I'M Fired.

The Downsizing of Asia

François Godement
The recent Asian financial disaster has prompted many questions. How did it happen? Was it due to poor public policies and a lack of market regulation? Is it part of a systemic and global disorder? Has the Asian model come to an end?

This book charts the economic fortunes of Asia from the early 1990s to the collapse in confidence in 1997 to 1998. It examines the reasons behind the economic crisis and surveys the likely social and political impact on Asia – the questioning of Asian values and the reappearance of ethnic and religious divides.

François Godement argues that the Asian economies have reached a crisis of maturity. The main components of healthy commercial growth remain in place, the damage has been caused by a lack of financial regulation, organization and discipline, and now there is a profound sense of pessimism. Cooperation between states in the region is now essential if they are to regain their economic momentum.

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François Godement
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This book has been written in trying times, as the Asian crisis unfolded and spread its consequences. I would never have finished the project without the encouragement and assistance at various stages of Régine Serra, Arnaud d'Andurain and R. Bin Wong. Ning, Noémie and Olivier have had to endure the permanent urgency that came with the topic. I wish to thank them all for their patience.
Great financial crises, like major political revolutions, lend themselves to two major undertakings: scapegoating, and looking for the root of the trouble. The first pursuit is an understandable reaction in the face of such change: somebody must be responsible. The search for culprits – speculators, the West, the Asian model or Asian debtors themselves – is only too tempting. The second pursuit is akin to asking whether the French Revolution started on 14 July 1789 because the price of bread reached a high on that day, or whether it happened because the French monarchy could not cope with the crisis in fiscal revenue or with the Enlightenment. Like revolution, financial mayhem is a major historical event. In the post-Cold War era, and particularly in East Asia, where geo-economy has largely displaced geopolitics as the major agent of change, a financial collapse is history in the making.

A crisis of transition

The closest that one can get to the cause of the 1997 to 1998 Asian economic crisis (‘the Crash’) is that Asian economic models met their fate when they embarked upon a course of international trade and financial liberalization that followed the Western model. Most Asian countries (with the important exceptions of Hong Kong and Singapore, which are very special enclaves) failed to set up adequate regulation and supervision that would have allowed capital markets to develop without dangerous imbalances. Overwhelmed by capital inflows from the world’s industrialized economies (and first and foremost from Japan), they overborrowed, overinvested and overreached themselves, until confidence snapped like a taut wire. What happened next is now well known. Net private capital inflows to
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Malaysia, the Philippines, South Korea and Thailand reached 93 billion dollars in 1996. But by 1997, the movement had reversed, with an outflow of 12 billion dollars.

The Crash was a crisis of transition, heightened by a lack of regional government cooperation at a time when economies and markets had become interlocked. The event points to the late adjustment of Asian governments and institutions to the kind of momentous changes that were happening in the economic field, changes that governments themselves had usually encouraged.

A paucity of predictions

On the surface, the Asian events of 1997 appear at first to be a financial tragedy, devoid of much historical and cultural depth. The cast includes, besides many pinstriped international bankers, the Indonesian president of a taxi company ironically called Steadysafe, which failed miserably, as well as innumerable owners of ‘bubble’ properties and short-term debts. Japanese high officials committed suicide to atone for the local equivalent of three-martini lunches with the firms they regulated. Korean auto firms that had been legally declared bankrupt went on acquiring dealerships in America and, in one instance, a lorry company in the United Kingdom. Asia-Pacific pundits kept chanting the mantra of sound fundamentals, although this did not sway the markets.

Much of the real debate on the crisis, its roots and its cures happened in fact outside the region. Asia became a proxy for debates between IMF and World Bank factions, used to propping up much smaller economies. Reform agendas for Asia were often discussed with no consideration at all of Asian realities. The problems of such complex societies cannot be cured by a few neo-liberal or monetary prescriptions, or by a blanket denunciation of Asian sins.

What caused the Crash? Was it the mere flutter of a butterfly’s wings – the failure of a Thai finance company for instance – which threw the entire regional system into a spin? Unlike the econometric models of quantitative economists, real financial systems share the weaknesses of all other human constructions. Panic, psychological contagion and herd-like behaviour can spread a disaster far beyond the boundaries and linkages that macroeconomic models can predict. Several economists, and a few international institutions, issued words of warning about some Asian economies after the Mexican crisis of 1994. But precious few translated these warnings into a general argument. Even Paul Krugman of the MIT – considered by some of his peers as a popularizer – who came closest to a prediction, was
not completely on cue. He later reformulated general arguments on the pattern of Asian growth (including the celebrated ‘sausage factory’ argument regarding productivity stagnation in Southeast Asia) to fit the actual events: the Crisis of 1997 was not born in the physical economy of Asia but in the financial arena where regulations were not in place. Confidence snapped. To its credit, the grand old lady of all international economic institutions, the Bank of International Settlements (BIS) in Basle, foresaw the impending disaster with clarity, and issued a warning in the most blunt language that could be used by bankers. But the BIS is entrusted with advising, rather than deciding. And its advice is aimed at saving lenders from themselves, not at rescuing hapless debtors. The lonely journalist, Bill Emmott, had single-handedly predicted the stagnation of Japan’s economy much earlier. His prediction was received as eccentric. In fact, he managed to anger both Japan’s friends (who saw the country acquiring a quasi number-one status internationally) and its enemies (who needed to depict Japan as a threat, and not as an invalid). Finally, there had been no dearth of dire warnings regarding the Chinese economy in previous years: overheated, overextended and riddled with confusion between market and bureaucratic forces, China’s economy had been the leading candidate in Asia for a so-called ‘hard landing’.

