

MIRACLES OF THE DAY BEFORE?: THE GREAT ASIAN MELTDOWN AND THE CHANGING WORLD-ECONOMY*

RAVI ARVIND PALAT
Department of Sociology
University of Auckland

Rather than viewing the spectacular collapse of stock and currency markets in East and Southeast Asia as a financial crisis caused by imprudent banking practices and 'crony capitalism,' this article argues that the meltdown was caused by overproduction. The first section demonstrates that high levels of corporate debt was necessary for regional firms to become competitive in the most exacting markets. Till the early 1980s, the coordination of investment strategies by elite economic bureaucracies under the aegis of Japanese capital ensured the creation of a regional division of labor. The very success of these strategies, however, rendered the regulatory frameworks progressively anachronistic. In a deregulated environment, the continued pursuit of capturing market shares through debt-led industrialization strategies led to chronic overproduction on a world scale and the crisis manifested itself along Asia's Pacific Rim only because it was most rampant there.

When the rest of the world are mad, we must imitate them in some measure.

- John Martin (1720).¹

No one foresaw that the Thai government's decision to float the baht on July 2, 1997 would be the tripwire to trigger a breathtaking collapse of economies along Asia's Pacific Rim just as they appeared poised to overtake the historically richer states of Western Europe. Led by Japan, economies along the ocean's eastern shores had transformed their muddied paddy fields into gleaming towers of glass and steel within a generation and had earned the sobriquet of "Asian miracles." Surviving civil war and a bitter and festering partition, South Korea had become the eleventh-largest econo-

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¹Quoted in (Carswell, 1993: 133).

my in the world. Cut-off from the Chinese mainland for almost 50 years, and denied international recognition as an independent state for half that time, Taiwan had been transformed into a formidable export platform and had amassed the largest foreign exchange reserves of any economy in the world by 1992 (Kwan, 1994: 13, 24). By compressing the process of industrial transformation, Taiwan and South Korea achieved in 15 years what had taken Britain and Germany over 50 years and Japan 35 years to accomplish and it did not seem far-fetched to suggest that they would be as wealthy as Great Britain and Italy by the early 21st century (Wade, 1990: 3; Daly, 1994: 165-66). By 1993, residents of the two city-states of Hong Kong and Singapore had already surpassed the United Kingdom in per capita income as they metamorphosed from entrepôts, clinging like limpets on the edges of the Eurasian land mass, into regional financial hubs. Following in the wake of these 'Four Dragons,' the 'mini-dragons' of Indonesia, Thailand, and Malaysia had registered average annual growth rates of over 8 per cent for the last 10 years and seemed well on their way to replicating the successes of their more illustrious neighbors.

Yet, these impressive accomplishments seemed to dissolve almost overnight as investors, fearing that the financial crisis in Thailand might be contagious, scurried to unload assets denominated in a wide range of East and Southeast Asian currencies. In an act of self-fulfilling prophesy, currencies and stock markets in Malaysia, Indonesia, the Philippines, Hong Kong, and South Korea tumbled like ninepins. No interest rate hike, currency floatation, or loan guarantee — not even the largest-ever international bailout orchestrated by the International Monetary Fund (IMF) — appeared sufficient to relieve the pressure on stock and currency markets along Asia's Pacific perimeters as the Indonesian rupiah, the Malaysian ringgit, the Philippine peso, the South Korean won, and the Thai baht plunged to record lows against the US dollar while the Singapore and Taiwan currencies fell to 10- and 11-year lows (*Financial Times*, 1998; Tett, 1998c).²

The magnitude of the currency hemorrhage was so acute that the 80 per cent decline of the Indonesian rupiah between July 1997 and January 1998 meant that its national debt was estimated to be 192 per cent of its gross domestic product and its per capita GDP reduced to \$305 — about its level 32 years ago when President Suharto assumed power when adjusted for

²As of December 17, 1997, in US dollar terms, the Indonesian stock market had lost 74.9 per cent of its value, the South Korean 67 per cent, and the Thai 63 (International Monetary Fund, 1998a). In 1997, stock values in other economies in the region had also declined: the Malaysian by 70.1 per cent, Singapore by 41.1 per cent, Hong Kong by 20.7 per cent, and Japanese stocks by 22.1 per cent (*Economist*, 1997c).

inflation (Montagnon and Thoenes, 1998). Similarly, the collapse of the South Korean won was so severe that its corporate crown jewels were virtually hollowed out: between October 1 and December 26, 1997 the market valuation of Daewoo Heavy Industries fell from \$2,764.5 million to \$1,140.2 million; of Pohang Iron and Steel from \$5,675.3 million to \$2,864.6 million; and of Samsung Electronics from \$6,751.8 million to \$2,369.6 million (Pollack, 1997a). And the Thai stock market, which had a market capitalization of \$133 billion in 1993 was worth only \$22 billion in February 1998 (Sanger and Stevenson, 1998). Most disturbingly, the deepening economic malaise in the region engulfed even Japan, the world's second-largest economy, which slumped to its worst-ever recession since the 1950s — with the domestic wholesale price index hitting a 19-year low in February 1999 — the jobless rate has been hovering over the 4.3 per cent mark since November 1998, the highest since records were maintained (Nussbaum, 1999a; Landers, 1999; Tett, 1999a; Nussbaum, 1999b).³

The herd-like behavior of investors and speculators in times of financial crises, panics, and manias was, of course, a well-established phenomenon since at least the early eighteenth century as suggested by the observations made by a French banker at the height of the South Sea Bubble quoted at the beginning of this article. What was astonishing about the collapse of the fast-growing economies along Asia's Pacific Rim was the scale, intensity, and velocity of the process. By most indicators of economic health and vitality, as illustrated by Table 1, the economies being hollowed out by the brutal intensity of currency depreciations, were extremely robust. Over the last 20 years, their growth rates had averaged over 8 per cent a year. Their domestic rates of saving were well over 30 per cent and their governments consistently recorded budget surpluses. And they enjoyed relatively low rates of inflation.

Given the apparently healthy state of these macro-economic measures, the IMF and chief executives, finance ministers, and central bankers of Western states were quick to attribute the precipitous collapse of these erstwhile 'miracle' economies to inadequate controls over the financial sector and to the pervasiveness of 'crony capitalism' — code for cozy arrangements between governments and entrepreneurs that led to ready infusions of cash

³By February 1999, over 3 million Japanese were unemployed as the jobless rate rose to an all-time high of 4.6 per cent, 0.2 per cent more than the corresponding US figure. As most of the newly unemployed were in the 35-55 age group, it meant that their prospects of retraining and returning to well-paid jobs were very low. Even worse, the unemployment rate was expected to jump higher in April when most industrial groups traditionally take on new employees (Tett, 1999a; Abrahams, 1999a).

TABLE 1. GENERAL ECONOMIC INDICATORS FOR THE ASIAN 'MIRACLE' ECONOMIES (in percent of GDP)

	1975-82	1983-89	1990-95	1996	1997
Real GDP Growth					
Japan	3.9	4.1	2.1	3.9	1.0
Hong Kong	9.3	7.2	5.0	4.9	5.3
Singapore	8.0	6.9	8.7	7.0	7.2
South Korea	7.0	9.6	7.8	7.1	6.0
Taiwan	8.5	9.2	6.4	5.7	2.0
Indonesia	6.2	5.5	8.0	8.0	5.0
Malaysia	7.1	5.4	8.8	8.6	7.0
Thailand	7.0	8.1	9.0	6.4	0.6
Inflation (Consumer Price Index)					
Japan	3.9	4.1	1.7	0.1	1.7
Hong Kong	8.6	6.7	9.3	6.0	6.5
Singapore	4.2	1.0	2.7	1.4	2.1
South Korea	17.6	3.8	6.6	4.9	4.3
Taiwan	8.6	1.2	3.8	3.1	2.0
Indonesia	15.0	8.1	8.7	7.9	8.3
Malaysia	5.3	2.0	3.5	3.5	3.7
Thailand	9.0	3.1	5.0	5.9	6.0
Domestic Saving					
Japan	31.9	31.9	32.7	31.3	30.8
Hong Kong	29.7	33.6	33.6	30.6	30.8
Singapore	33.4	42.0	46.9	50.1	50.0
South Korea	25.7	32.7	35.3	33.3	32.9
Taiwan	30.2	35.0	28.2	28.0	27.9
Indonesia	19.3	23.2	28.9	28.8	27.3
Malaysia	21.6	29.4	31.3	36.7	37.0
Thailand	19.6	25.4	34.4	33.1	31.8
Fixed Capital Formation					
Japan	30.9	28.4	30.0	29.7	28.4
Hong Kong	27.8	23.6	28.0	31.3	32.0
Singapore	38.2	38.1	33.8	36.5	35.4
South Korea	29.4	29.4	36.7	36.8	36.6
Taiwan	27.8	20.4	22.9	21.0	21.0
Indonesia	19.8	24.3	27.2	28.1	26.5
Malaysia	29.4	28.5	37.7	42.2	42.7
Thailand	23.6	27.7	40.4	40.8	35.8

TABLE 1. CONTINUED

	1975-82	1983-89	1990-95	1996	1997
General Government Balance					
Japan	-4.0	-0.4	-0.1	-4.1	-2.9
Hong Kong	1.5	1.6	1.6	2.2	4.2
Singapore	0.6	4.8	12.2	8.4	8.3
South Korea	-2.7	-0.3	-0.8	0.0	0.0
Taiwan	0.0	1.3	0.5	0.2	0.2
Indonesia	N/A	-1.3	0.0	1.4	2.0
Malaysia	N/A	-4.0	-0.3	4.2	16.0
Thailand	-5.8	-3.0	3.0	1.6	-0.4
Current Account Balance					
Japan	0.4	3.0	2.4	1.4	2.2
Hong Kong	1.9	8.3	4.5	-1.3	-1.5
Singapore	-8.8	1.8	12.0	15.0	14.0
South Korea	-4.6	2.5	-1.4	-4.9	-2.9
Taiwan	1.6	12.9	4.1	5.2	4.2
Indonesia	-1.2	-3.5	-2.5	-3.3	-2.9
Malaysia	-2.0	-0.7	-6.2	-4.9	-5.8
Thailand	-5.6	-3.2	-6.7	-7.9	-3.9
External Debt Service					
Indonesia	3.5	6.8	8.5	9.0	10.5
Malaysia	3.8	9.0	6.1	5.4	8.4
Thailand	3.8	5.8	4.4	5.4	7.1

Source: International Monetary Fund, 1997, *World Economic Outlook: An Interim Assessment*, Washington, D.C.: International Monetary Fund.

to those with the right political connections while insulating them from shareholder scrutiny, the need to disclose embarrassing financial information, or exposure to serious foreign competition in their domestic markets. Hence, to exorcise this demon, the Fund modified the standard recipe it prescribed to economies placed under its receivership by making financial restructuring the centerpiece of its rescue packages (International Monetary Fund, 1997a; International Monetary Fund, 1998b).

However questionable the IMF's track record may have been in resuscitating low- and middle-income economies during the debt crisis of the 1980s,⁴ the well-publicized venality of former Indonesian President Suharto's children and associates and the large, illegal payouts made to for-

mer South Korean presidents Chun Doo Hwan and Roh Tae Woo by the *chaebol* (giant industrial conglomerates) lent instant credibility to this diagnosis. Nevertheless, demands for the implementation of more transparent accounting procedures in the ailing Asian economies and for their financial institutions to meet the more prudential lending criteria followed by Western banks (the “Basle” convention) to purge the bogey of ‘crony capitalism’ ignored that it was precisely the close coordination between political and economic elites and the violation of Western practices of prudential lending that were the wellsprings for the remarkable economic performance of the Japanese and South Korean economies over the last quarter century.

