

Regional monetary cooperation in post-1997 East Asia

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The East Asian region has suffered from a certain lack of confidence after the regional financial crisis of 1997-98. The earlier hubris, even conceit, following the apparent success of the 'East Asian Miracle' —sustained rapid economic growth for several decades — evaporated with the East Asian debacle, which came several years after the disastrous 'Japanese Big Bang', also due to ill-considered financial liberalization. East Asian developments, since then, especially greater regional cooperation, offer interesting lessons about its potential limitations. East Asian developments since then, especially greater regional cooperation, offer interesting lessons about its potential and limitations.

Let us begin by reviewing the East Asian Miracle, for which there are at least three major competing explanations. The dominant version in the 1970s and 1980s, presented sustained rapid growth in the East Asian region as essentially due to unfettered market forces. The obvious policy implication was to liberalize, as well as open up or globalize. In the late 1980s, this was challenged by an almost opposite, 'dirigiste' position, which emphasized the role of the so-called 'developmental state'.

The most influential study on the subject since, offering an intermediate view, came about due to a rather fortuitous change of circumstances. Most importantly, the devaluation of the US dollar and the appreciation of the Japanese yen following September 1985 made Japan the single largest contributor of official development assistant (ODA) for over a decade. Japan gently insisted that the World Bank might reflect on the fact that those who had followed the World Bank's 1980s' structural adjustment prescriptions were languishing in slow per capita growth, if not economic contraction, as well as greater inequality, as in much of Africa and Latin America. In contrast, East Asia, which had adopted more heterodox policies, had experienced sustained high growth, often with little worsening inequality until some switched to financial liberalization from the late 1980s.

The World Bank tried to 'co-opt' this potential theoretical challenge by distinguishing between 'functional' and 'strategic' state interventions. Functional interventions were justified by the concept of market failure. In the face of market failures, governments needed to intervene by providing sound macro-economic management, physical infrastructure, social services, particularly in health and education, and other basic state functions such as ensuring the rule of law, etc. For the Bank since strategic interventions were not justifiable in terms of market failure, they were bound to fail, and therefore, should not be pursued. Using moot methodologies, it proceeded to argue that trade policies as well as industrial policies had basically failed,¹ though the contribution of 'directed credit' was conceded in an exceptional chapter reputedly authored by Joseph Stiglitz.

There were, of course, other efforts to explain the 'East Asian Miracle', including heterodox perspectives invoking institutionalist, evolutionary, post-Keynesian

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perspectives, etc., but these were far less influential. Several influential Western authors had recast the Northeast Asian experience in terms of a 'developmental state' (e.g. Johnson 1982; White 1988; Amsden 1989; Wade 1990). The World Bank instead insisted on Northeast Asian exceptionalism, attributed to unique cultural ('Confucianism') and historical circumstances (e.g. Cold War), etc. Hence, Northeast Asia was deemed not suitable for emulation. Instead, Southeast Asia was promoted as the model for emulation by other developing countries, especially after the 'MIT' (Malaysia, Indonesia, and Thailand) economies' economic liberalization from the mid-1980s.

Responding, some heterodox economists from the region dissented, arguing that the World Bank's (1993) *The East Asian Miracle* volume failed to acknowledge Southeast Asia's inferior achievements. Our dissenting volume (Jomo and others 1997) was published the day before the East Asian financial crisis broke in Bangkok on 2 July 1997, and has been wrongly credited for having predicted the debacle, which it did not do. Rather, we argued that the Southeast Asian success was much more modest than that of Northeast Asia, and that the lessons being drawn from the region's experience were misleading, especially by its denigration of the role of government interventions in the region's economies. Furthermore, the average growth rate of the MIT economies, was about 6 per cent, compared to the average of 8 per cent for the East Asian newly industrializing economies before the 1990s. Also, with far higher population growth in Southeast Asia, the actual difference in per capita terms — over the two decades before the 1990s — was closer to three per cent.

In Northeast Asia, domestic financial resources were much more important, and foreign direct investment (FDI) accounted for less than two per cent of gross domestic capital formation or capital investment, whereas in some countries of Southeast Asia, FDI was far more important than in most other developing countries. Perhaps as a consequence, no significant industrial entrepreneurial class has emerged in Southeast Asia, which in turn accounts for the dominance of 'rentier' elements, particularly those associated with finance capital. Southeast Asia has also been far more unequal than Northeast Asia. Many reforms undertaken in Northeast Asia were anti-communist in inspiration, such as Japanese 'stakeholder capitalism' and the land reforms in Japan, South Korea and Taiwan. Such 'initial conditions' helped create more egalitarian fast growing economies in which more people felt they had a stake.

There have been important policy differences within the East Asian region. For instance, there have been very few trade policy interventions in Singapore and Hong Kong, not surprisingly then, Hong Kong has been de-industrializing for well over two decades. While Singapore's industrialization has been led by pro-active selective interventions to attract foreign manufacturers like other so called 'free trade areas', the region's too are preferential trade areas, while recent 'free trade agreements' have actually had little to do with traditional trade issues per se, but have had much more to do with strengthening intellectual property rights, investment incentives and other privileges which have mixed consequences for economic development.

