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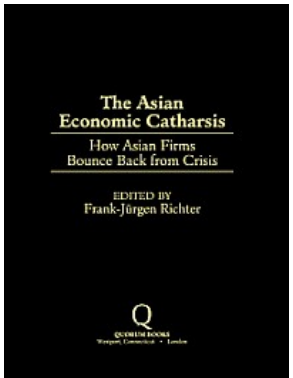
The Asian
Economic Catharsis
How Asian Firms
Bounce Back from Crisis
EDITED BY
Frank-Jürgen Richter
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How Asian Firms Bounce Back from Crisis

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This book provides an analysis of the strategic responses of Asian firms to the Asian economic crisis. It discusses up-to-date developments in both the theory and practice of Asian ways of management.

The contributors examine the ongoing organizational restructuring of Asian firms, analyze emerging cooperation strategies, and search for an Asian ‘‘post-crisis’’ management paradigm. While each author looks at the topic of the ‘‘Asian Economic Catharsis’’ differently, a common perspective is being put forward. There are plenty of new opportunities in Asia which have to be grasped and channeled.

The contributors to this volume are from industry, management consultancies, and academia. They use case studies to illustrate the long journey back of Asian firms.

This book offers insights to management practitioners and scholars seeking to understand Asian firms, and the issue of strategic reorientation and catharsis in the aftermath of the Asian economic crisis.

The Asian Economic Catharsis

Chapter 1
A Perspective on Asian Management

Frank-Jürgen Richter

INTRODUCTION

Recent dramatic changes in the global and national economic environment have presented Asian firms with a series of complex problems. Until a few years ago, Asia's vigorously growing companies were rapidly expanding, contributing to the so-called ''Asian miracle'' (Arogyaswamy, 1999; World Bank, 1993). Thus the Asian managers, seduced by the strength of their economies, became convinced that the long-term growth of their economies would continue, and they were sure of the superiority of *their* ''Asian style of management.'' Their thoughts were congruent with values widespread in Asia, wherein relationships usually count more than market efficiency; conglomerates and networks often matter more than individual firms; and wealth creation for society as a whole, over the long term, takes priority over short-term profit taking.

Meanwhile, in the Western literature, some authors praised Asian management methods (Fallows, 1996; Phongpaichit and Baker, 1996; Richter, 1999; Womack, Jones, and Roos, 1990), some harbored envy (Witley, 1992), and others warned of an economic threat from Japan, South Korea, and the Asian Newly Industrializing Countries (NICs) (Harland, 1997; Rowher, 1996). Only a few, like Yoshihara (1988) and Krugman (1994), warned about the coming crisis of the Asian economic system and the regression of the so-called Asian style of management.

Until the mid-1990s, however, there was widespread confidence that the ''Asian miracle'' of rapid growth would continue and that Asia would maintain its role as the chief powerhouse for growth in the world economy. Real per capita incomes in Asian economies had grown at an average rate of 4 to 6 percent per annum since the 1960s. Asia performed well above the world av-

erage for some three decades. Asian firms, which have grown increasingly global, not only challenged Western firms in terms of market share, but also questioned the fundamental assumptions about economic rationality which guide Western firms' behavior. Although there is no common definition of ''Asian management,'' there are some common features among the countries in how they perceive and do business:

- The crucial economic player in Asian societies is typically not the individual but rather the network in which the individual is embedded. Asians believe that social relations between economic actors do not impede market functioning but rather promote it. Just as Western economies have institutionalized ways of maintaining autonomy between actors, Asian economies are rooted institutions that encourage and maintain ties.
- The emphasis in Asia on pragmatism stands in contrast to ''Western'' rationality. The decision-making process of Asian firms, known as *nemawashi* in Japan, *noonchi* in Korea, *musjawara* in Malaysia, or *tonguo houmen* in China, is not well understood and may lead—in Western eyes—to biased and noncomprehensible decisions.
- The management practice is based on social arrangements peculiar to the employment system which assure acceptance of authority and the cooperative and diligent participation of all employees in corporate activities.
- Asian firms focus more on creating growth—and less on shareholder value as perceived within the framework of Western capitalism. Business groups proliferate across a wide range of industrial activities, hindering a clear focus on core competencies.

