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Reforming East Asia for Sustainable Development

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This article reviews the challenges faced by four East Asian economies in the wake of the currency and financial crises of 1997-98. Perceptions and opinions of East Asian economic development moved swiftly from commendation to condemnation, revealing a simplistic response to an experience that was seen to have challenged the neo-liberal orthodoxy. As such, government-business relationships and corporate governance have received particular attention and criticism. However, recovery is now recognized to have been facilitated by reflationary Keynesian policies, rather than the draconian IMF-prescribed programmes or 'reform' of corporate governance. Indeed, there is growing attention to, and concern with, the consequences and appropriateness of ongoing Anglo-American inspired financial liberalization. The regional slowdown of foreign direct investment, slowness of technological progress, and changes in investment policy present considerable challenges for ASEAN economies in particular. This article concludes that while liberalization of the global financial infrastructure continues, convergence of economic arrangements is not necessarily inevitable, and indeed, that an eclectic mix of policies and institutions is not only possible, but preferable. *Asian Business & Management* (2003) 2, 7-38. doi:10.1057/palgrave.abm.9200026

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Introduction

The rapid industrialization, economic development and concomitant structural transformation of East Asian economies has, over the last two decades and especially during the early and mid-1990s, received much international attention. The World Bank (1993) argued that of the eight highly performing (East) Asian economies (HPAEs) identified in its study, *The East Asian Miracle*, three South-East HPAEs — namely Indonesia, Malaysia and Thailand — provided the preferred models for emulation by other developing countries. Jomo *et al.* (1997) criticized the World Bank's claims that the South-East Asian highly performing economies were superior models for emulation, drawing attention to various factors indicating the unsuitability of South-Eastern economies for emulation.

International perceptions of and opinions on the East Asian experiences were radically transformed from praise to condemnation by the East Asian currency and financial crises of 1997-98. Previously identified and acclaimed as central to the East Asian success story, business-government relations became perhaps the most obvious example of this rapid shift in opinion. Instead, these relations have since been denounced as 'crony capitalism', now alleged to be responsible for the onset as well as severity of the crisis (Backman, 1999; Clifford and Engardio, 2000). Various accounts (Jomo, 1998; Furman and Stiglitz, 1998; Radelet and Sachs, 1998; Krugman, 1999; 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 study 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 South Korea, the most adversely affected first-generation newly industrialized economy. Now to the structure of the study, following the introduction, the next section will begin with a brief review of the reflationary Keynesian policies leading to macroeconomic recovery since 1999. The section will then 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 subsequent 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 section that follows focuses on the change in investment policy from regulation to promotion. The succeeding section critically assesses the appropriateness of IMF-prescribed reform programmes, and stresses the importance of alternative policy instruments. Ensuing section reviews the prospects for sustainable development in the region in light of the foregoing, while the penultimate section considers the likelihood of convergence — and the viability of distinct development models — in the face of continued globalization and Anglo-American inspired liberalization. The concluding remarks suggest the possibility of more eclectic mixtures of policies and institutions and hence a greater variety of systems or models.

Reforms and Recovery

There is considerable debate about the implications of the crises for economic development, particularly over whether the East Asian experiences of the last three decades offer different lessons and prescriptions for development from those advocated by the 'counter-revolution' against development economics. Influential economists at the United States Treasury, IMF, the World Bank and elsewhere have cited the East Asian financial crisis in criticizing the Bank's 1993 *East Asian Miracle* as flawed. 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 debacle', 'tigers or fat cats' and the like.

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 the IMF. However, as noted earlier, the situation changed dramatically a year later as the East Asian crisis seemed to be spreading West, via the Russian and Brazilian crises. The second half of 1998 saw much greater Western concern about the international financial system, and the possible damage its vulnerability might cause. 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 East Asian crisis, not least because of its new characteristics. Voices of the developing countries have weakened after the debt crises 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 1980s' debt crises, the broad range of reforms associated with the establishment of the World Trade Organization (WTO), and changing trans-national 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 good will come out of the traumatic debacle of 1997-98.

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 full-scale outbreak of the crisis. 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 the IMF. Initial IMF predictions were that growth would be stagnant for at least 3-4 years following the crisis (a U-shaped recovery). Instead, the economies of South Korea, Malaysia and, arguably, Thailand quickly recovered after sharp recessions in 1998 (a V-shaped recovery). The turnaround in economic performance can mainly be attributed to Keynesian[1] counter-cyclical fiscal measures. Both the Malaysian and South Korean economies recovered as a result of such reflationary macroeconomic policies. In contrast, the 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 South 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 3 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. The depreciation of the region's currencies caused by the crisis (see Table 1 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 4a-d). Figure 2 also shows that exchange rate volatility declined significantly after mid-1998, except in Indonesia, because of political instability. Appendix Figure 5a-d shows 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.

