective action by the governments of developing countries. Hence, it seems unlikely that much goodwill come out of the traumatic *débâcle* of 1997/98.

Contrary to the claim that "the market" will exact swift and painful punishment on governments and economies which do not have their macroeconomic houses in order, the timing, nature and consequences of the 1997/98 financial crises in East Asia underline the imperfect nature of financial markets. This was reflected in the long delay in "rectification". For example, although current account deficits were more serious in 1995 compared to 1997, there was no rectification then, let alone "punishment" of the culprits – i.e. the current account deficits in Malaysia and Thailand reached all time highs, without any commensurate adverse effect.[32]

Incredibly, at the September 1997 annual meetings of IMF and the World Bank in Hong Kong (China), the IMF policy-making Interim Committee – which represents all 181 IMF member countries via 24 ministers – gave the Fund a mandate to alter its Articles of Association. IMF would eventually have "jurisdiction" over the capital account, in addition to the current account of member countries' balance of payments, which it has had for many decades.[33] In December 1997, WTO also concluded its financial services agreement, which basically commits member countries to a schedule of accelerated liberalization of trade in financial services. Even the *Wall Street Journal* noted that the agreement would primarily benefit the United States and Europe, since it was most unlikely that the South would be in a position to export financial services to the North.

It is therefore likely that countries of the South will face even greater problems with their balance of payments as their services, and hence current account deficits worsen. Much of the nascent financial services that have emerged under protection in these countries is unlikely to survive international competition from transnational giants enjoying economies of scale and other advantages.

B. *Macroeconomic recovery*

As noted earlier, before the East Asian crisis, there were no clear macroeconomic warnings of imminent crisis. The countries of the region sustained high growth with low inflation. Their public finances were sound, and both the external debt and the current account deficit were manageable. Thus, East Asian government officials kept reiterating "healthy fundamentals" up to the outbreak of the full-scale crisis. Many attempts have since been made to explain the causes and consequences of the crisis, but there has been relatively little attention to the recovery.

With the possible exception of Indonesia – largely owing to its complicated political transition – the other three East Asian economies are now clearly on a path of recovery from financial crisis, the pace of which is far quicker than anticipated by most early forecasts, including those by IMF. Hence, the speed of the recovery has been as surprising as the earlier spread and deepening of the crisis (see the official IMF publications during the period 1997–2000). Initial IMF predictions were that growth would be stagnant for at least three to four years following the crisis (a U-shaped recovery). In late 1997 and early 1998, IMF failed to anticipate the sharp downturns of 1998. Then, once deep recession was evident, it anticipated continued recession in 1999 and very modest recovery from 2000. Instead, the economies of Malaysia, the Republic of Korea and, arguably, Thailand have quickly recovered after some sharp drops in 1998 (a V-shaped recovery).

The turnaround in economic performance can mainly be attributed to Keynesian[34] macroeconomic measures. Both the Malaysian and Korean economies recovered as a result of reflationary macroeconomic policies. Also, among financial reform

Table 6

EAST ASIAN FOUR: EXCHANGE RATES AND DEPRECIATION AGAINST US DOLLAR, 1997–2000

	Exchange rate (Monthly average)				*Depreciation (Per cent)*		
Currency	*Jan. 1997*	*Jan. 1998*	*July 1998*	*July 2000*	*Jan. 1997– Jan. 1998*	*Jan. 1997– July 1998*	*Jan. 1997– July 2000*
Indonesia: rupiah	2,369	9,767	14,233	8,249	312.2	500.7	248.2
Malaysia: ringgit	2.491	4.363	4.151	3.800	75.2	66.7	52.6
Rep. of Korea: won	850.6	1,700	1,294	1,119	99.9	52.1	31.5
Thailand: baht	25.72	53.12	41.22	39.29	106.5	60.3	52.8

Source: Computed from *Financial Times*, Extel data.

measures, the swift recapitalization of commercial banks from mid-1998 in both Malaysia and the Republic of Korea is now acknowledged as having been crucial for their recovery.[35] However, the restoration of bank liquidity through such measures is not what is usually meant by the structural reforms desired by IMF. In fact, such measures have been much criticized as likely to perpetuate, if not exacerbate the problem of moral hazard in the economy. After all, as Shin (2000) notes, "the injection of public money is necessary to revive its financial sector whether a government is committed to reform or not".

Interest rates were reduced drastically – almost in defiance of IMF prescriptions – to boost corporate recovery. IMF's initial macroeconomic policy emphasis involved retrenchment. By insisting on sharply higher interest rates, corporate failures soared, making voluntary corporate reforms even more difficult. Figure 1 shows interest rates peaking in Thailand in September 1997, in the Republic of Korea in January 1998, in Malaysia in April 1998, and in Indonesia in August 1998. Of the East Asian four, rates had risen least in Malaysia, by less than three percentage points. And although capital controls introduced in September 1998 succeeded in consolidating the downward trend in interest rates, Thai rates soon fell below Malaysia's from their much higher earlier levels. Interest rates fell throughout the region in the second half of 1998; this was helped by changed monetary policies in the West, and it is not clear whether Malaysia's capital controls were really necessary for bringing down interest rates by the third quarter of 1998.

The depreciation of the region's currencies caused by the crisis (see table 6 and figure 2) may also have helped corporate recovery and contributed to improved trade balances as well as foreign reserves among the four economies (see Appendix figures 1a, 1b, 1c, 1d). Figure 2 also shows that exchange rate volatility declined significantly after mid-1998, except in Indonesia due to political instability. Appendix figures 2a, 2b, 2c and 2d show that interest rates were highest when exchange rates were lowest, indicating that all four governments responded similarly by raising interest rates in response to the contagion of spreading currency crises and falling foreign exchange rates. The self-fulfilling nature of the crisis suggests that little else could be done in the face of such capital flight with open capital accounts. It is also difficult to determine how futile these initial monetary policy responses actually were.

The currency depreciations generally more than compensated for the declining export prices because of global price deflation of both primary and manufactured commodities associated with international trade liberalization. The Malaysian ringgit was fixed to the US dollar from early September 1998 in an effort originally intended to strengthen its value. Fortuitously, lower US interest rates in the aftermath of the Russian, Brazilian, LTCM and Wall Street crises of August 1998 served to strengthen other East Asian currencies, causing the ringgit to be undervalued instead from late 1998. In the Republic of Korea, to ensure exchange rate competitiveness, the authorities intervened in the foreign exchange market to slow down the pace of won appreciation from late 1998.

Figure 1

EAST ASIAN FOUR: MONTHLY INTEREST RATES, JANUARY 1997–MAY 2000

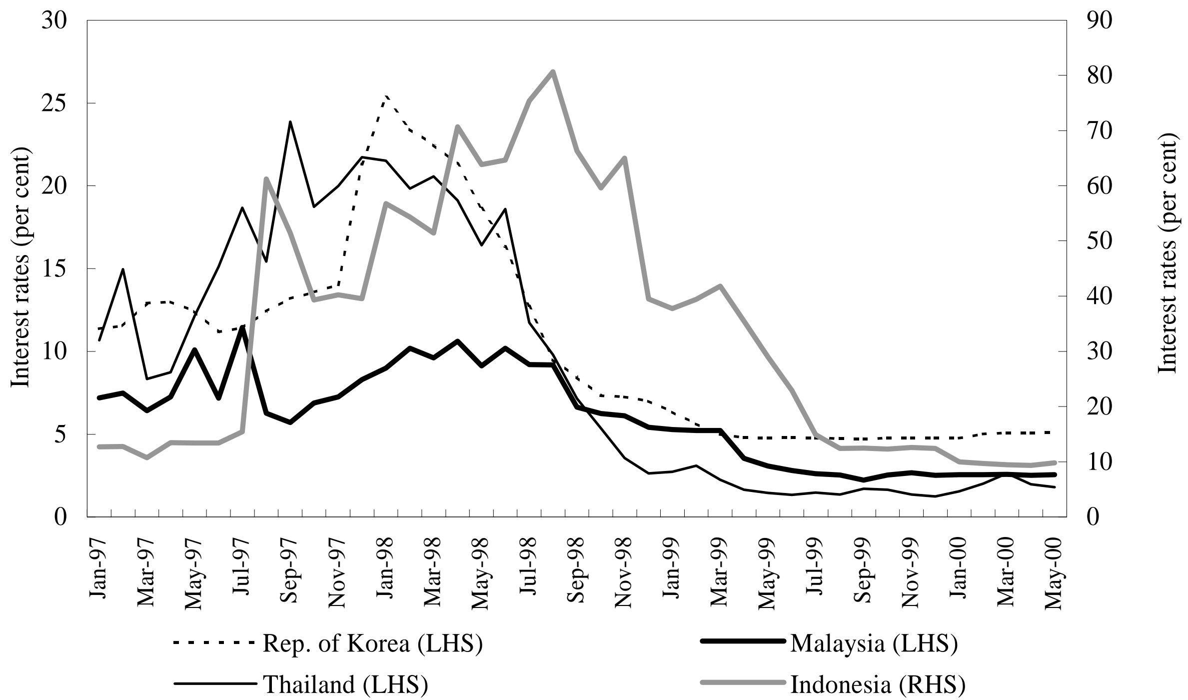
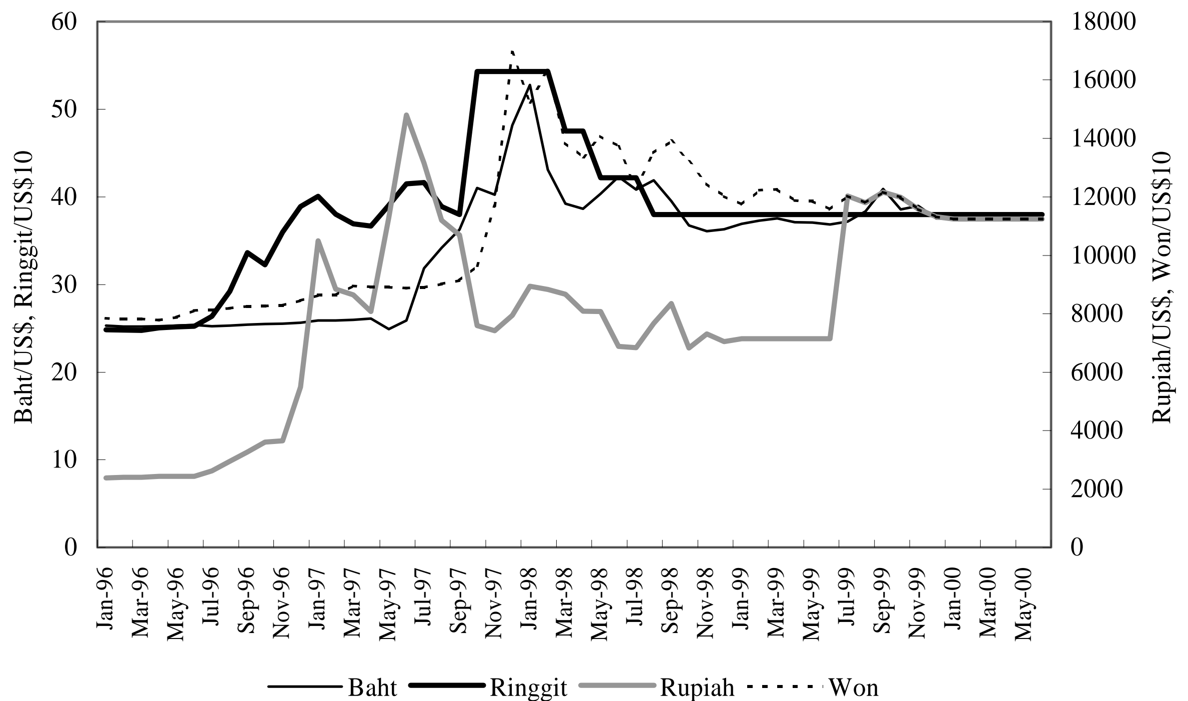


Figure 2

EAST ASIAN FOUR: MONTHLY FOREIGN EXCHANGE RATES, JANUARY 1996–JUNE 2000



As figures 3a and 3b show, budget deficits substantially increased in 1998, especially in the second half of the year. While government revenues were probably adversely affected by the economic slowdown, government expenditure rose with efforts to reflate the economy from around mid-1998. Government funds went to recapitalize financial institutions and for increased spending, especially for public works and to provide the "social safety nets" advocated by the Fund and the Bank. The recapitalization of financial institutions[36] was crucial for recovery by taking out inherited systemic risk from the banking system, thus restoring liquidity. The modest budget surpluses during the early and mid-1990s before the crisis were replaced by significant budgetary deficits to finance counter-cyclical measures. Thus, the balanced budgets of the pre-crisis period were crucial to helping overcome the crisis. It should be emphasized that such Keynesian policies were not part of IMF programmes.

Without capital controls, the East Asian economies could not reverse monetary policy without further adverse effects due to international exposure. Hence, monetary policy remained cautious until mid-1998. Thus, regional macroeconomic policies could only be changed after conducive changes in the international economic environment. Interest rates could only be lowered after the G-7 took concerted action to lower interest rates and increase money supply to avoid financial turmoil after the Russian crisis led to the collapse of the long-Term Capital Management (LTCM) hedge fund. In other words, East Asian Keynesian policies were made possible by international responses to the fear of global financial collapse from the third quarter of 1998. Ironically, this only became possible over a year after the East Asian crisis began, when it seemed to threaten the rest of the world, especially Wall Street.

C. *Reform of corporate governance*[37]

Many institutional arrangements in the most affected economies probably at least once contributed significantly to "catching up" and, while many features may no longer be desirable or appropriate, corporate reform advocates usually fail to even acknowledge that they were at least once conducive to rapid accumulation and growth. This is largely due to ideological presumptions about what constitutes good corporate governance, usually inspired by what has often been termed the Anglo-American model of capitalism. From this perspective, pre-crisis economic institutions were undesirable for various reasons, especially insofar as they departed from such a model. Worse still, with minimal evidence and faulty reasoning, the 1997/98 crises in the region have been blamed on these institutions, as if they were crises just waiting to happen. Not surprisingly then, from this perspective, thorough-going reforms should be the top priority and the pre-crisis systems need to be abandoned altogether.

IMF pushed for radical corporate reforms claiming that corporate structure was at the root of the crisis, with some reform-minded East Asian governments agreeing. However, it is doubtful that corporate structure was a major cause of the crisis, although there were some symptoms of corporate distress in all the crisis-affected economies before the crisis. First, corporate profitability was deteriorating, more rapidly in Thailand but also elsewhere in East Asia. Second, indices of investment efficiency, such as the ICOR, were rapidly deteriorating. Some of the economies (especially the Republic of Korea and Thailand) began to experience corporate failures from early 1997.

After Indonesia, the Republic of Korea and Thailand went to IMF for emergency credit facilities, the Fund kept emphasizing microeconomic reform as central to its recovery programme, especially in the last two countries (Lane et al., 1999). The newly elected reformist governments of Thailand and the Republic of Korea led by Chuan Leekpai and Kim Dae Jung, agreed with IMF's insistence on the urgency for comprehensive corporate reforms, although there was some dissent over the Fund's punitive macroeconomic policies. These reforms generally sought to transform existing corporate structures, regarded as having caused overinvestment and other ills, in line with ostensibly "global" Anglo-American standards. Shin (2000) describes how Korean corporate reforms sought to remould its corporate structure along more American lines.

