CHAPTER 6

BEYOND THE MIRACLE

Asia's Emergence

WAS THERE TRULY such a thing as the East Asia economic miracle? The question has been posed with ever greater urgency since financial and economic crisis engulfed the region after mid-1997. Already, before the crisis hit, the question of the "miracle" had been hotly contended. At the time, it was a matter of understanding why and how so much of Asia had managed to grow so fast and, it seemed, so smoothly. Malaysia's prime minister Mahathir Mohamad had very definite views. After all, he was still at that point in his prime; he could take pride in nearly two decades of fast growth under his stewardship—often more than 6 percent per year. On the day he was to discuss this matter, he welcomed the visitors to his office in Kuala Lumpur a bit stiffly from behind an enormous desk of pristine teak. The prime minister was clothed simply, in traditional Malay dress. He also wore, at chest level, a small, formal tag that read MAHATHIR. All of his aides sported their own tags.

Mahathir was definitely well connected; on a separate table at his side sat four screens, which blinked intermittently. The first served for video conferencing; the second was linked to the Internet; the third displayed a continuous news feed from Reuters; and the fourth provided up-to-the-hour information on developments across Malaysia. To the left, models of airplanes designed and built by Malaysians were displayed on a windowsill.

Mahathir did not particularly like the word *miracle.* It seemed to dismiss hard work and sacrifice and to gloss over enormous differences of market size and structure, history, culture, and—what was very important to Mahathir—nationalism. "There is no Asian miracle," he protested. "It is just the realization of an idea, an idea of how to manage an economic system. It is making the right choices, the right mixture of political and economic methods."

The urban landscape seemed to prove his point. Downtown Kuala

Lumpur—KL, as it is known in Asia—was a boom city, with a forest of gigantic cranes and construction equipment. The possibility of contraction or collapse was the furthest thing from everyone's mind. At street level, youths—Malay, Chinese, and Indian—clad in jeans and T-shirts zoomed on motorbikes through streets jammed with Japanese cars, Mercedeses, and the ubiquitous Proton, Malaysia's national car. The cultural mix was captured by the stark contrast of women in miniskirts and high heels next to women clad head to toe in demure Islamic dress. Twin office towers, astonishingly tall, tapered far up into the sky. Belonging to the state oil company, Petronas, they are the world's tallest office buildings. They are also an extraordinary architectural symbol of an Asian economic growth so sustained and so dramatic that even the World Bank called it a miracle. Embracing Malaysia in its southward sweep through the region, this miracle had transformed what was a plantation economy. "It was only in 1960," Mahathir said, "that we managed to catch up with the per capita income of Haiti"—the poorest nation in the Western Hemisphere. In the late 1990s, Malaysia was an increasingly technologically advanced society that aimed to pull even with the industrial West by 2020, if not before.

It took just thirty years to turn the former rubber colony into one of the world's largest manufacturers of semiconductors. But it would take only one year for a harrowing financial and economic crisis to bring the cranes to a halt and destroy a substantial part of what had been achieved, in Malaysia and among most of its neighbors and regional partners. The trigger was the collapse in mid-1997 of the Thai currency. But the causes of the crisis were manifold and contested—and at least a few of the major causes were tucked away, as it turned out, into the hidden folds of the region's economic systems, to which so much success had been credited. As financial crisis spiraled into recession across much of the region, outsiders and domestic critics alike assailed the credibility of the "Asian economic model"—whatever they believed it to be. The shift in perception was in no way better captured than by the transliteration of the term "Asian economic miracle" into "crony capitalism."

The severity of the crisis took many observers aback. And the contagion that it bred through the tightly interconnected financial markets, developing over time to engulf Russia and parts of Latin America in a recessionary embrace, raised even further doubts about Asia's economic platform. Yet the critical judgments obscured the enduring legacy and future promise of thirty years of economic growth and progress in East and Southeast Asia—growth at an intensity and rapidity nearly unprecedented in economic history.

The "essence of the miracle," as the World Bank put it, was Asia's attainment of the closest thing that economics has to the philosopher's stone—"rapid growth with equity." It is this that has pushed Asia to the forefront, and it is why the rising star of the Asia miracle replaced the setting star of Marxism and central planning as the model to study, and for some time to emulate. This was all the more striking that when one considers that thirty years ago it was feared that these countries, living in the shadow of the Vietnam War, would fall as dominoes as communism advanced across the rest of Asia. By any measure and despite the crisis, what was accomplished in those thirty years since was extraordinary.

But exactly what was the formula? What was the mixture of government and marketplace that enabled the countries to achieve what they did? If no two Asian countries shared the same blend, then all fell somewhere between the liberal model and the central-planning model. How to identify and explain the mixture has been the subject of vigorous and sometimes acid debate, both in explaining Asian success, and more recently, in accounting for what went wrong. Some argue that the secret was the guiding hand of the government—an elite cadre of bureaucrats who endlessly engaged in picking winners and calling the shots. They continually intervened through the management of trade barriers, credit, investment, and competition. They promoted aggressive competition internationally and detailed protectionism at home. Government and business were cosseted in a very cozy relationship, in which patrons rewarded their favorites with credit, privilege, and protection. Others reply that far more important was the fact that governments were "market friendly" and thus ensured that the macrofundamentals were right: high savings rates, low inflation, a strong orientation to exports, and high commitment to education—especially education geared to the changing technical skills required by industrialization. Add to all that consistency and persistence, supported by the deep conviction that what was at stake was not distribution but, in the starkest terms, survival in the face of militant communism.

Was it government guidance or was it the market? The unambiguous answer is both. Asia's success was realized through a balance of government intervention and market forces that, for all their local varieties, remains both distinctive and different. Market and state—business and government—each played its role, against a backdrop of coordination and common purpose, motivated by a drive to work that has been called "a hungry spirit." From its start in Japan, the balance evolved and adapted. Its common elements found separate expressions to fit the perceived needs of countries that ranged from industrial city-states to agricultural giants, from culturally homogeneous societies to those that are ethnically and religiously mixed. There were also some countries that from the beginning were less apt to use government intervention than to go with the market.

Chief among the common threads was a resolute choice to grow the domestic economy by harnessing it to exports—and thus committing to the rigors of international competition. Yet while the countries of the region have "competed out," they have also "protected in"—insulating their domestic economies, to one degree or another, from foreign competition. The entire edifice was built, to varying degrees, on regulation or coercion, in political as well as economic life. Most of the Asian success stories involved, at some point, dictatorship, authoritarianism, or at least regulated politics and a de facto one-party system. Yet at the same time, they built a consensus around the imperative of survival and the visible returns of growth—indeed, what has been called shared growth—which has resulted in growing equality. Most Asian governments did intervene—sometimes quite drastically. But they did so to influence the shape of market outcomes, not to replace or roll back markets. The paradox of Asia, then, was that in many ways it was government knowledge, enforced by political structures, that helped bring about "market-friendly outcomes."

The story of government and market that underlies the Asia miracle could still be summed up in one concept: "Countries, Inc." The analogy of the country as a firm—often employed by the region's leaders—keenly evoked the orientation toward trade, the quest for productivity, and the recourse to regimented organization. But more, these Countries, Inc. have enjoyed a degree of common purpose few firms can match: a nationalistic drive, molded by living memories of colonization, conquest, secession, civil conflict, subversion, or war.

The turmoil of 1997–98 and its economic cost raised new, disturbing questions: Was it all worth it? And what went wrong? As the crisis unfolded, a clue to the answers came from the different degrees to which it affected each country of the "miracle" countries—some managed to cope quite well, while still others struggled to face up to the difficulties and find their own solutions. All of this points to the fact that Asia's phenomenal economic success was not a single, homogenous process, but came about instead in ways peculiar to each country, each country with its own impact on society and with its own ability to adapt to challenges and change.

Indeed, local cultures and histories have made each Country, Inc. distinct. But in the beginning, all the nations shared a reference to a common model. That model was Japan: the first in the region to attain—and, arguably, surpass—the industrial achievements of the West.[1]

Japan: "I'll Go for Income Doubling"

In 1945, Japan was a devastated nation, humiliated by absolute defeat. Its leaders under arrest and discredited, its industry in ruins, a third of its urban housing nothing more than ashes and rubble, the country existed at a bare subsistence level. Its people were demoralized and adrift, their lives torn apart. There was hardly anything to eat. Boys stood by railway lines jumping up and down, begging American soldiers to toss them candy bars from the passing trains.

The confrontation with American power had overwhelmed the Japanese. The vast swarms of B-29s overhead during the war and the total devastation of the two atomic bombs that ended it had driven home the fact of superior American technological prowess. The occupation that followed brought them face-to-face with the American standard of living. They could see with their own eyes what they might dream of attaining. Yet the reality seemed far beyond their grasp. Or was it? "Come, Come, Everybody" was the theme song of Japanese radio's English-conversation program, and the tune, repeated in the streets, became a counterpoint, enticing listeners into the future.

The first several years after the war were excruciatingly hard, dominated by vast dislocations, chronic shortages, and high inflation. By the end of the 1940s, the U.S. occupation—impelled by both the cost burden and the emerging cold war—made what was known as the "reverse course" and began to focus on promoting Japanese economic recovery. As part of that, it imposed the Dodge Plan, which did much to extinguish inflation. The Korean War, beginning in 1950, turned Japan into a supply base for the American forces on the Korean peninsula and stimulated an export boom. The early 1950s were the beginning of recovery. Those years were immortalized in the 1952 best-seller *The General Manager,* whose hero trades in his prewar Datsun for a Ford and then earns enough to buy a Lincoln, which he drives around the outer garden of the Meiji shrine, shouting, "Light as a feather! Light as a feather! It's absolutely like flying above the clouds." No one could possibly think at the time that a Japanese automobile would one day be more desired, and a greater status symbol, than a car from Detroit.

It was only in the mid-1950s that Japan rose from recovery into sustained economic growth, which became the central national objective. In 1960, when Hayato Ikeda was about to move from being minister of international trade and industry to prime minister, he was asked what he would do. "Isn't it all a matter of economic policy?" he replied. "I'll go for income doubling." And that is what Japan was doing. By 1964, on the eve of welcoming the Olympics to Tokyo, Ikeda could proudly declare, "With the 19 postwar years of rapid growth, Japan's national income is approaching the Western European level; we are attempting to do in 20 postwar years what we were unable to do in the 80 years before the war." This could be measured in the standard of living. In the 1960s, consumers were acquiring the "three sacred treasures"—television, washing machine, and refrigerator. In the 1970s they moved on to the "three C's"—car, color television, and air conditioner.[2]

When the energy disruptions of the 1970s hit, the Japanese feared that the game was over. Their growth, based on cheap oil, could not continue, they thought. Yet despite the pessimism at the time, the energy crises proved to be only a temporary setback for Japan. By the early 1980s, its economy was already rebounding strongly, on the basis of rapid technological adjustments—moving from an energy-intensive economy to a "knowledge-intensive economy"—and a new emphasis on efficiency. Japan was now an economic superpower. By the end of the 1980s, the capitalization of the Tokyo Stock Exchange was equal to that of the New York Stock Exchange, and of the world's ten biggest banks, eight were Japanese. The real estate in the area of the Imperial Palace, in central Tokyo, was said to have a higher value than the entire western United States. To stand in the lobby of the Imperial Hotel and watch groups of Western and Japanese businessmen approach each other and bow and exchange business cards was to feel that one was in the agora of the world economy, the very pivot point of global commerce.

Buoyed by a strong yen, Japan went on an enormous shopping spree, buying not only companies but trophies of all sorts—vineyards in France, some of the world's most famous paintings, Rockefeller Center and the Exxon building in New York, and two of the five major film studios in Hollywood. American and European companies and business strategists sought to divine the secret of Japanese commercial success in order to replicate it; and as if indicating the future, the president of Mexico made a point of sending his children to the Japanese school in Mexico City.

There were many elements in Japan's postwar success. It was already a relatively developed country before World War II. The U.S. occupation implemented land reform and broke up the *zaibatsu,* the great industrial/financial combinations. The *zaibatsu* were succeeded by *keiretsu,* groupings of banks and industrial companies, but the links were less tight, and there was room for entrepreneurs like Akio Morita, the cofounder of Sony, to turn their backroom workshops into dynamic global companies. The fundamentals were right: The country had a large and educated workforce, low inflation, and a very high savings rate. American power had demonstrated the centrality of technology, and Japanese companies set out on a forced-pace campaign to obtain and absorb technology from America and Europe. Masaru Ibuka, Morita's partner at Sony, came across the transistor at Westinghouse in 1956 while on a State Department–sponsored tour, and Sony promptly acquired the rights. Firms sought continuing quality improvement as a competitive weapon and invested in ever-greater scale in mass production in order to win market share. All this was sustained on values that included an incredible work ethic, an extraordinarily intense identification with the firm, a shared sense of national identity (and of the country's precarious position), a desire to live better—and the searing memory of the defeat, the harsh postwar years, with the occupation and the humiliation that went with it.

One other factor was absolutely central, and that was Japan's commitment to exporting its way to growth. In the early 1950s, there was a vigorous debate in Japan over what kind of strategy to follow—what was called international tradism versus inward-looking "developmentalism": liberalism versus central planning. International tradism won out, with the result that Japan made a huge bet on the world economy, and one that paid off handsomely. Japan benefited enormously—and very consciously—from the increasingly open international trading system that America took the lead in shaping. Japan was helped by its being ignored as an economic force until the early 1970s. In the United States and Europe, it was regarded not as a competitor but as a source of cheap, low-quality goods. Hardly anyone recalled how effectively it had captured export markets in Asia from the British in the interwar years. And its protectionist policies were also overlooked. As an exporter, Japan moved up the product chain: from textiles and simple manufactures to ships and steel to complex mechanical goods, electronics, and high technology.

