State Power and the Asian Crisis

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Earlier versions of this paper were presented at the jointly sponsored seminar of the Department of Sociology, the School of Asian Studies, and the Center for Social Theory and Comparative History, UCLA, the Woodrow Wilson School, Princeton University, the Department of International and Public Affairs, University of Columbia, the Institute on Globalization and the Human Condition, McMaster University, the Henry R. Luce Lecture, Clark University, and the Program on US-Japan Relations, Harvard University. I am grateful to those who participated for their many astute and valuable comments. In particular, I wish to thank Parminder Bhachu, Jagdish Bhagwati, Ha-Joon Chang, Wan-wen Chu, William Coleman, Sheldon Garon, Nicky Hart, Atul Kohli, Arvid Lukauskas, Michael Mann, Richard Stubbs, Steven Vogel, and Robert Wade and the two anonymous referees of the Working Paper series for their comments on an earlier draft.

Forthcoming in ***New Political Economy,*** Millenium Issue, November 1999.

State Power and the Asian Crisis

By Linda Weiss

The Asian financial crisis has re-opened the debate about the role of the state in the region's industrialisation. Just when there seemed to be growing acknowledgment across the economic and political disciplines that certain kinds of state involvement were vital to the rapid upgrading of the Northeast Asian economies and that understanding what made states effective or ineffective was a crucial issue, along came the financial hurricane.[1] Profound disarray of an economic and social nature has been the most immediate and important consequence of this watershed event. Theoretical disarray has followed closely in its path.[2] This paper seeks to inject some theoretical rigour into the discussion of the Asian crisis. State power in the Asian setting - whether and in what way the state's transformative capacity is weak or robust - and how it relates to the impact of international markets is central to the argument that follows.

The argument: the two faces of the Asian crisis

Though commentators disagree about the fundamental causes of the crisis, explanatory efforts by and large have taken one of two different tacks. One focuses on variables inside the nation-state, giving primacy to domestic weaknesses (ie, flawed policies or institutions or some combination of the two). The other directs the analytical focus outward, attributing most weight to international and global financial markets (ie, investor panic).[3]

Rather than appraising the respective merits of an 'outside' or an 'inside' approach, we can move to a more fruitful starting point. We begin with the observation that this particular crisis has two faces, not one: a 'normal' or ordinary aspect and an 'abnormal' one.

To say that there is a normal aspect to the crisis is to make the simple but important point that there is little novelty to financial crises. Though they occur suddenly and unexpectedly, and at times perhaps even arbitrarily, they do so with great regularity. Though the latest crisis is always viewed as the most compelling, such events as we have witnessed in Asia, at least before the crisis deepened - including falling asset prices, plunging currency values, and weakened banks - have a long history. Whether one's perspective is that of 15 years or 150 years, it appears that the history of capitalism is strewn with financial crises of one form or another. Their recurrence over a very long period suggests that crashes, panics and manias are endemic in modern capitalism.[4]

The implication is that no country can be considered immune. This does not mean of course that all countries are equally susceptible to financial crises. Rather, in a world of volatile capital flows, *some* countries may become *more* vulnerable to crisis than others. What makes them so? Students of financial crises suggest that vulnerability is a function of some domestic weakness or weaknesses, which before the crisis were regarded as benign.[5] Generally speaking, then, the *normal* face of the Asian crisis directs analytic attention to *national-level* variables. These are examined in Part I.

But we cannot leave the analysis at this point. No matter which domestic 'weaknesses' are singled out, the very act of doing so runs the strong risk of overstatement and distortion. The afflicted economies were not basket cases, but reasonably sound, generally with moderate if not striking prospects for improvement. Most of them enjoyed high savings, balanced budgets, strong private sector investment, low inflation, a relatively egalitarian income distribution, and a strong export drive. 'Vulnerability' therefore needs to be placed in perspective: it is after all, merely a condition, not a cause of the upheaval that ensued. It cannot be emphasised too often that, regardless of one's theoretical perspective, there is a real danger in the temptation to make overly coherent - and thus apparently inevitable - an outcome which remains, in several important respects, genuinely confounding.

Separating out for special explanatory treatment the *abnormal* aspect of the crisis is one way of guarding against this tendency. In so doing, I propose to explain why a problem that should have been transient and quite quickly rectified like so many others before it,[6] turned into a full-blown disaster.

To emphasize the 'abnormal' face of the crisis is to draw attention to its *deepening* and its *severity*, and thus to highlight what was special about the Asian experience. Abnormality in this context refers to *outcomes far in excess of what one could reasonably anticipate or justify in the light of what is known about pre-crisis conditions* of the affected economies. Domestic weaknesses may explain country vulnerability, but such weaknesses are unlikely to be lethal. That is, they are unlikely to explain the way the bursting of the property bubble in Thailand, for example, turned into full-blown capital flight. There is, in short, much about the Asian crisis - its timing, its pattern of contagion and, above all, its magnitude - that has only a tenuous connection with the state of the real economy of the countries in question. Many have remarked on the peculiar depth and severity of the phenomenon. Few have attempted to theorise it. To do so, I shall turn again to political power variables, but this time (in Part II) originating *outside* the nation-states in question.

I propose, then, a two-pronged approach to the issue. If we take this duality seriously, it stands to reason that monocausal approaches will not take us very far. Rather than adding to the steady stream of monocausal explanations that presently compete for attention, a different tack is required. A state power framework enables one to address the question of the sources and evolution of the crisis with a degree of theoretical rigour, while at the same time giving due weight to national and international factors.

We have then two central questions: why were some East Asian countries much more vulnerable than others to financial meltdown - ie, why was the crisis so *uneven* in its occurrence (thus, for example, Korea proving more vulnerable than Taiwan); and why was it so *severe* in the Asian setting (ie, 'severe' relative to economic fundamentals and to earlier crises elsewhere)?

Financial markets, domestic institutions, international power actors

The general argument is that while global financial markets somewhat obviously and directly produced the outcomes commonly labelled as the Asian crisis (ie, by way of speculative runs and sudden withdrawal of funds - so-called investor panic or herding), they were not the primary determining factor. For financial markets to have wrought their effects in the first place (and in differential measure), two less obvious variables had to be present. The first - a 'normal' pull factor - is some sort of domestic vulnerability in the real economy, in this case, I shall argue, one whose common denominator is weak or decomposing institutional capacities. The latter, in turn, depending on the context, considerably exacerbated real economy vulnerabilities such as falling exports, rising current account deficits, and surplus capacity.

The second variable - an 'abnormal' push factor - consists in vulnerability which is externally induced or intensified. The common denominator of this second-order vulnerability is the strong external power of a leading state (the United States) pursuing its own national economic agenda (with a strong input from its domestic financial interests), partly on its own and partly in concert with the IMF.

Thus two theses are advanced. Both implicate state power. The more general thesis is that *the relative weakness of state capacity (in Southeast Asia), and its marked if incomplete decomposition (in Korea)* made these economies more prone to speculative investment (in the Korean case, over-investment), asset bubbles, and current account deficits, and consequently more vulnerable to financial upheaval. In the Korean case, it was not institutionalised weakness *per se* but the gradual decomposition of core capacities that paved the way for the high-risk borrowing strategies and over-investment of the chaebol, which then exposed Korea to sudden downturns and capital flight. In the Asian episode at least, one can generalise that by virtue of both limited and decomposing state capacities, certain economies became significantly more vulnerable than others to investor pullout (triggered in the first instance by the bursting of the property bubble in Thailand). But in saying this, one is merely drawing attention to the ordinary, 'normal' face of financial crisis.

The second more specific thesis is that it was an outside force, namely, *the relative strength of US international state power* which - as will be discussed below - partly through its own independent actions and partly through the auspices of the IMF, helped to deepen the crisis, turning an otherwise ordinary event (that is to say, transient and quickly repaired) into an unusually severe and protracted phenomenon.

PART I:

NATIONAL INSTITUTIONS AND ECONOMIC VULNERABILITY

Domestic power and the Asian crisis

In what way, then, is state power at issue in the crisis? When commentators invoke the state's role to explain the crisis, they typically draw on one of two quite different interpretations. By far the most common is the 'state interventionism' or 'too much state power' thesis.

(**1) Too much state intervention**. If there is an 'official' version of the Asian crisis, this is it. It views the crisis as a demonstration of the folly of state intervention in the economy. The 'too much power' conclusion is that 'interventionist' states have brought the Asian economies down by distorting market processes. For if states had not been so 'interventionist' in their economies in the first place, there would be fewer distortions (viz. corruption, cronyism, and other forms of rent-seeking) blocking efficient resource allocation. For proponents of this view, state interventionism shades ineluctably into cronyism; both are typically equated with the 'Japanese model' of state-guided capitalism (*aka* the 'Asian model'), and the crisis is seen as proof of its failure. As an expression of this understanding, consider the following statement celebrating, somewhat prematurely, the triumph of the American model in Asia:

> There is an emerging consensus on both sides of the Pacific that the Japanese model has failed. Countries up and down the Pacific Rim are embracing market oriented reforms in the wake of an economic crisis widely blamed upon Japanese style institutions.[7]

For all its crude overtones that replay the fruitless ‘state-versus-market’ dichotomy, this is probably the most popular view of what has gone wrong in Asia. It is favoured by the IMF, by top officials in the US Treasury and the Federal Reserve, and by liberal economists more generally. If state involvement is seen as a recipe for unstable economic foundations, this is because in most such reasoning, it is virtually inseparable from rent-seeking, political favouritism and straight-forward corruption. However, to the extent that such practices are the norm rather than the outlier, they may be seen as symptoms of *weak* state capacity, not robust; to this extent, evidence of their pervasiveness in the troubled economies is more likely to support than to refute the argument advanced here.

