WHITHER (OR WITHER?) THE DEVELOPMENTAL STATE?

Globalization And The Asian Crisis

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(First draft. Please do not quote. Comments are welcome.)
When has the entire earth ever been so closely joined together, by so few threads? Who has ever had more power and more machines, such that with a single impulse, with a single movement of a finger, entire nations are shaken?

--German philosopher Johann Gottfried von Herder, 1774 (Rothschild 1999: 108)

All these countries have spent forth years to build up their economies and a moron like (George) Soros comes along.

--Mohamad Mahathir, Prime Minister of Malaysia, 23 August 1997 (Loh 1997)

The proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country. He would be apt to abandon the country in which he was exposed to a vexatious inquisition, in order to be assessed a burdensome tax, and would remove his stock to some other country.

--Adam Smith, Wealth of Nations, 1776 (Rothschild 1999: 113)

When fiscal and commercial barriers will have been abolished between different states, as they have already been between the provinces of the same state; when different countries, in daily relations, tend towards the unity of peoples, how will you be able to revive the old mode of separation?

--François-René de Chateaubriand, 1841 (Rothschild 1999: 114)

GLOBALIZATION: FIN DE SIECLE?

As the new millennium draws near, globalization seems to have provoked a "fin de siecle" debate. Proponents emphasize the benign and seemingly boundless promises this "new" epoch of globalization entails. They point out that modern computer and communication revolution has caused "the death of distance" (Cairncross 1998). Increased interactions among peoples around the world have made national borders porous, promising to transform the state-centered Westphalian international system into a "global village." Globalization has contributed to the emergence of a global marketplace and the rise of a "homogeneous" global culture that is essentially "the spread of Americanization on a global scale," declared The New York Times' foreign affairs

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1 For a post-Westphalian perspective on future international order, see Falk (1998).
columnist Thomas Friedman (1999: 8). Although the driving idea behind globalization, as some have argued, is free-market capitalism, "global markets, global technology, global ideas, and global solidarity" can still "enrich the lives of people everywhere," proclaimed the latest *Human Development Report* (UNDP 1999b). Thomas L. Friedman firmly believes that the "globalization system" has replaced the Cold War system; hence, "the world is 10 years old."\(^2\)

Critics, however, are less sanguine. Some are concerned that globalization may heighten communal and cultural conflicts (Barber 1995). Others fear that it will exacerbate the gap between the "haves" and the "have-nots" -- both between and within countries. The trade-off for interdependence is "sovereignty at bay": governments increasingly worry that external forces will undermine their ability to control the economies and to protect their citizens.

Still others question whether globalization is really new. In a thoughtful piece intended to put globalization in a historical context, Emma Rothschild criticizes that "globalization has been depicted, for much of the last 20 years, as a condition of the present and the future -- a phenomenon without a past" (1999: 107).

Indeed, if globalization is simply defined as "the intensification of economic, political, social, and cultural relations across border" (Holm and Sørensen 1995), it has happened before historically. Two scholars taking a long historical perspective argue that the current era is actually the fourth one in the world history of capitalism (Burbach and Robinson 1999: 11).

Based on their analysis, I have summarized the characteristics of each of the four

\(^2\) Friedman (1999: 7 and xiii). A very critical book review charges that Friedman "can't see anything in context" and he "doesn't believe in history" (Smith 1999: 30). This is a
stages of the world history of capitalism in Table 1. This table shows that despite their similarities, these four eras have their own driving forces, *zeitgeist*, and distinctive political events.