From recent East Asian experiences, it was clearly better to first improve the macroeconomic environment and remove systemic risks in the financial system. There is no evidence whatsoever that the simultaneous attempts at radical corporate reforms helped recovery in any decisive way. The agenda for corporate reform needs to be determined after careful consideration of existing weaknesses, rather than by presumptions about what may be best according to some textbook ideological or policy-driven agenda. An economy's corporate structure is inevitably the consequence of evolutionary developments, including cultural heritage and colonial inheritance. Most economies accommodate a diver-

Figure 3a

INDONESIA, MALAYSIA, REPUBLIC OF KOREA, THAILAND: ANNUAL BUDGET BALANCES, 1996–1999

(Per cent of GDP)

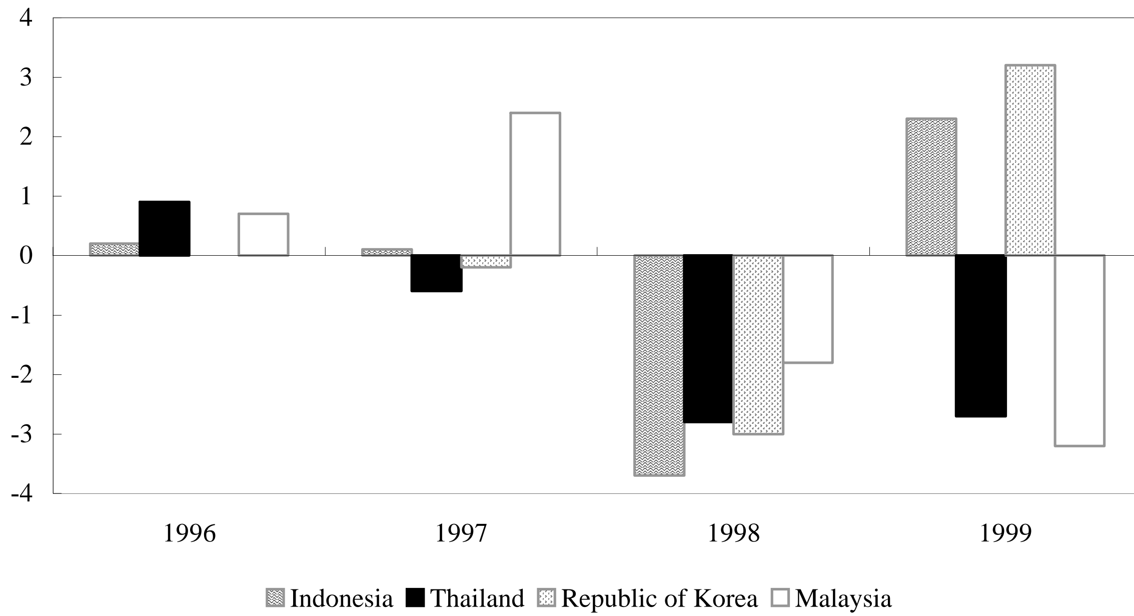
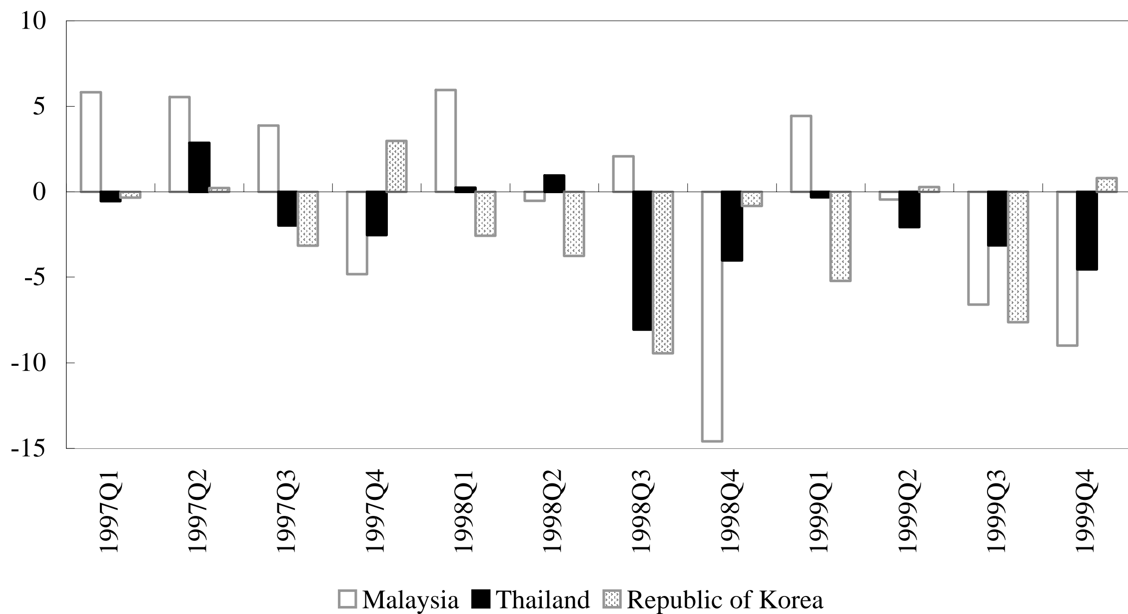


Figure 3b

MALAYSIA, REPUBLIC OF KOREA, THAILAND: QUARTERLY BUDGET BALANCES, 1997Q1–1999Q4

(Per cent of GDP)



sity of corporate structures. Inappropriate arrangements would have perished unless propped up by patrons such as the state. While others may have become dysfunctional owing to changing circumstances, there is no universally optimum corporate structure.

The East Asian experiences also suggest that the IMF programmes were generally not conducive to corporate reforms; they tended to exacerbate corporate failures sharply, and made corporate as well as financial adjustments more difficult. The East Asian experiences, particularly those of Malaysia and the Republic of Korea, suggest that improvements in macroeconomic conditions, especially interest rate reductions and appropriate increases in government spending, were necessary to facilitate adjustments and reforms. New stock issues, asset sales and foreign capital investments, all necessary for corporate restructuring, only became possible with the more buoyant economic conditions as of 1999.

It has also been argued that in all the East Asian cases, corporate reform efforts thus far have hardly succeeded in achieving their objective of correcting the structure of high debt and low profitability, but have instead imposed large costs on the economy. This view is seen as self-evident in the case of Malaysia, in view of the regime's approach, and for Indonesia owing to the political uncertainties since the crisis, but is also held to be true, albeit to lesser degrees, for the Republic of Korea (Shin, 2000) and Thailand (Pasuk and Baker, 2000).

Enterprises anywhere that are otherwise well managed and profitable may find themselves in serious financial distress because of developments beyond their control. During the East Asian crisis, sudden and steep currency devaluations increased firms' import costs and unhedged external liabilities denominated in foreign currencies, usually the US dollar. As these devaluations were accompanied by financial crises, limited access to emergency finance threatened the very survival of firms in the affected countries, especially small- and medium-sized enterprises; they faced insolvency or being taken over at "bargain basement" or "fire sale" prices, usually by foreign interests unaffected by the crisis. For a whole variety of microeconomic reasons, such takeovers were unlikely to result in superior management. Such elimination of otherwise viable enterprises would most certainly have undermined the processes of capacity and capability-building deemed essential for catching-up development.

Shin (2000) argues for building a second stage catching-up system for the Republic of Korea, instead of IMF and other proposed transitions on ostensibly Anglo-American lines. Other similar arguments from elsewhere in the region acknowledge that there were considerable abuses of the pre-crisis system by politically powerful *rentiers*, and these should, of course, be eliminated (Gomez and Jomo, 1999). Nevertheless, the other crisis-affected South-East Asian economies still need reforms to ensure more appropriate developmental regimes in line with changing circumstances and challenges. States need to develop a new range of institutions for more effective selective intervention to accelerate the development of new industrial, technological, organizational and managerial capacities to face the various new challenges associated with accelerated globalization in the past decade and a half.

There are also grave doubts as to whether the reforms have improved corporate resilience in the long run. Shin (2000) argues that foreign capital returned to the Republic of Korea because the economy began picking up from November 1998, after uncertainties had been substantially reduced, rather than the return of foreign investment having led the recovery, as hoped for by IMF. The recovery has been mainly driven by typically Keynesian policies and certainly not by reforms in corporate governance.

In light of the basis for and nature of the recent recovery, the earlier and ongoing emphasis on the urgency of corporate reform was clearly ill-informed and ill-advised. Corporate profitability has undoubtedly improved. But there is no clear evidence that corporate reform was key to bringing about these recoveries. In fact, it has been noted that many corporate reform measures have been intended to prevent future crises, even at the cost of short-term economic recovery. With their earlier predictions of imminent "doom without corporate reform" unrealized, those insisting on such reforms as a prerequisite for recovery have now switched to warning of a second downturn for countries like Malaysia, where resistance to reform has been officially articulated.

D. New international financial architecture[38]

As noted earlier, recent trends in IMF and WTO after the East Asian crises began are unlikely to make prevention of future crises any easier. By keeping open the capital account and allowing freedom for transborder movement of funds, it becomes difficult not only to introduce measures to prevent financial

crises, but also to introduce effective financial safety nets at the national level. Past IMF consultations with various governments have been unable to prevent major financial turmoil, with the frequency of currency and financial crises increasing, rather than decreasing, with financial liberalization in the last two decades. Despite its grudging acceptance of the efficacy of capital controls in Chile, Colombia and elsewhere, the Fund has been reluctant to urge countries to control short-term inflows before a crisis occurs.

Too little attention is being paid to the policies of the developed countries, especially the major economic powers, despite their impact on exchange rates in the rest of the world, especially in developing countries. Akyüz (2000a) has noted that all the emerging-market crises of the past two decades have been associated with large changes in the exchange rates of the major industrial economies. Developing countries seem generally incapable of maintaining exchange rate stability, while the major currencies experience big fluctuations. Hence, currency coordination between Europe, Japan and the United States is desperately needed for the stability of their own currencies as well as others in the world today. Despite frequent G-7 meetings, existing arrangements leave much to be desired. Consequently, there may be fluctuations of up to 20 per cent within a week. The effects of such huge swings on smaller open economies are not well understood, although they are expected to simply adjust to such changes.

Since the East Asian crisis, the international discussion on international financial reform to prevent future crises has emphasized questions of transparency and greater supply of information. However, there is no evidence that having more information will be enough to prevent crises. Also, efforts seem to be directed mainly at obtaining more information from governments, especially of the developing countries, with little being done to get information on the various financial markets, especially the most volatile and vulnerable ones such as those involving highly-leveraged institutions and offshore markets.

A global system of prudential controls should accommodate the existing diversity of national conditions as well as regional arrangements. However, the currently favoured approach to prudential regulation is to formulate international standards for countries to implement and enforce. In the recent past, such standards have usually been set by BIS, which serves banks in the OECD economies. There are several problems with this approach (Akyüz, 2000a; 2000b). First, such standards do not specifically take into account the risks associated with international lending. Currently, credit rating agencies are relied upon to fill the vacuum, but they have a tendency to be pro-cyclical, thus exacerbating, rather than checking, fluctuations. Second, the standards have mainly been designed to protect creditors, not debtors, and the countries they belong to. A similar level of exposure may imply different risks to different creditors as well as debtors. Third, the one-size-fits-all approach implicit in setting standards tends to gloss over important variations, thus undermining the efficacy of this approach. Although there is currently agreement that IMF should not set standards, it is likely to be involved in policing the enforcement of such standards, which would raise similar concerns.

After the East Asian crises, there seemed to be agreement that short-term capital flows required regulation. But while developing countries currently have the right to control short-term capital flows, the lack of international endorsement of such measures serves as a major deterrent for those considering their introduction.

Developing countries are currently being encouraged to either fix (through a currency board system or even dollarization) or freely float their currencies, but are being discouraged from considering intermediate alternatives. However, studies have shown that a float system is associated with the same degree of volatility as a fixed one (Akyüz, 2000a; 2000b), with the principal difference between the two being that of how external shocks work themselves out. It is crucial to insist that countries should be allowed to choose their own exchange rate regime, which should not be imposed as an IMF conditionality.

In managing crises, the recent East Asian experiences highlight the crucial importance of ensuring international liquidity by quickly providing foreign funds to economies experiencing crisis. Currently, such international liquidity provision is being frustrated by the following conditions:

(i) Multilateral institutions generally do not have the necessary finances readily at their disposal. Although IMF nominally has the requisite facilities, it lacks the required funds, which have to be raised with the approval and active support of its principal shareholders. This de facto requirement subjects the process to undue political influence, as was clear in the international financial community's changing responses to the East Asian crises as it unfolded from mid-1997.

(ii) IMF-imposed policy conditionalities accompanying the provision of such emergency liquidity have also been onerous. The East Asian experiences suggest that these conditionalities actually exacerbated the macroeconomic crises.

(iii) Such funds should be used to support a currency against speculation, but instead, currencies were allowed to collapse first, with the emergency funds going to pay off creditors.

Recent experiences underline the crucial importance of facilitating fair and orderly debt workouts to restructure debt payments due. Existing arrangements tend to treat debtor counties as if they are bankrupt without providing the protection and facilities of normal bankruptcy procedures.[39] With such a procedure, a debtor would have certain rights, including getting a temporary standstill on debt payments, continued financing for on-going operations, and orderly debt restructuring. While IMF's Articles of Agreement allow for such temporary standstills, this has not actually occurred.

Despite IMF's Articles of Agreement providing for a temporary standstill, in the recent case of the Republic of Korea the creditors got together and struck an agreement with the government, raising three problems:

(i) the government was thus coerced in taking over responsibility for private debt;

(ii) the creditors thus got better debt restructuring terms, whereas debtors would be more likely to get better terms in a bankruptcy court;

(iii) the new finance went to the creditors, instead of supporting the debtor.

VI. Reforming East Asia for sustainable development

The currency and financial crises in South East Asia suggest that the region's economic miracle had been built on some shaky and unsustainable foundations. Growth before the crises in Malaysia and Thailand had been increasingly heavily reliant on foreign resources, both capital and labour. Limited investments and inappropriate biases in human resource development have held back the development of greater industrial and technological capabilities throughout the region. South East Asia's resource wealth and relatively cheap labour sustained production enclaves for export of agricultural, forest, mineral and, more recently, manufactured products. However, much of the wealth generated was captured by restricted groups linked to those with political power. They nevertheless contributed to growth by reinvesting – albeit mainly in the "protected" national economy – in import-substituting industries commerce, services and privatized utilities and infrastructure.

Most of East Asia's macroeconomic fundamentals were generally sound at the time of the crash. Low inflation and falling unemployment had characterized the economy over the preceding decade. Savings rates continued to rise despite already being among the highest in the world. Fundamental weaknesses in the real economy more generally also slowed down growth in the mid-1990s. The growing shift to knowledge- and skill-intensive production and the emergence of China and India as major low wage production sites also threatened export-oriented manufacturing in the country. Unlike the North-East Asian economies, the South-East Asian three have not sufficiently developed the institutions needed to generate rapid technical change and firm progress towards the technology frontiers.

A. *Exchange rate appreciation and growing imports*

If falling exchange rates assisted export-competitiveness between 1986 and the early 1990s, the reversal from the mid-1990s had the opposite effect. The appreciation of the South-East Asian currencies, with the decline of the yen from mid-1995, was substantial. With the renminbi devaluations of 1990 and 1994, their appreciation had especially negative impacts on exports, the balance-of-payments current account and FDI inflows. The rising currencies as well as declining tariffs and other trade controls due to trade liberalization pushed up imports. There were no efforts to adjust exchange rates to neutralize the impact of import liberalization.