(2) Too little regulation. For others, however, the problem of state power is one of inadequate regulation or too little state control rather than too much. These commentators propose that state weakness (in a regulatory sense) helped to create the crisis. As Joseph Stiglitz, chief economist and vice president of the World Bank put it, 'The crisis was caused in part by too little government regulation (or perverse or ineffective government regulation)'.[8] The 'too little' proponents are chiefly concerned with the laxity of regulatory control over capital inflows consequent upon financial liberalisation (hence over-exposure to unhedged, short-term debt). This is undoubtedly important. After all, the opening of the capital account is central to the whole story of what has gone wrong in Asia. It resulted in massive amounts of short-term capital (in foreign denominated currency) coming in to service long-term investments (at pegged exchange rates). From this perspective, the cause of the Asian crisis was straightforward: if the state were a stronger regulator - preventing dangerous inflows - there would be no crisis, end of story. So the weak regulation of the capital account 'caused' the problem: for what comes in can go out; and very quickly it did go. This thesis has much to recommend it. But there is more at issue than regulatory capacity, as we shall see in the next section.

Indeed, the real intellectual challenge would seem to lie elsewhere. It is two-fold: The first task is to explain why capital flowed in in such massive amounts in the first place. In other words, what was the capital being used for and how did that use reflect underlying institutional weaknesses and exacerbate economic vulnerability? This is the focus of Part I. The second task is to explain why capital went out in a seemingly unstoppable haemorrhage - to the point where Indonesia, as the worst case, would become totally disconnected from the international banking community. This is the focus of Part II.

As indicated earlier, there would seem to be a good case for arguing that some economies may be more vulnerable to financial crisis than others. Identifying weaknesses in the 'real economy' is not too difficult in the Asian experience. Most analysts agree on what they are: falling export growth - which is the main cause of the ballooning current account deficits - was common to all the affected countries in the two years prior to the crisis. Falling exports in the troubled economies can be explained in a number of different ways.[9] But two common underlying conditions for the loss of markets can be identified. One is the *institutional inability or slowness to upgrade* skills, products, and technology and thus an over-reliance on the highly price-sensitive goods that are also being produced by new competitors down-market (e.g. pre-crisis Thailand). The other is the tendency to produce surplus capacity (resulting from what the Japanese call 'excessive competition'), due in part to the *absence of an institutional discipline for investment coordination*[10] and in part to the absence of an external or institutional pressure to upgrade (exemplified by the Korean experience).

Where this analysis differs from existing accounts on the vulnerability issue is in going deeper to trace its *institutional sources*. I propose that the sources of vulnerability in the real economy lie in relatively limited or weakened transformative powers of the state in the most affected countries (Thailand, Indonesia, and South Korea). The more limited transformative capacities of Thailand and Indonesia (above all, the failure to coordinate investment into productive sectors of the economy and to hasten upgrading of skills and technology) paved the way for high levels of speculative investment (notably in real estate), falling export growth, and rising current account deficits. In Southeast Asia, the flipside of this institutional failing was increased foreign indebtedness by private corporations and financial institutions in order to fund the deficits, massive investment in non-tradeables, and ultimately property bubbles which burst, triggering the first phase of the crisis.

In Korea, on the other hand, where state capacities had been gradually decomposing, excessive foreign borrowing by private companies and extensive 'over-investment' in leading export sectors (steel, petrochemicals, cars, semiconductors) resulted in oversupply, falling exports, interest repayment difficulties and a spate of corporate collapses, thus triggering the first phase of the crisis in Korea.

From weak transformative capacity to ‘real economy’ vulnerability and weak regulatory control

My account therefore takes a different tack, though one that is complementary, to the Stiglitz approach ('too little regulatory control'). For in all the troubled economies we are confronted with another kind of institutional debility: that is to say, limited or - in the case of Korea - weakened 'transformative capacity'.[11] I use this term to refer to national contexts where the socio-political project of government and the organisation of state-society relations are biased towards improvement of the production regime. In such contexts the goal of trading at ever higher levels of skill and technology (sectoral transformation) has priority over that of maximising consumer welfare, and the state - rather than the market alone - is viewed as an important means of achieving it.[12]

Transformative capacity is important for at least two reasons. The first and most immediate consequence of low (or weakened) transformative capacity is economic vulnerability in the form of falling export growth, rising current account deficits, and excess investment (surplus capacity). See Figure 1. For investors, current account deficits in particular are among the most important indicators of a nation's economic prospects. On the eve of the crisis, current account deficits (most marked in Thailand) soared as exports slowed and as borrowed capital was invested in non-tradeables (especially real estate). As the current account deficits ballooned, the demand grew for foreign capital to sustain them. Attracting such capital meant raising domestic interest rates, which in turn resulted in a dramatic fall in real estate prices, thus bursting the bubble economy. Thailand manifested in exaggerated form the problem common to the Southeast Asian economies: a consumption boom, stock and property bubbles, and asset price inflation. These were the immediate source of its increasing current account deficits. At a more fundamental level, however, these outcomes were ensured by the fact that Thailand had ceased to be a low-cost producer, yet remained poorly equipped to supply more sophisticated, less price-sensitive goods. In short, the move to upgrade the industrial portfolio - and thus move up-market of the cheaper producers in China and Vietnam - has been much delayed. This contrasts with the high-growth phase of Taiwan and Korea where the drive to trade at higher levels of technology was orchestrated by way of a selective industrial policy, which linked credit allocation and tax incentives to investment in specific sectors of the economy. As one might anticipate, in the absence of the more consistent regime priorities and dedicated institutional arrangements of their Northeast Asian neighbours, the Southeast Asian countries were much less predisposed to coordinating industrial investment and upgrading. The end result for Thailand has been massive capital inflows whose composition and destination the state has appeared neither able nor willing to shape. Below I indicate the ways in which Southeast Asian states failed to institutionalise such powers for sustainable development; and how the gradual unravelling of Korea's powers quickened in the 1990s.

Figure 1: Transformative Capacity and Vulnerability to International Financial Crisis

Country		*Three criteria of transformative capacity:*		*Capacity level**	*Economic vulnerabilities*
	(1) Transformative economic orientations	(2) Pilot agency (centralised bureaucratic coordination)	(3) Government-business negotiation		a) Falling export growth b) Current account deficits c) Surplus capacity
Thailand	~ 1	~ 0	~ 1	2	a, b
Korea	? 2	~ 1	? 2	5	a, b, c
Taiwan	X 3	X 3	X 3	9	- - -

~ Absent, weak or inconsistent
? Contested
X Intact
* Numbers (weights) allocated for expository purposes

Ironically, as we shall see, only in one area has 'too much' state power been of relevance. This concerns the international arena and the role of the United States as 'opportunistic hegemon', whose interests and actions have deepened, and in turn been served by, the Asian crisis.

The second consequence of transformative weakness in the Asian industrial arena has to do with financial regulation. Where *transformative* capacity is limited or reduced, this appears to underpin or pave the way for weak *regulatory* control in the financial sector. Conversely, where transformative orientations and organisational capacities remain robust - as in Taiwan, Japan,[13] and Singapore - the approach to financial liberalisation has tended to affirm rather than remove state control over capital flows. Korea and Taiwan illustrate these differences in the way each went about the task of liberalising the corporate bond market.

Whichever way we look at it, the fact remains that, in the six or seven years prior to the Asian meltdown, the Korean authorities were much ‘less guarded’ than Taiwan’s about the level of short-term inflows. Was it simply an error that led the Koreans to require that only foreign loans of more than one-year maturity be registered? There is some evidence to suggest that it was more a calculated policy choice, aimed at giving the *chaebol* access to affordable credit in a period marked not only by deteriorating economic performance, but also by state withdrawal from credit control and industrial policy. Rising wages and declining productivity in the first half of the 1990s made Korea less attractive to foreign lenders, thus placing a premium on long-term interest rates. As a result, long-term foreign loans became more expensive, harder to obtain, and recorded a net outflow as loan repayments continued. It was in this context that MOF officials took the decision to relax controls to allow the *chaebol* greater access to short-term portfolio investment. The result was a surge in the inflow of foreign capital, most of it portfolio investment, exceeding a cumulative total of US$27 billion between 1991-94 alone. The contrast with Taiwan's deregulation of the corporate bond market in 1993 is instructive. The Central Bank (CBC) for the first time allowed Taiwanese companies to remit the proceeds of overseas bond issues for domestic use. However, this was accompanied by new rules that all such foreign currency remittances be invested in plant expansion, and that the total or national aggregate for all such inflows was not to exceed US$3 billion. Moreover, the CBC backs up the regulations with close monitoring, intervening under its emergency powers when its suspects foreign inflows are not being used for designated purposes.[14]

One might speculate that the Korean government was less guarded than the Taiwanese about raising the level of short-term inflows because they were subject to greater pressure from big business. But even if such pressure could be demonstrated, it would not contradict a more fundamental point: Korean business would very likely find itself pushing against an open door in the 1990s in so far as state actors had been working for over a decade to relinquish financial control, wind down credit activism, and advance the chaebol's financial autonomy - in short, to dismantle the state's transformative capacity. In the preceding decade growing ideological divisions within the state elite helped to reorient ideas about the role and scope of the state in industrial governance; and by 1993, with the cold war behind them and the election of the first wholly civilian government under Kim Young Sam, the newly empowered neoliberals in the bureaucracy voted to dismantle their key transformative agency, the Economic Planning Board. Consequently, when the Koreans approached the task of liberalising the capital account in the 1990s, they did so with a view to preparing the ground for further dismantling state control over the economy - not to maintaining it.