Southeast Asia has inadvertently encouraged industrial dualism, where earlier attempts to promote import substituting industries have been followed by the promotion of export processing zones and licensed manufacturing warehouses. There is generally little integration of these manufacturing enclaves with the rest of the national economy, quite unlike Northeast Asia, where 'effective protection' has often been conditional on

‘export promotion’ — in other words, industries and firms have been provided with protection and other subsidies, but have also been required to export, so that production for the domestic market leads to production for export, unlike in Southeast Asia where there is little connection between the two.

The concept of market failure in economics assumes an inexorable systemic tendency to achieve equilibrium. But even if this is the case, achieving equilibrium has little to do with economic development. The concept of efficient market allocation is based on comparative statics, and not on structural transformation to achieve new comparative advantage in a dynamic sense. In the real world, achieving economies of scale are important, especially for economic development, rather than the constant, or declining returns assumed in economic models. The challenge is to identify and promote economic activities offering increasing returns to scale — as opposed to those only offering decreasing returns such as agriculture. This has been the premise for favouring industrialization and for promoting ‘infant industries’.

Over the 20th century, there was a secular long-term tendency for primary commodities’ terms of trade to decline against manufactured goods — as suggested over half a century ago by Hans Singer (1950) and Raul Presbisch (1950). The decline in the terms of trade of tropical primary commodities against their temperate counterparts — observed by Arthur Lewis, e.g. cotton versus wool — has also persisted over recent decades. More recently, in the last three or four decades, there has also been a significant decline in the terms of trade of ‘generic manufactures’, i.e. produced by industries with few entry barriers compared to products strongly protected by monopolistic ‘intellectual property rights’.

The success of well considered government intervention and its crucial role in ‘late industrialization’ and economic development all over the world are important reasons for insisting on industrial, or investment policy. Besides trade, there are other areas in which such policies have been important in East Asia, such as promoting new technology, improving human resources, offering appropriate investment incentives conditional on meeting performance criteria, e.g. effective protection conditional on export targets or promotion. Preferential credit for desired economic activities and the converse for undesired activities have been justified by the idea of ‘financial restraint’ — instead of the notion of ‘financial repression’ justifying ‘financial liberalization’.²

The ostensible philosophical basis for the ‘neo-liberal’ Washington Consensus — among the US government and the two Bretton Woods institutions, the International Monetary Fund (IMF) and the World Bank — is associated with 19th century English economic liberalism. But at the advent of the 20th century, the English liberal economist John Hobson recognized that the world had changed. The emergence of monopoly power and its political influence on public policy were the basis for his theory of imperialism, which Vladimir Illyich (Lenin) subsequently insisted was an inevitable consequence of capitalist development.

In a world of ‘imperfect competition’ then, profit maximization inevitably involves ‘rent seeking’. The key policy challenge becomes one of managing rents, of minimizing waste in the creation and distribution of rents.

‘Financial liberalization’ has been the corollary of the rise of ‘finance capital’ in the last three decades, especially after the demise of the Bretton Woods system, closely associated with the post-war Keynesian Golden Age when there was relatively rapid

growth, and some decline in inequality, not only internationally, but also within most economies, partly due to social policies in Europe and Japan.

Financial liberalization has had adverse consequences for the developing world, undermining financial arrangements, institutions and relations conducive to overcoming economic backwardness and market failure problems (Gershenkeron, 1962). To make matters worse, most advocates of financial liberalization have ignored the warnings of the gurus of financial liberalization. For example, Ronald McKinnon (1989) emphasized that correct sequencing is of the essence in pursuing financial liberalization, and capital account liberalization should come last, rather than first — as in some East Asian economies before the 1997-98 crises.

Financial liberalization seemed to be associated with the regional boom from the late 1980s. In much of Southeast Asia, a series of devaluations in the MIT economies and some financial liberalization in the mid-1980s was followed by a decade-long boom from the late 1980s until the 1997-98 crisis. There were three devaluations in Indonesia, one in Thailand, and another in Malaysia — with its devaluation against the US dollar³ reducing the value of the Malaysian ringgit by half against the Japanese yen. This series of devaluations made production costs much cheaper in the MIT economies attracting investments for the boom. But the US dollar pegs of the MIT currencies became more problematic after mid-1995, when Eisuke Sakakibara, then Japanese Vice Minister for International Affairs in the Ministry of Finance, and Larry Summers, then US Deputy Treasury Secretary, agreed to reverse the ‘endaka’ (high yen) by letting let the US dollar appreciate against the Japanese yen.

Other policy changes accompanying devaluation were also important for the boom in this region. The Japanese Ministry of International Trade and Industry (MITI) adopted a new Asia Industrial Development (AID) regional policy, encouraging Japanese firms to relocate, not only in the East Asian newly industrialized economies of South Korea, Taiwan, Hong Kong and Singapore, but especially in the Southeast Asian MIT newly industrializing countries as well as China. Towards the end of the Chiang Ching-kuo era and with Lee Teng-hui’s presidency in Taiwan province, the government encouraged Taiwanese companies to ‘move south’ to Southeast Asia, instead of the mainland, fearing problems from closer integration with the People’s Republic.