In mid-1997, the belief that Asian management was superior to Western forms of organizing was shattered as currencies plunged, financial institutions closed their doors, and rapid growth turned to recession, resulting in the failure of Asian firms and conglomerates. The Asian economic crisis destroyed businesses and reputations. Quite often, organizational orthodoxy survived the events of the crisis more or less intact. Throughout Asia, many firms have been worrying about the external factors of the economic crisis and are rightly concerned about these factors. Many, however, have become overly distressed over these and forgotten about internal ones within their own organizations. External factors like the foundations of economic policy and the efficiency of the finance sector are almost beyond their own control. Internal factors, on the other hand, such as their general ways of doing business are well within their power to change.

When Asian economies were growing rapidly, governments and firms paid little attention to returns on capital investment. Similarly, as long as labor was cheap and export markets were widely receptive, labor efficiency was not an issue. Today, improved labor efficiency is a priority in every part of any business, from research and development to sales. The steps Asian firms need to take are standard practices in most multinationals. For Asian firms, however, the extent of the improvements they must make represents a massive challenge.

This is not just another book on the Asian economic crisis. There are many excellent analyses available which trace the history of economic default with all its side-effects (see, e.g., Backman, 1999; Delhaise, 1999; Godement, 1999;

Jomo, 1998; McLeod and Garnaut, 1998). Instead, this book explores the impact of the crisis and the implications for business. How are Asian firms adjusting to the new economic realities? How have they developed their management style? Does ''Asian management'' have to be adjusted to the world's current dominant form of economic organization—American capitalism? Or are Asian firms developing hybrid forms of management that combine elements of both Western and Asian thinking?

With regard to these open questions, it seems that talk about the term *Asian economic catharsis* is preferable to *Asian economic crisis*, for Asian firms *must* develop a new organizational dynamism simply to survive. And many economists are certain that they will (Bhagwati, 1999; Cheah, 2000; Zahra, George, and Garvis 1999). The region has developed many efforts to overcome the emergency at hand through sweeping restructuring. With more positive economic signals appearing every day, many Asian managers assume that all will be well.

This book is not the last word in understanding the crisis and the resulting loss in confidence. The chapters seek to represent a wide range of perspectives, as viewed by academics, consultants, and businesspeople.

CRISIS AND CATHARSIS: AN OVERVIEW

Part I presents overviews of the subject. The likely length and severity of the Asian catharsis, the prospects for the future, and the implications and opportunities for firms in the years ahead are being considered, distilling lessons learned from entrepreneurs and managers that see the current situation as an opportunity to build, or even strengthen, their positions in the region through the pursuit of new game opportunities. Chapter 2 provides a forward look at the recovering nexus of Asian business. Chapter 3 reflects the decline of Japanese economic leadership in Asia. Apparently, there are serious questions about the Japanese economic model, both for Japan and its continued application to the emerging Asian economies. Chapter 4 explores the various dimensions of the crisis and discusses the implications for international business.

The remaining chapters in this book examine themes related to organizational restructuring, allying and venturing, and new Asian management paradigms.

ORGANIZATIONAL RESTRUCTURING AND THE MANAGEMENT OF THE FIRM

Asian firms will have an increasingly tough time sustaining growth through exports as they did in the past. It is not just that everyone is trying to export their way out of the crisis. Asia's economic collapse was largely triggered by overinvestment in production capacity that exceeded the various countries' domestic demand. The conviction that exports would absorb the overcapacity obviously proved wrong. Now, Asian firms have to make real changes within their businesses to stay competitive.