This contrasted with the approach taken in Taiwan where the goals and organisational arrangements of state actors (and thus what I have called their transformative capacity) remained largely intact in the period leading up to financial liberalisation. That legacy ensured a different approach to financial reform, one which would deploy the new rules as a means of securing state involvement in national economic management. In spite of the growing importance of liberal economic ideas in Taiwan's public discourse, it is likely that the continuing geopolitical threat (the China question) together with Taiwan's peculiar diplomatic isolation served as important countervailing pressures that tempered and moderated the domestic push to embrace economic liberalism. As a result, state actors in Taiwan by and large continued to view the state both as important goal setter for the national economy and as indispensable means of sustaining an internationally competitive industry. Accordingly, as Taiwanese authorities went about internationalising the financial system in the 1990s, they did so with a view to complementing and maintaining the state's powers of coordination. To the extent that the Korea--Taiwan differences suggest different routes to liberalisation, Korea appears to have moved in a more state-minimising, market-enhancing (neo-liberal?) direction, while Taiwan, like Japan, has chosen a more state-enhancing path via reregulation. In each case, the outcome appears to be shaped by the pre-existing constellation of ideas and institutions regarding the state-market relationship.[15]

The question of prime movers in state disengagement and financial deregulation is a separate and far from simple story which cannot be adequately recounted here. Suffice to say that the popular perception emphasises international forces bearing down on the Korean government - especially US pressures for economic liberalisation. But the nature and timing of those external pressures (most effective in the early 1990s as Korea seeks OECD membership) need closer scrutiny, as does the domestic momentum for reform. In the Korean setting, the first great step towards state disengagement and financial deregulation occurred in the early1980s. Domestic political crisis and intra-elite divisions over the state's role in economic change provided much of the impetus for change in this period. Push turned to pull in the 1990s as Korea's quest for OECD membership was made conditional upon greater opening of its capital account.[16] It is not hard to appreciate that Korea's desire to be part of the rich countries' club (something unavailable to Taiwan) would not only have 'intensified external pressure to liberalise the economy',[17] but also made such pressures more effective. But to claim that external pressure was the primary driving force behind Korea's efforts to reconfigure the state-finance-industry relationship and to dismantle some of the more elaborate machinery of state control would be misleading. For that reorientation had been underway throughout the 1980s, and that shift is inexplicable without reference to domestic pressures. In sum, there is no shortage of external pressure for liberalisation, especially after 1989 and the cessation of cold-war politics. But it may be easy to overstate its importance in a context where the *internal* pressures for liberalisation were far from weak. One can imagine insistent prodding from the US for financial deregulation making some impression; one can *expect* it to make a mark when it dovetails with the agenda of pro-liberalisation supporters within the financial bureaucracy and the government-sponsored think tanks like the Korean Development Institute. These same Korean bureaucrats and economists, not the Americans, were the ones who pressed for complete dismantling of the EPB, the 'central coordinating intelligence' which had presided over Korea's rapid transformation.

There is however a larger point to be made, which dovetails with the argument being advanced here. By the early 1990s, having already ceded a large chunk of its transformative capacity - including its sectoral investment coordination and upgrading role - to a private sector enthusiastic for independence (but ambivalent about state withdrawal from industrial credit), it was for the Korean government merely a short step to relinquishing control over the financial system. To say - as many have indeed pointed out - that liberalisation took place in a 'flawed' manner, that is, without accompanying regulatory controls, may be somewhat beside the point. For, as I have indicated, the Korean authorities appear to have undertaken liberalisation with a view to further dismantling, not securing, the state's core capacities. In the process, of course, they relinquished much more than they bargained for.

It is important to be clear about the causal logic of the present argument. It is not proposed that robust transformative capacity is always essential for effective regulatory control. Clearly countries do not require the elaborate underpinnings of state capacity in order to engage in regulatory control. Effective efforts to control the level and composition of capital flows can also evolve as a form of institutional learning, in response to the experience of severe financial crisis, as for example in the case of Chile.[18] Thus *firm* regulatory control of finance may sit alongside institutional arrangements which are far less elaborate than those entailed by transformative capacity. On the other hand, it is proposed that *loose* regulatory control is in some significant sense associated with limited or weakened transformative capacity. The proposition then is that governments tend to ‘choose’ a form of regulatory regime that matches up with their fundamental orientations and organisational arrangements. If, for instance, securing a strong and competitive industry is viewed as a basic economic goal and the role of the state is perceived as important to its achievement, one would expect reasonably strong complementarity between this (transformative) industrial orientation and the (closely managed) type of regulatory regime found in Taiwan, Singapore,[19] and Japan. If on the other hand the state's role is deemed of decreasing importance in achieving the economic goal (as in Korea), or the economic goal itself is inconsistent or uncertain (as, for example, in Thailand and Indonesia) one would expect a similar symmetry between weaker transformative orientation and regulatory looseness. So while on the surface of things it may appear that Korea's current problems have more to do with the state's failure to manage financial liberalisation than with its declining commitment to and capacity for transformative projects, the import of my argument is that the two are inextricably linked. The implication is that in so far as transformative capacity calls for greater coordination of investment flows and upgrading efforts, such a commitment entails more careful oversight of volatile capital flows and thus a degree of prudential regulation. This at least is the story for Taiwan.[20]

This section has proposed that transformative capacity is significant for two reasons. First, it paved the way for economic weaknesses such as falling export growth, rising current account deficits, and excess capacity. Second, it contributed to regulatory weakness, thus enabling uncontrolled speculative and short-term inflows. Let us see how this argument applies to the main crisis-stricken economies.

Southeast Asia: in search of the effective state

The fast growth of the Southeast Asian economies has tempted many to assume a fundamental similarity in the political economies of Southeast and Northeast Asia (hence the widely touted notion of an 'Asian model'). One consequence of this geographical elision is the tendency to see state involvement in the economy as all of a piece, the state's role in the Indonesian or Thai economy being considered much the same as for Korea or Taiwan. The result, say the same sources, is 'crony capitalism', a normative rather than analytical term to suggest that close ties between government and business are harmful to economic performance, in so far as they produce decisions based on non-economic criteria and are therefore market-subverting.

It is of course one thing to note the existence of cronyism, another to establish its *causal* role in the events culminating in the Asian crisis. Thus far, however, that case has not been established and any serious attempt to do so would do well to bear in mind two important points. First, among economists it is now recognised that so-called cronyism comes in different guises, some forms playing a positive developmental role.[21] Which forms prevailed in the East Asian setting on the eve of the crisis? We lack the necessary evidence, but considering the decent economic performance of the stricken economies in the pre-crisis period, one may presume that at least some aspects of cronyism were growth enhancing. Second, though the term has been used mostly by Western analysts to describe Asian practices, cronyism is equally at home in Western settings, at times central to the operation of a country's core institutions. For example, financial institutions in the City of London, up until the 1960s, operated principally through such networks.[22] Thus the presence of cronyism *per se* may offer little explanatory insight. It may be growth enhancing, retarding, or neutral; and it may constitute a core organising principle in even the most liberal free-market contexts. It is therefore possible to draw at least one interim conclusion: whatever the extent of cronyistic practices in Southeast Asia in particular or the region more generally, they are not the distinguishing building blocks of developmental states.

Indeed Malaysia, Thailand and Indonesia, in spite of the frequent rhetoric of growth *uber alles*, have never institutionalised 'developmental market economies' of the kind found in Japan, Korea, and Taiwan. If one takes the high-growth period of each country, the differences between first- and second- generation industrialisers in fundamental national orientations, in state architecture, and in coordinating capabilities seem to undermine rather than justify the notion of a unified ‘Asian model’. While government-business ties have often been close, they have rarely approached the 'governed interdependence' model of Northeast Asia, whereby a competent, relatively insulated economic bureaucracy institutionalises a negotiating relationship with organised industrial groups, in order to pursue sectoral industrial policies based on well-publicised criteria.[23] This is not to suggest that the Southeast Asian states are unremittingly weak. These countries have undergone considerable ‘structural transformation’, involving the shift from a largely agrarian and primary commodity-export base to an increasingly industrial one. There is no doubt that state capacity building has advanced considerably compared to most Third World countries; but the process of ‘sectoral transformation’ appears to have stalled, as I argue below. This process tends to demand a more elaborate set of capacities as well as consistent economic priorities.[24]

In Malaysia, where the bureaucracy for the past two decades has been preoccupied with ethnic redistribution, what passes for industrial policy has been appraised by analysts as a tool for resource redistribution rather than an instrument of industrial transformation.[25] The story for Indonesia is one similarly at odds with the transformative capacity of developmental states.[26] While ethnic distance has given the state some autonomy from the dominant (Chinese) entrepreneurial group, and while the state in the Suharto era has been surprisingly insulated from organised societal pressures, the overall picture is one of a relatively weak bureaucracy unable to monitor and enforce policy preferences. In his study of the politics of credit activism in the Suharto period, Andrew MacIntyre concluded that notwithstanding the development of an elaborate system of preferential credit (relatively little of it targeted to industry), official policy preferences were routinely subverted by a ‘patrimonially based allocation of rent-taking opportunities within the state elite'.[27] Strong interventionism plus autonomy from societal pressures may describe important features of the Indonesian state; but such features do not amount to a state that is developmentally oriented and configured.

