HANNS W. MAULL

Crisis in Asia: Origins and Implications

The crisis in Asia is complex: it started out as a financial crisis in Thailand in June 1997. Since then, it has since spread throughout much of East Asia[1], and has begun to trigger severe economic adjustments in the countries affected. It has thus spilled over into the real world of economic output, employment and income. As a result, massive social tensions have built up throughout the region, and with the abdication of Indonesien President Suharto we have witnessed what may turn out to be the first in a series of political typhoons, scattering both domestic politics and interstate relations throughout East Asia and beyond. Mahathir Mohamad's Malaysia may be next.

While the financial crisis seems far from over, it will presumably come to an end first.[2] The economic crisis may take longer – conventional wisdom among economists in the region now holds that it will take East Asian countries hit by the crisis about five years before moderate economic growth rates will become attainable[3]. And the political reverberations of the crisis have just begun to affect the region. It would be well to remember that the Great Depression began in 1929 in the USA with the crash of the stock market, and exploded in Europe with the failure of Austrian and German banks in 1931. By 1933, the economic crisis had helped Hitler to take power in Germany, and six years later Europe was at war. All historical analogies have their shortcoming, but the comparison seems justified both by the severity of the crisis and its origins: the Great Depression in the 1930s also ultimately was caused by systemic weaknesses in international monetary and financial arrangements.

»A crisis of global capitalism«

The crisis in Asia is an Asian crisis, but it is also a »crisis of global capitalism«.[4] Its origins lie in a mismatch between the magnitudes of international capital flows and real economic activity. Problems caused by huge and rapidly growing flows of private capital originate with both the supply and the demand side, and they have been exacerbated by institutional and regulatory deficiencies at both the national and the international level.

A confluence of two models of capitalism at the root of the crisis: America vs. Japan

On the supply side of international money, the origins of the crisis in Asia (as those of the earlier

1. The term »East Asia« here and throughout in line with common practice denotes the region comprising both North and South East Asia.
2. The definitive source for economic analysis (though much less so on the political dimensions) of the crisis is the web page of Nouriel Roubini and his colleagues at New York University. http: // www.stern.nyu.edu / ~nroubini / asia / AsiaHomepage.html#intro.
3. Dr. Chia Siow Yue, presentation at the ASEAN Round Table, Kuala Lumpur, June 1st, 1998; cf.also the analysis by, e.g., World Bank, East Asia: The Road to Recovery, Washington, DC 1998; UNCTAD, Trade and Development Report 1998, New York, NY 1998; and C. Fred Bergsten, A New Strategy for the Global Crisis, in: International Trade Policy Research Center, Newsletter, Lincoln, New Zealand, Oct. 1998.
4. This view has been expressed perhaps most prominently by Eisuke Sakakibara, Vice-Minister of the Japanese Ministry of Finance and known as »Mr.Yen«. While clearly self-serving from MoFs point of view, the characterisation nevertheless seems valid. A similar position remarkably is taken by George Soros; see his Toward a Global Open Society, in: The Atlantic Monthly, Jan.1998, here taken from http: /// www.theatlantic.com / issues / 98jan / opensoc.htm. For a powerful intellectual argument supporting this view, see John Gray, False Dawn, Oxford 1997.

crises affecting Mexico and Latin America) can be traced to two principal agents which each represent a distinct model of capitalism: the governments of America and Japan.[5] Faced with persistent bilateral trade and current account imbalances, rather than tackling the underlying causes of those imbalances (namely a largely closed economy and excessive savings and investments in Japan, and and overconsumption in the US), the two governments in 1985 agreed to support a major revaluation of the yen against the dollar.

This arrangement, known (after the Washington Hotel in which it was finalized) as the Plaza Agreement,[6] was less than a pure market solution. The two central banks intervened to make the deal stick. But the Plaza Agreement was signed against a background of financial deregulation and liberalisation of international capital flows which had become a hallmark of American neo-liberal foreign economic policies during the 1980s. America eventually did very well out of the Plaza Agreement, although initially Japan seemed to be the principal beneficiary: the United States could continue to finance its consumption binge through capital inflows from abroad, and during the 1990s, America was the top performer among the G-7 economies in terms of economic growth.