No one, however, had foreseen the chain of events that unravelled after 2 July 1997, the day when Thailand’s government gave up the struggle to defend the parity of the baht with the US dollar. Not even the staunchest critics of Asia’s economic policies, who berated either its growing social inequality or the lack of investment into education and technology, had foreseen the sudden wave of monetary and financial destruction that caught the region unaware. Only five months later, Alan Greenspan, the chairman of the Federal Reserve, would put this destruction of capital at 700 billion dollars, and the losses are still mounting. The region’s economy, in which international trust had become the modern-day complement to the celebrated Asian personal relationships as the basis for successful business, has ground to a halt.

The West has grown accustomed to a rose-tinted view of Asia, where one continuous and miraculous growth pattern apparently spread from one corner of the region to the other. As a matter of fact, Asian economies have gone through boom and bust cycles in the past. In 1980, for example, Korea underwent an 8 per cent recession of its GDP, and was bailed out by Japanese loans in 1983. In 1985, China’s reform programmes skidded off the rails, with Chinese foreign currency reserves very nearly disappearing. Southeast Asian economies also went through a rough patch in the mid-1980s. In the wake of the 1989 Tiananmen repression, Hong Kong’s stock market and real estate fell through the floor. Hong Kong’s
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market, deriving its collective psychology from traditional Chinese money mar-
kets, has gyrated up and down many times throughout its history. Taiwan’s
growing financial centre, resting on many insider deals and far too many ‘grey’ –
or technically illegal – security brokerages, had also collapsed before: for instance
in 1987, when its decline predated Wall Street’s Black Monday on 19 October 1987
by a few weeks. Even Japan’s Kabutocho fell from a high of nearly 39,000 in 1990
to a low of 14,300 in 1991, and although this can be seen in retrospect as a turning-
point for the Japanese economy, it did not grow at the time into a full scale regional
crisis. Yet, with two-thirds of Asia’s GNP, Japan appeared as a far more potent actor
than the small financial and currency markets of Thailand, Indonesia and even
Korea. In short, massive fluctuations which take their cue from traditional money
markets and from a speculative streak present throughout the emerging world are
bad for small, or poorly connected operators. However, the market never falls to
rock bottom for the main actors of bureaucratized and hierarchical societies, where
foreknowledge is the name of the game. It may not look like it to the small investor
losing his life savings, but Asian markets have historically rebounded almost as
quickly as they fell. After all, the Chinese were the inventors of the wheel of
fortune.

For these reasons, many in Asia have chosen to consider the crisis as a tempo-
rary setback, a case of market overreaction or at most a normal growth crisis, in a
region where the fundamentals still point towards prosperity. These were almost,
word for word, the reassuring thoughts that President Clinton aired at the Asian
Pacific Economic Cooperation (APEC) Vancouver summit on 14–15 November
1997. He reduced the financial crisis to mere ‘glitches’, thus missing the sense of
panic that was sweeping the region. But prosperity has failed to show up around
the corner, and the relentless beating taken by these markets gone astray has now
drowned out sound economic fundamentals.

The separation of economics and politics

I will now focus attention on the explanation for the Crash. What matters here is
the separation of economics from politics, and its unexpected consequences. In-
vestment, capital flows and growth belong to the economic sphere. But regulation,
supervision, transparency and – perhaps above all – a sense of balance between
dynamic growth and system stability can only be generated in the public and
political sphere. Asia performed well in the first area, and failed miserably in the
second. This verdict includes Japan, the world’s second-largest democracy.
A history of the Crash and its aftermath cannot therefore be an exercise in economic theory alone, much less an ideological exercise which compares the respective virtues of market democracy with the guiding hand of the state. Economics must certainly be brought in. Yet out there in the real world it is not only abstract economic laws that drive markets. Human decisions and collective psychology also shape economies, or even bend them out of shape. These elements are beyond the reach of scientific determinism.

The analysis of such a history can carry with it more than a whiff of ideology. A crisis is first of all a mirror for critics who seek the confirmation of their views in events. It is an exercise ground for experts and institutions with pet theories. Globalization has given economists and market analysts, two categories of professionals, often with limited knowledge of Asian history and culture, a license to apply schemes lifted from other contexts. Perhaps this is just retribution for the complacency of many Asianists and Orientalists who have relied too heavily on their belief in the uniqueness of Asian culture and institutions.