The Iron Triangle: "The 1955 System"

All of this was embedded in a market system that was characterized by a particular government-corporate collaboration. It achieved growth and standard of living objectives that, despite the often intense competition among Japanese firms, added up to a system that came to be known as Japan, Inc. It was one in which government bureaucrats often played a dominating role through regulation and something more ineffable but nevertheless potent: "administrative guidance." Some Japanese have recently described this as the 1940s System—a continuation of the system that was established on the eve of World War II, in which bureaucracies and companies worked closely together in order to operate a war economy but in which decisive power lay with the bureaucracies. After World War II, the bureaucracies moved into an even more ascendant position. But it is more relevant to describe it as the 1955 System. That year marked the beginning of the Liberal Democratic Party's ascendancy and the clear establishment of the "iron triangle" of bureaucrats, businessmen, and politicians.

In the Japanese system, this tight coordination between government and business was accepted as the natural order and was reinforced by the precariousness of Japan's position. In the words of one scholar, both bureaucrats and many business leaders "viewed government intervention in industrial affairs as a natural component of economic policy." Regulation of industry was strategic; it was "not considered distinct from the promotion of industry." Firms had to be strong at home in order to compete abroad, and the Japanese government saw no contradiction between promoting overseas competition and strongly regimenting the domestic market.

This system was meant to support producers, not consumers, and consumer prices were high. Such was the cost of ensuring security of supply and the continued health of business. The efforts required to manage this economic system were complex, and depended on a skilled and politically insulated bureaucracy. The whole apparatus of economic management was known as *jukyu chosei*—"supply-and-demand adjustment."

At the center of the *jukyu chosei* was one entity—a single, potent agency that coordinated both external and domestic industrial strategy: the Ministry of International Trade and Industry, which for most of the postwar era represented the command center for the noncommand Japanese economy. It was better known by its initials—MITI. As a former senior Japanese official observed: "There is a word for commanding heights in Japanese, at least up through the 1970s, and that is MITI."

From its headquarters in a gray-brown 1950s office block in the Kasumigaseki section in Tokyo, not far from the walls of the Imperial Palace, MITI coordinated the entire system of industrial policy. It aimed not only to help firms adapt to world export markets but also to help them take the greatest advantage of them. It channeled information and knowledge and facilitated the flow of new technologies. It utilized an array of tools to achieve its objectives: price setting; quotas for imports and market share; licenses; quality standards; industry associations; "old boy" networks; and a nonbinding but clear way of sending a message: administrative guidance. It interpreted changes in world markets to shape the rules of domestic industrial organization, providing continual advice and local interventions through local offices. It tried to ensure that "excessive" domestic competition did not erode the strength that Japanese firms needed in order to compete overseas. It organized mergers and megamergers, coordinated investment to avoid overcapacity, and encouraged the specialization of small and medium-sized companies. It also sought to restrict foreign competitors within Japan through a host of tools and barriers. International trade and domestic industry were thus closely intertwined, and MITI acted as the single coordinator. That was one of Japan's greatest innovations. Only one ministry matched (and some would say exceeded) MITI in prestige and influence, and that was the Ministry of Finance, which wielded control over credit and foreign exchange. But the Ministry of Finance operated in a more rarefied world, and was much less visible.

The people who ran both ministries were the top graduates of the top universities, particularly the law school of Tokyo University. They were called *bureaucrats*—and indeed, with no irony, so described themselves—but the word had none of the pejorative implications found in the United States. It was a Confucian term of respect, connoting responsibility, dedication, and power. And carrying out such far-ranging responsibilities put very heavy demands on Japan's bureaucrats.

MITI's role evolved over time as the Japanese private sector became stronger. The system proved to be, as one former official put it, "a very effective catch-up model." MITI became the focal point of Japanese economic expansion, of Japan, Inc. An entire culture grew up around it. Companies, required to interact with MITI on a near-constant basis, located their headquarters near the ministry, within what was known as the short walk. They served on its advisory councils, which were as much vehicles for receiving advice as giving it. Senior company officials were often careful to show great respect, and bow appropriately, to high-flying MITI officials decades younger than themselves.

MITI worked closely with industrial-sector associations, took their advice, and sought to promote the overall sector. However, some companies became famous for resisting MITI and going their own way. In preparation for international competition in automobiles, MITI tried to narrow down the number of companies to ensure economies of scale. As part of that, it tried to persuade Honda to stick with motorbikes. Ignoring MITI's strong advice, Honda went ahead anyway. The crucial consumer-electrics business developed with little government support. The classic case was VCRs—videocassette recorders. Three Japanese companies succeeded in transforming a fifty-thousand-dollar American invention, which only television stations could afford, into a five-hundred-dollar consumer item. MITI's role was modest at best. Yet whatever the missteps, this system was the nexus of daily life for the Japanese economy, and it was out of this nexus that Japan's extraordinary achievement arose. For the most part, the system performed as intended. It delivered the goods to such a degree that by the end of the 1980s, Japanese preeminence seemed destined to remove the last humiliations of the occupation. The boys who had jumped up and down trying to catch candy bars from the American GIs were now running not only an economic superpower but one that seemed poised to overtake the United States.

Instead, the economy was taken over by a huge and intoxicating speculative boom, which started to burst in 1990. In 1992, Japan went into a deep slump, the most severe economic crisis since the era of high growth had begun. The stock market fell as much as 75 percent, real estate values plunged, and banks loaded up with bad real estate loans teetered on the edge of bankruptcy. The weakness of the financial system proved a persistent drag on recovery. Japan was losing its competitiveness. A glowering pessimism settled over the country. Confidence among consumers and business eroded, coinciding with a splintering of the Liberal Democratic Party and the breakup of the monopoly on power it had exercised for half a century.

These troubles led to turbulent debate as to whether Japan, Inc. was finished. Did the formula for the relationship between government and marketplace need radical revision, with government to be constrained and the economy deregulated? The outcome of this debate, still being fought in the political arena as well as in argument, will determine Japan's economic future.[3]

A "Suicide Act" for Bureaucrats

The battle was embodied in the fate of Masahisa Naitoh, a MITI director general and head of the industrial policy bureau within MITI, who was to become the foremost advocate of deregulation in Japan. Like most of the leadership in the ministry, he was a graduate of the law school of Tokyo University. He entered the ministry in 1961. After participating in negotiations related to Japan's entry into the Organization for Economic Cooperation and Development (OECD) in the early 1960s, he began to harbor doubts about the long-term efficacy of the system. "I thought that planning could not work so well unless all information was directed to a specific center," he said. "But that is very unlikely. So the second best was the market mechanism. From the 1960s onward, the main theme for me was what should be the relation between government and companies. At that time, many in MITI thought only the wisdom of MITI people could guide the economy. But I thought MITI was not almighty. I read American antimonopoly and competition theory. And I always thought how well consumer electronics had done without government support."

As Naitoh rose through MITI, he kept such unconventional thoughts more or less to himself. Instead, he came to be seen as one of MITI's "golden boys." He played a key role in some of the most important and sensitive trade negotiations with the United States, including those on automobiles, televisions, and steel. By the late 1980s, he was in a prominent enough position to begin arguing the merits of a more deregulated economy. He was opposed on many fronts. "The MITI old boys felt that deregulation would hurt their positions," he said. "The company presidents and politicians also opposed it. Brochures were circulated saying that I advocated the destruction' of the current system. But all of this criticism only strengthened my conviction. I thought it should be done."

Naitoh was aligned with the "internationalist" faction within MITI. He was running the powerful Bureau of Industrial Policy and was a very likely candidate to rise to the highest post open to a civil servant, vice-minister. He also became more outspoken. He testified to the Hiraiwa Commission, headed by the chairman of the Keidanren (the powerful Japanese Federation of Employers), on the future of the Japanese economy. He insisted that deregulation was essential to restore waning Japanese competitiveness. He was the only senior official to take that position. "Within the government, what I did was not liked," he recalled. "Others thought government officials should simply implement the laws. I was said to be envisioning a 'suicide act' for bureaucrats."

Then, at the end of 1993, the unheard-of happened. The MITI minister, a politician, intervened in an unprecedented way: he abruptly fired Naitoh, ensuring that he would never be able to occupy the critical post of vice-minister. The firing became a cause célèbre in Japan, the crucible for an unfolding debate. Naitoh left for Washington—to teach and to become, in his words, a "political refugee." His enemies circulated articles in the Japanese press alleging that he was holding secret rendezvous with American CEOs.

But it was too late. By that time, there was a growing movement toward deregulation. The bursting of the "bubble," which had been built on spiraling stock market and property values, hit Japan very hard. Several years of sluggish, or even no, growth upset all expectations about the workings of the 1955 System. The slump showed up the problems with a high-cost, protected, production-geared economy. The financial implications were great. The imperative of cheap money for industry had meant that firms received loans less on the basis of their balance sheets than as a result of a managed system in which administrative guidance and networks played a large part. This system prevented a clear differentiation between stronger and weaker companies. Savings were managed to support the system. High consumer prices provided an incentive to save, not spend. But household savings were channeled into the banks and life insurance schemes, where they earned low negative returns. With the population of Japan rapidly aging and increasing numbers of people soon to claim pension benefits, the failure of Japanese savings to achieve better returns took on the character of a demographic time bomb.

Neither the low value of the yen, which helped exporters, nor several waves of government spending on infrastructure projects were sufficient to jump-start the economy. As the recession continued, voices grew louder in favor of a structural change to unharness the economy from its tight regulation and thus to restore its competitive position.

The Lost Decade

In the first few years of the recession, concerted political action was made more difficult by the instability of several coalition governments. Hopes for regulatory change grew after 1996, when the reformed Liberal Democratic Party (LDP) government of Prime Minister Ryutaro Hashimoto took over.

Hashimoto placed deregulation at the center of his political agenda. But the long ordeal of Japan's banking crisis came to overshadow everything else. It was no secret that many banks were insolvent because of loans that had gone very sour. But they were also regarded as too big to be allowed to fail. Too many interests were engaged. Yet, at the same time, there was no concerted plan to restructure the banking sector, with its immense inventory of bad loans. This became a huge drag on the whole economy—a drag that more than offset the world competitiveness of Japan's export-oriented manufacturing sector.

The result has been that the slump that began in 1992 continued into the new century. International capital markets came to distrust the Japanese government's will and ability to implement reform. Resentment grew among the Japanese public, which increasingly feared for its economic future—a dramatic reversal of confidence and a sign that for many Japanese, the "miracle" was an increasingly distant memory. Although on the surface there was no suffering, and economic hardship in the world's second-largest economy was minimal, the 1990s began to be described as Japan's "lost decade," in reference to Latin America's 1980s. From 1992 to 1999 the country averaged a 1 percent growth rate, and in the late 1990s the economy experienced a real recession—and again in 2001.

The "state" had served Japan extraordinarily well over many decades. But the downturn, the impact of globalization, the stalemate and lethargy of government's response—all these broke the bond of confidence between government and public. After his party's disappointing showing in the election, in July 1998 Hashimoto resigned. Two prime ministers who followed each another in quick succession, Keizo Obuchi and Yoshiro Mori, had little support from the public.

However, the July 2001 election proved to be the LDP's best showing since 1992, with Juichiro Koizume coming out as prime minister. A charismatic figure enjoying a cult status, a heavy-metal fan with an aging rock-star demeanor, a trendily clad and wavy-haired bachelor, Koizume proved hugely popular in ways never seen before for a Japanese politician. Japanese teenage girls lined up in the streets of Tokyo for his posters, and the selection of his favorite Elvis Presley songs, complete with a photo of him superimposed next to Elvis, turned into a best-selling CD. Koizume impressed the public with his unusually candid language. His election theme was "reform with no sacred cows." For a time, his approval ratings were over 80 percent—unprecedented for a prime minister. Although Koizume was frequently referred to as a maverick, he had come from a family with a long-standing political tradition. A third-generation politician, he had been in politics since 1970, and prior to his election as prime minister had already served ten terms as a member of the House of Representatives. In fact, he ran in the LDP presidential race for the first time in September 1995, losing to Hashimoto.

The tasks facing Koizume are tremendous, as is the political resistance to many of his proposed reforms. The mountain of bad debt continues to grow. Adding to the pressure is Japan's demographics. With the nation's population aging quickly, the fear is that, given the burden of debt, Japan's government will not be able to pay pensions and for pensioners' health care. Koizume's plans include opening up the rest of the economy to competition; dealing with more than $1 trillion worth of bad loans and revitalizing domestic bank lending; expanding foreign trade, which currently accounts for less than 17 percent of the GDP (compared with close to 45 percent for China); and reforming the tax system to ensure a fair distribution of the taxation burden. Koizume's most ambitious goal is privatizing Japan's postal savings system, which, with more than $2 trillion in deposits, is the world's biggest financial institution. Its privatization would be a crucial step toward profoundly restructuring Japan's financial system.

Despite the formidable resistance to reform, however, changes are seeping in from many sources. One is foreign shareholding. As Masahiso Naitoh noted, the result is that "Japanese companies are having to change, whether they like it or not." A growing number of Japan's young people are less interested in the path of secure lifetime employment in a single company. The ultimate challenge is being posed by globalization. "If Japan does not become part of the global change," said Naitoh, "Japan is going to be left behind. Everybody is going to say that Japan used to be a great nation, and that's what's going to be written in history books." He paused and then added, "Now can I look at the positive side? Japan has a clearer vision and a common target. Japan could really function better because it has the vitality and the capability. It has the technological expertise. There is a lot of potential for us to revive. It is very important for everyone involved to be aware of Japan's strengths. Then we can switch to optimism."

