

Extended Review Article

**THE EAST IS IN THE RED:
FROM ECONOMIC MIRACLE TO ECONOMIC
CRISIS IN EAST AND SOUTHEAST ASIA**

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Seiichi Masuyama, Donna Vandenbrink, and Chia Siow Yue eds. *Restoring East Asia's Dynamism*, ISEAS, 2000, xxvii + 319 p. ISBN: 9812301062 (hbk); 9812301054 (pbk).

Iyanatul Islam and Anis Chowdhury. *The Political Economy of East Asia: Post-Crisis Debates*, Oxford 2000, x + 278 p. ISBN: 0195540905.

Pasuk Phongpaichit and Chris Baker. *Thailand's Crisis*, ISEAS, 2000, viii + 275 p. ISBN 8787062887 (pbk).

Peter Boomgaard and Ian Brown ed. *Weathering the Storm: The Economies of Southeast Asia in the 1930s Depression*, ISEAS, 2000, xiv + 332 p. ISBN: 9812300791 (pbk).

Earthquakes occur where the plates that compose the earth's surface meet. The Pacific Ocean is defined by these meeting places, and thus surrounded by regions subject to earthquakes and vulcanism. The emerging market financial crises of 1997/98 – of which Asia's crisis was both a trigger and a major component – similarly erupted when what were then the two most powerful economies in the world collided with each other as well as with what were then surprisingly dynamic local economies. America and Japan each sought to impose its vision of proper economic policy on dependent economies in East Asia; each sought to make its influence permanent by shaping a network of public and private institutions; each sought solutions to its own internal economic problems. Meanwhile Southeast Asian states and elites were looking for ways to sustain a quarter century of rapid growth in the face China's emergence as the premier low wage exporter. Because the emerging markets crisis derailed a quarter century of economic growth in Southeast Asia, and because in retrospect it was a harbinger of the end of the information technologies boom, its causes and consequences deserve careful attention.

Each of these four books tries to make sense of a piece of the current crisis, or its mirror image in the 1920-1930s Depression. *Weathering the Storm* tries to make sense of and provide an accounting for the quite diverse effects the Depression had on different regions of Southeast Asia. *The Political Economy of East Asia (PEEA)* provides an overview of development economists' arguments about what went right in Southeast Asia until 1997 and then what made things go wrong. *Restoring East Asia's Dynamism (READ)*, despite the title, collects detailed sector and country level responses to the crisis rather more than providing a set of prescriptions for recovery. Finally *Thailand's Crisis* excavates 1997's Ground Zero in a detailed account of the political, economic, and social origins and consequences of the crisis. While each is fine in its own right, and while each illuminates differing pieces of the financial crisis puzzle, none captures well the underlying causes of the crisis.

The historical record is the best place to start, because the current crisis has strong similarities to the past one. *Weathering the Storm* is an economic historian's book. Despite some nods by the editors towards lessons for the current crisis, most of the chapters resolutely avoid any comparison. Instead, almost all are preoccupied with simple data generation problems – what happened to whom, and when? Often the information needed to make an assessment, let alone a correct assessment, of what happened to peasants and peasant economies in Southeast Asia is missing. Colonial states either did not or could not collect statistics that might shed light on the most basic questions: Did real incomes fall or rise for most people? Was the state able to collect taxes, and from whom? Could lenders make good on their claims? Even when information is available it comes with the caveat: this may have been true here, in this particular region, but elsewhere possibly not.

The single loudest message from this book's essays thus is the diversity of local experiences. Some commodities and the peasants producing them were hammered by falling prices, but other commodities recovered. Falling prices for imported manufactured goods offset some of the fall in export income, particularly where colonial administrations abjured the use of tariffs to favor the metropolitan economy, so the propensity to consume imported goods affected families' real income trends. France unmercifully squeezed the peasants in its colonies, but the US colonial administration in the Philippines turned a blind eye to tax evasion; no explanation for the difference is provided. Everywhere peasants proved remarkably adept at shifting crops – though not always to winners – and at moving into new activities. Still, the overall message that emerges from these chapters is the closing of an era.

After all, from roughly 1890 to 1920 economies in Southeast Asia saw roughly the same kind of boom they would later experience from 1970 on. In both periods a shift from a set of mature leading sectors to a novel set of leading sectors induced a rapid expansion of production in Southeast Asia. Foreign and local capital and “foreign” and “local” workers rushed into rubber, copra, tin, rice, and petroleum production to take advantage of expanding demand in the European and US processed food and automobile industries. Just so Southeast Asian economies competed first to attract producers of labor-intense simple manufactures and later producers of somewhat more sophisticated electronics for the rapidly expanding information technology industries of the US, Japan, and Europe. In each period, Chinese

migrated to new production zones or linked those zones to export markets with infusions of commercial credit and access to their marketing networks, while other Southeast Asians migrated as workers or family farmers. In each period governmental authorities encouraged output expansion in a remarkably similar range of commodities. In each period, this government suasion, combined with cheap capital and easy entry into product markets, encouraged overproduction and financial crisis. Finally in both periods Japan contested US and European domination of the area at the same time that indigenous actors (then nationalist parties, now states) sought to define their own path.