What is more, ideological debate about Asia also marks the return of a suppressed yearning. The region has been ahead of all others in witnessing the obsolescence of ideologies. It was once an economic and political battleground, where the Cold War was played out between the two superpowers and where communism made one of its strongest attempts at social revolution. From the twin defeat of the former Soviet bloc and communism, the present world order has been constructed. Both defeats happened in Asia. The age of revolutions ended in Asia. China’s reformist transition predated the fall of the Soviet model. Today’s world, especially after the demise of communism and the end of the Cold War, has effectively brought an end to the possibility of politically based revolution in the foreseeable future: this is what Francis Fukuyama’s ‘end of history’ is really about. The inspiration for his thesis came from Asia, where Chinese communism converges with state capitalism, and where revolutionaries of yesteryear, such as Pol Pot, end up literally in the trash can.

It is over Asia that the proponents of authoritarian development have locked ideological horns with the advocates of liberal democracies. It is in Asia that political stability has been designated as the pre-condition for economic growth, in spite of some noteworthy evidence to the contrary. Strong states and fast economic growth have reduced the range of dissent and alternative policies. There remains a debate in Europe and America between progressive and conservative worldviews, although on both continents the successful progressives are often enlightened conservatives in disguise. In East Asia, liberalism and democracy are the only
currency that effectively counters the established systems, while the advocacy of socialism in any form has simply disappeared from sight.

Given this separation of economics and politics, it is not surprising that Asian history is being reshaped by an economic upheaval. Asian societies have exhibited a marked preference for stability. Many customary social arrangements already existed to foster this stability – in addition to coercive political rule in some places. Upheaval could hardly have come about from self-conscious political forces. These forces often failed, whether they were China’s political reformists of the 1980s, Japan’s fresh faces in the politics of the 1990s, or Southeast Asia’s NGOs. As in the era of failed revolutions in the Europe of the early nineteenth century, conservative priorities and evolutionary tactics gained the upper hand in Asia while ebullient and politically based movements regularly dissolved.

Or at least they did until the Crash. The ‘separation of economics from politics’ has been a major tenet of Asia’s long-term evolution. Extraordinary advances were made in the economic field, with Asia becoming the world’s centre of dynamic growth. To the sceptical reader, we should point out that even the present economic recession in Asia will hardly take it back to its starting point of the early 1960s. For 30 years, East Asia’s overall yearly growth rate has exceeded 5 per cent. According to World Bank criteria, the number of people living on or below the poverty line has been reduced from 60 per cent to 20 per cent of East Asia’s population. But although democratization advanced in the industrialized economies of Asia (South Korea, Taiwan and Hong Kong), the politics of economic growth remained largely unchanged. In Northeast Asia (except Taiwan, which now possesses a more sophisticated entrepreneur culture) and in Singapore, Japanese-inspired policies of nurturing economic growth are in place and a holy trinity of bureaucrats, large firms and politicians work hand in hand. The less developed parts of Asia have been able to adopt from Japan only its policy of export promotion and import substitution. There, the nexus of the relationship between politics and the economy has more to do with traditional protection, community policies and that long-forgotten idiom: ‘squeeze’. In some cases, such as the post-Tiananmen Square Asian communist systems, the separation of politics from economics is an ever-present, if undeclared dogma.

Self-conscious political action, including the active repair and reform of collective institutions and laws, is usually the most visible top strata of human society. Economic change is the underlying bottom strata, whose shifts can go unseen but are none the less powerful. In any liberal society, the top and the bottom strata interact without any predominance. But Asian societies have been different. They have combined guided or even forced development with political authoritarianism
or attachment to political tradition, as in the Japanese case. Even in the most obvious cases of political upheaval in recent Asian history, restoration rather than revolution has been the key. For example, Corazon Aquino and Fidel Ramos re-established Philippino democracy after the Marcos era. Other ASEAN states, Malaysia and Singapore, for example, which have more tolerance for a political opposition, have somewhat relaxed the state security limitations on personal freedom, without going back to the administrative practices and political systems of the immediate post-colonial era. Certainly, there have been strong political and social movements. One need only look at China’s turbulent history under Deng Xiaoping or at the simmering political and religious tensions in Indonesia that predated the Crash.

Yet, by and large, the surface of the Asian political sea has mostly been unruffled, with national captains firmly in charge. Economic change, and perhaps the modern information revolution instigated by the Internet, have been the only areas in which horizons could infinitely widen, and where the individual spirit has flowered.

When political rigidity prevents institutions and laws from yielding to powerful shifts in economic and social forces, there are two outcomes: either economic growth and social renewal stop, leading to a closed society, or one day the ground erupts under pressure from deeper tectonic forces. The Crash represents such an eruption.

A revolutionary agenda without revolution

The Crash therefore does not only pose questions about economic policies or political disruption, social suffering and the chaos that may result from them. In fact, we remain convinced that those nostalgic for Asia’s revolutionary era, who would like to see a return to messianic revolutionary upheaval, will be heavily disappointed. Notwithstanding the fall of Suharto, along with that of every other Asian government that has come under the International Monetary Fund (IMF)’s helping hand, there is no major challenge arising from within Asia’s stricken societies. What is at stake is indeed more serious than nineteenth-century-type political revolutions, complete with the storming of the president’s palace, a new flag and perhaps a new national anthem. Left right politics are dying out in Europe and America; although astute politicians still ride on their coat-tails, yet rely more on market research than on political ideology to win elections. Asians are far too pragmatic to return to this Old World game. In fact, Asians are going to be so
nostalgic about the past prosperity of their economies in the near future that one of
the main political issues, and a real danger, will lie in attempts to rebuild that past
along the same lines. A withdrawal into nationalism, hostility at foreign presence
and intervention and confusion over democratic gridlock, will be part of Asia’s
new political scene.