A similar conclusion applies to Thailand. In contrast with Indonesia where oil exports have played a dominant role in economic expansion, Thailand's rapid growth since the 1980s has a stronger base in manufacturing exports. Yet, like Indonesia, Thailand's growth appears to owe little to a state-coordinated industrial strategy.[28] This may imply that Thailand, like Malaysia and Indonesia, has developed successfully without a developmental state, thus questioning the 'governed market' arguments developed to account for Northeast Asia's rapid transformation. An altogether different interpretation however may be more plausible: the *absence* of developmental institutions in each of the SEA countries may give rise to systemic weakness and incomplete transformative capacity, thus heightening economic vulnerability.[29] Some aspects of the Thai experience are consistent with this argument. For in spite of expanding manufacturing exports since the mid-1980s (heavily skewed towards electronics, fabricated in Japanese plants), on the eve of the crisis, Thailand appeared trapped at the lower end of technology, pursuing what neoclassical economists would consider a key plank of economic success: static comparative advantage based on access to cheap labour and raw materials. Whatever the precise basis of its rapid growth, Thailand it seems has been relatively slow to upgrade skills and technology for its capacity to shift skills and technology upmarket is relatively weak. This is reflected in very low, high-school completion rates,[30] in the underdevelopment of the domestic production of capital goods, and in real labour costs rising faster than real productivity. It is also reflected to some extent in the comparative rankings of state funding of R&D in 1998. Thus, for example, while Taiwan ranked 24th out of 53 industrialised and major developing nations worldwide, Thailand at 48th place was located at the lower end of the scale along with Malaysia (42) and Indonesia (53) at the bottom.[31] Recent moves by the Thai government since the Asian crisis suggest there is some substance to the 'transformative weakness' argument being advanced here,[32] for they have identified inadequate upgrading as a serious problem demanding a coordinated national effort.[33]

On the eve of the crisis, the chief problem for Thailand was not simply soaring current account deficits (7.9 per cent of GNP in 1996), but the fact that its prospects for rectifying them were relatively low because the national industrial structure was not being adjusted fast enough to absorb the rise in labour costs engendered by rapid economic growth.[34] Given the weakening state of Thailand's manufacturing export sector, coupled with the absence of a national upgrading effort, it was unlikely that the huge capital inflows would find productive outlets of their own accord. Moreover, far from overseeing capital flows, the state failed to ensure that capital was invested productively and earning foreign currency to service the debt.

Without wishing to overstate the differences which distinguish SEA countries like Thailand from first-generation industrialisers to the north, it is nevertheless important to highlight them. More generally, while there may be considerable 'embeddedness'[35] of Southeast Asian states in their surrounding societies (whether via ethnically-structured, patrimonially-linked, or interest-based networks), the findings of several area and comparative studies indicate that there has been much less 'insulation' of relevant state agencies where transformative projects can be pursued at some remove from particularistic interest politics. Where investment and financial flows are concerned, for example, this institutional weakness has been reflected less in the absence of relevant rules (inadequate regulation), or the proliferation of errors (policy mistakes), than in an inability to ensure policy *implementation*.

In Thailand, for example, even before the rules were changed - when the purchase of real estate and foreign securities by residents required approval from the Bank of Thailand - the Bank and MOF remained vulnerable to political intervention. In comparison with the Northeast Asian experience, the interdependence of government and business in the SEA economies, at least during their high-growth phase, has been governed much more weakly by transformative goals and institutional arrangements and, in consequence, public policy has more often been captured by particular interests jostling for favour in the political process.[36]

Korea: revenge of the international market against the transformative state?

In Korea, what began as a banking crisis was precipitated by a series of corporate collapses throughout 1997, beginning with the Hanbo group in January. Indeed the *chaebol* loom large as the villains of the Korean debacle. If one is seeking a common denominator in these events, it was not that of weak-state cronyism, or even of a strong state overriding efficient market logic. Rather it was one of private sector excesses: uncoordinated over-investment exacerbated by state retreat, that is, massive private borrowing for investments in sectors not only already well-supplied by other *chaebol*, (eg, petrochemicals, steel, semiconductors) but also subject to cyclical downturn.[37]

This was a pattern that would become increasingly marked in the decade just prior to the financial meltdown, as government gradually abandoned its long-standing role of coordinating industrial investment. First under Roh Tae Woo's presidency, then finally under Kim Young Sam's, policy loans were phased out and financial liberalisation speeded up.[38]

Ironically, it was a pattern that marked the *loosening* of the business-government relationship and gradual decline of transformative capacity in Korea. There can be no clearer symbol of this change than that offered by the definitive dismantling of the Economic Planning Board which was merged with the MOF in 1993. Although their explanatory aims may differ, many studies allude to the state's declining willingness and ability to operate a formal industrial policy and to oversee *chaebol* investments by the early 1990s.[39] ‘So what?’ economists would retort. Why should government be any better than business in deciding where to invest? Why indeed! Yet posed like this, the question misses the point. Like the Japanese, Korean and Taiwanese authorities have long emphasised the benefits of limiting what they refer to as ‘excessive competition’, whether through licensing, credit control, producer cartels, or some combination of these.[40] In spite of state encouragement, however, producer cartels have been much less successful in Korea than in Japan, highlighting industry's weak capacity for self-governance.[41] Licensing and credit control are further instruments of industrial policy that can function to limit ‘excessive competition’ and its consequences (viz. over-investment and surplus capacity). But once the state retreated from industrial policy, and its efforts to encourage industrial self-governance among the *chaebol* had failed, neither did the market take over to produce an optimum result, nor did the *chaebol* seek collectively to advance their wellbeing.

Whether one ponders this outcome theoretically in terms of market failure, prisoner’s dilemma, the logic of collective action or some such hypothesis, it is hard to avoid the conclusion that some form of central coordination may have helped to mitigate the excessive, overlapping investments of the *chaebol*, and by the same token served to concentrate *chaebol* efforts on the process of industrial upgrading. Instead, decomposing political capacity unleashed a frenzied scramble for market share among the *chaebol* (especially among middle-level conglomerates seeking expansion), resulting in overinvestment and high-risk borrowing strategies. As government-business ‘interdependence’ became steadily 'ungoverned', the *chaebol* tended to take the easier course of expansion rather than upgrading, pursuing growth rather than innovation.[42] This pattern became a hallmark of the Korean industrial landscape in the democratisation decade.

But the Korean pattern of over-investment and massive foreign borrowing was far from being fatal. It was certainly not Korea's first encounter with economic downturn, difficulties of foreign debt repayment, or even IMF intervention. Because of its massively-leveraged conglomerates, Korea has always been vulnerable to external shocks, leading in 1980 to a 6 per cent loss in GNP. Such shocks however had proved more containable in the past. So why was it so uncontainable now? What was new? Was it the composition of external debt, or perhaps its level or provenance? Surely not, for even in a more protected financial system, Korea managed to scale the heights of foreign indebtedness and was no stranger to repayment difficulties. (Large debts of short-term maturity prompted Korea's first major crisis of 1971-72; and the debt-cum-oil crisis of 1979-1982 involved difficulties servicing a huge foreign debt. Yet these problems were overcome with much less upheaval compared with the 1990s.[43])

To understand what was new about the 1997 experience, we need to consider the role of external factors in turning a run-of-the-mill debt crisis into an over-the-top financial crash. One thing had altered fundamentally - the geopolitical landscape. Since the end of the Cold War, the US-Korea security relationship had gradually weakened. Consequently, Korea in the 1990s was no longer a special case whose deviation from the free-market norm could be tolerated for larger political goals.[44] Thus, far from seeking to buttress the Korean state as it had done in other times of difficulty, the US was now prepared to stand back and let the crisis rip through the institutional fabric it so wished to tear apart.

PART 2:

INTERNATIONAL POWER ACTORS AND DEEPENING FINANCIAL CRISIS

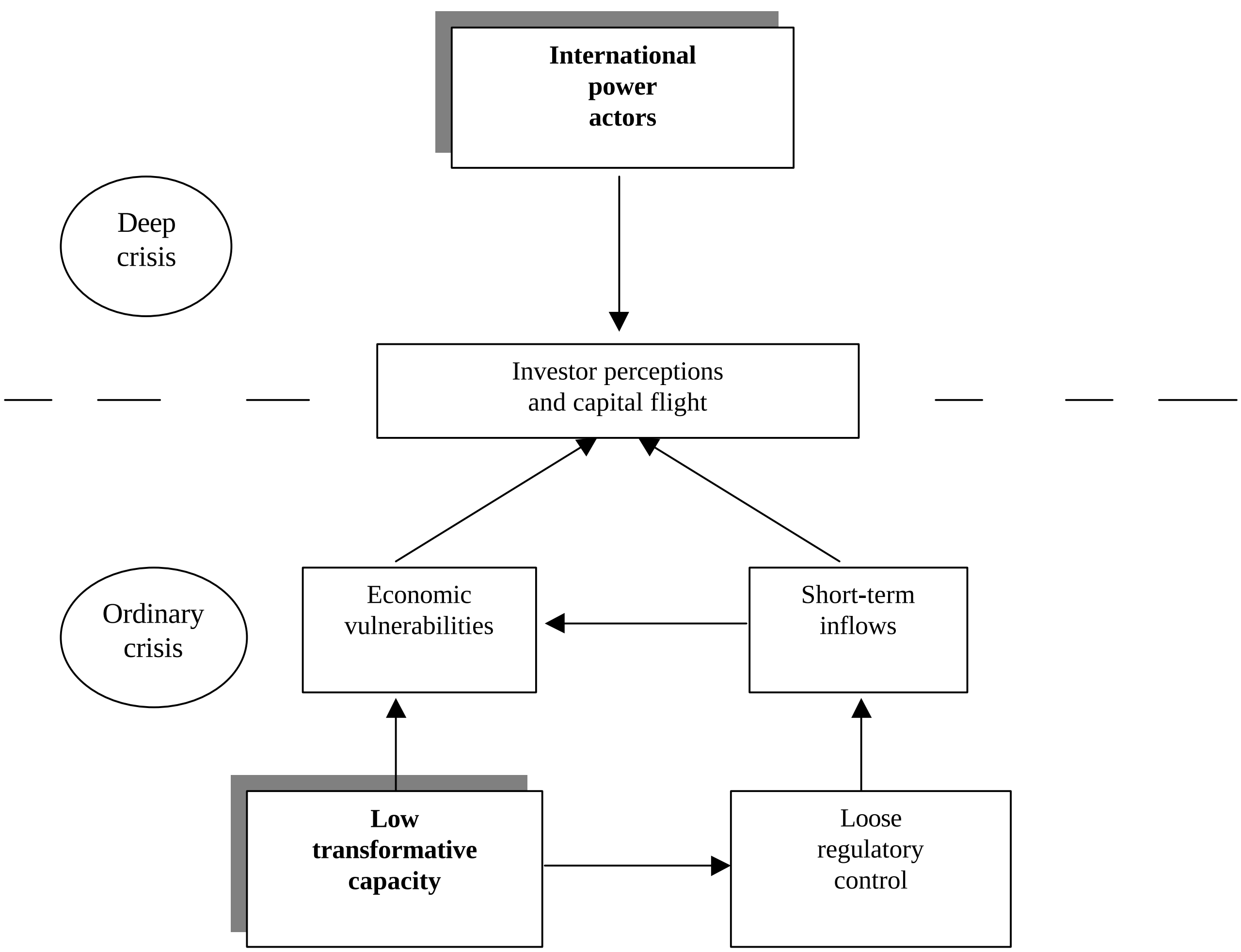
When crisis turned to tragedy

I have argued that weak or weakened transformative capacity rendered some economies more *vulnerable* to economic turmoil. But the fact remains that vulnerabilities of various kinds do not necessarily produce a banking or currency crisis. Moreover the kind of weakness identified here is far from lethal. It is certainly no candidate for explaining the *scope* or *depth* of the crisis - in short, why it turned abnormal.

To the question of 'Why is the crisis so much worse than it is supposed to be?', several authorities have suggested it is because of investor panic, self-fulfilling expectations and sheer 'herd' behaviour whereby everyone withdraws from the market simply because that is what everyone else is doing.[45] But what nurtured and sustained the panic? It may well be that the herding phenomenon is more prevalent in a global environment where the world's money is controlled by fund managers who feel most secure when they follow everyone else. However, to invoke panic, herding and similar behavioural metaphors is to provide not so much an explanation as a restatement of the problem. Why was capital flight so massive, so relentless, and thus so damaging? To answer this we must look outside the nation-states in question, to the role of external power actors which coalesce around and within the US federal administration.

The explanation thus requires that we turn our attention to the exercise of state power (and the constellation of interests therein embedded) - but this time state power which is being applied *externally* by the world's most powerful nation-state. It has been proposed in another context that (externally oriented) state power can in certain limited cases - the United States being the exemplary case - provide a (temporary) substitute for domestic capacity *by forcing other nation-states to relinquish their internal transformative powers*.[46] See Figure 2 for the two dimensions of the argument.

Figure 2: The two faces of the Asian crisis



Today, the most vivid illustration of that proposition can be seen in the extraordinary behaviour of the United States in the Asian region in exploiting the financial crisis to force systemic change in the troubled economies. Acting externally to bring about structural change has been a persistent pattern in the post-war American experience. That pattern shows how a leading power, apparently weak in domestic transformative capacity, but powerful externally, may seek to compensate for relative domestic weakness by attempting to force change upon others and, if possible, conformity with its own system. In the troubled 1980s when debate turned on the industrial decline of the United States, such power inversion invoked the idea of the US as an 'opportunistic' great power with a free-riding strategy: shifting the costs of change on to others more readily than adapting its own institutions. In the triumphalist 1990s, it would seem more evocative of an ‘intellectual’ hegemon convinced of the economic superiority and global applicability of its own system.

The role of the US Treasury-Wall Street-IMF complex[47]

Of the three international power actors involved in deepening the crisis, it has been the US Treasury-finance nexus that has been the least visible yet the most damaging. While the IMF is also implicated in the unfolding drama, its role has differed on two counts: its interventions have neither enjoyed the level of autonomy disposed of by the other actors (though independence is strongly desired by the Fund), nor deployed their more calculated self-interest. The key proposition is that the US administration has not merely used the crisis as a leveraging opportunity to prise open markets once closed to foreign financial institutions; it has played a critical role in deepening the crisis in the first place.[48] The impact of external power sources coalescing around the US administration can be seen in three main ways, as elaborated below.

(1) Securing the door after the horse has bolted.

The main point can be summarised thus: the US government did not act with due speed to contain the panic, indeed appeared also to prevent containment, intervening only after the situation had deteriorated to an alarming degree. This is important because - if one takes earlier crises as the norm - early intervention would in all probability have circumvented investor panic, curbed capital flight, and brought the crisis to a swift resolution. Even a slight familiarity with earlier financial crises indicates that when the foreign exchange turmoil struck Korea, the primary need was clear and straightforward. It was to maintain liquidity and thus to persuade foreign creditors to maintain lending by rolling over existing loans as they came due.[49] That could be done without IMF guarantees, simply by ensuring that lenders understood that Korea's problem of inadequate reserves was a temporary problem of liquidity, not insolvency. Above all, Korea needed workouts, not bailouts: 'coordinated action by creditor banks to restructure its short-term debts, lengthening their maturity and providing additional temporary credits to help meet the interest obligations'.[50] But it was not until Korea's reserves were almost depleted and *after the major damage had already been done* that the US Federal Reserve - in January of 1998 - took the steps that would earlier have averted the 'deep' crisis: bringing together the major players to coordinate a program of debt restructuring and short-term loan rollovers.

The key proposition therefore has to do with actions of the US administration, which entailed both calculated non-intervention as well as prevention of intervention. The unwillingness to intervene in a timely manner to stem the degradation of the currency poses a striking contrast with US action in earlier such episodes in Europe and Latin America (where recovery was relatively quick).[51] For instance, when sovereign debt led Mexico to the brink of bankruptcy in 1982, and twice more in 1994 and 1995 in response to massive capital flight and the peso crisis, the US moved quickly to coordinate a rescue plan. In the recent peso crisis, the US government and the IMF took early action to rescue the currency, first with a credit line of $6 billion, finally orchestrating a rescue fund of $50 billion, engineering a massive international loan which restored investor confidence. This is not to say that the Mexican and Korean crises were similar; they were not. The point is that *timely intervention* was at hand in the Mexican case - and it worked. As Kindleberger has remarked, the strategy 'proved persuasive'. 'The haemorrhaging stopped, capital returned.'[52] As studies of financial crises indicate, whenever international cooperation or even a lender of last resort has come to the rescue - and such instances appear to be the rule, not the exception - the business depression that follows financial crisis is momentary, slowing the economy only briefly; recovery after the panic is swift, without deeper significance.[53]

By not intervening, it could be argued that the United States was merely bringing policy into alignment with the new geopolitical reality.[54] In a post-cold war environment, there was no longer the significant national (security) interest in protecting Asia that in the past would so often over-ride the economic interest of opening Korean markets to US goods and finance.[55] Should one therefore leave it at that: calculated inaction occurred because it was not in US interests to intervene? It could be argued, for instance, that the United States government acted swiftly to support Mexico, but not Korea, because of strong political pressures for intervention by domestic firms with high levels of direct investment in the Latin

American region. With much less direct investment in East Asia, US firms were unlikely to form a strong constituency for timely intervention in the Korean crisis.

Such negative considerations surely played a part. But more positively, one might also argue that it was now very much in US interests *not* to intervene. Greater leverage over the stricken - and thus over market access - was the ultimate payoff. A number of top-level officials conceded as much in public statements as the IMF was called in by the Koreans. In a now widely publicised statement, Deputy Treasury Secretary Lawrence Summers proclaimed in February 1998 that ‘The IMF has done more to promote America’s trade and investment agenda in Korea than 30 years of bilateral trade talks’.[56]

Certainly no-one anticipated quite how stricken the Asian economies would become, but that does not weaken the proposition that there was an element of calculation involved in the 'failure' to intervene. While it is highly plausible that the US administration could not have anticipated just how devastating the impact of the crisis would be, it is implausible to suggest complete ignorance of the seriousness of the situation. It is implausible for at least one good reason. The Japanese authorities had declared themselves prepared to intervene relatively early in the crisis - as early as August-September 1997- with the establishment of a $100 billion bailout fund. That proposal (effectively laid to rest by the US administration) would surely have conveyed some sense of the gravity of the situation unfolding.[57]

It is of course notoriously difficult to mount a convincing case for the sort of calculated behaviour that leaders are usually at pains to conceal. But we can add two further pieces of evidence in support of the proposition that in failing to intervene in a timely manner, US power actors were mindful of the benefits to themselves (rather than the costs to others). First, as already intimated, the United States government also acted to prevent intervention by another nation-state. When the Japanese stepped forward in August 1997 with a formal offer of funds to redeem some of its neighbours' debts, and a proposal to create a new multinational financial institution which would offer credit facilities to the ailing economies in the region, the Americans quickly scuttled the plan.[58] Perhaps, as Johnson suggests, the worry was that the Japanese would begin to deploy their surplus capital for the benefit of Asian countries, thus withdrawing it from the world's largest debtor nation (viz. close to US$350 billion of Japanese money invested in US Treasury bonds). Perhaps, more simply, Japan's proposal was rejected because of the fear that a contender to the IMF would not impose US-friendly conditions on those seeking its assistance. Whatever the precise mix of motives, it is surely not far fetched to anticipate a very different outcome, had the United States supported rather than undermined the Japanese proposal.