Ultimately, Japan will have to break the very model that served it so successfully in the decades between the 1950s and 1970s. The 1955 System made Japan a formidable competitor; it delivered a standard of living that, at the beginning, would have been inconceivable. But the days in which the state "guided" the market, and in which MITI was synonymous with the "commanding heights," are now clearly long over. What will the future look like? The battle between "state" and "market" is something that will dominate Japanese society in the years ahead. It will be fought not only on the field of politics but also in the minds of the Japanese people.[4]

Korea: The Pros and Cons of Picking Winners

In Rangoon, Burma, on the sunny morning of October 9, 1983, Korean members of the receiving line were taking their places inside the Martyrs Mausoleum. They were awaiting the imminent arrival of South Korea's president, Chun Doo Hwan, who was beginning a five-nation tour in Burma and was due at the mausoleum for a wreath-laying ceremony. The South Korean ambassador, flags flying from his limousine, roared up with a motorcycle escort and hastened into the mausoleum. A Burmese soldier lifted his bugle to his lips. He managed barely two notes before a huge explosion ripped through the mausoleum, blowing its roof off, throwing bodies high into the air, and shaking buildings a mile away. Five South Korean ministers and three vice-ministers were among those killed, including a Stanford-educated economist named Kim Jae-Ik, who had been masterminding the next phase of economic development in his country. But the perpetrators missed their main target, President Chun, who was still a few minutes away. Misled by the motorcade and the Burmese bugler, they had mistaken the South Korean ambassador for Chun and had detonated their remote-controlled bomb too soon.

There could be no doubt about who had organized the bombing: communist North Korea. The objective was to destabilize the southern half of the Korean peninsula. South Korean soldiers immediately went on the highest alert status along the demilitarized border zone that separated the two countries. It was yet another battle in a war that had never really ended. But what had surely changed since the all-out war in the early 1950s was that South Korea was well on its way to becoming an economic powerhouse, shaming totalitarian North Korea. And it was doing so very quickly.

In 1945, when the peninsula was partitioned, South Korea had been left with very little. Most of the existing industry—largely the Japanese-built hydroelectric stations on the Yalu River and the nearby chemical and fertilizer plants—had ended up in North Korea. In 1950, 135,000 North Korean troops invaded the south. Communist China entered the war in support of North Korea, and as the communist troops advanced, it had seemed for a time that South Korea might not survive at all. Seoul, its capital, changed hands four times. The war ended in 1953, with a truce, not a peace treaty—a constant reminder to South Korea of how precarious was its existence and how dangerous was the threat from the north. Kim II Sung, North Korea's megalomaniacal leader, never wavered in his relentlessly hostile policy. Thus, in the aftermath of the war, South Korea desperately needed to build up its economic strength, especially as both China and North Korea embarked on rapid industrialization, communist-style. But South Korea was in a terrible state, devastated by the war. Seven percent of its population had been killed, including a large proportion of young men, and two thirds of its meager industrial capacity had been destroyed. Its projects were doomed.

Such was the inauspicious beginning of the rule of President Syngman

Rhee, who dominated the South Korean scene from the end of World War II until 1960. The Korean peninsula had been a colony of Japan since 1895, and the Japanese had jailed Rhee from 1898 until 1904 for nationalist activities. He had then made his way to the United States, where in 1910 he completed a Ph.D. at Princeton University, under Professor Woodrow Wilson. Altogether, he spent forty years outside the country, campaigning for Korean independence. Once in power, he was much more concerned with politics and with managing relations with the United States than with development. Nationalism, not economics, was his forte.

The real push to industrialization came in 1961, following a military coup. General Park Chung Hee emerged as the strongman, running the country from 1962 until 1979. Tough, autocratic, and absolutely committed to economic development, he was the founding CEO of "Korea, Inc.," and he played the part, ruling with an iron fist. He was supported by energetic young military officers, a skilled and increasingly experienced bureaucracy, a broad base of citizens willing to work, and a national commitment to industrial development. The continuing danger from the North drove everything.

Of all the Asian countries, South Korea proved to be the one that most consciously, if ambivalently, adopted the Japanese model. The result was a system that was, in the words of economist Dwight Perkins, "highly interventionist, but with the discipline of having to export." Certainly, there was irony in Korea's focus on Japan. Not only had it been a colony, but the Koreans had a long history of resisting Japanese domination. The Japanese occupation had been brutal and the Koreans were bitter long after independence. They were intent on building up their own nation and their own national identity. As a result of the Japanese occupation, however, many of them had been educated in Japanese-language schools, and they were strongly influenced both by the MITI model and by Japanese culture. Moreover, they could look across the Sea of Japan, where the rise of an economic superpower was all too evident. President Park, who had attended a Japanese military academy and had served two years as an officer in the Manchurian army during World War II, pursued closer Japanese-Korean relations as part of his development strategy.

A MITI variant could serve Korea's urgent interests. The country was very poor; per capita GNP did not reach \$100 until 1963. In the mid-1960s, the economist Joan Robinson, one of Keynes' disciples, celebrated what she called the economic miracle of North Korea and declared that it would economically overwhelm the poverty-stricken South. In the first decade of military rule, the government focused on building up exports to compensate for declining U.S. foreign aid. Initially, the export-push system was nondiscriminatory, providing protection and a wide variety of subsidies and support to all comers. But soon the economic planners in the Park government came to a conclusion with far-reaching implications: They were convinced that Korea needed big companies if it was to compete in international markets and withstand foreign imports. To achieve that goal, they promoted a series of national champions called *chaebol*s—holding companies that controlled diversified industrial groups. Park and his team selected firms that were already successful in one field (for example, rice milling or real estate or construction), typically run by a strong-willed entrepreneur who was not lacking in self-confidence. These firms were then nurtured with low-interest government loans, tax incentives, and other advantages to enable them to become large, strong, and diversified industrial groups. Thus were born companies whose names are now globally known—Hyundai, Samsung, Lucky Goldstar, and Daewoo.

In 1973, Park's government became even more interventionist, launching what was known as the Heavy and Chemical Industries Initiative—the foundation upon which Korea's global role would be built. It was done mainly for reasons of security. North Korea was a military machine, its objectives could not be doubted, and thus, for South Korea, the issue was basic—escaping extinction. With a Communist victory looming in Vietnam, Park and those around him feared the U.S. security shield would be withdrawn. And South Korea was hardly equipped to go it alone. Its only cannons, of World War II vintage, were not usable; the United States had stopped making the spare parts. It did not have antitank weapons to resist North Korea's T-62 tanks, and its military stores were sufficient for no more than three days of warfare. South Korea's renewed sense of insecurity was greatly stoked by President Jimmy Carter, who in 1976 announced his intention to withdraw U.S. forces from the Korean peninsula. It took some dissuading to get Carter to relent, but he tied the presence of U.S. troops to human rights, further widening the gap with the authoritarian Park regime.

Government officials made the basic investment decisions under the Heavy and Chemical Industries Initiative, and then enforced them through control of credit. The result was a very concentrated economic system, based upon a strong and tight relationship between government and a limited number of large industrial companies. Park himself was the hands-on CEO, selecting companies, monitoring progress, bullying through corporate or bureaucratic impediments, traveling around the country by helicopter to swoop down on the different sites and see them for himself. Park also had his own demanding version of "management by objectives." Each New Year he visited all of his ministers to discuss their goals and how they would be achieved. The following New Year he would return to the ministers and go through the previous year's promises—"sentence by sentence." Those who failed to hit 80 percent of what they had promised were fired. Everybody got the message, and they understood what Park wanted—high, sustained growth.

The government targeted six strategic industries for support—steel, petrochemicals, nonferrous metals, shipbuilding, electronics, and machinery. It pushed the *chaebol*s to pursue aggressively only the most advanced technology, and it pushed for scale. To be efficient, for instance, an automobile manufacturing plant had to produce 300,000 vehicles a year, which was far beyond South Korea's ability to absorb given the fact that at the time, the country had a total of only 165,000 passenger cars. Thus it was imperative to develop an export market as soon as possible and at the same time create a domestic market.

The *chaebol*s had generous access to credit and were insulated from downturns by government support. They were protected from foreign competitors in the Korean market—and from domestic competitors as well. The companies received exclusive licenses for their products, and only one *chaebol* was allowed to sell in the domestic market during the first phase of a new industry. The government forced the *chaebol*s to attain international competitiveness in their fields according to a strict timetable and across a broad range of their products. If they did not, they suffered economic and political penalties. The program was pursued with extraordinary dedication, embodied in a very powerful work ethic. As one manager was to put it, Koreans "overcame poverty with hard work and discipline." In many cases, it went further than that. Government work rules were very tough, workers were highly regimented, and the workweek was close to sixty hours. The *chaebol*s had many advantages, one of which was cross-subsidies within the groups. The heads of the *chaebol*s became enormously rich, which did not prevent them from continuing to work hard and aggressively. But there was no question of who was the boss. They would regularly be called to the presidential palace, the Blue House, where President Park would take them to task for failing to act in the interest of the state. They were to do as they were told.[5]

At the end of the 1970s, the government began to back off from the massively interventionist Heavy and Chemical Industries Initiative program. Part of the reason was the rise of domestic opposition and discontent with the Park regime. A shift to stabilization was seen as a way to placate the population by controlling inflation and spreading the benefits of industrialization more widely. The obvious break came in October 1979, when President Park was assassinated by the head of the Korean CIA. The man who thereafter took power, General Chun Doo Hwan, was even more interested in stability. He was also somewhat hostile to the large *chaebol*s and their considerable influence.

A strong intellectual force in the person of Kim Jae-Ik also drove Korea's change of course. Born in 1938, Kim had attended Seoul National University and then completed a Ph.D. in economics at Stanford University. He first made his influence felt as a member of the powerful Economic Planning Board and then, in 1979, became the architect of stabilization and the promoter of liberalization. His objectives were to get growth under control, reduce government intervention, and create a more level playing field on which small and medium-size firms could flourish.

Kim became President Chun's chief economic adviser, which many found odd—"the dour soldier and the exuberant U.S.-trained economist." But they were unusually close. In the words of a colleague, "he was the man who explained economics to the general." Kim recognized how successful the industrialization strategy had been until then, but he was also convinced that it had to be changed; otherwise the country would come to grief. Many of the *chaebol*s were becoming woefully inefficient and would have been virtually insolvent without continuing government bailouts. The banking system, largely government owned, was accountable to virtually no one. The agricultural system was massively inefficient. Kim's prescription was to pull back the economic frontiers of the state, sell off at least some state-controlled enterprises, free up the financial sector, and reduce import barriers in order to expose inefficient industries to foreign competition. He wanted a bigger role for foreign investment. He recognized that the complexity of the economy had now grown beyond the government's ability to manage it. And to the astonishment of his colleagues, he even made some headway in convincing the generals, who held ultimate power, to trim defense expenditures.

How much farther would Kim, with his self-effacing charm, have gone had he not joined that delegation of senior officials visiting Rangoon in October 1983? The carnage at the Martyrs Mausoleum was a terrible reminder of the dangers South Korea faced. Kim's death was described as "the biggest loss" of the entire event. Although only forty-four at the time of his death, Kim Jae-Ik was to be remembered, in the aftermath, as "legendary."

Building upon Kim's legacy, South Korea thereafter pursued policies aimed at less intrusive indicative planning, an expanded role for the market, and financial and import liberalization. The changes did not come easily. They met considerable opposition both from the powerful bureaucracies and from Korean companies used to being taken care of. In the words of one civil servant, much "hidden regulation" remains in the late 1990s, promulgated by officials who did not want to lose their power.

Korea finds itself no longer a low-wage society. The regimented labor system has shown recurrent strains. The tension began with the massacre of striking workers at Kwangju in 1979, which precipitated the coup that brought down General Park. Periodic labor unrest has continued ever since. Many Korean workers had felt excluded from the benefits of their labor. But in the 1980s, wages went up substantially and job tenure was guaranteed, and after 1987, unions were freed of government repression and control. More recently, however, compounding the trouble, there has been the pressure to make labor markets more flexible, both to enable South Korea to compete with the new tigers and to bring labor laws into line with international practice, as a condition of having joined the OECD. The unions have responded with often-violent strikes and demonstrations.

Worried about prospects for the domestic economy, the *chaebol*s sought to maintain competitiveness by investing abroad. The top five *chaebol*s alone were planning to spend $70 billion over a decade on overseas investment. Korea's economy continues to stagger under the weight of nonperforming loans used to build up big industries and the persisting need to rationalize and restructure the industries created in the 1970s. Moreover, South Korea does not have the networks of small and medium-sized companies that have been a source of stability for Japan. In addition, Koreans—observing the high price of German reunification—worry about the economic and social costs should

North Korea suddenly collapse and the cherished goal of reunification become a reality. Yet with all the ups and downs, South Korea achieved its enormously impressive growth. And the considered judgment of Asia expert Ezra Vogel stands as a concise view of what was accomplished over three decades: "South Korea was unrivaled, even by Japan, in the speed with which it went from having almost no industrial technology to taking its place among the world's industrialized nations." He adds, "No nation has come so far so quickly, from handicrafts to heavy industry, from poverty to prosperity, from inexperienced leaders to modern planners, managers, and engineers."

Korea is paying a heavy political penalty for its economic success. Massive state intervention created massive opportunities for corruption. Industrial policy Korean-style meant that the state extended enormous largesse to favored companies and there was a price to be paid by those so favored. "If you were not close to the government, you could not survive in the Korean marketplace," one businessman explained. "The Korean businesses that were eager to do business followed the informal rules for the flow of funds in the generation of business"—in other words, kickbacks, bribes, and political payoffs.