The difficulty, which we are already seeing in Japan’s political system, will be in
bringing Asians themselves to look at systemic, yet non-revolutionary changes to
the top strata of their societies. These changes include the following priorities: a
limit to state intervention in the economy; reform in the structure of capital and
large firms; freeing property rights and ending the closed management system for
domestic savings; building a welfare net, if not a welfare state, which can replace
the protection of customary relationships; and building regional interdependence
in the monetary and financial fields. These changes also imply open economic (and
therefore, political) information and above all, government accountability for policy
mistakes or fraud. It is a tall order. Without these changes, Asia’s tigers will
become cowering cubs in the open spaces of international finance. These mighty
animals prospered because they were always guaranteed a free lunch by the gov-
ernments that nurtured them. Now that global economic rules forbid this guaran-
tee, they have to earn their lunch on a daily basis, not over the five-to-ten-year
stretches of the developmental state model.

The lack of elasticity in Asia’s public policies, administrative systems and social
organizations is another major topic of this book. The massive disruption caused
by the record growth of the past two decades, the devastating effects of foreign
capital on time honoured structures, will receive due attention. Yet we do not view
the Crash of 1997 so much as an economic crisis – although indeed it has bor-
rowed many feathers from that particular bird – but rather as a collision, if not a
‘clash of civilizations’ (Samuel Huntington). It is a clash of systems, between
formerly mercantilist Japan and triumphant neo-liberal America. While East Asian
economies have been popularly classified as tigers and dragons, they are no match
for the market economies. With the advent of sudden and almost full liberaliza-
tion, the market has become a blunt instrument, while East Asian economies
caught in a transitional stage from their former mobilization model are paralysed
by this sudden change of rules. It is a clash of cultures, between Asian models of
cooperation and hierarchy, and Western individualistic market behaviours. This
involves heartbreaking decisions for Asians which are largely misrepresented in
the hype about corruption or cronyism. This focuses only on the deviant elements
in more fundamental patterns of social relationships. There is also a clash of long-
term strategic choices. Industry-based Asia has cornered successively the auto,
shipbuilding and semiconductor sectors only to find that these are now glutted and devalued. The West rests more and more on service activities, from the financial sector to the new information ‘industry’, and the worldwide marketing of brands that become generic products in all languages, from Coca-Cola and Gillette to Mercedes-Benz or Nestlé.

The Crash may well have started as a classic case of liquidity crunch. ‘Overloaning’ is certainly not a Western nor an Asian twentieth-century invention. Traditionally, when the year drew to an end in the centre of traditional banking of Ningbo (in Zhejiang province, China), merchants and bankers alike followed the time-honoured tradition of paying their debts before the New Year. To do so, of course, they had to call in outstanding loans. Since there were always more paper loans than currency available, the rush to do so inevitably left someone standing with worthless paper in hand on the eve of the Spring Festival, which marks the beginning of a new cycle. Every year in Ningbo, hapless merchants went under as a result of standing last in line to recover short-term debts.

In 1997, the ‘change of rules’ of several banking systems and capital markets – and most identifiably the adoption by banks of the celebrated 8 per cent Cooke ratio of reserves and assets to outstanding credit – created a massive stampede to reclaim cash from outstanding loans. Any Ningbo merchant at the beginning of the twentieth century would have understood what went on. An insolvency crisis, stemming from excessive short-term credit unexpectedly falling due, is also a standard cause for a financial crisis in an emerging economy. It is therefore not uniquely Asian, especially since Western banks joined the party en route. What is uniquely Asian is the reliance on large infusions of capital, whether from domestic savings or foreign sources, to fund rising industries, spawn international firms and garner political and social support. With the capital liberalization movement under way since the mid-1980s, the long-term focus of Asian economies on industry, and their short-term disregard for returns on capital, have become untenable. The changeover to financial bubble economics in the hope of quick profits reflects this problem. The liberal transition to international market rules kills the Asian goose which took its time to lay a golden egg. The jolt from the Asian financial sphere quickly became a revolution, or, literally, an epochal transformation that destroys entrenched customs and institutions, leaving open the possibility of chaos – or of a complete reconstruction.

No measure of modernization, Westernization or globalization has created a political revolution in East Asia since the Second World War. Yet the thunder from the hooves of a thousand Western bulls heading back to the safety of home, and from millions of smaller Asian bears fleeing their markets to join them, create the
setting for revolutionary change. It is no use blaming the celebrated herd instinct, which makes almost every mutual fund manager mimic his colleagues, nor challenging the incredibly lightweight judgement of many celebrated gurus. Barton Biggs is no Voltaire, George Soros is no Rousseau. Several conservative political leaders in Asia have rightly pointed out the bias of market judges who stand to make money from quick variations in pricing. That does not lessen their influence, at least not in the short term, nor the possibility that this short-term influence creates a more lasting spiral.