Table 1: Globalization -- *déjà vu?*

<table>
<thead>
<tr>
<th>Epochs</th>
<th>First (1492-1789)</th>
<th>Second (1789-1900)</th>
<th>Third (1900-1970s)</th>
<th>Fourth (1970s-present)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Duration</td>
<td>Discovery and conquest</td>
<td>Revolution, capital, and empire (Hobsbawn)</td>
<td>The &quot;Age of Extremes&quot; (Hobsbawn)</td>
<td>The &quot;information age&quot;</td>
</tr>
<tr>
<td>Age of ___</td>
<td>Mercantilism and primitive accumulation</td>
<td>Industrial capitalism</td>
<td>&quot;monopoly&quot; capitalism</td>
<td>Globalization (world capitalism)</td>
</tr>
<tr>
<td>Symbolic events</td>
<td>Columbus' &quot;discovery&quot; of the Americas</td>
<td>The French Revolution; England's 18th-century manufacturing revolution</td>
<td>World War I; Russia's Bolshevik revolution in Russia</td>
<td>The fall of the Berlin Wall; and the disintegration of the Soviet Union</td>
</tr>
<tr>
<td>Political manifestations</td>
<td>Capitalists emerging from &quot;feudal cocoon&quot;</td>
<td>Rise of the bourgeoisie and the nation state</td>
<td>Rise of financial industrial corporations; imperialist wars; and a socialist alternative</td>
<td>End of the Bretton Woods system; collapse of socialism; failure of Third World national liberation movements</td>
</tr>
</tbody>
</table>

Ankie Hoogvelt points out that three key economic figures are conventionally marshaled to attest to the increasing internationalization of the world economy: (1) world trade volume (in particular the allegedly rising ratio of world trade to output), (2) the growth and spread of foreign direct investment through multinational corporations (also expressed in relation to world output and trade), and (3) the expansion of all international capital flows (and their patterns of integration) (1997: 69).

Using these three criteria to construct credible longitudinal comparison, one can probably come to the same conclusion as the UNDP's *Human Development Report* (1999a: 30): "globalization is not new: the world was more integrated a century ago; very interesting twist of the "End of History" argument. See Fukuyama (1989).
trade and investment as a proportion of GDP were comparable, and with borders open, many people were migrating abroad." So, what's new this time?

Most analysts point out the revolutionary new technologies and the speed of change caused by these technologies. Rothschild thinks that "for both its admirers and its opponents, it [globalization] is associated with new and unprecedented technologies: the Internet, international capital markets, supersonic travel, cable news, and just-in-time deliveries across very large distances" (1999: 107). Barber argues that a new "McWorld" will emerge that "demand(s) integration and uniformity and that mesmerize(s) people everywhere with fast music, fast computers, and fast food -- MTV, Macintosh, and McDonald's -- pressing nations into one homogeneous global theme park, one McWorld tied together by communications, information, entertainment, and commerce (1995: 4). UNDP's 1999 Human Development Report suggests that what is really new about globalization is that it involves (1) new markets, (2) new actors, (3) new rules and norms, and (4) new (faster and cheaper) tools of communication.\footnote{For a complete list of these "new's," see UNDP (1999a: 30).}

The speed and affordability of communication are truly remarkable. For example, a three-minute call from New York to London in 1960 cost the equivalent of $46 in 1990 dollars, but in 1990 the cost for the same call dropped to $3. If we give the average cost of computers in 1990 an index of 100, the index for 1960 would be 12,500. The dramatic decline of cost and increase of speed inspires Friedman to draw the following contrast:

While the defining measurement of the Cold War was weight -- particularly the throw weight of missiles -- the defining measurement of the globalization system is speed -- speed of commerce, travel, communication and innovation. The Cold War was about Einstein's mass-energy equation, \( e = mc^2 \). Globalization is about Moore's law, which states that the computing power of silicon chips will double every eighteen to twenty-four months (1999: 9).
Are these new characteristics offering developing countries unprecedented opportunities or barriers? The answer to this question requires a reexamination of the world economic structure (hierarchy and division of labor) in light of the new dimension of this era's accelerated change. If indeed knowledge is power and rapid dissemination of information is crucial for development, as the World Bank's *World Development Report* (1999) points out (1999), then globalization -- especially the computer and communication technology -- has reinforced, if not widened, the differential in power between the Global North and the Global South.