Korean efforts to relocate in Southeast Asia were much more modest and largely limited to Indonesia and Vietnam. Singapore’s Sijori (Singapore-Johor-Riau) growth triangle initiative with neighbouring Johor in Malaysia as well as Riau in Indonesia from 1986 was followed by other efforts to integrate with China (e.g. Suzhou) and India (e.g. Bangalore) with rather mixed consequences. Meanwhile, Hong Kong was de-industrializing, with manufacturing relocating to the Pearl River delta and beyond.

The impact of financial liberalization in East Asia has proved to be disastrous, starting with the fall-out of the Big Bang in Japan in the late 1980s and its near moribund economy in the decade and half since. Korea accelerated capital account liberalization to join the Organization for Economic Co-operation and Development (OECD) in the early 1990s, distorting the financial incentives for Korean conglomerate or *chaebol* behaviour, again with disastrous consequences. In Indonesia, bank proliferation from 1988 undermined monitoring and supervision with cataclysmic consequences. In Thailand, the post-coup 1993 Bangkok International Banking Facility (BIBF) and its 1994 provincial counterpart had problematic consequences culminating in the 1997-98 regional crisis.

After a serious banking crisis in the late 1980s, when the share of non-performing loans (NPLs) reached 30 per cent of the total commercial bank loan portfolio, the Malaysian authorities became more cautious with bank regulation. While careful about foreign bank borrowing, the Malaysian authorities aggressively promoted its stock market, especially after the break with the Singapore stock exchange in 1990. These successful efforts to promote the stock exchange in Malaysia attracted tremendous inflows of portfolio investment funds, particularly in the 1992-93 period, which were subsequently reversed with adverse consequences at the end of 1993. In early 1994, the Malaysian government temporarily introduced capital controls on inflows, which were subsequently removed after intense lobbying leading to a new stock market bubble in 1995-96 attracting fresh inflows.

But has international financial liberalization delivered on its own promises, even if not by developmental criteria? Advocates of international financial liberalization have made three major claims. First, there should have been flows of funds from capital rich to capital poor economies. But for most of Asia, Latin America, Africa, and the so-called ‘transitional economies’, the net flows of funds have actually been in the opposite direction, from the poor to the rich economies. East Asia was an exception in the early and mid 1990s, as finance followed investment and growth. Second, financial liberalization promised to lower the cost of funds. However, the cost of funds has not gone down, but actually went up until recently, increasing financial rents in the OECD economies. Third, financial liberalization also promised lower volatility and greater stability with financial deepening, especially with the development and availability of new financial derivatives. However, although some new financial derivatives have reduced some old sources of volatility and instability, they have also introduced new sources of the same. The most well known example has, of course, been the hedge funds (Brouwer 2001).

Two other adverse implications of international financial liberalization should also be mentioned here. Financial liberalization has generally meant that financial interests have become far more influential. They have influenced public policy, with typically deflationary consequences. The trend in the last two decades for having more ‘independent central banks’ has actually reduced the monetary policy discretion available to governments, besides reducing financial policy instruments for economic development. The recent emphasis on ‘inflation — rather than growth or employment — targeting’ has also resulted in slower employment expansion and growth by prioritizing deflationary macroeconomic policies. Financial liberalization has also undermined crucial financial ‘industrial policy’ instruments for accelerating industrialization and other desired structural transformations.⁴

Massive capital inflows are presumed to somehow have desirable consequences for economic growth, though there is little empirical basis for this. By their very nature, short-term inflows rarely contribute to real capital formation, and hence, to growth. Many East Asian countries have adopted monetary policies (e.g. ‘sterilization’) to limit the adverse consequences of massive capital inflows into their economies, but these also reduce possible gains from such inflows. The claim that such massive capital inflows would be desirable for economic development is thus misleading.

Instead, they have often had adverse consequences. First, there have been asset market bubbles — mainly stock market bubbles and real property market bubbles, and

consequently, associated construction booms, which have often worsened trade deficits. Second, consumption binges tend to be fuelled by cheap credit, e.g. the number of luxury cars sold in Thailand during the mid-1990s rose sharply. Not surprisingly, much of the elite and middle class like and support such financial policies, which do not contribute to and may even undermine the long-term development of these economies. Third, the availability of more and cheaper funds may encourage the misallocation of investment funds. While this may be true, their actual significance may be exaggerated by casual empiricism citing misleading anecdotal examples⁵, as in East Asia.

Various circumstances contributed to the build-up to the 1997-98 crisis, including domestic as well as international financial liberalization and the mid-1995 Sakakibara-Summers reversal of the previous decade's dollar depreciation and rising yen. With this reversal, currency speculators began to look for new opportunities to take advantage of. With foreign credit cheaply available mainly dominated in US dollars, even by Japanese and European banks, powerful vested interests in Southeast Asia wanted their currencies to continue to be pegged to the US dollar, although such pegs would now render the Southeast Asian economies less competitive.

The foreign debt building up was mainly short-term, rather than long-term, even when deployed for long term investments, primarily due to the Bank of International Settlements' capital adequacy requirements encouraging short-term lending. Stock markets in so-called 'emerging markets' have been especially fickle and vulnerable to 'herd behaviour' by portfolio investors. Significant build-ups of foreign assets in regional markets increased the likelihood of contagion from abroad. In Southeast Asia, such 'external shocks' were exacerbated by the official policy responses of authorities in the region, often seriously compromised by influential vested interests, though such 'cronyism' alone could not have caused the debacle.