In the presidential elections of 1987, a divided opposition had allowed Chun's handpicked successor, Roh Tae-Woo, to take over. But the public became increasingly angry with authoritarianism and repression, as well as resentful of inequality and corruption. The top "managers" of Korea, Inc.—the generals and politicians—had grabbed too much profit for themselves, and the calls for transparency could no longer be shut out. In 1993, newly elected President Kim Young-Sam launched an anticorruption drive that would prove comprehensive in its sweep—and politically popular. As a result, former presidents Chun and Roh were tried and found guilty for their roles in the 1979 coup and the 1980 massacre of pro-democracy demonstrators. At the same time, the heads of eight *chaebol*s were given prison terms for paying bribes to Roh. The "informal" flow of funds to Roh had been very considerable—$650 million, according to the indictment. Ignominiously shackled together, clasping hands, the two former presidents listened to their sentences in August 1996. For Roh, it was twenty-two years in prison; for Chun, a sentence of death. It is said that Roh spent his first nights in jail reading Margaret Thatcher's memoirs, no doubt reflecting on her free-market philosophy and the case against state intervention.

In its way, the outcome was an indictment of the entire system that had propelled Korea to the forefront of the world economy. "What has been normal and necessary in the past as part of a phase of economic development in Korea is now being questioned," observed a key member of a commission charged with reforming Korea's economy. "A more mature economy going into the next stage of development will require the realignment of market, government, and industrialization."

But worse was still to come. As the Asian financial crisis engulfed Korea, it further exposed the weaknesses of the banking system and *chaebol*s. By late

1997 Korea's foreign reserves were down to $6 billion, with $1 billion exiting the country per day. Korea, the world's eleventh-largest economy, was teetering on the verge of collapse. On December 3, the IMF approved a $55 billion rescue package conditioned on reform. Three weeks later, Koreans went to the polls and elected a new government. Their new president was Kim Dae-jung, the veteran opposition figure and the living symbol of resistance to the long years of military dictatorship. Kim's election was a first step in coping with the legacy of that time—both political and economic. His election program contained measures that relied on preserving Korea's economic achievements while allowing the regimented *chaebol* structure to gradually loosen up. "The new government in Korea was what saved the situation," said Stanley Fischer, deputy managing director of the IMF at the time. "If Kim Dae-jung hadn't won the election, Korea's ability to turn that situation around would have been in question." Within a month and a half Korea's economy started to rebound. In 1999, Korea posted a close to 11 percent GDP growth. By 2001, its foreign reserves exceeded $95 billion, and instead of being a net borrower, Korea became a net lender. Inflation was firmly under control. In 2001, Korea celebrated the early repayment of the IMF loan.

The restructuring taking place in Korea is extensive. *Chaebol*s had proven to be one of the major causes of Korea's vulnerability during the crisis, and the government demonstrated its resolve and commitment to reform when it allowed Daewoo—one of the major *chaebol*s—to collapse under the $80 billion of debt. The collapse sent shocks through the system, crippling Korea's financial markets and setting off another downturn, exacerbated by the slowing demand for high-tech products. The effect was multiplied when Hyundai failed to restructure its $46 billion debt, causing Korea's stock market to finish the year 6 percent lower than the year before. But many were encouraged by the fact that the government chose to allow such big players to fail instead of turning to the state-owned bank for bail-outs—a traditional recipe for propping up the *chaebol*s. In the years following the crisis, Korea has made substantial progress in financial sector restructuring, with the consolidation of the commercial banking system, operational restructuring to strengthen profitability, recapitalization, and improvements in prudential regulation and oversight of banks. The amount of nonperforming loans has decreased sharply from 45 percent of total loans at the end of 1998 to just above 25 percent by the end of 2000. Kim Dae-jung demanded that the *chaebol*s eliminate cross-guarantees and aim for profitability instead of sales growth. Privatization has continued, and Western corporate governance methods are being instituted. The number of start-ups, particularly in the high-tech sector, has increased significantly—an important indicator of growth of small and medium entrepreneurship.

Much like the rest of the region's, Korea's growth slowed in 2001. This time, however, there seems to be little risk that the recession will turn into a crisis akin to that of 1997. Structural reforms undertaken by South Korea in the wake of the 1997 financial turmoil were among the most profound in the region, leaving the country with high levels of foreign reserves, current-account surpluses, and minimal short-term foreign debt. In addition, Korea is much less dependent on exports—particularly exports of electronics—compared to many other Asia, Inc. countries (exports make up only 15 percent of Korea's GDP, compared with more than half for Taiwan and Singapore). Nevertheless, managing the transition to a more flexible economy amidst a global recession and the still deeply entrenched interests of business and organized labor will continue to tax and challenge Korea's process of reform.[6]

Taiwan: Confucian Capitalism

Sun-Moon Lake, enfolded in the mountains of central Taiwan and often covered with mist, has long been Taiwan's favorite honeymoon resort. It takes its name from its shapes as seen from various nearby hilltops. On one shore is a magnificent temple, dedicated to Confucius and two warrior deities. In 1949, Generalissimo Chiang Kai-shek made his way to Sun-Moon Lake in search of some respite. He had just fled mainland China to escape capture by Mao Zedong's advancing communist forces. And it was there by the side of the lake that Chiang was handed the telegram telling him the news he had never wanted to hear—of the final collapse of his nationalist forces on the mainland. He turned stone-silent and, for an hour, sat motionless. Then he stood up and set out for a walk in the forest with his son. After a long silence, for want of anything else to do, he suggested that they go fishing. His son paid an old fisherman to take them out in his boat. Lost in depression and hardly paying attention, Chiang cast out a net and, to his surprise, caught a very large fish. The fisherman said it was the largest he had ever seen taken from the waters of Sun-Moon Lake. It was a good omen, he added. Yet that hardly seemed possible. After all, the fall of Taiwan, Chiang's last redoubt, appeared imminent. His old nemesis, Mao Zedong, was on the verge of total victory. And Chiang had nowhere else to go.

The rivalry between Chiang and Mao had defined modern China. The balance between them had seemed very clear in 1949, when Mao's forces won their final victory, taking control of all of mainland China, from the Vietnamese border. Yet a quarter century later, by the time of their deaths, the balance looked quite different. Chiang and Mao both died in the mid-1970s—within a year of each other—at the ages of eighty-seven and eighty-three, respectively. By then Chiang had presided over an extraordinary economic miracle that was catapulting Taiwan into the forefront of industrial nations while Mao had succeeded in creating a series of catastrophes that left mainland China an economic disaster.

Like South Korea, Taiwan was a creation of the cold war, and its postwar history was a "rags-to-riches story," in the words of one of its economic architects. For fifty years, beginning in 1895, it had been a colony of Japan—a "rice bowl"—and then briefly a province again of China after World War II. It became a separately functioning country only in 1949, when Chiang, leader of the Nationalist Party, sought refuge there with upward of 2 million soldiers and civilians. Although outnumbered by the Taiwanese Chinese by three to one, the refugees from the mainland controlled Taiwanese life. The split between them and the native Taiwanese would be of lasting economic, political, and social significance.

For Taiwan, one issue was paramount: survival. As far as the Communists on the mainland were concerned, Taiwan was still a province, its conquest the uncompleted business of the civil war. For their part, Chiang and the nationalists refused to acknowledge that Taiwan was not China, and talked for many years about retaking the mainland. With the passing of the years, however, Chiang's ambition shifted from "a fierce resolve" to "an aspiration, then a myth, then a liturgy." But survival remained the most urgent imperative. At first, it was necessary simply to withstand an onslaught from the mainland. Later, it was to weather Taiwan's isolation as the People's Republic took its place in the international community, snapping most of Taiwan's diplomatic links, including those with the United States. It faced a constant and almost unique struggle for legitimacy in the international system. But Taiwan's precarious position—as Dr. Johnson said of hanging—concentrated the mind, strengthening national unity and focusing resolve on building the economic sinews required for survival.

Things hardly looked promising in the late 1940s and early 1950s. The country had few resources, few entrepreneurs, and no savings, and it had been heavily damaged during the war. Moreover, there was a strong view that the Chinese people were not suited to modern capitalism. They could not operate beyond the family, it was said; nor would they save. They were too suspicious; they were not innovative. No less an authority than the great sociologist Max Weber, in his study on the rise of capitalism, had declared that Confucianism was incompatible with capitalism. In 1949, some attributed the nationalists' defeat to their being mired in a traditional Confucian system. This view sounds quaint today; after all, the Asian miracle is now sometimes called "Confucian capitalism."

Yet Taiwan did have a few strong foundations. A legacy of its fifty years of Japanese colonization was the heavy emphasis on education; by 1949, half of the population was literate. Also, the totality of defeat on the mainland turned into a strength, for the nationalists went through a deep and painful soul-searching about what had brought them to disaster. They identified a number of causes—hyperinflation, corruption, inequality, lack of agrarian reform, arbitrary government power, failure to embrace modern science and technology. These became the lessons they methodically sought to apply on a much smaller stage. Early on, the Nationalist government carried out a land reform that created a strong agricultural base and promoted equality. It inculcated a powerful anticorruption ethos in its new bureaucracies. Almost from the beginning, there was also the conviction that government's prime role was to create an environment in which entrepreneurs could flourish, and then it would withdraw incrementally. Planning would guide Taiwan toward a market system. The objective, in the words of one of the senior planners, was to manage "a process of the gradual depoliticization of the economic system."

"Gradual" would prove a fair description. Through most of the 1950s, Taiwan concentrated on the familiar import-substitution strategy, with a heavy investment in infrastructure and a focus on labor-intensive production, backed up by protective tariffs and tax incentives. It also embraced state-owned enterprise. It did so in part because it had to do something with the state companies the Japanese had left behind. It also saw such companies as essential for aggregating the scarce skills and resources that were available. And it was influenced by the very evident rise of state-owned enterprise in Europe.

U.S. foreign aid was very important in this period, enabling Taiwan to invest in equipment while still paying for its imports. But by the late 1950s, Taiwan could see that American aid would end (as it did in 1965) and thus there was an urgent need to be able to earn foreign exchange. At the time its number-one export was sugar, which would hardly do. Thus it made a decisive shift into a new phase—toward export of manufactured goods into the world market. This meant not only an opening up but also, although less obviously, the beginning of relaxation of domestic controls. The government supported these new would-be industries through low-cost loans, lower tariffs on imports that went into making exports, and aggressive scouring for technology. It also encouraged direct foreign investment, in order to facilitate the transfer of skills and technology and upgrading of quality. The results were spectacular: Exports rose from $123 million in 1963 to $3 billion in 1972. A new phase began in 1980, with an emphasis on technology and research and development; and from there on, the trend toward liberalization became more explicit.

The government was consistently concerned with promoting the emergence of an entrepreneurial class. Sometimes it had to do the "emerging" itself, hunting down businessmen to whom it could entrust specific tasks. For instance, it needed to find a private businessman to take over a government polyvinyl chloride plant originally financed by the U.S. aid program. After much looking, it finally identified a Taiwanese candidate, Y. C. Wang, who was working as a lumber salesman in Japan. Persuaded to come back, he built his Formosa Plastics into the world's largest manufacturer of PVC—and ended up one of the two or three richest men in Taiwan. But in striking contrast to Korea, Taiwan's overall development rested much more upon small and medium-sized businesses, frequently family owned and often operating in networks.[7]

The Supertechnocrats

One of the smartest things Chiang did was leave economic policy making to what became known as the supertechnocrats—very able officials, many of them scientists and engineers, who operated without a great deal of political interference. They were able to call upon Chinese living abroad, including a number of prominent economists in the United States, and eventually on generations of Taiwanese who had gone abroad for their education—and turned what had been feared as a "brain drain" into a "brain bank." Chinese studying or working overseas became a tremendous resource, among other things providing an exceedingly effective network for technology transfer.

From the early 1950s until the mid-1980s, just five men had preponderant say over economic policy making. They combined old and new. They played, observed one scholar, "a role much like that of good traditional Confucian advisors, but both their style and the content of their work were new in Chinese history. They were part of the world scientific and development communities, and they believed in growth and progress." Indeed, for forty years, two of these men, moving among a number of key positions, dominated the entire process.

The first was K. Y. Yin, who orchestrated the move into the export phase and who became known as the "father of Taiwan's industrial development." Trained as an electrical engineer, he had worked all over China before World War II. During the war, he had been a member of the Chinese government's purchasing mission in the United States. And from 1949 through the early 1960s, he was Taiwan's chief planner. He thought like an engineer. "An engineer is a scientist who is knowledgeable about economics," he said. He became a voracious reader of economic texts. He could argue over the details and the finer points in Adam Smith—yes, government did have the role of providing for defense—and offer emendations on Keynes. In planning Taiwan's future, he embraced both Walt Rostow's concept of the economic takeoff and Arthur Lewis's emphasis on export-led growth. He was also a believer in moving the system toward the market. After his death in 1963, people said that his towering monument was the simple phrase "Made in Taiwan," inscribed on quality goods that could be sold in advanced industrial countries.

His place was taken by his deputy, K. T. Li, who held sway until the end of the 1980s and who became known as "the father of the nation's economic miracle drive." Graduating with a degree in physics from one of China's most prestigious universities, Li won a scholarship in the early 1930s and went first to Scotland and then to study nuclear physics at Cambridge. After Japan invaded China, he returned home to join the war effort, working in the military industries. He, too, thought in technical terms. "Economic modernization," he explained, is a "huge engineering system that requires extremely careful and elaborate planning." But as time passed, he was also intent on progressively withdrawing the state from the market—replacing "the arbitrary political power of the government" with "the automatic adjustment mechanism of the market."

Li was obsessed with creating conditions in which entrepreneurship could flourish and business could develop beyond the immediate family unit. This meant that the government had to focus on getting infrastructure in place, developing a rational institutional and legal framework—and looking at things from the entrepreneur's point of view. "Since there is not a textbook on how to improve the climate of business," Li said, "I put myself in the shoes of investors and then rely on scientific method to provide the answers."