Finally, in November and December of 1997 the Koreans themselves were making frantic behind-the-scenes efforts to enlist United States support in their plans for crisis management - and thus stave off calling in the IMF. The Korean government appealed to Washington and to Wall Street for financial support in a bid to raise $15 billion to replenish foreign exchange reserves. As to why Korea’s funding plans failed, Ministry of Finance officials - in a report submitted to the Korean National Assembly’s special committee on currency crisis management - have claimed that the United States government stood in the way of Korea’s crisis management efforts. Whether such allegations are true, they seem of a piece with the US administration’s earlier response to the Japanese proposal.[59]

How then is one to interpret calculated non-intervention - as a matter of indifference or of national interest, or perhaps some combination of the two? The geopolitical argument leans towards indifference: ‘If we don’t help the Koreans it won’t impact negatively on our security interests.' The interest argument leans towards positive benefits: 'If we don't help the Koreans this time it may just help to advance our economic interests that little bit further.' Attributing motives, even in the best of circumstances, is an exercise fraught with imprecision. It is especially difficult when consensus among the key decisionmakers is often hard to discern. The real issue is: 'Could the US Treasury and the Federal Reserve have intervened earlier to prevent the crisis deepening, as they had on other occasions?' If the answer is yes, as I have proposed, then regardless of the precise mix of political motives for the absence of timely intervention, the devastating consequences of their inaction have been all too clear.

(2) Screaming 'fire' in the theatre.

The second way in which external power deepened the crisis has to do with the imposition of a US trade and investment agenda in the IMF agreements. The latter have already received wide discussion, so let us simply note two points. First, the documents leave little doubt as to the embeddedness of the US Treasury in the financial interests which dominate Wall Street. (While the IMF is no mere instrument of US interests, seeking to maintain an independent role, it nevertheless depends on US support and is inescapably drawn into a close relationship with the world's leading nation-state and 'its' finance capital.) The IMF plan for Korea, for example, imposes as a condition of funding a series of institutional makeovers which have nought to do with dousing the fire or even making the structure fireproof. These include the opening of capital markets to enable hostile takeovers and foreign (majority) ownership of Korean firms, as well as greater access for foreign banks and insurance companies. It should be noted, however, that in Korea's case some aspects of structural reform included in the IMF agreements - notably the restructuring of its giant industrial groups - had been sought and pursued unsuccessfully by governments for at least a decade. According to official thinking, under the authority of the agreements, corporate reform might at last go forward. To this extent, the crisis was being hailed by some policymakers as a ‘blessing in disguise’ - allowing more foreign ownership of Korean assets, at least in the short term, but also restoring balance to the government-business relationship by granting state authorities the power to force long overdue streamlining of the conglomerates.[60]

In some cases, the reform measures were sound but poorly sequenced. Thus, for example, the IMF's insistence that the Indonesian government take tough action to clean up its banking system, led, on the first of November 1997, to the sudden closure of 16 banks with links to the Suharto family, which in turn precipitated a run on deposits that became a haemorrhage. This is because the closure was undertaken before Indonesia had established a system of deposit insurance. A stunned populace, faced with the prospect of a massive bank collapse, rushed to withdraw its savings. A similarly abrupt imposition of conditionality measures had occurred two months earlier in Thailand with the freezing of several financial institutions. This precipitated among investors a rush for the exit, thus giving rise to the image of an IMF whose actions - to use Jeffrey Sach’s vivid imagery - amounted to ‘screaming “fire” in the theatre’.[61]

But the main outcome of the IMF agreements was the unintended one of inviting panic by undermining investor confidence. 'Lenders who listened to the IMF could not be blamed for concluding that Korea would be unable to service its debts unless its economy had a total overhaul. Unsurprisingly, after the program was announced, the bond rating agencies downgraded Korean debt to junk bond status.'[62] By emphasising the need for major structural overhaul, the IMF prescriptions suggested to investors a systemic weakness that did not exist, thus fuelling further investor panic resulting in currency plunges and capital outflows. In this way, by shouting 'fire' in the theatre, the IMF helped engineer the very outcome that it was supposed to have prevented.[63]

(3) Striking the fallen.

There is a third aspect to the 'external power' story, which has attracted the widest commentary and discussion. This concerns the uncalculated but significant harm wrought by standard IMF austerity measures, such as the imposition of high interest rates in highly inappropriate circumstances. These measures exacerbated the liquidity problem, thereby helping to kill off sick and healthy companies alike. In the Indonesian setting, in particular, IMF measures often had the most perverse results, threatening to kill off the patient whose health they were designed to restore. (The case of the sudden bank closures mentioned earlier provides a powerful illustration.)

As for the standard IMF policies of high interest rates and reduced public spending, these certainly added significantly to the economic and social hardship (and indeed were scaled back considerably by the second half of 1998).[64] But the IMF measures have had less causal impact than the other two areas of US intervention. This is not simply because they were quickly watered down in some settings, but because they were introduced after the main damage had been done: In short, capital had already left - and this is after all our main explanatory target in this context.

Let us be clear about the argument as it applies to crisis deepening. I am not claiming that the US government or American financial institutions or even the IMF set out to deepen the crisis. What I am proposing is that *some* of their actions (including their absence of action) were critical in deepening the crisis, that some of these actions were *calculated* to further US interests, and that in so doing they were more cognisant of the *benefits* to the US than of the costs to the East Asians - and that they had the *unintended consequence* of exacerbating a situation that should have been quite quickly repaired.

Conclusion

We have then a two-pronged approach to the Asian meltdown: why Asia became embroiled in financial turmoil in the first place, and why it turned so savage. Institutional weaknesses (e.g. in the orientation and organisation of state actors) contributed to real economy vulnerabilities, which then acted as flashpoints to investors as other events, above all the actions of external power actors, helped to precipitate full-scale panic (that is, the deep crisis) (See Figure 2).

I have argued that far from East Asia being at the mercy of global financial markets, the impact of global finance depends, in the first instance, on core coordinating capacities of domestic political institutions, and ultimately on the strength and cooperation of leading (international) power actors. This is a state capacity (though non-statist) explanation.[65] It is able to encompass both *domestic* and *international* variables while at the same time making power relations - particularly those connected with *state* power - the focal point of analysis.

In sum, global markets were a key (if somewhat obvious) factor in the Asian financial crisis, but not in a primary determining sense. For financial markets to have impacted so dramatically on the economies in question, two critical if less obvious variables had to be present: a pull factor in the form of domestic vulnerability - in this case afforded by either relatively limited or decomposing state capacities; and a push factor in the form of a strong external impulse which served, directly and indirectly, to deepen that vulnerability - in this case, the organised expression of US economic power.

Thus the Asian crisis offers support for a state power argument in two ways. First, it suggests how relatively low *domestic* transformative capacity can increase vulnerability to international shocks like financial crises. This contradicts a widespread perception according to which the Asian crisis was able to strike hardest where countries had adopted Japan-style institutions of economic governance. But institutional analyses offer little evidence to suggest that the Southeast Asian countries have been guided by developmental states pursuing structural change as a national priority. From this perspective, it is not the strength but the limited nature of their developmentalism (both as orientation and institutional complex) that appears the more salient. Having more limited transformative goals and organisational capacities has left Thailand and Indonesia not only less effective in the game of technological catch up, but in some respects less guarded about capital inflows and more vulnerable to financial volatility. By contrast, South Korea - once a powerful example of state-guided capitalism - has seen its developmental orientations contested and its coordinating powers unravel. This began with a slow process of ideological osmosis in the 1980s as economic liberalism took hold in the upper ranks of the bureaucracy, and culminated in the virtual dismantling of the country's pilot agency soon after 1993. In this process, outside pressures to prise open Korean markets tended to make most impact when they coincided with the domestic agenda and internal struggles for reform. Though certain legacies of guided capitalism persist in Korea's half-way house of economic management (*viz*. strong resistance to direct foreign investment), the resulting changes have meant a virtual abandonment of control over both the sectoral flow of credit (enabling 'excessive competition' and overinvestment) and the composition of capital inflows (enabling soaring indebtedness of short-term maturity). The relevant contrast is with Taiwan where geopolitical particularities and political continuities helped to offset the influence of neoliberal ideas, leaving transformative orientations and institutions largely intact[66]

Secondly, the Asian crisis illustrates how the 'transformative' role of state power applied *externally* can exploit vulnerability and deepen the effect of international shocks. The preeminent example offered here is that of the 'opportunistic' behaviour of the United States, which had the unintended effect of helping, both directly and indirectly, to deepen and extend the crisis, turning the historically 'normal' face of financial crisis into something 'abnormal' and extraordinary.

