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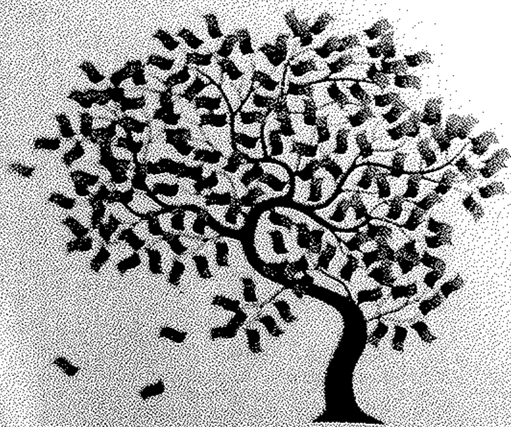

CRISIS AS CATALYST

Asia's Dynamic Political Economy

A VOLUME IN THE SERIES

Cornell Studies in Political Economy
edited by Peter J. Katzenstein

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Crisis as Catalyst

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EDITED BY

Andrew MacIntyre, T. J. Pempel,
and John Ravenhill

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Preface

In 1997–98 an economic tsunami swept across Asia. The currencies of many East Asian countries depreciated radically; previously sky-high growth rates plummeted; corporations, banks, and other financial institutions shuttered their doors; government budgets were upended; unemployment levels shot up. Numerous political repercussions shook Asia in the wake of these radical economic developments. These often involved dramatic policy shifts or even complete changes in regimes. The economic difficulties faced by Asia, meanwhile, precipitated upheavals in many other parts of the world—from Russia to Brazil. The crisis led to wide-scale and often competing academic and journalistic analyses of its causes. The editors and many of the contributors to this volume were active in these early debates.

The waves that engulfed East Asia in crisis have long since receded. Most of the countries affected have returned to levels of productivity and growth higher than in other developing regions, albeit lower than those they enjoyed in the decade before the crisis. Nonetheless, East Asia a decade after the onset of the crisis is radically different on many dimensions from the region shaken up in 1997–98. The differences, however, are hardly uniform. In some ways, today's Asia shows sharp breaks from prior practices. But in others the shadows of continuity are far more striking than any signs of breaks with the past. Moreover, although certain new trends seem relatively uniform across the region, far more frequently the mixture of change and continuity has differed from one country to the next.

This variance in experience across issues and across countries suggested the need for a project that would provide a systematic review of postcrisis developments in the region. Our preliminary discussions led us to conclude that a decade after the crisis provided enough chronological distance, while simultaneously setting up a convenient benchmark, to allow scholars to think systematically about the crisis and its impacts. We sought to examine what lessons have been learned, how effective the policy responses have been, what institutional changes have occurred, and how well these various changes equip countries to cope with the challenges that they face today and will face in the coming years. In framing our project, we sought to address a number of questions: What has changed due to the crisis? What did it fail to affect? How and why did different actors in various countries use the crisis as a catalyst to promote change? How, cumulatively, is the Asian region different today from what it had been before the crisis struck? To what extent were certain breaks with the past spawning new regional interactions and a new regional identity?

To explore these issues, we held two conferences during 2006. The first took place at the Crawford School of Economics and Government at Australian National University on July 21–22, where we benefited from helpful comments from a number of outside discussants. The second conference was held at the Institute of East Asian Studies (IEAS), University of California, Berkeley, on November 3–4. Generous financial support was provided for the project by the East Asia Forum, the East Asia Foundation, the Crawford School, and IEAS. We thank Taehwan Kim and Hyung Taek Hong for their guidance and help in securing support from the East Asia Foundation, Maree Tait and her colleagues at the Crawford School for managing the initial conference in Canberra, and Martin Backstrom and Kumi Sawada Hadler for their support for the Berkeley conference. Dr. Miwa Hirono of the Department of International Relations, Australian National University, did an outstanding job in assembling and preparing the manuscript to Cornell University Press specifications. Mary-Lou Hickey, of the same department, similarly excelled in coordinating responses from the contributors during the production process.

Roger Haydon of Cornell University Press provided considerable help in shaping the project for eventual publication. Finally, we thank Peter J. Katzenstein and an anonymous reader for exceptionally helpful comments on the individual papers and on the project as a whole.

Andrew MacIntyre
T. J. Pempel
John Ravenhill

Abbreviations

ABF	Asia Bond Fund
ABMI	Asian Bond Market Initiatives
ACU	Asian currency unit
ADB	Asian Development Bank
AFTA	ASEAN Free Trade Agreement
AMF	Asian Monetary Fund
AMU	Asian monetary unit
APEC	Asia-Pacific Economic Cooperation
APT	ASEAN+3
ARF	ASEAN Regional Forum
ASA	ASEAN currency swap arrangements
ASEAN	Association of Southeast Asian Nations
ASEM	Asia Europe Meeting
BA	Barisan Alternatif (Alternative Front) [Malaysia]
BIS	Bank for International Settlements
BN	Barisan Nasional (National Front) [Malaysia]
BSAs	bilateral swap arrangements
CARP	Comprehensive Agrarian Reform Program [Philippines]
CAR	capital adequacy ratio
CBMs	confidence building measures
CDA	Constitutional Drafting Assembly [Thailand]
CDRF	China Development Research Foundation
CGE	computable general equilibrium
CGFS	Committee on the Global Financial System
CFQ	corporate governance quality
CMI	Chiang Mai Initiative

considerations also seem to dominate foreign-controlled bank lending policies. For instance, after plunging into the consumer credit card business at great cost, they now have the bulk of their assets tied up in unstable real estate markets. It will be interesting to see whether the Korean government will be able to achieve its industrial policy objectives with a foreign-controlled banking sector.

CONCLUSION

The Political Economy of East Asia

Directions for the Next Decade

Andrew MacIntyre, T. J. Pempel,
and John Ravenhill

In this concluding chapter, we present our effort to look forward rather than back. We reflect on what we see as key forces for change across several dimensions of the political economy of the region, most of them unleashed by the crisis of 1997–98. Although we draw on the themes and issues explored in the other chapters of this volume, we make no attempt in this chapter to synthesize all that has come before. We focus here on three key dimensions of the evolving political economy of East Asia: (1) the East Asian model and the changing patterns of business-government relations, (2) trends in regional integration and cohesion, and (3) the extent of the vulnerability of the region to future economic shocks.

The East Asian Model Today

The notion that a single East Asian model exists that is capable of capturing the essence of the political economy of all the high-growth economies of the region has always been more than a little problematic. Beyond the simple commonality of high rates of economic growth, important differences have long been present among the cases. This was something the literature on the region came increasingly to recognize as the pace of economic growth in Southeast Asia accelerated in the late 1980s (Mackie (1988) provides an early cogent argument). Reflect, for a moment, on the basic contrasts between the first wave of capital-intensive economies—Japan, South Korea, Taiwan, and Singapore—and the second wave of resource-rich economies in Southeast Asia. Moreover, the third wave—the formerly socialist economies, dominated by China—manifest very different characteristics. Even *within* these categories, enormous differences existed on key dimensions of political economy. Consider, for instance, the contrast in the treatment of foreign direct investment (FDI) between Singapore and South Korea or the differences in state capacity among Indonesia, Malaysia, and Thailand. Further complicating the discussion of any single East Asian model has been the fact that the pivotal episodes of sustained high growth took place at different times. Roughly speaking, in Japan the transformative decades (after World War II) were the 1950s, 1960s, and 1970s; for the newly industrialized countries (NICs) they were the 1960s, 1970s, and 1980s; for the resource-rich Southeast Asian nations they were the 1970s, 1980s, and 1990s, and for China and Vietnam they were the 1980s and 1990s to the present.