The first contest for control over Southeast Asia turned into half a global war, with Japan's initial forays into China spiraling upward into open conflict for control over Southeast Asia. Geopolitics in the second crisis are complicated by Japan's declining economic fortunes and China's successes – Japan's fears of a united and hostile China in the 1920s and 1930s are echoed in the strategic preoccupation with China characterizing US policy until the World Trade Center attack in September 2001. Nonetheless, the third leg of the triangle – the salience of the economic relationship between Japan and the US in the 1920s and between China and the US in the 1990s – is similar. Both Japan and China needed exports to the US market to fund capital goods imports and dynamize productivity growth in local industries.

The second contest for control over Southeast Asia has not started any major power wars (at least, not yet). But precisely this competition for control between the US and Japan moved the tectonic plates that structured the 1990s crisis. Put briefly, the Americans and Japanese provided Southeast Asia with self-serving advice regarding the most appropriate industrial and trade policy, and this combined with American and Japanese trade conflicts to cause lethal levels of surplus capacity in Southeast Asia. In isolation, each set of policy recommendations would not have generated a crisis. Together, they created an unstable situation: the worst aspects of Japanese-style state support for investment funded by the most volatile sorts of short-term American-style capital flows.

During the 1980s Japanese investment in various Southeast Asian economies recreated their own vertical *keiretsu* structure in order to serve domestic markets in those Southeast Asian economies. At the same time, American political pressure to reduce the US-Japan bilateral trade deficit and US manipulation of the dollar-yen exchange rate motivated a relocation of Japanese electronics and consumer goods production away from Japan and towards Southeast Asia. Southeast Asian governments willingly accepted this surge of investment, which produced record growth rates in the 1980s and early 1990s. During this period relatively closed capital accounts and state bureaucracies able to resist social pressures for excessive credit creation gave Southeast Asian economies some degree of control over macroeconomic outcomes. But as the US trade deficit shifted from Japan to Southeast Asia and China, the US state began to pressure Southeast Asian economies to open up their capital accounts as part of a campaign to open all emerging market economies to US service exports.

The combination of efforts at Japanese-style *dirigisme* and American-style open capital flows made it attractive for local social groups to try to influence the state's control over investment flows. Newly rich entrepreneurs bid for control over state organs in order to continue the inflow of foreign

capital and privilege their own investments. Overseas investors, believing that the growth rates of the early 1990s were infinitely sustainable, rewarded those efforts by pumping roughly US\$420 billion into Southeast Asia in the 1990s, allowing a tripling of investment in those economies. Why didn't all this investment produce sustainable growth? Why did it instead produce surplus capacity and terms of trade that fell 20 percent from 1990 to 1997, and then an even more catastrophic fall in export prices from 1999 to 2001? These are the questions that *The Political Economy of East Asia* attempts to answer, but without much reference to the geopolitical or historical factors mentioned above.

Instead, and despite the title, *PEEA* provides a fine survey of what the development economics literature has to say about Southeast and East Asia. This survey is one of the best non-technical primers on development economics, with reference to East Asia. It unconsciously presents the clash of American and Japanese views through a structured consideration of the relative merits of arguments about developmental states – in which political economists claim that state direction can produce growth and that free trade conflicts with growth – against more purely neo-classical arguments in favor of letting markets alone and having a free trade policy stance. Although the authors display a slight bias towards neo-classical policy prescriptions, they do so because they can produce a reasonable argument that Southeast Asia does not possess developmental states, and because state intervention may only be a necessary condition for growth. They argue on theoretical grounds that government intervention, combined with a wrong-headed trade policy stance that penalizes exports, will not produce growth. In contrast, they say, the absence of government intervention combined with trade policy neutrality or export promotion will produce growth. Thus they argue that the right trade policy is sufficient for growth, so long as some minimally competent and stable state is present.