The pace of restructuring has varied considerably within Asia. Southeast Asian firms, in particular, are finally getting down to the painful task of restructuring their businesses. Japan and South Korea, however, may be seen as lagging behind their neighbors. The accelerating pace of restructuring throughout most of Asia may help cushion the region from Japan's and Korea's problems.

How can Asian firms maneuver through the storms of the crisis? First, they can embark on a fast turnaround program, which may comprise typical elements as short-term adjustments and operational improvement. The approach Asian firms adopt to manage turnaround programs should not be so very different from that taken by any multinational in similar straits, although Asian firms face a tougher challenge. Many Asian firms are unprepared.

For many Asian firms, debt has been a dead weight around their necks. They have either been at risk of defaulting on their loans, or they have already stopped making debt repayments. These firms have little choice but to take the drastic measures needed to avoid extinction. At the same time, Asian firms need to release cash by, for example, selling nonessential assets, limiting capital spending to the bare minimum, and cutting back on inventories and accounts receivable. They must also reassure lenders if loans are to continue, or even increase. Promoting early retirement and negotiating salary reductions are further options. Reducing purchasing costs and improving marketing and pricing capabilities are essential.

The chapters in this section highlight the organizational responses of Thai construction firms, Indian banks, and Chinese state-owned enterprises. Although all the firms analyzed show some kind of organizational response, they vary substantially in terms of direction, magnitude, and timing of response. The case of Chinese state-owned firms is of particular interest: China's surprising stability—until now—amidst the economic turmoil of other Asian countries led to delays in the restructuring efforts of the state sector. In the near future, with China's entry into the World Trade Organization (WTO), limitations to foreign investment might be further reduced, since China's state-run enterprises, which in the past used to be off-limits for foreign investors, are expected to be transformed into market-driven corporations. This policy will provide China's economy and foreign companies with new opportunities. However, as the recent Asian crisis suggests, it will probably add risk as well.

ALLYING AND VENTURING: THE UNFOLDING OF A NEW INTERFIRM RATIONALITY

Some Asian management practices proved to work out until recently. By carefully combining resources located within and outside the organization, Asian firms have steadily made innovations across the spectrum of industry and have formed alliances and conglomerates. Until the economic crisis occurred, this way of organizing in Asia efficiently facilitated the supply chain, flexible production, and forceful research and development (R&D) activities by emphasizing

process innovations. Like the Japanese vertical production networks—where there are several suppliers of parts all of whom are competing with each other and where a 20 percent attrition rate holds—this is competition actually. Whereas if IBM is making all its chips within the organization through vertical integration, or if General Motors is buying 75 percent of parts from within its own system rather from outside, it may be argued that Japanese vertical production networks have been more efficient. The oriental concept of cooperation always comprehends elements of competition, whereas the basic relationship is based on trust and interdependence. However, the risk of Asian cooperation practices is that the pooling of resources may be worn out to expand in unrelated businesses.

Most of the reforms being championed by the International Monetary Fund (IMF) and Western economists have been aimed at unraveling the tight networks of collaboration among government agencies, financial institutions, firms, and distributors. The concern, however, is that the region's conglomerates are being dismantled, with little concern about what might replace them as engines of growth able to hold their own in the global economy.

The chapters in this section provide some fresh thoughts on how to transcend traditional forms of cooperative arrangement in Asia, taking advantage of both occidental and oriental perspectives. The reader can witness Sony's bold experiments in reorganizing its business network and new kinds of alliances in the Japanese finance sector, and read some strategic advice on how to increase the competitiveness of joint ventures in India.

On one issue, above all, the chapters agree. The major aim of reforming business networks should be to identify risks that might threaten survival by separating healthy businesses from ailing ones. Diversification at any cost is no longer tenable. Asian firms do not have the capacity to manage all of their businesses well, nor are the domestic markets big enough to support them. Firms have to give up their inclination with growth, but they have to generate profits.