Nevertheless, there is a loose sense in which the scholarly literature and policy discourses employed the notion of a single East Asian model as a kind of shorthand for a mix of policy, political, and institutional arrangements that pertained in varying degrees across the high-growth economies of the region. More than anything else, what drew attention to East Asia as a region over the past three to four decades was its very rapid rate of economic growth. Enormous analytic energy was devoted to making sense of the spectacular economic transformation of countries across the region, much of which is summarized in a loose conventional wisdom, commonly referred to as the East Asian model. Most accounts highlighting policy aspects of the East Asian model have emphasized macroeconomic management, investment in public goods such as education, and opening to the international economy, with debate about the extent to which government intervention in particular sectors contributed to the result (Wade 1992; World Bank 1993; Asian Development Bank [ADB] 1997; Yusuf 2001).

Driving such policies were the political preferences of the coalitions in power, which were generally conservative in character and (for a range of reasons) strongly emphasized the pursuit of industrial development. These ruling coalitions worked within institutional frameworks that concentrated power heavily in the executive branch of government in ways ranging from straightforward authoritarian regimes to the former Japanese single-dominant-party model. The common result was that governments enjoyed substantial autonomy in coordinating and controlling policy and in limiting demands from societal groups that might force major diversions from a maximization of economic growth. A central element in the political economy of these countries was the close and cooperative ties between business and government, ranging from depersonalized institutional relationships to cozy crony ties (Deyo 1989; Haggard 1990; MacIntyre 1994; Root 1996).[1]

If this stylized combination of policy, politics, and institutions captures something essential in the political economy of East Asian countries during the various key decades of their respective industrial transformations, we argue it is much less

1. Some accounts went deeper still, focusing on systemic factors such as demographic and social make-up, international security conditions, and access to global markets (Woo 1991; Stubbs 1999; Doner, Ritchie, and Slater 2005).

useful today. Certainly, considerable continuity is evident postcrisis in the sound macroeconomic management pursued by countries in the region. Gross savings as a percentage of GDP are extraordinarily high across the region, averaging substantially more than 30 percent (with the notable exception of the Philippines). Inflation rates remain low. Governments continue to run budget deficits that are, at worst, only a small percentage of GDP. And, a continuing source of controversy with trading partners, they manage their exchange rates with an eye toward keeping their exports competitive, the consequence being that they enjoy substantial current-account surpluses.

Continuity may characterize what have been considered to be the core economic dimensions of the East Asian model; it is far less obvious in the political domain. This is clear from the changes in the institutional landscape, the political complexion of governments, the expansion of the media sector, and the heightened global economic engagement. Although by no means uniform, broad moves in these general directions enable us to talk of substantial changes in the underlying political economic patterns of the region. The East Asia of 2007 was not the East Asia of 1997, much less the East Asia of 1987 or 1977. Some elements in this story of change stem from the shocks and disruptions of 1997–98, but many others grow out of slower-moving but deeper-running processes of change unleashed by sustained high growth itself. And the international context within which East Asian governments have to develop their domestic and international strategies has changed dramatically. Four main aspects of change illustrate this: political and legal institutions, changing political preferences, the mass media and information flows, and global economic engagement.

Political and Legal Institutions

Perhaps the most fundamental changes bearing on the established conceptions about the East Asian political economy involve political and legal institutions. In essence, the domestic political frameworks of most of the countries are no longer characterized by such heavy concentrations of power as in the past. Not all of East Asia has moved quickly in this direction, and some countries have had partial countermovements. But the primary trend across most of the region has been toward a deconcentration of power. The executive branch of government is no longer so dominant relative to other branches of government and, significantly, there is a greater turnover among those in control of the executive branch. This has meant that political leaders are more constrained in their options and that, typically, the coordination of policy has involved an increasingly diverse set of actors, making it more difficult to pursue any single direction. No longer is policy as tightly controlled and as insulated from public pressures. Civil society actors have become much more significant. For the most part, these trends have been a function of democratization, democratic consolidation, and refinement of democratic institutions. Some cases have clearly stood apart, most conspicuously China, Vietnam, and Singapore, whereas Malaysia has seen at best minimal change in this direction.

However, in most cases—South Korea, Taiwan, Indonesia, Thailand (with a caveat for the military hiatus) and even the Philippines (when compared to the Marcos period)—changes have moved broadly in this direction. In the case of Japan, the last decade and a half has seen substantial refinement of democratic processes, with the bureaucracy becoming more responsive to elected politicians and the possibilities for a turnover in parliamentary control becoming much more real.

Closely related to changes in the national political architecture of the region have been shifts in legal institutions. Change on this front has been more gradual but apparent nonetheless. Throughout most of East Asia, the law had long functioned predominantly as a heavily subservient tool of executive governments. Today, this is less the case. In some cases—South Korea, Taiwan, Thailand, the Philippines, and Indonesia—there has been a marked shift since the height of their respective periods of rapid growth. Japan has had an independent judiciary throughout the postwar period, but it too has become more active. Interestingly, although the Chinese political executive remains all-powerful, we see the beginnings of judicial activity, at least in some civil and commercial matters.

Contrary to many liberal assertions, there is no necessary connection between independent and capable legal systems and levels of economic development, as the case of Singapore clearly illustrates (Jayasuriya 2003). But the significance of these changes for summary understandings of the political economy of the region is that, here again, we see further decentralization of power and greater contestation. More specifically, the increasing significance of the judicial sector has rendered close relationships between policymakers and large firms more susceptible to challenge. Local or foreign firms, aggrieved by collusive or other prejudicial policy conditions secured by their competitors or perhaps upstream suppliers, now have greater scope for seeking redress through the judicial system. Changes to judicial institutions, together with the weakening of executive control and increased political turnover, have made it much more difficult to sustain previous patterns of enduring and close relationships between government and business that are so often associated with the East Asian model.

Political Preferences

The second key dimension of change is the political complexion of governments across the region. Broadly speaking, East Asian governments have become less uniformly conservative in their political orientation. In particular, anticommunist national security preoccupations have receded; there is less emphasis on internal political controls and less common automatic presumption that large business interests are to be preferred over competing interests such as labor and the environment. Although causality runs in both directions here, institutional changes (broadly speaking, the repercussions of democratization) have opened the door to this development. With the marked exception of China, across much of East Asia today there is less of an all-consuming conviction that full-speed economic growth is of the utmost national importance. Less, that is, than was the case with Japan

during its post–World War II reconstruction phase, than was the case for the NICs facing what they saw as severe external security threats during the cold war, and than was the case for the resource-rich Southeast Asian states facing what they saw as severe internal security threats, also during the cold war. Other substantive priorities are receiving more official attention than previously, particularly equity and distributional considerations but also environmental considerations. And, as shown by the data presented in MacIntyre, Pempel, and Ravenhill (chap. 1 in this volume), governments have given priority to reducing vulnerability to external shocks by accumulating massive reserves of foreign currency at the expense of higher rates of domestic investment and economic growth.