The technocrats studied the Japanese experience repeatedly and with great care. Yin took a deep personal interest in the Meiji Restoration, which, beginning in 1868, initiated Japan's modernization, and he sought to sort out its lessons. Li's first job after World War II, before his flight to Taiwan, was to investigate the industry that the Japanese had built in northeast China, which made him a lifelong student of how the Japanese did things. In Taiwan, both men adapted aspects of Japan's bureaucratic structure—MITI-style, yet without the sense of permanence that characterized the Japanese system. They also came to the conclusion that Taiwan, like Japan, would need to export to survive, which meant continually improving quality while remaining price-competitive. That, in turn, required the constant and efficient absorption of technology. It also meant protecting the domestic market sufficiently to safeguard infant industries from more advanced foreign competitors. In short, they adopted the Japanese approach—"competing out and protecting in." But the protection would be allowed to phase out, as Taiwanese firms were deliberately subjected to the rigors and tests of international competition in their home market.

The supertechnocrats bludgeoned domestic companies to get their products up to world standards and down to world prices, and encouraged foreign investment to promote new export capabilities when they felt domestic firms were not up to the task. But Yin and Li ran into powerful opposition in promoting what Li called the "openness orientation." They were both accused of colluding with individual businessmen. Many wanted protection to continue. Li responded: "For those with the mentality of the 1950s—glorification of public enterprise and resentment of the intrusion of private [former imperialist] Japanese capital—the events of the 1980s have been traumatic. All these policy innovations amounted to the abandonment of some highly treasured vested ideas, which were vaguely associated with nationalism"—but which could not stand up to the realities of the world market.

In the late 1990s Taiwan faced the same squeeze as the others of the first generation of high-growth—but no longer low-wage—Asian countries. They were pressed on one side by the low-wage, newly industrializing countries (including mainland China) and on the other by high-technology products from the established industrial countries. Taiwan tried to respond by augmenting its high-technology capabilities. Also, Taiwanese entrepreneurs, in the quest for low wages, stepped up their foreign investment, including a great deal on the mainland. A second challenge was the continuing transition away from authoritarianism to a more democratic rule, which has gone hand in hand with economic development and the broadening of the middle class. The Kuomintang long kept a tight grip on power, appointing rather than electing the president. Chiang Ching-kuo, Chiang Kai-shek's son, held that post for ten years. Then, in 1988, the party appointed Lee Teng-hui, a former agricultural economist who had graduated from Cornell University. Although a member of the Nationalist Party, he was also a native Taiwanese, not a mainlander. In 1996, he was renewed in his post, this time in free, contested elections that went on despite Chinese naval maneuvers in the Formosa Strait.

The biggest and by far the most complex challenge is indeed Taiwan's relation to the People's Republic. Economics is drawing them together. Taiwanese firms have invested tens of billions of dollars on the mainland over the last decade, making Taiwan by far the biggest foreign investor in China. But politics still keeps them apart. In Taiwan's schools, children learn in detail about the geography of China, memorize its dynasties, and study maps that show Taiwan as a province of China. But there is little taste to be absorbed by the People's Republic, which still regards Taiwan as an errant province to be regathered. Nevertheless, changes, albeit gradual, have been noticeable. Taiwan's March 2000 presidential election ended the more than half-century rule by the Kuomintang and brought to power Chen Shui-bian of the strongly pro-independence Democratic Progressive Party (DPP)—an event that the Taiwanese called "the change of the sky." Despite the tough rhetoric on China's part, which included an unprecedented warning by Prime Minister Zhu Rongji to the Taiwanese against supporting Chen's "separatist clique," Beijing's reaction to the election was considerably more subdued than may have been expected. Following the elections, the DPP's stance, which had previously been uncompromising on the independence issue, had also softened. Chen assured China that he would be open to discussing the one-China issue and that Taiwan would not exclude unification with the mainland as a possible alternative. He issued a series of specific decrees aimed at further developing the economic cooperation across the strait.

As rags-to-riches stories go, Taiwan's is spectacular: Its per capita income has risen from $100 in 1949 to almost $14,000 today. For several years, its central bank held the largest foreign reserves of any country in the world. Today the country produces 30 percent of the world's notebook computers and half of the world's computer keyboards, monitors, scanners, and motherboards. However, Taiwan's heavy reliance on exports, which contribute close to half of its GDP, has inevitably proven to be a weakness in a time of worldwide supply, overcapacity, and falling demand for Taiwan's electronics exports. Other, deep-seated problems inherent in the system have also contributed to the deceleration: nonperforming bank loans, largely accumulated during the Asian financial crisis; an unpredictable judicial system; poor corporate governance; low energy efficiency and environmental degradation. Next to the country's dynamic, export-oriented electronics sector, which has fueled Taiwan's extraordinary growth, are the traditional industries serving the domestic market, which face considerable challenges. But Taiwan's joining the World Trade Organization will propel reform, making the country's domestic sectors more competitive and eventually helping to reignite growth.

At the beginning of Taiwan's independence, government played an overwhelming role in the economy. There was hardly an alternative. Time has seen a progressive withdrawal of the frontier of government, along with a continuing emphasis on the macrofundamental agenda: The supertechnocrats put policies in place to encourage very high savings. With inflation and the defeat on the mainland entwined as a permanent nightmare in their minds, they relentlessly fought inflation with budget discipline and monetary restraint. They put a sustained emphasis on education and on the development of technology and skills. They paid attention to equity and income distribution. They sought deep engagement with the world economy. And they were willing to surrender that most addictive of all of government's allures—the exercise of power.

"Countries with a Chinese cultural tradition are often perceived as having entrenched, powerful bureaucracies and central governments," K. T. Li was to observe. "This not only is historically true but is still true for Taiwan. Nevertheless, what we as policy makers did in Taiwan was to help various parts of the economy first to stand and then to walk. And then we let go."

In coming years, Asians may come to ponder Li's precepts more closely than ever before, for Taiwan survived the regional financial crisis relatively unscathed, preserving its record of political opening, balanced growth, and bolstered national confidence.[8]

Singapore: The State as Venture Capitalist

When Dr. Goh Keng Swee, nearly eighty and frail, entered the restaurant of the venerable Raffles Hotel, everybody turned to look at him. After all, he was a father figure. If Lee Kuan Yew was the patriarch of modern Singapore, then Dr. Goh was next in line, its economic architect, the man who designed the system that delivered Singapore's economic miracle—7 to 9 percent growth rates almost every year for three decades. But, Dr. Goh would insist, the source of that miracle is greatly misunderstood. "The lecturers in the universities are all wrong," he said. "The critical factor was our decision to emphasize science and math courses in the schools, and the mothers' insistence that their children take science and math. It was the mothers that were really responsible."

It was, of course, fitting to see Dr. Goh at Raffles. After all, it was Sir Thomas Stamford Raffles, who in 1819 arrived at the island and, finding only a small Malay fishing village of about 120 people, began to build it into a British colony as well as an entrepôt for the region. In the 1930s, the young Goh was picked out, as was the custom with the promising young native Singaporeans, to attend the elite school named for Stamford Raffles in order to be trained to enter the local government. He was then sent to England, where he earned a Ph.D. at the London School of Economics. It was only after he returned to Singapore and joined the civil service that he teamed up with Lee Kuan Yew.

Also educated at the school named for Raffles before going off to Cambridge University, Lee had come home from England determined to throw himself into the anticolonial movement. Before the struggle was over, Lee would not only overcome the British but would also best the Communists in a bitter battle for control over the nationalist movement. His dream was of a single country comprising both Malaysia and Singapore, but in 1965, after just two years of such a union, the experiment fell apart. Lee wept in public. He was left the leader of a much diminished nation, the city-state of Singapore, with fewer than 3 million people. Somehow he would have to make a nation out of what was there—a poor and poorly educated population, 75 percent of whom were Chinese, with most of the rest Malay and Indian, with no sense of national identity. Gangs, crime, and Communists all made life in Singapore a permanent crisis, and its prospects were quite problematic.

If Singapore was to find a future, there were only two obvious resources—the people and the leadership. In Lee Kuan Yew, Singapore had a man with an unusual combination of talents—he was a charismatic leader, a skilled and shrewd politician, a superb technocrat with a broad view, and a visionary. "To build a country, you need passion," he once said. "If you just do your sums—pluses, minuses, credit, debit—you are a washout." He had passion, and he evinced little doubt about his own judgment or authority. He also had, as he would note later in life, a formidable talent for persuasion.

In Dr. Goh, the country had a pragmatic economist. "If we were economic pioneers," Goh said, "it was due to simple economic necessity. The key to success is not a matter of planning but rather the ability to adapt to changing situations." The country's one and only foray into five-year plans was in the 1960s. But, said Goh, it was "cooked up during a long weekend" as a sop to keep the World Bank happy. Yet whether there was a plan or not, the system that Lee and Goh created provided the state with a strong, guiding role in the economy. The results have been given many different names: "the administrative state," "the state as venture capitalist," and, occasionally, "capitalism with socialistic characteristics."

All this was a response to the situation at hand. In its early years, Singapore was a country besieged. It had no great confidence that it could make it, or even survive. As there was so little to work with, Lee, Goh, and their colleagues were not very confident in the capabilities of local entrepreneurs. They were also much influenced by the postwar British Labour Party and the postwar trend toward state ownership. Indeed, they began their public careers as committed socialists, but they ended up professing their faith in the market, albeit with a strong government say. For the most part, they developed the system on their own. If there was one major external influence, it was a Dutch economist named Albert Winsemius, originally an expert in the economics of ice cream. Winsemius was their guide to the international economy, helping them decide which industries to encourage and providing pep talks during times of uncertainty and despair. Yes, they could do it; they could create a viable economy out of what was essentially a port backed up by small farms.

Goh and Lee established the Economic Development Board to guide the creation of a modern economy. They put in place state-owned companies, which they went out of their way to staff with the best they could find. They forced civil servants to think like businessmen, tying their promotions to the profitability of the state-owned enterprises they ran. They financed social services—health care and housing—but were always careful not to make them so complete as to deprive Singaporeans of their sense of personal and family responsibility. As one of the current government ministers put it, a less-than-total welfare system "helps Singaporean people see the future more clearly." And they built upon the Chinese propensity to save by promoting a very high savings rate. In fact, they implemented it through the Central Provident Fund, which at its height took 50 percent of all wages. The money was used to finance infrastructure, industry, and housing. The most famous example of the infrastructure development was the transformation—masterminded by Goh—of a wide expanse of swamp called Jurong into a vast industrial park. Many regarded the project as ridiculous and likely to fail, and it became known as Goh's Folly. Today, however, it is synonymous with Singapore's economic success.

They also made an enormous commitment to education—but they charged, at least at the university level, something for it. Nothing in Singapore should be free. In 1968, the country produced no engineers; now it aims to turn out twenty thousand a year. Throughout the process of modernization, the government was a very active facilitator. It was the agenda keeper, the long-range planner, a strategic player in its own right, and the manager of resources. A small elite of bureaucrats, selected meritocratically, ran the whole system. The sense of immediate vulnerability, the small size of the country, the unfolding success, and Lee's considerable talents as a mobilizer and implementer—all created a national consensus, a common purpose, and effective coordination that made Singapore look like a very cohesive company. After all, even the secretary-general of the trades union council was a member of the cabinet.

Yet state domination was only part of the story. For over the same period of time, Singapore made a crucial commitment to international commerce—in an era when import substitution and protection were the order of the day. Lee and Goh were all too conscious of Singapore's diminutive size; it was, in their view, simply too small to go it alone. They would seek to anchor it firmly in the world economy. "There was no choice except to produce for export," said Goh. "Our domestic market was too small, and the skills of local enterprise at the time were too low."

First, Singapore would create an environment conducive to economic growth—low inflation, stable and predictable "rules of the game" for business and foreigners to operate by, a high savings rate, an anticorruption ethos, and a climate friendly to business. As one economist put it, "In Singapore, companies are good." Second, it made the very unfashionable decision to court multinational corporations, for these firms would move in with a crucial dowry—technology, skills, capital, and access to markets. The firms were vetted carefully for what they brought and what industries they represented. Singapore was looking for stable companies with strong technologies and a willingness to invest with a long-term perspective. It wanted high-visibility projects that would contribute to building, as one minister put it, the Singapore "brand name"—embodying quality, reliability, and a comfort level for foreign investors higher than available elsewhere. One of the very first companies to be so enticed was Texas Instruments, which arrived in 1968 to begin manufacturing transistors. In those years, Singapore benefited greatly from the upheavals of Mao's Cultural Revolution, which lured multinationals away from Hong Kong and Taiwan and instead toward Singapore, which had the great virtue of being farther from China. The government went out of its way to facilitate the activities of foreign companies with everything from infrastructure investment to aligning its educational programs to their needs.

By the middle 1990s, Singapore was worrying about losing out to the newer low-cost production areas, and it has sought to protect itself by moving up the value chain to higher technologies and by carving out an "external economy," new spheres of economic activity—as, for instance, in the "second Singapore" it is overseeing in China. It began this redefinition in the 1970s, but the urgency grew.

When financial crisis swept the region in the late 1990s, Singapore shuddered but held firm. It held in part thanks to its role as a financial center and "safe haven" in the region. Its currency had not been tied to the U.S. dollar but was managed against a basket of currencies of Singapore's major trading partners. Singapore companies had little U.S. dollar debt and therefore proved less vulnerable to the crisis than their counterparts in neighboring countries. Singapore was also inherently more transparent; corruption, which had vastly exacerbated the effects of the crisis on the other tigers, was virtually absent. The recession that followed the crisis was short-lived. For that Singapore could thank an entire legacy of careful, even conservative technocratic management by Goh and his successors and their preparedness for change. At a time of great need, that legacy paid off. Only two years later, in 1999, Singapore's economy was showing a close to 10 percent growth.