IN SEARCH OF AN ASIAN ''POST-CRISIS'' MANAGEMENT PARADIGM

Restructuring so far has focused on fixing the organization's short-term problems, not generating new business models. For its long-term prosperity, Asian firms still face plenty of tough challenges. In the long term they have to rethink their way of doing business by changing their organizational layout, modes of knowledge creating, or their corporate culture. High growth may not resume for years, so firms need to focus on highly efficient organizations and cultures.

The pace of change, however, may be rather slow. Despite the strength of the crisis, ''Asian capitalism'' will continue to exist in most Asian economies. In many cases, however, management systems with hybrid characteristics are emerging, whether in Southeast Asia, Japan, South Korea, India, or even China. The future could bring a hybrid of Asian and Western capitalism and manage-

ment styles rather than the domination of one system. The best of both worlds may be merged in post-crisis management practices. As Asian firms are in the midst of change, the business models–or paradigms–also are subject to change and developments. Hence, there is the hope that management practices and academic discussion around a new Asian management paradigm will be advanced.

Part IV provides a glimpse of models that seek to describe a new Asian management paradigm. Asian management, as it existed before the crisis in 1997, was instrumental in propelling Asia's dynamic growth. The old mechanisms of relying on fast growth, however, have become counterproductive. It is suggested that Asian firms need to induce creative learning to be rewarded with a proactive management system. Creative learning is seen as a new mechanism for reflecting on culturally bound behavior and for providing an avenue through which new models of perception may emerge. The creation of knowledge may also provide a platform for increasing the value of products and services. Chinese network management as an alternative strategic management model, in particular, may be best suited to situations that resemble the scarce business environments in which it was developed—environments generally found in emerging economies—and in unstable situations like those that have developed in the midst of the Asian economic crisis.

Another suggestion centers around the assumption that, in foreign transplants, Asian—and more particular—Japanese management was successfully transferred by introducing a set of changes in its original structure, due to the need to cope with different environments. This ''hybrid model'' can be used as a benchmark for Japanese parent companies willing to change their management systems.

In the end, the Asian economic crisis may well be a blessing for the region because it has provided an opportunity for a fundamental review of practices, models, and assumptions. Like the entrepreneurs who built the Asian economies, today's firms have the opportunity to lead a revival providing they can redirect their businesses. Today, those willing to forgo rapid expansion in favor of building focused businesses that create value for shareholders may be those that can look forward to a bright future.

Asian firms may move beyond manufacturing and toward knowledge industries. The region's relative backwardness in knowledge industries means it can take a path of growth by developing the Internet, e-business, and computer software.

Asia still offers one of the most important contexts for business and management in the world today. Understanding Asian management practices presents a daunting intellectual challenge. Managers, academics, and policy scientists are presently only just beginning to work toward a more mature handling of the Asian economic crisis and its consequences for the management of Asian firms. Whether this volume provides a fully comprehensive view of the challenges faced by Asian firms, only time will tell. Asian firms have now started their long way into recovery. They need inputs along the way, together with a will-

ingness to challenge their own understanding in light of new evidence. This book should provide a step in that direction.

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Chapter 2
Recovering from the Crisis: New Game Opportunities in Asia

Ian C. Buchanan, Chipper Boulas, and Babu Raj Gopi

ASIAN GROWTH: MYTH OR MIRACLE?