More than in the case of Western — or even Latin American — firms, large Japanese and South Korean conglomerates depended on high levels of corporate debt to scale the peaks of industrial production. Indeed, if they had merely relied on retained corporate earnings and equity markets for investment funds, it is hardly conceivable that they could have emerged as formidable competitors in the most exacting markets in so short a time (Wade and Veneroso, 1998a). ‘Late-late industrializers,’ as Alice Amsden 1989: 139-55) argued, also had to deliberately distort relative prices — through the provision of cheap finance including government guaranteed loans, funds at negative interest rates, or outright subsidies — in strategic sectors if they were to successfully industrialize at a rapid pace. Put another way, their growth was ‘miraculous’ only because they violated the canons of neo-classical orthodoxy which, being ideologically-distorted encapsulations of the Euro-North American trajectories of growth, could not accommodate the centrality of industrial policy in its market-conforming paradigms.

While theorists of the ‘developmental state,’ emphasized the role of state intervention in economic growth, the first section of this article, argues that an important factor in the ability of the ‘dragon’ economies to withstand the debt crisis of the 1980s that consumed Latin American economies was the integrated nature of their export-oriented industrialization programs under the aegis of Japanese capital. Whereas state-led industrialization strategies

⁴Between the Mexican debt crisis of 1982 and 1990, the restructuring of highly indebted low- and middle-income economies under joint World Bank and IMF supervision led to the debtor states collectively owing 61 per cent more at the end of the period than they did at the beginning. While total resource flows — all bilateral and multilateral aid, grants by private charities, direct private investments, trade credits, and bank loans — to ‘developing countries’ amounted to \$927 billion, these highly-indebted low- and middle-income states remitted \$1345 billion in debt service alone to the high-income states. To put this in perspective, if US Marshall Plan aid to Europe amounted to about \$70 billion in 1991 dollars, in the eight years from 1982, the poorer countries have financed six Marshall Plans for the richer ones through debt service alone (George, 1992: xv-xvi).

in Latin America was premised on borrowing in overseas markets, the trans-border expansion of Japanese subcontracting networks did not involve high levels of foreign debt. Simultaneously, while debt-financed industrialization programs in Latin America led to the creation of autonomous national industrial structures, the outward expansion of Japanese production networks fostered progressively tighter economic integration of manufacturing processes along Asia's Pacific perimeters.

From this perspective, it is not the lack of Western standards of prudential lending or the close relationship between political and economic elites in South Korea and Japan that was primarily responsible for the financial crisis but the disintegration of the regulatory frameworks which had enclosed these practices and relationships. While business conglomerates in these economies had depended on the government for large infusions of cheap capital and market protection till the 1970s, by the mid-1980s as they expanded their overseas operations prodigiously, they began to chafe at government oversight. Simultaneously, there was increasing pressure on East and Southeast Asian states from Western governments, business enterprises, and financial institutions to relax controls over cross-border capital and investment flows.

Hence, the second section suggests that if the coordination of investment strategies in the region by elite economic bureaucracies in Japan and the 'dragons' had enabled them to withstand the collapse of most low- and middle-income states in the early 1980s, the weakening of the oversight capabilities of these pilot agencies prepared the conditions for the meltdown of 1997-98.⁵ The loosening of controls over cross-border capital and investment flows, maintenance of high interest rates, implicit government guarantees of loans, and exchange-rate stability led to a vast infusion of foreign capital to East and Southeast Asia. This obscured the fundamental structural problems generated by high-speed economic growth.

Emancipated from government control, and flush with access to large sums of borrowed capital, enterprises in the region expanded their production capacities rapidly while speculation in real estate kept pace. The uncoordinated expansion of production in the Four Dragons and the three 'mini-dragons' — precisely when large inflows of foreign direct investments (FDI) were also flowing to China, Vietnam, and several other low- and middle-income economies — led to conditions of overproduction and sharply drove

⁵Even though enterprises in Thailand, Indonesia, and Malaysia did not have the same institutional mechanisms, access to large volumes of cheap loans from Japan in the 1990s facilitated the rapid expansion of manufacturing capacity in these economies.

down profits as the third section demonstrates. Given integration of financial flows and production operations along the Pacific shores of Asia, the IMF's insistence on treating each economy in isolation contributed to the spread of the contagion. Due to the existence of interpenetrating networks of accumulation, demands for the liquidation of insolvent Thai or Indonesian companies compounded the bad loans held by Japanese banks by eroding their asset base and contributed to a further withdrawal of confidence by investors.

Though the rapid collapse of stock and currency markets gave it the appearance of a financial crisis, from the viewpoint adopted here, the fundamental cause of the meltdown is a crisis of overproduction. Once the crisis is recast in this manner, it becomes evident that the problem is a crisis of accumulation on a world-scale rather than a regional affliction. The crisis manifested itself in East and Southeast Asia only because economies located there attracted more investments in manufacturing than most others. Thus, the last section demonstrates that, as the precipitous decline of their currencies restored the export competitiveness of industries in the Asian 'miracle' economies, the crisis spread beyond the region. Since trade surpluses accruing to the ailing 'dragons' have to be balanced by trade deficits in high-income states, it led to a withdrawal of capital from Latin America, Russia, and elsewhere. This led, in turn, to the Russian default of August 1998, the subsequent collapse of Brazil in the steepest decline of its economy since the debt-crisis of 1982, and the contingent weakening of other Latin American economies. Simultaneously, as their trade deficits climb to new heights, there have been large-scale lay-offs in North America and Western Europe. In this context, the spectacular rise of stock markets is due to the shift of capital from productive activities to speculative ones precisely because profit margins in the latter have slumped.

A FINE BALANCE

So insistently has the imminence of a "Pacific century" been prophesied in recent years that we tend to forget that the 'miracle' economies of the seventies were neither the 'Four Dragons' nor their Southeast Asian off-shoots. In the 1960s and 1970s, the most impressive rates of growth among 'developing countries' were registered by the Latin American giants of Argentina, Brazil, and Mexico. Larger than any of the economies that would later be called the 'Four Dragons,' and fueled by cheap loans from international currency markets,⁶ these Latin American 'miracles' constructed relatively sophisticated, autonomous industrial complexes and seemed well on target

to reverse their dependent relationship with the United States, even buying up some US firms (Evans, 1979: 274)!

Most East and Southeast Asian economies had neither the natural resources nor domestic markets of sufficient wealth and size to contemplate a debt-led industrialization strategy on the Latin American scale. Instead, with the exhaustion of their own import-substituting industrialization policies by the late sixties, Taiwan and South Korea became recipients of declining Japanese labor-intensive light industries, producing largely for markets in the United States and other high-income economies. A quadrupling of oil prices, in particular, accelerated the flight of industries from Japan as rising costs of commodities and labor led to a fall in the net profit share of its domestic manufacturing sector by over 60 per cent between 1970 and 1975 (Itoh, 1990: 165; Leyshon, 1994: 124).⁷ In response to this accelerated outward expansion of Japanese capital, South Korean and Taiwanese-based corporations sought to accommodate the “pollution-prone” and “resource-consuming” industries of Japan by extending their own production and procurement networks to Hong Kong, the ‘mini-dragons’ and, less significantly, to the Philippines (Ozawa, 1979: 18-19; Eccleston, 1989: 245; Steven, 1990: 77-78). Singapore and Hong Kong had been oriented towards overseas markets even earlier as they lacked significant domestic markets and had been separated from their hinterlands. In Malaysia, the Malay-dominated state also began to be more receptive to overseas investors after the ethnic conflicts of 1969 as domestic capital was dominated by the Chinese minority.

If the increased exports of textiles, clothing, plastics, and toys from the ‘dragon’ economies were less spectacular than the production of steel, automobiles, and fighter aircraft in the Latin American ‘miracles,’ the industrial achievements of the former were to prove more enduring as they were not as vulnerable to the vagaries of financial markets as the latter. Thus, once the flow of cheap credit was choked off in 1979 when the United States government began to borrow from international currency markets to curb inflation, it undercut debt-led industrialization strategies in Latin America and elsewhere precisely when the pursuit of multiple parallel patterns of industrialization had reduced the benefits accruing to each economy. In contrast, not only was industrialization along Asia’s Pacific perimeters not exposed

⁶Of the five states — Mexico, Brazil, Venezuela, South Korea, and Algeria — which received the lion’s share of the flows of cheap credit by the early eighties, about one half of all publicly announced bank loans in Euro-dollars, only one was in East Asia (Frieden, 1987: 131-36).

⁷Net profit share is derived by dividing net profits (including rent and interest) by net value added.

to high-levels of debt, but there was less competition between economies in the region as they were loosely integrated within the technostructures of Japanese corporations.

Two aspects of the trans-border expansion of Japanese production and procurement networks are particularly salient for our present purposes. First, unlike the contemporaneous expansion of American and European enterprises to the 'newly industrializing countries' (NICs), beach heads for Japanese capital in neighboring locations on Asia's Pacific perimeters were established by small — and medium-sized companies (Ozawa, 1979; Palat, 1996). This peculiarity stemmed from a unique structural characteristic of the Japanese economy — the presence of the *sogo shosha* or general trading companies which provided the infrastructural support necessary for foreign investment that small firms could not have shouldered by themselves. Abiding resentments against the Japanese for their colonial occupation of Taiwan and South Korea, and their wartime atrocities against peoples of Southeast Asia made it strategically prudent for Japanese investors not to insist on majority equity participation in their joint ventures in Asia.

This strategy not only enabled Japanese enterprises to diversify their sources of supply but it also significantly impaired the capacity of peripheral producers to affect prices by rapidly expanding supplies without corresponding increases in demand. Additionally, participation in joint ventures increased the exposure of host governments to risk and external debt and thereby reduced their ability to regulate foreign investors. Although it was the relative weakness of Japanese capital that prevented them from insisting on majority control over these overseas joint venture projects, by the early eighties it had become apparent that minority ownership better served their needs (Bunker and O'Hearn, 1993: 93-100; Steven, 1990: 94).

Second, the small-scale and low skill- and -capital intensities of these ventures did not undermine the salience of industrial policies in the several jurisdictions. If this prompted theorists of the 'developmental state' to highlight the role of economic bureaucracies and state intervention in the success of the East and Southeast Asian economies, patterns of regulation and forms of industrial organization in each jurisdiction was determined by its discrete configuration of class and power relations and its location within larger political and economic networks as illustrated by the relative anonymity of the brand-names of Taiwanese enterprises on the one hand, and the ubiquity of the names of the South Korean *chaebol* — Daewoo, Hyundai, Lucky Goldstar, Samsung — on the other.

These differences, in turn, laid the foundations for the differential impact of the current economic maelstrom on the several economies along the

Pacific perimeters of Asia. In Taiwan, the establishment of an ethnically-bifurcated state by the Guomindang (GMD) and the consequent discrimination against native Taiwanese entrepreneurs by the nationalized banks in the allocation of cheap credit⁸ meant that the extension of Japanese subcontracting units to the island was particularly fortuitous. If discrimination by nationalized banks had compelled native Taiwanese entrepreneurs to rely on kin and community networks to mobilize capital and labor, the dense network of family-based small enterprises provided a conducive environment for the institution of original equipment manufacturer (OEM) arrangements with Japanese and American corporations (Hart-Landsberg, 1993: 41). The production of low-cost products by small — and medium-scale Taiwanese firms marketed under such well — known brand-names as Sears, J.C. Penny, Hewlett-Packard, IBM, Sony, Sharp, Mitsubishi, National, Westinghouse, Wilson Sporting Goods, and Schwinn Bicycles was so extensive that the executive of an American transplant operation told researchers that “You really can’t consider Taiwan an exporting nation. Taiwan is simply a collection of international subcontractors for the American market” (quoted in Bello and Rosenfeld, 1990: 243).