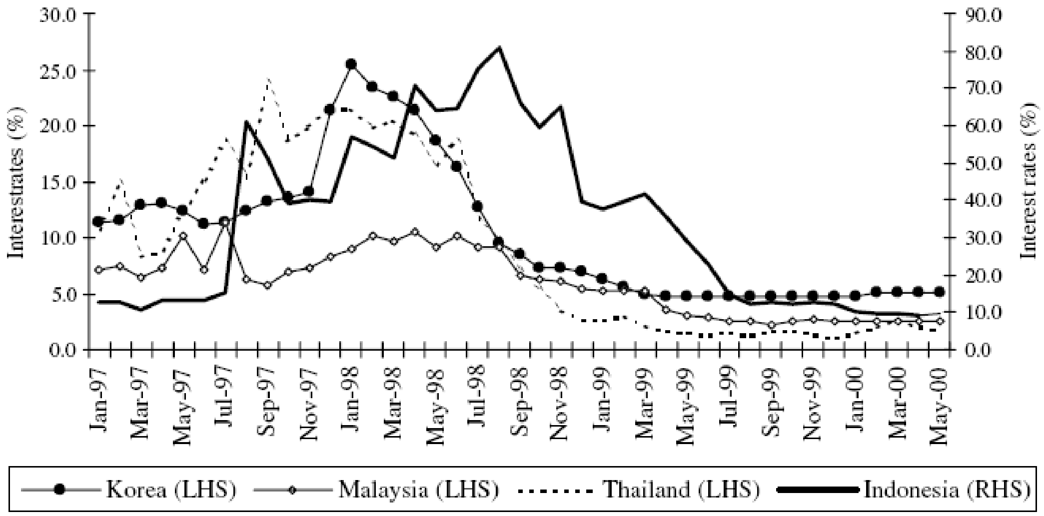

Figure 1 East Asian 4: monthly interest rates (overnight interbank rates), January 1997-May 2000. *Sources:* Financial Extel & BOK, BNM, BOT, BOI.

Table 1 East Asian four: exchange rates and depreciation against US dollar, 1997-2000

Currency	*Exchange rate*	*(monthly average)*			*Depreciation (per*	*cent)*	
	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.

The self-fulfilling nature of the crisis suggests that little else could have been done in the face of such capital flight with open capital accounts. It is also difficult to determine how effective these initial monetary policy responses actually were. The currency depreciations generally more than compensated for 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, instead causing the ringgit to be undervalued from late 1998. In South Korea,

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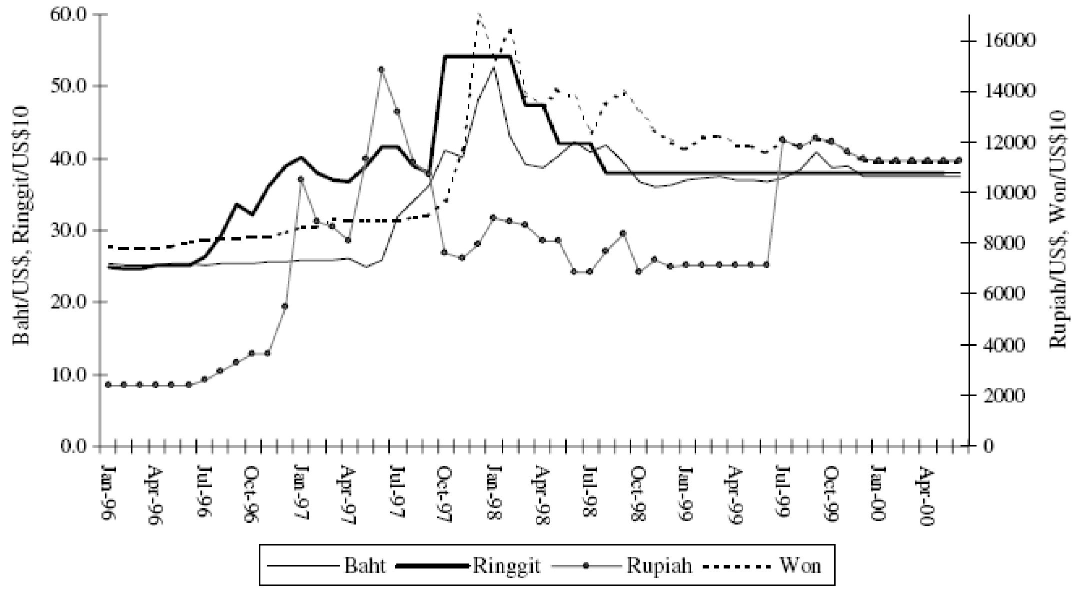

Figure 2 East Asian 4: monthly foreign exchange rates, January 1996-June 2000. *Source:* Financial Extel.

the authorities intervened in the foreign exchange market to ensure exchange rate competitiveness by slowing down the pace of won appreciation from late 1998.