If Internet epitomizes the current globalization, then Table 2 clearly shows that globalization is mainly an American phenomenon, and that it perpetuates and strengthens American power. The gap is so huge that one African official reports that "there are more phone lines in Manhattan than in all of sub-Sahara Africa" (Shapiro 1999: 20).

Table 2: Uneven Globalization
-- Internet Users by Regions (1998)

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage of world's users</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>57.00%</td>
</tr>
<tr>
<td>Europe</td>
<td>21.75%</td>
</tr>
<tr>
<td>Asia-Pacific</td>
<td>17.00%</td>
</tr>
<tr>
<td>South America</td>
<td>3.00%</td>
</tr>
<tr>
<td>Africa</td>
<td>0.75%</td>
</tr>
<tr>
<td>Middle East</td>
<td>0.50%</td>
</tr>
</tbody>
</table>

Source: NUA Internet Surveys (1998)
Asia is an important area to study. Until the outbreak of the 1997 financial crisis, this region had commanded attention and emulation. But some of the same star tigers are now frowned upon because of their sudden change of fortune. According to the world system theory, Asia was incorporated into the Western core-dominated capitalist system as the periphery (Wallerstein 1979). Consequently, their rise and fall have been closely related to globalization. This point should not be lost.

GLOBALIZING ASIA

Asia's rapid ascent has attracted much attention. Some analysts have used the expression "miracle" to describe the economic success of many Asian countries in the last three decades. Others firmly believe that there is an East Asian model of development that holds rich potential for other developing countries. Scholars have also long debated over how to explain Asia's economic success and whether this success story can be replicated elsewhere. A full treatment of this debate is beyond the scope of this paper. However, the discussions on globalization -- specifically the merits of participating in the international economy and the proper role of the state in economic development -- are very relevant to understanding Asia's economic development strategy.

Basically, there are two perspectives that offer competing explanations to the East Asian miracle. Table 3 provides a stylized comparison between these two main schools.

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4 Peter Berger helpfully reminds us that after all model is a term that has two connotations: "on the one hand it means a specific pattern or type, on the other it means an example to be emulated" (1987: 142).
5 In addition, there is an unconventional "no miracle" view. Paul Krugman, an economist at MIT, argues that Asia's rapid growth was mainly due to heavy investment spending,
Table 3: Two different stories of the East Asian miracle

<table>
<thead>
<tr>
<th></th>
<th>The Neoclassical view</th>
<th>The Revisionist view</th>
</tr>
</thead>
<tbody>
<tr>
<td>Main reason for success</td>
<td>Getting the prices (basics) right</td>
<td>Getting the prices wrong</td>
</tr>
<tr>
<td>Market vs. state</td>
<td>State follows the market</td>
<td>State leads the market</td>
</tr>
<tr>
<td>More concerned about</td>
<td>Government failures</td>
<td>Market failures</td>
</tr>
<tr>
<td>View on external ties</td>
<td>Positive: help obtain efficiency and gains</td>
<td>Positive: but should be regulated by the state</td>
</tr>
<tr>
<td>Roles of government:</td>
<td>• Investing in human capital</td>
<td>Fundamental plus selective</td>
</tr>
<tr>
<td>nature of policies</td>
<td>• Promoting private enterprises</td>
<td>• &quot;Financial repression&quot;</td>
</tr>
<tr>
<td></td>
<td>• Maintaining an open economy</td>
<td>• Industrial policies: subsidies, quotas, infant industry protection</td>
</tr>
<tr>
<td></td>
<td>• Maintaining macroeconomic stability (&quot;fundamental&quot; intervention policies)</td>
<td>• Export promotion</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Entrepreneurial roles</td>
</tr>
</tbody>
</table>

It is important to note that unlike the dependency school, which seeks to limit less developed countries' (LDCs) "exploitation" by the harmful international division of labor, both these two schools emphasize the benefits to LDCs of participation in the international economy. However, whereas the neoclassical school stresses that LDCs should participate based on their comparative advantage arising from natural factor endowment, the revisionist school points out that the state must deliberately but judiciously employ incentives to promote industrial development. Most successful Asian countries adopted an export-led industrialization (ELI) strategy. As a contrast, their Latin American counterparts that had adopted an import-substituting industrialization (ISI) strategy were less successful (Haggard 1990, Gereffi and Wyman 1990).