America came to this position out of its belief in markets, and specifically armed with the neoliberalist creed, which had been popularized first by Margaret Thatcher and then by Ronald Reagan. Part and parcel of the neo-liberal ideology was a strong belief in liberalising not only the flow of international trade, but also of capital.[7] Deregulation of international capital flows thus became an important and successful part of the political agenda, and set off a stampede across the world. Behind this stampede was the belief in efficiency gains through better allocation of capital resources, in other words: a drive for higher returns on investment not only through real economic activity, but also through short-term money investments. The result was an exponential increase in overall financial activties, and an even greatergrowth in international financial flows, from currency market operations to portfolio and foreign direct investments. Speculation is an integral part of this model of capitalism, which is prone topanick.[8]

Japan's decision to go along with the revaluation of the yen was rooted in its own, rather different model of capitalism.[9] This model was built on high savings and cheap money to spur productive investments, much of which was geared towards exports with the objective of strengthening Japan's economic power. Imports, on the other hand, tended to be seen as a sign of weakness and vulnerability, and were discouraged wherever possible. Japan's capitalism thus was „capitalism in one country", which tried to keep the economy insulated from competition, while pursuing essentially mercantilist export strategies geared not towards profit maximisation, but towards conquering market shares. The Japanese paradigm of capitalism included close collaboration between the state and business, both of which benefitted from the availability of cheap money and the absence of competitive pressures across much of the economy. The collusion between government and business – in which the banks played the key intermediary role – was highly successful in helping Japan to »catch up and surpass the West«, but this very success eventually also produced problems on a massive scale.[10]

Because money was cheap, the Japanese model of »developmentalist capitalism« entailed an inherent proclivity towards over-investment, overcapacities and over-indebtedness, as well as towards »bubbles«: speculative investments in land,

5. The classical treatments of this theme of distinctive forms of modern capitalism are Andrew Shonfield, Modern Capitalism, London 1969 and Michel Albert, Capitalisme contre capitalisme, Paris 1991. Cf. also Francis Fukuyama, Trust, The Social Virtues and the Creation of Prosperity, New York 1995.6. Cf. Yoichi Funabashi, Managing the Dollar: From the Plaza to the Louvre, Washington, DC 1989 (rev.ed.).

7. As Jagdish Baghwati has argued, while the case for free trade as a means to enhance the overall prosperity of societies through gains in efficiency is well established, this is not true for free flows of capital. There the gains are as yet unproven and uncertain, while the risks are potentially devastating. See Jagdish Baghwati, Free capital movement has its downside, in: The Straits Times, June 2, 1998.

8. Cf. Bank of International Settlement, 68th Annual Report, 1997/98, esp.pp. 131 ff.

9. Cf. as locus classicus Chalmers Johnson, MITI and the Japanese Miracle, Tokyo 1982, and now also Jacob M.Schlesinger, Shadow Shoguns: The Rise and Fall of Japan's Postwar Political Machine, New York 1997.

10. Cf. Franz Waldenberger, Japan: das Erfolgssyndrom als Krisenursache, in: Internationale Politik und Gesellschaft 4/1998, pp. 403-412.

property and stocks.[11] Originally, this tendency was reigned in by effective bureaucratic controls operated by Japan's brilliant mandarins. But when the international political repercussions of Japan's economic strategies began to hit home via trade frictions with the U.S., the Japanese system already had become largely immobilised by powerful coalitions of vested interests; Japan therefore preferred to opt for revaluation, rather than for structural reform (although those were discussed at length, and seemingly even initiated in the wake of the much-heralded Maekawa Report of 1985[12]). Under American pressure, Japan did begin to liberalise its financial sector, however, and thus enabled Japanese capital to go abroad in the search for higher returns. As Japan's „bubble economy" burst, and investments at home thus offered few possibilities with anything like a decent rate of return, in the 1990s Japanese financial institutions began pouring money into East Asia, thus regionalising the earlier Japanese bubble economy. In the financial crisis in Asia, those chicken came home to roost – further exacerbating the already grave problems of Japan's finanical institutions.

Weaknesses of the international monetary order

Ironically, the two very different paradigms of American and Japanese capitalism from the point of view of the crisis in Asia thus produced similar results: a veritable flood of (short-term) money into East Asia. Thus, in 1996, net private capital inflows into the five most seriously affected economies in East Asia (South Korea, Thailand, Malaysia, Indonesia, and the Philippines) came to about 100 billion dollar, while in 1997, there was a net outflow of slightly more than this. In other words, there was a swing of about 200 billion dollar, equivalent to about twenty per cent of pre-crisis GNP of

11. This was recognised as early as in the 1930s by a brilliant Japanese economist, Murakami Yasusuke, who foresaw problems of complacency, entrenched bureaucratic-industrial infrastructure, and corruption resulting from politics captured by business interests. Cf. Walter Hatch / Kozo Yamamura, Asia in Japan's Embrace, Cambridge 1996, pp. 53 f.

12. A summary of the Maekawa Report will be found in: Haruo Mayekawa (sic), Internationalization and restructuring of the Japanese economy, in: Ryuzo Sato / Julianne Nelson (eds), Beyond Trade Friction, Japan – U.S. Economic Relations, Cambridge 1989, pp. 31-40.