Politically, *PEEA* also argues that, regardless of the merits of the developmentalist case, unresolved ethnic conflicts, clientelistic politics, a weak bureaucracy, and an over-reliance on raw materials exports characterizes Southeast Asian states. Thus even if the developmentalist argument were right, and even if these states could promulgate a dirigist program like the Japanese or Korean ones, they would be unable to execute it. The authors, however, fail to explain how growth occurred despite these weak states in the period before the early 1990s, when states were more interventionist, and then began to falter in the mid-1990s, when – as we will see – these states became weaker and more exposed to clientelistic demands. Thus, like most of the other books surveyed here, *PEEA* ends up seeing the crisis primarily as a financial crisis. This leads the authors of *PEEA* to a fairly optimistic prognosis for Southeast Asia, even though they argue that the crisis has led to under-investment in the kinds of human resources that first made Southeast Asia an attractive place in which to invest, and that are crucial to any increases in total factor productivity. Precisely this kind of public under-investment in post-1982 Latin America helped produce a decade of stagnation, making Southeast Asia a relatively more attractive place for foreign investors. The authors' optimism also ignores the crucial role American demand played in Southeast Asia's initial successes, in Southeast Asian economies' resilience during the

crisis and in the sudden collapse of growth in 2001 (although to be charitable this occurred after the book was written).

Restoring East Asia's Dynamism is similarly Pollyannaish about the future. Based on a series of conferences organized with Japanese money and held in 1998, it tries to present an Asian view of the crisis by gathering scholars from preeminent regional think tanks. If I may condense ten quite detailed papers into a set of common conclusions, then the major points made in this book are that Asians do view the crisis differently if only because they locate the bulk of the blame for the crisis in global capital markets rather than in local failings, notwithstanding what all agree was "overhasty" liberalization of the capital account in the early 1990s. However, these authors also see excessive property speculation, moral hazard related to implicit government guarantees and non-arm's-length lending practices, and low productivity service sectors that exacerbated cost-push inflation as major local causes of the crisis. Finally, they accuse the IMF of pro-cyclic policies that aggravated the crisis.

READ also presents quite detailed suggestions for and analyses of specific countries. Among these perhaps the best is the analysis of Japanese automobile and electronics production chains in the appendices to chapter 9. These appendices clearly show the limits to local development strategies and the degree to which investment flows responded to changes in the yen-dollar exchange rate. They also show the limits to recovery strategies based on exports. The post-crisis combination of IMF fiscal restraint and local banks' inability to lend squashed domestic demand and meant that economic recovery rested almost totally on export growth. In the immediate post-crisis years, US investors and consumers made this strategy viable by pouring cash into information technology (IT) and internet firms. This caused a huge increase in demand for IT hardware, much of which was sourced from Asia. Indeed, Morgan Stanley estimates that 40 percent of GDP growth in non-Japan Asia in 2000 came from IT hardware exports to the US. On the supply side in Southeast Asia, expanding IT output also made sense, because the profitability of domestic market oriented operations using imported components plummeted. Exporters, by contrast, could translate the fall in local currency priced inputs into a slightly better price in world markets and still be profitable. Finally electronics were politically attractive to states trying to salvage continued growth and continued state control from the crisis: didn't it make sense to abandon low-wage, low-tech industries like clothing in favor of electronics, where the potential for technical and labor upgrading was so much greater? Wasn't this the best response to an inability to compete with China's unlimited supply of low-wage workers for labor-intensive, low-skill industries? Couldn't the state retain more direction over the economy by influencing a few large firms than by dealing with a myriad of small ones?

In short, everyone rationally responded to the crisis by expanding electronics output yet further. Thus, by 2000, electronics, largely semiconductor-related, accounted for 60 percent of Malaysia's exports and 42 percent of Malaysian GDP. Electronics occupied a similar position in Korea's economy, with semiconductor exports amounting to US\$21 billion in 2000 and information and communication equipment another US\$28 billion. Hyundai's old semiconductor subsidiary, Hynix, alone generated 4 percent of South Korean exports (after having accrued US\$4 billion in debt). IT

products accounted for 62% of Korea's increase in exports between 1997 and 2000. Regional giant Singapore also relies on electronics for more than half of its exports. Even one quarter of Thailand's exports (and one sixth of its imports) are electronics. All this exposed Southeast and East Asian economies to the vagaries of the US demand for IT goods. The near simultaneous collapse of the major stock markets and the World Trade Center buildings sharply drove down demand for and prices of electronics goods. Standard memory chip prices fell 80 percent in 2001, a sharper decline than that for any of the raw materials whose prices fell in the 1930s. Falling electronics prices shaved US\$21 billion off of South Korea's 2001 export revenues, an amount equal to 5 percent of GDP. GDP contracted in Singapore and Taiwan, led by falling industrial output in those two as well as in Korea and Malaysia.

From this perspective Asia's surprising dominance of global computer hardware has turned from a sign of its strength into a sign of its weakness. Having constructed economies based on external demand for IT hardware by suppressing domestic demand in favor of extraordinarily high savings rates (approaching half of GDP in Singapore's case), channeling that saving into semiconductor fabs (which cost roughly US\$2 billion each) and other forms of fixed capital, and holding enormous foreign exchange reserves (about US\$674 billion in East and Southeast Asia – to be spent on what?), how can they reorient their economies in the face of this larger crisis? Just as in the 1920s and 1930s, an individually rational response to the huge upsurge in demand created by a new leading sector has generated a collectively irrational level of overcapacity that will take years to work off. IT hardware with previously good prices and prospects suddenly seem to be just as much undifferentiated commodities as palm oil and rubber did in the Depression. Is all that has changed the leading sector?