We are reminded of the famous financial experiment by John Law in France between 1718 and 1720. He created a capital market by selling debt papers for his South Sea venture. The historical inventor of bubble economies saw his debt paper fall in spite of official backing by the Regent. The resulting crisis of confidence would draw many to the revolutionary camp. John Law had invented a fundamental feature of capitalism, but he knew little about the necessary regulation of markets, and even less about the need for transparency in accounting. The financial apprentis sorciers of the Asian miracle are his children.

From the first to the second Crash?

The Asian crisis is not merely a systems failure that the political leaders of the Asia-Pacific can solve by putting their heads together, or that the men in white at the IMF’s emergency ward may cure by prescription. True, an initial failure of these leaders and institutions has aggravated the crisis of confidence. The restoration of trust is the essential ingredient of any solution, as Jeffrey Sachs remarked quite early on. Leaders like Dr Mahathir, the Prime Minister of Malaysia, who waved their arms wide in an effort to slow down the flow of capital responding to panic and speculation, failed to understand that trust could no longer be decreed, but had to be rebuilt from scratch.

The reason for these leaders’ failure to ward off the crisis does not rest only with their flawed understanding of markets. By the early autumn of 1997, the financial collapse of a region that had, in any case, been bound together by very thin glue was leading to a far more momentous event. A social and political breakdown was also on the way, and it challenged the roots and the legitimacy of political systems throughout the region. This was no longer a case of the lonely butterfly over the Gulf of Siam stirring a typhoon hundreds of miles away. It looked more like an elephant that had been thrashing around in the jungle, suddenly charging into a clearing. The political structure that had provided the real glue for the
region’s economic success suddenly became the fatal flaw that prevented the re-
gion from putting itself right. ‘Corruption’, ‘crony capitalism’ and ‘bureaucracy’
were the key words used by observers to describe a general loss of faith in Asian
states and their ability to manage capital into open markets.

True, there is much hypocrisy in this sudden flurry of denunciations. In many
cases, capital has been drawn to the region precisely because a strong public hand
guaranteed large returns. Crony capitalism, heavy-handed bureaucratic interven-
tion and state-induced economic strategies are not new in Asia. They have been
around for decades, and were usually seen as facilitators of the high growth rate of
Asian economies. Even those who defended a free market approach against gov-
ernment interventionism had come around, seduced by the success of Asia’s
emerging economies. In 1993, the World Bank had only praise for the Asian
governments who ‘intervened systematically and through multiple channels to
foster development . . . , targeting and subsidizing credit to selected industries . .
. establishing and financially supporting government banks’. The World Bank
noted without any apparent regret that ‘some of these interventions violate[d] the
dictum of establishing for the private sector a level playing field’.9 These very same
practices would later be called ‘bad loans to good friends’, thus becoming the basis
for an indictment against several Asian governments in 1997.

Only five years before the Crash, the literature on the economic miracle ap-
plauded the long term perspective of Asian state intervention and corporate plan-
ing. This was seen in stark contrast to the Western financial dictatorship of
quarterly reports to shareowners, and to the lack of strategy due to an insistence
on short-term financial results. In 1997, the dismal science of economics once again
reversed itself. ‘Short-termism’, as critical economists used to call slavish attention
to immediate financial results, has become respect for ‘shareholder values’. It has
fled the West to rule East Asia. Governments and bureaucracies that were praised
for creating a favourable long-term investment climate are now requested to de-
molish the means whereby they steered, and sometimes controlled, their econo-
 mies. The Asian model is now fair game.

Domestically, Asian public opinion certainly hovers between blaming interna-
tional capital and indicting local political leaders for incompetence or worse. This
crisis within a crisis has been felt with varying degrees of severity around Asia. In
South Korea, the incumbent ruling parties have suffered a defeat at the polls by
their eternal opponent, Kim Dae-jung. This change at least provides a quick politi-
cal alternative within a democratic system that moderate politicians and realistic
generals had put in place over the previous decade. In Japan, police cars screeching
to a halt in front of large corporate headquarters, heads bowed in shame on the top
floor and promises to end the insider deals are certainly nothing new. But the
arrest of top civil servants at the nation’s most prestigious institution, the Ministry
of Finance, and the suicides of several of them.\textsuperscript{10} are novel indeed. Top civil
servants were spared by the anti-corruption drive in previous years. To commit
suicide was an act of despair for small businessmen or ordinary crooks, not for
connected insiders. It is not enough to note that the Hashimoto government fell to
new depths in the polls: this had happened to several previous governments. But
never had faith in the system sunk so low, and Japan been so far from playing a
positive role in regional affairs as in 1997 to 1998.

In Indonesia, President Suharto and his clan were initially very far from com-
mmitting political suicide. That would have been the practical requirement that was
thrown at them by the IMF and a grim Mr Camdessus, who presided over the
signing of a deal with Indonesia in January 1998. The first family, in power since
1965, was at the centre of the storm created by the financial crisis, and was also the
symbol of what prevented its resolution. Rather than give up Indonesia, Inc.,
Suharto, the Javanese king, his children and his courtiers began playing an old
game of shadow puppets. They kept open the very firms that were supposed to
have been shut down and equivocated on key rescue measures. Even more omi-
nuously, they seemed unable or unwilling to check the storm of ethnic hatred and
xenophobia that was rising against the Indonesian Chinese minority. Although
the police and armed forces contained the worst disturbances up to Suharto’s fall
in May 1998, there was no mistaking the direction of the wind. Extreme Islamist
forces and well connected businessmen were using the Chinese as scapegoats for
the financial crisis.