Table 1:

Exchange Rate Losses in East Asia, May 1997 to June 1998

	Indonesia (rupiah)	Thailand (baht)	Malaysia (ringgit)	Philippines (peso)	South Korea (won)
Exchange rate per $. May '97	2.431	26.10	2.51	26.4	892
Exchange rate per $, June '98	11.150	40.9	3.93	39.1	1.400
loss of value, percentage	– 78 %	– 36 %	– 36 %	– 33 %	– 36 %
Exchange rate, Oct. 23, 1998	7.500	37.6	3.785	41.8	1.313
loss value, percentage	– 68 %	– 31 %	– 34 %	– 38 %	– 32 %

Source: FEER

this group of countries, within 24 months.[13] The result has been a drastic fall in exchange rates, as the following table shows:

It was not only the exchange rates of those East Asian economies, which fluctuated heavily, however. The crisis was triggered by a shift in currency relations between the two largest economies in the world. Between May 1996 and May 1997, the value of the dollar grew from about 105 yen to 129 yen; in June 1998, it reached 140 yen. Thus, the Japanese currency had lost a fifth of its value in 1996/97, and about one quarter one year later. Exchange rate movements of such dimensions within such a short time-frame are bound to have far-reaching, and highly destabilising, implications for real economic activities. The devastating impact of the loss of four fifth of the value of the Indonesian rupiah drives home the point: an international monetary system which allows such fluctuations of the most important of all prices – the price of a currency – cannot be described as international monetary »order«; it much more resembles chaos.

As the crisis in Asia has once more demonstrated, public international financial institutions are overburdened with the task of preventing and managing financial crises in the wake of inter-na-tional flows of private capital. The IMF, which plays the key role in both prevention and crisis management, did foresee trouble in all afflicted countries, but it was unable to get their governments to take appropriate action.[14] Whether the IMF has been effective as a crisis manager, whether its medicine cures or just exacerbates the disease, is hotly contested[15], but there can be no doubt that its pills are very bitter for those who have to swallow it. IMF intervention also poses issues of moral hazard – forcing countries concerned to bail out imprudent or even reckless lenders, and thus encouraging them to continue to behave imprudently in the future – and limits to available resources. International supervision of banks in emerging markets has also been weak: neither the IMF nor the Bank for International Settlements (whose membership anyway still largely hails from Europe, and excludes most problem cases) were aware of the magnitude of problems. In short, international flows of private funds now exceed the capacity of public infrastructure in the international financial system to cope. In particular, there exists no systemic mechanism to separate long-term capital flows into emerging markets from short-term, speculative movements – the problems is »how to liberalise fully the flow of long-term capital, which is very desirable, without fully liberalising short-term flows«.[16] As, among many others, such eminent authorities and practitioners as Henry Kauffman and George Soros have been arguing, the international financial system has become seriously deficient. As a result, systemic shocks, which probably are endemic to a world with free flows of capital, now can produce demands for national economic adjustments of staggering proportions. This, in turn, will cause major political upheavals.[17]

The roots of the crisis in East Asia

Obviously, generalisations about the causes of the crisis in Asia are misleading and may be dangerous: the specific conditions differ from country to country. Some economies in East Asia – notably

13. Michael Richardson, Asian Worries Deepen, in: IHT, June 17, 1998, quoting World Bank Vice President Jean-Michel Severino saying that since July 1997, about $ 115 bill. had been transferred abroad from the five countries by local and foreign investors. See also Martin Wolf, Global Capital Flows and Emerging Economies: Lessons of the Asian Crisis, Paper presented at the Trilateral Commission 1998 Annual Meeting, March 21-23, 1998, Berlin, and Tung Chee-hwa, Asians Sins Alone Don't Explain This Crisis, in: IHT, June 17, 1998.

14. Shalendra D.Sharma, Asia's Economic Crisis and the IMF, in: Survival, Vol. 40 No. 2 (Summer 1998), pp. 27-52 (27 f.); Heribert Dieter, Die Asienkrise und der IWF: Ist die Politik des Internationalen Währungsfonds gescheitert? Duisburg 1998 (= INEF Report 29/1998), pp. 14 ff.

15. Cf. Jeffrey Sachs, The IMF is a Power Unto Itself, in: Financial Times, Dec.11, 1997 and Heribert Dieter, Die Asienkise und der IWF: Ist die Politik des Internationalen Währungsfonds gescheitert? Duisburg: Institut f.Entwicklung und Frieden 1998 (INEF Report 29/1998).

16. Alexandre Lamfallussy, quoted in: Carl Gewirtz, Getting Banks To Lend More Carefully, in: IHT, Feb. 16, 1998. Note, however, that individual countries do have options to dampen the influx of speculative money. Thus, Chile has been practicing an obligation for foreign investors to deposit part of their funds interest-free with the Central Bank, thus effectively making foreign credits more expensive. Dieter, op. cit., p. 25.