There is one other reason why the Asian economies have been more integrated with the world economy than other regions. That is, some scholars (e.g., Cumings 1987) have suggested a regional approach to better understand East Asia's patterns of development. Specifically, the development of regional political economy in East Asia not productivity growth -- a pattern similar to the Former Soviet Union. See Krugman (1994).
has followed a "flying geese" model. According to this model, countries gradually move up in technological development by following in the pattern of countries just ahead of them in the development process (Radelet and Sachs 1997). In this vision, Korea and Taiwan take over leadership in textiles and apparel from Japan as Japan moves into the higher-technology sectors of electronics, transport, and other capital goods. A decade or so later, Korea and Taiwan are able to upgrade to electronics and auto components, while the textile and apparel industries move to Indonesia, Thailand, Vietnam, and China.

Steven Radelet and Jeffrey Sachs argue that to some extent, the flying geese pattern can be seen as the natural outcome of market forces. This would imply that global economic forces also shape the patterns of industrialization in the region. But they also admit that "even the simplest labor-intensive products (apparel, footwear, electronics assembly) are part of a sophisticated international division of labor, one increasingly determined by multinational enterprises and technological designs created in the advanced economies" (1997: 52).

It is for this reason the neo-Marxist dependency writers contend that Asia owes its "success" to a temporary comparative advantage entirely based on the exploitation of cheap labor in such designated export platforms as "free export processing zones" with few linkages to the surrounding economy. This type of development, akin to what Peter Evans (1979) has called "dependent development" in the Latin American context, has resulted in deepening inequalities and marginalization. This position becomes known as

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6 The "flying geese" model was first developed in the 1930s by the economist Kaname Akamatsu to explain the pattern of industrial development in Asia. Some recent articles resurrect this concept to account for the relationship between Japan's foreign investment and the rise of newly industrialized countries (NICs). See Bernard and Ravenhill (1995) and Romm (1992). Bruce Cumings (1987) invoked the theory of "product cycle" to explain patterns of industrialization in Asia.
the new international division of labor (NIDL) thesis (Hoogvelt 1997: 204).

Ankie Hoogvelt asks whether the developmental state phenomenon in East Asia was historically specific, rather than culturally specific (emphases original). "The historical specificity of the 'model' relates to the external environment of the geo-politics of the Cold War and its unique conjunction with a certain phase in the development of capitalism on a world scale" (1997: 213).

Roger Burbach and William I. Robinson echo the NIDL view. They rebuke most of what they call "detractors of globalization" that focus on global trade, and therefore the market. Instead, they argue that "the process of globalization is driven by the transnationalization of production and capital ownership, which in turns leads to the rise of a transnationalized bourgeoisie that sits at the apex of the global order (1999: 7 and 15). "Global capitalism, therefore, is now represented in each nation-state by in-country representatives, who constitute transnationalized fractions of dominant groups," they assert (1999: 34). These leftist scholars fill in a very important void in this "groovy McWorld" interpretation of globalization: that is, it is important to consider the politics -- class, democracy, and civil society -- of globalization.

Politics is about authoritative allocation of scarce resources, and globalization entails distributional consequences, as it creates a new form of transnationalized bourgeoisie. One can even argue that modern computer and communication technology constitutes new means of production and creates new relations of production. It threatens to exacerbate existing class conflicts by increasing inequalities.

Stephen Gill (1999) offers an insightful neo-Marxist interpretation of the Asian

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7 That is why the latest Human Development Report calls for "globalization with a human face (UNDP 1999b)
crisis. He argues that the Asian crisis is partly attributable to geopolitics, namely, "the third phase of a longer process involving the reassertion of U.S. strategic dominance," which is reflected in the ideology of neoliberalism and the mechanism of the International Monetary Fund's (IMF) strict conditionality.