Such economic vulnerability had been greatly increased with ill-considered economic liberalization policies, especially financial liberalization. Also, the initial policy responses in the region to the unfolding crises were generally 'pro-cyclical', as recommended or required by the international financial institutions, especially the IMF, and desired by 'market' pundits in the business media. Such pro-cyclical policy responses exacerbated the situation in Southeast Asia. Western-trained economists had imbibed currency crisis theories which did not take into account the different circumstances in the region, for instance, in contrast with Latin America. Also, many policies recommended to — or even forced upon — governments in the region were politically biased. For instance, the IMF favoured the 'Berkeley mafia' in Indonesia, and largely acted in concert with them rather than on the basis of an informed independent assessment of actual conditions in Indonesia and their causes.

By early 1998, however, it was clear that IMF 'solutions' were part of the problem, and there was a significant shift away from the original 'currency crisis' diagnoses of the Asian crisis. Instead, Asian values and business practices were blamed, especially poor 'corporate governance'. Thus, social capital and corporatism were instead viewed as 'cronyism', and profit maximization became rent seeking, as the earlier alleged bases for the East Asian miracle were turned on their head.

In the first year of the crisis, the tendency among pundits, particularly in the international business press, was to blame the victims — to condemn the East Asian economies for alleged malpractices, etc. In the third quarter of 1998, US President Bill

Clinton and others started talking about the desirability of a new international financial architecture, implicitly recognizing that the international monetary and financial system had developed in an ad-hoc fashion after the Bretton Woods system was destroyed by President Nixon in 1971.

This change of heart seemed to have been encouraged by the apparent spread of the crisis to Russia in August 1998. The crisis in Russia precipitated the collapse of the Long-Term Capital Management (LTCM), a hedge fund based on the 1997 Nobel economics laureate winning financial investment model. Fear that the LTCM collapse would have major repercussions on Wall Street encouraged the US Federal Reserve (Fed) to coordinate a bail-out of LTCM by private parties. The US Fed then lowered interest rates -- reversing the outflow of funds from East Asia -- in the last quarter of 1998, helping economic recovery in the region.

Economic recovery in the following period, especially in 1999 and 2000, was strongest in South Korea. In Southeast Asia, the recovery started later, but was stronger in Malaysia — compared to Thailand and Indonesia. When the Malaysian government introduced capital controls in September 1998, orthodox economists insisted that the measures would be disastrous. Although it is not possible to definitively attribute Malaysia's strong recovery to the capital controls, there is also no proof that the capital controls caused any significant harm to the Malaysian economy (Jomo 2003).

We now live in very different international circumstances from earlier times, particularly during the boom years in East Asia since the 1960s. In the 1990s, for instance, more than 80 per cent of foreign direct investment consisted of mergers and acquisitions (M&As) —mainly acquisitions, rather than mergers, presumably, in emerging markets, World FDI also declined from the mid-1990s. Much more FDI to East Asia now goes to China, with the proportion rising in less than a decade from under two fifths over two-thirds.

China's labour surplus economy has meant that its productivity gains have translated into consumer price deflation there. Consequently, China has become even more competitive, especially with its improving industrial policy initiatives. Thus, contrary to conventional wisdom, a state-owned enterprise (SOE), Bao Steel has become the most efficient steel producer in the world, overtaking Pohang Steel Corporation (Posco), the Korean SOE, once denounced by the World Bank as unviable. China has thus become an increasingly diverse formidable and versatile economic force, not only in the region, but in the world.

Lessons from the Crises

Drawing from the experiences of the 1997-8 East Asian crises, six major lessons for international financial reform can be drawn. First, existing mechanisms and institutions for financial crisis prevention are grossly inadequate. The continuing trend of financial liberalization is likely to increase — rather than decrease — the likelihood, frequency and severity of currency and financial crises. Outside Malaysia, there has been too little done to discourage short-term capital flows and too much faith in the expected protection from international adherence to codes and standards (Rodrik 1999).⁶ South Korea has joined Japan, China, Taiwan, Hong Kong and Singapore in building up huge foreign currency (mainly US dollars) assets, at great cost, for 'self-insurance'. This regional trend has also reduced the role and influence of the Fund in the region following its bitter

experiences during the 1997-8 crises. Financial liberalization has reduced the macroeconomic instruments available to government for crisis aversion, and has often left governments with little choice but to react pro-cyclically, tending to exacerbate economic downturns. National macroeconomic policy autonomy needs to be assured to enable governments to intervene counter-cyclically to avoid crises, which have generally had much more devastating consequences in developing countries than elsewhere.

Second, existing mechanisms and institutions for financial crisis management are also grossly inadequate. The greater likelihood, frequency and severity of currency and financial crises in middle-income developing countries in recent times — with devastating consequences for the real economy and also for ‘innocent bystanders in the neighbourhood’, as in the East Asian crises — makes speedy and effective crisis resolution imperative. There is an urgent need to increase the availability emergency financing during crises and to establish adequate new procedures for timely and orderly debt standstills and workouts.⁷ IFIs, including regional institutions, should be able to provide adequate counter-cyclical financing during crises (Ocampo 2000).⁸ Instead of current arrangements which tend to privilege foreign creditors, new procedures and mechanisms are needed to ensure that they too share responsibility for the consequences of their lending practices.