17. Cf. Harold James, Im Teufelskreis der Depression, in: Die ZEIT, Oct. 15, 1998, p. 42.

Taiwan, but also (and more tenuously) China – have, so far, not been much affected by the crisis. Even those which have in many important ways differ from each other. Yet for all the countries affected by the first wave of the crisis, difficulties were foreseen only for Thailand and Malaysia. When the IMF first warned that several East Asian countries might be vulnerable to the type of financial crisis which had hit Mexico in December 1994, it pointed to some worrying similarities between them and Mexico in 1994, namely »... an imprudently large and growing current-account deficit (...), financed increasingly by short-term capital inflows; a rapidly rising external debt; deteriorating international competitiveness (...); lack of financial transparency in government-private sector financial relations; an under-regulated, poorly capitalised and over-exposed banking system; and – most troubling – especially in Thailand and Indonesia (and, to a lesser extent, South Korea) – the rising share of capital investment flowing, not to enhance export promotion in knowledge or value-added manufactures and high-technology industries, but in highly speculative and overvalued property ventures financed largely with unhedged short-term borrowing in foreign currency«.[18]

What factors explained these common problems? Wrong policy choices (such as the decision to peg currencies to the dollar) may provide some of the answers, sheer hybris resulting from the exuberant growth record of the past, some others. Yet at the root of the crisis in Asia lies something else: a distinctive pattern of relations between political and economic power, between regimes and entrepreneurs.

This distinctive pattern (often called »developmental state«) played an important role in enabling East Asia to catch up very rapidly with the West. Today, it is often - and somewhat unfairly – characterised as »crony capitalism«. It is true, however, that this pattern of relations encourages mutual back-scratching between governments and business. Government, through cheap credits, regulation and subsidies, provides entrepreneurs with opportunuities for profits. They, in turn, provide the political class with money to secure support and award loyalties. The financial sector in general, and banks in particular, are at the hub of this structure. Through that sector, money flowed in both directions. Through it, the economies of East Asia gained access to seemingly unlimited funds from abroad (and the dollar pegs allowed them to expand money supply with breathtaking speed without much inflation).[19]

The nexus between business and politics

This nexus between business and politics held both for democratic and non-democratic systems. It has been characteristic for Japan since Kakuei Tanaka invented money politics in the early 1970s[20], and it also is deeply ingrained in South Korea and Thailand - all three democratic political systems. On the other hand, this pattern also prevails in Indonesia, in Malaysia and the Philippines – and in the socialist market economies of China and Vietnam, where banks are central in shoring up the state-owned enterprises. Probably the most extreme case of crony capitalism (a term originally coined to describe Ferdinand Marcos' regime in the Philippines) has been Indonesia, were several members of President Suharto's immediate family went into business in their twenties and made fortunes out of their ability to manipulate the state bureaucracy.[21] The origins of this collusion between the state, banks and business lie in the idea of the »developmental state«[22], in which governments take a hands-on approach to economic management in the pursuit of economic development. Policies to mobilise savings and channel them into favoured sectors, enterprises and activities were central to this. At the core of the developmental state lies the »iron triangle« of politicians, bankers and businessmen, and bureaucrats (chiefly in the Ministries of Finance and Economic Planning). Abuse may not be inevitable (as the case of Singapore, otherwise a typical developmental state, shows) - but the danger of

18. Sharma, op. cit., p. 27.
19. For a detailed analysis, cf. UNCTAD, Trade and Development Report 1998, New York 1998, Ch. III and, particularly, The World Bank, East Asian Crisis, Washington, DC 1998, pp. 1 ff, 54 ff.
20. Jacob M.Schlesinger, Shadow Shoguns: The Origins and Crisis of Japan, Inc., in: Washington Quarterly, Spring 1998, pp. 135-148.
21. Adam Schwarz, A Nation in Waiting, Indonesia in the 1990s, St.Leonards, NSW 1994, pp. 139 ff.
22. Johnson, op. cit.

Tabelle 2:

The Economic Woes of East Asia

Contry	Growth Rate, 1996	Growth Rate, 1998 (e)	Growth Rate, 1999 (c)	Export growth/ decline (in $), year-on year, summer 1997/98	Import growth/ decline (in $), year-on-year, summer 1997/98	Trade balance, latest 12 month ($ bill.)	Current account balance, latest 12 months ($ bill.)
Indonesia	8.0 %	– 15 %	– 0.6 %	– 3.6 %	– 39.4 %	+ 20.4 (7/98)	– 2.1 (Q1/98)
Thailand	5.5 %	– 8 %	– 1 %	– 7.7 %	– 39.8 %	+ 10 (7/98)	+ 2.0 (Q1/98)
Philippines	5.7 %	+ 2.5 %	+ 4 %	+ 18.2 %	– 19.8 %	– 4.2 (8/98)	– 2.2 (Q2/98)
Singapore	6.6 %	+ 2 %	+ 2.5 %	– 13.4 %	– 26.7 %	+ 3.0 (8/98)	+ 14.4 (Q2/98)
Malaysia	8.6 %	– 2.1 %	+ 0.5 %	– 12.6 %	– 34.2 %	+ 8.0 (8/98)	– 4.8 (1997)
Korea	7.1 %	– 7 %	– 1 %	– 10.2 %	– 39.6 %	+ 31.7 (9/98)	+ 30.0 (8/98)
China	9.7 %	+ 8.2 %	+ 8.6 %	+ 0.8 %	– 1.1 %	+ 44.9 (9/98)	+ 29.7 (1997)
Hong Kong	4.0 %	– 2 %	+ 2.4 %	– 7.9 %	– 13.3 %	– 14.2 (8/98)	– 6.1 (1997)
Japan	3.8 %	0.3 %	n.a.	– 13.5 %	– 20.1 %	+ 9.8 (8/98)	+ 113.6 (9/97-8/98)