Also, their manufacturing export structures had become somewhat rigid and were not sufficiently exchange rate elastic. Unlike agricultural and final goods, which have competitors and substitutes, intra-firm trade (especially transnationals directly exporting assembled and processed items abroad) has accounted for much of their exported manufactures. This largely transnational-dominated trade – where demand is primarily determined in major markets abroad – meant that import demand continued to be strong.

However, the cheaper currencies brought little improvement in FDI trends from the mid-1990s, and especially from 1997. Unlike gradual currency depreciations, which can attract production from abroad, especially when accompanied by strong macroeconomic fundamentals, volatile currency movements tend to discourage such inflows. The otherwise strong macroeconomic fundamentals tended to strengthen South-East Asian currency values in the absence of earlier government devaluation efforts.

The 1997/98 currency devaluations lowered domestic production costs in South East Asia vis-à-vis North America and Europe. However, the regional nature of the crises and the preceding Japanese economic stagnation reduced regional demand for exports, which has become increasingly important with growing regional economic integration in recent decades. Besides, because many foreign subsidiaries in South East Asia have low value-added production processes, with strong vertical linkages to the rest of the firm or industrial group, the devaluations neither lowered demand for imports nor increased export demand as much as might be expected from the changes in relative prices. However, the recovery in world demand for electronics since late 1998 has contributed a great deal to economic recovery in the region, especially in Malaysia and the Republic of Korea. Sticky wage rates are likely to reduce the additional foreign exchange earnings to be gained with their devalued currencies.

Overexpansion in construction and lending for non-productive purposes has also limited South-East Asian financing of manufacturing growth even before the crisis. To make matters worse, the limited South-East Asian capacities to export services and construction materials aggravated trade imbalances. Instead, construction and services were responsible for massive increases in import bills in the early and mid-1990s. Unproductive investment ventures, including property and share purchases, attracted financing from banks and other financial institutions. The decline in FDI and export growth since the crises has further reduced domestic demand for services and construction. To boost their asset markets and reflate their economies, some governments (especially Malaysia) have continued to encourage lending for asset purchases, both in the stock and property markets. Before the crisis, some governments (e.g. Indonesia and Malaysia) had launched uneconomic projects, often at unnecessarily high expense.

Investment in South East Asia expanded faster than savings grew in the early and mid-1990s. As a proportion of GDP, gross fixed capital formation (GFCF) has shown a trend increase, which has inevitably caused falling capital productivity. With investment rising faster than GDP, incremental capital output ratios (ICORs) for these economies rose. Large injections of capital during early industrialization required stable financing, which in South East Asia traditionally came from high savings rates. Primary exports have enhanced access to foreign exchange, while FDI, much increased since the mid-1980s, has also supplemented national savings.

B. FDI slowdown

FDI as a proportion of gross fixed capital formation averaged about 20 per cent for Malaysia in mid-1990s, with lower shares for Indonesia and Thailand, but still above the developing country average of around 5 per cent (UNCTAD, 1997: figure II.19). FDI can complement limited domestic capital resources to enhance growth, although FDI's share of GFCF fell in 1996. However, the South-East Asian share of total FDI going to South, East and South East Asia fell from 61 per cent in 1990/91 to only 30 per cent in 1994–1996. China and India had become major rivals, especially for labour-intensive FDI. And unlike recovery after the recession of the mid-1980s, largely due to the massive relocation of East Asian investments, FDI inflows to South East Asia on a comparable scale seem most unlikely in the foreseeable future.

The fall in FDI to South East Asia from late 1996 was a consequence of a number of factors. First, the mid-1990s did not see a further massive exodus of North-East Asian capital seeking new investment sites in the region, as had happened in the late 1980s and early 1990s. The early massive investments were neither sustained nor replaced by other sources. The falling yen from the mid-1990s also reduced the significance of the already declining Japanese FDI inflows.

Second, the exhaustion of labour reserves in Malaysia and Thailand – the most attractive of the second-tier South-East Asian NIEs for FDI – had already started to discourage prospective labour-intensive investments. Malaysia had a foreign labour force exceeding two million in 1996, which accounted for 20 to 30 per cent of the country's labour force, while Thailand probably had a similar number. The incentives had also changed in the early 1990s, so that labour-intensive firms faced pressure to relo-

cate in less developed locations within the country, or even abroad. The crisis is likely to discourage FDI flows for years. FDI interest in the region has declined since 1996, with an increasing proportion consisting of acquisitions to take advantage of the regional "fire sales" rather than adding new production capacity through green-field investments.

The early and mid-1990s were also characterized by increased privatizations. Powerful interests captured much of the rents associated with privatization. Initially, the abuses did not seem overly debilitating due to rapid growth. Private interests, working hand in hand with the politically powerful, began dominating financially profitable *rentier* activities. Privatizations basically involved the transfer of existing assets from public to private hands, with no necessary addition of capacity. Thus, privatization absorbed scarce private sector financial resources without enhancing economic capacity. With "know-who" becoming more important than "know-how", "cronyism" undermined the development of entrepreneurship and other capabilities.

External liberalization pressures forced the removal of a number of incentives and tariffs, pushing private interests into other *rentier* activities. The establishment in 1995 of WTO and other regional trade deregulation efforts, such as the ASEAN Free Trade Area (AFTA) and Asia-Pacific Economic Co-operation (APEC), accelerated liberalization processes. Incentives used to promote exports (for example, the export abatement allowance) and tariffs that had sheltered domestic producers began to fall sharply by the mid-1990s, forcing *rentier* activity to shift to other sectors.

C. Slow technological progress

While industrial policy in the Republic of Korea and elsewhere in North East Asia ensured strong institutional support driving technical change, this has generally failed to materialize in most of South East Asia. Singapore has successfully developed and maintained institutions necessary to sustain its leading role as the South-East Asian regional hub for medium to high technology-intensive production and services. The Republic of Korea as well as Japan and Taiwan Province of China have successfully developed the necessary institutions to not only speed up the absorption and development of technologies, but also to strengthen their technological capacities and capabilities more generally. Such slow technological deepening in the real sector must have limited the South-East Asian region's growth potential. Institutional deficiencies in South East Asia can be seen in the institutions supporting technological deepening, human resources, technology diffusion mechanisms, as well as disciplinary mechanisms (Rasiah, 2001; Jomo and Felker, 1999).

Ambitious and expensive technological-deepening institutions and mechanisms were introduced in both Malaysia and Indonesia, especially in the 1990s, without much concern for ensuring international competitiveness in the medium term. While such initiatives had important technological-deepening objectives, serious failures have restricted their impact.

Rising production costs and tough external competition forced Malaysia to review its export strategies and domestic capabilities. Growth in foreign-dominated export-processing activities has largely involved expansion of relatively low value-added production. With labour reserves exhausted, the premium for skilled workers has gone up in Malaysia and Thailand. Cheap labour imports from neighbouring countries have held down unskilled workers' wages and slowed down labour-intensive firm initiatives to upgrade their process technologies (Edwards in Jomo and Felker, 1999).

Achieving higher productivity inevitably requires complementary developments in human resource capabilities. Given the problems of getting firms to invest in training workers, there is a strong need to stimulate state-business collaboration in creating and coordinating institutions to enhance human resources for technological upgrading. In North East Asia, the share of engineers and R&D scientists and technicians rose quickly with the strong incentives offered for increasing their number. South East Asia outside of Singapore has lacked comparable human resource support to facilitate a rapid transition to higher technology manufacturing (see table 7).

Official measures of technology transfers have undoubtedly increased in South East Asia. Institution building to facilitate local technology absorption and development has, however, been weak (Jomo and Felker, 1999). The region does not have enough effective mechanisms to govern and promote effective technology transfer. In North East Asia, governments established institutions to assist local licensees to get more favourable bargains from foreign licensers and to speed up absorption and development of desired technological capabilities (Johnson, 1982; Amsden,

Table 7

SELECTED ECONOMIES: SELECTED HUMAN CAPITAL INDICATORS

Countries	*Scientists and technologists per 1000 people (1986–1990)*	*R&D scientists and technologists per 10,000 people (1986–1989)*	*R&D expenditure as a percentage of GNP (1987–1992)*
Japan	110	60	2.8
United States	55	n.a.	2.9
Sweden	262	62	2.8
Germany	86	47	2.9
France	83	51	2.3
Canada	174	34	1.4
Britain	90	n.a.	2.3
Rep. of Korea	46	22	2.1
Turkey	26	4	n.a.
Brazil	30	n.a.	0.6
Malaysia	n.a.	4	0.4
Thailand	1	2	0.2
Indonesia	12	n.a.	n.a.
Jamaica	6	0	n.a.
Kenya	1	n.a.	n.a.
Bangladesh	1	n.a.	n.a.

Source: UNDP (1995); MASTIC (1994, cited in Rasiah, 1998).
Key: n.a. – not available.

1989; Wade, 1990). Weak monitoring and enforcement mechanisms have restricted the extent of technology transfer and competitive gains in international markets. Until recently, North-East Asian governments intervened to support catching-up and frontier R&D activities. Strict conditions imposed by governments using performance standards ensured minimal waste of resources.

Limited domestic capabilities have meant that payments for imports and profit repatriation have reduced the potential benefits of industrialization to the region. While transnationals have been reluctant to source more inputs locally, local firms have also not adequately developed productive capabilities to increase their participation in foreign firms' value-added chains. Industrial policies have not done much to cultivate and strengthen the capacity of local firms to take greater advantage of domestic content stipulations.

South East Asia's second-order or deeper economic fundamentals have generally been weak. The required mechanisms for effective technology development to improve competitiveness have been inadequate. Despite some efforts to address the situation, the region was struggling to sustain competitiveness in international markets before the crash. The region was already handicapped by various institutional failures to achieve greater industrial upgrading.

D. New investment policies in South East Asia[40]

The economic crises of 1997/98 have led to significant changes in economic policy in South-East Asia (Montes, 1998; Jomo, 1998). Short-term considerations (IMF emergency credit conditionalities, efforts to restore market confidence, and the urgent desire to stimulate recovery) have shaped many recent reforms. The seemingly inexorable thrust towards economic liberalization has been bolstered by an expanding corpus of multilateral rules and policy directions promoted under the auspices of WTO,

APEC (Asia Pacific Economic Cooperation), and ASEAN. To many observers, these changes signify the demise of government intervention.

However, such pronouncements may be premature, as there is still considerable evidence that crisis-affected governments are continuing to promote and shape economic growth, development and industrialization. The following brief review of some recent trends in investment policy suggests that government interventions continue to be important. Parallel policy adjustments have occurred in the areas of international trade, finance, infrastructure and human resource development.

The aftermath of the crisis has seen the reduction, if not the elimination, of barriers to foreign investment in previously protected sectors. Having surrendered some of their discretionary powers to regulate entry into key economic sectors, South-East Asian governments must now let global markets reshape their industrial sectors according to their (inherent) comparative advantages. Although the scope in South East Asia for old-style industrial policy has been greatly reduced, the region's governments do not necessarily have to stop trying to influence investment trends. Governments have been paying more attention to the nature and quality of investments, and have been encouraging the development of domestic technological capabilities and skills.

Seen against the policy priorities of the 1990s, the post-crisis investment policy reforms are less drastic than they may seem. The Indonesian, Malaysian, Philippine and Thai governments began to liberalize investment gradually during the decade-long boom preceding the collapse of 1997/98; arguably, some even developed new approaches to investment promotion (UNCTAD, 1998). In this period, South-East Asian governments balanced infant-industry policies in certain sectors while promoting new export industries, usually with FDI. They promoted FDI inflows into export-processing zones and licensed manufacturing warehouses (Rasiah, 1995) by providing special exemptions from tariff protection for inputs and investment rules for sectors not for export. The authorities also tried to foster linkages with the domestic economy and to enhance transfers of technology from transnational corporations to domestic producers.

Undoubtedly, the crises has forced most governments to put on hold policies to upgrade industrial technologies. For the time being, all kinds of investments are being used to accelerate economic recovery. Changes are more evident in some countries than in others, but adjustments in the aftermath of the crises are likely to give way to further reforms as recovery is consolidated and governments pay greater attention to sustaining development in the medium term.

To a greater or lesser extent, investment policies before the crisis embraced new priorities, instruments, and institutional frameworks. Investment policies recognized the growing globalization of production involving international operations by transnational corporations themselves. Instead of aiming for nationally integrated and controlled industries, governments sought to position national economies to a maximum feasible advantage within the corporations' own international divisions of labour. Infrastructure and policy support was oriented towards ensuring location attractiveness, as governments modified their incentives to attract particular activities, such as management, procurement, logistics, R&D and design.

The shift from policies to support infant industry towards policies to attract export-oriented transnational corporations had earlier distinguished the South-East HPAEs from the other HPAEs as well as other developing countries. Acceptance of transnational corporation-led integration into regional and global systems of production distinguished the second-tier South-East Asian NICs from their late-industrializing predecessors, Japan and the Republic of Korea. Meanwhile, the industrial capabilities of Taiwan Province of China enabled it to define unique terms of engagement with transnational corporations.

Although the other HPAEs in East Asia have also drawn heavily on foreign technology, they have done so on terms in line with limiting foreign ownership of industry to promote domestic industrial capital. Both the Republic of Korea and Taiwan Province of China initially invited foreign investment in order to establish new export-oriented industries such as electronics, but they restricted FDI over time while accessing foreign technology through licensing.

South-East Asian efforts to promote indigenous industrialization have been more limited and generally less successful. Indonesia, Malaysia and Thailand all have resource-based industries that can compete internationally, while Thailand probably has the most internationally competitive light manufacturing industries. But South East Asia's export-led growth boom before the crisis was driven mainly by mas-

sive foreign investments from Japan and the other first-generation East-Asian NIEs (Jomo et al., 1997: chap. 3), with North American and European investors joining later. Alarmist predictions that footloose FDI would render the region's growth ephemeral have proven to be largely unfounded except in the case of relatively small Taiwanese investments during the early 1990s. However, passive reliance on foreign capital and technology inflows will generate little more than direct employment.

Consequently, greater attention has been given to the dynamic effects of new investment projects, even extending to matters such as market access, technology transfer and human resource development. Such considerations for evaluating investment performance became far more important during the decade-long boom prior to the 1997/98 crises. While capital formation, employment generation and foreign exchange earnings were not irrelevant, governments did become more selective in their investment promotion efforts, largely with a view to maximizing value added and positive externalities over time. The new emphasis on investment externalities has, in some countries, shifted the objective of investment promotion policies from particular industries to industrial clusters of complementary assembly, component production, and producer-service activities. Emphasis has shifted from maximizing new green-field FDI in export-oriented industries to encouraging reinvestment by established producers in deepening their local operations, upgrading skills, forming domestic economy linkages, and gaining a larger share of their parent companies' global operations.