Conversely, the greater size and prominence of the South Korean conglomerates can be traced directly to President Park Chung Hee’s determination to achieve political stability through economic growth after his *coup d’etat* in 1961. Unlike Chiang Kai-shek in Taiwan, Park did not have a large and experienced cadre of technocrats with extensive experience in managing industrial plants. Hence, rather than seeking to dominate the commanding heights of the economy, the new government nationalized the banks and soon controlled an astonishing 96.4 per cent of the country’s financial assets (Amsden, 1989: 16, 72-73; Bello and Rosenfeld, 1990: 51; Woo, 1991: 51-52, 84). Combined with access to large dollops of military and economic aid from the United States, the new regime was able to shape the direction of industrial production through the allocation of subsidized capital, credit guarantees, and favorable — even negative — interest rates to targeted firms and industries.⁹ As a result, the debt-equity ratio of firms in South

⁸By some estimates, in the early seventies over 82 per cent of the capital raised by small and medium entrepreneurs came from the informal money market (Greenhalgh, 1994: 766; Bello and Rosenfeld, 1990: 242).

⁹Between 1966 and 1970, domestic bank lending rates in South Korea were 24.4 per cent while the foreign interest rate was 6.4 per cent, and when adjusted for exchange rate depreciation and inflation, the real private cost of borrowing from abroad was *minus* 4.1 per cent. Between 1971 and 1975, the domestic lending rate was 17.0 per cent, foreign interest rate 7.9 per cent, and the real cost of private borrowing abroad was also *minus* 4.1 per cent (Amsden, 1989: 76, table 3.8; Woo, 1991: 104, table 4.7).

Korea averaged between 300 to 400 per cent in the 1970s. In contrast, even favored firms in Taiwan had debt-equity ratios of only 160 to 200 per cent while Brazilian and Mexican firms averaged between 100 and 200 per cent. Moreover, by 1981, over 200 types of policy loans—targeted for specific industries at rates lower than the already highly discounted rates for favored firms, and over which the banks had no control—had evolved in South Korea to further promote specific types of manufacturing activity (Woo, 1991: 12). The government's control over industrial licensing also meant that firms entering sectors with long-fruiting lags or high risks could be rewarded with licenses in the more lucrative sectors. Due to the higher technical requirements of targeted sectors, and the emphasis on increased exports, the regime tended to favor larger firms often controlled by political supporters: the Ssangyong group in cement rather than the more established Tongyang Corporation, for example, or the state-owned Pohang Iron and Steel Company, or the Hyundai group in shipbuilding, or the trio of Hyundai, Samsung, and Daewoo in the machine building sector (Amsden, 1989: 14-18, 73).

These differences in industrial structure are an important part of the reason why the current economic crisis has impacted far more severely on enterprises in South Korea which were more reliant on debt-led strategies of expansion than those in Taiwan. Differently put, if the brand-names of Taiwanese firms are not as recognizable as those of the *chaebol* and if Taiwanese firms have not been as prominent in leading sectors like automobiles and semi-conductors, their smaller size and OEM arrangements have insulated them from the debt crisis that has hollowed out their more celebrated counterparts in South Korea.

In the sixties and seventies, the potential drawbacks of a debt-led industrialization strategy were, however, overshadowed by the advantages derived from the loose integration of production structures in South Korea and Taiwan under the aegis of the Japanese Ministry of Trade and Industry and the Japanese conglomerates. Elite bureaucracies in both South Korea and Taiwan formulated national industrial policies to ensure that partnerships with Japanese and other foreign enterprises would generate optimal synergies through backward and forward linkages. To foster OEM arrangements, for instance, the Taiwanese government not only provided tax incentives for exporters but as gatekeeper for the national economy, insisted that foreign investors not compete with local enterprises in the domestic market and included stringent domestic content requirements in approvals for foreign investments.

Similarly, in South Korea, in return for privileged access to capital and

industrial licenses, the government imposed stern discipline on the *chaebol*. Export-related criteria assumed pre-eminence in assessing enterprise performance both because continued improvement in exports provided a reliable indicator of efficiency and because tight control over the allocation of industrial licenses and cheap credit and the high debt to equity ratios rendered financial indicators a poor guide. If secure access to cheap credit and a battery of incentives encouraged *chaebol* to pursue expansion into areas with long-fruiting lags and high risks, it heightened their dependence on the government and the regime did not hesitate to dismember firms failing to fulfill their export targets or other performance criteria without plausible reasons. Even the very largest conglomerates were not immune to such sanctions as indicated by the experience, for instance, of the Shinjin corporation which had a larger share of the domestic automobile market than Hyundai in the 1960s. Since Shinjin could not survive the oil crisis of the early seventies and competition from Hyundai's "Pony," its credit lines were cut and the government, in its role as banker, transferred the company's assets to Daewoo Motors.¹⁰ In this context, it is significant that though the government imposed strict discipline on the *chaebol* and had no hesitation in dismembering and cannibalizing poor performers, business failure did not lead to unemployment as assets were simply transferred to other politically better connected conglomerates (Eckert, 1993: 102-04; Amsden, 1989: 15, 139-55).

Elite bureaucracies in South Korea and Taiwan, as well as in Japan, were able to exercise considerable autonomy and authority in the formulation of industrial policy because the reconstituted regimes in these jurisdictions represented genuinely new constellations of power as prewar elites had been sidelined and the social and economic dislocations caused by war, revolution, and civil strife had made a complete overhaul of the foundations of rule imperative. Singapore's expulsion from the Malay Federation in 1965 similarly conferred a great degree of relative autonomy on the state as it

¹⁰Other examples of bankruptcy and subsequent cannibalization of assets by other, politically well-connected *chaebol* include Asia Motors; the Taihan group; the construction firms, Kyungnam and Samho; and the Korea Shipbuilding and Engineering Company (Amsden, 1989: 15). The dominance of the regime in the 'sword-won' nexus was also demonstrated by the severe punishments meted out to firms provoking its displeasure. In a celebrated case, Yang Chang Mo, the head of the Kukje-ICC group, had the rug pulled under him for making a meager contribution to the President Chun Doo Hwan's New Village Movement in 1984. Banks were ordered to stop honoring checks of the group even though it was the seventh-largest conglomerate and within weeks Kukje-ICC was compelled to file for bankruptcy and its companies — ranging from textiles and footwear to steel and overseas construction — were sold at heavily discounted prices to more politically pliable *chaebol* (Hart-Landsberg, 1993: 69-70; Bello and Rosenfeld, 1990: 70-71).

skillfully exploited the acute sense of insecurity among the island's dominant Chinese population surrounded by a hostile sea of Malays to repress labor. Apart from being endowed with a high degree of relative autonomy, these state apparatuses were also aware that, perched precariously as they were along the ideological faultlines of the Cold War, they could inoculate their subject populations against the appeals of revolutionary socialism only if they could plausibly promise to raise living standards. If the colonial administration in Hong Kong was fortuitous in being insulated from an anti-colonial insurgency, the imperative to promote material prosperity was no less compelling as a cash-strapped Britain insisted that the colony be self-supporting and because the imposition of a United Nations embargo on exports of strategic goods to China led to a collapse of export revenues. Consequently, while the different methods they chose to administratively guide economic growth are too familiar to warrant repetition here, it suffices to note that the efficiency and technical proficiency of their authoritative economic bureaucracies are widely acknowledged (Amsden, 1989; Johnson, 1982; Johnson, 1987; Rodan, 1989; Wade, 1990; Schiffer, 1991; Haggard, 1990; Castells et al., 1990).

Conversely, though Thailand, Malaysia, and Indonesia also acquired some of the institutional accouterments of a 'developmental state,' their economic bureaucracies never achieved the autonomy and proficiency of their counterparts in Japan and the 'dragons' (Henderson, 1998). In Malaysia, while the adoption of the 'New Economic Policy' in 1971 involved the creation of ministries and economic agencies modeled on those in Japan and the 'dragons' — the Ministry of Trade and Industry, the Malaysian Industrial Development Authority, the Economic Planning Unit, and state-holding companies — these were dominated not by a technocratic elite but by a political elite seeking to further their personal interests, both political and financial. At the same time, the split between domestic capital dominated by the ethnic Chinese minority and foreign capital ensured that linkages between these fractions of capital remained weak and the economy did not benefit from synergies and spin-offs.¹¹ In Thailand, despite the creation of pilot agencies such as the National Economic and Social Development Board and Board of Investment in the 1960s, economic policy was dominated by the Bank of Thailand and the Ministry of Finance. Consequently, the concern for macro-economic stability took precedence over industrialization and export-oriented strategies began to be implemented comparatively late,

¹¹Though ethnic Chinese amounted to only 29 per cent of population of Malaysia, they accounted for 61 per cent of the share capital in the mid-1990s (Henderson, 1998: 11).

in the mid-1980s and in association with the structural adjustment policies of the World Bank and the IMF. Finally, after the brutal overthrow of the Sukarno regime in Indonesia, President Suharto also instituted an economic bureaucracy — creating a plethora of agencies such as the National Economic Planning Board, the Investment Coordinating Board, the State Logistics Boards, and the Technology Research and Development Board — under his direct control. If these organizations played key roles in the development and expansion of state-funded industrial projects, it was more in the interests of appropriating the benefits for the Sino-Indonesian and *Pribumi* (“indigenous”) conglomerates and for the companies owned by the President’s family and friends. Crucially, the pervasive clientalism that characterized developmental strategies in Malaysia, Thailand, and Indonesia meant that economic bureaucracies did not have the autonomy to subject businesses to performance criteria or to deflect counter-productive investment flows (Henderson, 1998: 14-19).

If the creation of economic bureaucracies prompted theories of the ‘developmental state,’ these qualifications suggest that their importance was exaggerated in the ability of the East and Southeast Asian NICs to withstand the collapse of most other low- and middle-income states during the debt crisis of the early 1980s. This achievement was due to the loose integration of production structures of these NICs under the aegis of the Japanese Ministry of Trade and Industry and Japanese conglomerates. Since Japanese enterprises did not insist on majority equity control, the significance of their influence — exercised through the transborder expansion of their subcontracting networks and through their control over supply and distribution circuits — is underestimated by conventional measures. A broad measure of regional integration ensured that investment strategies would be complementary rather than competitive as had been the case in the state-centric developmental strategies in Latin America and Eastern Europe.

YEARS OF LIVING DANGEROUSLY

Paradoxically, the creation of a dense network of intra-regional linkages debilitated the coherence of national industrial policies precisely when these policies were also under pressure from changes in the political ecology of world production, trade, and investment. Thorough-going deregulation of cross-border flows of trade and investments in the United States and Western Europe in the 1980s fractured domestic coalitions underpinning the ‘developmental state’ in Japan and the ‘Four Dragons’ as large conglomerates relocated their production operations to circumvent protectionist barriers.

ers and to better exploit cost and wage differentials in conditions of kaleidoscopic realignments of exchange rates. The creation of transnational corporate structures diluted the dependence of corporations on their domestic state apparatuses while the progressive elimination of controls over capital flows provided access to large volumes of cheap credit. Cumulatively, these conditions provided propitious conditions for corporations to pursue a debt-financed strategy of expansion, aimed at increasing their market share, without being constrained by authoritative economic bureaucracies. The simultaneous pursuit of similar strategies of expansion, however, reduced the benefits accruing to each enterprise and thereby compounded the problem of indebtedness.

In the first instance, President Richard Nixon's decision to revoke the convertibility of US dollars to gold in 1971 enabled the American government to freely issue vast quantities of non-convertible dollars into international circulation. Correspondingly, a depreciating dollar expanded overseas markets for US products at the expense of European and Japanese competitors (Parboni, 1981). In conditions of greater international competitiveness and rising protectionist tendencies in high-income states, the global economic recession of the early seventies and the structural shift of the Japanese economy from heavy and chemical industries reduced overall corporate demand for investment funds and total corporate liabilities fell from ¥181.6 trillion in fiscal 1975 to ¥9.5 trillion in 1980 and to ¥8.3 trillion in 1985.¹² As a consequence, major manufacturing firms like Toyota Motors and Matsushita Electric accumulated such large surpluses that they began lending to other enterprises and by the mid-eighties, financial activities or *zaitech* had become the most important source of profits for a whole spectrum of Japanese automotive, electronics, and precision machinery manufacturers (Palat, 1996: 326-37; Calder, 1997: 19-20).¹³

Just as the increasing importance of financial activities in the profits of manufacturing enterprises freed them from their reliance on banks, excess liquidity freed commercial banks from a reliance on the Bank of Japan. As

¹²Put differently, the debt-equity ratio of major Japanese firms fell from an average of 80 per cent in the 1960s to about 25 per cent by the early 1990s (Pempel, 1997: 350).