As to what all this means for the so-called replacement of capitalist diversity in Asia with free-market liberalism or with some variant of the Anglo-American model of capitalism, one thing can be said with some confidence. While 'global' and 'national' are commonly portrayed as antithetical, mutually exclusive principles of organisation and interaction, 'Asia in crisis' has shown that they are in fact in critical respects interdependent and mutually reinforcing. The extent and sustainability of financial liberalisation will continue to depend on the solidity of domestic structures. Where these structures are weak, global networks merely end up undermining their own conditions of existence. The extreme case is that of Indonesia where domestic collapse has gone hand in hand with the country's involuntary detachment from the global financial system. At the other extreme lies the Malaysian response of voluntary semi-detachment from global finance, ostensibly in an effort to build and strengthen its institutional capabilities. Somewhere between these two extremes, others like Hong Kong, Taiwan, and Singapore are drawing lessons from the crisis by tightening and improving capital controls (or, in the more acceptable language of high finance, ‘prudential regulation’).[67] Above all, 'Asia in crisis' vividly illustrates the implausibility of a world economy sustained by unlimited global flows, and draws attention instead to the underlying (institutional) limits to liberalisation. Based on the variety of national-level responses, and not least the strength of the intellectual arguments by pre-eminent economists[68] calling for reregulation of global finance, is it plausible to anticipate that post-crisis Asia will edge more closely towards neoliberal American ways than those of state-guided Japan?

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Endnotes

[1] On the World Bank's two-step shuffle towards this recognition, see its 1993 report on the *East Asian Miracle*; and, partly in response to the trenchant critical commentary surrounding that report, the Bank's most recent efforts to probe the sources of state effectiveness in its 1997 report on *The State in A Changing World*, (Oxford University Press, 1997).

[2] Thus, for example, many liberal economists as well as high-ranking US officials spanning that complex of interests in the IMF, the US Treasury and the Federal Reserve tend to attribute the crisis to Japan-style institutions, or the state-guided model of capitalism. For many years prior to the crisis, however, neoliberal orthodoxy held that success in the region stemmed from free-market policies. Neither interpretation may be correct, but both cannot be true.

[3] For a somewhat different, more detailed classification of the various approaches to the crisis, see Kanishka Jayasuriya, 'See Through a Glass, Darkly: Models of the Asian Currency Crisis 1997-98', Asia Research Centre, Murdoch University, Western Australia, 1998.

[4] Charles Kindleberger, *Manias, Crashes and Panics* (John Wiley, 1996).

[5] Thus determining the precise nature of these weaknesses is a matter of some controversy, with the 'list' changing retrospectively with each new crisis: viz. a trade imbalance, an overvalued currency, foreign indebtedness and so on . See Charles Wyplosz, 'Globalized financial markets and financial crises. Paper delivered at the conference on 'Coping with Financial Crises in Developing and Transition Countries: Regulatory and Supervisory Challenges in a new era of Global Finance', Amsterdam, 16-17 March, 1998. As Jagdish Bhagwati remarks, 'Like cats, crises have many lives, and macroeconomists, never a tribe that enjoyed a great reputation for getting things right or for agreeing among themselves, have been kept busy adding to the taxonomy of crises and explanations.' See 'The Capital Myth', *Foreign Affairs*, May/June 1998, p.10.

[6] As discussed in Kindleberger, *Crashes, Manias and Panics*.

[7] B. Lindsay and A. Lucas, 'Revisiting the Revisionists: The Rise and Fall of the Japanese Model', *Trade Policy Analysis*, interactive edition, No. 3, July 1998, p.1.

[8] ‘The Role of International Financial Institutions in the Current Global Economy’, Address to the Chicago Council on Foreign Relations, Chicago, 27 February 1998, p.2.

[9] See, e.g., Robert Wade, ‘From “miracle” to “cronyism”: explaining the Great Asian Slump’, *Cambridge Journal of Economics, Vol.* 22, No. 6, 693 -707.

[10] It could be argued that this is much more important in a context like Korea’s where highly competitive, expansion-oriented industrial groups dominate the economy, than in a relatively small-firm context like Taiwan’s where investment ‘mistakes’ can be more readily corrected through market mechanisms without destabilising the economy.

[11] Is the more ‘limited’ capability of Thailand equivalent to the ‘weakened’ capability of Korea? I am grateful to Robert Wade for posing the question though space prevents an adequate answer. Nonetheless, some differences are apparent in the following section, e.g. the difficulties in Thailand of achieving sectoral transformation and policy implementation that may be more characteristic of ‘limited’ transformative capacity; compare these with Korea where decomposing capacity has been to a larger extent ‘voluntary’ and linked to a degree of economic reorientation among state actors.

[12] Linda Weiss, *The Myth of the Powerless State* (Cornell University Press & Polity Press, 1998).

[13] Japan’s current economic malaise, though exacerbated by the 1997 crisis, has deeper domestic roots, analysis of which would take us far from the present task. For a discussion of Japan’s continuing strengths in transformative capacity alongside apparent weakness in financial restructuring, see Linda Weiss, ‘Developmental States in Transition: Adapting, Dismantling, Innovating, not “Normalizing”’, *The Pacific Review*, Special Issue, Vol. 13, No. 4 (1999).

[14] In the early 1990s, for example, the CBC closed down Taiwan’s stock market for one year when it discovered that about one third of foreign inflows approved for equity investment were not being thus invested, but were apparently being used to speculate against the currency. The CBC’s emergency powers of intervention were a quid pro quo for the Bank’s agreement to proceed with financial liberalisation.

[15] For the larger theoretical framework explaining divergent national approaches to regulatory reform, see Steven Vogel's important study, *Freer Markets, More Rules: Regulatory Reform in Advanced Industrial Countries* (Cornell University Press, 1996).

[16] These are the preliminary findings of research in progress in which I compare the Korean and Taiwanese approaches to financial liberalisation. Some of this research is reported in Weiss, 'Developmental States in Transition...'.

[17] 'The Misunderstood Crisis', *World Development*, Vol. 26, No. 8 (1998), p.228.

[18] As a result of severe financial dislocation in the early 1980s, Chile has actively discouraged short-term inflows, effectively taxing all loans and bank deposits from abroad: when a company borrows abroad, 30 per cent of the loan has to be deposited for one year in a non-interest-paying account at the central bank. Chile applied this rule until recently, dramatically changing the composition of foreign investment to emphasise long-term rather than portfolio capital.

[19] See the Special Supplement on Singapore in the *Financial Times*, 30 March 1999.

[20] It is sometimes suggested that Taiwan's large foreign reserves (US$85 billion at the end of 1996) were sufficient to explain its relative immunity from the events of 1997. But what lies behind the amassing of such huge reserves, second only to Japan in world holdings for many years? The answer is partly to do with the ability to maintain a trade surplus, an ability which cannot be disconnected from 'the government's policy of encouraging exports and limiting imports', with a strong focus on technological upgrading. Building up large reserves is also perceived by government as a way of demonstrating credibility and guaranteeing domestic security in world from which it is diplomatically excluded. See Yu Tzong-Shian, *The Story of Taiwan: Economy*, (Government Information Office, 1999), p.55. For an account of how and why Korea and Taiwan diverged in their approaches to financial liberalisation, see Weiss, 'Developmental States in Transition...'.

[21] For this observation I thank Jagdish Bhagwati who notes, with some irony, that the hysteria over Asian cronyism has emerged at the very time when economists have begun to find developmental benefits in certain of its forms.

[22] Though in Western settings the term usually deployed is that of 'relational banking' rather than 'cronyism'. On the importance of such practices in the City of London and, in particular, how the Bank of England

intervened behind the scenes to rescue failed merchant banks, see Michael Lisle-Williams, 'Merchant Banking Dynasties in the English Class Structure: Ownership, Soldiarity and Kinship in the City of London', *British Journal of Sociology*, Vol. 35, No. 3 (1984), pp. 333-62.

[23] See Weiss, *The Myth of the Powerless State*, pp. x-xv and ch. 3.

[24] On the different institutional capacities demanded by each type of transformation, see Weiss, *The Myth of the Powerless State*, pp. 66-7.

[25] K. S. Jomo, *Southeast Asia's Misunderstood Miracle*, (Westview Press, 1997), pp. 105-7.

[26] For the pioneering study of Indonesia from a political economy perspective, see Richard Robison, *Indonesia: The Rise of Capital*, (Allen & Unwin, 1986).

[27] Andrew J. MacIntyre, 'The Politics of Finance in Indonesia: Command, Confusion, and Competition', in: S. Haggard *et al.* (Eds), *The Politics of Finance in Developing Countries*, (Cornell University Press, 1993), pp. 151, 161.

[28] Richard Doner and Daniel Unger, 'The Politics of Finance in Thai Economic Development', in: Haggard, *The Politics of Finance in Developing Countries*. Instead, industrialisation has occurred partly 'by invitation' of the Japanese who have forged strategic alliances with local partners and led FDI in cars and electronics. See, e.g., Mitchell Bernard and John Ravenhill 'Beyond Product Cycles and Flying Geese: Regionalization, Hierarchy, and the Industrialization of East Asia', *World Politics*, Vol. 47, No. 2, pp. 171-210. The ability to exploit relatively cheap labour and abundant natural resources - so-called 'comparative advantage' - has also played a part. But the key question (raised by several analysts of the region well before the financial crisis) is whether this is sufficient for sustained development.

[29] In particular, the capacity for 'sectoral transformation' which involves the continual shift upmarket of skills, products, and technology has been significantly weaker than the capacity for 'structural transformation'. See note 24.

[30] According to a recent study, there has been no significant structural shift away from the low skilled, lower-valued added end of production. Even by the year 2000, it is estimated that over 70 per cent of the labour force will still have reached only an elementary level of education. See Jomo, *South East Asia's Misunderstood Miracle*.