To varying degrees, the other South-East HPAEs have sought to emulate their regional neighbour, Singapore, which initiated its "second industrial revolution" after achieving full employment in the late 1970s and, beginning in 1986, sought to establish itself as the best location for the regional headquarters of transnational corporations. Unlike the Republic of Korea and Taiwan Province of China, Singapore adopted an FDI-led path to export-oriented industrialization in the late 1960s, partly for political reasons (Rodan, 1989). Yet, despite its desire for foreign investment, Singapore is not opposed to government intervention. The Singaporean state has shaped the investment environment by providing a range of facilities, infrastructure, subsidies and complementary public investments (Low, 2001; Chng et al., 2001). Although its circumstances are very different from those of its neighbours, Singapore's experience clearly demonstrates that the scope for proactive investment policy in a liberal ownership regime is much greater than commonly presumed.

As investment policy goals have shifted, policy instruments have changed accordingly. Negative restrictions, such as foreign ownership limits and local content requirements, have been or are currently being phased out in most sectors, although significant exceptions remain. Tax holidays have also become less important insofar as most governments offer them to varying degrees. Instead, some governments have begun providing infrastructure and services designed to enhance their investment environments, attract desired investments, and induce positive externalities such as:

(i) one-stop facilitation of administrative approvals;

(ii) provision of specialized physical, customs-related, and technical infrastructure;

(iii) support for labour procurement and skills development;

(iv) matching of investors with local suppliers;

(v) other services relating to investors' routine operations, such as immigration, customs and other tax services, as well as trouble-shooting administrative problems with other government bureaucracies.

Implementation of these new investment policies has involved daunting political and administrative challenges, requiring government investment agencies to develop greater expertise and flexibility rather than a sector-neutral and passive policy stance. Reshaping national investment environments in line with new investor demands requires understanding the great variation within particular industries, the logistical needs and strategic concerns of transnational businesses, and the rapidly changing international investment environment. Changing the main task of investment policy from *regulation* to *promotion,* and now *services*, requires changing often deeply entrenched institutions and organizational cultures within the relevant bureaucracies. Hence, new investment policies have often involved creating new specialized agencies, authorities and administrative zones.

The new investment policy direction has had to respond to and cope with important challenges. Most important, the operations of relatively sophisticated transnational corporations have had limited impact on the production linkages, skill formation and other externalities of host economies, ostensibly because of limited domestic "absorptive capacity", resulting

in the inadequacy of skills and other technological capabilities. Clearly, FDI alone cannot ensure the development of capabilities, as is often presumed. Instead, dynamic externalities from foreign investment are more likely in host environments with appropriate skills, infrastructure, and supplier and technical capacities. In less conducive investment environments, export-manufacturing FDI may not generate the desired consequences, remaining primarily low-skill, import-dependent enclaves, as in Mexico.

This situation poses difficult challenges for countries with weak skill endowments, particularly related to engineering. For them, foreign investment is expected to catalyze industrial development, but these countries have limited complementary capabilities to offer. They have few technologically advanced producers able to integrate easily into the international supply chains of transnational corporations. Similarly, the efforts of transnational corporations to develop internationally integrated production specializations may constrain host-country efforts to promote domestic linkages and spillovers. Although some transnational corporations have begun to devolve functions like procurement, marketing, design, and even R&D to their South-East Asian operations, certain functions remain centralized in regional headquarters in Singapore or Hong Kong (China). Most subsidiaries in other South-East Asian countries lack the authority to make important decisions in close proximity to a regional headquarters. As a consequence, they may not even have the independence to develop new supply sources for anything other than the simplest components. These challenges point to the potential scope for policy initiative by governments and private entrepreneurs in enhancing the gains from FDI under a liberal investment regime. However, government efforts to foster linkages, skill formation, and technology spillovers have so far met with considerable difficulties.

Investment policy regimes are usually seen as lying somewhere along a continuum from the restrictive to the more liberal and incentive-neutral, with the analytical focus on regulations that shape entry barriers. From this perspective, the main trend since the mid-1980s has been the relaxation of restrictive regulations on foreign ownership. So-called trade-related investment measures – such as local content, foreign exchange balancing and technology transfer requirements – have also been relaxed. However, three issues have compromised this regional trend towards open investment regimes.

First, liberalization has occurred unevenly across sectors and countries. Although general investment barriers have been relaxed, the remaining restrictions have become more significant, sending clearer signals about policy priorities and concerns. After Singapore, Malaysia has the most open investment regime, allowing wholly foreign-owned firms to operate in the export-oriented manufacturing sector with minimal restrictions. However, following the crises, Thailand and Indonesia have opened their financial and other services to foreign mergers and acquisitions, while Malaysia has liberalized more cautiously in this regard.

Second, exemptions from (national) equity ownership requirements in the South-East HPAEs have usually been tied to exports and sometimes other more specific policy goals. For example, unlimited foreign ownership was allowed in export-oriented industries, but not for import-substituting production. Integration into the global economy in the 1980s and 1990s did not involve incentive neutrality and market-determined specialization. Instead, government initiatives responded to fresh opportunities offered by firms' new strategies vis-à-vis the globalization of industrial production.

Third, South-East HPAEs have been using investment *subsidies* such as tax holidays, exemptions and deductions, rather than entry restrictions (Felker and Jomo, 1999). Incentives have been used to promote particular industries or to impose specific performance requirements. Such subsidies have been conventionally viewed as due to (socially inefficient) competition among prospective host governments. Nevertheless, they have enabled host economies to promote certain industries to some advantage when investment externalities exceed subsidy costs, for example owing to scale or agglomeration economies.

It has also been argued that investment incentives compensate transnational corporations for their search costs and extra risks involved in transferring advanced production activities to new locations (UNCTAD, 1998: 97–106). Generally, governments in the region have used investment incentives to signal their commitment to attracting and retaining investors. Unlike investment restrictions and direct export subsidies, many investment subsidies are not proscribed by existing WTO provisions.

Investment subsidies have been addressed in recent years by the prospect of a multilateral investment policy regime. First mooted unsuccessfully as

part of the GATT Uruguay Round initiative on trade-related investment measures, another unsuccessful attempt was made through the OECD's Multilateral Agreement on Investment. WTO's Working Group on the Relationship between Trade and Investment is drafting a Multilateral Investment Agreement. If successful, such discretionary investment subsidies and other promotional measures will deprive developing countries of crucial policy tools in an increasingly challenging globalized investment environment.

Current reform programmes, as prescribed by IMF, exclude a priori the possibility that government investment policies can encourage technology transfer, linkage formation, skill development and other externalities. An important requirement for sustainable recovery is stronger expertise and more flexibility in public agencies overseeing industrial development. In the wake of the East Asian crisis, IMF has urged or even required countries to dismantle or reduce such subsidies. However, as they lose some policy instruments for promoting and shaping industrialization, South-East Asian countries will need to retain and hone the remaining instruments in order to cope with new challenges.

A country's comparative advantage as a location for production linked to transnational corporations increasingly depends on factors that affect those corporations' costs and competitive advantages. Besides political stability and investment security, transnational corporations are increasingly concerned about the quality of physical infrastructure and administrative systems, skill endowments, and proximity to quality suppliers. Host governments require considerable public expertise, institutional flexibility, and judicious investments in skill and technical capacities to ensure a mutually advantageous investment environment.

Authorities will undoubtedly continue to seek new ways of encouraging industrial and technological progress. Overcapacity in several manufacturing sectors and slow recovery in Japan probably mean that the new manufacturing FDI will not quickly resume the dizzy rates in the decade preceding the crisis. More worrying is the shift in FDI flows towards mergers and acquisitions and away from new green-field investments or even reinvestments of profits. Such trends have important implications for the development of industrial and technological capabilities. While facilitating investments has become central to recovery throughout the region, the new situation also poses significant downside risks. For example, opportunities for more value-added activities, such as design and R&D, may be constrained by the new strategies and internal organization of transnational corporations.

For other reasons too it is unlikely that nuanced proactive investment policies will continue to shape new investment trends. The region's opening to export-oriented FDI in the past did not result in the same sort of industrial linkages and technology development found in the Republic of Korea and Taiwan Province of China, because of poorer policy, weaker institutional support and fewer capabilities. Whatever the potential advantages of mergers and acquisitions, it is unlikely that these will be fully realized without appropriate institutional support, skills, policy incentives, and the ability to extract and capture rents.

Building new investment-management capabilities continues to face formidable difficulties. Assisting governments to regulate foreign investment is low on the agenda of the powerful international financial institutions as well as most domestic reformers. In Indonesia, the desire to restore investor confidence is likely to constrain government policy activism for some time. Although there are some signs of emerging public-private coordination in fostering skills and technology development in Thailand, some of the indigenous industrial capacities built up in recent years have been lost with the financial liquidation of many manufacturers. Malaysian Prime Minister Mahathir's rejection of orthodox prescriptions for economic restructuring in Malaysia has mainly protected financial and other non-manufacturing interests. Although the government retains important policy instruments, efforts to revive growth in the short term have forced Malaysia to liberalize its de facto investment policy regime.

Prospects for rebuilding investment-management capacities have also been clouded by current multilateral efforts to proscribe discretionary government interventions and regulations affecting investment flows. Establishing a multilateral investment regime even more restrictive of national government initiative may reduce the potential for abuses of investment policy. The main effect will be the loss of an important tool for fostering long-term industrial development.

VII. Prospects

Since mid-1997, the sustainability of the growth and industrialization processes in South East Asia has been in grave doubt. Unlike the North-East Asian economies, the South-East HPAEs have been far more dependent on foreign investment. Although only Singapore and Malaysia stand out statistically in the proportion of FDI in total investment, much of the non-resource-based, export-oriented manufacturing in all three North-East HPAEs is owned and controlled by foreigners; while those of Japan, the Republic of Korea and Taiwan Province of China also have foreign investment, their governments have been far more selective and restrictive. Their levels of FDI are well below the average for developing countries (around 5 per cent). Instead, these economies have emphasized the development of national (not necessarily state-owned, except perhaps in Taiwan Province of China) industrial, technological, marketing and related capacities. In contrast, most *rentier* entrepreneurs in South East Asia have continued to capture *rentier* opportunities (often based on political and other connections), rather than develop the new capabilities desperately needed to accelerate late industrialization.

There is a real danger that South-East Asian economies will lose their earlier attractiveness as sites for FDI, and their indigenous capabilities seem to be inadequate to sustain internationally competitive export-oriented industrialization in its absence. Foreign investors can choose among alternative investment sites in line with overall firm strategies, domestic market prospects, infrastructure and other support facilities, incentive and tax regimes, relative resource endowments, comparative production costs in the short and medium term, as well as other considerations of likely competitive advantage. With limited indigenous capabilities and the irrepressible industrialization of China and, more recently, India, the South-East HPAEs, including Malaysia and Thailand, are less attractive than they used to be.

There is little evidence that the massive devaluation of the crisis-affected South-East Asian economies will support sustained growth. For some analysts, the crisis was precipitated by the collapse of Thai export growth (and the related slowdown in output growth) after the devaluation of the Chinese renminbi in 1994 and appreciation of the US dollar in mid-1995. The crisis beginning in mid-1997 saw the depreciation of all crisis-affected currencies, leaving South-East Asian economies (including Thailand's) a little more cost-competitive, but only in relation to those economies that did not experience currency depreciations. They did not become more competitive in comparison with their neighbours, often their main competitors.

In the immediate aftermath of the crisis, palm oil prices rose, helping to alleviate the worst impact of the crisis. However, vegetable oil prices generally collapsed with the bumper soybean harvest of mid-1999. Fortunately for Malaysia and Indonesia, petroleum prices rose strongly in 1999 and into 2000, but again there is no evidence that commodity prices increased as a result of the depreciated currencies. The strong upswing in the electronics business cycle since 1998 has also helped the region, especially Malaysia, with the share of electronics in Malaysian manufactured exports rising from below 60 per cent before the crisis to more than 70 per cent. But again, there is little evidence that higher demand for electronics is mainly due to lower production costs owing to the weaker currencies. On the contrary, some observers have argued that increases in Malaysian electronics output and exports have been below those of the industry as a whole, and even below those of neighbouring Singapore, which experienced less drastic currency depreciation.

More worrying, there is considerable evidence that commodity prices have decreased in recent years, including those of most primary as well as manufactured commodities. There is now considerable evidence of significant price deflation for generic manufactured goods, which are subject to ineffective entry barriers, in contrast to industries that are subject to effective entry barriers as a result of enforceable intellectual property rights. This divide is characterized by a race to the bottom for the former as lower prices (and cheaper currencies) transfer economic gains from the producers (workers and contract suppliers) to the oligopolies commanding market shares and to consumers (in the form of lower consumer prices) (Kaplinsky, 1999).

Before the 1997/98 crises, Thailand and Malaysia were already experiencing full employment with significant labour shortages; estimates of foreign worker presence in both economies in the late 1990s ran into the millions. It is widely believed that this presence was tolerated, if not encouraged, by the authorities, especially in Malaysia, as the governments wanted to remain competitive in low-wage economic activities such as plantation agriculture. Thus labour immigration discouraged industrial upgrading and limited indigenous Malaysian technological capabilities, further exacerbating the

problem of inadequate industrial capacity to sustain further rapid industrialization and technological progress.

While the first phase of economic recovery in the region may be rapid as its existing capacity is more fully utilized, the decline of new, especially green-field, investments in the crisis-affected economies since the mid-1990s is cause for concern. Malaysia, for example, has experienced three consecutive years of decline in investment approvals since 1996, although investment approvals have exceeded applications in recent years (Jomo, 2001a). Also of concern is the apparent shift of investments from manufacturing for export to production for domestic consumption, particularly of non-tradeables, contributing to the property price bubble and increasing the vulnerability of the financial sector as a whole. Malaysia has successfully held down interest rates since September 1998, but loan growth has fallen far short of the central bank's target of 8 per cent for 1998 as well as 1999. The share of bank credit going to manufacturing, agriculture and mining has also declined significantly, while loans for property and share purchases have been encouraged once again and now account for even larger shares of new loans than before the crisis.

There is a real possibility that, while strong economic recovery during 1999 will continue into 2000 and beyond (World Bank, 1998), growth may begin to sputter as existing capacity becomes fully utilized and new investments are not forthcoming – at least at the same levels as those preceding the crisis (Rasiah, 2001). The changed international situation does not augur well for the South-East HPAEs, which have grown rapidly in recent decades but have been unable to sustain the momentum of manufacturing growth.

VIII. Concluding remarks

Finally, to return to the key question of growth prospects for the region after the 1997/98 crisis, one can reiterate the following.

Although there was no one development model for the eight HPAEs, all experienced rapid growth due to high savings and investment rates as well labour utilization and human resource development. Exports were also important in all these economies, although most were far from being open economies. It is now generally agreed that international financial liberalization was the principal cause of the crisis, though those in favour of such liberalization would argue that the problems involved improper sequencing and/or inadequate prudential supervision rather liberalization per se. Such international financial liberalization generally began in the region from around the late 1980s, and certainly cannot be considered part and parcel of the development strategies responsible for the rapid growth, industrialization and structural changes before that.

Returning to the various institutional features that made possible the East Asian miracle in the past is, for several reasons, no longer an option. The international economic environment has changed quite radically in the past fifteen years. International economic governance profoundly altered with IMF's stabilization programmes and the World Bank's structural adjustment packages in the wake of the debt crises of the 1980s. New conditionalities have been imposed in the region by the Bretton Woods institutions, together with the emergency credit facilities provided to Indonesia, the Republic of Korea and Thailand during the 1997/98 crises. It is increasingly recognized that economic liberalization and such conditionalities have had adverse consequences for growth, let alone distribution. International economic liberalization has been further advanced by other institutions and processes, most notably the conclusion of the Uruguay Round of international trade negotiations with the advent of WTO in the mid-1990s.