The Indonesian New Order that held together since 1966 has come unstuck,
and the potential for chaos is great. Perhaps this was Suharto’s trump card in
confronting the international financial community and the United States, as trouble
in Indonesia will reflect on its neighbours and create strategic uncertainty through-
out Southeast Asia. In retrospect, his departure from power has done nothing to
slow down the Indonesian economic crisis, and nor to prevent it from throwing its
regional neighbours into recession. By June 1998, the rupiah had lost 78 per cent
of its value on the dollar, a precipitous fall which inexorably triggered an economic
implosion.

Indonesia’s crisis and instability are by far the most severe in the region. Huge
forest fires over much of Borneo and Sumatra have been an additional plague. In
the autumn of 1997 the fires disrupted the entire Southeast Asian area, weakening
revenue from tourism and worsening the plight of rural people. The spell of rural
drought that fuelled the fires also created a shortage in edible grain and cooking
President Suharto had succeeded in his New Order by feeding the hungry multitudes in Java, and was awarded a medal from the Food and Agricultural Organization (FAO) for this feat. The fact that largely protectionist and monopolistic recipes had achieved this is an irony which is lost on the International Monetary Fund (IMF). The IMF challenged Indonesia to liberalize and in effect dismantle the agricultural and primary material distribution system at precisely the moment when heavy shortages materialized. The ensuing panic, the Suharto government’s well-meaning attempt at restoring food security by a temporary ban on some exports, and food riots and famine in parts of the archipelago, spelt disaster. Millions of factory workers lost their jobs and were heavily ‘encouraged’ by the armed forces to return to their home villages, in an effort to avoid demonstrations in the urban centres. Suspended for 32 years by the wily general, history is back and knocking on Indonesia’s door. The political forces that had been suppressed are now straining at the leash in the first revolution achieved by the Crash of 1997.

Other Asian societies prove much more resilient than Indonesia. Korea, Malaysia, Thailand and the Philippines all saw their currencies decline by about a third against the dollar in the year after July 1997. Thailand was hard hit by a recession that destroyed the middle classes’ financial savings and impoverished farmers. Yet popular anger hardly rose beyond a widespread disbelief in the government’s ability to solve the problems. Almost a year later, more organized political opposition surfaced ominously, combining legitimate social discontent with some of the worst offenders from the pre-Crash era. Malaysia, which had seemed to be heading for a free fall after Dr Mahathir unwittingly drew the attention of market operators by his sharply anti-liberal polemics against ‘speculators’, has proved to be much more cohesive. This is due in good part to the strength of existing foreign industrial investment, and to the fact that its foreign debt was largely publicly held. Had it not been for the regional sense of panic, there was nothing that government austerity could not cure. The Philippines, thanks to their comparatively late arrival in the Asian fast lane, have less international debts, less financial bubble and simply less acquired wealth to lose.

At the time of writing, the other Asian shoe has not dropped yet. That shoe belongs to the Chinese world in Asia. Singapore, Hong Kong, Taiwan and China itself are not immune from the region’s woes. Singapore let its currency slide downwards as early as July 1997, and Taiwan did so in mid October. By early June 1998, this devaluation was contained to less than 20 per cent against the dollar. Stock markets were affected, too, and Hong Kong suffered the biggest onslaught, losing more than 50 per cent from its 1997 peak, although the Hong Kong dollar,
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pegged to the US dollar, held steady. The price to pay for this monetary stability is a steep decline in financial and real estate values, with an economic recession officially announced in late May 1998.

The situation in China remains unique. It is either half-open, or half-closed to the winds of international markets, depending on one’s viewpoint. Its currency is partly convertible for commercial, but not financial, transactions. Only a panic from within China, leading to black market currency transactions, can really destabilize the renminbi. But in other respects, China is hard hit. International investment, frightened by regional prospects, began to dry up in 1998, regional exports are down. Furthermore, many observers draw from the regional disaster an analogy with China’s own domestic financial bubble. These prospects are disquieting. In the course of a year, the Chinese went from fast growth with inflation to price deflation with much reduced growth. As it does so, the state and public enterprise deficit is bound to build up, while a burst of spending is required to fuel the domestic economy. The social spectre of unemployment looms large on the Chinese horizon.

The Chinese leadership has worked hard, however, to contain the consequences. It has pledged to abstain from a devaluation of the renminbi that would trigger another round of currency depreciation throughout the region. It confirmed, albeit cautiously, the ongoing reforms and talked about restructuring, once more, the giant public banks of China. This show of will, though useful, will not prevent observers from questioning the feasibility of these policies eventually.