In varying degrees, we see this change in the complexion of politics in Japan, South Korea, Taiwan, Thailand, the Philippines, Indonesia, and even Malaysia. To be sure, there are still large conservative parties in all these countries, and they remain influential in setting the policy agenda. But, in most cases, they are either less conservative than before and/or face serious competition from nonconservative parties. For the most part, this shift in the center of political gravity has been gradual, but in some cases, it was quite stark and grew out of the financial crisis. Where governments with pro-reform agendas and constituencies were in power or came to power soon after, they introduced dramatic reforms in areas such as corporate governance and financial regulation. South Korea, Japan, and Indonesia provide the clearest illustrations of this.

The Mass Media and Information Flows

The development of increasingly sophisticated markets for information supplied by local and foreign media companies is frequently overlooked. Yet it is an important dimension of change in its own right, with significant implications for the political economy of the region. In the past, most East Asian countries were characterized by radical information asymmetries. To varying degrees, political leaders were able to maintain control of information and public debate, sharing policy-relevant information with allies in the corporate sector on a discretionary basis and limiting what was known by potential challengers to the dominant regime. This has changed very markedly over the past ten to twenty years due to democratization, the gradual strengthening of legal institutions, and the development of technologies that have combined to lower the cost of information dissemination. Furthermore, the growth of vibrant media companies throughout the region has expanded the competition to distribute information. The widespread penetration of the Internet, despite the efforts of many governments to constrict its availability, has further opened up vast new access to global information pools.

Around East Asia today, markets are much better informed, political oppositions are much better informed, and publics are much better informed. In terms of the classic East Asian model, the net effect has been to further reduce the dominance of the executive branch of government, to fuel challenges to close business-government relationships regarded as collusive and, more broadly, to open up public discussion about policy. All these diminish prior patterns of centralized governments that sought to, and were capable of, controlling and coordinating policy in partnership with sections of the corporate sector.

Global Engagement

The fourth broad trend across the region that shows evidence of radical shifts from past patterns is the increasingly global engagement of most East Asian economies. Before the crisis, almost all of the East Asian economies were active participants in global trade. Their involvement has become even more pronounced, so that the ratio of East Asian exports to the overall GDP of the region is now higher than in any other region in the world, surpassing even Europe (World Bank 2006, 4). Changes in investment have occurred more slowly, but foreign capital is increasingly present in much of the region, most strikingly, in China but also in places such as Korea and Japan, which for much of their developmental phases were effectively closed to FDI. Indeed, this is one area in which we see a measure of convergence across the region; unlike the past, today all of East Asia is actively seeking FDI.

Although inferring causality from increased global economic engagement has its own problems, continued export access and continued capital flows necessitate increased sensitivity to developments elsewhere; the combination brings with it enhanced potential for internal change. Moreover, the encroachment of multilateral regulatory regimes imposes new compliance obligations on Asian governments. There is increased evidence of substantial change in the area of corporate governance, for example, with, not surprisingly, Japan and South Korea being the most conspicuous instances. Interestingly, however, as Edward Steinfeld shows (chap. 9 in this volume), significant changes are evident in China as well, although more in terms of corporate behavior than in the regulatory environment. Greater global economic engagement brings new commercial players, greater contestability, and greater constraints imposed on policymakers by events elsewhere. And these all represent significant changes from precrisis patterns.

To summarize, we see important change in these four areas. In some cases, changes have gradually unfolded over several decades; in others, it has been a rapid response to the upheavals of 1997–98. Our concern here is to draw attention to such changes and to the fact that, cumulatively, they represent substantial departures from established conceptions of how East Asian political economies have functioned. We emphasize our caution in making these summary judgments because, just as the conventional wisdom about East Asia was never more than a loose ideal type, trying to capture the essence of the political economy of the region today is fraught with scholarly danger. This said, we nevertheless make a strong claim about the broad direction of change.

East Asia today is marked by less-strong executive governments, greater political pluralism and contestation, more frequent political turnover, stronger legal systems, less-close and -stable relationships between business and government, much easier access to information, and greater engagement with the global economy. In short, in important respects, the political economies of many parts of East Asia are now organized differently and operate differently. This makes it much more challenging to pursue the sorts of highly disciplined policy regimes that are generally believed to have underpinned the spectacular economic transformations of most of the countries in the region.

In addition to eroding the potential for highly disciplined policy regimes, these changes also erode the scope for continuing the various patterns of close relationship between firms and policymakers. Greater contestability, greater turnover in political leadership, somewhat stronger legal institutions, greater diversity in the political preferences of ruling parties, reduced information asymmetries, and greater market contestability through foreign investment—all these trends have the effect of diminishing the scope for close and stable relationships between political and corporate leaders. We can see this even in the extreme form of such relationships—the highly personalized crony capitalist relationships so conspicuous in much of Southeast Asia during the initial decades of rapid growth. Cronyism has certainly not disappeared in East Asia (anymore than it has in other economies), but it is generally no longer as prominent. It persists because the potential benefits to firms that are able to establish close ties to powerful political leaders are so great, but they are becoming less conspicuous as the political and legal environments become less conducive. Acquiring and sustaining such relationships for more than a few years have become much more difficult and risky than in the past. In place of the long-term close relationships of the past, many of which were a key component of a common commitment to long-term national growth, we see more short-term political exchange relationships, with both parties in pursuit of more immediate gratification of their particular needs.

Crisis and the East Asian Political Economy

The contagion from the collapse of the Thai baht did not discriminate among regime types in East Asia—it was equally devastating for what had always been regarded as one of the strongest states in the region (Korea) as for one of its weakest (Indonesia). State capacity apparently had no impact on the vulnerability to crisis. Of far greater significance were basic economic variables, particularly the volume of foreign exchange reserves that countries held and the ratio between these and short-term foreign debt.

What association was there between the crisis, state capacity, and changes in the political economy of the region? It is tempting to posit a straightforward relationship between the depth of the crisis and the subsequent magnitude of changes made in the domestic political economies—a correlation apparently borne out in our two Southeast Asian paired comparisons. In both comparisons, the more severely affected economies (Indonesia and Thailand) experienced much greater postcrisis change in their domestic political economies than did the less affected economies (Malaysia and the Philippines). In both cases, the crisis led directly to the fall of the incumbent political regimes—Chavalit in Thailand and Soeharto in

Indonesia—opening the way for reform-minded governments. In Korea, the onset of the crisis coincided with the presidential election of November 1997 and may have contributed to the narrow victory of Kim Dae Jung over the ruling party candidate Lee Hoi Chang. Certainly, the severity of the crisis made it easier for Kim to pursue an active reform agenda once in office.

Such a straightforward argument about the relationship between the depth of the crisis, change in regime, and subsequent policy change, however, removes agency from the equation and denies the saliency of ideas. It discounts the capacity of governments to learn, not least from the experience of other countries in the region that may be suffering far deeper crises than the one afflicting their own economy. Nowhere is this capacity for learning from the crisis elsewhere more evident than in China. As Steinfeld (chap. 9 in this volume) shows, the Chinese leadership adopted a radically different set of economic policies in direct response to its interpretation of the causes of the crises elsewhere in the region.