¹³Between 1975 and 1984, in the Japanese manufacturing sector, financial assets as a proportion of liabilities rose from 42.6 per cent to 66.3 per cent. By 1984, Toyota Motors and Matsushita Electric had annual financial earnings, unconnected to their manufacturing operations, of ¥48.9 billion (\$211.7 million) and ¥57.7 billion (\$249.8 million) respectively. And by 1987, profits from Toyota's financial operations had tripled from its 1984 levels and its total cash holdings was enough to buy Honda. Continuing its mercurial rise, these holdings had reached over \$25 billion and Matsushita's performance was only slightly less spectacular (Calder, 1997: 19).

the Japanese government sought to cushion the impact of higher prices of commodities and the slower growth of employment opportunities in the immediate aftermath of the oil price hikes by increasing government expenditure — between 1973 and 1985, the total value of all outstanding Japanese national government bonds rose more than twelve times in nominal terms and five times in real terms — it recognized that Japanese banks could underwrite these bonds only by borrowing from international currency markets. Additional pressures to remove restrictions on foreign exchange transactions and on the operation of foreign banks in Japan came from the internationalization of Japanese industry: as Japanese banks sought to follow Japanese industry abroad, foreign governments used restrictions on foreign banks operating in Japan as a reason to prevent the entry of Japanese banks to their financial centers (Calder, 1997: 21-26; Itoh, 1990: 171; Leyshon, 1994: 124-27).

If loose monetary policies in the early seventies had enabled the United States government to shift competitive pressures to the more extroverted economies of Western Europe and Japan, the relentless flight of manufacturing operations to low- and middle-income countries began to undermine the national foundations of US power by the end of the decade. Not only did the growing quantity of dollars outside the United States, increasing by an annual average of 26 per cent between 1977 and 1981 (Kolko, 1988: 48-49), lead to a crisis of confidence in the greenback as the medium of international trade but it also eroded the material bases of the American economy. To reverse the currency hemorrhage, the US Federal Reserve adopted tighter monetary policies and hiked domestic interest rates above the world average in 1979 while simultaneously dismantling restrictions over banks and financial institutions. As the deregulation of US banking and financial systems weakened the growing power of offshore banking centers by offering banks all the advantages they could get in those locations plus the additional advantage that none of them could offer — proximity to the most important center of world power — it led to a spectacular reversal in world monetary flows: by 1984, the US had become a net importer of capital for the first time since 1914, and by 1986 a net debtor as well (Arrighi, 1994: 309-18; Kolko, 1988: 61, 83-85).

These changes in US government policy reinforced pressures towards financial liberalization along Asia's Pacific perimeters. In Japan, higher American interest rates accelerated the outflow of capital and Japan emerged as the biggest international creditor by the mid-eighties. As investors sought higher returns abroad, a steep rise in demand for foreign currencies in Japan depressed the value of the yen in foreign exchange mar-

kets and conferred an additional competitive advantage on Japanese businesses. In turn, this increased pressure from the United States and other core governments to realign exchange rate mechanisms, culminating in the Plaza Accord of 1985. This led to a sharp appreciation of the Japanese yen—soaring from ¥240 to ¥170 to the US dollar within seven months and reaching ¥120 by early 1988 (Itoh, 1990: 176; Leyshon, 1994: 130).

The realignment of the yen-dollar exchange rate rapidly accelerated the pace of Japanese direct foreign investments which grew at an annual average rate of 62 per cent between 1985 and 1989 (Leyshon, 1994: 130; Bernard and Ravenhill, 1995: 318; Bowles and MacLean, 1996: 159).¹⁴ Unlike the earlier phase of Japanese overseas investments, however, the new wave of investments was more geographically dispersed: whereas 40 per cent of Japanese direct foreign investments in manufacturing had been in Asia in the mid-seventies, cumulative investments in the region accounted for only 28 per cent in 1988. Conversely, the cumulative share of Japanese investments in the manufacturing sector for North America rose from 16 per cent in 1976 to 41 per cent in 1988 (Palat, 1996: 321-23; Daly, 1994: 173-74; Nakao, 1995: 44-46).

The greater geographical dispersion of Japanese investments overseas reflected the emergence of Japanese TNCs as primary agencies for the outward expansion of Japanese capital as they sought to circumvent the threat of trade sanctions by installing production facilities in North America, Western Europe, and less significantly, Australasia. Since Japanese conglomerates had accumulated large surpluses, the overseas expansion of their corporate structures was not financed by large borrowing unlike the subsequent expansion of the technostructures of the *chaebol*.

Finally, the greater prominence of overseas operations in the activities of large conglomerates, along with the de-regulation of international capital flows, sharply reduced the dependence of Japanese corporations on their government and gradually undermined the salience of national industrial policies. Thus, whereas the earlier wave of Japanese FDI had complemented domestic production, the massive transfer of manufacturing facilities overseas in the eighties termed *endaka fukyō* or 'high yen recession,' led to declining employment opportunities, a wave of bankruptcies and involuntary closures of small- and medium-scale industries, and a greater coercion of labor.

¹⁴US share of world DFI declined from an annual average of 66.6 per cent between 1965-69 to 11.9 per cent in 1988. In contrast, the Japanese share increased from an annual average of 1.8 per cent in between 1965 and 1969 to 23.3 per cent in 1988. Corresponding figures for the next largest investor, the United Kingdom, was 11.8 per cent for 1965-69 and 18.3 per cent in 1988 (Ikeda, 1996: table 3.7).

In an uncharacteristic study that compared joblessness in Japan according to the same measures used in the United States, Japan's Employment Planning Agency discovered that unemployment rate in Japan was higher than in the US in 1977, 1982, and 1986 (Palat, 1996: 325; Steven, 1996: 42)!¹⁵

Since a realignment of the yen-dollar exchange rates did not lower Japan's trade surpluses, other members of the G-7 states (Canada, France, Germany, Italy, the UK and the US) prevailed upon the Japanese government to lower its domestic interest rates below international levels to stimulate imports. Far from lowering Japanese trade surpluses, a reduction of domestic interest rates consonant with the terms of the Louvre Accord of 1987, fueled a surge in speculative activity as Japanese corporations launched a massive investment-led boom in which capital goods substituted for consumption goods and speculation in stocks and real estate substituted for export markets. This is indicated by a sharp increase in the funds intermediated in Japan, rising from an annual average of ¥58.6 trillion between 1975 and 1984 to an annual average of ¥122.9 trillion between 1985 and 1990. By another measure, the assets of Japan's largest twenty banks increased by 450 per cent between 1980 and 1990 and by 1991, ten of the world's top twenty financial institutions and five of the top ten global firms measured by market value were Japanese (Leyshon, 1994: 132; Selden, 1997: 318). When *zaitech* activities and borrowings from international financial markets had severed links between major corporations and large banks in Japan, smaller firms and less fiscally sound enterprises as well as organized crime syndicates began to account for a large and constantly increasing share of loans made by Japanese financial institutions (Pempel, 1997: 353). This spurred a wave of speculative investments within the country and speculation in stocks and real estate was so rampant that the notional market value of land in the Greater Tokyo area exceeded that of all the property in the United States by the time the bubble burst in 1991.¹⁶ And the Nikkei 225 stock index which had rung in 1980 at 6,556 had increased by almost 6 times when it peaked at 38,915.87 in December 1990: this was almost twice its level before the Louvre Accords (Morgenson, 1998).

If a high yen undermined the competitiveness of Japanese exports, combined with cheap credit, it also encouraged corporations to more vigorously transfer manufacturing operations overseas or to install cost-cutting machinery in their remaining domestic plants. As cost-cutting gained

¹⁵In 1986, if people wanting work were also included, the Japanese unemployment rate would have been 16.9 per cent while the US rate was only 11.2 per cent (Steven, 1996: 42).

¹⁶Some estimates suggest that real estate alone accounted for 10.6 per cent of total bank lending by 1991 (Leyshon, 1994: 133).

prominence in investment strategies, the Asian region once again became a favored destination for Japanese investments: the share of Japanese manufacturing investments in Asia rose from 31 per cent of the North American share in 1986-89 to 45 per cent in 1990 and 88 per cent in 1993. Since land, labor, and commodity costs were lower in Asia, these figures underestimate the significance of the reorientation of Japanese investment flows to the continent. Within Asia itself, higher wage rates in the 'Four Dragons' and greater labor militancy in earlier sites of investment, especially South Korea, compelled a shift of low-cost, less-skilled manufacturing operations to the 'mini-dragons,' China, and other low-income states. South Korea and Taiwan became hosts to products requiring intermediate technology such as video recorders and color TVs while South Korean and Taiwanese corporations extended their own production and procurement networks to Southeast Asia and China. One indicator of the transformation of production structures engineered by these changes in investment patterns is provided by the share of manufactured goods as a percentage of Indonesia's exports rising from 3 per cent in 1980 to 40 per cent in 1991 (Berger, 1997: 346; Daly, 1994: 174-75; Steven, 1996: 77-100).¹⁷

The surge in speculative activities and the outflow of large volumes of capital overseas 'hollowed out' Japanese industries and savagely deepened social polarization as prices, especially of land, skyrocketed beyond the reach of most families. The widening gap between those with and without assets threatened to unravel the domestic coalitions that had kept the Liberal Democratic Party in power since 1955, and prompted the Bank of Japan to raise interest rates. A sharp escalation in interest rates in 1990 deterred further investments in securities and the Nikkei index fell sharply — by 40 per cent between January and September 1990. This was accompanied by associated drops in bonds and the value of the yen in foreign currency markets. Most notably, as money became more expensive, property

¹⁷Indonesian export-oriented industrialization was, however, characterized by high levels of labor militancy in the 1980s. The expansion of employment in the manufacturing sector from 2.7 million workers (6.5 per cent of the total labor force) in 1971 to 4.5 million in 1980 (8.5 per cent of labor force) and 8.2 million in 1990 (11.6 per cent) was accompanied a steady increase in strikes. The number of strikes which had never been more than 35 a year between 1965 and the mid-1970s, rose to 72 in 1979, to more than 100 a year in 1980 and 1981, to over 200 in 1982, and to pre-1965 levels by 1990. Most of these were concentrated in the export-oriented sectors—especially in the garments, textiles, and footwear industries—and primarily stemmed from the government's inability to ensure that employers followed regulations. Between 1990 and 1995, 90 per cent of strikes in West Java, the main industrial area, were demands for the payment of minimum wages fixed at about US\$2.00 per day in 1996 (Berger, 1997: 350).

prices fell precipitously, by 50 per cent or more in a few months. The combined effect of sharp declines in bonds, stocks, and property values led to enormous losses for Japanese banks — with estimates of losses from imprudent loans running to ¥30 trillion. The full extent of their losses were, however, camouflaged by so-called *tobashi* accounts¹⁸ and by shifting losses to offshore banking centers like the Cayman Islands (Leyshon, 1994: 134-35).

