Foreward

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The Asian crisis was a once-in-a-lifetime event. It caused not only wrenching output losses and devastating financial repercussions but also soul searching across the region. An economic model that had made Asia the world's fastest growing region came under a cloud. The question to which the crisis ultimately pointed was whether an approach to economic development dominated by big banks, large corporations, government bureaucrats, and powerful families had outlived its usefulness.

The answer emanating from Washington, D.C. and a surprising number of Asian capitals was that the model needed to be comprehensively updated if not replaced outright. An approach based on high levels of capital formation, financed by keeping exchange rates and consumption low and importing financial capital from abroad, had been suitable for a period when the task at hand had been to direct as many resources as possible at the growth problem. State-led development worked well so long as growth was based on the acquisition from abroad of proven technologies, which were readily identified by bureaucrats. A model based on big banks and conglomerates had advantages when the immediate challenge was to grow the region's exports and more fully exploit economies of scale.

The crisis brought to the fore the idea that Asia had graduated to the stage where further increases in living standards depended on inventiveness as much as effort – "on inspiration as well as perspiration." But if Asia was now entering a new age of technological uncertainty, it was questionable that bureaucrats still knew better than markets how to allocate resources among competing uses. A market-based financial system more suitable for taking bets on competing technologies might have to replace the region's bank-dominated financial systems. The privileges accorded special interests and powerful families might have to be revoked in order to adequately reward innovators for their efforts.

In this context, the limited steps taken in the first half of the 1990s to update the model had decidedly destabilizing consequences. The deregulation of financial systems, not accompanied by the removal of government guarantees for the banks, led to an unsustainable credit boom rather than a more efficient allocation of financial resources. The liberalization of capital accounts, not accompanied by a shift toward more flexible exchange rates, led to excessive capital inflows that heightened financial vulnerability. Political and economic liberalization led to wage explosions, as previously corporatist labor unions flexed their economic and political muscles. In a sense, the Asian crisis was simply the precipitating event revealing that this half-way house was fundamentally unstable.

Yet it was not clear what form the new model would take. There were deep-seated historical and cultural reasons to believe that personal connections would continue to play a larger role relative to contractual relations than in the United States. It was not realistic to think that Asia would simply import, lock, stock and barrel, the model of arms-length transactions fashionable in that country. Similarly, while the desire for regional integration was reinforced by the experience of the crisis, regionalism would necessarily take a different form in Asia than in Europe, whose integration was shaped by its distinctive political history. If the end result was not yet clear, what was evident from the start was that the new model would be cast in a different mold than its U.S. and European counterparts.

The contents of this volume, presented at a conference hosted by Thammasat University in November 2002, allow one to hazard provisional answers to these questions. When the conference was held, almost exactly five years had passed since the onset of the crisis. The country studies and comparative analyses contained here thus allow one to form some impressions of how Asia has responded and what that response implies for the future development of its economy.

The chapters, as I read them, suggest three perspectives on these questions. First there is the macroeconomic perspective. In macroeconomic terms, Asia bounced back vigorously from its crisis. By 1999 growth was again strongly positive everywhere but in Indonesia. Korea grew by an astounding 10 per cent in 1999-2000. Growth in Thailand bounced back to a more moderate but still impressive 4.5 per cent. The post-NASDAQ slump in the global electronics industry, the recession in the United States, the SARS epidemic, the events of September 11th, uncertainty surrounding the U.S. war in Iraq, and the intensification of competition from China all complicated recovery in the crisis countries. This makes it particularly impressive how buoyant growth remained in the face of these disruptions and how persistent it has proved. In Korea, growth proceeded at 3 per cent in 2001, 6 in 2002 per cent and (an estimated) 2.5 per cent in 2003 (this last being the year of a short-lived recession). Comparable rates for Thailand were 2, 5, and 5 per cent, while those for Indonesia were 3, 4 and 4 per cent. (All figures are from the September 2003 edition of the IMF's *World Economic Outlook*.) That growth resumed at impressive rates compared to other regions, if not necessarily also relative to Asia's own history, and that it persisted at a time when recovery in the industrial countries was relatively weak raises questions about whether radical changes to the Asian model were really required.

A second perspective is the structural. Asian countries took to heart the need for structural reform to prevent the recurrence of financial crises. In particular, the countries of the region essayed far-reaching changes in their financial systems, suggesting that this was the aspect of the Asian model most urgently in need of updating. The initial response was modest: governments provided liquidity support to keep their financial systems afloat, closed some but not all weak financial institutions, and issued unlimited guarantees for bank liabilities. Subsequent efforts were more concerted: insolvent institutions were merged, closed or nationalized, public funds were provided for recapitalization, and nonperforming loans were transferred to centralized asset management corporations (later in Thailand than in the other crisis countries). Prudential supervision of lenders and transparency standards for corporate borrowers were significantly strengthened. Indonesia has moved toward consolidated supervision as recommended by the Basel Core Principles. Korea tightened its supervision of nonbank financial institutions. Thailand has begun to move away from its blanket government guarantee on deposits to limited deposit insurance. In all these countries, commercial bank profitability has begun to recover. Evidently, the result of these financial reform efforts is more efficient financial systems.

But reform of corporate sectors in these same five years has been less ambitious and successful. Many large corporations proved to be too large and too powerful, politically and personally, to be dismantled. Thus, while the Korean government made a statement by forcing several chaebols into receivership and seizing Daewoo, it also acceded to political pressure to provide support for a number of the country's largest conglomerates. In Indonesia and Thailand, bankruptcy systems favored debtors over creditors and slowed the process of corporate restructuring. Governments were also reluctant to force corporate liquidations threatening to create significant amounts of unemployment or to see nationalized banks and public asset management companies take losses that had to be borne by taxpayers and explained to their elected representatives. Thus, a challenge for the development of a coherent Asian model will be to meld a new, more market-led financial system with a still traditionally structured corporate sector.

The third perspective is that of regional cooperation. While by the mid-1990s Asia was already pursuing a number of cooperative initiatives, regional cooperation was less extensive and systematic than in either Europe or North America. The region's national political and economic systems being heterogeneous, leaders had to work hard to identify a common interest. And Asian countries' tradition of non-interference in one another's affairs raised questions about the viability of a regional arrangement predicated on strong mutual surveillance. Early efforts to respond to the crisis by creating an Asian Monetary Fund went nowhere. Subsequently, however, efforts to promote regional integration have gathered momentum. The Chiang Mai Initiative announced in the spring of 2000, creating a network of swap lines and credits among ASEAN+3 governments, was a significant step in the direction of mutual financial support. The Asian Bond Fund agreed to three years later similarly represents a significant effort to develop regional securities markets. Both initiatives start out small, but they can be ramped up quite rapidly if there is the political will, and specifically if the obstacles to stronger regional surveillance can be overcome. Note that by starting with swap lines and government bond purchases, the governments of Asia have chosen rather different foci for their integration effort than their European and North American counterparts. This suggests that Asia's model of regional integration, like its model of growth, will differ from those of other regions.

Little more than half a decade after the outbreak of the Asian crisis, the long-run implications of that event are still unclear. But it is clear that the crisis was a transformative experience – that existing modes of economic, political and social organization were permanently altered. At the same time, the economic, social and political models of other regions do not provide particularly useful guidance for thinking about how the Asian model will be remade. The contributions to this volume provide a starting point for thinking about these issues.