The legacy is once again being put to the test as Singapore feels the pinch of the global economic slowdown. With the electronics sector accounting for 43 percent of Singapore's manufacturing, the country is having to face a major drop in its exports and the worst recession in almost forty years. But Singapore, in its modern form, has always demonstrated creativity and adaptability in confronting challenges. Lee summarized the formula: "Because of our unusual circumstances—no natural resources, nothing except people on a small island—we must have the imagination and vision to use the technologies that come along and carve out a future for ourselves."

Singapore is already a prominent East Asian information technology hub. It likes to call itself a "wired island" and has allocated $1 billion to invest in high-tech start-up ventures. The government has been promoting policies that encourage innovation and entrepreneurship, liberalizing financial services and telecommunications sectors to spur domestic competition. With its emphasis on human resources, the government is reviewing the school curriculum to prepare Singapore's children for the pharmaceutical and biotechnology sectors that are becoming increasingly prominent in Singapore's economy.

Over the years, Singapore has shown that it is sufficiently flexible to adjust to economic challenges. Much of its success has been government-driven. But in contrast to many other East Asian states, Singapore's government has always been willing to let go and let the markets take over. This adaptability has been one of Singapore's greatest strengths, which had turned it into the economic miracle that it is. "It was hard work . . . to establish ourselves as a viable nation linked by trade and investment to the major industrial countries, and as a successful hub for the dissemination of goods, services, and information in our region," wrote Lee many years later in in his memoir *From Third World to First.* It was hard work that paid off in abundance.[9]

Malaysia: The Sons of the Soil

Three of the first four "tigers"—Taiwan, Singapore, and Hong Kong—were all-Chinese communities. In the "tigers" that came next—Indonesia, Malaysia, and Thailand—the ethnic Chinese have been engines of the local economies. In the case of Malaysia, however, the entire thrust of development has been aimed specifically at solving its "Chinese problem"—dominance of economic activity by the local Chinese, with their long commercial tradition and markets, although the Malays, rural and poor, made up the majority of the population. "Malaysia's subsequent success," observed a close student of its economy, "results in large part from its effort to solve its racial problems." And it was so successful that the country in two decades was transformed from an exporter of rubber and palm oil to one of the world's largest manufacturer of computer chips. Though heavily dominated by exports, the economy diversified and deepened. For a time, the stock exchange was the world's thirteenth-largest. Living standards improved at a rapid pace. "Not bad," in the words of Prime Minister Mahathir, for a country that was considered "a primary candidate for the dustbin of history."

The turning point was the 1969 anti-Chinese riots—sparked by a strong Chinese showing in elections. Malays—three quarters of whom lived in poverty—saw the little political power they had slipping away to the Chinese. Democracy was suspended, and a "New Economic Policy" was launched, intended to promote rapid growth but also, crucially, to bring about redistribution. It was a massive program of affirmative action, quotas, and favoritism that was meant to lift the majority *bumiputras*—the sons of the soil, that is, indigenous Malays—out of poverty and into schools and universities and then into the middle class. There was no end to the ingenuity of the program. All business enterprises were to have at least 30 percent Malay participation. The government offered *bumiputras* lower mortgage rates than non-*bumiputras.* And on and on.

Yet at the same time, the government sought to ease the social frictions and build broad support for the New Economic Policy. To be sustained, redistribution required wealth creation first and foremost, and the entire population began to benefit—including, very considerably, the Chinese. The program involved a high degree of state ownership, much regulation, and a large bureaucracy. It also entailed a massive investment in education. In 1957, when Malaysia became independent, it did not have a single Malay-language school. "The purpose of Malay education," a noted British colonial educator had declared, "is to make them better farmers and fishermen." As if in reply, Prime Minister Mahathir, himself the son of a teacher, would later proudly point out, "The sons of rice farmers and fishermen own and run billion-dollar companies successfully." Foreign investment was encouraged. The country was launched on a high growth curve—7.8 percent per year in the 1970s. Per capita income rose from $390 in 1970 to $1,900 in 1982. The country also developed national unity. There was enough economic growth to go around.

But by the early 1980s, the New Economic Policy floundered. The government had expanded public enterprise and made a very large investment in heavy industry, which was not working. Losses and inefficiency were mounting. The deficit of public enterprises grew markedly as a share of the GNP. Economic growth faltered. At that point, Prime Minister Mahathir and his finance minister, Daim Zainuddin, engineered a sharp shift to the market.

In instituting these changes, Mahathir was moved less by economic philosophy than by what had always been his motivating force—nationalism. His father was the first Malay head of an English school in British-controlled Malaya. As a teenager during World War II, Mahathir was a pushcart vendor, but he went out of his way to avoid selling fruit to the occupying Japanese. At the war's end, he joined the anti-British colonial movement even before going off to study at the King Edward VII College of Medicine in Singapore. By age twenty-one, he was already a member of the anticolonial United Malay National Organization (UMNO), which in 1997 was still the ruling party. In 1969 he wrote a book, *The Malay Dilemma.* Its criticism of the lack of governmental response to the economic weakness of the Malays vis-a-vis the Chinese got him kicked out of the UMNO, and it was banned. Three years after the anti-Chinese riots, and after the kind of remedies he had proposed in his book were being implemented, he was invited back into the party. He held a succession of positions until becoming prime minister in 1981. It was only then that the ban on *The Malay Dilemma* was lifted.

As prime minister, Mahathir took steps to make it clear that there was now going to be a new emphasis on efficiency and modernization. To symbolize the change, he required that all government employees, including members of Parliament, punch in on a time clock. He also set out to apply relevant parts of the Japanese model to the Malaysian economy. At one point, he spent several weeks traveling incognito in Japan seeking to uncover "its spirit and roots." Books about Japan were often best-sellers in Malaysia, and Mahathir made a point to read them, underlining key passages and insisting that his aides study them as well.

The nationalist struggle continued to define how Mahathir looked at the world. Despite Malaysia's increasing integration with the world economy, he frequently rose up in anger and indignation at what he saw to be any instance of condescension, judgment, or unsolicited advice from Western sources. Mahathir restricted domestic criticism, and viewed criticism from outside the country as expressions of colonialism. To a German environmentalist campaigning against logging, he wrote, "Stop being arrogant and thinking that it is the white man's burden to decide the fate of the peoples of the world." He has banned a number of Western publications and reporters, and attacks what he calls the "so-called Western controlled free press."

But in the early 1980s, when he directed the turn in the Malaysian economy, it was because of the crisis that had hit the economy and because of his judgment that it was now strong enough to relax state control and—striking for such a nationalist—to open up further to foreign investment. The country needed the growth and rising national income if it were to solve the Malay economic dilemma. "By the early 1980s, Malaysia had developed the managerial skills and expertise to go forward, including an entrepreneurial class," said Mahathir. "That did not exist in the 1960s and 1970s. Thus, in those years, you had to have stronger state control. Once these were in place, however, you could pull back and leave it to the private sector and the markets to perform." He continued, "The real concern was the drain and limitations of government resources."

Between 1984 and 1986, a Mahathir-appointed national commission developed the rationale for privatization. "We said it was not the business of government to be in business," explained Mahathir. "The private sector would be the primary engine of growth." The actual privatization has not been laissez-faire, however. The government has continued to hold large, even controlling, stakes in many firms. Asset sales were often far from transparent. The beneficiaries, critics said, were prominent Malay businessmen with connections to the ruling party. The government replied that all it was doing was picking "winners"—people who would make a success of the partly privatized companies. And it included among the beneficiaries the broader Malay population, which acquired stakes in the firms through state-sponsored pension and trust funds. These funds mobilized a form of popular capitalism, giving ordinary people a stake alongside the insiders. Mahathir codified the shift in government strategies in a new program, the National Development Policy and Vision 2020, which aimed at 7 percent annual growth, meaning that the GNP would double every ten years. In this enterprise, the private sector would operate in close "partnership" with the government.

Yet events would soon show that this logic cut two ways. The tight, cocoonlike coordination of government and business bolstered Malaysian confidence and pride as long as it delivered its impressive economic results. But when the regional financial crisis deepened into recession, Malaysians were shocked and poorly prepared. The country seemed to flounder, unsure what course to take and how much to question its own economic organization. At the heart of this quandary perhaps lay something deeper than suspicion of global speculators and fast money. For Malaysians knew they had something precious to preserve: their hard-won social and ethnic harmony, the product of nearly three decades of spreading the benefits of growth.

The crisis exposed underlying structural weaknesses in the economy, particularly in the financial and corporate sectors, and threatened to undermine these achievements. Indeed, the losses were staggering. Following several years of sustained over-7-percent growth, in 1998 Malaysia's real GDP fell by 7.5 percent. Labor market conditions deteriorated and poverty increased. As the crisis deepened, tension grew between Prime Minister Mahathir and his more reformist deputy, protégé of seventeen years, and heir apparent, Finance Minister Anwar Ibrahim. Anwar was dismissed in September 1998, arrested, and sentenced to a combined fifteen years' imprisonment on various charges. The disclosures that followed this drastic change in relationship between Mahathir and Anwar alienated many Malays, causing disillusionment with the judicial system and resulting in protests and clashes with police.

Nevertheless, only two years later, Malaysia was back in the saddle. The key factor behind the country's speedy recovery was the fact that in many respects Malaysia's economy had been run relatively soundly prior to the crisis. Malaysia's bank regulation had been more prudent and therefore prevented its banks from getting into as much trouble as South Korea's and Thailand's. By 2000, thanks to its strong export industry and flexibility of labor markets, the nation reached precrisis levels of growth without a buildup of unsustainable public-sector debt. The speed of the recovery prevented a deep and lasting reduction in living standards, and the negative impact of the crisis on the poor was less than had been feared—and much less than in Thailand, South Korea, or Indonesia. Malaysia launched a comprehensive program of financial-sector reform, which included credit-risk management and consolidation of the banking sector. Revisions to bankruptcy legislation and establishment of new courts have moved Malaysia closer to international "best-practice" standards. Like many countries in the region, Malaysia is facing a slowdown in demand for electronics and a resulting decline in GDP growth. But Malaysia's economy is broader-based than that of many other tigers and is likely to withstand the downturn relatively well.

Malaysia's seventy-six-year-old leader continues to criticize the institutional arrangements of the global market and to defend his own brand of intervention. "Market is all about making as much profits as possible," he said to visitors in the presidential place. "What happens to people is irrelevant to the market. . . . There must be a balance between a free market and some regulations which are essential in order to safeguard the interests of consumers and of people in general." Yet he recognized that it is Malaysia's taking on a role in the globalized world that has brought a much higher standard of living: "There is no question of opting out. The fact that you don't accept certain ideas doesn't mean that you step off the world. In our case, we rejected some of the ideas that have been accepted by the whole world because we think our own ideas could solve our problems. But we are dependent upon the rest of the world. Our trade is a hundred and forty percent of our GDP, you see, so we need the world. We cannot step off the world."[10]

Asia, Inc.

Matching the transformation in Malaysia, Singapore, and Taiwan are similar stories of dramatic change in national economic prospects and standards of living in most of the other countries of East and Southeast Asia. And indeed, as export-led growth in each country engaged a seemingly virtuous cycle of intraregional trade, demand for increasingly complex goods, and more growth, a truly regional economy came alive. It embraced, subsumed, and linked together more and more countries with more and more demographic, social, and economic diversity, but all these countries participated in some way in the apparent "miracle" of export-led and widely shared growth. A transformation was under way from "Countries, Inc." to "Asia, Inc.," the new regional integrated economy, which, in the long run, will be a central fact of the twenty-first century.

Yet each country's history and political culture—as well as its resource base and demographics—refracts in particular ways the "Countries, Inc." approach and, in the face of challenges, beckons different prospects of adaptability, flexibility, and future success. In Indonesia, the government-market relationship was negotiated and questioned in the context of a long conflict between two groups of technocrats—the "engineers," who wanted to undertake big, high-visibility projects, and the "economists," who wanted to reduce government control and intervention. Unlike Taiwan, Indonesia was unable to resolve that clash until the late 1980s, when the country made a major turn toward the international market and deregulation. It was certainly influenced by the opening up of other countries in the region. Its major objective was to free itself from excessive dependence on oil and gas exports. "Bureaucrats must take on a new role," said Ali Wardhana, one of the leading Indonesian economists, at the time. "Instead of intervening to control private economic agents, bureaucrats need to avoid intervention and facilitate private activity."[11]

The program helped make Indonesia a high-growth country that successfully moved toward being a significant diversified exporter and away from a heavy reliance on oil and natural gas exports. But with 203 million people spread over seventeen thousand islands, Indonesia did not have the same kind of focus that the smaller Asian countries enjoyed. It faced major questions about regional development, the link between education and economic advancement, the prominent role of the Chinese entrepreneurs, equity and income distribution, and high-level corruption. Its political system became a new target for international human rights activists.

In what seemed a partial victory for the critics and activists, early 1998 saw the departure of General Suharto, who had taken power in the face of an imminent communist coup in 1965 and had maintained control through an essentially one-party system ever since. The turmoil of Asia's vast financial and economic crisis had pushed resentment of Suharto's autocratic style—and of the enrichment of his family members—beyond the point of recovery. Although discontent had simmered periodically in the past, the crisis—rapidly translating into diminished living standards—brought students and the middle classes into the streets of Jakarta on an altogether different scale. For several weeks the elite considered its options, while Suharto held out. But then the turmoil deepened. Student demonstrators were killed. Anti-Chinese riots broke out. Suharto's support was gone. In May 1998, he dramatically stepped down, after thirty-two years in power, appointing a longtime adviser, B. J. Habibie, to succeed him. As Habibie struggled to entrench his own legitimacy, he took aim at the personal fortunes and business empires that people close to Suharto—most of all Suharto's own family—had built through monopolies and cozy preferential treatment of all sorts. But no one forgot that Habibie was also the leading luminary of the "engineers" faction of the Suharto regime—those associated with big infrastructure and prestige projects, not prudent fiscal management and government with a light touch.