Though the Bank of Japan failed to revive the Japanese economy after the speculative 'bubble' collapsed in 1990 by lowering interest rates once again, cheap money in Japan provided a windfall for other economies. Since Japan accounted for fully one-third of world savings — about 60 per cent of liquid household assets are in banks in Japan in contrast to about 25 per cent in the United States (Passell, 1997) — bankers from overseas could borrow yen at less than 1 per cent and then lend it to banks in economies along Asia's Pacific Rim and elsewhere at 2.5 to 3 per cent. In turn, East and Southeast Asian banks charged their domestic investors 8 to 10 per cent, and thus earned themselves a nice markup. Alternatively, investors from the region could bypass their domestic bankers and borrow directly from banks in Japan, the United States, or Western Europe — though interest rates on the US dollar were not as low as on the yen, at approximately 5 per cent, it was still cheaper than loans in the rupiah, the baht, the peso, the ringgit, or the won. All across the region, credit therefore grew rapidly between 1990 and 1996: by 24 per cent per annum in Thailand, by 16 per cent in Malaysia, by 14 per cent in Indonesia, and by 10 per cent in South Korea (Jayanth, 1998; Fuerbringer, 1997; Uchitelle, 1997b; Uchitelle, 1997a). And in the Philippines — which, apart from Hong Kong, was the only economy in the region to permit foreign ownership of banks before the onset of the current crisis — as new private banks and foreign banks fought for market share, there was a lending binge as loans grew by an extraordinary 52 per cent in 1996 with dollar-denominated loans soaring from 16 per cent of banks' total loan portfolio in 1992 to 25 per cent in 1997 (McDermott and Wessel, 1997).¹⁹ Put another way, the growing incoherence of national industrial policies along Asia's Pacific seaboard led to the creation of competitive rather than complementary structures of accumulation and eroded the emerging regional division of labor. This was, however, camouflaged by the growth of intra-

¹⁸*Tobashi* accounts refer to an arrangement whereby losses of one privileged client of a brokerage house are shifted to another client on the understanding that the buyer would be provided with a similar accommodation should the stock's performance fail to enable the buyer to recoup its purchase price in the open market (Bennett, 1997).

¹⁹In absolute amounts, flows to South Korea, Indonesia, Malaysia, Thailand, and the Philippines grew from \$47 billion in 1994 to \$56 billion in 1996 (Wade, 1998: 1539).

regional trade in which trade in components replaced trade in finished goods, a trend indicative of the fact that the installation of factory complexes was not accompanied by forward and backward linkages. Additionally, the progressive expansion of the operations of large Japanese and South Korean conglomerates in North America, Western Europe, and elsewhere also meant that corporate strategies were less congruent with the interests of their respective national economies.

Unlike the earlier Latin American and East European cases where loans were incurred by governments, loans were incurred mainly by private enterprises in the Asian economies in the 1980s and 1990s. However, since governments in East and Southeast Asia derived their legitimacy by delivering material benefits to their subject populations, regimes routinely made off-the-book guarantees to underwrite loans to favored companies and it was widely understood that governments would not countenance bankruptcies of major corporations. Loans to private enterprises and financial institutions were hence assumed to be tantamount to sovereign debt and as governments in the region consistently produced surpluses, their ability to service debts was rarely questioned. This created what economists call a "moral hazard problem:" the promise of government bailouts meant that bankers did not risk losses and were under no pressure to evaluate project proposals carefully. At the same time, central banks in the East and Southeast Asian 'miracle' economies linked their currencies to the US dollar. This enabled banks and borrowers to take advantage of lower interest rates in international money markets, particularly in Japanese yen, while minimizing their exposure to sudden changes in currency values.

During the era of high-speed economic growth, these arrangements so admirably suited both banks and borrowers that financial institutions in the Asian 'miracles,' and those in South Korea and Thailand in particular, borrowed tens of billions of dollars overseas and agreed to repay the principal on a few months' notice to economize on interest expenses (Passell, 1998). This is indicated by Table 2, which reveals that short-term loans consistently overshadowed loans with longer maturities, except for Taiwan where cross-border interbank borrowing data largely reflects activities of offshore banking units. While the data presented in this table reflects the activities of banks reporting to the Bank for International Settlements (various years) rather than total external indebtedness of various countries, it is indicative of the magnitude of short-term loans maturing in the 12 months or less to mid-1998. Despite sharp declines after the crisis deepened, outstanding short-term loans still amounted to \$72.4 billion for South Korea, \$46.8 billion for Thailand, \$50.3 billion for Indonesia, \$23.0 billion for Malaysia, and

TABLE 2. FOREIGN DEBT OF SELECTED ASIAN ECONOMIES

Positions vis-à-vis	Consolidated cross-border claims in all currencies and local claims in non-local currencies					
	Total	Distribution by maturity		Distribution by sector		
		Up to and including one year	Over one year	Banks	Public sector	Non-bank private sector
	In billions of US dollars	In percentages of total consolidated claims				
South Korea						
end-1995	77.5	70.0	18.8	64.4	8.0	27.6
mid-1996	88.0	70.8	19.2	65.7	6.7	27.4
end-1996	100.0	67.5	20.0	65.9	5.7	28.3
mid-1997	104.2	68.0	19.7	65.3	4.2	30.4
end-1997	93.4	62.8	23.3	59.2	4.3	36.4
mid-1998	72.4	45.8	38.9	57.0	6.6	36.3
Thailand						
end-1995	62.8	69.4	27.3	41.0	3.6	55.2
mid-1996	69.4	68.9	27.4	40.3	3.1	56.4
end-1996	70.1	65.2	30.2	36.9	3.2	59.6
mid-1997	69.4	65.7	30.4	37.6	2.8	59.5
end-1997	58.5	65.8	30.7	29.9	3.1	66.9
mid-1998	46.8	59.3	36.5	26.1	4.2	69.6
Indonesia						
end-1995	44.5	61.9	34.8	20.1	15.1	64.7
mid-1996	49.3	60.0	35.8	20.5	13.3	66.2
end-1996	55.5	61.7	34.1	21.2	12.5	66.2
mid-1997	58.7	59.0	35.0	21.1	11.1	67.7
end-1997	58.2	60.6	36.1	19.9	11.8	68.3
mid-1998	50.3	55.0	41.7	14.2	15.1	70.6
Malaysia						
end-1995	16.8	47.2	40.9	26.4	12.4	60.4
mid-1996	20.1	49.7	41.1	28.1	11.4	60.5
end-1996	22.2	50.3	36.2	29.3	9.0	61.8
mid-1997	28.8	56.4	30.8	36.4	6.4	57.1
end-1997	27.3	52.7	37.8	35.3	6.4	58.2
mid-1998	23.0	48.6	41.6	31.2	6.6	62.1
Taiwan						
end-1995	22.5	87.2	11.8	63.7	1.7	34.6
mid-1996	22.5	86.4	12.7	57.7	2.5	39.8
end-1996	22.4	86.4	13.8	57.8	2.1	40.0
mid-1997	25.2	87.3	11.3	61.6	1.6	36.8
end-1997	26.0	81.6	15.4	55.2	1.6	42.5
mid-1998	23.2	80.1	16.6	56.4	1.5	41.5

TABLE 2. COUNTIED

		Consolidated cross-border claims in all currencies and local claims in non-local currencies				
		Distribution by maturity		Distribution by sector		
Positions vis-à-vis	Total	Up to and including one year	Over one year	Banks	Public sector	Non-bank private sector
		In billions of US dollars	In percentages of total consolidated claims			
Philippines						
end-1995	n/a	n/a	n/a	n/a	n/a	n/a
mid-1996	10.8	55.1	39.3	32.0	25.4	42.6
end-1996	13.3	58.2	35.2	39.5	20.5	40.0
mid-1997	14.1	58.9	30.7	38.9	13.1	48.0
end-1997	19.7	60.4	34.0	45.2	12.2	42.6
mid-1998	17.8	56.7	37.1	45.5	12.4	41.6

Note: Totals may not add up due to rounding and to the inclusion of unallocated amounts in country aggregates.

Source: Bank for International Settlements, various years, *Consolidated International Banking Statistics*, Basle: Bank for International Settlements.

\$17.8 billion for the Philippines.

The sheer size of short-term loans to feed the debt addiction of enterprises in the region was caused, in particular, by thorough-going financial deregulation in the 1990s and the virtual removal of restrictions on cross-border flows of capital, especially in South Korea and Thailand. Rather than steam-rolling East Asian opposition, as Michael Moran 1991: 111) observed, pressure by the US government to liberalize the financial sector had the support of large domestic constituencies in the region and transformed the competitive conditions that had facilitated the alliance between entrepreneurs and political leaders celebrated by theorists of the 'developmental state.'

In Thailand, as the shift to export-oriented industrialization in the 1990s was financed by heavy borrowing from Japanese banks in particular, the Anand government deregulated foreign exchange in 1992. The following year, the government established the Bangkok International Banking Facility (BIBF) in an attempt to attract more foreign funds to cover growing shortfalls in its current account deficit. The BIBF was an attempt to turn Bangkok into a regional financial center by enabling local and foreign commercial banks to take deposits from overseas and to borrow foreign curren-

cies and to lend these funds to both local and foreign borrowers. These measures saw Thailand's external debt climb from 34 per cent of its GDP in 1990 to 51 per cent in 1996 (Lauridsen, 1998: 138).

In lock-step with financial liberalization in Thailand, the government of President Kim Young Sam also relaxed its control over cross-border capital flows in 1993. By now, the *chaebol* had acquired the high credit ratings required to get access to cheap credit on their own and were chafing at governmental oversight. Financial deregulation exposed weaknesses of financial skills in the country as the Kim government granted banking licenses freely: nine in 1994 and 15 in 1996 when there had been only a total of 6 banks before 1994. As there was virtually no supervision over these banks, and there was an implicit understanding that the government guaranteed loans, South Korea's foreign debt almost trebled from \$44 billion in 1993 to \$120 billion in September 1997. It is also revealing that in the mid-1990s, FDI amounted to only 2.5 per cent of South Korea's GDP while the corresponding figures for China was 20 per cent and for Taiwan 7.4 per cent (Chang Ha-Joon, 1998: 223, 226; Cumings, 1998: 50, 55; Wade, 1998: 1539).

Financial de-regulation did not proceed to a similar extent in Malaysia and Indonesia as indicated by the higher exposure of South Korean and Thai banks and financial institutions to overseas loans in Table 2, while non-bank enterprises in Malaysia and Indonesia accounted for the bulk of their overseas loans. However, Malaysia too had established a mechanism to tap off-shore sources — the Lanuan International Offshore Financial Center — in 1993 to access loans from 'debt-pushing' Japanese and continental European banks and the net foreign liabilities of commercial banks more than doubled from 10.3 billion ringgit at the end of 1995 to 25.2 billion ringgit in June 1997 while their net external reserves declined from -5.3 million ringgit to -17.7 billion ringgit over the same time-span (Jomo K. S., 1998: 182-83).

Accompanying the relaxation of controls on capital flows, governments first marginalized and then abolished elite economic bureaucracies. In South Korea, for instance, the Kim Young Sam government first subordinated the Economic Planning Board (EPB) to the Ministry of Finance in 1993, and then abolished it (Chang Ha-Joon, 1998: 227; Cumings, 1998: 54; Henderson, 1998: 21). The subordination of the EPB was emblematic of the growing dominance of monetarist policies in the region. Dependence on capital inflows conferred greater priority on inflation control than on strategic economic planning since currency depreciations would escalate real debt burdens. The relaxation of government controls and the easy availability of credit permitted heads of *chaebol* to compete against each other more vigor-

ously by constructing bigger and more sophisticated plants over a wider range of industries

The rapid elimination of barriers to foreign investments without a concomitant elimination of protectionist legislation, not only in the euphemistically-named “emerging markets” but also in Western Europe and North America exacerbated the problem of overproduction. Following the lead of Japanese transplant factories in North America, American and European firms also constructed factories in Asia and Latin America to circumvent real or imagined barriers and to exploit wage and cost differentials between and among different segments of the world market for labor and commodities. Consequently, though car exports from Japan fell from 8.6 million vehicles in 1986 to 2.9 million in 1995 and Toyota was poised to replace Chrysler as one of the “Big Three” automotive producers in the United States, only one Japanese car factory had been closed. Symbolically, 1995 was the first year when the value of Japanese off-shore manufacturing (¥41.2 trillion) surpassed the value of exports from the Japanese home islands (¥39.2 trillion) (Uchitelle, 1997b; *Economist*, 1997b; Pempel, 1997: 350).

Nowhere was the problem of over production more evident than along Asia’s Pacific shores. Fueled by large infusions of capital, five states — Thailand, South Korea, Indonesia, Malaysia, and the Philippines — accounted for almost one-half of the growth in world manufacturing output between 1991 and 1996 by some estimates (Uchitelle, 1997b). Overall, investment in the Dragons and mini-dragons averaged about 35 per cent of their gross domestic product in 1996, with Malaysia registering the highest rate of 43 per cent (*Economist*, 1997a; Ridding and Kynge, 1998). Nothing, it appeared to the region’s boosters, could derail this pattern of relentless growth. An unchecked and uncoordinated increase in productive capacity was, however, to create its own problems as we see in the next section.