Therefore, to understand the Asian crisis, one must take into account these political and social factors -- at both systemic and subsystemic levels. With these cautions, we can proceed to discuss the relationship between globalization and the Asian crisis and speculate the future of the developmental state model in an era of the global economy that is embedded in neoliberalism.

THE ASIAN CRISIS: GLOBALIZATION GONE HAYWIRE?

Just how globalized has Asia become? Employing some of the most commonly used indicators in the study of globalization (i.e., growth of trade volume, trade share of GDP, growth of external debt, and external debt share of GNP), Table 4 shows that the Asian countries have become much more globalized in the last two decades. To the extent such increased exposure to the world market offers them more opportunities, it also makes them more vulnerable.

Several findings are in order. First, all these countries had experienced very large growth in merchandise trade between 1980 and 1996 (in current dollars). Trade indeed had been one important -- if not the -- "engine of growth." As is well known, Asian countries have become very important exporters of manufactured products.

Second, leading up to the onset of the Asian crisis in 1997, Thailand, the
Philippines, and Malaysia had become more and more dependent upon trade (i.e., foreign markets) -- measured by the percentage share of trade volume of gross domestic product (GDP). But other countries, such as Indonesia, South Korea, Taiwan, and Singapore had seen their trade dependence decline, despite growths in absolute numbers. This indicates the increased importance of their domestic markets. Hong Kong, historically an entrepôt, saw its trade share rise, mainly because of Mainland China’s rapid economic development and expanding exports since 1980.

Table 4: Globalization and Asia: Growing Trade Dependence and External Debt

<table>
<thead>
<tr>
<th>Country</th>
<th>Trade volume</th>
<th>Trade share of GDP (%)</th>
<th>External debt ($ billion)</th>
<th>External debt as % of GNP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Thailand</td>
<td>15.8</td>
<td>129.1</td>
<td>54</td>
<td>83</td>
</tr>
<tr>
<td>Indonesia</td>
<td>32.7</td>
<td>92.6</td>
<td>54</td>
<td>51</td>
</tr>
<tr>
<td>Philippines</td>
<td>14.0</td>
<td>55.0</td>
<td>52</td>
<td>94</td>
</tr>
<tr>
<td>Malaysia</td>
<td>23.7</td>
<td>154.2</td>
<td>113</td>
<td>183</td>
</tr>
<tr>
<td>South Korea</td>
<td>39.7</td>
<td>269.1</td>
<td>74</td>
<td>69</td>
</tr>
<tr>
<td>Taiwan</td>
<td>39.5</td>
<td>218.3</td>
<td>95</td>
<td>80</td>
</tr>
<tr>
<td>Singapore</td>
<td>43.4</td>
<td>255.9</td>
<td>440</td>
<td>356</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>41.7</td>
<td>379.3</td>
<td>181</td>
<td>285</td>
</tr>
</tbody>
</table>

Notes: ¹ Merchandise exports plus merchandise imports. Sources: Compiled and calculated from World Bank (1999: 228-31) and CEPD (1998: 204 and 213).

Third, not coincidentally, all of those countries worst hit by the Asian crisis had assumed significantly larger external debt burdens. In particular, Thailand and Indonesia had accumulated massive foreign debts, amounting to dangerous levels of GNPs. The bad experience of these Asian debtors shared many important similarities with the Latin American debt crisis in the 1980s. During that crisis, a combination of factors -- rising interest rates in the international financial markets, declining earnings from exports from these debtor nations, and pressure on these nations to devalue their currencies -- rapidly raised these nations’ debt ratios (export earnings / GNP) to unbearable levels, threatening a default. The crisis was only averted with the IMF’s intervention (Frieden 1991).
Even though the Asian countries has become increasingly globalized in terms of trade and debt, which is both their blessing and curse, globalization in Asia has also been quite uneven. Table 5 shows the disparate "information power" in Asia.