Before the crisis, Beijing had looked to Korea as a potential model for the modernization of the Chinese economy and particularly to the Korean *chaebol* as a potential prototype for reforming state-owned enterprises. This enthusiasm disappeared with the crisis. Indeed, the crisis effectively marked the death knell of the developmental state approach across the region. In an increasingly integrated global economy, in which participation in production networks is often the key to penetrating foreign markets, the old-style developmental state approach that attempted to exclude foreign participation in domestic production processes has outlived its usefulness. To some extent, then, we see greater uniformity in developmental models across the region in the postcrisis period than at any time in the previous half century; all states (with the exceptions of the pariah regimes of Myanmar and the Democratic Republic of Korea) now are open to foreign investment and have shown themselves keen to enter into free trade agreements (FTAs) with their major extra-regional trading partners. When these agreements involve industrialized countries as trading partners (with many states keen to sign on to agreements with the United States and, more recently, with the European Union, given its new willingness to enter into preferential agreements with East Asian states), they will extend beyond the current World Trade Organization (WTO) provisions on issues such as intellectual property and trade in services, and will inevitably bring even more international discipline to domestic economic policies.

This is not to suggest that East Asian economies are necessarily converging toward an Anglo-American variety of capitalism nor that governments have abandoned a belief that state intervention can be beneficial in the acceleration of economic growth—witness the ongoing role of government-linked companies in Singapore and the determination of the Chinese government to promote national champions in key industrial sectors. And some countries, as part of a more general backlash against globalization, are witnessing a new populist reaction against the foreign presence that has increased dramatically following the postcrisis liberalization. This has occurred, for instance, in the policies of the post-Thaksin military government in Thailand (seemingly inspired in part by the king's ongoing call for

greater self-sufficiency, first made in December 1997 at the height of the crisis), in new restrictive foreign investment laws introduced in Indonesia in July 2007, and in court judgments in Japan and Korea that have supported moves by local companies to mount poison-pill defenses against hostile takeovers by foreign corporations, especially equity capital companies.

Trends in Regional Integration and Cohesion

Before the onset of the crises, extra-national ties for most of the East Asian region generally fell into one of three types. First, and congruent with the broad export orientation of most successful Asian economies, there was considerable economic linkage in the form of cross-national investments spawning regional production networks and enhanced intraregional trade. For the most part, these were corporate-driven processes devoid of explicit government controls and oversights, although, as is widely acknowledged, corporations in most of East Asia (Taiwan being the obvious exception) rarely operated in direct opposition to national governmental goals and governments encouraged the production networks through duty-drawback arrangements and export-processing zones. Many of these economic links were indeed intra-Asian, but virtually all of the Asian exporting countries simultaneously maintained extensive market dependence outside the region, most notably on the United States.

The second type of extra-regional arrangement involved more explicitly governmental efforts and multilateral fora. But these were predominantly global rather than regional institutions: the United Nations, IMF, General Agreement on Tariffs and Trade (GATT)/WTO, World Bank, and so on. Subglobal multilateral bodies with East Asian memberships were few: the Association of Southeast Asian Nations (ASEAN), Asian Development Bank, and such pan-Pacific bodies as the Asia-Pacific Economic Cooperation (APEC) grouping and the ASEAN Regional Forum (ARF).

Finally, a third type of arrangement had Asians looking beyond their national borders. These were the various bilateral arrangements that were forged, primarily in the security arena. Of particular importance were formal U.S. treaties with Japan, South Korea, the Philippines, and Thailand. Also relevant were various bilateral fora set up to resolve border disputes between China and many of its neighbors. Of a similar nature were various military-to-military exchanges across the region.

Overall, therefore, the precrisis regional architecture of East Asia was closely tied to access to U.S. markets and dependent on the multilateral and bilateral fora developed and fostered by the United States as part of its overall global strategy. Aside from ASEAN and the series of bilateral security ties among various Asian countries, there were virtually no independently generated and specifically East Asian institutional bodies.

The crisis changed this. Like most such major traumatic events, the economic crisis delivered an exogenous shock that challenged political and business elites across Asia to reassess their earlier norms and operating assumptions. The crisis by no means determined their eventual choices, but it provoked fresh thinking and consideration of many previously ignored alternatives in the collective effort to prevent future disasters. One particularly striking trend since the crisis has been the move toward more governmentally initiated efforts to create new regional institutions.

Following the crisis, Asian elites embraced a bevy of new institutions and processes at the regional level. In effect, East Asians have since 1997–98 been creating a new layer for political and economic activities between that of markets and multilateral institutions. Such new institutions, it seemed clear, were essential, given that neither the markets that had woven the webs of corporate interconnection nor the limited political institutions already in place had been effective in warding off the crisis or in dealing with it once it had hit. At the same time, such new bodies were a supplement to, rather than a replacement for, both market forces and global engagements. East Asia continued to be responsive to global market pressures as well as to the classic workings of international politics. What was different was that the new regional institutionalism afforded Asia the potential to engage global markets and global power struggles from a position of greater collective strength.

An important impetus for the new regional thinking came from Korean President Kim Dae Jung. At the ASEAN+3 (APT) meeting in Hanoi in December 1998, Kim proposed forming an East Asia Vision Group (EAVG) to examine areas where the region could profitably pursue regional approaches to collective problems. Three years later, the EAVG presented a sweeping set of proposals for greater regional cooperation. Its report clearly stated the underlying motivations and goals: "the Asian financial crisis of the recent past provided a strong impetus to strengthen regional cooperation. It spurred the recognition that East Asia needs to institutionalize its cooperation to pre-empt or solve similar problems that may arise" (East Asia Vision Group [EAVG] 2001).

The goals of the EAVG were sweeping: to prevent conflict and promote peace; to develop closer economic cooperation through trade, investment, finance, and development; to increase human security through environmental improvements and good governance; to enhance cooperation in education and human resource development; and, most comprehensively, "fostering the identity of an East Asian Community" (EAVG 2001). The most tangible institutional outgrowth of the EAVG report was the creation of the East Asia Summit (EAS), which met for the first time in Kuala Lumpur in December 2005.

As Pempel (chap. 8 in this volume) notes, however, from its inception membership in the EAS went beyond the EAVG reference of APT to include Australia, India, and New Zealand. In many respects, the contest over membership in the EAS was a concretization of the growing struggles between China and Japan for regional leadership. China has long preferred regional institutions in which the influence of the United States is circumscribed, perceiving this as a means of enhancing its own role. Japan, in contrast, with its strong strategic ties to the United States and a growing reluctance to see the regional influence of China bolstered, has consistently sought to foster a much more inclusive, pan-Pacific region. It was clear that the United States was not going to join (or be invited to join) the EAS, and so Japan, along with Singapore, pressed successfully for the larger membership. The EAS quite explicitly described itself not as a replacement for the smaller APT but rather as a complement to all existing regional mechanisms.

One of the first areas in which new efforts were made to institutionalize regional collaboration was, naturally enough, in finance. Thus as Jennifer Amyx (chap. 6) and Pempel (chap. 8 in this volume) make clear, the Chiang Mai Initiative (CMI), the Asia Bond Fund (ABF), and the Asian Bond Markets Initiatives (ABMI) were all put into place as regional institutions charged with providing an additional buffer between global financial markets and the national Asian economies. The potential for regional solutions to the problems of financial vulnerability has been enhanced by the massive increase in East Asian holdings of foreign exchange. At the time of the crises, Asian reserves stood at $742 billion. In 2005, these had more than tripled to $2.5 trillion.