Third, the agenda for international financial reform needs to go beyond the recent preoccupation with crisis prevention and resolution to address the declining availability and provision of development finance, especially to small and poor countries (Ocampo 2000), which have very limited and costly access to capital markets. There is growing pressure on the IMF, in particular, to return to its supposedly ‘core function’ of providing emergency credit and ‘core competencies (*sic*)’ of crisis prevention and mitigation.⁹ Furthermore, the World Bank and other multilateral development banks have either abandoned or sharply reduced industrial financing, for example, further limiting the likelihood of developing countries securing funding to develop new manufacturing capacities and capabilities. The United Nations Conference on ‘Financing for Development’ in Monterrey in March 2002 did not adequately address this challenge.

Fourth, inertia and vested interests stand in the way of urgently needed international institutional reforms. There is a need to reform the governance of existing international financial institutions to ensure greater and more equitable developing country participation — and hence, ownership — in operations, research and decision-making at all levels in various tasks — old and new — which the international financial system must begin to address more adequately. There is also a related need to reduce the concentration of power in, and of, some peak institutions, such as the International Monetary Fund (IMF), by delegating authority to other agencies (e.g. a World Financial Organization [WFO] or Authority [WFA]), as well as by encouraging decentralization, devolution, complementarity and competition (with other IFIs including regional IFIs).¹⁰

Recognition of the exaggerated effects of currency movements at the international level should encourage greater surveillance and cooperation among the three major international currency issuers, but unfortunately, there is little evidence that the G7 or other similar arrangements have had much success in international macroeconomic, or even just monetary coordination. A greater role for the IMF in this regard, especially with greater voice for developing country interests assured, can go a long way with a great deal more legitimacy than an arrangement which only involves the major industrial

economies. Through the IMF, which they control anyway, the G7 can more effectively consult developing countries in matters of international economic governance to avoid insensitive and potentially important oversights as well as further loss of legitimacy (Rodrik 1999).

Fifthly, the reforms should restore and ensure national economic sovereignty and autonomy — which have been greatly undermined by international liberalization as well as regulation — that is essential for more effective macroeconomic management and development initiative. Policy conditionalities¹¹ accompanying IMF financing must be minimized, if not eliminated altogether. It is now very clear that ‘one size does not fit all’ and externally imposed policies have not contributed much to either economic recovery or growth (Weisbrot and others 2000; Weisbrot and others 2005), let alone sustainable development. Such ‘national ownership’ will ensure greater legitimacy for public policies and must include regulation of the capital account as well as choice of exchange rate regime.¹² Since it is unlikely that international financial reforms in the foreseeable future will adequately provide the ‘global public goods’ and other international financial services needed by most developing countries, it is imperative that while reforming the international system to better serve their needs, national policy independence is also assured to better address regulatory and interventionist functions beyond global and regional purview.

Finally, there is growing appreciation of the desirability of regional monetary cooperation in the face of growing capital mobility and the increasing frequency of currency and related financial crises, often with devastating consequences for the real economy. It has been argued, for instance, that growing European monetary integration in recent decades arose out of governments’ recognition of their declining sovereignty in the face of growing capital mobility, especially after their capital accounts were liberalized (Baines 2002). Instead of trying to assert greater national control, with likely limited efficacy, cooperation among governments in the region was considered more likely to be effective in the face of the larger magnitude and velocity of capital flows. However, there is no single formula or trajectory for fostering such cooperation, and it is unlikely that such cooperation can be successfully promoted independently of cooperation on other fronts.

The existence of such regional arrangements also offers an intermediate alternative between national and global levels of action and intervention, and reduces the otherwise likely monopolistic authority of global institutions or arrangements. To be successful and effective, such regional arrangements must be flexible, but credible, and capable of effective counter-cyclical capacity for crisis prevention as well as management. In East Asia, the Japanese proposal for an Asian monetary facility soon after the outbreak of the East Asian currency crises could have made a big difference in checking and managing the crises, but was blocked by Western opposition. With the growing reluctance in the West — especially by the USA — to allow the IMF to serve as a ‘lender of last resort’ (as in the more recent Argentine crisis), there should be more tolerance of regional cooperative arrangements as alternatives for securing international cooperation on monetary and financial affairs.

Regional Financial Cooperation

East Asia was historically viewed for many centuries as coinciding with the sphere of influence of the Chinese empire, especially during the era of the Ming voyages of Zhuang He (Cheng Ho) six centuries ago. From the 1930s, Japanese militarist fascism promised a Greater East Asian Co-Prosperity Sphere, encouraging collaborator nationalisms in Southeast Asia against Western colonial rule. More recently, Japanese economic hegemony in East Asia since the 1960s has been increasingly challenged by the recent economic resurgence of China.