Thailand's Crisis gives many reasons to think that this most recent running of the traditional business cycle also involves secular changes. This extremely well written book details the crisis from the inside out, with a much stronger emphasis on the domestic politics of the crisis than the other three books; indeed it could be said it offers an argument that political crisis preceded and caused economic crisis. The exclusive focus on Thailand is both its weakness and strength. After a very brief discussion of the economic causes of the crisis, the book launches into a series of topical chapters covering the politics of IMF policy recommendations, efforts at social policy, efforts at bureaucratic reform, and pre- and post-crisis political clashes over democratic reform and the (re-) distribution of power. There is not much effort to extend these discussions into comparisons with other Southeast and East Asian polities, but the discussion of Thailand itself provides many interesting points of possible comparison.

The authors of *Thailand's Crisis* lay out a dialectical argument about Thai politics in the 1990s. During the 1980s a relatively insulated state bureaucracy and a handful of banks connected to the state elite generated sustained economic growth based on raw materials exports. Powerful regional elites emerged from this growth and they sought to control the state and weaken the bureaucracy so that they could use the state to effect a self-transformation into an urban elite. Thus the 1990s saw a weakening of informal and bureaucratic controls against over-lending. At the same time, the rising power of these rurally based regional barons provoked a backlash from

the urban middle class, which sought to end the electoral and governmental corruption that sustained those rural barons. The authors see these urban movements as Thailand's first true mass movements, because Thailand lacked the colonial past that generated mass mobilization in the rest of Southeast Asia. The authors are somewhat pessimistic about Thailand's future, because they see no way to resolve these conflicts between old and new businesses, and old and aspiring centers of political power. In short, Thailand has experienced a massive structural shift in its economy and in its social relations, as an agrarian, village-centered economy has given way to a more anomic urban economy. Raw capitalism has arrived, and Thai political actors haven't quite figured out how to cope with the social dislocation this creates. To their credit the authors recognize that this change cannot be undone.

This depiction of Thailand thus provides another eerie historical similarity: in the late 19th century, conflicts between have and have-not elites in Argentina triggered the 1890 Barings crisis, which, like that of 1997, spread into a world-wide halt in lending to the emerging markets of the time. The same Barings that Nick Leesom felled in 1996 was caught short by an inflation unleashed by have-not elites seeking to capture capital gains from land speculation. The 1890s crisis also sparked a conflict between new urban middle classes and old rural elites over the nature of state power and the extent of democratic control over the state.

To sum up, these books are very good at seeing the trees, indeed sometimes the groves, but not so good at seeing the forest that constitutes the 1997-98 crisis. They end up being fairly optimistic because they largely see the crisis as a financial crisis, and not as the passing of an era of growth based on a one-time-only capitalization of the IT infrastructure in the rich countries. And, to an astonishing degree, they ignore the tectonic implications of continued Chinese growth, continued Japanese stagnation and the (tenuous?) continuation of US hegemony. All three factors limit the potential for recovery in the other economies of Southeast Asia. So too does the current unstable local political landscape.

China remains a formidable competitor in virtually all fields of basic manufacturing, as well as some surprisingly sophisticated fields where its state has bargained access to advanced technology. Its low wage levels will exert continuous downward pressure on prices because no matter how much output its large market absorbs, any productivity gains will translate into yet more available labor and prices will have to match local wages. China won't price itself out of markets for basic goods the way that Taiwan or South Korea did. The shrinking Japanese market also exerts downward pressure on prices, by removing what had been an important source of demand. The US need to pry open markets for its only competitive exports – services, entertainment, and infrastructure capital goods – means that the US will try to maintain post-crisis status quo in which finance is de-localized and local states are unable to direct the economy. Finally, the loss of the lodestone of the old Southeast Asian politics – political quiescence generated by high rates of growth that in turn entailed rising real wages and capital gains for old and new entrepreneurial elites – has left most social groups and political elites in a directionless conflict over the future.

All this is not to say that Southeast and East Asia has no future. There is probably a new high growth path to be found in supplying China with

things it cannot make or cannot make cheaply, or in being the best supplier of something needed for the continued, if slower, roll-out of the IT economy in the rich countries. This appears to be the strategy in Taiwan and Singapore respectively. But not everyone can be Taiwan or Singapore. In that sense the future will be like the past: the 1920s and 1930s depression also sorted out economic winners and losers in Asia, leaving some better positioned and some less so when the new growth wave came through. The current crisis, which started in 1997 and which is not yet over, is likely to do the same.