The Asian model under siege

Overall, the Crash raises a host of inescapable questions. First and foremost, there is the issue of the so-called Asian economic miracle. Had it all been a mirage? And even more importantly, will it return? Even though few professional economists accept the notion of an integral Asian economic model, fast growth has become something we expect from the region. Yet in 1997 to 1998, the advice most frequently thrown at Japan’s leaders was to jumpstart their economy by a mixture of Keynesian measures and economic deregulation. This advice came from Western-style prescriptions against recessions. It neglected the fact that Japan’s budget ran a high deficit. That successive Japanese governments essentially threw good money after bad, and that no amount of loose public spending can bolster the Japanese consumer and investor’s shaken confidence are two facts perhaps conveniently overlooked by Japan’s partners. In this sense, they seem to expect a cure that would come from adopting Western financial recipes, after discarding the Asian miracle cook book.
A ‘miracle’ is shorthand for the mix of policies and institutions that created the successes of Japan, Korea, Singapore and, to a lesser extent Taiwan, and which the rest of Asia sought to emulate with varying degrees of loyalty to the original model. I believe that the Asian miracle or model was no mirage. For a very long time, however, it was denounced or denied by most international economists – the World Bank only came around and recognized it in the twilight of the early 1990s, when it was already passing away at Asia’s economic heart, Japan.

The Asian model was stretched thin, over predominantly agrarian societies in Southeast Asia where education and cultural cohesion were less obvious. It was also scuttled in Northeast Asia under the pressure and demands of global trade partners. Being good at playing go is not a guarantee you will win a game of chess. While Western observers rail against the lack of objective and clear rules in an Asian economic environment that to them appears to be rigged, Asians, who place personal trust and mutual reliance over rules, are nostalgic for the intuitive and collective economic strategies that made their success. Inevitably, the debate on solutions to the present Asian crisis becomes a conflict of interests involving more than just awarding brownie points or penalties to participants. At stake today is the future property of Asia’s capitalism, which has remained up to the Crash far more based on indigenous national lines than Europe’s, or even America’s. In other words, Asian capitalists – who are very real when they are Korean chaebol families or Indonesian tycoons, and a more fluid entity in Japan or Singapore – are not necessarily told to adapt or perish. They are really called upon to adapt and perish, as a final proof of their adaptation. Understandably, they are reluctant to take this step.

In fact, the chief contradiction in the global advice flowing to Asia from the IMF, the US Treasury and Europe, remains the focus on separate, national crises rather than on the strong wind sweeping the region. Putting out the fire in each economy is not possible unless some sense of regional coordination is restored. And in many cases, it really remains to be invented. The direct investment and market liberalization revolution that swept Asia from the mid-1980s usually bypassed the issue of region-wide regulation and organization. Asian capitalism and foreign investment created some elements of a region-wide industrial workshop. Capital markets were swamped by deregulation and by the huge role of offshore markets, including for example the infamous Bangkok International Banking Facilities (BIBF). This has countered the national excesses of statism and monopoly firms. But the present situation neglects the prominent role that regulatory authorities play both in America and to some extent in Western Europe. Perhaps Asia does not need at this stage the equivalent of the US Justice Department’s
antitrust division. Throwing open the capital markets has in effect weakened national champions and big firms that always relied on their domestic backyard to fend off competition and raise capital. The Asian economic model has been thrown off balance by this change. No other model has replaced it, nor is there in many cases any effective regulatory system overseeing banks or some of the region’s capital markets.

For these reasons, it is unreasonable to expect a quick fix to Asia’s economic troubles. The question of renewed growth is inextricably caught up with the issue of deep, structural and region-wide reform. This issue unavoidably leads to a second question: how stable are the Asian developmental states, whose legitimacy had rested in no small part on their ability to deliver economic growth and to redistribute it according to customary and collective ways? Even more importantly, is political stability really desirable, at a time when the obvious inadequacy of public policies leads to a cry for reform? Listening to Western commentators from the media and markets, it often seems as if Southeast Asia’s post-war generation of political leaders would serve their nations best by vanishing from sight. As for Japan, a key reason for widespread Nippo-pessimism is the awareness that the Liberal Democratic Party remains as unavoidable as bad weather at the Nagano Winter Olympics. In the urgency of the crisis, subtle answers such as a regional preference for gradual reform or the issue of regulation in the semi-voluntary transition to free market economics are often lost on outside actors. ‘Everything, now!’ seems to be the clamour from the outside world.

In the process, political leaders and economic bureaucrats often stand indicted for the very real sins of graft and nepotism. Indeed, the case of Indonesia’s presidential family serves as an obvious illustration. Graft at the top has become the symbol of economic mismanagement throughout the region. Yet the question of how to reshape societies traditionally based on personal relationships rather than on public compacts remains a harder one to solve. Few, for instance, stop to ponder why one of Korean president Kim Dae-jung’s first acts of power was to reinstate the practice of anonymous bank accounts that his predecessor had outlawed. In Asian societies, trust and transparency do not always go hand in hand; and in Asia, as everywhere, political leaders are made by their own societies as much as they shape them.

This book aims to provide an answer to these large and sometimes unmanageable issues. In a previous work originally published in 1993, I have tried to depict the many facets of the Asian renaissance. The coming of age of post-colonial Asia was not a purely economic event. I underlined at least some of the obstacles to the
formation of a genuine region in the historical sense. Chief among these obstacles was Japan’s growing aloofness, behind the veneer of post-war policies and economic diplomacy. Japan was no longer the abnormal post-war state locked in its relationship with the United States, nor had it the will to translate its status as the regional economic powerhouse into political, or even monetary responsibilities. I believed that the call of Asianism was more imaginary than real, although it served a useful notice on the need for a culturalist approach in understanding Asia’s societies.