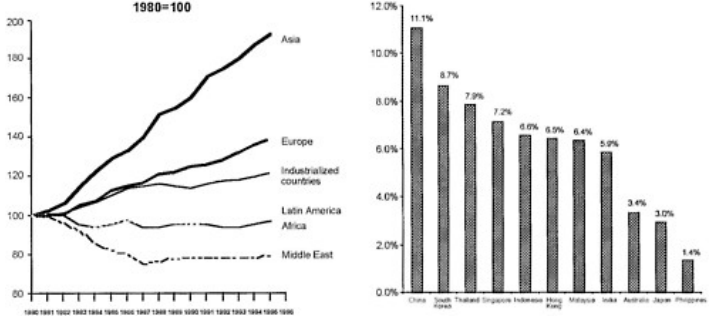
Any balanced assessment of Asia's prospects must first explode the myth of the Asian ''miracle.'' In reality, there never was any miracle, nor was there even an Asia (Arogyaswamy, 1999; Buchanan, 1999; Krugman, 1999)! The so-called Asia is a colonial legacy, a region so vast and complex that it contains 60 percent of the world's population and defies any attempt at precise definition. It consists of some 24 of the world's most diverse economies and over 2,000 language groups. Populations range from under 300,000 in Brunei to over 1.2 billion in China. Gross national product per capita extends from U.S.$200 in Nepal to U.S.$39,640 in Japan, and gross domestic product growth rates range from under 1 percent in Brunei to more than 11 percent in China (see Figure 2.1). While the geographically co-located portfolio of countries which, for lack of a better term, we will refer to as ''Asia,'' has not experienced a miracle, the region has outpaced the rest of the world with its sustained high growth.

Explaining why so many Asian-based economies all managed to transform, modernize, and industrialize their economies faster than anywhere else in the world, or at any other time in history, requires a new perspective. The crucial issue is to understand the changes in the global geopolitical, technological, and economic environment in the years following World War II, as well as their impact on the internal political economies in Asia, specifically how different countries shaped their domestic policies in response to the global and regional geopolitical circumstances of the period.

The External Growth Drivers

Following the end of World War II, the world began to split into two ideological camps centered around Moscow and Washington. This bipolar, nuclear-

Figure 2.1 Growth in Real GDP Per Capita



Source: Booz-Allen & Hamilton.

equipped world redefined the rules of military—and ultimately economic—competition. The Cold War contributed to dramatic increases in defense spending, with both powers investing heavily in new technologies. Though primarily directed into military programs, this spending produced commercial benefits by revolutionizing computing, communications, and transportation technologies. Together, the exponential improvement in price-to-performance ratios in these key areas effectively ''shrank'' the globe. This opened up a period of global economic competition, which initially resulted in manufacturing relocating to take advantage of factor cost differentials.

The beginning of Asia's 40 years of prosperity can be traced back to a series of events that took place in the four years following the end of World War II. These events, which occurred in three world regions—Europe, the United States, and Asia—created strong growth drivers that uniquely benefited developing Asia.

The first critical event took place in 1948 in post-war Europe. Following the Allied response to the Soviet isolation of Berlin, the Berlin airlift, a nuclear-tipped Iron Curtain divided East from West, and no further Soviet expansion was possible. In the United States during the 1940s three new key global institutions—the IMF, the World Bank, and the General Agreement on Tariffs and Trade (GATT)—were created. These institutions contributed to a steep fall in global tariffs and, ultimately, to the globalization of capital flows. In Asia, the two critical events were the accelerating wave of newly independent states emerging from colonial rule, and in 1949 the creation of a Communist People's Republic in the world's most populous nation, China.

The communist victory in China signaled the opening of a new battle front in the Cold War as a Bamboo Curtain began to descend across the region. Unlike Europe's Iron Curtain, this Bamboo Curtain did not yet have a precisely defined frontier, and the two superpowers and their allies fought to bring emerging independent states to their side of the curtain. Over the years following the end of World War II, the new leaders of over a dozen countries were confronted with tough political, security, and economic choices in post-colonial Asia.

The Domestic Response

The newly independent nations of Asia looked at the post-war bipolar world and recognized that their first choice had to be which of the global ideological camps to join, a decision influenced in part by their proximity to China, their powerful new communist neighbor. The outcome of this first—ideological and pragmatic—decision was the emergence of three broad political groups within post-war Asia: the communist command economies, the stuck-in-the middle socialists, and the democratic market economies.