Amyx (chap. 6 in this volume) makes clear, however, that simply having these reserves available does not, in fact, mean that they can be instantly and collectively mobilized in the event of some future crisis. CMI remains a series of limited bilateral swap arrangements rather than a pooled body of readily available emergency money (although in 2007 an agreement was reached, in principle, to move toward a common pool). And as Pempel observes, the Asian bond markets remain illiquid and are mostly used by national governments or major regional or para-statal institutional investors such as the Asian Development Bank or the Singapore Central Provident Fund. Yet, looking to the future, the Asian bond markets are clearly poised to develop into more liquid and well-subscribed engines of capital investment that have the potential to be significant new instruments allowing Asian monies to be mobilized in support of the vast number of Asian development projects that are expected to occur in the next decade plus.

Beyond the creation of formal governmental institutions, the postcrisis period and, at least as important, the post-9/11 period, saw renewed diplomatic energy invested in the so-called track II process. Like the formal regional institutions already noted, track II processes remain state-centric and national in their conceptualization. Unlike track I negotiations, which involve direct government-to-government talks, track II processes bring together private experts and government officials in their private capacities to engage in focused discussion on such problems as maritime security, human trafficking, and countering weapons of mass destruction. One such track II body, the Council for Security Cooperation in the Asia Pacific, has representation drawn from some two dozen security centers in countries around the Asia-Pacific; one of its two cochairs is always from an ASEAN country. Another, the Northeast Asia Cooperation Dialogue, is narrower in scope, with members drawn from the countries that are currently part of the Six Party Talks concerning the nuclear program of the Democratic Republic of Korea (University of California Institute on Global Conflict and Cooperation 1996).

The crises heightened the perceived need for broader policy dialogues and information exchanges across the region. Track II dialogues fit that need well because the purpose of such bodies is to engage in enhanced mutual understanding, confidence, and cooperation among countries in Northeast Asia through dialogue. Their meetings serve as laboratories in which different ideas can be explored and tested, alternative agendas can be set, and possible policy options can be explored (Ball, Milner, and Taylor 2006; Job 2003). In addition, track II meetings have been highly valuable in creating an epistemic community of regional norm entrepreneurs across East Asia. Such individuals, by their regular participation in such meetings, are able to develop mutual trust and understanding, engage in collective socialization, and push forward collectively arrived-at norms (Tay 2005).

Both track I and track II meetings have expanded greatly, particularly since the attacks on the United States on September 11, 2001. National governments have not focused exclusively on tightening their ties to one another through formal regional institutions. As Pempel (chap. 8) and John Ravenhill (chap. 7 in this volume) point out, in the wake of the crisis, the region has also seen a proliferation of bilateral and minilateral FTAs. No longer satisfied to wait for agreements at the global level through the WTO and Doha, individual governments have begun to forge multiple overlapping trade bargains with one another. Some reflect the influence of domestic liberalizers anxious to use FTAs as a wedge to break up previously rigid protectionist forces at home; most enhance the regional liberalization of trade. But significantly, they all provide an important departure from precrisis economic patterns of institutional collaboration and economic interaction.

At the same time, the FTA process has hardly ignored issues of national competition and global strategic positioning. Thus, Japan and many of its allies in the United States, such as Fred Bergsten of the Institute of International Economics, have pressed for the creation of a Western Pacific free trade area that would supplement the recent wave of bilateral FTAs, ensuring, in Bergsten's words that Asia would avoid the tendency to "draw a line down the middle of the Pacific" (2006, 15). A push for a Pacific FTA is complementary to the Japanese approach to regional institutions more generally. China, in contrast, has laid great stress on enhancing its FTA with ASEAN.

The governments of East Asia have thus moved postcrisis toward more broadly enhanced intraregional cooperation with one another. Such formal cooperation in itself is, of course, only a first step to any institutionalization of the region. Sentiments favoring a deepening of regional cooperation continue to be offset by specific governmental perceptions of national interest. Moreover, market forces rarely line up perfectly with government preferences. They, too, continue to drive regional developments, both toward cooperation and competition. Regional cooperation within Asia, although expanding, does not detract from the continual interactions of the region with the broader international arena. As Munakata has poignantly noted, East Asian countries "obtained autonomy in designing their regional cooperation, but they could keep this autonomy only by gaining the confidence of the private sector in the effectiveness of their regional institutions, as well as earning the trust of extraregional governments in the positive contributions the region could make" (2006b, 13).

Today's region bears no resemblance to the elegant and structured metaphor afforded by the flying geese model, which pictured each national economy in the region moving methodically and systematically toward improved positions in the product life cycle, presumably following the lead goose, Japan, with the various newly industrializing economies close behind. Instead, a series of complex production networks and investment corridors criss-cross one another; the pattern of intraregional trade has become far more complex, reflecting the fragmentation of manufacturing engineered by production networks and the consequent growth of intraindustry trade. And, in particular, China has become by far the most favored site in the region for FDI, making that country the vortex of ever-increasing amounts of regional economic activity.

Within this greater economic complexity, however, another trend stands out. The export-oriented economies of East Asia have, for the most part, reduced their direct dependence on sales to the U.S. market. Ravenhill's data on this are clear. Between 1996 and 2004, the Japanese dependence on the U.S. market fell from 27.5 to 22.7 percent; ASEAN saw its dependence fall from 19.6 to 15.6 percent. In addition, the Korean trade profile shifted dramatically. The United States, which ranked as the number one export and import partner of Korea prior to the crisis, lost considerable ground. It fell, in the postcrisis years, to number three for Korean imports and number two for exports. China, meanwhile, jumped to be the number one Korean export market, with a 21.8 percent share (the United States, in the much weaker number two slot, had a 14.6 percent share). The major exception to this pattern has been the increasing dependence of China on sales to the United States, reflecting its growing significance as a source of U.S. imports. And it is emblematic of the much broader increase in the Chinese regional role. Rapid Chinese economic growth, combined with the kinds of increased openness to global and regional markets analyzed by Steinfeld, has catapulted China into becoming the number one trading partner for Japan, South Korea, and several ASEAN countries.

The reduction in the centrality of the U.S. market to East Asian exports has been mirrored by a diminished institutional presence by the United States, in large part a consequence of actions by the George W. Bush administration. When the administration took office in 2001, it was committed to weakening the prior U.S. commitments to multilateralism and, hence, to throwing off what it saw as the multilateral shackles on unilateral action. Soon after coming to power the United States broke with fifty years of U.S. multilateralism by explicitly renouncing a host of long-standing and relatively new global agreements, from the antiballistic missile (ABM) treaty to the Kyoto Accord to the Convention Against Small Arms, the Biological Weapons Convention, the Chemical Weapons Convention, the International Court of Justice, and many others (Ikenberry 2001; Daadler and Lindsey 2003, 13; Walt 2005, 97). In virtually all cases, the U.S. government had been a proponent of these regimes prior to Bush.

APEC and ARF, both bodies that provided the United States with regularized high-level interactions with East Asia, declined in stature after the crisis and even more so with the accession of the Bush administration. APEC was criticized by

U.S. officials as having failed to secure adequate liberalization of markets in Asia. Subsequently, it lost some of its focus as a result of U.S. efforts to use its meetings to advance statements of political support for the so-called global war on terror. ARF, as well, lost U.S. support in the face of much greater skepticism about multilateral approaches to security than the prior administration had. Indeed, in 2005 and 2007 Secretary of State Condoleezza Rice did not even show up for the ARF meetings.