Source: Far Eeastern Economic Review, July 9 and Nov. 5, 1998; The Economist, Oct. 24, 1998

pervasive corruption clearly is high under such conditions.

Regionalisation of the crisis

The political economy of East Asia thus contained serious vulnerabilities, and it was perhaps not all that surprising that a crisis erupted. The developmental state gradually lowered inhibitions against excessive use of foreign funds, and cronyism and authoritarian structures prevented effective early corrections to avoid desaster. What nobody foresaw was its rapid spread throughout East Asia and the sheer magnitude of the problems. Whatever the sins of East Asia, the economies of the region suffered damages clearly out of proportion with their excesses which caused the crisis. Nor was this damage confined to the economies which displayed those vulnerabilities: Hong Kong and Singapore were hit almost as hard as Thailand, Indonesia and South Korea (cf. Table 2).

The fact that the crisis quickly drew the whole region in its maelstrom suggests that East Asia by then had become a fairly highly integrated economic space. Yet this argument, while true, can easily be overstretched: the crisis also affected countries outside the region (such as Russia and several Latin American economies). The linkages existing between the various segments of the East Asian economic space are more subtle than simple spill-over effects of the crisis or even the common features of its political economy outlined above. They relate to the combination of cheap and abundant capital (mostly from Japan and overseas Chinese networks) with equally cheap and abundant labour (in South East Asia and, above all, in China), which encouraged over-investment in industrial capacity throughout the region.[23] The regional networks of production had expanded at overdrive speed. When supply began to outstrip demand, and export growth started to slow throughout the region, the bubble burst. The history of the car industry in East Asia over the last

23. Cf. Michael Ehrke, Needed: Domestic Modernization and an Asian Currency System, in: Internationale Politik und Gesellschaft 2/1998, pp. 213-216 and Henny Sender, Asian Indigestion, in: Far Eastern Economic Review, Oct. 1st, 1998, pp. 10 ff.

decade illustrates this story well – and it makes clear that European and American producers also were part of the problem. Car industry capacities in recent years have been jacked up not only by massive investments in Korea by Korean chaebol, but also in Indonesia (where President Suharto's youngest son, together with a Japanese firm, launched a new »national car« project with generous tariff exemptions on imports), Thailand (in which Ford and General Motors invested heavily), Vietnam and China. East Asia not only suffered from overinvestment in speculative bubbles, but also in manufacturing capacities.[24]

The challenges of adjustment: implications for Asia

What will the crisis mean for the future of East Asia? While the possibility of a rapid recovery cannot be ruled out and should certainly be hoped for, it does not seem likely. If one starts from the more realistic assumption of a very serious (though ultimately probably still only temporary) hiatus in East Asia´s economic rise, which would be comparable in magnitude and duration to the Great Depression in the U.S. and Europe in the 1930s, then it seems likely that the future will bring considerable economic, social and political turmoil to East Asia. We are likely to observe another acceleration of history, and just as it was nearly impossible to imagine the Europe of 1997 from the vantage point of the year 1987, it will now be almost impossible to envisage the shape of East Asia in 2008.

While the only way to explore the future under such conditions is the construction of widely dif-ferent (but internally consistent) scenarios, some tendencies are discernible. They concern all dimensions of East Asian societies: economics, social structures, politics and interstate relations.

Economic changes

It is clear that the enormous overhang of bad debts which exists in the most seriously affected economies of East Asia (as well as in – so far not yet fully affected – mainland China) will have to be socialised and nationalised: governments will have to assume the burden of keeping their economies going by taking over bankrupt firms or providing a modicum of social safety for laid-off workers, and they will ultimately also have to guarantee and service rescheduled external debts.[25] Whether domestic demand can remain the locomotive of growth under such circumstances, as present economic policies in China seem to assume, is doubtful; in any case, economies with a high external debt burden will have to find salvation in exports. This will not be easy: in the short term, exports have suffered from the reverberations of the crisis, rather than benefitting from the theoretically expected boost through currency devaluations (cf. Table 2), and over the longer term a surge in inflation, which will result from the abrupt fall in exchange rates, will tend to erode export competitiveness. Moreover, East Asia's export markets in the region and, in particular, in Japan already have been shrinking drastically, and those in America and Europe are also likely to be affected by the slow-down in economic activity originating in the crisis. Nevertheless, exports will eventually have to expand dramatically in dollar terms to help economies out of their present predicament.