The Southeast Asian region has long been seen as a residual category, lying at the margins of or beyond China as well as the Indian sub-continent, both geographically as well as culturally with its polyglot cultures as well as diverse Western colonial boundaries. The South East Asian Treaty Organization (SEATO), an American Cold War creation, was mainly Southeast Asian in name. The Association of South East Asian Nations (ASEAN) was ostensibly set up in 1967 to promote economic and cultural cooperation, though it has little to show on the latter front to this day. The first ASEAN industrial projects were Japanese-financed after a spate of anti-Japanese protests in the region in the mid-1970s, while agreement to create the ASEAN Free Trade Area (AFTA) only came in 1992.

Ironically, ASEAN has become less relevant as a Southeast Asian organization as it declared victory following the end of the Cold War by allowing Vietnam, Laos, Cambodia and Myanmar (Burma) to join its ranks. By the late 1980s, following the yen appreciation, the East Asian region was poised for greater regional cooperation despite lingering resentment of Japanese hegemony, due to its unwillingness to atone for its wartime record. In response to the failure to conclude the Uruguay Round of GATT (General Agreement on Tariffs and Trade) negotiations in December 1989, Malaysian Prime Minister Mahathir famously called for an East Asian Economic Grouping (EAEG). Earlier, Japanese Prime Minister Nakasone's proposal for East Asian economic cooperation had been referred to the US for approval by the Australian government. The US response was to insist on 'Pacific rim' cooperation in the form of APEC (Asia-Pacific Economic Cooperation), which has little to show for itself after a seemingly promising start in the mid-1990s.

The experience of the 1997-98 East Asian regional financial crisis and the international responses to it has profoundly reshaped the region. This is apparent not only in the greater official interest in East Asian — as opposed to Asia-Pacific or Pacific rim — regional cooperation in recent years. ASEAN itself may have lost some of its earlier relevance and dynamism following its expansion to include the Indochinese countries of Vietnam, Cambodia, Laos and Myanmar (Burma) and as the ASEAN Free Trade Area (AFTA) has failed to deliver on the unrealistic expectations it generated earlier.

Yet, the seemingly awkward 'ASEAN + 3' East Asian regional arrangement — including the ten ASEAN members, China, Japan and the Republic of (South) Korea — has quickly attained an unexpected relevance in both political as well as economic spheres. Admittedly, the European attempt at engaging East Asia through the Asia-Europe meetings (ASEM) has not yielded much, beyond the usual predictable pious statements and a number of formal institutional initiatives, but ASEM's fate may well be a reflection of the difficulties of engaging two rather different and varied regions.

The decline of APEC has been apparent since the second half of the 1990s. In 1995, the Osaka summit checked and ameliorated some of the commitments to regional

economic liberalization made only a year earlier. The Western, especially American, response to the regional financial crisis from July 1997 only served to deepen the Pacific gulf. East Asians even perceived some western glee at the end of the Asian miracle following the Japanese slowdown after its financial ‘big bang’ less than a decade earlier, as both IMF and market responses quickly blamed the East Asians themselves for the debacle.

Initially, the East Asian problems were portrayed as similar to those of Latin American ‘macroeconomic populism’ involving ‘fiscal profligacy’. The crisis economies were advised or even forced to adopt contractionary fiscal and monetary measures, which only served to exacerbate the crises, instead of providing counter-cyclical impetus. After it became abundantly clear that the East Asian macroeconomic authorities had been fiscally prudent, at least the IMF reversed itself on fiscal policy, but continued to press for tight monetary measures as the only option consistent with continued capital account openness.

By early 1998, however, the refrain of the Washington Consensus had changed. In a succession of speeches at the beginning of the year, US Federal Reserve Board chair Alan Greenspan, US Deputy Treasury Secretary Larry Summers and IMF Managing Director Michel Camdessus pronounced the new mantra, blaming the crisis on poor corporate governance in East Asia. Soon, the media and academic pundits were waxing eloquent as the East Asian Miracle’s ostensible basis in Confucian cultural or ‘social capital’ came to be denounced as the crisis’s purported roots in ‘cronyism’ and the like.

Regional responses may actually have reflected growing nationalism in the region as the absence of helpful responses by the West caused consternation and resentment. This was especially pronounced in long-time US allies such as Thailand and South Korea where the ruling regimes were replaced by their main political opponents. In Thailand, the political discourse turned decidedly nationalist on all sides as the crisis provided a rallying point previously absent in the kingdom which had never been formally subjugated by any colonial power. In South Korea, the already strong nationalist discourse broadened from its previous anti-Japanese focus, but was also mixed with strong democratic and anti-chaebol (conglomerate) impulses.

In Malaysia too, Prime Minister Mahathir’s unorthodox policy responses successfully played to a nationalist gallery, disguising his use of state resources to save business cronies and the pre-emptive elimination of his designated successor, generally perceived as the only available political alternative in the long-standing ‘one-party’ state. In Indonesia, where the crisis was most protracted and economically damaging, expectations of foreign assistance were less significant than the opportunity to get rid of a 32 year old military despot and his privileged business cronies.