The communist command economies resisted the global wave of economic integration, recreating the Soviet political and economic model, which was based on top-down, centrally planned, command-and-control systems that emphasized

self-reliance and import substitution. The outcome was a set of closed ‘‘autarchic’’ economies that were insulated from accelerating global economic and technological change, and relied on directed, public sector investment as their primary growth driver. This was the model in China before 1977, in Vietnam before 1987, in the Soviet Far East before 1988, and in North Korea today. This group missed out on the globalization wave and Asia’s rapid growth.

The stuck-in-the-middle socialists sought to follow a nonaligned political middle ground between the two global superpowers. They elected hybrid, but mainly import substituting, economic policies and in many ways missed out on the high-growth ‘‘miracle’’ (see, e.g., World Bank, 1993).

The democratic market economies broadly embraced market economics and more-or-less democratic political systems. This small group of resource-poor NIEs came closest to being economic ‘‘miracles’’ in that they defied conventional economic wisdom, overcame a lack of natural resources, and embarked on a true high-speed industrial revolution based on labor-intensive, export-oriented policies.

While the countries in this third group were all more open to investment, technology, and pricing/resource allocation signals from the global economy than either the communist or socialist economies, their economic policies varied, depending on their population and resources.

The economies that were relatively resource rich, had large populations, and had potentially large domestic markets tended to adopt import-substituting policies. These nations—Indonesia, Malaysia, the Philippines, and Thailand—believed that their raw materials would be in ever-increasing (‘‘Malthusian’’) demand and should be protected from foreign exploitation. This strategy depended on ever improving terms of trade and the acquisition of capital goods, which could then be employed in protected domestic ‘‘infant industries’’ until they advanced up the scale curve. Unfortunately, many industrial infants remained in need of perpetual protection. Economic growth in these nations depended on rising commodity prices alone, and until the mid-1980s, most failed to fully capitalize on the rapid rise in global integration, transfer of technology, and global division of labor.

The remaining Asian developing market economies were mostly small and resource-poor nations with strong political leadership facing poverty-stricken populations. These nations experimented with different policy models and became early adopters of the then radical option of opening up to international trade and investment flows. In these ‘‘option-poor’’ countries, low-cost labor—their only resource—became the basis of economic success, and they exported it by adding value to imported commodities for re-export. These nations, along with the four NIEs and Japan, grew rapidly on the back of the global division of labor and ultimately capital. This globalization was in turn facilitated by declines in the cost of global transport, communication, and information processing, which were the by-product of the Cold War technology explosion.

Over the next four decades, global trade in manufactured goods grew three

times faster than global output and the terms of trade shifted away from primary products toward the labor-intensive manufactured goods exporters of Japan, the NIEs, and—after 1977—coastal China. Their unfashionable domestic policies, with their emphasis on labor-intensive, export-oriented industrialization, coincided with external growth drivers of globalization, producing, if not a miracle, then certainly an unprecedented high-speed industrial revolution. Thus, these economies' apparent limitations proved their fortunes: with no resources except people, and no policy options except to open up to inward and export-creating investment, they grew by integrating into a global economy growing faster than at any earlier time.

THE FOUR PHASES OF GROWTH

Recognizing that the individual growth strategies of the newly decolonized Asian nations that adopted market-based economies were a function of the uniquely attractive external environment and country-specific domestic political and economic forces, we can distinguish four distinct stages of growth in the region's pre-crisis history (see Figure 2.2).