After thirteen months in power, in May 1998, Habibie was forced from office. The following month, Indonesia held its first democratic elections in forty years, electing Abdurrahman Wahid, a charismatic Muslim cleric more popularly known as Gus Dur, as its fourth president. His vice-president was Megawati Sukarnoputri, his rival in the campaign for the presidency and daughter of Indonesia's founding father and first president, Sukarno. But Gus Dur's presidency was marred by corruption from the beginning. He showed little interest in the economy, reportedly falling asleep during cabinet meetings on the subject. The restructuring of the main conglomerates was put on hold, as was the banking and financial reform, leaving the country struggling under the burden of debt, tightened liquidity, and weakened currency. After less than two years in power, Wahid was impeached on accusations of corruption, and in July 2001 Megawati became president.

Megawati's first-step was to put together one of Indonesia's best and most widely respected technocratic cabinets since the late 1980s. The new government put economic reform and macroeconomic stability back on the agenda, inspiring hope that the first turnaround in the last five years might be coming. The challenges facing the new government, however, are daunting. Indonesia had suffered one of the deepest recessions in the region during the Asian financial crisis and, in contrast to the other countries, never fully recovered. The country's outstanding foreign debt is more than twice its annual exports. Separatist movements, which have already resulted in the loss of East Timor, continue to threaten the country's territorial integrity, just as political turmoil, communal violence, and Islamic fundamentalism continue. Even with the best economic team in power, Indonesia's road toward recovery and cohesion will be a long one. Confidence will not be quickly rebuilt.

Thailand's growth after the mid-1980s was propelled by foreign investment, led by the Japanese. The country went through some tough political battles, centered on a struggle for power between various military and civilian groups. But Thailand is unique among the countries in the region in that it has had a king, Bhumibol Adjulyadej, who has ruled for half a century and provided continuing stability and legitimacy—and moral conscience—through the various crises. Thailand is a classic case in which the infrastructure—roads, and pollution control, for example—has not kept pace with the rapid rise in the GNP.

Since the early 1990s, the government has sought to reduce its role in the economy through large-scale privatization. "The policy of privatization was carried out for two reasons, necessity and prudence," said former prime minister Anand Panyarachun. "State companies needed the injection of more state funds if they were to survive and grow. The state could not afford to do that even if companies were profitable. The public was demanding leaner government, getting rid of the fat, and did not want to see state-owned companies to be continued as state employment agencies without any productivity effect or long-term potential." Anand spoke of another force behind the move toward privatization: "The timing of the end of the communist system was also a major factor in propelling the global trend toward the free market. All fears of capitalism's failures and my belief in the dominance of the state were cast aside with the collapse of the communist state and, with it, of government control."

But the Asian financial crisis put a halt to the reform. The crisis revealed profound underlying weaknesses in the system and disturbing levels of corruption. The consequences of the crisis proved tragic for the country. The dramatic advances of the previous decades in poverty reduction came to a halt. Poverty incidence increased sharply, leaving close to 10 million people living on less than $1.50 a day. Although growth resumed in 1998 and a set of political and economic reforms was undertaken to address systemic problems, the recovery proved fragile. The downturn in the global economy stemmed the demand for Thailand's electronics exports. The reforms had been far from decisive, and the economy continues to struggle under the mountain of nonperforming loans and mounting government debt.

The country for which communism remains the central fact is Vietnam. With a population bigger than Taiwan's, Korea's, Malaysia's, and Singapore's combined, it is poised to enter the league of the fast growers. It has a well-educated population and, in many ways, the attributes to spur growth. Yet its transition is likely to be more difficult than those of the other countries in the region, for the system's legitimacy and ideology are rooted in the Vietnam War and a hostility to capitalism and the West. To embrace the market would be to call into question the fundaments of the regime, which is hardly something that the current leadership wants to do. Thus, for the time being, Vietnam is suspended between state domination and private initiative. There is a market system, but the private sector has not been freed up, nor has reform of state enterprises begun in earnest.

A sure sign that East Asian growth was a comprehensive, regional phenomenon came from the Philippines. For many decades, the country operated far beneath its economic potential. Social inequalities were extreme. The government was a dictatorship of the landed elite, with the notorious and profligate Ferdinand Marcos at the helm. Unlike other authoritarian leaders in the region, Marcos rarely channeled his ill-gotten wealth back into the local economy. Instead, he and his cronies stashed it in Swiss banks and spent it overseas. The thousands of pairs of shoes belonging to his wife, Imelda, came to symbolize the corruption of the system.

Marcos fell in 1986, overthrown by the popular front led by Corazon Aquino. Her husband, Benigno, an outspoken opponent of Marcos, had been assassinated three years earlier by Marcos gunmen when he landed at Manila's airport. The Philippines remained a suspect destination for trade and investment, its chronic corruption and disorder contrasting with fast growth elsewhere in the region. Yet the peaceful political evolution under Mrs. Aquino and her successor, Fidel Ramos, set the stage for the Philippines to claim its connection to the rest of Southeast Asia. Aquino and Ramos brought economic policy into line with their regional partners. Thanks to freed currency markets and the lowering of trade barriers, the black market became less pervasive.

However, several years of sustained fast growth and great progress toward ending chronic energy and infrastructure shortages were cut short by the Asian financial crisis. The quick succession of presidents from Aquino to Ramos, to Joseph Estrada, to Gloria Macapagal-Arroyo in the space of just a few years contributed to political uncertainty. Macapagal-Arroyo, who is an American-educated economist and strong proponent of globalization (and a self-described admirer of Margaret Thatcher), views reform as one of her primary goals. "The lack of confidence among investors," she said, "is the result of a perceived lack of transparency and of a level playing field. So what is the antidote to this? Transparency and a level playing field!" The challenges are daunting. Macapagal-Arroyo inherited a widening fiscal deficit and growing public debt; structural weakness in the banking and corporate sectors; financial-market weakness, and a deterioration in public governance and accountability. These conditions have been exacerbated by the global downturn in the electronics industry, which accounts for 60 percent of the Philippines' exports. Nevertheless, the reforms instituted by Aquino and Ramos made the Philippine economy much stronger—a fact that was proven in the country's fairly resilient response to the Asian financial turmoil. Now there seems to be once again—for the first time after many years—a genuine consensus for reform. Persistent challenges notwithstanding, the Philippines has closed the gap on its neighbors—a gap to which some had thought the country was "culturally" and inexorably fated.

All this points to a regional economy—an Asia, Inc.—that is more diverse than its individual components but in which all the countries are linked to common economic threads—and increasingly, subject to common threats.

Perhaps the greatest single factor in forging this regional economy was the wave of Japanese investment that swelled across Asia, seeking lower costs, in the middle 1980s. The flow accelerated after Japan's huge shopping spree in the United States and Europe came to grief. It has made Asia into an export platform—as well as a market—for Japanese companies. "Japanese investment was a catalyst for change," said Anand Panyarachun, Thailand's former prime minister. "Thailand decided to establish competitive terms to attract Japanese investment in our country rather than see it go to Malaysia, Indonesia, or elsewhere in Southeast Asia. It was a decisive policy to seek that investment yen and to create a more open economy for foreign investment. It represented a conscious move on Thailand's part to try to help establish a regional market and to be part of it."

Japan's capital exports did much to tie the Asian economies together, but Korea, Taiwan, and Hong Kong have also become big investors throughout the region, seeking, like the Japanese, lower costs. Trade within the region has grown quickly as these countries become important markets for one another. Companies and entrepreneurs have been increasing their own cross-border stakes, while the rise of locally based multinationals is also tying the region together. Meanwhile, rapid economic growth has turned tens of millions of people into consumers. The growing demands for choice and quality of life are shifting the economic rationale of societies from a producer logic to a consumer logic. Many of the Countries, Inc. have relatively small populations, so the regional Asian economy gives them access to a larger market, of which they are part, which helps them get to scale.

Something else provides unique sinews for the regional economy—the connections among the *hua ch'ia* ("the Chinese across the bridge"), the ethnic Chinese who live, trade, invest, and collaborate across the region. They have proved to be a major force, tying economies together as well as lessening government control. An estimated 25 million Chinese live in Southeast Asia. They make up 32 percent of the population in Malaysia, 15 percent in Thailand, 4 percent in Indonesia, and 1 percent in the Philippines. The ethnic Chinese have an inordinately large entrepreneurial and commercial role; they boast twelve families worth $5 billion or more and are estimated to control at least $2 trillion. They are famous for doing their deals without contracts, lawyers, bankers, and consultants—even when values run into the billions of dollars. Kinship-based rules of the game assume the role that contract law performs elsewhere, facilitating trade, investment, and the movement of capital. Their collective GNP—a somewhat metaphorical concept—has been estimated at $450 billion, which would make them, as a separate country, the world's ninth-largest economy.

Mainland China, too, is increasingly becoming a new unifying force in the region. East Asia's smaller economies have viewed China's rise with some alarm—and with a reason: China gets nearly four fifths of all foreign direct investment into the region (the reverse of FDI trends in the mid-1990s). Its exports, whether in textiles or electronics, are cheaper and, given its vast labor pool, are likely to remain that way. But the other side of the coin is that China is also proving to be an economic engine for the region. China's economy is significantly broader-based than those of its neighbors and is much less dependent on exports. During the Asian financial crisis, China's ability to take in the tigers' exports did much to accelerate their recovery. A similar pattern became apparent in 2001: in the first four months of the year, when the U.S. demand for Asia's electronics plummeted, China's imports of electronics and other goods from the rest of the region grew by 16 percent compared to the year before. In fact, some believe that China is likely to replace the United States in the near future as the top market for Asian exports. Economic ties among the East Asian economies are likely to become stronger as a result of China's and Taiwan's joining the WTO, which means that China's strength will continue to help propel the rest of the region toward growth.

While the regional development is testament to the success of Countries, Inc., it also reduces the ability of nations to continue to run themselves as Countries, Inc. It becomes more difficult to deploy government knowledge and to exert a guiding hand, for the span of economic activity—investment, alliances, trade, market development—extends beyond the borders of national sovereignty, and thus beyond the ability of governments to manage and intervene as they did in earlier and, by comparison, simpler times. The result is a new mixture, featuring greater privatization and deregulation, fewer rules, less control, and reduced protection. At the same time, governments are facing pressure to take on the new role of coordinator of economic relations among the nations of the region. The current framework for cooperation is ASEAN, the Association of Southeast Asian Nations, which grew up during the 1970s and 1980s as a political bulwark against communism in China and, more so, in Vietnam. Its vocation is no longer exclusively political. Indeed, ironically, Vietnam is a recent admittee.[12]

The End of the Miracle?

Regional integration brings new risks. Asia and the world learned this lesson with devastating impact when Thailand's baht currency collapsed in July 1997. Though little known up till then outside the region, the baht would shortly become world famous. For its collapse triggered a series of financial crises that swept through the region, generating the economic collapse of the "tiger" economies, then reverberating as far as Russia and Brazil and leading to the disintegration of one of the world's largest hedge funds, Long-Term Capital Management, and the freezing up of credit in the United States.

All this became known as "contagion"—an epidemic of crises that threatened the health of the world's financial system and indeed the overall world economy. And all this began, improbably enough, in one corner of the world economy, the wildly overbuilt condo and office building market of Bangkok. The starting point was the way the Thai baht was valued internationally. The baht was set at a fixed and what became an unjustifiably high exchange rate with the dollar. Local banks and finance companies borrowed enormous amounts of short-term money at market rates from international banks and lent it out at higher interests to domestic borrowers, fueling a fiendishly speculative construction boom. But it was becoming increasingly clear that the baht was overvalued. Those in Thailand who saw a coming devaluation started moving their money out of the country. Hedge funds began to bet that Thailand's fixed-rate currency peg was unsustainable and the country would have no choice but to devalue. On July 2, 1997, after using $33 billion in foreign reserves in an attempt to defend the currency, the government did devalue, thereby sundering the currency peg to the dollar. This devaluation broke the bubble and exposed the weaknesses of the local banks and financial institutions, which had borrowed overseas to finance the construction boom. Now, as the baht sank in value against the dollar, the repayment obligations skyrocketed. Fearing further devaluation, international banks and emerging market investors fell all over each other, rushing for the door and pulling out their money as fast as possible—which only further weakened the baht. As the crisis reverberated through the Thai economy, it rapidly led to bankruptcies and layoffs and a deep economic downturn. The condos and office buildings stood empty, silent testament to the boom that had gone bust—and to the shattered ambitions and hopes.

In different forms, the same drama would be repeated through much of Asia, sometimes with dizzying speed. Within weeks the Malaysian ringgit, the Philippine peso, and the Indonesian rupiah were all under siege. By the time the IMF announced a $17.2 billion support package for Thailand—barely a month and a half after the crisis had erupted—it was already too late. Regional stock markets began a dramatic collapse in value, while the currencies continued in what now seemed to be a free fall.

But it was not until November 1997, when the contagion hit South Korea, that it became apparent that the regional crisis could go global. For Korea was the world's eleventh-largest economy. It had borrowed enormously from international banks, and now its currency, the won, was under severe attack. As Korea's situation continued to deteriorate, the crisis turned into a panic—and a rout. Stanley Fischer, then deputy managing director of the IMF, hurried to Korea. "I got imprisoned in my hotel room," he recalled. "I couldn't move out because as soon as I opened the door, there were ten thousand photographers. It was a state of panic, and it was at that point that I went to the Korean Central Bank and asked to be shown how much money the bank had left." He was shocked by what he saw. "It was essentially all gone."