The Japanese response was very different. In September 1997, soon after the regional crisis began in Thailand on 2 July, the Japanese Ministry of Finance proposed a \$100 billion Asian monetary fund or facility — dubbed the AMF — to help authorities in the region cope with the crisis. The initial official Chinese response is reported to have been negative as they had not been consulted prior to the announcement and may have been wary of Japanese intentions of strengthening regional hegemony through the AMF, but the Chinese authorities have since been keen on such regional cooperation. Japanese International Finance Vice-Minister Eisuke Sakakibara had presumed US support for the scheme after briefing his counterpart, Larry Summers, but instead faced rebuffs from the

US as well as the IMF after the announcement. Instead, the US then convened but offered few resources to the Manila Framework Group in November 1997, which had little perceptible effect as conditions continued to deteriorate.

Only in mid-1998, a year after the crisis began, did the Clinton administration begin to raise the need for a 'new international financial architecture', to better avert and manage the increasing frequency of currency and financial crises following international financial liberalization after the demise of the Bretton Woods system in the early 1970s and the 1980s' international (sovereign) debt crises.

But, there is nothing like a crisis to focus the mind. The Russian crisis of August 1998 moved the US to action. Besides the need to prop up the Yeltsin regime after more than half a decade of economic collapse never before seen in modern times, there was a palpable fear that the East Asian crisis was spreading west, and threatened other economies closer to home. US Fed coordination of the initiative to contain the collapse of the hedge fund, Long Term Capital Management (LTCM) following the Russian crisis was awkward to explain after the preceding criticism of Asian bail-outs as evidence of cronyism. Soon after, the Fed lowered interest rates, encouraging funds to flow back to the region, stabilizing its currencies and facilitating a sharp V-shaped recovery except in Indonesia where new political dynamics compromised the economic recovery effort.

At the annual IMF-World Bank meetings in October 1998, Japanese Finance Minister Miyazawa's new initiative for Asia was warmly welcomed by the US as the prospect of Latin American crises loomed large. The quid pro quo was for Japan to fund a new short-term IMF facility to bail out Latin American countries as the US Congress appropriated \$18 billion for an IMF capital increase (Tadokoro 2003: 232). The Miyazawa initiative offered bilateral assistance of up to \$30 billion in the form of loans and credit guarantees to help revive the region's crisis-hit economies. Most importantly, it complemented IMF assistance and was not linked to any alternative multilateral institutional framework for regional cooperation on monetary and financial matters. In the following year, the Japanese established currency swap backup facilities to the South Korean and Malaysian central banks.

From 1999, the ASEAN+3 finance ministers began meeting annually in conjunction with the Asian Development Bank (ADB) board of governors meetings (Amyx 2002). At their second meeting in Chiang Mai in May 2000, they announced new arrangements to increase liquidity in the event of future currency crises by expanding the pre-existing ASEAN Swap Agreement and setting up a bilateral currency swap network involving Japan, China and South Korea. Efforts have also been made to enhance related monitoring, surveillance and training. However, countries need to have an IMF-supported programme in place before they can avail themselves of more than 10 per cent of the available funds. Thus, the funds actually available are even less and can barely be expected to withstand concerted speculative attacks. Most importantly, the arrangements remained formally bilateral, rather than multilateral, with many of the bilateral currency swap agreements still not actually signed yet! Finally, in May 2005, the ASEAN+3 finance ministers agreed to multi-lateralize the arrangement to enable the relevant bilateral agreements to be collectively activated more promptly in case of emergency. In May 2007, the finance ministers of Japan, China and the Republic of Korea agreed to multilateralise the arrangement and to double the available funds. However, no mention was made as to whether the IMF-supported programme requirement remains.

The memory of the Asian crisis lingers on and has encouraged several East Asian economies to develop 'self-insurance' arrangements against the threat of currency crisis by accumulating huge foreign exchange reserves, mostly held in the form of US Treasury bonds. Such self-insurance is undoubtedly very expensive, not only because of the low interest rate accruing to the bonds and the continuing decline of the greenback in recent years, but also because it diminishes funds which might be better deployed for more productive purposes in the economy concerned or in the region. Recognition of the continuing problems of global and regional hegemony has animated recent debates about other possible alternative arrangements.

The Asian bond market was launched in mid-2003 by the Executives' Meeting of the East Asia-Pacific central banks (EMEAP). They launched a one billion dollar Asian Bond Fund to invest in US dollar sovereign and quasi-sovereign bonds issued in EMEAP countries except Japan, Australia and New Zealand. Later that year, the ASEAN+3 launched the Asian Bond Market Initiative to provide the necessary infrastructure for a well-functioning regional bond market. Subsequent developments suggest slow, but steady progress in local currency bond market development (Chin 2005). Further development of the Asian bond market will broaden financial intermediation within the region, encouraging the recycling of funds within the region without strengthening the banking sector, while reducing vulnerability to currency mismatch problems.

The two main regional initiatives thus far — the elaborate bilateral currency swap arrangements for liquidity support and the regional bond market — hardly threaten global hegemonic interests. In fact, development of the regional bond market has secured support from those 'outside the region who are eager to benefit from its expected by-products, including financial liberalization and reform in ASEAN+3 economies' (Amyx 2004: 3). After all, the US dollar remains the anchor currency for most Asian monetary authorities maintaining currency pegs.

However, the region, especially China, is also very mindful of the likelihood of Japan using regional initiatives to its own advantage. During 2001-2, Japanese Finance Ministry officials seemed to be trying to use the ASEAN+3 cooperative framework to promote a yen-centred regional exchange rate regime. The promotion of the yen as the region's common currency was seen as an attempt to revive Japanese financial markets, i.e. to promote 'regional integration through the prism of Japan's national interests rather than through the prism of greater regional collective interests' (Amyx 2004: 9).