As Figure 3a and b shows, budget deficits substantially increased in 1998, especially in the second half of the year. While government revenues were probably adversely affected by the economic slow-down, government expenditure rose with efforts to reflate the economy from around mid-1998. The re-capitalization of financial institutions[2] 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 1997-98 crisis were replaced by significant budgetary deficits to finance counter-cyclical measures. Thus, balancing budgets over the economic cycle — rather than annually — was crucial to helping overcome the crisis. It should be emphasized that such Keynesian policies were not part of the original IMF programmes. Such East Asian Keynesian policies were later tolerated from the third-quarter of 1998, perhaps only because of international fears of global financial collapse.

Reform of corporate governance[3]

Many institutional arrangements in the most affected economies may have once contributed significantly to 'catching up'. While such features may no longer be desirable or appropriate, corporate reform advocates usually fail to

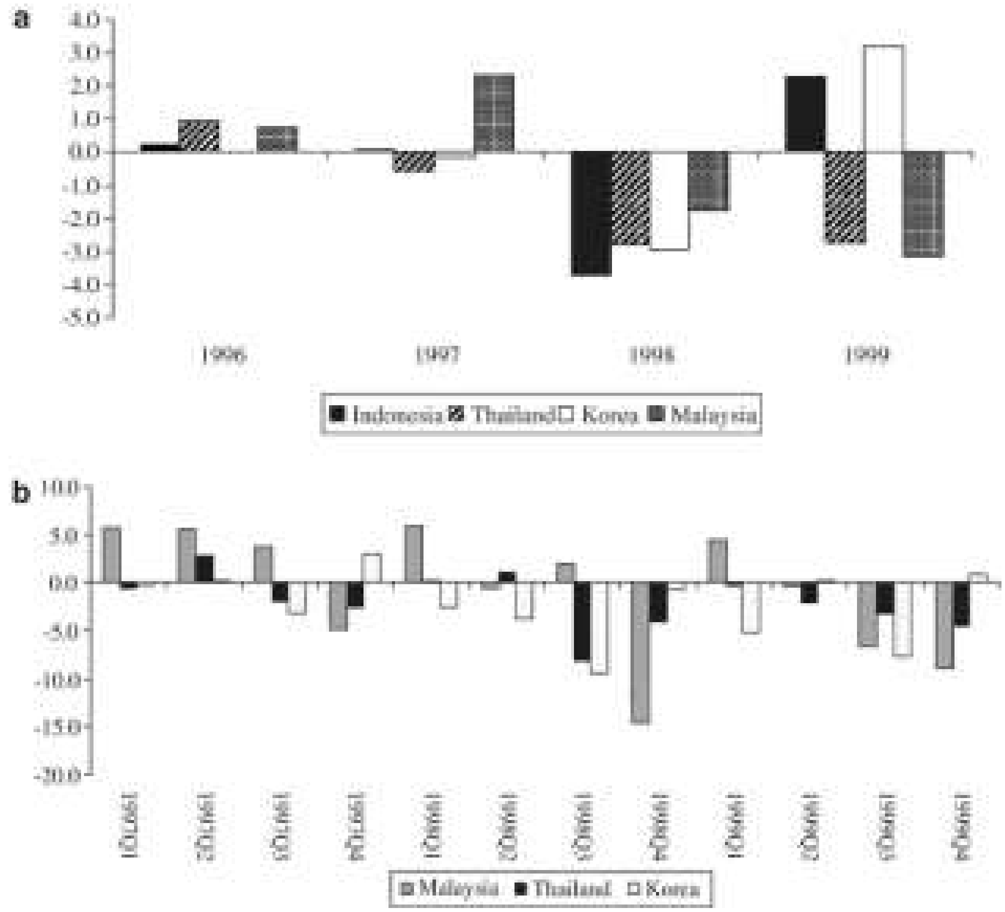

Figure 3 (a) Indonesia, Korea, Thailand and Malaysia: annual budget balances (% of GDP), 1996-1999, *Sources:* ADB, Asian Dev Outlook 2000 and SEACEN Financial Statistics; (b) Korea, Thailand and Malaysia: quarterly budget balances (% of GDP), 1997Q1-1999Q4, *Sources:* ADB, Asian Dev Outlook 2000 and SEACEN Financial Statistics.

acknowledge that they may at least once have been 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 just waiting to happen. The IMF and World Bank have pushed for radical corporate reforms, claiming that corporate governance 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, namely deteriorating profitability and investment efficiency, in all the crisis-affected economies before the crisis.

