ASIA-PACIFIC WORKING GROUP
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SESSION 1:
ALTERNATIVES TO REGIONAL DEVELOPMENT IN ASIA

It wasn't long ago, in fact it was the early 1990s when the coming century, the 21st century, was supposed to be the Pacific century. The economies of the newly industrializing countries of the region became what were regarded as the most successful developing economies, in a first wave which included South Korea, Taiwan, Singapore and Hong Kong, and a second wave from the Southeast Asian countries. This was at the same time that neo-liberalism emerged and became the ascendant economic doctrine in the North, in the South and in multi-lateral institutions.

The contradiction is that these economies almost point by point, except for the case of Hong Kong, followed exactly the opposite of neo-liberal free-market prescriptions that demanded leaving everything to the market. This interesting and important contradiction would have implications throughout the 1990s.

When the Southeast Asian economies emerged as registering 6-10% growth rates in the period from 1985 to 1995 the World Bank (WB) and the International Monetary Fund (IIMF) released a study called the *East Asian Miracle* that tried to show that not only the Northeast Asian economies, but also the Southeast Asian economies, had essentially succeeded because they had followed market-friendly policies.

For those with slightest acquaintance with the region this was something that was absurd. The Korean economy was almost a socialist economy and Japan is really a socialist economy masking as a capitalist economy (according to many Japanese scholars). It was fairly clear that whatever policies the Southeast Asian countries followed, whether neo-liberal or state interventionist policies, it was inevitable that they would grow sharply and fast because off the massive entry of Japanese investment. Between 1985 and 1990 there was something in the order of $50 billion of Japanese investment that moved into the region.

This was a time when the Americans had forced the revaluation of the Japanese yen to solve their balance of trade problems. It was no longer profitable to produce in Japan and they shifted capital equipment, primarily related to labor-intensive manufacturing, to Southeast Asia or to China. That massive amount of capital could not help but trigger growth whatever your policies were, whether neo-liberal, state interventionist or socialist. Any economy confronted with this would grow. Indonesian and Thai economists were the first to admit that this was externally-induced growth.

These were state-assisted capitalist economies with a great degree of protection, some of them export-oriented but with the market being managed each step of the way, to use Robert Wade's terms, by administrative guidance, more in the Northeast Asian economies than in the Southeast Asian economies.

This part of the world had achieved prosperity by being unorthodox and by the late 1980s and 1990s the American's intensified pressure in terms of trade, whether bilateral pressure or through multilateral mechanisms like the GATT, to get them to open up. Part of the reason the WTO was established, and especially trade related property rights, or TRIPS, was to discipline the Asian economies during this period.

This was also the period, because of neo-liberal policies of financialization, that there were tremendous amounts of capital in the capital markets in the North that wanted entry into Asia. Trade pressures didn't work and the Americans tried to create the Asia Pacific Economic Cooperation whereby New Zealand, Australia and the US pushed to get a trans-Pacific free-trade area that would have eliminated tariffs by 2020.

By the mid 1990s people were beginning to think that APEC would become a reality and this would be the end of this trade protected area. It didn't quite happen that way. Not only did the bilateral pressures not work when it came to trade, but APEC was masterfully sabotaged by the Japanese who informally worked with a number of the other Asian countries to obstruct and make bureaucratically ineffective many of the agreements that had been arrived at in the formal APEC sessions. APEC still continues to exist and meet, but it is like the old League of Nations, physically seemingly alive but actually brain dead.

Trade pressures didn't work, but what did work were the pressures for financial liberalization. The US, with the help of the IMF, was able to get Asian economies to liberalize their capital accounts and investment laws and allow the free entry of speculative investment. People wondered why, when the region was so tough on trade that they allowed financial liberalization. The reasons for this were that it wasn't just a push from the outside, but may technocrats wanted to liberalize because they were worried that the massive Japanese wave of direct investment was tapering down.