The torrent of exports from East Asia which eventually will have to materialise will no doubt exacerbate trade tensions between East Asia and the rich industrialised countries. This will probably only be sustainable politically if East Asia moves towards a much more serious acceptance of the rules, norms, and principles of a neo-liberal world economic order. This will force those economies and societies into opening themselves in ways which probably will be as far-reaching and traumatic as the opening of East Asia by the West in the second half of the 19th century. Whether this new opening will crush the „Asian capitalism“ of the developmental state (as it crushed China in the 19th century), or lead to new and successful hybrid forms of synthesis between »Western« and »Asian« institutions and arrangements (as in the case of Meji Japan) remains to be seen. What seems clear is that those economies will have to change very rapidly and drastically – and the heavy burdens of adjustment they will have to bear will have to be born for no more noble and inspiring a cause than

24. Cf. World Bank, op. cit., pp. 53 ff.
25. Cf. Far Eastern Economic Review, June 18, 1998, pp. 10 ff.

to satisfy the expectations and demands of international financial markets in the hope to attract capital inflows as the only chance to regain moderate growth rates.

Social changes

The most obvious negative fallout for East Asia from the crisis is rapidly rising unemployment and falling standards of living for large segments of societies, including much of the new middle classes.[26] In Indonesia, the rural areas have also been affected very seriously by a drought caused by the El Niño weather phenomenon and the forest fires which for several months in 1997 clouded much of South East Asia in what euphemistically has been called »haze«. The economic crisis may also affect the countryside in other countries, as migration to urban areas slows and people return to their home villages, rather than sending money back home. Altogether, economic recession is likely to increase social tensions across many societal cleavages – between the rich and the poor, between cities and the countryside, between different ethnic groups and different ideological camps. This will put a heavy burden on politics.

Politics in East Asia will also become more complicated as a result of the rapidly opening gap between expectations and results. East Asian societies have become used, perhaps even addicted, to high growth rates, which certainly have helped to ensure political stability and regime legitimacy. For some years to come, however, economic realities will dictate lower, rather than higher material rewards for most people: societies will be asked to make sacrifices for the sake of regaining export competitiveness and the confidence of international capital markets.

Politically, it will be very difficult to secure support for necessary economic stringency and strident structural adjustments by pointing out the need to satisfy IMF demands and recover market confidence, as past experiences from Latin America and Africa reveal. Governments may thus appeal to nationalism as a means to mobilise societies for painful changes, as the Korean and Malaysian governments have been doing already, more or less successfully. In ethnically complex societies, this could easily become explosive, fanning inter-ethnic tensions; and even in homogeneous societies (such as Korea), nationalism could become counterproductive if it assumes xenophobic characteristics (as again already seems to be the case in Korea). In several East Asian countries, there already exists a groundswell of anti-Western, specifically anti-American sentiment triggered by the crisis, and the IMF has become something of a scapegoat for many. Conspiracy theories proliferate, and have been given credence by senior officials, such as the Malaysian Prime Minister Mahathir Mohamad.[27] Political difficulties could also arise out of demands for punishing the guilty, or of efforts to identify scapegoats (an obvious target here are the ethnic Chinese in several South East Asian countries).

These tensions are unlikely to be confined within national boundaries. They are bound to lead to migration and refugees, and may ignite cross-border conflicts. Thus, the fate of the Chinese minority in Indonesia has already led China to intervene with the government in Jakarta, and has also caused tensions in relations between (predominantly Chinese) Singapore and Malaysia, as well as with Indonesia (both with wealthy Chinese minorities and histories of inter-ethnic violence). Governments may also try to mobilise nationalism as a means to enhance social cohesion and political legitimacy, and this may exacerbate old and new tensions and conflicts of which East Asia has plenty. And the region is not particularly well equipped to cope with them: the relatively benign international climate in recent years depended heavily on high economic growth and rapidly expanding interdependence. Regional institutions such as APEC, the ASEAN Regional

26. See ILO Cross-Departmental Analysis and Reports Team (CD/ART), The social impact of the Asian financial crisis, Technical report for discussion at the High-Level Tripartite Meeting on Social Responses to the Financial Crisis in East and South-East Asian Countries, 1998(http://www.ilo.org/public/english/60empfor/cdart/bangkok/index.htm) and the report by the World Bank (op. cit., Ch. 5).
27. See Lim Kok Wing, Hidden Agenda, Kuala Lumpur 1998. The aversion against the IMF was not ubiquitous, however: in Indonesia, is was originally perceived in a positive light, as it put pressure on Suharto and his family to relinquish their dominant position in the national economy. This seems to be changing, however, as Indonesians become aware of the less palatable aspects of the IMF programme.