Furthermore, the needs and requirements of the HPAEs have changed over time; given their variety, there is no single universal set of institutional reforms for all these economies. However, bank-based financial systems are still more likely to serve the developmental finance requirements of these economies. But the scope for directed credit (praised in World Bank, 1993) and financial restraint has been considerably reduced by internal as well as international financial liberalization. Instead, with the Financial Services Agreement under the General Agreement on Trade in Services (GATS) and the imminent broadening of IMF's mandate to also cover the capital account, there is likely to be greater pressure to promote and open up capital markets in the region.

As with finance, there is also little conclusive evidence of the superiority of Anglo-American corporate governance. Nevertheless, the Fund and the World Bank continue to press for corporate governance reforms and corresponding conditionalities

imposed during the East Asian crises, insisting that such changes are necessary for economic recovery. However, the relatively stronger economic recoveries in Malaysia and the Republic of Korea have had little to do with such reforms and were primarily due to successful, Keynesian-style, counter-cyclical reflationary policies. East Asian business relations – once celebrated as synergistic social capital – has since come to be denounced as "crony capitalism" ostensibly responsible for the crisis. The family firm, a feature of early capitalist development in much of the world, has also been targeted for reform as if it were responsible for the abuses associated with parasitic "cronyism".

Economic liberalization more generally has greatly reduced the scope for industrial policy or selective government interventions. Yet, the World Bank's advocacy of poverty targeting – for example, in connection with its social safety net programmes – has underscored the legitimacy of such selectivity, besides implicitly acknowledging government capacity to do so reasonably well. Despite the recent push for trade liberalization as well as abandonment of several GATT arrangements that acknowledged and sought to compensate for different national economic capabilities, UNCTAD's annual *Trade and Development Reports* have continued to affirm the remaining scope for trade-related industrial policy. Similarly, the work of Stiglitz and others have reiterated not only the need for but also the potential for finance-related industrial policy.

This paper has considered some recent developments in South-East Asian investment regimes in line with industrial policy despite initiatives such as the Uruguay Round's trade-related investment measures (TRIMs), the OECD's aborted Multilateral Agreement on Investment and WTO's Multilateral Investment Agreement. The scope for corresponding technology policy has also been identified despite the strengthening of corporate intellectual property rights. Human resource development is probably the area for industrial policy initiatives least fettered by recent liberalization trends, despite the World Bank's advocacy of non-subsidization of post-primary education and recent trends in education and health care privatization.

Ensuring a return to the high productive investment rates of the past is helped by the continued high domestic savings rates in the region in spite of the devastating social impacts of the 1997/98 crises in the East Asian region. It is now generally acknowledged that much of the additional funding made available by foreign bank borrowings as well as portfolio investment inflows into the region helped fuel asset price bubbles, which later burst with such catastrophic consequences. Yet, financial liberalization in the region has been furthered – rather than checked – in the aftermath of the crises, mainly due to the conditionalities imposed by the Fund as well as the urgent need for foreign funds to help economic recovery.

Some popular accounts of the East Asian miracle economies portrayed them as geese flying in the slipstream of the lead goose, Japan. Many went further to imply that they were Japanese clones or at least "wannabes". Even serious scholars of the region have written of a yen bloc, for instance, despite the fact that most Japanese corporations used the US dollar to denominate their internal transactions, and most monetary authorities in the region, including Japan, never sought the internationalization of their currencies. In short, the picture of East Asian homogeneity has long been grossly exaggerated.

In the unlikely event that the Europeans and the Japanese do not resist the continued promotion of the Anglo-American capitalist norm for the rest of the world, it is quite likely that we will witness a greater degree of conformity and uniformity in the formal rules and institutions of the economy. But such conformity may remain superficial, rather than become substantial or, as is perhaps more likely, the Anglo-American forms may take root unevenly in different situations depending on changing historical, economic, political, cultural, social and other environmental factors. In the same way that Islam once spread rapidly across North Africa, providing a common legal and cultural basis for long-distance trade, the English language and Anglo-American norms may well become universal in the forthcoming era. But just as the acceptance of Islam has resulted in a great variety of Muslim cultural expression and behavioural norms, a twenty-first century Anglo-American global capitalism may still be quite diverse.

Neo-liberal globalization of Anglo-American capitalism seems likely to continue in the near future. These trends will probably be led by the two Bretton Woods institutions as well as WTO. Nevertheless, there continues to be some diversity of opinion within as well as among these institutions, which is likely to be reflected in policy prescriptions. WTO's formal democracy provides some basis for reformist initiatives, while the Fund and World Bank will continue to be under pressure to become more accountable, if not democratic.

As noted earlier, the aftermath of the debt crises of the early and mid-1980s saw stabilization programmes and structural adjustment packages begin this process, especially in the most heavily indebted economies which had to approach the Bretton Woods institutions for emergency credit facilities, and were therefore obliged to accept the accompanying conditionalities. The currency and financial crises of the 1990s have seen similar outcomes, with East Asian governments obliged to accept, implement and enforce conditionalities imposed by the Fund, the United States Treasury, as well as other foreign government agencies. But such circumstances for the extension of the neo-liberal globalization agenda underscore the constraints it is subject to. Not only is there growing resentment over such impositions within the countries concerned, but there is also growing international understanding and wariness of the underlying interests and agendas involved. In other words, every success also hardens resistance. This alone will ensure that the future of liberalization is far from assured and unlikely to be either smooth or even.

Even in the improbable scenario that all developing countries are compelled to subject themselves to such conditionalities, the outcomes are unlikely to be the same. Initial conditions can account for many variations, as we have seen from our very limited sample of four East Asian economies. Different economies have developed different capacities and capabilities, and may therefore be affected rather differently by liberalization and globalization.

Sequencing will also give rise to differences. There are at least several different sequencing issues; that of different aspects of domestic and external liberalization may involve many different permutations. Policy makers for those economies that liberalize later are also in a position to learn from the experiences of those before them, and thus to anticipate and prepare themselves better.

The mixed consequences and experiences of liberalization and globalization thus far have also greatly undermined the previously smug self-confidence of what has been termed the Washington Consensus. With the benefit of hindsight, Stiglitz's (1998) predictions of a post-Washington Consensus may well have been premature. The circumstances of his departure from the World Bank and the more recent controversy over the contents of the *World Development Report* for the year 2000 on poverty are important reminders of the continued hegemony of the Washington Consensus, albeit slightly chastened. Hence, it is not a self-confident, unchallenged and unproblematic consensus, but rather one that is increasingly vulnerable, not least because of developments in East Asia.

The earlier appreciation of the East Asian miracle posed an important challenge to the economic neo-liberalism underlying the stabilization programmes and structural adjustment packages of the 1980s and 1990s. While the East Asian *débâcle* of 1997/98 has been invoked to negate much of that earlier analytical challenge, it has also raised troubling questions about financial liberalization. While much of the earlier criticisms of liberalization and economic globalization came from outside the mainstream of contemporary economic thinking, much of the recent debate and dissent over financial and capital account liberalization, as well as the role of the Bretton Woods institutions, has involved orthodox economists, including many who have been strong advocates of liberalization with regard to international trade, investment and other economic areas.

And while there is unlikely to be any imminent radical change in the international financial architecture, as the threat posed by and the memory of the East Asian financial crises recede, it is unlikely that there will be a simple return to the smug and simple-minded advocacy of economic liberalization on all fronts, as in the recent past. Much more nuanced and sophisticated understanding of economic liberalization and its consequences may therefore have a greater intellectual and policy-making impact.

However, while the economic convergence promised by neo-liberal economic globalization is unlikely – not only because it is mythical, but also because there can never be the truly level playing field promised by liberalization – one cannot deny that even partial liberalization has limited the range of options as well as the variety of possible economic arrangements. The changed institutional or systemic ecology permits fewer species to survive. But variety, albeit increasingly limited, there can and will be.

In these circumstances, it is increasingly probable that systemic differences will be less stark and obvious. But this will perhaps compel closer attention to the remaining variety as well as the remaining scope for diversity, which should in turn lead to more careful attention to detail and to greater appreciation of the sources of efficacy of policy instruments, for example. Hence, it seems likely that there will be less interest in alternative economic models or sys-

tems, but more consideration of the microeconomic bases for the viability of particular policies and institutions. This could, in turn, lead to a much more eclectic mixture of policies and institutions, and hence, to a greater variety of systems or models.

Notes

1 Namely: Hong Kong (China), Indonesia, Japan, Malaysia, the Republic of Korea, Singapore, Taiwan Province of China and Thailand.

2 This section and the next draw from the introductions to Jomo (2001a) and Jomo (2001b).

3 Many economists have been obliged to reconsider their earlier assessments of the causes of the Asian crisis, most notably Paul Krugman. In the immediate aftermath of its outbreak, the crisis was seen by some as vindication of his earlier popularization of a critique of the East Asian miracle as due primarily to massive factor inputs subject to diminishing returns (Krugman, 1994). In March 1998, Krugman dissented from the view associated with Jeffrey Sachs of the East Asian crisis as due to a "good old-fashioned financial panic … a panic need not be a punishment for your sins … an economy can be "fundamentally sound" … and yet be subjected to a devastating run started by nothing more than a self-fulfilling rumor". Instead, he argued "that the preconditions for that panic were created by bad policies in the years running up to the crisis. The crisis, in short, was a punishment for Asian crimes, even if the punishment was disproportionate to the crime … The specific spirit that pushed Asia to the brink was the problem of moral hazard in lending – mainly domestic lending" which he associated with "crony capitalism" (Krugman, 1998a). Attributing the crisis to "cronyism" turned on its head one of the main arguments about how intimate business-government relations in East Asian economies had helped to create the conditions for the regional miracle. However, by October 1998 Krugman (1998b) had completely changed his view: "When the Asian crisis struck … countries were told to raise interest rates, not cut them, in order to persuade some foreign investors to keep their money in place and thereby limit the exchange-rate plunge ... In effect, countries were told to forget about macroeconomic policy; instead of trying to prevent or even alleviate the looming slumps in their economies, they were told to follow policies that would actually deepen those slumps … But, because crises can be self-fulfilling, sound economic policy is not sufficient to gain market confidence; one must cater to the perceptions, the prejudices, and the whims of the market. Or, rather, one must cater to what one hopes will be the perceptions of the market … The perceived need to play the confidence game supersedes the normal concerns of economic policy." Later, Krugman (1999b) added: "The scope of global "contagion" – the rapid spread of the crisis to countries with no real economic links to the original victim – convinced me that IMF critics such as Jeffrey Sachs were right in insisting that this was less a matter of economic fundamentals than it was a case of self-fulfilling prophecy, of market panic that, by causing a collapse of the real economy, ends up validating itself."

4 Of course, the availability of cheap foreign funds – for example, owing to a low real interest rate – can help to temporarily close both domestic savings-investments as well as foreign exchange gaps, especially if well invested or deployed.

5 Financial analysts had become fixated with the current account deficit. This indicator, almost alone, had become the fetish of financial analysts, especially since the Mexican meltdown of early 1995. In earlier, different times, some economies sustained similar deficits for much longer, without comparable consequences. As noted in the immediate aftermath of the Mexican crisis of 1995, several South-East Asian economies already had comparable current account deficits then, despite, or rather because of, rapid economic growth.

6 In some countries, government-owned, non-financial, public enterprises (NFPEs) have been very much part of this supposedly private sector, debt growth phenomenon.

7 There is also no evidence that the stock market boom of the mid-1990s more effectively raised funds for productive investment; in fact, the converse seems more likely, with financial disintermediation from commercial banks to the stock market.

8 While the United States economy was strengthening, the South-East Asian economies were growing even faster.

9 In the mid-1990s, as the US dollar strengthened along with the United States economy, both the Japanese and the Germans allowed their currencies to depreciate against the US dollar, with relatively little disruption, in an effort to regain international competitiveness.

10 Montes (1998) emphasizes that sentiments can either favourably or unfavourably influence fundamentals and the health of financial systems. In particular, the collapse of the South-East Asian currencies due to sentiments would adversely affect the viability of investments made in different exchange rate conditions, which could in turn further exacerbate the domestic banking crisis.

11 Montes argues that the rural-based economies of South East Asia have been better able to carry out real devaluations from nominal changes in currency value, while their export sectors have not been too tied down by supply-side inflexibilities to respond to real devaluations. After asserting that stock markets have served to share risks among asset owners rather than raise financing, he argues that, except for financial system weaknesses, South-East Asian real sectors have been relatively immune from the recent asset market frenzy.

12 Montes points out that equity and portfolio investments have overtaken direct investment, loans and trade credit in providing external financing in the 1990s. He cites Reisen's warning (Montes, 1998: 34) that offers of foreign financing should be resisted if they would "cause unsustainable currency appreciation, excessive risk-taking in the banking system, and a sharp drop in private savings". Hence, in a market-sentiment driven world, currencies become too strong with offers of strong external financing and too weak when capital withdraws.

13 Woo (2000a) has argued that "occasional excessive price movements in financial markets" should not be too readily attributed to rational anticipation of changes in government policies that were not eventually realized – the main argument usually invoked to reject claims of speculative bubbles.

14 Short-termism – encouraged by financial liberalization – also accentuated the bias against longer-term productive investments.

15 In the face of limited information and a rapidly changing situation, such behaviour is often considered rational by market players, even if unfortunate.

16 Hedge funds may, however, go in different directions, for instance, when the currency sell-off of one fund provokes another fund to snap up bargain equities – for instance, foreigners were often persistent net buyers of Japanese stocks throughout the bursting of the bubble in Japan in the 1990s.

17 Krugman's (1998c) attempt at theoretical "catching-up" is particularly worthy of consideration in the light of his own previous attempts at understanding related international economic phenomena as well as East Asian economic growth. As the crisis was still unfolding, such an attempt was hardly definitive, especially without the benefit of hindsight. Yet, as policy was very much being made on the hoof, his attempt to highlight certain relationships may well be illuminating. Hence, Krugman argues that: "It is necessary to adopt an approach quite different from that of traditional currency crisis theory. Of course Asian economies did experience currency crises, and the usual channels of speculation were operative here as always. However, the currency crises were only part of a broader financial crisis, which had very little to do with currencies or even monetary issues per se. Nor did the crisis have much to do with traditional fiscal issues. Instead, to make sense of what went wrong, we need to focus on two issues normally neglected in currency crisis analysis. These are the role of financial intermediaries (and of the moral hazard associated with such intermediaries when they are poorly regulated), and the prices of real assets such as capital and land."

18 None of the fundamentals usually emphasized seemed to have been important in the affected economies: all the governments had fiscal surpluses and none were involved in excessive monetary expansion, while inflation rates were generally low.