[31] The survey findings are reported in Jeffrey Sachs, ‘Missing Pieces’, *Far Eastern Review*, 25 February, 1999, pp. 10-12. Note however that in the ranking of private-sector R&D spending, Malaysia (31) and Thailand (36) do slightly better than both small-firm dominated Taiwan (38) and large-firm dominated Korea (44), while Indonesia again commands last place.

[32] Early in 1998, in response to Japanese advice, it was reported that the Thai authorities had begun to canvas advice on Japan style ‘catch-up’ industrial policy on the understanding that sustained growth requires increased sophistication of the industrial structure. By January, the Thai government had produced a plan to transform the industrial structure, formulating a master plan for each selected industry to receive funds for upgrading, and jointly establishing with business an R&D centre. Whether this can succeed without also making organisational changes governing bureaucrats and business, not to mention the educational system, is rather doubtful. See *Nikkei Weekly*, 3 August 1998, p. 15.

[33] Even the Harvard economist, Jeffrey Sachs, an earlier proponent of market reform and institutional dismantling in Russia, appears very recently to have reached a similar conclusion with regard to the Asian region when he argues that ‘the key to the rapid growth in export earnings must also involve a continual upgrading of export products. In the future, East Asia will therefore have to give even more attention that in the past to improvements in education and scientific [read also technological] capacity’; *ibid*, p. 12.

[34] It is estimated that the average hourly wage of a Thai worker in the mid-1990s was $3; the equivalent for a Chinese worker was 90 cents.

[35] For a discussion of the concept and its significance, see Peter Evans, *Embedded Autonomy* (Princeton University Press, 1995).

[36] For a different, yet complementary account of Thailand’s weak political capacity highlighting constitutional limitations, see Stephan Haggard and Andrew MacIntyre ‘The political economy of the Asian economic crisis’, *Review of International Political Economy*, Vol. 5, No. 3 (1998), pp. 381-92.

[37] World Bank President, James Wolfensohn comes surprisingly close to this conclusion when he states that the Asian crisis has been ‘caused not by government policy, but by the private sector excesses, not by government action, but to a degree by government inaction in terms of supervising and controlling the financial and corporate sectors’; Address to the National Press Club, 25 March (1998).

[38] Policy loans, which are significantly subsidised, were one the dominant form of corporate credit; by 1995-96 they accounted for only 18 per cent of bank credit and 5 per cent of all lending. The figures cited are from the Bank of Korea, as reported by the OECD. Some Korean analysts report higher figures, depending on the definition of 'policy loan'.

[39] This is not to imply that the state had undergone metamorphosis into a 'hands off' beast, and that all forms of industry support were suddenly withdrawn. As Alice Amsden points out, government still supported business 'at the margin', providing protection and cheap credit for R&D for infant technology-intensive sectors, while scaling down support to capital-intensive industries; 'South Korea: Enterprising groups and entrepreneurial government', p. 366.

[40] On the Japanese preoccupation with 'excessive competition', see Lonny E. Carlile and Mark C. Tilton (eds), *Is Japan Really Changing Its Ways?: Regulatory Reform in the Japanese Economy* (Brookings, 1998).

[41] Ha-Joon Chang, 'Korea: the misunderstood crisis', *World Development*, Vol. 26, No. 8, pp. 227-8; Weiss, *The Myth of the Powerless State*, ch. 3.

[42] One indication of this orientation is the extent of *private*-sector R&D spending. Out of 53 industrialised and major developing nations, Korea ranked 44th, behind Malaysia (31), Thailand (36) and even small-firm dominated Taiwan (38). See note 31.

[43] On earlier crises, see Meredith Woo-Cumings (Jung-en Woo), *Race to the Swift* (Columbia University Press, 1991).

[44] For a similar, though more elaborate, argument along these lines, see Meredith Woo-Cumings 'Industrial Policy and Corporate Governance in East Asia', Asia Development Forum, Manila, 12 March (1998).

[45] An extended argument emphasising the role of investor panic can be found in Steven Radelet and Jeffrey Sachs, 'The East Asian Financial Crisis: Diagnoses, Remedies, Prospects', Harvard Institution for International Development (1998).

[46] This argument is developed in Linda Weiss and John Hobson, *States and Economic Development* (Polity Press, 1995).

[47] The expression - a variation on Bhagwati's - is drawn from Robert Wade and Frank Veneroso, who advance a different argument, though in some ways complementary to the one developed here. See 'The Asian

Crisis: The High Debt Model Versus the Wall Street-Treasury-IMF Complex', *New Left Review,* No. 228 (1998)

[48] For a different approach, which also emphasises the impact of international relations, see Richard Higgott 'The International Relations of the Asian Economic Crisis: A Study in the Politics of Resentment', paper presented to the Asia Research Centre conference, *From Miracle to Meltdown: The End of Asian Capitalism?*, Fremantle, Australia, August 1998.

[49] Kindleberger, *Crashes, Manias, and Panics*.

[50] M. Feldstein, 'Refocusing the IMF', *Foreign Affairs*, Vol. 77, No. 2 (1998), pp. 25-6, 31.

[51] The European episodes are discussed in Kindleberger, *Crashes, Manias, and Panics*.

[52] *ibid*, p. 187.

[53] *ibid*; see also Barry Eichengreen, *Globalizing Capital: A History of the International Monetary System* (Princeton University Press, 1996).

[54] Robert Wade suggests that even earlier intervention by the United States - e.g. to rescue the Thai currency - was ruled out by congressional restrictions placed on the use of public resources after the Mexican crisis; 'The Asian Debt-and-Development Crisis of 1997-?: Causes and Consequences', *World Development*, August 1998. But the main focus here is on what could be done to assist - e.g. via currency swaps, emergency credits, international loans, and the like - *before* a country reaches the stage of requiring an IMF rescue package.

[55] Meredith Woo-Cumings, 'Industrial Policy and Corporate Governance in East Asia', argues cogently along these lines to explain why the US acted differently towards Korea in 1997 compared with earlier crises.

[56] For an effective analysis of the IMF's role in the crisis, see Richard Leaver, 'Moral and Other Hazards: The IMF and the Asian Currency Crisis', paper presented to the Asia Research Centre conference. See note 56.

[57] Of course, Japanese banks were more exposed than American banks in their lending to the region (especially in Thailand and Indonesia). This would certainly account for Japan's readiness to intervene promptly.

[58] Chalmers Johnson, 'Economic crisis in East Asia: the clash of capitalisms', *Cambridge Journal of Economics*, Vol. 22, No. 6 (1998) pp. 653-62. On the responses to the Japanese proposal and subsequent

suggestions to relaunch it, see John A. Mathews and Linda Weiss 'The Case for an Asian Monetary Fund', *Working Paper No. 55*, Japan Policy Research Institute, S

San Diego (1999).

[59] The allegations were reported in the *Korea Times*, following submission of the report on Korea's currency turmoil to the National Assembly on 17 January 1999. According to the Korean daily, officials were reluctant to give full details of alleged US obstruction 'for fear of punishment in financial markets'.

[60] If not publicly stated, at least these were the views conveyed in interviews just after the IMF agreements were signed in Seoul, as reported in John A. Mathews, 'Fashioning a new Korean model out of the crisis', *Cambridge Journal of Economics*, Vol. 22, No. 6 (1998), pp. 747-60. At least eighteen months on, the 'blessing in disguise' view seems optimistic, since the *chaebol* continue to resist all but the most cosmetic of changes. In response to government pressure and appeals for the largest groups to bolster their finances by selling non-core assets, the top five conglomerates in 1998 agreed on sweeping reforms, to include swaps and mergers of troubled units. But negotiations have stalled over selling prices and other terms. In April 1999, the government again warned that companies resisting reforms would be cut off from fresh loans, prompting the Daewoo Group to propose the sale of assets, including its shipbuilding unit; see *Korea Economic Weekly*, 26 April (1999). Whether this heralds restructuring more generally, c*haebol* reform is widely viewed as the key to Korea's future path. See, e.g., Woo-Cumings, 'Industrial Policy and Corporate Governance in East Asia'.

[61] 'The IMF and the Asian Flu', *The American Prospect*, 37, March-April (1998), pp. 16-21.

[62] M. Feldstein, 'Refocusing the IMF', *Foreign Affairs*, Vol. 77, No. 22 (1998) p. 31.

[63] Variations on this argument can be found in Feldstein, *ibid*.; Sachs, 'The IMF and the Asian Flu'; Stiglitz, 'The Role of International Financial Institutions in the Current Global Economy'; and Wade and Veneroso, 'The Asian Crisis...'.

[64] As early as January 1998, just one month after the IMF had launched its Korean rescue programme, the Fund retreated from its previous conditionalities, allowing the Korean authorities to soften inflation targets, as well as those for the budget and monetary growth, Chang, 'Korea: the misunderstood crisis', p. 229.

[65] The distinction is discussed in Weiss, T*he Myth of the Powerless State*, ch. 2.

[66] This argument is developed in Weiss, 'Developmental States in Transition...'.

[67] As Robert Wade and Frank Veneroso remark, in a context where words are weapons, there is wisdom in substituting the term ‘prudential regulation’ for that of ‘capital controls’, for who could oppose the former? See ‘The Gathering World Slump and the Coming Battle over Capital Controls’, *New Left Review*, Septermber/October 1998.

[68] The line-up of heavy-weight economists who challenge the ‘free financial flows are good for development’ thesis includes Dani Rodrik, Jagdish Bhagwati, Joseph Stiglitz, Jeffrey Sachs, and Paul Krugman. In so doing, they draw a firm line between the case for trade liberalisation on one hand and that for finance on the other, which has not been established.