<table>
<thead>
<tr>
<th>Table 5: Uneven Globalization: Disparate Information Power</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Country</strong></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Thailand</td>
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<tr>
<td>Indonesia</td>
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<tr>
<td>Philippines</td>
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<tr>
<td>Malaysia</td>
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<tr>
<td>South Korea</td>
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<tr>
<td>Taiwan</td>
</tr>
<tr>
<td>Singapore</td>
</tr>
<tr>
<td>Hong Kong</td>
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<tr>
<td>China</td>
</tr>
<tr>
<td>India</td>
</tr>
<tr>
<td>Japan</td>
</tr>
<tr>
<td>USA</td>
</tr>
<tr>
<td>Finland</td>
</tr>
</tbody>
</table>

Notes:
1. The figures for South Korea, Taiwan, China, Japan, the USA, and Finland are as of 1998, using the following formula: (high estimate of all Internet users in 1998)/(1998 population). Compare figures in this column with caution, because the access to the Internet had expanded tremendously between 1995 and 1998.
2. The figure for Taiwan is an estimate, using the following formula: [(Units of desktop PCs produced in 1995) + (units of notebook PCs produced in 1995)] / (1995 total population). Compare figures in this column with caution. Admittedly many of these Taiwanese computers were exported. However, the UNDP data on other countries do not affirm they are for domestic use, not export.

Sources:
UNDP (1998: 167 and 193); pp. 167, 193; Computer Industry Almanac (1999); Figure 5.3 from World Technology Evaluation Center (1999); and Asiaweek (1999).

Most of the proponents of globalization are considered "technophiles" (Luke 1989). They often argue that the modern computer and communication technology is a hallmark of globalization. In this paradigm, what matters is a country's "information power," which depends more on access to computers and the Internet than on armament.

In fact, some scholars speculate that in the era of globalization, the state, if it
continues to exist at all, will become a "virtual state," which thrives on such ultra-mobile factor of production as knowledge or human capital. International relations, consisting of these virtual states, will be inherently peaceful (Rosecrance 1996). If this is true, then it is clear that not all Asian countries are equally promising.

It should be pointed out that as computers prices and Internet access fees continue to drop (rapidly), more and more people will join the cyberworld, and a few more countries can become the new kids on the information block. In particular, the initial increase for those countries that start out with a very modest base (such as China) can be exponential. Undoubtedly the advent of Worldwide Web in the mid-1990s was a powerful boost to the global population of Internet users. Table 5 takes into account population size, and compares the "information density" of select countries.

Finland, with a population of just over 5 million, is the "most wired nation" on earth. The U.S. has the most Internet users in absolute numbers (about 90 million) -- more than six times than that of the next, Japan.8

Not surprisingly, those NICs that have actively promoted the information technology (IT) industry, such as Taiwan and South Korea, fare quite well in terms of "information power." In particular, Taiwan decided in the early 1980s to promote the IT industry as a strategic industry in anticipation of these broad trends in technology and trade (Wang 1995/96; Lin 1998). On a per capita basis, it is now even more wired than Japan. However, in the long run, China seems to have limitless potential.9

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8 Computer Industry Almanac, Inc. (1999). The top 15 countries in Internet use in absolute numbers are: U.S., Japan, U.K., Germany, Canada, Australia, France, Sweden, Italy, Taiwan, South Korea, Spain, Netherlands, China, and Finland. Users in these 15 countries make up 90% of Internet users worldwide.

9 Computer Economics, Inc. forecast that China will have the second largest population (37 million) by 2005 -- behind the U.S. (126.6 million users) (NUA Internet Surveys
We can thus conclude that although all the East Asian countries have become much more globalized in recent years, they differ in their dependence on trade, external debt, and foreign investment. They also differ in terms of their information power. It appears that those countries that score low on "information power" are also the ones that were hardest hit by the Asian crisis -- albeit the correlation is only moderate.