Nowhere, of course, had I foreseen an upheaval on the scale of the 1997 Crash. It is now revealing or confirming existing weaknesses and strengths throughout the region. This is a severe test for countries that had just begun to practise a cooperative approach to regional relations. But it is harshest for the Asian poor, who had started to benefit from the lift-off during the previous decades. They are the first to suffer in the fall back to earth.

A test for global cooperation

Finally, the Asian Crisis is a test of the new global order. One-third of the world’s economy, and by and large its dynamo in the past two decades, does not come to a standstill without serious consequences for the rest of the world. True, the crisis has remained surprisingly regional. It first spread like wildfire among the emerging economies with frailties like that of Thailand. Growing regional interdependence, which was the most positive feature of Asia’s economic development since the mid-1980s, turned into a trap. Since more than 50 per cent of East Asia’s trade is now among East Asians themselves, the roof has collapsed on regional exports, with a major recession under way in 1998. Meanwhile, capital flight towards Western markets, along with reduced export and commodity prices are benefiting America and Europe. It is only in a second stage, hardly reached as of mid-1998, that the missing dynamo in East Asia will start to slow down the rest of the world’s economy.

Even before this happens, Americans and Europeans have an obvious reluctance to accept more Japanese or Asian trade exports as a way to help them out of the crisis. Renewed growth of Asia’s domestic economies is therefore held to be the key. Meanwhile, stringent austerity and falling domestic consumption are already creating large commercial and current account surpluses for Asia. For historical and political reasons, Japan has declined to lead Asia’s economic growth in more prosperous times. It is now being asked to use its domestic economy as a
dynamo of last resort for Asia. But the Japanese consumer or saver’s mood cannot be decreed. In a newly opened context of capital liberalization, there is a great risk that money created by Japan’s government and the Bank of Japan will simply fly out of the window towards more attractive foreign capital markets. It is therefore highly doubtful that Japan will commit its own domestic policies to ‘saving’ the region, as Prime Minister Ryutaro Hashimoto bluntly put it to his regional colleagues on 15 December 1997.

The Crash of 1997, and the strategic, cultural or industrial clashes we have discussed above, should not be the cause for an East–West rift. Western solutions to the region’s problems are brought up by many Asians but, apart from the United States’ inexhaustible desire to lead the region, Western powers are remarkably uninterested in the region’s power balance, provided it remains stable. The Crash has taught a harsh lesson to all believers in weak, voluntary and informal cooperation. The logic of regional integration and institution-building is even more compelling today than yesterday. Yet the strength of the regional economic implosion, and the very high profile that Westerners have taken in prescribing or interdicting solutions, through the IMF or sometimes directly, are disquieting. The optimistic talk about an Asia-Pacific era, the hopes for an Asia–Europe dialogue, the theories implying a global triad are now questioned. Naturally, sentiment is a factor lurking close to the surface in many judgements made about the Asian crisis. Asian nationalist frustrations, jingoist triumphalism in America and a measure of Schadenfreude\textsuperscript{13} in Europe, are obvious impediments to future relations.

They are also misplaced sentiments. I do not believe in the Asian chorus trying to sell the region’s strong fundamentals, as these fundamentals count for nothing if the right policies are not in place; policies capable of withstanding the inevitable changes that go with the advent of global integration. Asia can no longer claim political and economic uniqueness and national leaders must become accountable to their people. Yet the resilience of Asian societies, the solidity of their family structures and the quest for educational opportunities are genuine cultural assets even if they do not constitute Asian values \emph{per se}.

The drawbacks of globalization, long known to Europeans and Americans with their rust belts and employment problems, also caught up with Asia. Through their extraordinary success – and the pyramidal financial constructions that gave them clout – many large Asian corporations became world-class operators. The comparative advantage of backwardness had exhausted itself, with Asian societies facing the type of global pressure the West had known for several decades. At the end of 1996, a symbolic clash occurred in France between the supporters and opponents of a major take-over by Daewoo Electronics of the Thomson consumer
firm. Many French people resented the loss of the family jewels, Daewoo essentially paying for the acquisition with the promise of future investments. More to the point, Korean unions, who knew how high Korean wage costs had risen, were worried about the loss of industrial jobs to France.

The game has therefore become more complex for rising economies and societies that competed successfully in the global marketplace during the first phase of their growth. Today, they need more brains than brawn to keep moving forward. Politics will dictate whether their societies adapt to this new requirement. The West can play a role in so much as it can ease some of the pain during the transition. At the grassroots of Asia’s diverse societies, the instinct that may propel this change is already countering unavoidable trends towards a retreat from globalization and social revolt. To make the change compatible with the powerful force of tradition – still the binding glue for most Asian cultures – is the most difficult item on the agenda, and the one which foreign actors rarely perceive. The reformation of Asia will be a milestone in Asian history alongside the Asian renaissance of yesteryear.
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