THINGS FALL APART

Hypnotized by the rapid growth of manufacturing capacity all along Asia’s Pacific coasts, observers seldom recognized that while the wholesale demolition of the foundations of the ‘developmental state’ emancipated enterprises from state-centric industrial policies, the easy availability of credit meant that there was no incentive for corporate leaders to change their operational procedures. If the single-minded pursuit of increasing their share of the world market in particular products had enabled many Japanese and South Korean corporations to leap-frog over well-established American and European competitors in some of the most technologically

sophisticated sectors, this strategy had been predicated on national industrial plans which had serially targeted strategic sectors of increasing complexity. Without the administrative guidance provided by elite economic bureaucracies, the continued emphasis on capturing market share through debt-led patterns of industrial expansion led to rampant overproduction, often at the expense of technological innovation. Combined with a rise in the value of the US dollar to which currencies of highly-indebted East and Southeast Asian economies were pegged, this severely impaired the ability of companies to service their debts and the capacity of governments to underwrite loans incurred by private enterprises.

Alarm bells warning that rosy extrapolations of the high rates of growth consistently registered by the Asian 'miracles' over the last decade into the next century were unwarranted began ringing more insistently from early 1997 when it was evident that the rate of growth of their exports had declined from 20 per cent in 1994 and 1995 to a mere 5 per cent in 1996. The proximate cause for this was the rising value of their currencies which were linked to the US dollar. As the greenback rose by 50 per cent against the yen between April 1995 and December 1996, it eroded the competitiveness of exporters in those East and Southeast Asian economies whose currencies were pegged to the dollar. Compounding their problems, China devalued the yuan substantially in 1994. Though the real magnitude of the devaluation is disputed, what was significant was that it was perceived as substantial and investment flows were switched accordingly. Simultaneously, a deceleration in the rate of growth in high-income economies in 1995 and early 1996 was not compensated by a corresponding rise in intra-Asian trade, and hence further dampened the growth of exports (*Economist*, 1997a; Wade, 1998: 1541).

In this new 'scissors crisis,' the East and Southeast Asian NICs were trapped in a pincer movement: the depreciation of the yen made it impossible for them to compete in upstream products embodying high-level technology while they could not match the labor cost advantages of China, Vietnam, and other low-income economies. The Chinese share of regional exports rose from 6 per cent in the mid-1980s to 26 per cent in the mid-1990s and in 1997, China replaced South Korea as the fourth largest exporter of electronics after the United States, Japan, and Germany (Cumings, 1998: 70).

Rather than scaling down their investments in manufacturing when export markets contracted, investors continued to rapidly increase productive capacity. This aggravated the problem of overproduction and increased the downward pressure on prices and profits. By early 1997, computer memory chips which comprised about 16 per cent the value of South

Korean exports fell to a fifth of their levels a year ago and firms like Samsung which had relied on these chips for about 90 per cent of their profits in 1995 saw their earnings collapse (Pollack, 1997b; *Economist*, 1997a; Burton and Baker, 1998). Similarly in the automobile industry, by 1996, Asia's Pacific Rim had emerged as the world's largest producer of cars, making a half million vehicles more than North America's output of 15 million. On a world-scale, automobile production so out-ran effective demand that manufacturers were operating at only 73 per cent capacity by most estimates. Yet, as firms relentlessly struggled to capture and maintain their market shares, it was forecast that by the turn of the century, world capacity would rise to about 80 million vehicles a year while demand was expected to be only about 60 million. If these projections are correct, even if every automobile factory in North America were to be closed, there would still be overproduction (*Economist*, 1997b)! Despite all this, the easy availability of credit and an entrenched corporate culture of competition between *chaebol* heads encouraged Samsung to try and compensate for the sharp plunge in prices for computer memory chips by entering the already saturated automobile market, and one in which one firm (Kia Motors) had already filed for bankruptcy and another (Ssangyong) had been sold!

One important further consequence of this predatory competition between *chaebol* for capturing and retaining market share by expanding output was that it reduced outlays on research and development to such an extent that IBM alone is estimated to have invested more in research and development in the early 1990s than all South Korean corporations combined (Bello, 1998; Lee, 1998). Equally importantly, the continued rise of wages due to labor militancy in the 1980s meant that unit labor costs in South Korean manufacturing increased by 46 per cent between 1985 and 1996 compared with 25 per cent for Taiwan and 4.4 per cent for the United States (Butler, 1996). Higher wages not only led to a massive transfer of manufacturing operations to neighboring locations in Asia, as well as to the United States and Europe — by one estimate, manufacturing wages in South Korea were 30 per cent higher than in Britain — but were also responsible for the South Korean rate of FDI growing at a rate faster than that of Japan in the 1990s. The government's attempt to sneak through a law that would have ended lifetime employment and seniority-based wages in January 1997 was thwarted by three weeks of angry demonstrations and provided a further impetus to the flight of investments overseas (*Economist*, 1997d).

Finally, the elimination of controls over capital flows also eroded the national foundations of accumulation as corporate networks became pro-

gressively transnational in structure. Simultaneously, as innovations in transportation, communications, and manufacturing systems facilitated the segmentation of production into ever narrower and more widely dispersed part-processes and their integration within the technostructures of large conglomerates, the installation of factory complexes are not accompanied by the backward and forward linkages within states that had accrued during earlier phases of industrialization.

Even the unchecked expansion of production facilities was insufficient to accommodate the influx of capital and much of this excess capital was diverted into speculation in real estate. In South Korea, for instance, foreign portfolio investment inflows rose from \$9 billion in 1990 to almost \$121 billion in 1996, dwarfing FDI flows which merely increased from \$7.2 billion to \$19.5 billion over the same period. In conditions of rapid urban growth, this large influx of capital suggests speculation in real estate and infrastructural development (Henderson, 1998: 20). Similarly in Thailand, loans from financial institutions to property developers skyrocketed from a total of 264 billion baht in 1993 to 767 billion baht by March 1996 and by the following year, residential vacancy rates in the country was estimated to be between 25 and 30 per cent, and vacancy rates for offices in Bangkok at 14 per cent (Lauridsen, 1998: 139). In the Philippines, financial de-regulation, high interest rates, and stable exchange rates led to inflows of some \$19.4 billion net foreign portfolio investments between 1993 and 1997 while industrial growth dropped from a 17 per cent annual rate in mid-1993 to -2.3 per cent in mid-1997. In Malaysia, commercial bank lending to manufacturing, agriculture, and mining accounted for only about 25 per cent of total bank lending and possibly less for foreign borrowings since these had to be backed by collateral in real estate or stocks (Jomo K.S., 1998: 183). Finally, in Indonesia real estate loans accounted for about 25 per cent of the total exposure of both banks and finance companies by 1997 (Bello, 1997).

Conversely, the two 'dragon' economies that fared the best in the crisis—Singapore and Taiwan—had mechanisms to moderate property market speculation. Though privately owned commercial banks were licensed from the late 1980s in Taiwan, the central bank mandated that their reserve requirements (compulsory deposits held by the Central Bank) remain at 24 per cent of their deposits. By contracting money supply, this requirement dampened speculative activity. Additionally, the government continued to retain controls over cross-border flows of capital. The Singapore Government also retains controls over the financial sector as well as restrictive trading regulations for the stock exchange. The requirement that all foreign stocks, excluding Malaysian ones, be denominated in foreign curren-

cies, shifted the exchange-rate risk onto would-be speculators and dampened their activities. Consequently, before the onset of the crisis in mid-1997, the volume of trade in the Kuala Lumpur Stock Exchange had been higher than in Singapore. Similarly, the state's central role in providing housing in Singapore, and the government enforced savings scheme, the Central Provident Fund, depressed speculation in real estate (Henderson, 1998: 30-32).

As prices collapsed due to overproduction while currency appreciation constrained the growth of exports, firms used to a regimen of easy credit increasingly resorted to short-term borrowing to cover their debt payments (Burton and Baker, 1998). This merely compounded the problem of growing mountains of debt denominated largely in unhedged foreign currencies for highly leveraged firms especially since rates of domestic liquidity and inflation in the Asian 'miracles' was far in excess of those countries to which their currencies were pegged: by 1997, banks in Indonesia, Malaysia, the Philippines, Thailand, and Singapore had collectively run up debts of \$73 billion, or about 13 per cent of their joint domestic output (Bremner, 1997). Fears that enterprises would not be able to repay loans incurred in dollars or yen increased after the first of the bankruptcies that were to sweep the region occurred in January 1997 with the collapse of Hanbo Steel, the sixth-largest of the South Korean chaebol and a relatively minor Thai construction company, Somprasong Land (Hanke, 1997).

By February, investors started off-loading their holdings in Thai baht and as Thai interest rates soared, it pricked the bubble in the speculative real estate market where it was estimated that non-performing loans accounted for 25 per cent of total loans and 33 per cent of the country's GDP. In turn, the collapse of property prices undermined the asset base of the country's banking system and the country's central bank, the Bank of Thailand, was compelled to lend over \$8 billion to financial institutions teetering on the verge of insolvency. In addition, the bank had committed so much of its foreign exchange reserves in forward contracts in a futile bid to defend the baht's peg to the dollar that by late June, its reserves amounted to just two days' imports. The relentless pressure finally compelled the Thai government not only to free the currency from its long-standing link to the US dollar but also to renege on its equally long-standing policy to prop up insolvent financial institutions (Bello, 1997; Bardacke, 1998; Hanke, 1997).

Once exchange stability had been compromised in Thailand, and leading financial institutions allowed to fail, it undermined the twin pillars of the regional financial system: the tying of the currencies of the Asian 'miracles' to the US dollar and the ability of their governments to underwrite loans to

private enterprises. The tight integration of structures of capital accumulation along the eastern shores of the ocean — by the early 1990s, trade within East and Southeast Asia had surpassed that across the Pacific (Islam and Chowdhury, 1997: 11-16; Katzenstein, 1997: 3-4; Kwan, 1994: 4-5, 11-12, 100-01, 106-09; Selden, 1997: 321-32) — led to fears that the contagion would spread to neighboring economies and investors stampeded to liquidate their holdings in these currencies, what Robert Wade (1998) calls the ‘gestalt effect.’²⁰ As their currencies came under increasing pressure, news reports were punctuated by announcements that, one after the other, the ‘miracle’ economies had floated their currencies: Malaysia on July 14; Singapore on July 17; and Indonesia on August 14.

Compounding the situation, when cross-national flows of capital were largely unregulated, many institutional investors are required to maintain portfolios only in investment-grade securities as they were not equipped to assess creditworthiness of overseas borrowers. Hence, any downgrading of the sovereign credit-worthiness of states — especially by one of the two major credit-ratings agencies, Moody’s Investors’ Service and the Standard and Poor’s Ratings Group — inevitably triggers an automatic outflow of money as foreign creditors call in their loans. The effects can be dramatic: when both Moody’s and Standard and Poor downgraded South Korea’s credit rating on October 24, 1997 just as the Hong Kong stock market had plunged, there was a massive run on the won. Despite the Bank of Korea using some \$2 billion of its foreign exchange reserves to prop up the currency, the won nose-dived from 890 to the greenback in July 1997 to 1,200 in late November before the government requested IMF assistance. Rather than stabilizing the currency, the government’s acceptance of the conditions attached to the \$57 billion rescue package led to an even more precipitous decline in the value of the won, as it plummeted to 1,962 by late December. Bad short-term loans were then estimated to amount to over \$100 billion, and all types of non-performing loans were said to equal 51 per cent of the South Korean GNP before an advance of \$10 billion in loans by thirteen high-income states and the IMF temporarily rallied markets. Nevertheless, between November 1997 and January 1998, South Korea slid from being the eleventh-largest economy to the seventeenth-largest — behind Mexico,

²⁰This is in sharp contrast to the insular, inward-looking industrial structures of the Latin American economies. Until 1990, for instance, Brazilian regulations mandated that the domestic content in manufacturing had to be 98 per cent by value and 95 per cent by weight (Lissakers, 1991: 59). By 1990, after the Collor Government had liberalized domestic content requirements in Brazil, intra-regional trade in Latin America accounted for a mere 0.4 per cent of world trade as opposed to 4 per cent for East and Southeast Asia.