Phase 1: Post-Colonial Transition (Pre-1960s)

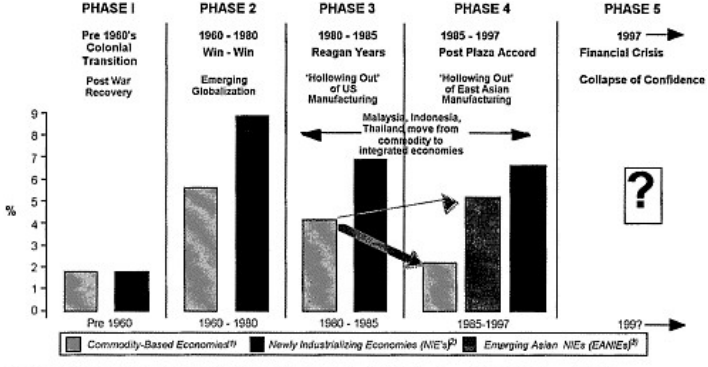
In the first phase, the pre- and trans-colonial period, growth for both groups of market-oriented economies was slow.

Phase 2: ''Win-Win'' (1960–1980)

This second phase, from 1960 to 1980, coincided with an era of tremendous growth in the world economy, when the global growth rate was over 5 percent per annum, faster than at any other time in history. During this win-win phase, world commodity prices temporarily broke out of their long downward trend, achieving a short but dramatic price increase. This increase followed a dramatic increase in the world money supply as G7 finance ministers sought to offset the deflationary impact of the 1973 tripling of oil prices by the OPEC cartel. As a direct consequence of this money supply–driven global inflation, the commodity-based economies grew at record rates during this period.

Meanwhile, the globally integrating economies (GIEs) grew on the back of an unprecedented decline in tariffs; rapid growth in world trade; and falling transport and communication costs. These economies grew at over 9 percent per annum, almost twice the rate of growth of the global economy and substantially faster than the commodity-based economies. However, this period of growth was not specific to Asia. It was a win-win period for the majority of developing countries, most of whom benefited from rising commodity prices and accelerating global division of labor.

Figure 2.2 Phases of Growth of Asia's "DemocracticMarket" Economies



(1) Australia, New Zealand, India, Sri Lanka, Philippines, Indonesia, Malaysia, and Thailand; (through 1985).
(2) Hong Kong, Singapore, South Korea, and Taiwan.
(3) Indonesia, Malaysia, and Thailand.

Source: Booz-Allen & Hamilton.

Phase 3: The Reagan Years (1980–1985)

Between 1980 and 1985, the global growth drivers were influenced by the Reagan administration's policies of supply-side economics. U.S. domestic policies led to high interest rates and an overvalued dollar. The consequences in such an open and competitive domestic economy were predictable: major U.S. manufacturers moved production out of the country. Virtually all of the dramatic growth in outward foreign investment of labor-intensive jobs went to just four economies—the four Asian NIEs that had followed outward-oriented development strategies. The commodity-based economies suffered from a worldwide recession triggered by a quadrupling of oil prices in 1979, the global tight money policies that followed, and the consequential steep decline in commodity prices. This caused the economic performance of the commodity-based economies to decline by half to 2.5 to 3 percent per annum.

During this period, the globally integrated economies benefited from an overvalued U.S. dollar. The U.S. economy exported manufacturing jobs and sucked in an unprecedented incremental U.S.$122 billion of manufactured imports. The four NIEs plus Japan captured 46 percent of this increase, relative to a historical share of around 20 percent. This was sufficient to sustain their growth rates at just slightly less than during the ''win-win'' years and resulted in 7 percent per annum average real growth.

Phase 4: Post–Plaza Accord (1985–1997)

In the second half of the 1980s, Asia's growth was driven by the results of a meeting in New York's Plaza Hotel in 1985. This resulted in concerted action to push down the value of the dollar.

The dramatic increase in the value of the yen and other East Asian currencies against the dollar came at a time when labor was becoming more expensive and less flexible in the GIEs. This led to an explosive outflow of labor-intensive investment from Northeast Asia to the low-labor-cost countries of Southeast Asia. In the 18 months that followed the Plaza Accord, Thailand received more inward investment from Japan alone than it had in the entire preceding 25 years.