At that point, with reserves down to the last few billion dollars, money was pouring out of the country at the rate of $1 billion a day as Korea continued defending the won. "It didn't take a great deal of quantitive insight to see that that was not a long-term viable solution, not a long term viable solution," Robert Rubin, at the time secretary of the Treasury, later dryly remarked. To put it more simply, disaster loomed. Korea devalued and by early December negotiated a $55 billion package from the IMF and other nations. But it was not enough. Banks that had lent to Korea were not rolling over their loans, and Korea's reserves continued to flow out of the country. "The last week of December was very, very, very risky," Rubin would say—"the most concerning moment" of the entire crisis. "I think that the world may have been very close—far closer than almost anybody realized—to a very severe crisis in the last week of December of 1997. There was a very real chance you could have had a default in Korea, the eleventh-largest economy in the world. And that could have had far broader and more dangerous effects around the world."

With virtually no time left, a new rescue program was initiated. What Korea needed was not a bailout, but a "bail-in." The IMF and the United States were prepared to put up large resources to bolster Korea. But all that would be useless unless the banks agreed to keep their money in Korea and roll their loans over. Rubin and other finance ministers personally called the heads of the major banks. The president of the New York Federal Reserve Bank, William McDonough, assembled some of them in the Fed's boardroom in lower Manhattan. His advice to the CEOs, said McDonough, was that "there should be no additional public-sector money for Korea unless you guys reschedule the debt." The message was the same around the world. As Rubin summarized it: "None of this is going to work unless the banks and the investment banks could work out their programs of deferring obligations." In other words, if the loans were not rolled over, something that went by the rather clinical name of "systemic failure"—otherwise known as a global financial collapse and perhaps a world depression—could ensue. On Christmas Eve, the IMF released a statement that the rescue funds to Korea would be accelerated. It added something else: "international bank creditors" would roll over or extend their loans. The bankers had understood the alternative; they were mostly now on board. And the rest would go on board over the next several days. The worst moment in Asia's crisis was over.

The most striking aspect of the crisis was its very unexpectedness. In contrast to Latin America's "lost decade" or Africa's debt crisis, this crisis had struck a region that seemed to have its macroeconomics under control and that had sustained decades of rapid growth. In 1996, $100 billion of foreign investment had flown into East Asia. In 1997, $150 billion flew out. A Hong Kong investment banker recalled the shock of the first few months of the crisis: "Asian businessmen, politicians, and the foreign investors didn't even think that there was a possibility that money might flow out of Asia. That's why the 1997 crisis was so amazing and so heartbreaking for everyone. Most Asian corporations and individuals were known for their high savings and for their hard work and for not overspending. People never thought that there could ever be a crisis in Asia. Certainly no one had forecast the domino effect."

The crisis generated many recriminations. By far the most vocal came from Mahathir Mohamad. Malaysia's prime minister heaped calumny on hedge funds and blamed international speculators for "villainous acts of sabotage" and "the height of international criminality." At the September 1997 joint IMF/World Bank meeting of international bankers in Hong Kong, Mahathir went on to say that "currency trading is unnecessary, unproductive and totally immoral; it should be stopped; it should be made illegal"—a statement that immediately sent the Asian currencies and stocks further down. But, the acerbity of his comments notwithstanding, Mahathir did express the shock that many in the region felt on discovering not only their exposure but their vulnerability to the volatile and sometimes drastic movements of money in an integrated global financial system. As they saw it, the crisis had wiped out 20 or 30 percent of the national wealth that had been laboriously built over several decades, decimated the middle class, and thrown millions of people into unemployment.

But what had caused the contagion in Asia? Two major explanations emerged. One held that the contagion was essentially a panic, a run on the bank. As lenders and investors saw weakness develop in one country, they began to pull their money not only out of that country but also out of neighboring countries. As so often happens, the panic was a self-fulfilling prophecy. According to this view, the policy response of the IMF, especially in the early stage, made the crisis worse. Extremely high interest rates, encouraged by the IMF, forced borrowers into bankruptcy, causing a freezing up of economic activity and turning a panic into deep recession. The reply to this was that, without high interest rates, the currencies would have continued to weaken.

But the panic did not take place in a vacuum. The alternative explanation described the "bank run" as a symptom of deeper ailments and attributed the crisis to structural weaknesses. The instigating factor of the crisis had been the buildup of short-term and often poorly secured borrowing from abroad and the attacks by hedge funds against the local currencies. But as the "first crisis of globalization" spread throughout the region, it exposed the previously concealed or overlooked frailties of the tiger economies—particularly the combined structural weaknesses in the financial sector and the corporate sector. Capital controls had been removed in such a way as to encourage the flow of short-term money, rather than more stable long-term investment. Borrowing had gone to extremes. Although hedge funds were often blamed for the crisis, the real transmission mechanism was short term bank lending—in the words of economist Carmen Reinhart, Asia's "key form of hot money." The greatest proportion ($97 billion) of short-term capital had come from Japanese banks, which had been searching for better business than they could find in the depressed economy at home. European banks (at $85 billion) were not far behind, followed by U.S. banks (at $24 billion). To exacerbate the problem, much of the money that had been borrowed short term was then lent out long term. Since transparency was lacking and bank supervision poor, the magnitude of the debt buildup was not recognized until it was already too late. As a result, when the banks grew panicky and stopped rolling over loans, crisis became virtually unavoidable.

Underlying all this was what critics began calling "crony capitalism"—what they maintained was the flip side of the Asian economic miracle. This was the overly cozy relationships among banks, business, and governments that led to favoritism, sweetheart deals, speculation, corruption, poor corporate governance, and overinvestment. The manifestations ran from the hundreds of millions of dollars of unsecured lending to a taxi company in Jakarta that just happened to be controlled by the daughter of the country's president to the government-directed investment in industrial overexpansion in Korea. The consequence was lack of prudency, transparency, and sound economic foundations. The countries did not have sufficiently effective legal and financial institutions and regulation to provide buffers for their increased integration into the global capital markets. "It was an article of faith that all these countries would thrive and prosper if they opened themselves up and allow free flows of trade investments, currencies, people, ideas, machines—everything," observed James Wolfensohn, the president of the World Bank. "But it assumes that you have the administrative machinery or the system in place which can prevent yourself from being demolished when you have a withdrawal of capital." When the doubts about the sustainability of the Asian miracle surfaced, foreign investors became increasingly concerned about all these factors—East Asia's financial fragility, corporate indebtedness, management failings, overcapacity in key manufacturing subsectors, and extreme dependence on exports. Underlying these concerns was the apprehension that the competitive strengths of these nations were eroding in the face of rising wages and a new intensified competition.

And they were right. Asia had become the showpiece of global economic growth, which generated a confidence that turned into complacency and overconfidence. Some Asian leaders had taken to lecturing the rest of the world on what they saw as the innate superiority of "Asian values" and argued that "Asian capitalism" was something different and better. Outsiders looked at Asia and saw the future. "If we're not in Asia by tomorrow," one CEO said in the mid-1990s, "we're too late." The optimism fueled the booms in investment and construction. But the confidence overlooked the fact that competitive pressures on these countries were growing—not only from countries farther down the chain, such as Bangladesh, but specifically from China, whose de facto currency devaluation in 1994 had further increased its competitiveness. These countries were losing market share to China, which meant that their export sectors were vulnerable. And the growth rates would be lower than implied in the flow of funds and investment and the accelerating speculation.

The crisis sparked dramatic political repercussions. The brutal halt to sustained growth confronted an entire generation with its first experience of recession—and in some countries depression—in the process shattering some illusions and eroding the credibility of political leaders. The crisis sent millions back into poverty—a tragic reversal of East Asia's impressive achievements in fighting poverty during the preceding decades. Along with the insolvent large corporations, many family-owned businesses across the region went bankrupt; savings were wiped out, and a new middle class was set back enormously. In Indonesia the very social fabric of society collapsed as a result of the crisis, bringing in its wake economic dislocation, ethnic violence, and the threat of secession. But the deepening of the crisis also coincided with—and in many cases drove—political change, with elections in Korea and the formation of a new coalition in Thailand. There the new leaders benefited from a window of opportunity to force mergers, bankruptcies, and financial-sector restructuring. In order to improve their balance of payments and financial credibility, many governments quickly took the opportunity to cut back on expensive and wasteful investment projects.

The crisis forced the long-delayed macroeconomic restructuring. The devaluation of currencies renewed the competitive position of Asian exporters in the world market. And the region tried to diversify its economies away from electronics exports and took measures to boost domestic demand. Improved corporate governance, increased market discipline, and tighter financial surveillance mechanisms increasingly became a focus of reform. But the recovery proved uneven across the region. Moreover, even in the countries that had witnessed spectacular recovery, the drive for reform frequently fizzled, leaving in place many of the structural problems in the financial and corporate sectors that had led to the crisis in the first place. Governments were slow to tackle politically sensitive privatizations, while insolvent corporations continued to drag the economies down.

Despite having found themselves at the epicenter of the world's first global contagion, there is a full realization in the region that without regional and global integration growth is impossible. "Asian countries that have grown fastest—Korea, Hong Kong, Singapore, China," observed Stanley Fischer, "have been the ones that have recognized that by integrating into the world economy, by exporting, by relying on import markets, and gradually opening up they can do much better." Work on increasing regional integration has accelerated after the crisis. Together, the East Asian countries make up a market comprising more than half the world's population. Half of East Asia's trade takes place within the region. Although such interdependence had proven dangerous during the crisis, it became a blessing during the recovery, with each country boosting the others' growth. Many of the countries have great strength in high-tech and information technology. Asian expatriates, who have been making careers in high-tech sectors overseas, have taken back technical and managerial know-how. The countries have good education systems that focus on math and science. English is fast becoming a widespread language.

So was the crisis the end of the East Asian miracle era? After a period of rapid growth, East Asia has entered a period of gradual and uneven change and reform in both economic arrangements and politics. More sustained recovery will require the revitalization of the values and attitudes that did so much to power thirty years of industrial development and social and economic progress—and that may have been, for all the pains of growth and transition, little short of miraculous. Most of the countries did, in fact, come out of the crisis more quickly than anticipated. They benefited from the boom in information technology, computers, and telecommunications. Their exports surged, especially to the United States. But then the United States went into a recession, part of a synchronized global downturn. Asia's export industries went into their own steep slide, and with that so did their economies. The Asian countries, their reforms either only partly implemented or stymied, faced a new crisis—not a financial contagion, but a worldwide economic slump. It would be a new test for a region that had found its destiny not in dominoes, but in the global economy.[13]

Becoming "Relevant to the World"

In 1959, when Lee Kuan Yew assumed office as Singapore's prime minister, he was only thirty-five. What would follow was more than thirty years of struggle against almost insurmountable odds to make Singapore first an independent country—and then an affluent one. "When we started in 1959," Lee wrote forty years later, "we knew little about how to govern, or how to solve our many economic and social problems. All we had was a burning desire to change an unfair and unjust society for the better. To do that, we had to win political power. Having gained it, we had to retain the support of our people to continue our unfinished job."

At the start of Lee's career, Singapore's per capita income was $400. By the time he left the office in 1990, it exceeded $12,000; by 1999, it stood at $24,000. Throughout his thirty-one years in office, Lee would prove himself as one of Asia's outstanding modern leaders. He presided over the building of a multiracial, multilingual society unified by a sense of a unique Singaporean identity out of a disparate collection of agricultural communities divided by race, language, and religion. International investors were tirelessly courted, first to bring manufacturing to Singapore and then to upgrade the economy from mass manufacturing to high-tech industry. Singapore developed the region's finest infrastructure of airport, port, roads, and communications networks. Lee led in the creation of a modern country, which, squeezed at the very tip of the Malay peninsula and measuring a bare 640 square kilometers, is a leader in electronics and information technology industries, a country with the highest per capita international trade dependency and the best health and education system in Asia.

Singapore's survival was never a given. It took confidence and vision—as well as organization and tenacity—to fight against third world poverty, British colonialism, brutal Japanese occupation, communist insurgencies, entrenched criminal gangs, and bloody communal riots. For Lee, it meant a lasting lesson that he wants young Singaporeans to remember: "We cannot afford to forget," he wrote in his memoir, *From Third World to First,* "that public order, personal security, economic and social progress, and prosperity are not the natural order of things, that they depend on ceaseless effort and attention from an honest and effective government that the people must elect."

On a recent afternoon, Lee could be found at the Singapore government's official residence. The sun was streaming through the tall windows of the spacious conference hall, reflecting in the crystal chandeliers and bouncing off the mirrors lining the walls. After a tumultuous career following a dramatic rise in his country's fortunes, Lee could say that his main objectives had been achieved—perhaps much more than he might have ever imagined. Singapore was an independent country that was among the world's most affluent nations. The world had come to depend on Singapore as much as Singapore had come to depend on the world. Lee had long come to view globalization both as a tremendous challenge and an opportunity: "The trading system which the victorious Western allies created after World War II," he said, "provided the backdrop, provided the framework for an exchange of goods, services, people, ideas, and capital that generated wealth." So how does a country prosper in today's globalized world? "That depends on the size of your economy and the group that you are with," said Lee. "The Japanese are a big economy, second-largest in the world. But they are alone. So they have a lot less leeway than the French and the Germans and the Italians, who are together with about fifteen other countries. As for a country like Singapore. . . . Our external trade is about three times our GDP. *Three times our GDP.* So when that external trade goes down, you cannot but feel the hurt. But it can't be helped, that's part of life. That's part of the global system."

He took a bigger view. "With the end of the British Empire," he said, "many trading outposts like Singapore had perished. We had to make ourselves competitive, even before we knew the word. We had to remake ourselves and become relevant to the world. Being relevant to the world—and as the world changes being relevant in spite of those changes—is the business of living. The countries that make themselves relevant become better off. Their people become better off. Those who opt out suffer."[14]