Forum, or the Korean Energy Development Organisation KEDO, which developed rapidly since the early 1990s, are still young and feeble; even ASEAN itself, the oldest and strongest regional organisation, has suffered from almost complete irrelevance to crisis management.

Political and institutional changes

Domestic politics throughout the region will thus probably become turbulent and volatile. Broadly, the direction of change may well be towards more democratic forms of government: if the deficiencies of existing political systems are to be corrected and the fundamental adjustments required to make East Asian economies fit for the global economy, then political systems will have to become more accountable, more transparent and more participatory. The crisis in East Asia thus eventually may turn into a „fourth wave“ of democratisation,[28] and political developments in South Korea, Thailand and Indonesia already point in this direction: democratic changes have been accelerated in the former two countries, while the »soft authoritarianism« of President Suharto has given way to a more open and pluralistic political situation.

In practice, however, the relationship between economic and political change will hardly be simple and linear. Even the relationship between de-mocratic governance and economic mismanagement is far from clearcut. In the past, the unhealthily close relationship between big business, banks and the state which is characteristic for almost all systems in East Asia has developed under both democratic (Japan, South Korea, Thailand) and authoritarian (China, Indonesia, Malaysia) conditions; conversely, while democratic changes have helped necessary economic policy corrections in South Korea and Thailand, authoritarian Singapore and market-socialist China have so far been able to weather the financial storms. Processes of democratisation tend to enhance transparency and accountability and help build regime legitimacy, but they also complicate decision-making processes and may inhibit governments in taking painful but necessary decisions.

What is clear, however, and has been pointed out already, is that governance will become a lot trickier in East Asia. There are several dimensions to this: first, the international economic environment will be much more demanding for East Asian economies: they will have to regain lost credibility with international financial markets, and will be watched much more closely than before. Second, policy demands imposed on governments in East Asia by those markets (and by the IMF) will often be very intrusive and politically difficult to comply with. Third, those demands from abroad will have to be met against a domestic background of rising social tensions, disappointed expectations and demands for justice and participation of groups which had been neglected during the boom, but now suffer from the crisis. Governments in the region may try to deal with this more demanding domestic political environment through ideological mobilisation and/or enhanced provisions for repression of opposition; already, there are signs in some countries that precautionary measures against civil protest are being intensified. And fourth, the management of international relations in the region will become much more complicated.

In short, politics throughout East Asia are likely to be rather tense and turbulent for years to come. Governments will have to deal with demands for massive and thorough restructuring of their economies. In the process, they will confront the need to dismantle much of the old power structures (and hence their own political base), and they will have to tap new sources of political support and legitimacy. All this will take place against a background of low or even negative growth, with little money to spare but large needs for additional public spending (e.g., in the realm of social security).

Ideally, all this requires a strong and democratic state; and there is much reason to assume that in the longer term, political changes in East Asia will broadly be in the direction of democratisation. The principal reason for this is the logic of globalisation: competition between nation-states for access to capital demands transparent, open and accountable polities, with firm rule of law and a critically attentive public. In the short and medium term, however, developments will prob-

28. Cf. Samuel P. Huntington, The Third Wave, Democratization in the Late Twentieth Century, Norman & London 1991.

ably be rather more complicated than a simple progress towards more democracy. The capacity of the state to take strong action in the general interest without being beholden to particular sectors, groups or people is limited throughout East Asia, be it under democratic or authoritarian rule. To develop such political systems will require vibrant civil societies and major innovations in economic, social and political institutions. In other words, East Asia will be expected to to do in a few years what took Western industrialised countries a century.

The challenges of adjustment: implications for the world economy

The evidence for a major economic contraction in much of East Asia is growing by the day. If we assume that the region will indeed experience a great depression, this would undoubtedly have major repercussions on the rest of the world – directly or indirectly. This gives urgency to efforts to prevent the worst from happening in the region, and to reflate economic activity as quickly as possible.

Getting East Asia back on a growth track thus is one of the two major issues facing the world economy one year after the onset of the crisis. The other is how to make sure that there will not be another, perhaps even worse financial crisis in the near future.

Economic changes

To reflate East Asia, three important conditions will have to be met. First, exchange rates need to be stabilised at levels which are reasonable in terms of real exchanges. By mid-1998, this had more or less been achieved for all economies but Indonesia – but the stabilisation still appears fragile, and further shocks seem possible. Stabilisation of exchange rate fluctuations therefore seems an important longer-term objective for the region – a point to which we will come back.