In the 10 years between 1985 and 1995 they had created massive export machines that were dependent on constant foreign capital. Foreign capital was the fuel of the Southeast Asian economies and if they did not find alternatives sources of capital to Japan then they would be dependent on the health of the Japanese economy. The push came from technocrats that saw the speculative funds and hedge funds as an alternative source of financing. Bangkok, Kuala Lumpur, Manila and Jakarta followed the same formula of financial liberalization. They liberalized their financial sector and raised interest rates several points above the interest rates in the North to attract that capital. They fixed their exchange rates with respect to the US dollar and made sure that they would not fluctuate greatly to reassure foreign investors that they would not lose the value of their investment.

We are often criticized for fixing exchange rates, but actually there was tremendous pressure from the outside to do that and part of that pressure came from the IMF. This turned out to be the Achilles heel of the Asian miracle.

We liberalized and capital came in, but capital is interested mainly in investments that yield quick, fast and high returns. They were not going into industry where bulk investments are needed; they were not going into agriculture because everyone knew that Asian agriculture is a hopeless case. The money went into the stock market and mostly to real estate. As a result, the prices of land and housing in places like Bangkok went sky high, almost as high as in San Francisco.

When there is an over supply of investment in certain sectors, the prices will begin to come down. But meanwhile that over-investment created a great number of dislocations within the economy including pressure on the exchange rate, pressure on trade and the current account. These pressures began to worry investors. These indicators, and the fact that many of these countries were lapsing into deficit in terms of their trade, worried investors that these countries were on the verge of crisis and they began to pull out.

Capital controls had been eliminated, which meant that in the good years capital came in, but when investors wanted to leave there was no way to prevent their exit. When the exit began, because of over investment and the collapse of prices in Bangkok, there was a financial contagion that hit Manila, Malaysia and Indonesia. The spread was largely because investors did not differentiate among the economies; all were considered Southeast Asian economies. If Thailand was in trouble, then all the Asian countries must be in trouble and their currencies might collapse. Massive panic ensued in the summer of 1997 when, in the space of a few weeks, $100 billion left the region, including South Korea.

This financial exodus left behind tremendous effects which are still there, for instance 22 million people in Indonesia and 1-2 million in Thailand dropped below the poverty line in just a few short weeks. For all intents and purposes the region has not really recovered since then. And this is why the 1997 crisis marked the end of the East Asian miracle and after that it was China's show; the closing of one era and the emergence of another.

Following the crisis, our currencies collapsed, bankers called in their loans, and governments were saddled with the responsibility of paying off the debts of the collapsed private sector. Investors moved away from these economies and began to focus on India and China and the IMF was the only source of funds to help in East and Southeast Asia. The IMF came in and in IMF fashion said we will give you these massive loans provided you agree to certain conditions. The main condition, which was very strange, was to cut back on government expenditures.

Anyone who has taken elementary economics knows that when the private sector is in crisis the last thing you do is cut off government support because you are going to have a pro-cyclical effect. So the IMF, thinking it was facing an inflation problem – for countries that were clearly already in recession – applied an anti-inflationary, government-expenditure cutting strategy, which in fact worsened the recession. In 1998 practically all the Asian countries entered into recession.

Also, the IMF funds were destined, not to assisting countries to recover, but to the banks, the creditors. Very little of the money went into helping revive economies, much as during the Mexico crisis, a lot of that money went to foreign speculative investors and banks.

The third thing that happened was that the IMF now saw the opportunity to do what Washington had always wanted to do but had been unsuccessful, which was to remove the protections in the trade structures. In Indonesia, Thailand and Korea, the word was bring down your tariffs, eliminate your quotas and all those informal barriers to trade came down, not only trade, but also foreign investment regulation, especially direct investment.

After 30 years of trying, Washington finally penetrated these economies. India, China and Vietnam did not enter into crisis because they were smart enough not to liberalize their capital account. So the big winner in the East Asian context of the economic collapse was China.

In the first few years after the crisis, efforts to try to revive our economies were uncoordinated. Malaysia was the first country to try to break with the IMF model and in the midst of the crisis in 1998 Mahathir imposed capital controls, which relieved the pressure, kept some of the capital in the country and allowed Malaysia to escape the most devastating impacts of the Asian financial crisis. Even the IMF later admitted that Malaysia had succeeded.