Some of the economies (especially South Korea and Thailand) began to experience corporate failures from early 1997. After Thailand, South Korea and Indonesia went to the IMF for emergency credit facilities, the Fund kept emphasizing microeconomic reform as central to its recovery programme (Lane *et al.*, 1999). These reforms generally sought to transform existing corporate structures, regarded as having caused over-investment and other ills, in line with ostensibly 'global' Anglo-American standards. With the benefit of hindsight, it is now clear that it would have been 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. Most economies accommodate a diversity of corporate structures. While some 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 South Korea, suggest that improvements in macroeconomic conditions, especially interest rate reductions and appropriate increases in government spending, were necessary to facilitate adjustments and reforms.

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 new costs on the economy. This is 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 South Korea (Shin, 2000) and Thailand (Pasuk and Baker, 2000). As currency 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; often, 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 take-overs 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 catch-up development.

Shin (2000) argues for building a second stage catch-up system for South 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. There are also grave doubts as to whether the reforms have improved corporate resilience in the long run. As noted above, the recovery has mainly been driven by typically Keynesian policies, and certainly not by reforms in corporate governance.

New international financial architecture

As noted earlier, recent trends in the IMF and the WTO after the East Asian crises began are unlikely to make prevention of future crises any easier. 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. Akyiiz (2000a)[4] 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. The effects of huge swings of up to 20 per cent within a week 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. 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 the BIS, which serves banks in the OECD economies. Although there is currently agreement that the 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 (Akyiiz, 2000a, b), 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 lack of readily available funds, onerous conditionalities attached to emergency funds, and funds going towards paying off creditors, rather than supporting currencies against speculation.

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[5] procedures. While the IMF's Articles of Agreement allow for temporary standstills on debt, this has not actually occurred.

Pre-crisis Developments and Recent Challenges

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 as well as privatised 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 economies 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 other major low-wage production sites also threatened export-oriented manufacturing in the countries. 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 technology frontiers.

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. 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, exchange rate movements could not reverse FDI trends decline with appreciation with the US dollar from the mid-1990s, and devaluations from mid-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-d-vis* North America and Europe. However, the regional nature of the crises and the ongoing Japanese economic stagnation reduced regional demand for exports, which had 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 from late 1998 until 2000 contributed a great deal to economic recovery in the region, especially in Malaysia and South Korea. Sticky wage rates are likely to reduce the additional foreign exchange earnings to be gained with their devalued currencies. Over expansion in construction and lending for non-productive purposes have 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 crises, 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 contributed to 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.

FDI slowdown

FDI as a proportion of gross fixed capital formation averaged about 20 per cent for Malaysia in the mid-1990s, with lower shares for Indonesia and Thailand, but still above the developing country average of around 5 per cent (UNCTAD, 1997/1998). FDI can complement limited domestic capital resources to enhance growth, although FDI's share of GFCF began to fall 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, and even less since. China and India had become major rivals, especially for labour-intensive FDI.

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 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.

The incentives had also changed in the early 1990s, so that labour-intensive firms faced pressure to relocate in less developed locations within the country, or even abroad. FDI interest in the region has declined since 1996, with an increasing proportion consisting of acquisitions to take advantage of'fire sales' in the region, 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. However, these privatizations basically involved the transfer of existing assets from public to private hands, with no necessary addition of capacity, and also 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 the WTO and other regional trade deregulation efforts, such as the ASEAN Free Trade Area (AFTA) and Asia-Pacific Economic Cooperation (APEC), accelerated liberalization processes. Incentives used to promote exports and tariffs that had sheltered domestic producers began to fall sharply by the mid-1990s, forcing *rentier* activity to shift to other sectors.

Slow technological progress

While industrial policy in South 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, however, 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 failure to develop the necessary institutions for the absorption and development of technologies 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 as well as disciplinary mechanisms (Jomo and Felker, 1999; Rasiah, 2001). 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-

Table 2 Selected human economies: selected 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 ofGNP (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.

dominated export-processing activities has largely involved expansion of relatively low value-added production. 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.

It is clear from the North-East Asian experiences that there is a strong need to stimulate state-business collaboration in creating and coordinating institutions to enhance human resources for technological upgrading. South-East Asia outside of Singapore has lacked comparable human resource support to facilitate a rapid transition to higher technology manufacturing (see Table 2). 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. Limited domestic capabilities have meant that payments for imports and profit repatriation have reduced the potential benefits of industrialization to the region.

While trans-nationals 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.

New Investment Policies in South-East Asia

The economic crises of 1997-98 have led to significant changes in economic policy in South-East Asia (Jomo, 1998; Montes, 1998).[6] 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 the WTO, APEC and ASEAN. To many observers, these changes signify the demise of government intervention.

However, 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 re-shape 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.