The prior U.S. combination of economic plus security preeminence in Asia has been eroded, starting with the crises and Asian reactions to perceived U.S. high-handedness. But the erosion has accelerated since 9/11. The former U.S. centrality to the political economy and regional architecture of East Asia has been overshadowed by its obsessive attention to security generally and to the Middle East in particular. U.S. neglect has freed up policy space for Asians to explore opportunities for cooperation—and contestation—without the defining centrality of the United States. Many of the changes in the regional architecture reveal that shift.

All the same, many governments in Asia, particularly many of the ASEAN countries and Japan, remain concerned about the decline in U.S. attention to the region, dreading the prospect that a not-always-benevolent China may fill any consequent power vacuum. As a consequence, these governments have worked actively to retain U.S. interest and involvement in the region. Heavy ASEAN lobbying, for example, resulted in Secretary Rice's appearance at the ARF meetings in 2006 after she had skipped the 2005 meeting (although she was absent again in 2007). And the United States, along with a number of European and Australasian countries, has been a regular participant in the IISS Shangri-la Dialogue on security since its inauguration in 2002.

Thus, since the crisis, the governments of East Asia have shown an increased predisposition to come together in response to perceived threats from increased globalization or, at least, as a way to enhance Asian collective bargaining power within global institutions. The result has been an increasing array of regional institutions, most of them with exclusively Asian memberships. It is also clear that markets within Asia have become increasingly interwoven and complex, with China, rather than the United States (or Japan), sitting at the vortex of many of the new developments. Moreover, as Asians have looked for ways to deal more effectively with future crises, they have sought to take advantage of their collective resources and to build up regional strengths rather than relying so heavily (as in the past) on purely global institutions, these having increasingly been seen as unresponsive to specific Asian needs. This intra-Asian focus has been bolstered by a declining economic centrality for U.S. markets and actions by a U.S. administration that has been far less predisposed to bind itself through the multilateralism and Asian-Pacific regionalism that it previously accepted. Yet Asian cooperation in many matters of the purse has not been matched by similar cooperation in security. There the Asian picture is far less cohesive and exclusively Asian. The United States continues to play a large part in Asian security matters, in many cases at the welcome behest of Asian governments.

East Asian regionalism is currently characterized by organizations with both overlapping and contested memberships and functions. Which institutionalization of regionalism will prevail—ASEAN Plus Three or ASEAN Plus Three Plus Three (India and Oceania) or Asia-Pacific—remains to be determined. One important factor in this contestation over the definition of the region is whether successors to the Bush administration reverse the recent moves away from Asian economic engagement. But in the short to medium term, it is clear that, just as the East Asian model no longer provides an apt description of realities on the ground, so too prior conceptions of an Asian region held together simply by market forces or exclusively committed to pan-Pacific principles have also begun to change substantially.

East Asian Vulnerability to Future Crises

The key question that governments and publics in East Asia a decade after the crisis want answered is: Have the problems that rendered economies vulnerable to crisis in 1997–98 been resolved? In the contemporary global economy, no country is entirely immune from crisis, not least because of the possibility of contagion because any crisis can spread from the weakest links to the relatively healthier economies. And, as with wars, governments typically are fighting the symptoms of previous crises rather than successfully anticipating the sources of future vulnerability. The volume of short-term funds under private control in global financial markets can swamp even the largest national holdings of foreign reserves (those of China and Japan), whereas IMF resources can at best play but a token role in rallying support for besieged currencies. East Asian governments continue to worry about the effects of capital flows on their capacity to achieve core economic objectives, including control over inflation and exchange rates, and hence their capacity to maintain the competitiveness of their exports.

In the absence of perfect foresight, the best that governments might be expected to do is to address the factors that were widely identified as the principal sources of vulnerability to financial crisis in 1997–98. These include:

- Overly rigid exchange rates tied to an inappropriate peg (the U.S. dollar).
- Inadequate foreign exchange reserves measured against short-term foreign liabilities.
- Excessive dependence on bank lending for corporate financing.
- The mismatch between banks' long-term domestic lending in domestic currencies and their unhedged short-term borrowing in foreign currencies.
- Financially unsound banking systems burdened with high ratios of nonperforming loans (NPLs).
- State-owned and/or state-directed banking systems that relied heavily on relational banking.
- Weak systems of prudential regulation.

Changing the exchange rate regime would seem to be one of the easiest of the financial sector problems to fix. The choice of exchange rate regime, after all, is under government control; moreover, there are typically few domestic interests with strong preferences that will mobilize in support of one type of regime rather than another. Yet, as Benjamin Cohen (chap. 2 in this volume) shows, substantial continuity has occurred in exchange rate regimes in East Asia in the decade since the crisis. Not only have most governments retained a soft peg, rendering their currencies vulnerable to speculative attack, but the U.S. dollar is still the dominant referent even when governments have chosen a basket of currencies against which to peg. And a determination to maintain exchange rate stability has imposed other costs through, for instance, impeding attempts to develop derivatives markets.

As Cohen argues persuasively, for governments preoccupied with maintaining export-led growth (and when the United States remains an extremely important final destination for the exports of many countries), there is method in this madness. And some learning has occurred in the policies of the East Asian governments on exchange rate regimes in response to the disasters of 1997. Some governments—most notably Indonesia, Korea, and Thailand—have allowed their currencies to fluctuate substantially more than in the precrisis years (an average monthly change over the years 2000–6 of close to 3 percent for Indonesia, 1.5 percent for Korea, and 1.25 percent for Thailand; not radically different from the monthly average of 2 percent for freely floating Japan) (World Bank 2006, 9, exhibit 7). The won appreciated by more than 35 percent against the dollar between 2001 and early 2007; the Thai baht appreciated by more than 20 percent in eighteen months starting in the middle of 2005.

The key question is whether such additional flexibilities will render currencies less vulnerable to speculative attack. Here, another factor enters the equation—the huge increase in East Asian government holdings of foreign exchange reserves since the crisis (figure C.1). This accumulation, built up by the increased trade surpluses (an estimated $362 billion in 2006; World Bank 2007, 3), is perhaps the single most dramatic change in the financial realm over the last ten years. By the end of 2006, both China and Japan had close to $1 trillion in reserves, accounting for around 40 percent of the world total foreign reserves. The Korean holdings, in excess of $220 billion, were more than ten times those at the onset of the crises. Increases in other countries have been less spectacular, but most have doubled their foreign exchange holdings in the years since the crisis, in the Taiwanese case from an already substantial base. The volume of foreign reserves under national control continues to dwarf the limited amount of finance currently available under the regional bilateral swap arrangements of the CMI (see Amyx, chap. 6 in this volume). For most countries, the current value of foreign exchange holdings is substantially in excess of total debt, let alone short-term debt, so nonrenewal of short-term lending would not have the catastrophic effect it had in 1997 (Griffith-Jones and Gottschalk 2006, 21). Many commentators now suggest that East Asian economies may be holding excessive levels of reserves and, by continuing to absorb large inflows of capital by running balance of payments surpluses, may be generating problems for domestic economic management.