In early 2005, the Executive Secretary of the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) proposed the creation of an Asian Investment Bank (AIB), patterned after the European Investment Bank, to more effectively mobilize private funds to finance the region's annual infrastructure financing needs, estimated by the Japan Bank for International Cooperation (JBIC) at around \$200 billion. The existing Asian Development Bank (ADB), also initially proposed by ESCAP's predecessor and now widely seen as controlled by the Japanese Ministry of Finance, currently provides about a quarter of that amount on concessionary terms. Such a regional infrastructural investment financing facility — drawing on private sector funds, but available to sovereign borrowers on better terms than otherwise available on commercial financial markets — can also increase financial intermediation within the region besides helping to recycle funds for more productive uses.

A major problem in East Asia is relatively poor understanding of and little agreement on past successes as well as failures. This has meant that post-crisis economic liberalization policy reforms have sometimes continued despite increasing international criticisms of the Washington Consensus. There is also far too little meaningful regional cooperation in East Asia cognizant of the region's diversity, characteristics and environment.

We need to better understand our circumstances and conditions. We need to better understand our past in order to better comprehend the present and prepare for the future. To do so, we will not only need much more critical understanding, but also much more original and creative thinking to better chart economic policy for the region. We need to create the conditions for continued economic growth and transformation to sustain economic development and to ensure greater justice in the region by reducing inequalities. With greater global awareness, we will need to address not only disparities within countries, but also among countries in the region, and between the region and the rest of the world.

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Endnotes

¹ An exceptional chapter — authored by Joseph Stiglitz, who won the Nobel Prize for economics in 2001 — acknowledged that 'directed credit' had succeeded.

² In 1973, Edward Shaw (1973) and Ronald McKinnon (1973) developed their critique of 'financial repression' based on the case of Korea in the 1960s. Ironically, contrary to what their works suggest, savings and investment rates actually rose in the peninsula despite its ostensibly repressed financial system, which had emerged under the military dictator General Park Chung Hee.

³ The devaluation of the US dollar during the second Reagan administration is now being emulated by the second George W. Bush administration in yet another attempt to try to devalue its way out of the current problems of the US economy following Nixon's withdrawal from — and destruction of — the Bretton Woods system in 1971 and the Plaza (Hotel) accord of September 1985.

⁴ In Singapore, which has not had much in terms of trade policy, financial policy has seen the emergence and growth of institutions such as the Development Bank of Singapore (DBS), in its early role, while other financial policies have also been important for ‘catching up’.

⁵ It made sense to invest in D-RAM production in the late 1980s, when a unit price well over US\$80. Not surprisingly, a great number of Korean and Taiwanese firms went into D-RAM production, driving down the unit cost to under \$2 by the mid-1990s. With the benefit of hindsight, it is easy to criticize ‘over-investment’ or misallocation of resources, but that was certainly not foreseeable at the time of investment. In any case, pro-cyclical market tendencies (e.g. capital following growth, finance following investment) tend to exacerbate such problems.

⁶ Pistor (2000) has demonstrated that international legal standards are unlikely to have the desired outcomes owing to the significance of historical “original conditions” and varied “path dependence”.

⁷ There is a growing consensus on the need to set up standstill and other procedures for international debt workouts akin to US bankruptcy provisions for corporations and municipal authorities, though the Krueger (2002) proposals have not been well received by those governments most likely to be affected by them owing to the ‘adverse selection’ consequences for them.

⁸ Social safety nets should not be seen as a substitute for social policy, which should be adequate to ensure a decent standard of living within a government’s means besides developing human resources for development.

⁹ Then US Treasury Secretary — and former World Bank Vice President and Chief Economist — Lawrence Summers is a prominent proponent of this view, e.g. see his speech at the London Business School on 14 December 1999, reported in the *Financial Times* the next day. The full text is available at www.lbs.ac.uk/news-events/scripts/summers.

¹⁰ As Ocampo (2000) put it, “The required financial architecture should in some cases have the nature of a network of institutions that provide the services required in a complementary fashion (in the areas of emergency financing, surveillance of macroeconomic policies, prudential regulation and supervision of domestic financial systems, etc.), and in others (particularly in development finance) should exhibit the characteristics of a system of competitive organizations.”

¹¹ They have been shown to be ill informed, erroneous and irrelevant to the problems at hand, besides exacerbating the crises in East Asia.

¹² Interestingly, then IMF Senior Deputy Managing Director Stanley Fischer (2001) admitted that “willingly or otherwise, a growing number of countries have come to accept [the belief that intermediate regimes between hard pegs and free floating are unsustainable]... Proponents of the bipolar view — myself included — have perhaps exaggerated their argument for dramatic effect.”

Supplementary remarks on:

IMF’s two faces: counter-cyclical for developed countries, pro-cyclical for developing countries

IMF surveillance: from 1977 to 2007 (from June to August)

The role of the IMF in multilateral lending and conditionality: Turkey and Africa

Changing IMF governance; enhancing developing countries’ voice and participation