India, and Russia — as its GNP dropped from \$500 billion to \$312 billion (*Economist*, 1997f: 84-87; Cumings, 1998: 56-57).

Unable to defend their currencies, the governments of Thailand, Indonesia, the Philippines, and South Korea reluctantly sought emergency assistance from the IMF. If other ailing economies were able to resist this humiliation, their currencies continued to plummet and sent debt repayments of their highly-leveraged companies skyrocketing. The sheer magnitude and brutality of currency depreciations hollowed out entire economies as buyers hesitated to place orders fearing that cash-starved firms would be unable to fill them while firms hesitated to bid for business as volatile currency markets made it impossible to estimate costs. Finally, foreign banks, once so amenable to rolling over short-term loans, were now demanding quick repayment and cutting off lines of credit (Uchitelle, 1997c; Fuerbringer, 1997; Burton and Baker, 1998). Thus, as indicated by the figures presented in Table 3, the five ailing economies of Indonesia, Malaysia, the Philippines, South Korea, and Thailand suffered a net outflow of private capital to the tune of \$12 billion in 1997 in contrast to a net inflow of \$93 billion the previous year.

As the financial meltdown turned the spotlight firmly on banking practices in East and Southeast Asia, severe problems that had been papered over by the high growth rates of the 'miracle' economies became manifestly evident. In return for off-the-book guarantees by governments to underwrite borrowings by their domestic financial institutions, these institutions were routinely obliged to make loans to enterprises deemed to be in the 'national interest' and to those owned by people with the right political connections. The rapidity of financial deregulation meant that many of the new banks and financial institutions borrowing from off-shore sources were family enterprises without the skills and experience required to handle large volumes of capital and calculate exchange risks.

In Thailand, once the government abandoned the currency's long-standing link to the US dollar, the baht went into free fall and completely destabilized the country's financial system. In return for a \$17 billion IMF-led bailout, the government was compelled to impose a 20 per cent cut in public expenditures, close 56 finance companies and lay off more than 200,000 white-collar employees (Bello, 1997). In Indonesia, after much hesitation, the government finally accepted the stringent conditions attached to a \$43 billion IMF rescue plan on January 15, 1998, including interest rate hikes; the liquidation of four heavily indebted banks including two banks linked to President Suharto's favored children; elimination of restrictions on wheat and flour imports and a severe dilution of the government's food distribu-

TABLE 3. EXTERNAL FINANCING FOR THE MOST AFFLICTED ASIAN ECONOMIES: SOUTH KOREA, INDONESIA, MALAYSIA, THAILAND, AND THE PHILIPPINES (in billions of dollars)

	1994	1995	1996	1997	1998	1999
Current Account Balance	-24.6	-41.0	-54.6	-26.3	11.6	43.2
External financing, net	47.4	81.5	100.6	28.8	-0.5	-1.2
Private flows, net	40.5	79.0	103.2	-1.1	-28.3	-4.8
Equity investment, net	12.2	15.9	19.7	3.6	8.5	18.7
Direct equity, net	4.7	4.9	5.8	6.8	6.4	14.2
Portfolio equity, net	7.6	11.0	13.9	-3.2	2.1	4.5
Private creditors, net	28.2	63.1	83.5	-4.7	-36.8	-23.4
Commercial banks, net	24.0	53.2	65.3	-25.6	-35.0	-18.8
Non-bank private creditors, net	4.2	9.9	18.2	21.0	-1.7	-4.6
Official Flows, net	7.0	2.5	-2.6	29.9	27.8	3.5
International financial institutions	-0.4	-0.3	-2.0	22.1	21.6	-2.0
Bilateral creditors	7.4	2.9	-0.6	7.9	6.1	5.5
Resident lending/other, net	-17.5	-26.5	-26.8	-35.0	-16.9	-14.9
Reserves excl. gold (- = increase)	-5.4	-14.0	-19.3	32.5	-41.1	-27.0

Source: Institute of International Finance, 1998, *Capital Flows to Emerging Market Economies*, Zurich: Institute of International Finance.

tion monopoly (Bulog or the National Logistics Board); and the scrapping of local content requirements in automobile assembly. Despite all this, the rupiah continued its headlong descent, plunging from 8,650 to the US dollar when agreement between the IMF and the government was reached to 16,500 a week later. Such savage volatility in exchange rates made a mockery of the agreement which had been premised on an exchange rate of 5,000 rupiah to the dollar. When the rupiah had been trading at 2,400 to the dollar six months earlier, the currency's fall was so drastic that only 22 of the country's 228 publicly traded companies had assets exceeding their liabilities (Mydans, 1998; Bremner, 1997).

As the projected 1998 growth rate for Malaysia dropped from 7 per cent to 4-5 per cent, the government was forced to scale back its megaprojects (such as the road and rail link to Thailand, and the Bakun dam) and to announce an 18 per cent cut in expenditures for 1998 to maintain budget surpluses and admit that these measures would lead to a loss of over 200,000 jobs. Cut-backs in government expenditure and corporate investments also raised the possibility of a sharp increase in crime as an estimated 2 million

migrant workers, many of them in Malaysia illegally, had no incentive to return to their home countries which were also mired in the economic downturn afflicting the region (Kynge, 1997; Mydans, 1997; McNulty, 1998; Ridding and Kynge, 1998). Eventually, Malaysian Prime Minister Mahathir's attempt to stem the currency hemorrhage by reimposing controls in August 1998 over capital flows appear to have at least partially reversed the tide. Rather than retreating to an insulated economic environment, these regulations were designed to severely restrict currency speculation. Thus, while they did not impact on inflows of foreign investments or the repatriation of interest, profits, and dividends they virtually rescinded the convertibility of the ringgit on the capital account (Wade and Veneroso, 1998b: 21).

As Robert Wade and Frank Veneroso 1998b: 35-38) note, the Malaysian attempt to rollback financial liberalization met with concerted American opposition because an integration of world financial markets is an overriding economic priority for the United States. To make up for its very low domestic savings rates, and to maintain its high rates of consumption and investment, US financial institutions need to draw upon savings in other economies and this is most easily facilitated by an integrated global financial market.²¹ The greater the degree of world financial integration the greater the ability of Wall Street firms to use the American dollar's role as the international reserve currency to their advantage. Since US Treasury bills offer a means to borrow money cheaply from world markets, the intermediated funds can be recycled as FDI outflows, portfolio investments, and loans at much higher rates of interest. Additionally, US enterprises also see capital movements as a battering ram to deregulate economies all across the planet.

Most ominously, the worsening economic predicament along Asia's Pacific perimeters revealed the precarious position of Japanese banks. Renewed pressure from international organizations, Western governments, and international investors, led to the Japanese banking industry admitting that potentially bad loans amounted to at least \$600 billion, a sum larger than the entire Chinese economy, and possibly as much as \$1 trillion. It was claimed, however, that only about \$87 billion of this amount was fully unrecoverable (Tabb, 1995; *Economist*, 1997e; WuDunn, 1998c; Tett and Wighton, 1998; Leyshon, 1994: 134-35; WuDunn, 1998d; WuDunn, 1998a; WuDunn,

²¹In 1995, gross domestic savings in South Korea and Thailand amounted to 36 per cent of their GDP, and the corresponding figure for China was 42 per cent. Gross domestic savings in the United States had declined from 19 per cent of GDP in 1980 to 15 per cent in 1995 (Wade, 1998: 1540).

1998b; Bremner, 1999; Nakamae, 1999).²² Though their exposure to bad loans in East and Southeast Asia was relatively modest — only about \$93.3 billion of the total were lent to institutions in Thailand, South Korea, Indonesia, Malaysia, and the Philippines (International Monetary Fund, 1997b: 1, table 2) — compared to the hundreds of billions of dollars in dubious loans in Japan itself, where property values had fallen by 80 per cent between 1992 and 1998 (Bremner, 1998).²³

The precarious position of Japanese banks was reflected in the sale of foreign bonds as cash-strapped banks traded in securities to raise funds and reversed the flow of capital. Prior to the current crisis, high domestic rates of savings and low interest rates had led Japan to become the largest exporter of capital, especially to the United States where private and public institutions were required to raise US\$1 billion a day on average. The looming mountain of bad debts however led Japanese investors to sell a record net ¥3.5 trillion (\$28.3 billion) in foreign bonds in December 1997. By the end of January 1998, British investors had overtaken the Japanese as the largest foreign holders of US government bonds, with \$300.1 billion worth of Treasury bonds compared to \$293.3 billion held by the Japanese (WuDunn and Kristoff, 1997; Coggan and Harris, 1998; Bloomberg News, 1998).

Higher interest rates and more prudential lending standards mandated by the IMF so abruptly turned off the financial spigot to some of the most enterprising companies in the world because their high debt-to-equity ratios meant that they could neither pay the extra interest charges nor recapitalize their debt since they could get no further loans. Not only did the cash-flow crunch virtually paralyze their manufacturing arms but the decline in aggregate demand further undermined immediate prospects of recovery.

²²The Japanese banking industry estimates total bad loans in the banking system to be ¥28,000 billion while the Japanese Ministry of Finance, which uses a broader definition of 'problem' loans puts it at ¥77,000 billion. The financial daily, *Nihon Keizai Shimbun*, estimates that write-offs or disposals of bad loans by the country's largest 19 banks could total ¥10,210 billion in 1997 and would cause losses for nine of the 10 largest banks (Tett, 1998a). Despite the banks making large write-offs, the Financial Supervisory Agency, Japan's banking watchdog, estimated that the largest 17 banks held ¥39,720 worth of potentially bad loans ("category two") at the end of September, 1998, ¥3,800 of "category three" or restructured loans, and ¥125 billion of "category four" loans to borrowers that were already defunct. Corresponding figures for March 1998 were ¥40,200 billion, ¥4,410 billion, and ¥77 billion (Tett, 1999b). By another estimate, bad loans totaled ¥49 trillion in February 1999 (Landers, 1999). These widely diverging estimates illustrate the difficulty of accurately assessing the magnitude of the problems as banks try to conceal the extent of their exposure.

²³By another estimate, all Japanese loans to East Asia excluding Hong Kong amounted to \$119 billion or just 3 per cent of all outstanding Japanese bank loans. And 75 per cent of these loans to Southeast Asia were to subsidiaries of major Japanese corporations (Strom, 1997).

Completing the vicious cycle, plunging values of local currencies exponentially aggravated the burden of short-term debts they had incurred. Cumulatively, the withdrawal of even provisions for letters of credit, higher debt repayments caused by relentless currency depreciations, and the imposition of Western standards of prudential banking have run some of the most innovative enterprises to the ground just when the elimination of restrictions on foreign ownership and investment rendered them virtually defenseless against corporate predators from overseas (Wade and Veneroso, 1998a).

Nowhere was the pain and humiliation of the IMF-imposed structural reforms felt more acutely than in South Korea. With the high debt-to-equity ratios of the *chaebol* and falling market shares due to overproduction and higher manufacturing costs, a plummeting won substantially increased short-term debt repayments and by the end of 1997, nine of the top 30 *chaebol* as well as hundreds of other smaller enterprises sought bankruptcy protection. When the won had reached historic lows against the US dollar, the IMF's insistence that the South Korean government increase the ceiling on foreign equity ownership from 26 per cent to 50 per cent by the end of 1997 and to 55 per cent by 1998 and eliminate all restrictions on foreign ownership of banks made South Korean companies potential bargains for foreign corporations. Due to the depreciation of the won, for instance, the world's largest producer of computer memory chips, Samsung Electronics, had a market capitalization of only \$2.4 billion at the end of 1997. This was about what it would cost to build just one of its factories, though the company also had about \$7.9 billion in debt (Pollack, 1997a).