Seen against the policy priorities of the 1990s, 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, 1997/1998). 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 trans-national corporations to domestic producers. Undoubtedly, the crises have forced most governments to put on hold policies to upgrade industrial technologies.

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 trans-national corporations themselves. Instead of aiming for nationally integrated and controlled industries, governments sought to position national economies to the maximum 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 trans-national corporations had earlier distinguished the South-East HPAEs from the other HPAEs as well as other developing countries. Acceptance of trans-national 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 South Korea.

Meanwhile, the industrial capabilities of Taiwan province of China enabled it to define unique terms of engagement with trans-national corporations. Both South 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 mainly driven by massive foreign investments from Japan and the other first-generation East-Asian NIEs (Jomo *et al.*, 1997, chapter 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 Taiwanese investments to the region 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, components 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 Asian NICs 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 trans-national corporations.

Unlike South 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; Wong, 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 pro-FDI regime is much greater than commonly presumed.

Investment policy: from regulation to promotion

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. 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. 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. Most important, the operations of relatively sophisticated trans-national corporations have had limited impact on 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. 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 catalyse industrial development, but these countries have limited complementary capabilities to offer. Similarly, the efforts of trans-national corporations to develop internationally integrated production specializations may constrain host-country efforts to promote domestic linkages and spill-overs. Although some trans-national 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 in close proximity to regional headquarters lack the authority to make important decisions. 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 initiatives 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 spill-overs 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. The so-called trade-related investment measures (TRIMs) — 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 pro-FDI 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 liberalised more cautiously in this regard.

Second, exemptions from (national) equity ownership requirements in the South-East Asian NICs have usually been tied to exports, and sometimes, other more specific policy goals. 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-d-vis* the globalization of industrial production.

Third, South-East Asian NICs 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 trans-national corporations for their search costs and extra risks involved in transferring advanced production activities to new locations (UNCTAD, 1997/1998: 97-106). 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. The 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.

An Alternative to Anglo-American Reforms

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. In the wake of the East Asian crisis, the 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 trans-national corporations increasingly depends on factors that affect those corporations' costs and competitive advantages. Besides political stability and investment security, trans-national 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.

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 reinvestment of profits. Such trends have important implications for the development of industrial and technological capabilities.

While encouraging productive 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 organisation of trans-national corporations. 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 South 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 capture and deploy rents to enhance development. Assisting governments to regulate foreign investment is low on the agenda of the international financial institutions as well as most domestic reformers. In Indonesia, the desire to restore investor confidence and severely diminished state capacities are 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 some manufacturers. Malaysian Prime Minister Mahathir's rejection of orthodox IMF 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 liberalise 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. However, 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.

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 Asian NICs have been far more dependent on foreign investment. Although only Singapore and Malaysia stand out statistically in terms of the proportion of FDI in total investment, much of the non-resource-based, export-oriented manufacturing in all three South-East Asian NICs is owned and controlled by foreigners; while Japan, South Korea and Taiwan province of China also have foreign investment, their governments have been far more selective and restrictive, with their levels of FDI 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) 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 Asian NICs, including Malaysia and Thailand, are less attractive than they used to be.

There is little evidence that the massive devaluation of the currencies 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 the 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 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.

The strong upswing in the electronics business cycle in 1999 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, increases in Malaysian electronics output and exports were below those of the industry as a whole, even neighbouring Singapore, which experienced less drastic currency depreciation.

More worryingly, 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, especially from industries 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 experiencing full employment with significant labour shortages; estimates of the foreign worker presence in both economies in the mid-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, 2001). 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 fell far short of the central bank's target of 8 per cent for 1998 as well as 1999. Strong economic recovery during 1999 continued into 2000, but sputtered in 2001. Existing capacity may have become fully utilized while new investments have not returned to the levels preceding the crisis (Rasiah, 2001). The changed international situation does not augur well for the South-East Asian NICs, which have grown rapidly in recent decades, but have been unable to sustain the momentum of manufacturing growth more recently.

The Key Question of Sustainable Development

Finally, to return to the key question of sustainable development 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 as greater labour utilization and human resource development. Exports were also important in all these economies, although some 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 deregulation would argue that the problems involved improper sequencing and/or inadequate prudential supervision, rather than 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 last two decades. New conditionalities have been imposed in the region by the Bretton Woods institutions, together with the emergency credit facilities provided to Indonesia, South 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 with the advent of the 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 the 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 South Korea have had little to do with such reforms, and were primarily due to successful, Keynesian-style, counter-cyclical reflationary policies. East Asian government-business relations — once celebrated as synergistic social capital — have 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 has also 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 Report* has continued to affirm the remaining scope for trade-related industrial policy.

Similarly, the work of Stiglitz and others has 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 (MAI) and the 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-subsidisation of post-primary education and recent trends in education and health care privatization.