Thailand, which was the epicenter of the crisis, took the IMF medicine for a few years but there was a tremendous resentment. When Michel Camdessus (IMF Chairman) attended the UNCTAD meeting in Bangkok in 2000, someone threw a pie in his face. It was caught in the *Financial Times* and the response in Thailand was interesting because the guy who threw the pie was treated as a national hero. Instead of being arrested he was let go and that was when we began to realize that there was something afoot here.

In 2001, Thaksin the prime minister of Thailand until 2006, ran on an anti-IMF platform and won. He began to institute policies like freezing the rural debt, preventing bankruptcies, pouring money into the private sector; he instituted a universal healthcare program of 30 baht per person and gave 1 million baht per village to invest in productive activities. The country began to revive.

From 2002 on it was clear that the source of these revivalist economies was China. The red-hot Chinese demand was driving exports and recovery from the Asian financial crisis, but it was an uneven recovery. Korea was supposed to be the tiger, the country where the bureaucracy was able to control the development process, where the market was managed. Alice Amsden had a phrase that the strategy of the Koreans was to get relative prices wrong deliberately. Korea really went under, it passed into IMF's sovereignty, and there was really no challenging the IMF the way it was challenged in Thailand. Now, the rate of de-protectionism in the Korean economy is very high. The last calculation is that 50% of Korean assets are owned by foreigners. Many of the big Korean firms came under control of foreign firms and a classical structural adjustment program resulted in a lot of unemployment. It has been an economic as well as a psychological crisis. Korea now has the highest rate of suicide among the OECD countries. It continues to maintain its industrial structure, but is very much an ailing economy and the foreign take over has been quite rapid.

The Asian countries began to realize that some sort of regional organization was needed so that never again should each one confront capital alone as they had confronted it in 1997. At the height of the crisis, the Japanese had proposed an Asian monetary fund, but the United States vetoed it because it feared that it would render the IMF irrelevant. After a few years the ASEAN countries and Japan, Korea and China came up with ASEAN+3, or the Chiang Mai Initiative, which is a financial cooperation agreement that allows countries to form bilateral agreements and borrow from each other should they again be subject to speculative attacks.

The second response to the crisis, and because the Americans basically vetoed any change to the global financial architecture, was the view that the only way to ensure against attack was to build up reserves. Asian countries have built up tremendous reserves as a kind of war chest. Much of the reserves are in US dollars, gained through exports and deliberately undervalued currencies. Asian currencies are very strong at this point in time, but they would even be stronger if the governments allowed the currencies to reach real levels.

Now, since they have so much, they lend to the United States and we are seeing China, Japan and the ASEAN countries propping up middle class spending the US, who in turn buy Asian products. It is an interesting international Keynesianism, but all are worried that this sub-prime crisis is going to make American consumers stop buying.

Aside from the Chiang Mai Initiative, there has not been any innovative thinking about the establishment of European-style integration in the region. There is ASEAN, it has been there since 1967 and it is the grandfather of all multi-lateral institutions, but it is basically a collection of independent countries with very little real economic integration. The original plan among four and then five countries was that it would be the basis for regional import substitution for industrial integration, an eventual integration of the economies. There were certain incentives and mechanisms in ASEAN to promote industrial integration across the region, but it was mainly the Japanese, who were trying to build up a cost-effective regional structure. The Japanese took advantage of these mechanisms and the regional integration was a Japanese corporate, Mitsubishi/Toyota-type of division of labor, which was not exactly what ASEAN needed.

Part of the problem is that there have been two contending visions within ASEAN. One envisions a regional bloc, with reduced tariffs among members, but raised ones against third countries. Another is to see ASEAN coming together under free trade rules as the first step towards global free trade, which is not really planned integration of economies. This has never been resolved and Indonesia and Malaysia tend towards the planned integration and the Philippines and Singapore tend to the free trade idea. Another problem is that ASEAN has been mainly a project of government elites who have not been able to incorporate the industrial economic elites who have mainly been interested in defending their home markets. Finally, ASEAN has been non-transparent, discussions take place among the elite technocratic level and the people have not been brought into the process.