Centerpiece of the South Korean reforms has been a restructuring of the *chaebol*. Confronted with an economic contraction of 6 per cent in 1998 — and growing unemployment with a jobless rate of 7 per cent or 1.6 million people in 1998 in a country that has virtually no social security net²⁴ — the conglomerates have been compelled to succumb to government and international pressure and sell off or merge their inefficient subsidiaries. Prominent casualties include the hand-over of Samsung's fledgling automobile affiliate to Daewoo in return for the latter's electronics unit; and the LG Group's sale of its computer-chip manufacturing unit to Hyundai which also acquired the insolvent Kia Motors. The *chaebol* also agreed to grant greater autonomy to their subsidiaries, cut overlapping investments in

²⁴As a part of the IMF imposed reforms the government utilized 10 trillion won (\$8.5 billion) in 1998 to extend the social security net to provide dole to workers for upto half a year (WuDunn, 1999).

order to reduce domestic competitors in strategic export industries to only two, and to reduce their debt loads from 550 per cent of their equity to 200 per cent though foreign investments, share issues, and asset sales. Some of the weaker *chaebol* were even selling their assets to foreign investors: Ssangyong, the sixth biggest conglomerate till 1997, sought buyers for its core cement and oil refinery to avoid bankruptcy; two-thirds of Hansol, the country's biggest paper manufacturer, was bought by a Canadian-Norwegian consortium, and Interbrew from Belgium purchased a 50 per cent stake in the country's leading brewery (WuDunn, 1999; Burton, 1998a; Burton, 1998b). Overall, the *Financial Times* estimated that capital expenditure by 69 companies based along Asia's Pacific Rim — 59 of which were Japanese — was only 7.8 per cent of gross fixed tangible assets in 1997 compared to 10.1 per cent for the 130 American companies surveyed and to 8.4 per cent for European companies.²⁵ However, despite the slowdown in the replacement of capital stock by Japanese companies, they continued to enjoy significant advantages over European and North American companies in investment and capital expenditures per worker (Brown, 1998).²⁶

Tightening credit and overcapacity also made it all but impossible for companies to justify new investments. In Japan, while the automobile industry had an installed capacity to produce 14 million vehicles annually, they produced only 10.4 million in 1998, a decline of 8.4 per cent over the previous year. Except Nippon Steel, all the top steel companies registered losses. Stung by an estimated ¥80 billion losses in 1998, and its sixth net loss in seven years, Nissan Motor Company implemented a major restructuring program designed to consolidate its model platforms from the current 20 to just five by 2005, shed some of its more marginal subsidiaries, and even sell its Tokyo headquarters (Strom, 1999; Harney, 1998; Harney and Abrahams, 1998).

The problem of overproduction was compounded by a scheme introduced in 1993 to boost the country's housing sector by Kiichi Miyazawa, the current finance minister, when he was prime minister. The Housing Loan Corporation, the government's largest mortgage lender, not only relaxed its normal lending criteria but also introduced cheap *yutori* loans which permitted borrowers to make very low payments for the first five years but

²⁵Of the American companies surveyed, 118 were from the United States, 9 from Canada, and 3 from Brazil and most of the 101 European companies surveyed were from France, Germany, and the UK.

²⁶Investment per worker by the Japanese companies surveyed was estimated at £317,000 compared to £154,000 in the Americas, and £152,000 in Europe. Capital expenditure per employee was estimated at £25,000 in Japan, £16,000 in the Americas, and £13,000 in Europe.

much higher ones after that on the assumption that Japanese household incomes would pick up after the recession of the early 1990s. The current economic meltdown undermined this premise, especially since declining sales and growing inventories virtually eliminated overtime work which often functioned to provide an essential 'top up' income and now almost a million Japanese households face huge mortgage payments when their incomes are being slashed (Tett, 1998b).

To be sure, there were several problems with strategies of growth pursued by the fast-growing economies along Asia's Pacific perimeters — the competitiveness of their export industries had been undermined because their currencies were tied to an appreciating American dollar, their enterprises had three or four times the debt-to-equity ratios of Western firms, and their financial sectors were regulated very inadequately. Nevertheless, these problems did not warrant the credit rating of the ailing Asian economies being reduced to junk status as speculators and investors scrambled to off-load assets denominated in rapidly-depreciating currencies. As long as their enterprises could cover operating costs and make loan repayments, high debt-to-equity ratios did not threaten continued economic growth.

A PARADISE OF THE BLIND

Even if *Asiaweek* magazine may have been premature in publishing an obituary to the 'Asian Economic Miracle' in its 1997 end-of-year issue, the economic maelstrom engulfing economies along Asia's Pacific Rim ripped the aura of invincibility that had enveloped them for almost a quarter century. As the crisis was triggered by the huge debt-burden of several economies in the region, it has been viewed almost exclusively as an 'Asian crisis.' More narrowly, as the thrust of the reforms force-fed to the most afflicted economies has been directed towards improving their financial difficulties, it has been perceived as a financial crisis that can be resolved through the adoption of more prudential lending criteria and more transparent accounting procedures. However, from the standpoint adopted in this article, the underlying cause of the crisis was overproduction on a world scale. The crisis manifested itself first along the Pacific coasts of Asia only because several of the fastest-growing economies in the world were located there.

In fact, precisely because the savage intensity of the crisis within the ailing 'dragon' economies has been the cynosure of world attention, the wider global consequences of these afflictions have virtually been ignored. Since China remains highly protectionist, steep devaluations of the currencies of Japan and of the East and Southeast Asian NICs have led them to register

record surpluses in their trade with the United States, Western Europe, and Latin America. In 1998, Japan's politically contentious trade surplus with the United States grew by 23 per cent rise over the previous year: at ¥6,700 billion, it was the highest since 1987. With the European Union, the Japanese trade surplus grew by 26 per cent. However, the deep-rooted economic dislocations in its immediate neighborhood meant that its surplus with Asia fell by 36 per cent. As a result of the IMF-mandated structural reforms and the ensuing cutbacks in imports, South Korea's foreign exchange reserves stood at an all-time high of \$41 billion by August 1998 and were estimated to reach \$50 billion by the end of the year (Wade and Veneroso, 1998b: 25; Cumings, 1998: 70; Abrahams, 1999b). The waves of bankruptcies, joblessness, and currency turmoil submerging these economies implies that intra-Asian trade which had accounted for 53 per cent of all Asian trade can no longer be the motor for regional growth and recovery (Bello, n.d.). Estimates suggest that Indonesia, Malaysia, South Korea, and Thailand have suffered import declines ranging from 30 to 40 per cent in 1997.

The continuing currency hemorrhage undermined economic stability in Latin America, tipped as recently as June 1998 to be the fastest growing region in the world. Between June and September of that year, funds were withdrawn from Latin American money markets at three times the rate of withdrawal from Asian and Pacific funds and Venezuela and Brazil went deeply into deficit and Argentina teetered on the verge of collapse (Wade and Veneroso, 1998b: 15-18; *Economist*, 1999a). Similarly, the Russian economy has been particularly stricken with financial problems since August 1998.

If the United States and Western Europe appear to have weathered the storm, these appearances may be deceptive. While they have benefited from debt repayments, the trade deficits are increasing so precipitously that by October 1998 the Japanese yen had once again rebounded against the US dollar — from reaching its eight-year low of ¥147.8 to the US dollar in August 1998, it traded at ¥114 in January 1999. Even as high-income states in North America and Western Europe experience a recovery from the fourth major recession since the late 1960s, the average rate of unemployment in the eleven European Union countries averaged 11.3 per cent in 1996 when the average annual rate of unemployment in the 16 leading economies during the Great Depression, between 1930 and 1938 was 10.3 per cent (Brenner, 1998: 3). If the United States was exceptional in having a low unemployment rate of only 4.3 per cent in 1996, a University of Michigan study indicated that between 1969 and 1997, the inflation-adjusted median earnings of white high-school graduates fell by almost 30 per cent.

Even more tellingly, in 1997 these less skilled white workers earned less in real terms than their black counterparts did almost 30 years earlier (Weinstein, 1999). And last year, in the midst of the exuberance on Wall Street, American firms announced the layoff of 677,795 workers, the largest figure in this decade. As the biggest ten mergers in American history took place last year and most are yet to announce their rationalization plans, layoffs in 1999 may be even higher (*Economist*, 1999b).

The growing gap in income levels all over the world, combined with gross overproduction has led to a shift of capital from manufacturing into speculative activities as demonstrated most vividly by the spectacular rise of the Dow Jones Index. As profits shrink in the productive sector of the economy, capital flows into speculation as has been a recurrent pattern in the history of the capitalist world-economy (Arrighi, 1994). Yet, such flights of capital into speculation does not lead to employment and wrecks the fabric of society.

In short, far from being a financial crisis caused by imprudent banking protocols and 'crony capitalism' the meltdown of Asian economies was caused by the progressive elimination of controls on cross-border flows of capital, commodities, and investments and the attendant erosion of the regulatory competences of their state apparatuses. The first section of this article demonstrated that close coordination between business and government elites in Japan and the 'Four Dragons' and the loose integration of their export-oriented industrialization programs under the aegis of Japanese capital had led to the creation of a series of complementary industrial structures which were able to withstand the collapse of most other low- and middle-income economies in the early 1980s. However, their very success made rendered this institutional scaffolding anachronistic: as corporations began to expand their production operations overseas, the regulatory structures became more of a handicap than an advantage. Consequently, conglomerates based in Japan and the East and Southeast Asian NICs began to lobby for a loosening of government controls to gain access to cheap credit from international financial markets, to circumvent non-tariff restrictions in overseas markets, and to lower labor costs by relocating production facilities to low-wage areas. Simultaneously, pressures by Western governments and the multilateral financial agencies on economies everywhere to lower tariffs and lift restrictions on foreign investments prodigiously expanded the potential sites for investments and competition among them exerted a downward pressure on wages. These conditions made it conducive for major manufacturers in every industrial sector to maintain a presence in every market especially since the collapse of the Japanese 'bubble' economy meant that

Japanese banks were eager to lend money to overseas borrowers in a bid to recoup the huge losses they had suffered. While large infusions of capital were vital if enterprises were to continuously upgrade their production operations and to compete in highly sophisticated products in core markets, the simultaneous pursuit of parallel strategies of industrialization sharply reduced the benefits accruing to each enterprise and led to overproduction over a wide range of sectors. And overproduction led to falling profits and plant closings that in turn reduced demand even further and triggered a chain reaction. In this context, the crisis manifested itself first in East and Southeast Asia because overproduction was most noticeable in the fast-growing economies of the region.

If sharp currency depreciations in East and Southeast Asia appear to have arrested their fall, the hollowing out of their economies has led to widespread unemployment, bankruptcies, and fire-sales of otherwise viable enterprises. Acquisitions of many firms in the stricken economies by enterprises based in Western Europe and the United States have not only further corroded state-centered strategies of economic growth but also called into question the structuring of Pacific-Asia as a coherent economic region. Simultaneously, the resulting decline in effective demand in the erstwhile 'dragons' have exacerbated the problem of overproduction just as workers in Western Europe and North America face increasing pressure from low-cost imports from the Asian economies. Focused as most analysts are on the short-term, there has been little attention to the underlying problem of overproduction and the larger questions involved in the structural change from an industrial economy to a new economic configuration, the contours of which remain unclear.

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RAVI ARVIND PALAT is a senior lecturer in sociology at the University of Auckland, New Zealand. He has a BA in economics from the University of Madras, an MA and an MPhil in history from the Jawaharlal Nehru University, New Delhi and a Ph.D. in sociology for the State University of New York at Binghamton. He has taught sociology at Binghamton and Auckland and Asian Studies at the University of Hawaii. He has published articles in *Theory & Society*, *Thesis XI*, and other journals and is the editor of *Pacific-Asia and the Future of the World-System* (Greenwood, 1993).