The modest successes of exchange rate stabilisation were bought, moreover, at the price of high interest rates (with the major exception of Japan, of course), which have exacerbated already massive debt problems. The crushing debt burden – both internally and externally – is the second major problem which has to be addressed. So far, the IMF rescue packages have only postponed, but not reduced this burden, which threatens to smother economic revival. It is clear that solutions will have to be found to remove this burden, be it through write-offs, securitisation or socialisation – but past experiences with debt problems in the Third World do not give much reason for optimism.

The third major problem is an urgent need for liquidity: much of East Asia is suffering from a severe credit crunch.[29] This probably means that solutions for the debt overhang will have to be found quickly, so as to enable the affected economies to reflate through injection of new money. Persistent problems in getting exports moving in the most afflicted countries show that there has been little progress on this, so far. Somewhat alarmed, the IMF has responded to this con-undrum by quietly relaxing its initially stringent requirements on public finance in Thailand, Korea and Indonesia.

Taken together, this complex challenge of exchange rate stabilisation, debt management and liquidity injection probably can be addressed meaningfully only through a concerted effort involving most major players in the crisis, both private and public. This effort would have to involve public policies (through decisions taken by the major industrialised countries and the governments in East Asia) and private actions (by banks and other private financial institutions), coordinated both between governments and between the public and private sectors (perhaps through the G-7 and APEC).[30]

Materially, Japan, the United States and Europe would need to make major contributions to such an effort. Japan is first in line: its own economic mismanagement has led to a contraction in economic activity and hence a major decline in imports. Japan needs to revive its own economy, and strengthen import absorption capacities through deregulation and liberalisation of those parts of its economy which have been protected

29. Cf. UNCTAD, op. cit., Ch. III and Orgy of Destruction: Focus Banking in Asia / IMF-World Bank, in: Far Eastern Economic Review, Oct. 1st, 1998, pp. 43 ff.
30. For a proposal along these lines, see Business Week, Jan. 26, 1998.

and sheltered from competition. To reflate its economy, Japan will have to overcome a serious lack of consumer confidence – and it is far from clear what policies would have to be pursued to overcome this diffidence.[31] The distortions in the Japanese economy (and particularly, but not only, in its financial sector) have also reached orders of magnitude which make corrections quite risky and difficult.

America and Europe would have to underwrite some of the debt write-offs, and would have to make sure that their markets will be kept open for exports from East Asia. Realistically, East Asia will need substantial current account surpluses for a number of years to deal with its problems. If protectionist measures in America and Europe unduly interfere with East Asian exports, the revival of growth in the region would be slowed, and American and European interests damaged, as well.

Institutional changes

Ambitious as this extensive agenda for crisis management may sound, it is far from sufficient to deal with the implications of that crisis. Events in East Asia have highlighted serious deficiencies and gaps in international financial infrastructure and institutions, which urgently need to be addressed. This has been discussed for some time under the heading of a »new financial architecture« for the world economy. The key elements in any such architecture would have to be a) the elimination of subsidies and corruption in investment and a strengthening of financial institutions in capital-receiving countries, b) a strengthening of international financial institutions in their capacity to monitor, preempt and contain future crises, and c) efforts by capital-supplying countries to reign in the volumes and volatility of capital exports. Here, too, realistic solutions would have to be developed through coordination of regulators and the industries involved.[32] A number of practical proposals have been floated, ranging from the „»obin tax« on international capital movements to mixed or wholly private insurance agencies.[33] To arrive at the desirable levels of transparency, supervision, and capacity to monitor and channel capital flows, however, governments would have to relax standards of national sovereignty considerably.

Beyond the development of global public infrastructure for financial markets, international monetary arrangements will probably need to be reviewed comprehensively. It is not clear, for example, what role the IMF should play in those arrangements, and how well-equipped it is to assume those tasks. Nor can the arguments against floating exchange rates be ignored much longer. In fact, it seems likely that a restabilisation of exchange rates will be one of the outcomes of the crisis in Asia, although the details of the arrangements inevitably still are uncertain. Such a restabilisation of exchange rates could result either from a recasting of the international monetary system (the most ambitious but also least likely path), through a combination of regional and global arrangements (such as a »snake« between the principal currencies, the dollar, the Euro and the Yen, combined with currency cooperation within each region), or, by default, through a regional currency arrangement in East Asia alone. If the latter route were to be chosen, this could spill over into the formation of a »hard« region – with the risk of a disintegration of the world economy into competing regional blocks and a serious confrontation between »Asia« and »the West«. ◀

31. Cf. Michael Ehrke, Japan: Unfähig, die Krise zu bewältigen? in: Internationale Politik und Gesellschaft 4/1998, pp. 413-422.
32. Cf. Wolfgang H. Reinicke, Global Public Policy, Governing without Government? Washington, DC 1998, pp. 118 ff and passim.
33 Cf. Soros, op. cit.; Dieter, op. cit., pp. 30 ff