There is fanfare of ASEAN brotherhood and hundreds of meetings take place every year, but ask a peasant in Thailand or the Philippines about it and they will probably say it is a brand of fertilizer. That is the sad state of ASEAN; it is a paper organization that has not been democratized. It has achieved some things when it comes to the security level. It has reconciled enemies, Vietnam and Thailand used to be blood enemies back in the communist/anti-communist days. At the political level many people will dispute that ASEAN has been a success, especially since it went out of its way to bring Burma in. So it has been disastrous at the human rights level. At the economic level it has really been a paper tiger. You have nothing in the region that compares to say the ALBA initiative in Latin America.

Where the action is in terms of alternatives, both at the national and regional levels, is in Latin America. ALBA, the Bolivarian alternative for the Americas is the kind of experimentation that is very exciting. The Venezuelan government sells oil to 14 Caribbean countries at a 40% discount; it has a deal with Bolivia to sell its oil in exchange for soybeans and with Argentina to sell its oil in exchange for heifers.

As Chavez has said this is not a free trade project, the logic of ALBA is a logic that goes beyond capitalism – those are his words. It is, as they call it, a work in progress which is quite exciting because there is an element of idealism and pragmatism in it. You don't find that kind of rethinking of national and regional strategies in ASEAN at this point.

Coming into this is a very dangerous juncture given that things do not stop and the Chinese industrial machine marches on. You have to find a way to relate to China. Right now countries that are strategically aimless after the Asian financial crisis are just letting demand from China pull them along and this is just an effective way to become appendages of the Chinese economy.

It is broadly agreed upon now that the era of export-oriented growth is over. To think that one can still be successful as an export-oriented economy is quite foolish given that China will not be out done in its ability to bid down the price of labor for a very long time. There is the sense that economic strategy should be reoriented toward the domestic market.

A second idea is that you cannot have strategies that are centered on expanding the domestic market, unless we in the region undertake what has been long postponed, which is a redistribution of income. The strategy of refocusing the domestic market is very much dependent on equity. This does not mean that countries de-link from the international economy, but that the centre of gravity of the economy should be a revived domestic economy, because for so long the domestic economies or domestic markets have been serving the needs of export-oriented industrialization.

The third thing, in terms of production structures, is to diversify the kind of production structures to move away from the domination of big national firms and trans-national corporations into a more diversified structure with a mix of ownership patterns, with state enterprises, cooperatives and private enterprise.

Equity or equality is the key to building sustainability into our equations, especially to building ecological sustainable development. The reason we were pushed into high growth rates of 6-10% was so the elite could grab most of that growth and allow a little to trickle down. But in a new age where we can't take that kind of industrialization anymore the only solution for some continued positive growth is by making equity a centerpiece of the economy.

One of the lessons of the 1990s was the very devastating impact of debt, whether state or private sector, and the importance of sourcing capital needs within the local economy. As many of you who have been to Asia know, we don't lack for capital within our countries. This capital is locked up by the elites. There are tremendous riches and some of the most unequally distributed resources in the world. Foreign capital is not the answer; it is domestic capital provided you can pry it open with enforcement, taxes, transfer payments, etc.

Finally, there is the importance of moving away from globalization and moving towards new forms of regional integration that add depth and diversity to our economies. Rather than have our economies create lopsided regional structures, Asia needs the kind of planned integration that goes beyond the free trade paradigm, which you see going on in ALBA in Latin America.

The key criterion of the old economy or neoclassical economics or neoliberalism has been the reduction of unit cost and everything is subjected to this very narrow definition of efficiency. The market is supposed to be the best way to bring the most efficient allocation of resources. But in looking for alternatives we need to look beyond this narrow definition of efficiency and should be looking, instead, for effectiveness. We should be looking at national and regional economic paradigms that are effective in the sense of promoting social integration, in promoting values that people hold dear, including community, solidarity, equity and democracy. They must be effective in terms of advancing the whole of society, rather than the market-driven society; in the sense of society being in control of the market and imposing limitations on the market.

This is the perspective associated with Karl Polanyi. That capitalist development has been a process by which the market has been dis-embedded from the social matrix and is driving society. We must enter a new era in which the market is re-embedded in society, where society controls and regulates the market. That is what Polanyi called effective economics.