Ensuring a return to the high investment rates of the past is helped by the continued high domestic savings rates in the region in spite of the devastating 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 perceived 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 and cooperation 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. The English language and Anglo-American norms may well become universal in the forthcoming era, but 21st 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 the 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. The WTO's formal democracy provides some basis for reformist initiatives, while the Fund and the 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.

Policy makers for those economies that liberalise later are also in a position to learn from the experiences of those before them, and thus to better anticipate and prepare themselves. 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 later 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.

Conclusion

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 debacle 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 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 understandings 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 systems, 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 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. y [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 y.. belongs to the species of remedy which cures the disease by killing the patient.''

2 For instance, the re-capitalization of commercial banks in 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 re-capitalize the most distressed banks.

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

4 This section draws heavily on Akyiiz (2000a, b).

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

6 This subsection draws heavily from Felker and Jomo (1999).

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Appendix

As stated in the main text, this appendix provides details on trade balance and reserves, exchange rates, interest rates, and related economic magnitudes for the four countries studied (see Figures 4 and 5).

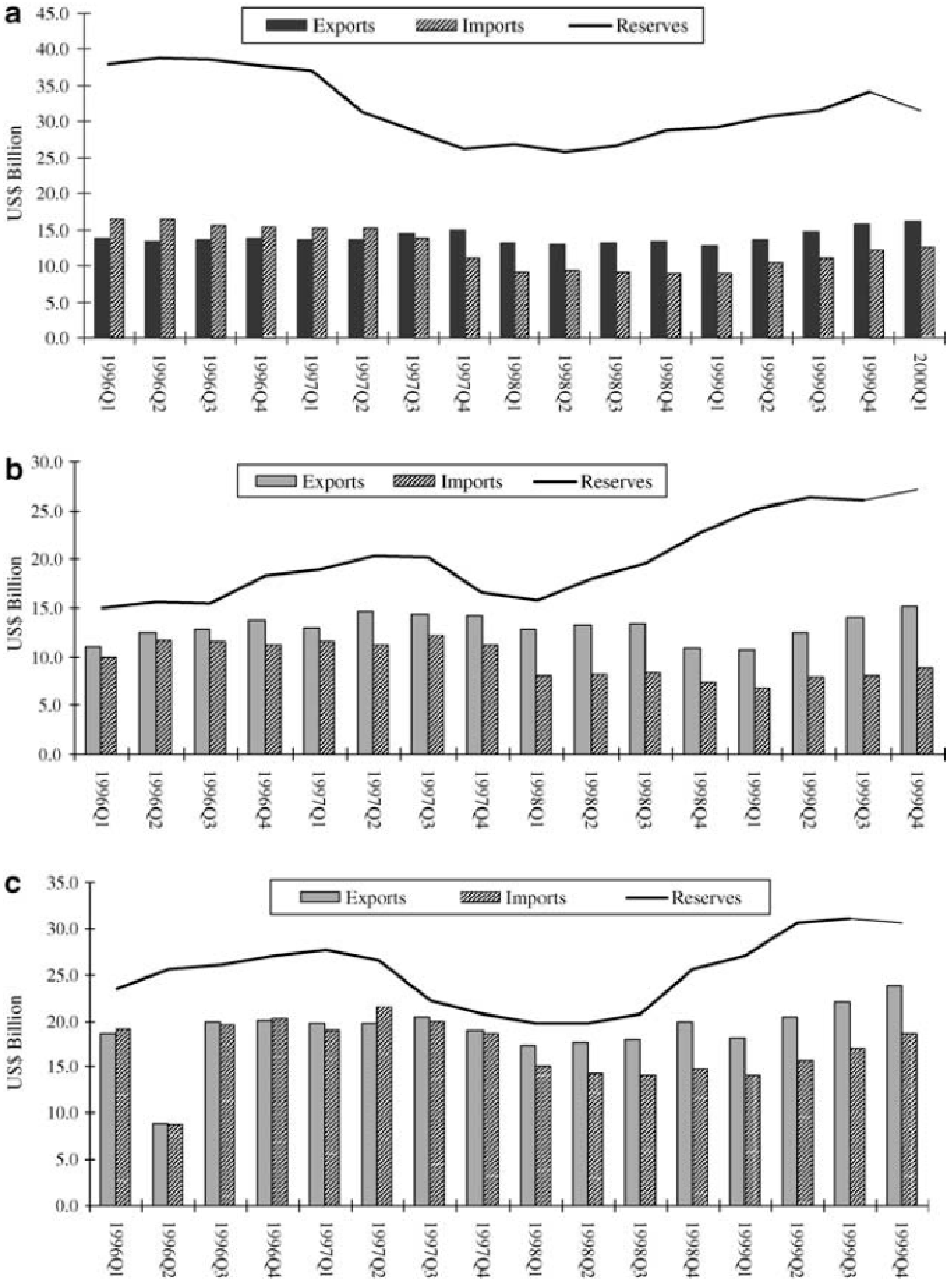


Figure 4 (a) Thailand: quarterly merchandise trade balance & reserves, 1997Q1-2000Q1, *Source:* IMF; (b) Indonesia: quarterly merchandise trade balance & reserves, 1997Q1-1999Q4; *Source:* IMF; (c) Malaysia: quarterly merchandise trade balance & reserves, 1997Q1-1999Q4, *Source:* IMF; (d) Korea: quarterly merchandise trade balance & reserves, 1997Q1-2000Q1, *Source:* IMF.

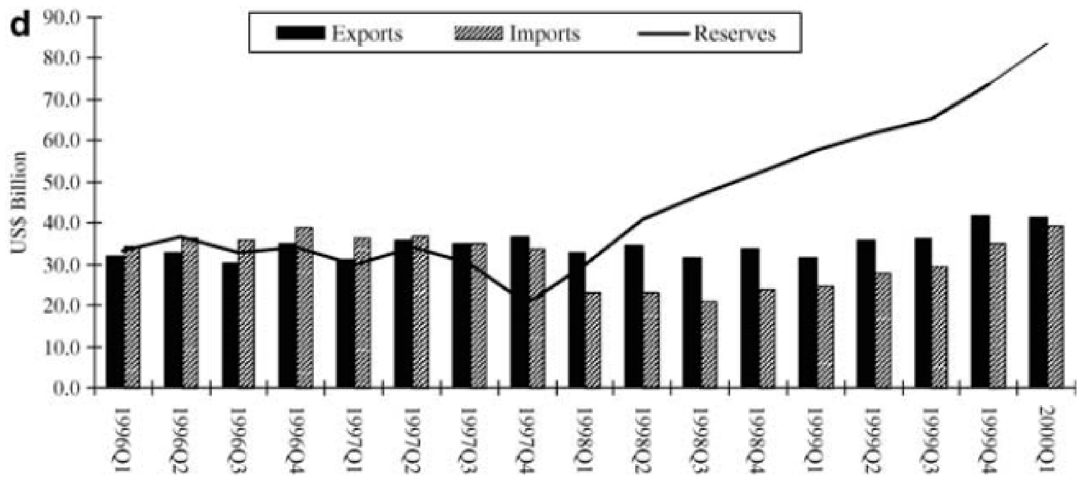
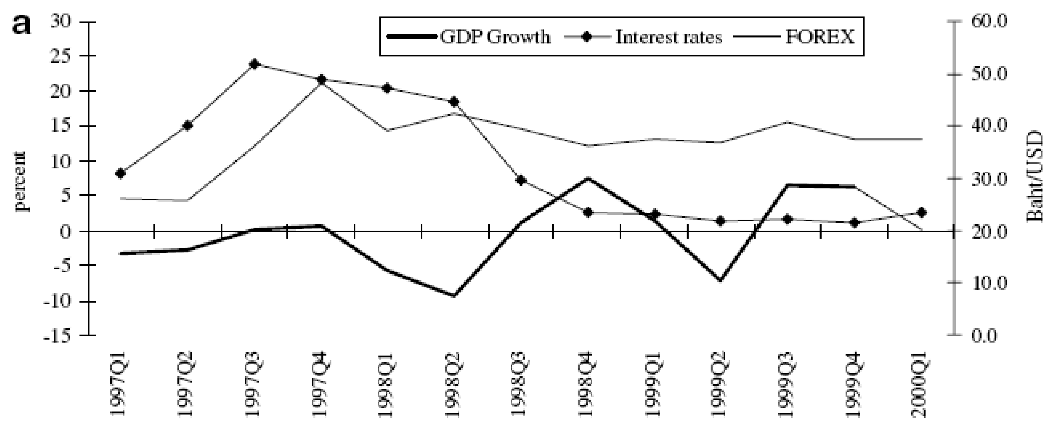