Commodity prices continued to fall, and the growth rates of commodity-based economies dropped to 2 percent per annum. GIE growth also slowed to 6 percent per annum. However, fueled by the dramatic influx of foreign investment and sustained by rapid shifts in government policy, including a shift away from import substitution toward labor-intensive, export-oriented industrialization, Malaysia, Indonesia, and Thailand experienced a growth surge.

Thus, the combination of the Cold War and its by-products—access to new markets and U.S. technology; rapid growth in world trade and investment flows; and an accelerating global division of labor—created a global surf wave. The group of Asian economic superstars that rode this wave were christened by the

World Bank as HPAEs (High-Performance Asian Economies)—and created a new global paradigm that will influence policymakers long into the future.

ASIAN MELTDOWN: WHAT WENT WRONG?

In 1997, after over four decades of strong growth driven mostly by foreign direct investment and integration with a rapidly growing global economy, the Asian ‘‘miracle’’ was already well on its way to becoming an Asian ‘‘bubble’’ (Henderson, 1998; Soros, 1998). The principal causes were the gradual shift from productive direct investment to portfolio investment that occurred between 1993 and 1996 and the sticky exchange rates of many Southeast Asian nations, which contributed to growing current account deficits. The economies most at risk of a financial crisis were the latecomers: the three Emerging Asian Newly Industrializing Economies (EANIEs) and South Korea, the one NIE which had, in line with the Japanese model, created a bloated bureaucratic superstructure to ‘‘direct’’ economic activity.

The financial avalanche began on July 2, 1997, in Bangkok, when the Bank of Thailand floated the baht. Over the next six months, the currencies and stock markets of the most vulnerable economies fell like dominoes (see Figure 2.3).

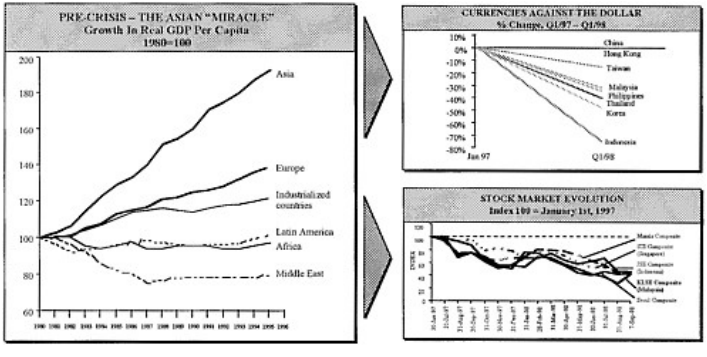
What went wrong with the Asian miracle? Why did this sudden avalanche occur? And why did it begin in Bangkok?

While the trigger event of the July 1997 baht crisis had many uniquely Thai political, cultural, and institutional elements, most of the underlying political, economic, and institutional weaknesses surfaced by the currency and banking crisis were common also to Indonesia, Malaysia, Korea, and—to a lesser extent—the Philippines.

The specifically Thai aspects that contributed to this, the first avalanche site, included a post-war political system based on a pragmatic alliance between the military and foreign educated-technocrats that granted the technocrats a free hand in running the economy, provided that the growing economy would fund a large and growing military budget. In 1992, a bloody repression of peaceful civilian protestors destroyed the trust in, and prestige of, the military and opened the way for a strengthened parliamentary democracy and a reduction in the technocrats’ authority.

The emergence of a pluralistic democratic system and a multiplicity of new parties bred rampant vote buying, and the combination of increasingly expensive elections and governments with an average life span of one year created the worst kind of short-term, ‘‘pork-barrel’’ money politics. Major infrastructure projects were forced through and awarded to crony capitalists rather than justified on economic terms. Though the economy was booming, the demands of foreign direct investors and increasingly wealthy Thais for better public infrastructure—roads, public transport, telecommunications, power, water, and airports—were not being satisfied. Accelerating corruption and mismanagement began eroding Thailand’s underlying competitiveness.

Figure 2.3 The Asian "Miracle"



Source: Booz-Allen & Hamilton.