The increased flexibility in some exchange rates coupled with the enhanced capacity for intervention in foreign exchange markets that these increased foreign

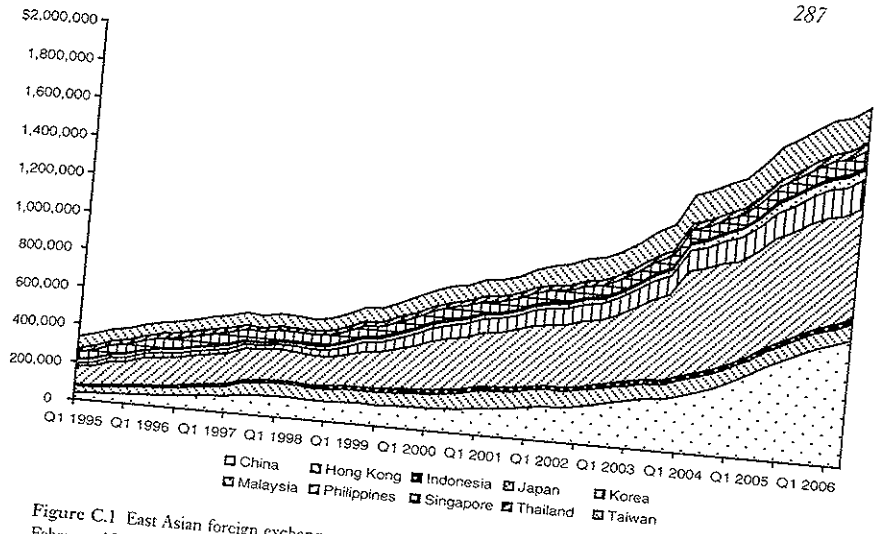

Figure C.1 East Asian foreign exchange reserves, 1995–2006 (SDR [millions]; 1 SDR = US$1.50 on February 15, 2007). SDRs, special drawing rights.

reserves afford may just tip the balance in any future battle between governments and speculators. For government intervention to be successful, it must be backed by sufficient reserves so that speculators will be uncertain as to the direction of the next move of the currency. Most observers believe that the foreign exchange holdings of East Asian governments are of a sufficient magnitude now that the central banks will be able to resist a speculative attack.

For many observers, the critical link between financial-system weaknesses and the real economy came through the excessive reliance in many East Asian economies on bank lending as the primary source of corporate finance. The problems arising from a mismatch between the banks' short-term borrowing internationally and their long-term lending domestically (a practice that was entirely rational from an individual corporate perspective) were compounded by the failure of banks to hedge against foreign exchange risk (again an understandable approach in an environment in which the government was believed to be providing a guarantee of exchange rate stability). The heavy dependence of the corporate sector on bank finance, critics argued, also facilitated state interference with lending policies and led ultimately to the moral hazard quandary of banks that were regarded to be too big to fail. To what extent have these two problems—the lack of hedging against foreign exchange risks and the excessive reliance on bank lending for corporate finance—been overcome since the crisis?

Obtaining data on the hedging practices of private banks is not at all easy. As a proxy for measuring the hedging problem, the Bank for International Settlements

(BIS) calculates what it terms a foreign-currency mismatch ratio, the foreign currency share of total debt divided by the ratio of exports to GDP. This ratio has fallen substantially since the crisis, in part because of the increased denomination of international bank lending in local currencies (Bank for International Settlements [BIS] 2006, 44–45). Aggregate international bank lending to East Asian countries has declined since the financial crisis, down from $691 billion in 1995 to $477 billion in 2004, although bank lending to China and to three of the crisis economies—Malaysia, the Philippines, and Korea—has increased (although only marginally in the case of Korea) (Ghosh 2006, 30). Another positive sign in terms of reducing dependence on volatile international lending is the decline since the crisis years of the share of short-term debt in overall debt (table C.1).

In the years since the crisis, Asian governments have actively promoted the development of bond markets to provide an alternative to bank-based financing for corporations. A vibrant bond market would also help fund the massive infrastructure investments that East Asia will require in the coming decades. Moreover, some believe that an efficient local bond market will also help overcome the costs of the current global system of capital flows, whereby Asian current account surpluses are invested in low-yielding assets offshore (typically in U.S. Treasury bills) and some of the money then re-lent to the region by foreigners (often banks and hedge funds) at substantially higher rates of interest.

Various factors historically have impeded the development of bond markets in East Asia. Among the most important are the relatively small size of many of the economies, the absence of public-sector funding needs (because most governments have historically not run significant budget deficits), relatively high and variable interest rates, a history of capital controls, and a poor regulatory environment (Eichengreen and Luengnaruemitchai 2006). Combined, these produced a context that made it risky for investors, especially foreigners, to make the long-term commitment to fixed-interest securities.

Following the financial crisis, many East Asian governments encouraged the development of domestic bond markets. In addition, as Amyx and Pempel (chaps. 6 and 8 in this volume) detail, the regional grouping of central banks, Executives' Meeting of East Asia-Pacific Central Banks, promoted the development of a regional bond market. To date, however, the volume of funds under this initiative (totaling only $3 billion) pales in comparison with developments at the national level—the importance of the regional initiatives lying not in the volume of funds

Table C.1 Share of short-term debt in total debt (%)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Indonesia	21	25	24	13	13	16	16	17	17	17
Malaysia	21	28	32	20	14	11	15	17	18	22
Philippines	13	18	23	11	8	9	10	9	10	8
Thailand	44	42	34	28	24	19	20	20	21	22

Source: World Bank (n.d.).

involved but in exposing the governments in the region to the practical problems associated with establishing viable bond markets. It has been at the national level that the main growth of bond markets has taken place. As table C.2 shows, several East Asian countries in addition to Japan—most notably Korea, Malaysia, Hong Kong, and China—by the end of 2004 had sizable domestic markets for corporate bonds (in excess of $30 billion).

Also evident from table C.2, however, is the fact that despite an increase in the size of corporate bond markets in the postcrisis era, they remain relatively insignificant sources of financing compared with either bank lending (domestic credit) or equity (stock market capitalization, which is particularly important in Hong Kong and Singapore). (Columns 2–5 of table C.2 compare the value of corporate bonds and other financing sources expressed as a percentage of GDP.)

Clearly, East Asian bond markets still have a long way to go before they assume the same significance as a source of corporate financing that they enjoy in most industrialized economies. A number of factors underlie this constricted development, almost all related to government actions or omissions (largely, it seems, through the government's privileging of other economic and/or political objectives rather than because of the influence of nongovernmental actors; although some banks might have been expected to oppose the development of bond markets as an alternative to bank credit, the liberalization and internationalization of the East Asian banking systems after the crisis weakened the political influence of local banks). Several countries—most notably China, Indonesia, Malaysia, and the Philippines—maintain restrictions on access to bond markets by foreigners. Many also retain significant restrictions on issuers of debt. These restrictions are usually linked to limits on capital mobility, all driven by a concern to protect the local currency from speculation and to maintain export competitiveness. In many countries, these restrictions have

Table C.2 Corporate bond markets and other financing sources in east Asia, end of 2004

	Corporate bonds		*Other financing sources (as % of GDP)*		
	(1) Amount outstanding (billions of US$)	(2) Percentage of GDP	(3) Domestic credit	(4) Stock market capitalization	(5) Government bonds
China	195.9	10.6	154.4	33.4	18.0
Hong Kong	61.9	35.8	148.9	547.7	5.0
Indonesia	6.8	2.4	42.6	24.5	15.2
Japan	2,002.0	41.7	146.9	76.9	117.2
Korea	355.6	49.3	104.2	74.7	23.7
Malaysia	49.7	38.8	113.9	140.8	36.1
Philippines	0.2	0.2	49.8	37.5	21.8
Singapore	21.7	18.6	70.1	211.4	27.6
Thailand	31.9	18.3	84.9	67.1	18.5
United States	15,116.6	128.8	89.0	138.4	42.5

Source: Data from Gyntelberg, Ma, and Remolona (2006, 14, table 1).

produced thin markets, thereby constraining the available range of financial instruments, particularly derivatives (Hohensee and Lee 2006).