Figure 4 *Continued*



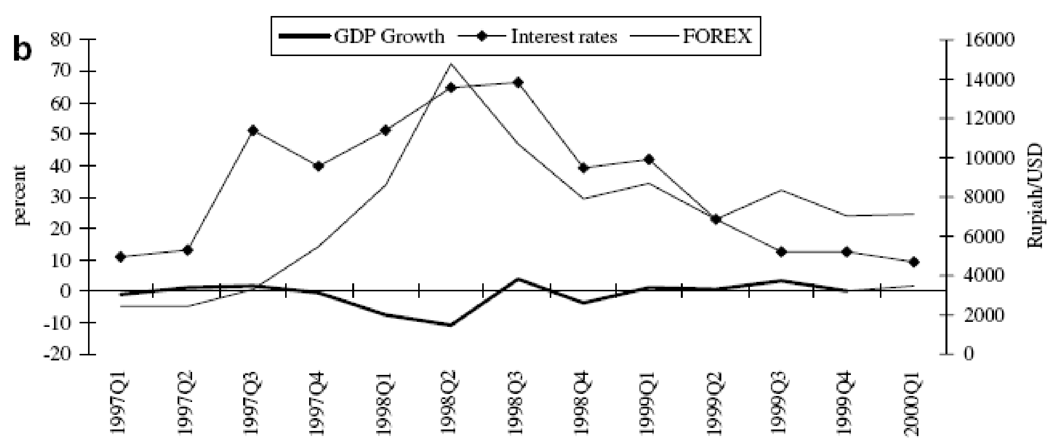
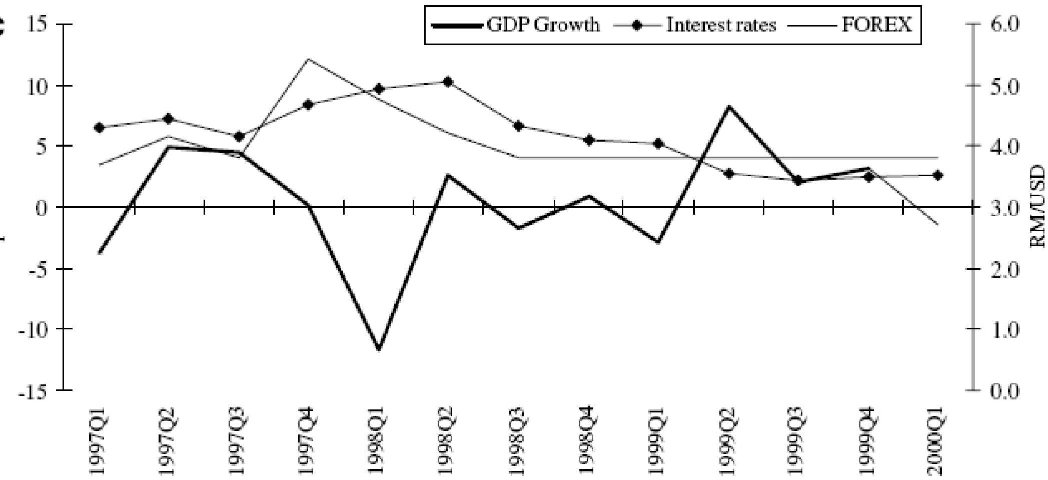


Figure 5 (a) Thailand: **GDP** growth, foreign exchange & interest rate, 1997Q1-2000Q1, *Sources:* Financial Extel & BOT; (b) Indonesia: GDP growth, foreign exchange & interest rate, 1997Q1-

2000Q1, *Sources:* Financial Extel & BOI; (c) Malaysia: GDP growth, foreign exchange & interest rate, 1997Q1-2000Q1, *Sources:* Financial Extel & BNM; (d) Korea: GDP growth, foreign exchange & interest rate, 1997Q1-2000Q1, *Sources:* Financial Extel & BOK.

c



d

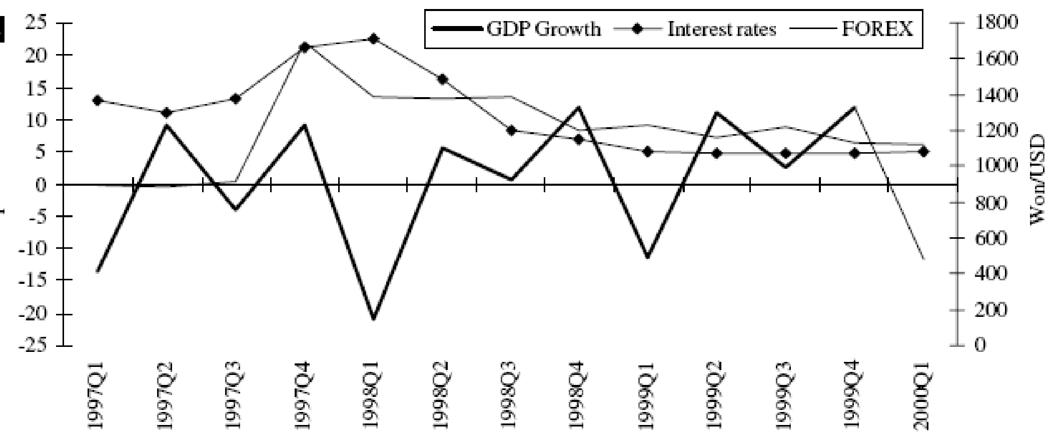


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Figure 5 *Continued*