19 Whereas the other three crisis-affected East Asian economies succeeded in attracting considerable, mainly short-term, US dollar bank loans into their more bank-based financed systems, Malaysia's vulnerability was mainly due to the volatility of international portfolio capital flows into its stock market. As a consequence, the nature of Malaysia's external liabilities at the beginning of the crisis was quite different from that of the other crisis-stricken East Asian economies. A greater proportion consisted of equity, rather than debt. Much of the liabilities, including the debt, was private – rather than public – compared to Malaysia's exposure in the mid-1980s. Also, compared to the others, much of Malaysian debt in the late 1990s was long- rather than short-term in nature. Monetary policy as well as banking supervision in Malaysia had generally been much more prudent compared to the other crisis victims. Banks in Malaysia had not been allowed to borrow heavily from abroad to lend on the domestic market, as in the other economies. Such practices involved currency and term mismatches, which increased the vulnerability of the financial system to foreign bankers' confidence, as well as pressure on the exchange rate pegs. These differences have lent support to the claim that Malaysia was an "innocent bystander" which fell victim to regional contagion for being in the wrong part of the world at the wrong time. Such a view takes a benign perspective on portfolio investment inflows, and does not recognize that such inflows are even more easily reversible and volatile than bank loan inflows. The magnitude of gross inflows and outflows reflect the much greater volatility of these flows, often obscured by focusing on net flows (Jomo, 2001a). Contrary to the "innocent bystander" hypothesis, Malaysia's experience actually suggests greater vulnerability owing to its greater reliance on the capital market. As a consequence, the Malaysian economy became hostage to international portfolio investor confidence. Hence, when government leadership engaged in rhetoric and policy initiatives that upset such investment confidence, Malaysia paid a heavy price as portfolio divestment accelerated.

20 Recent findings suggest that national savings tend to equal national investment, suggesting that flows of capital to "the best possible use" are far from universal and much smaller than simple theories predict. Lack of information or other risks and uncertainties tend to reduce cross-border capital flows.

21 Eatwell suggests a negative correlation between dependence on "foreign savings" and economic performance. This is true if we do not break down the nature of foreign savings. The numbers are strongly biased by the inclusion of short-term money market flows, which may include efforts by governments to prop up their currencies with high interest rates, which temporarily suck in money from overseas. Brazil, Mexico and especially Venezuela typified this a few years ago. If only long-term direct or equity investment were considered, a lot of poorly performing Latin American economies would be screened out. South-East Asian countries, especially Malaysia and Singapore, would then rank high in both foreign savings (measured "appropriately") and economic performance.

22 Of course, capital flight is not an inevitable consequence of financial liberalization, but may reflect the fears and consequent hedging behaviour of locals.

23 Currently, high interest rates represent a very unhappy situation for the region. They are intended, in part, to prop the currency up to maintain confidence but, perhaps more importantly, to allow local companies to pay off their foreign debts. The cost of this is slower growth. With lower interest and exchange rates, which help the economy to grow and help consumers, mismanaged local companies would have to reorganize themselves, or otherwise lose their equity (which they deserve, in many cases, to forfeit). Foreign creditors who were stupid enough to lend dollars to mismanaged companies should see their bank loans and bonds defaulted on. Bankrupt local companies could be bailed out and recapitalized, with 100 per cent equity ownership then going into mutual funds or pension funds distributed equally to the masses of ordinary citizens. Liberalization is generally associated with higher interest rates. However, lower interest rates could have been due to a combination of pegged exchange rates, capital controls, and the deployment of funds inside such economies. Pegged exchange rates are enforced by capital controls which "trap" a pool of savings inside an economy. The trapped savings are typically exploited by governments or banking cartels that may keep interest rates too low, even below inflation rates. The capital controls may thus force savers to accept low interest rates and stop them from getting a fairer return elsewhere. The cheap savings may get loaned to undeserving corporations or for other purposes, possibly at the direction of the government.

24 One could argue that some of this is the result of greed, stupidity and lack of education or regulation. If used carefully, derivatives are ultimately insurance contracts.

25 There is evidence of a strong positive correlation between financial openness, foreign investment, GDP growth and per capita income driven by the performance of the Asian countries.

26 In more democratic polities, there is also likely to be considerable pressure from the citizenry to be more assertive

in international economic affairs and to regain control of national economic leadership (Gray, 1998: 7). (I am grateful to Din Merican for reminding me of this.)

27 Because of the separation of ownership and management of portfolio investments, though it may be in the interest of investors to "buy and hold", it is difficult to write contracts to motivate pension managers, mutual funds and other intermediaries to stay put.

28 Of course, liquidity is one of the features which induces otherwise risk averse investors to buy into a situation. Furthermore, in any transaction, there is a buyer for every seller.

29 Arguably, the Philippines currency has not taken quite as hard a hit, in part because their (colonial-inherited) banking and accounting standards are considered relatively better, but also because short-term capital inflows have been relatively less, given the recentness of its economic recovery.

30 See Jomo (1998); and *Cambridge Journal of Economics* (November 1998). See also Jomo (2001a), chap. 1 for an account of the Malaysian experience.

31 Furman and Stiglitz (1998) have critically reviewed the relevant literature to argue against raising interest rates to protect the exchange rate. In particular, where leveraging is high, as in East Asia, high interest rates will take a huge toll by weakening aggregate demand and increasing the likelihood and frequency of insolvencies. Unexpected interest rate hikes tend to weaken financial institutions, lower investments, and hence output. They offer three main reasons why keeping interest rates low while letting the exchange rate depreciate may be a preferable option in the face of the trade-off involved:

(i) To avoid crisis, there should be greater concern about interest rate increases than about exchange rate declines (Demirguc-Kunt and Detragiache, 1998);

(ii) Invoking a moral hazard argument, they suggest that any government intervention to stabilize the exchange rate is likely to encourage economic agents to take positions they would otherwise not take, later compelling the government to support the exchange rate to avoid the now larger adverse effects;

(iii) Invoking an equity argument, they ask why borrowers, workers, firms and others adversely affected by higher interest rates, should be compelled to pay for speculators' profits. When a government defends its currency, it is often making a one-way bet, where the expected loss is the speculators' expected gain. In contrast, if the government does not wager any reserves, the gains of some speculators are simply the losses of others (Furman and Stiglitz, 1998: footnote 132).

32 In a telling episode at the beginning of September 1997, IMF deputy head, Stanley Fischer, pointed out that although the current account deficits in South East Asia had emerged quite some years ago, markets had failed to adjust – contrary to the predictions of conventional economic theory. (Instead of recognizing the failure of market mechanisms, US Federal Reserve Chair Alan Greenspan gently chided Fischer in response, as if expecting IMF to "remind" Wall Street of what it had forgotten.) Meanwhile, "the market" had become so fixated with the current account deficit that this indicator, almost alone, has become the fetish of financial analysts, especially since the Mexican meltdown of early 1995. In earlier, different times, some economies sustained similar deficits for much longer, without comparable consequences. As noted in the immediate aftermath of the Mexican crisis of 1995, several South-East Asian economies already had comparable current account deficits then, despite, or rather because of, rapid economic growth. Yet, as Fischer observed, the currency markets had failed to adjust earlier on in South East Asia (Fischer, 1997).

33 In the wake of the Mexican crisis in early 1995, the IMF had stepped back momentarily from its advocacy of virtually unfettered financial, including capital account, liberalization. Unfortunately, the short-termism of financial markets extends to human and institutional memories as well as to related policy-making and advocacy. (I am grateful to Anthony Rowley for confirming these details with Kunio Saito, director of the IMF Tokyo regional representative office, on 17 December 1997.)

34 As Keynes (1936: 322–323) argued, the remedy for crisis is lowering, rather than increasing, interest rates: "The right remedy for the trade cycle is not to be found in abolishing booms and thus keeping us permanently in a semi-slump; but in abolishing slumps and thus keeping us permanently in a quasi-boom. … [A] rate of interest, high enough to overcome the speculative excitement, would have checked, at the same time, every kind of reasonable new investment. Thus an increase in the rate of interest ... belongs to the species of remedy which cures the disease by killing the patient."

35 However, a much lower share of recent Malaysian bank-lending is going to productive purposes, compared to the other three economies with their more bank-based financial systems. As shown in Appendix tables 3a, 3b, 3c and 3d, in 1999 only 19 per cent of commercial bank loans and advances went to manufacturing in Malaysia, compared to 35 per cent in the Republic of Korea (in 1998), 30 per cent in Thailand, and 36 per cent in Indonesia.

36 For instance, the recapitalization of commercial banks in the Republic of Korea in September 1998 involved an injection of 64 trillion won. Similarly, the Malaysian effort involved over RM47 billion to take non-performing loans out of the banking system, and another RM5-7 billion to recapitalize the most distressed banks.

37 This subsection and the next draw heavily on Furman and Stiglitz (1998).

38 This section draws heavily on Akyüz (2000a; 2000b).

39 Hazel Henderson (1999) argues that rather than invoke US bankruptcy procedures for private firms (chap. 11), the more relevant and appropriate reference point for developing country governments are the provisions for municipal authorities (chap. 14).

40 This sub-section draws heavily from Felker and Jomo (1999).

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APPENDIX

Appendix table 1

EAST ASIAN FOUR: MACROECONOMIC INDICATORS, 1990–1999

(Percentage change over previous year)

	1990	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
Malaysia										
Real GDP	9.7	8.2	7.8	8.4	9.2	9.5	8.6	7.5	-7.5	5.4
Private consumption	13.1	9.5	3.0	4.6	9.8	9.4	6.9	4.3	-10.8	2.5
M2	12.8	14.5	19.1	22.1	14.7	24.0	21.4	22.6	1.5	11.6
M3	18.2	15.3	19.6	23.5	13.1	22.3	21.2	18.5	2.7	8.3
Inflation	3.1	4.4	4.8	3.6	3.7	3.4	3.5	2.7	5.3	2.8
C.A. deficit/GDP	2.1	8.9	2.8	4.8	6.3	8.5	4.9	-5.0	12.9	14.0
Foreign reserves[a]	9,327	10,421	16,784	26,814	24,888	22,945	26,156	20,013	24,728	30,853
Rep. of Korea										
Real GDP	9.0	9.2	5.4	5.5	8.3	8.9	6.8	5.0	-6.7	11.0
Private consumption	9.6	8.0	5.5	5.6	8.2	9.6	7.1	3.5	-11.4	10.3
M2	17.2	21.9	14.9	16.6	18.7	15.6	15.8	14.1	27.0	27.4
M3	28.7	23.6	21.8	19.0	24.7	19.1	16.7	13.9	12.5	8.0
Inflation	8.5	9.3	6.3	4.8	6.2	4.5	4.9	4.5	7.5	0.8
C.A. deficit/GDP	-0.8	-2.8	-1.3	0.3	-1.0	-1.7	-4.4	-1.7	12.8	6.1
Foreign reserves[a]	14,459	13,306	16,640	19,704	25,032	31,928	32,402	19,710	51,963	73,700
Thailand										
Real GDP	11.6	8.4	7.8	8.3	8.9	8.7	6.4	-1.8	-10.4	4.1
Private consumption	12.8	6.6	7.8	8.7	8.3	8.6	6.6	-1.3	-2.2	n.a.
M2	26.7	19.8	15.6	18.4	12.9	17.0	12.6	16.4	9.5	2.1
M3	-	19.9	18.5	19.7	17.6	18.7	13.4	3.2	8.9	1.6
Inflation	6.0	5.7	4.1	3.3	5.0	5.8	4.8	5.6	8.1	0.3
C.A. deficit/GDP	8.3	7.5	5.5	5.5	5.6	8.0	7.9	-2.1	12.7	9.1
Foreign reserves[a]	13,247	17,287	20,012	24,078	28,884	35,463	37,192	25,697	28,434	34,781
Indonesia										
Real GDP	7.2	7.0	6.5	6.5	7.7	8.2	7.8	4.7	-13.2	0.2
Private consumption	17.2	8.0	3.1	11.8	4.7	9.7	9.2	5.3	-2.1	1.5
M2	44.2	17.1	20.2	22.0	20.2	27.6	29.6	23.2	62.3	11.9
Inflation	7.4	9.4	7.5	9.7	8.5	9.4	6.5	6.6	58.5	20.5
C.A. deficit/GDP	3.4	3.8	2.1	1.6	1.7	3.6	3.3	-2.3	4.1	3.5
Foreign reserves[a]	7,353	9,151	10,181	10,988	11,820	13,306	17,820	16,088	22,401	27,160

Source: Asian Development Bank, Bank Negara Malaysia, Malaysia (Treasury), *Economic Report*, Bank of Thailand, Monetary Authority of Singapore, International Monetary Fund, *International Financial Statistics*.

a Foreign exchange (IFS line 1d.d), US$ million; current account surplus in US$ million.

Appendix table 2a

THAILAND: FOREIGN DEBT INDICATORS, 1970–1998

(US$ million)

	1970	*1980*	*1990*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*
Total debt stock (EDT)		8,297	28,165	41,865	52,717	65,597	83,093	90,777	93,731	86,172
Long-term debt (LDOD)	726	5,646	19,842	27,138	30,083	36,418	41,998	53,164	56,466	59,410
Short-term debt		2,303	8,322	14,727	22,634	29,179	41,095	37,613	34,836	23,523
Net flow on debt	365	1,808	3,534	4,132	11,112	10,474	18,226	6,755	5,796	-10,998
of which short-term debt		-37	2,210	2,235	7,907	6,545	11,916	-3,482	-2,777	-11,313
Aggregate resource flows and net transfers (long-term)										
Net resource flows (long-term)	139	2,087	4,691	4,175	8,226	4,863	10,630	14,220	9,615	8,987
Foreign direct investment (net)	43	190	2,444	2,113	1,804	1,366	2,068	2,336	3,746	6,941
Portfolio equity flows	0	0	449	4	3,117	-538	2,154	1,551	-308	2,341
Profit remittances on FDI	19	38	312	350	420	465	480	510	550	580
Major economic aggregates										
Gross national product (GNP)	7,096	32,091	84,272	108,975	122,790	141,500	164,619	176,593	149,257	112,720
Exports of goods and services (XGS)		8,575	31,289	42,919	49,596	58,679	74,093	75,385	76,157	69,227
International reserves (RES)	911	3,026	14,258	21,183	25,439	30,280	36,939	38,645	26,897	29,537
Current account balance		-2,076	-7,281	-6,303	-6,364	-8,085	-13,554	-14,691	-3,024	14,241
Debt indicators										
EDT/XGS (per cent)		96.8	90.0	97.5	106.3	111.8	112.1	120.4	123.1	124.5
EDT/GNP (per cent)		25.9	33.4	38.4	42.9	46.4	50.5	51.4	62.8	76.4
RES/EDT (per cent)		36.5	50.6	50.6	48.3	46.2	44.5	42.6	28.7	34.3
RES/MGS (months)		3.3	4.4	5.1	5.4	5.4	5.0	5.1	4.1	6.4
Short-term/EDT (per cent)	27.8	29.5	35.2	42.9	44.5	49.5	41.4	37.2	27.3	

Source: World Bank, *Global Development Finance 2000.*
Key: MGS: Imports of goods and services.