In most countries, the exceptions being Hong Kong and Singapore, regulation and prudential supervision of bond markets remain far from international best practice. As Eschweiler (2006) notes, the problem often is less one of inappropriate principles than lack of effective enforcement. Among the issues here are the lack of independence of supervisory/regulatory authorities from the government, the absence of sufficient qualified and experienced staff within these agencies, and a general absence of the technical capacity to monitor markets so as to identify manipulation and systemic risk.

Reference to these weaknesses returns us to issues directly relevant to the broader health of the East Asian financial systems. On one dimension, the ratio of NPLs, banking systems have returned to at least the position that they were in before the onset of the crisis. As table C.3 documents, government efforts to relieve banks of their NPLs, often at significant expense to the public coffers, had been largely successful by 2005.

As Natasha Hamilton-Hart (chap. 2 in this volume) documents, the role of the state in East Asian financial systems today is not necessarily smaller than in the precrisis period. The collapse of financial systems during the crises necessitated that the states took over bankrupt institutions. Some of these institutions have subsequently been reprivatized, in particular those in Indonesia, Korea, and Thailand, often leading to a substantial increase in foreign ownership compared with the precrisis period. Others remain in state hands. The trends toward privatization and internationalization may be expected to continue as markets improve, although, as Hamilton-Hart indicates is the case in Indonesia, there is no inevitability that governments will move to completely relinquish their ownership or control over the banking systems.

Greater foreign participation in East Asian financial systems can be expected, other things being equal, to increase competition and to bring these systems closer to international best practices. Ultimately, however, much will depend on the quality of the regimes of supervision and prudential regulation. Although most countries have made substantial progress in both areas, the lack of skilled personnel with the requisite experience in a particularly complex field limits the effectiveness of ongoing efforts at financial system reform.

Table C.3 Nonperforming loans in the commercial banking system of the crisis-affected countries, December 1997–2006 (% of total loans)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Indonesia	7.2	48.6	32.9	18.8	12.1	7.5	6.8	4.5	7.6	6.1
Korea	6.0	7.3	13.6	8.8	3.3	2.4	2.2	2.0	1.3	0.9
Malaysia	na	10.6	11.0	9.7	11.5	10.2	9.0	7.5	5.8	4.8
Philippines	4.7	10.4	12.3	15.1	17.3	15.0	14.1	12.7	8.5	6.0
Thailand	na	45.0	39.9	19.5	11.5	18.1	13.9	11.6	8.3	8.1

Source: Data from World Bank (2007, appendix table 9).

In sum, the changes that have occurred in East Asian financial systems over the last decade have rendered these systems less vulnerable to crisis. By far the most dramatic change has come in national holdings of foreign exchange reserves, which are now of sufficient magnitude to give many countries an opportunity to, at least temporarily, resist speculative attacks on their currencies. Coupled with this is the increased flexibility—albeit not as substantial as many economists might advocate—of several of the exchange rates around the region (presumably, again other things being equal, having the effect of reducing the overall magnitude of foreign reserves required and making the work of speculators more difficult). The problem of currency mismatches, if not entirely resolved, appears to have been reduced, and according to BIS data is certainly less of an issue in East Asia than in other developing regions. Finally, progress has occurred in the development of nonbank sources of corporate finance and in improving supervision and prudential regulation of the financial system. Things may not be perfect, but substantial strides have been taken in the right direction, and East Asia as a whole has erected substantial barriers against possible future crises.

Conclusion

This volume has been concerned with the extent to which significant change has taken place in the political economy of East Asia since the financial crisis of 1997–98 and with the causes and consequences of such change. In concluding the volume, rather than seeking to synthesize all that has come before, we have tried to look forward and reflect on how the changes already underway are likely to evolve and how they have affected the vulnerability of East Asia to future crises. We have highlighted the major trends emerging across the region on three key dimensions: the evolving national political economies of East Asian countries, patterns of regional integration, and responses to perceptions of external vulnerability of East Asia.

In domestic political economy, a trend away from all-powerful executive government continues to gather momentum. East Asian political systems are characterized by increasing political pluralization and contestation, increasingly institutionalized leadership turnover, gradually strengthening legal systems, rapidly expanding public access to information, and intensifying engagement with the global economy. The financial crisis was by no means the sole (nor always the primary) cause of these developments, but it was an important contributing factor, sometimes reinforcing trends that were already underway as part of the wave of democratization that swept the region in the 1980s. The net effect of these changes is that tightly disciplined policy regimes, close and long-running relationships between political and corporate leaders, and a presumption that the state is the all-important key to development are likely to continue to gradually recede.

The financial crisis itself played a much more direct role in driving the other major developments we highlight in this chapter. A desire to strengthen regional cohesion flowed directly from the dissatisfaction of the East Asian governments with the response of the international community to the catastrophe that enveloped much of the region in 1997–98. The region has moved from a situation in which it was often characterized as underinstitutionalized to one in which it has become the most active global site for the negotiation of agreements on trade and financial cooperation. It may be premature to speak of an *East Asian* identity being institutionalized. Nonetheless, the years since the crisis have seen new East Asian regional institutions come into being despite the initial still-birth of the Asian Monetary Fund (which would have led countries in a different direction). In some official circles, a significant emotive attachment to East Asia has developed.

Concurrently, however, ongoing tensions among the major states of the region are leading some governments to hedge their bets by reinforcing their extra-regional linkages. These moves embrace security, diplomatic and economic linkages, including the reinforcement of alliance relations with the United States, the inclusion of non-East Asian actors such as India in regional institutions, the new Chinese–Russian–central Asian linkages under the Shanghai Cooperation Organization, and the negotiation of preferential trade agreements with the United States, the European Union, and countries in South America. Although the rapid economic growth of China has led to a major reorientation of production networks across East Asia and has been the major factor driving the increasing share of East Asian exports that are consumed within the region, nowhere currently is there any sentiment for constructing a closed region. The region is not turning inward on itself but, instead, the deepening of intraregional ties is part of a wider pattern of deepening global economic engagement. The porosity of the East Asian region that Katzenstein (2005) notes has been unchallenged by developments since the crisis.

The final theme we highlight is the progress made toward reducing the vulnerability of the East Asian countries, both individually and collectively. Although the possibility of a future financial crisis has certainly not been eliminated in East Asia (any more than elsewhere in the global economy), significant steps have been taken to reduce the risk of a reoccurrence of a crisis similar to that of 1997–98. National reserves of foreign exchange are now much more substantial, there is somewhat greater flexibility in the foreign exchange regimes of a number of countries, and progress has been made in strengthening banking-sector governance and corporate governance more broadly.

The financial crisis that shook East Asia in 1997–98 has proved to be a marked disjunction on several dimensions of the domestic political economies and international relations of the countries. Peering into the future is always a hazardous business, but our expectation is that the three trends identified here will be significant elements in what lies ahead.

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