Appendix table 2b

INDONESIA: FOREIGN DEBT INDICATORS, 1970–1998

(US$ million)

	1970	*1980*	*1990*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*
Total debt stock (EDT)		20,938	69,872	88,002	89,172	107,824	124,398	128,940	136,173	150,875
Long-term debt (LDOD)	2,948	18,163	58,242	69,945	71,185	88,367	98,432	96,710	100,338	121,672
Short-term debt		2,775	11,135	18,057	17,987	19,457	25,966	32,230	32,865	20,113
Net flow on debt	890	2,280	7,216	9,331	-1,124	5,066	9,941	12,346	10,087	-4,935
of which short-term debt		667	3,160	3,742	-70	1,470	6,509	6,264	635	-9,750
Aggregate resource flows and net transfers (long-term)										
Net resource flows (long-term)	686	1,902	5,901	7,945	3,622	9,594	12,901	15,564	11,592	-808
Foreign direct investment (net)	83	180	1,093	1,777	2,004	2,109	4,348	6,194	4,677	-356
Portfolio equity flows	0	0	312	119	2,452	3,672	4,873	3,099	298	250
Profit remittances on FDI	128	3,234	2,192	2,623	2,577	2,800	3,000	3,400	3,300	2,800
Major economic aggregates										
Gross national product (GNP)	9,698	74,806	109,209	132,938	151,992	170,284	192,474	221,277	209,438	85,486
Exports of goods and services (XGS)			29,870	38,234	41,940	46,517	54,880	58,793	65,819	57,470
International reserves (RES)	160	6,803	8,657	11,482	12,474	13,321	14,908	19,396	17,487	23606
Current account balance			-2,988	-2,780	-2,106	-2,792	-6,431	-7,663	-4,889	3972
Debt indicators										
EDT/XGS (per cent)			233.9	230.2	212.6	231.8	226.7	219.3	206.9	262.5
EDT/GNP (per cent)		28.0	64.0	66.2	58.7	63.3	64.6	58.3	65.0	176.5
RES/EDT (per cent)		32.5	12.4	13.0	14.0	12.4	12.0	15.0	12.8	15.6
RES/MGS (months)			3.1	3.3	3.4	3.2	2.9	3.5	3.0	5.3
Short-term/EDT (per cent)		13.3	15.9	20.5	20.2	18.0	20.9	25.0	24.1	13.3

Source: World Bank, *Global Development Finance 2000.*
Key: MGS: Imports of goods and services.

Appendix table 2c

MALAYSIA: FOREIGN DEBT INDICATORS, 1970–1998

(US$ million)

	1970	*1980*	*1990*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*
Total debt stock (EDT)		6,611	15,328	20,018	26,149	30,336	34,343	39,673	47,228	44,773
Long-term debt (LDOD)	440	5,256	13,422	16,379	19,197	24,147	27,069	28,605	32,289	36,117
Short-term debt		1,355	1,906	3,659	6,951	6,189	7,274	11,068	14,939	8,656
Net flow on debt	63	1,592	-1,851	2,041	5,470	2,220	5,138	6,387	8,397	-3,361
of which short-term debt		481	-367	1,565	3,312	-762	1,085	3,974	3,871	-6,283
					Aggregate resource flows and net transfers (long-term)					
Net resource flows (long-term)	99	2,052	1,183	6,093	10,923	8,680	10,495	12,031	9,152	8,529
Foreign direct investment (net)	94	934	2,333	5,183	5,006	4,342	4,132	5,078	5,106	5,000
Portfolio equity flows	0	0	293	385	3,700	1,320	2,299	4,353	-489	592
Profit remittances on FDI	166	1,190	1,926	2,713	2,985	3,250	4,000	4,000	4,200	4,500
					Major economic aggregates					
Gross national product (GNP)	4,089	23,607	40,902	55,166	60,969	68,918	83,101	94,563	94,833	68,581
Exports of goods and services (XGS)	14,836	34,514	46,421	54,656	68,526	85,992	94,065	95,387	71,900	
International reserves (RES)	667	5,755	10,659	18,024	28,183	26,339	24,699	27,892	21,470	26,236
Current account balance		-266	-870	-2,167	-2,991	-4,520	-8,469	-4,596	-4,792	9,683
					Debt indicators					
EDT/XGS (per cent)		44.6	44.4	43.1	47.8	44.3	39.9	42.2	49.5	62.3
EDT/GNP (per cent)		28.0	37.5	36.3	42.9	44.0	41.3	42.0	49.8	65.3
RES/EDT (per cent)		87.1	69.5	90.0	107.8	86.8	71.9	70.3	45.5	58.6
RES/MGS (months)		4.6	3.6	4.4	5.8	4.3	3.2	3.4	2.6	5.2
Short-term/EDT (per cent)		20.5	12.4	18.2	26.6	20.4	21.2	27.9	31.6	19.3

Source: World Bank, *Global Development Finance 2000.*
Key: MGS: Imports of goods and services.

Appendix table 2d

REPUBLIC OF KOREA: FOREIGN DEBT INDICATORS, 1970–1998

(US$ million)

	1970	*1980*	*1990*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*
Total debt stock (EDT)		29,480	34,986	44,156	47,202	72,415	85,810	115,803	136,984	139,097
Long-term debt (LDOD)	1,991	18,236	24,186	32,236	35,002	40,802	39,197	49,221	72,128	94,062
Short-term debt		10,561	10,800	11,920	12,200	31,613	46,613	66,582	53,792	28,139
Net flow on debt	847	6,415	1,058	4,698	2,262	28,321	22,706	33,300	16,774	7,190
of which short-term debt		3,396	1,000	720	280	19,412	15,001	19,969	-12,790	-1,653
Aggregate Resource flows and net transfers (long-term)										
Net resource flows (long-term)	411	2,440	1,369	7,753	8,603	12,244	13,045	19,358	22,382	13,201
Foreign direct investment (net)	66	6	788	727	588	809	1,776	2,325	2,844	5,415
Portfolio equity flows	0	0	518	3,045	6,029	2,525	3,559	3,700	1,257	4,096
Profit remittances on FDI	5	64	266	247	253	270	295	320	350	375
Major economic aggregates										
Gross national product (GNP)	8,997	60,801	252,384	314,337	345,232	401,782	487,918	518,501	473,939	316,195
Exports of goods and services (XGS)	22,050	76,679	89,858	97,860	114,850	151,237	157,229	168,928	160,061	
International reserves (RES)	610	3,101	14,916	17,228	20,355	25,764	32,804	34,158	20,465	52,100
Current account balance		-5,312	-2,003	-3,944	990	-3,867	-8,507	-23,006	-8,167	40,552
Debt indicators										
EDT/XGS (per cent)		133.7	45.6	49.1	48.2	63.1	56.7	73.7	81.1	86.9
EDT/GNP (per cent)		48.5	13.9	14.0	13.7	18.0	17.6	22.3	28.9	44.0
RES/EDT (per cent)		10.5	42.6	39.0	43.1	35.6	38.2	29.5	14.9	37.5
RES/MGS (months)		35.8	30.9	27.0	25.9	43.7	54.3	57.5	39.3	20.2
Short-term/EDT (per cent)		35.8	30.9	27.0	25.8	43.7	54.3	57.5	39.3	20.2

Source: World Bank, *Global Development Finance 2000.*
Key: MGS: Imports of goods and services.

Appendix table 3a

THAILAND: LOANS AND ADVANCES BY COMMERCIAL BANKS, 1989–1999

(Per cent of total loans)

	1989	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
Agriculture	6.5	6.6	7.0	6.2	5.5	4.4	3.7	3.4	2.7	2.8	2.6
Manufacturing	25.8	25.1	25.3	23.7	24.0	24.2	25.8	27.1	30.9	30.7	30.1
Construction	3.8	4.0	4.0	4.0	3.8	4.1	4.4	4.9	4.5	4.7	4.3
Trade and transportation	19.5	19.3	19.1	18.9	20.0	18.4	20.3	20.9	20.4	20.2	19.3
Finance and real estate	14.8	17.0	17.0	17.6	17.3	17.6	17.4	15.9	16.1	14.7	17.7
Service industries	5.7	6.1	6.8	7.3	7.7	7.8	7.8	7.8	7.6	8.0	7.5
Households	10.8	10.6	11.2	12.3	12.6	12.7	12.3	12.6	10.8	11.4	11.0
Others	13.0	11.3	9.7	9.9	9.0	10.9	8.2	7.6	7.1	7.6	7.4
Total loans (dom. credit)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Change											
(per cent growth p.a.)	29.9	32.7	21.0	20.7	23.5	28.3	22.9	14.2	24.8	-13.6	-2.0
Total loans											
(per cent of GDP)	60.6	68.4	72.1	77.1	85.0	95.2	101.5	103.5	125.5	113.0	109.1

Source: Computed from *SEACEN Financial Statistics* and Bank of Thailand data.

Appendix table 3b

INDONESIA: LOANS AND ADVANCES BY COMMERCIAL BANKS, 1989–1999

(Per cent of total loans)

	1989	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
Agriculture	8.3	7.3	7.5	8.3	8.0	7.3	6.6	6.0	6.9	8.1	8.1
Manufacturing	32.0	31.3	29.2	30.1	34.2	31.9	30.7	26.9	29.5	35.2	36.4
Construction	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Trade and transportation	31.6	30.4	29.1	26.6	25.1	23.5	23.1	24.1	21.8	19.8	19.6
Finance and real estate	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Service industries	16.4	18.3	18.3	21.5	23.8	26.9	28.4	31.3	30.0	28.5	26.5
Households	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Others	11.7	12.7	16.0	13.4	8.9	10.5	11.2	11.7	11.8	8.4	9.5
Total loans (dom. credit)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Change											
(per cent growth p.a.)	38.0	50.0	49.9	47.6	45.6	49.5	51.6	55.0	60.5	49.3	
Total loans											
(per cent of GDP)	44.6	53.8	16.2	8.9	21.6	25.6	24.2	24.8	29.1	28.9	-24.8

Source: Computed from *SEACEN Financial Statistics* and Bank of Indonesia data.

Appendix table 3c

MALAYSIA: LOANS AND ADVANCES BY COMMERCIAL BANKS, 1989–1999

(Per cent of total loans)

	1989	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
Agriculture	5.4	5.2	4.8	4.4	3.5	2.6	2.2	2.1	2.0	2.0	2.3
Manufacturing	20.9	23.2	24.2	24.0	23.0	24.0	24.2	22.0	20.1	18.8	18.8
Construction	7.1	6.8	3.8	8.1	7.9	7.7	8.0	8.9	10.1	10.3	9.6
Trade and transportation	17.6	16.1	15.3	13.6	13.4	13.0	12.6	12.1	13.1	13.7	13.5
Finance and real estate	23.7	22.6	22.1	23.3	24.2	20.7	22.7	25.2	24.1	13.9	13.1
Service industries	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Households	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Others	25.3	26.1	29.7	26.5	28.0	31.9	30.2	29.7	30.5	41.3	42.6
Total loans (dom. credit)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Change											
(per cent growth p.a.)	18.1	20.3	20.4	8.8	10.9	14.4	30.5	24.5	32.9	7.2	3.5
Total loans											
(per cent of GDP)	65.5	67.8	71.9	70.2	68.1	68.6	78.7	85.8	102.8	109.1	107.4

Source: Computed from *Quarterly Economic Bulletin*, Bank Negara Malaysia data.

Appendix table 3d

REPUBLIC OF KOREA: LOANS AND ADVANCES BY COMMERCIAL BANKS , 1989–1999

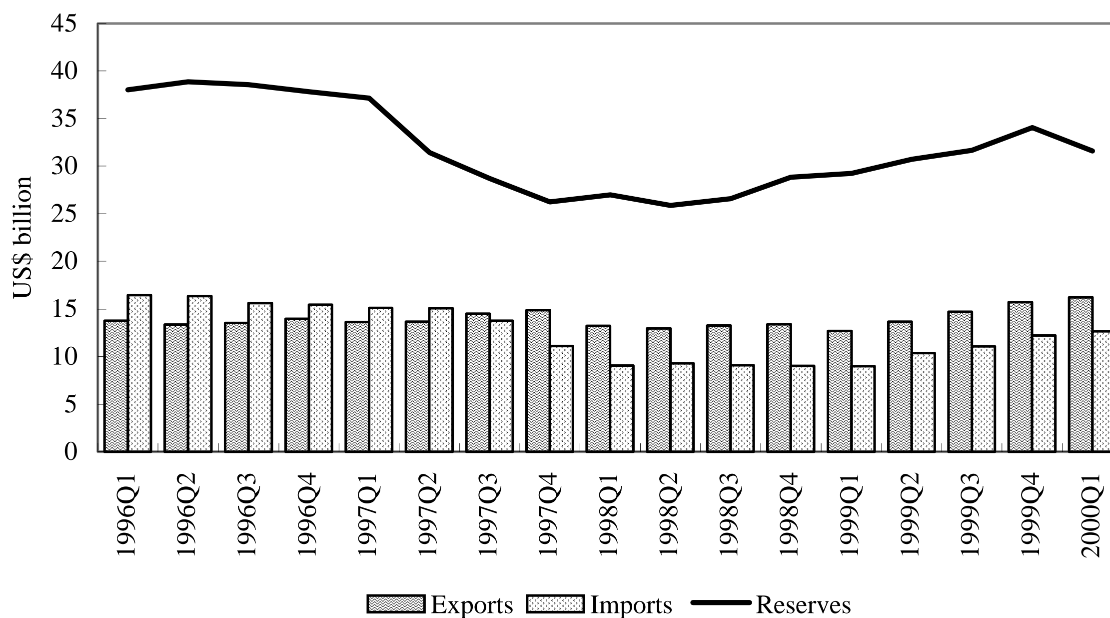
(Per cent of total loans)

	1989	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
Agriculture	9.8	10.0	9.9	8.7	9.0	9.5	10.2	9.7	9.6	9.8	n.a.
Manufacturing	41.4	42.0	46.7	43.8	43.4	42.1	40.9	39.2	37.1	35.3	n.a.
Construction	9.6	8.7	7.5	6.7	6.7	6.6	7.5	7.4	6.9	7.1	5.9
Trade and transportation	7.0	7.2	7.8	7.3	7.5	7.6	8.0	8.8	9.3	9.3	n.a.
Finance and real estate	6.5	5.6	0.5	6.3	4.7	3.3	2.1	2.1	2.9	5.0	6.8
Service industries	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Households	2.7	3.1	3.1	2.4	2.2	2.0	2.2	2.3	2.6	2.9	n.a.
Others	22.9	23.4	24.5	24.7	26.6	29.0	29.1	30.5	31.6	30.6	n.a.
Total loans (dom. credit)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Change											
(per cent growth p.a.)	28.2	18.4	15.4	20.3	12.0	18.0	12.2	16.2	13.1	-0.1	24.9
Total loans											
(per cent of GDP)	41.9	41.4	39.5	41.8	41.5	42.0	40.4	42.3	44.2	44.6	n.a.

Source: Computed from *SEACEN Financial Statistics* and Bank of Korea data.

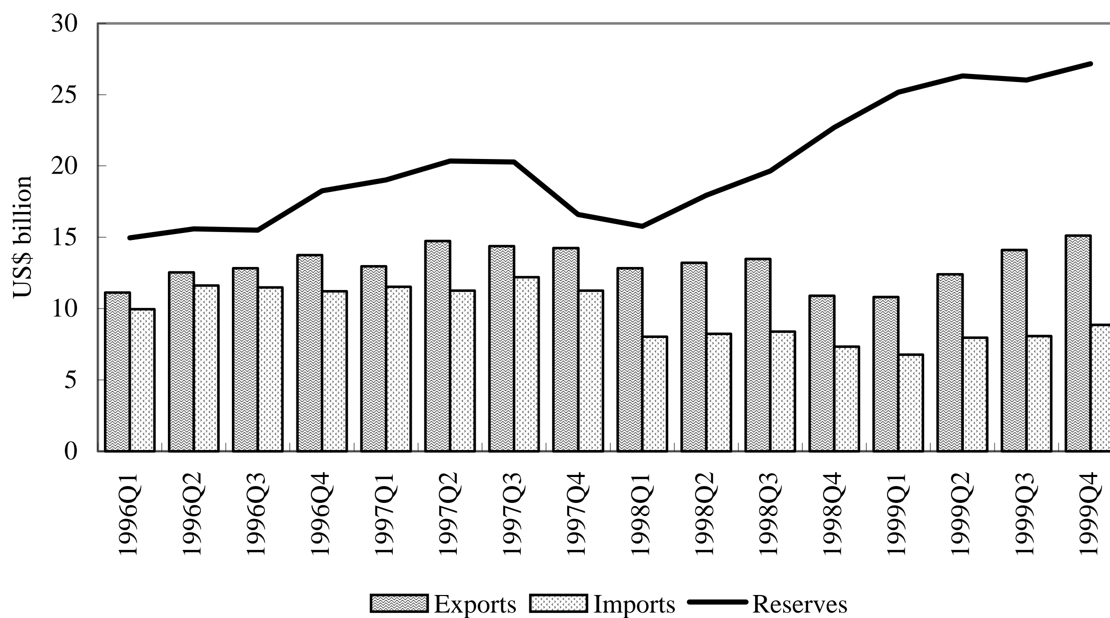
Appendix figure 1a

THAILAND: QUARTERLY MERCHANDISE TRADE BALANCE AND RESERVES, 1996Q1–1999Q4



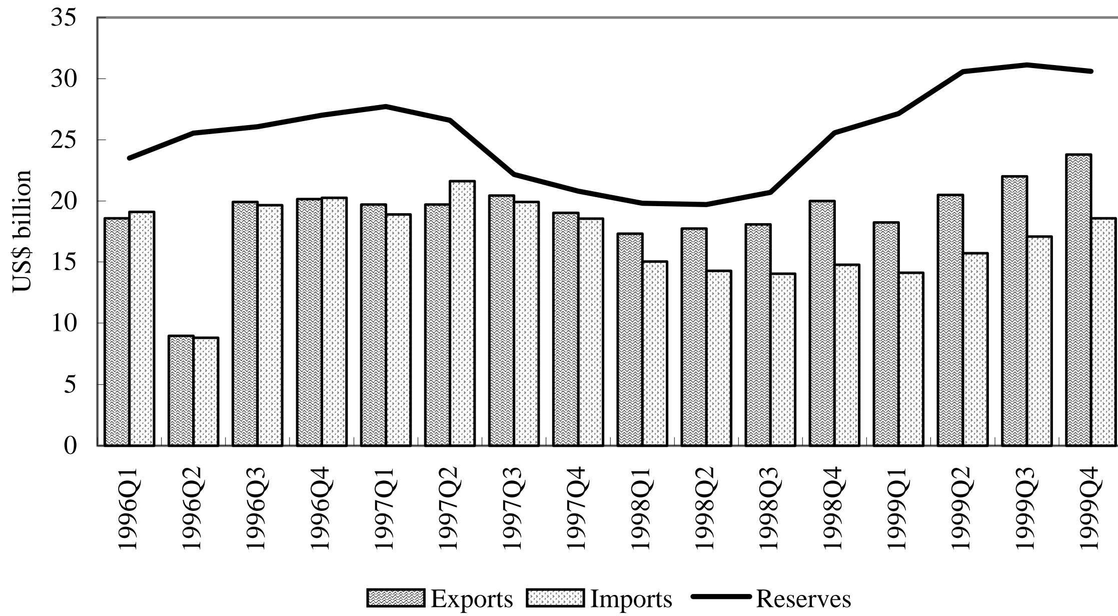
Appendix figure 1b

INDONESIA: QUARTERLY MERCHANDISE TRADE BALANCE AND RESERVES, 1996Q1–1999Q4



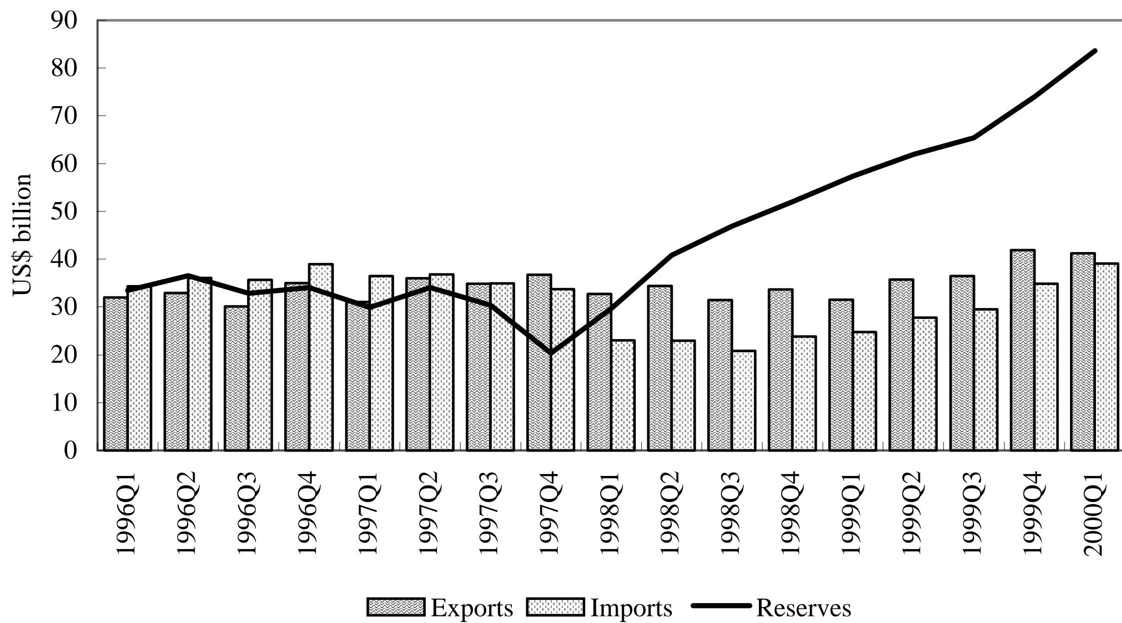
Appendix figure 1c

MALAYSIA: QUARTERLY MERCHANDISE TRADE BALANCE AND RESERVES, 1996Q1–1999Q4



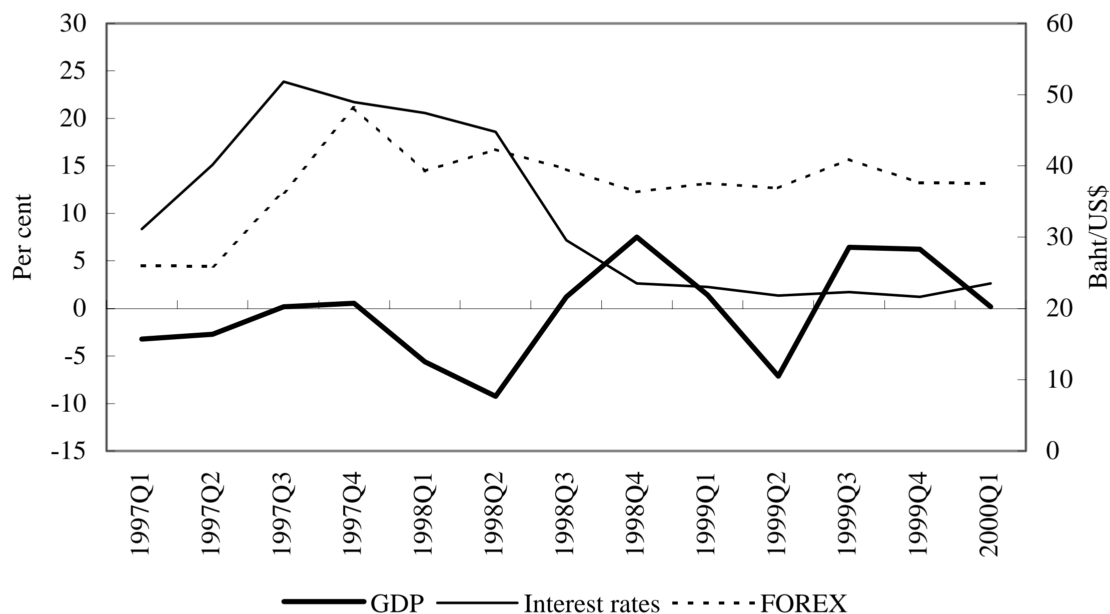
Appendix figure 1d

REPUBLIC OF KOREA: QUARTERLY MERCHANDISE TRADE BALANCE AND RESERVES, 1996Q1–1999Q4



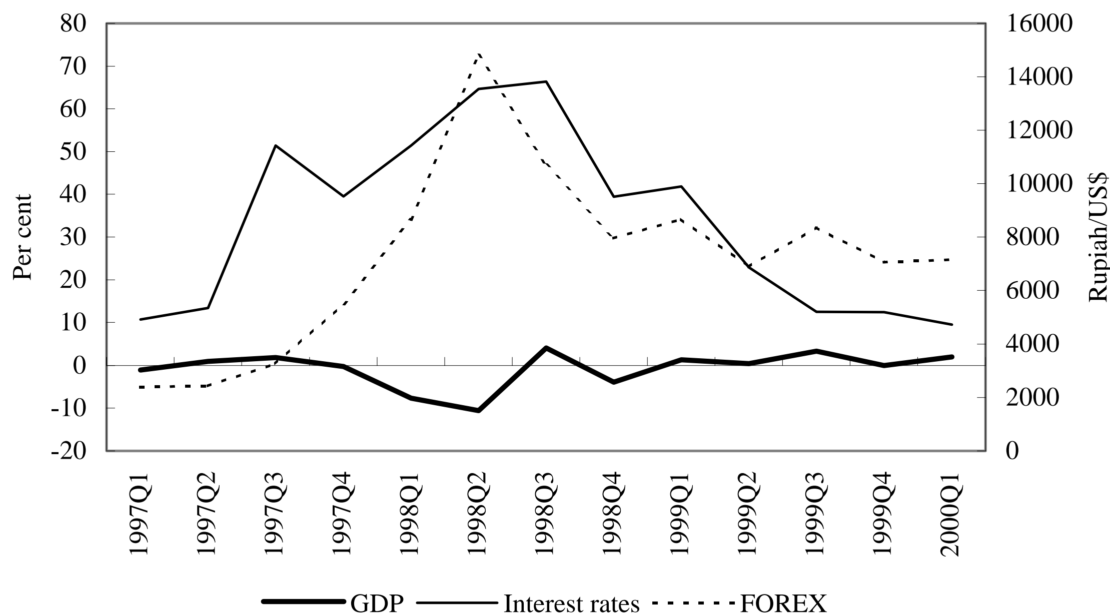
Appendix figure 2a

THAILAND: GDP GROWTH, FOREIGN EXCHANGE AND INTEREST RATE, 1997Q1–2000Q1



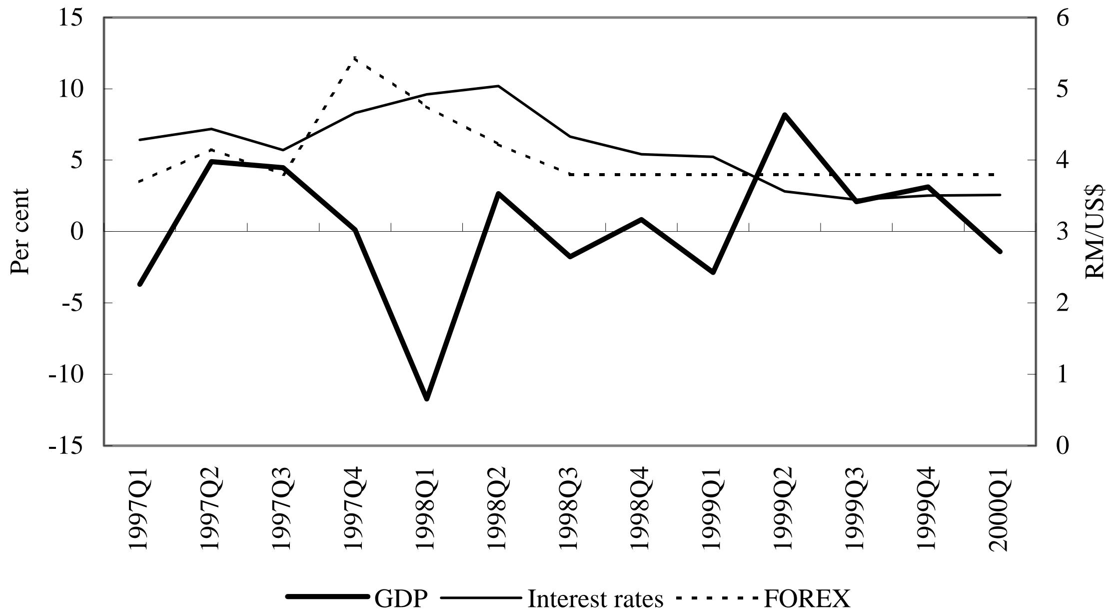
Appendix figure 2b

INDONESIA: GDP GROWTH, FOREIGN EXCHANGE AND INTEREST RATE, 1997Q1–2000Q1



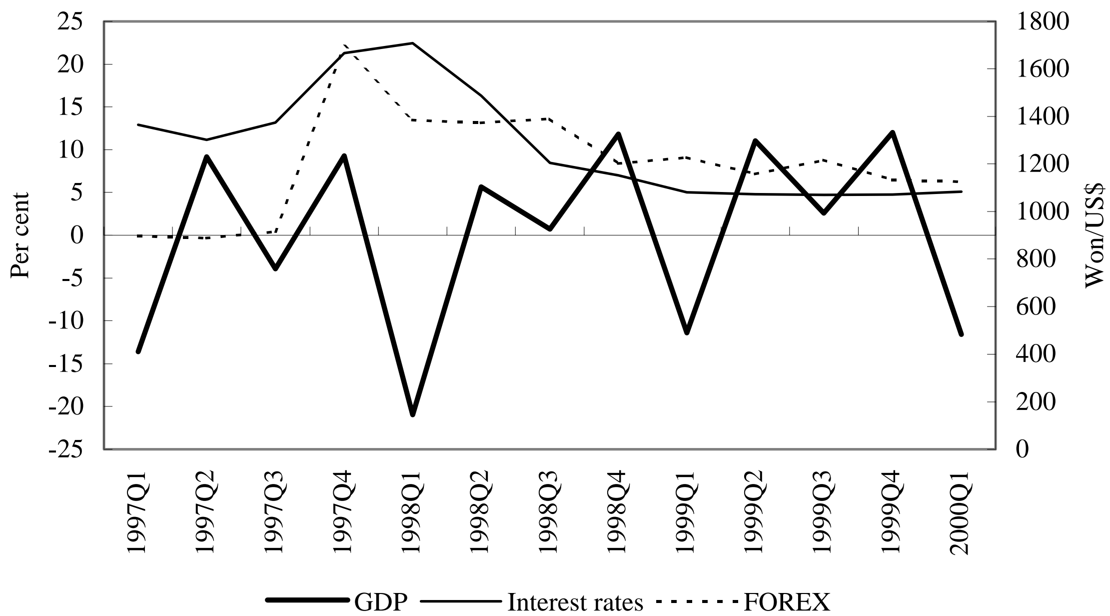
Appendix figure 2c

MALAYSIA: GDP GROWTH, FOREIGN EXCHANGE AND INTEREST RATE, 1997Q1–2000Q1



Appendix figure 2d

REPUBLIC OF KOREA: GDP GROWTH, FOREIGN EXCHANGE AND INTEREST RATE, 1997Q1–2000Q1



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