The finding by Amartya Sen, the 1998 Nobel economics laureate, is pertinent here: Accurate information flows are necessary to prevent man-made disasters, such as famine. To what extent is a lack of transparency responsible for the Asian countries' downfall -- if it is considered a man-made crisis? And to what extent is that lack a result of their diminutive "information power"? From this standpoint we can understand why developing IT industry is so important for Asian countries: it not only produces new sources of growth, but also lays foundation for a more open and resilient society.

The effects of the Asian financial crisis were devastating. Table 6 shows some tangible effects of the Asian crisis on various countries. The currencies of these five affected countries plummeted against the U.S. dollar, beginning with the devaluation of the Thai baht in July 1997. And their economies went into recession. These two factors combined to shrink their gross national products (GNPs) -- in current dollars, but not so obvious in purchasing-power-parity.10

-- NEWSBYTES reports that China is expected to surpass Japan to become the largest Asian Internet market in user terms in 2001 when it is expected to have 40 million users. This estimate is based on the latest demographic figures from China's Xinhua News Agency, the official mouthpiece of the Communist Party, which calculated that 1.5 million were online in December 1998 (NUA Internet Surveys, 1999a).

10 Data from Economist (1999b) indicate that all of these five countries experienced contraction in 1998. Indonesia's decline was the steepest -- about 15%. These numbers are somewhat different from those in Table 6, due to the different periods of coverage: Table 6 covers August 1998-August 1999. The figures in Table 6 looks more favorable,
Table 6: Impact of the Crisis: Declining Currency and Dwindling Wealth

<table>
<thead>
<tr>
<th>Country</th>
<th>Exchange Rates to U.S. Dollars</th>
<th>GNP in U.S. Billion Dollars</th>
<th>Growth rate</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>June 97</td>
<td>July 98</td>
<td>August 99</td>
</tr>
<tr>
<td>Thailand</td>
<td>24.5 baht</td>
<td>41</td>
<td>37.3</td>
</tr>
<tr>
<td>Indonesia</td>
<td>2380 rupiah</td>
<td>14,150</td>
<td>6,915</td>
</tr>
<tr>
<td>Philippines</td>
<td>26.3 peso</td>
<td>42</td>
<td>38.8</td>
</tr>
<tr>
<td>Malaysia</td>
<td>2.5 ringgit</td>
<td>4.1</td>
<td>3.8</td>
</tr>
<tr>
<td>South Korea</td>
<td>850 won</td>
<td>1,290</td>
<td>1,199</td>
</tr>
</tbody>
</table>

Notes:  
1 Exchange rates obtained on 4 August 1999 from Yahoo! Currency Converter ([http://www.yahoo.com](http://www.yahoo.com))  
2 All current dollars.  
3 Estimates based on the following formula: [(July 98 GNP) * (July 98 exchange rate) * (1 + Growth rate of the last 12 months)] / (August 99 exchange rate).  
4 GDP growth. Since GNP figures for August 1999 are still not available, figures for GDP are used as an approximate estimator.  
Sources: Jackson (1999a: 2) and Asiaweek (1999).

However, what is not shown on these aggregate figures -- but can only be imagined -- is the human suffering, particularly the poor. As these countries have accepted the IMF’s conditionality, social spending (on education, health, and unemployment assistance) have been cut. Scared foreign investors have fled. Domestic entrepreneurs have seen their confidence shaken. The newly emergent middle class and non-agricultural labor force have seen their wealth wiped out. Poverty has increased.

One scholar estimated that the number of people living on less than one U.S. dollar per day in the five affected countries was approximately 40 million prior to the crisis, and they were concentrated in Indonesia and the Philippines. But during the first year of the crisis the number of Asians living in absolute poverty more than doubled in countries without elaborate social safety nets, and pockets of absolute poverty reappeared in South Korea and Thailand (Jackson 1999a: 2).

Until the outbreak of the crisis in 1997, the Asian countries were touted as among the most successful LDCs. Their predominant development strategy -- an ELI strategy because, as Economist (1999b) points out, several of these countries have witnessed
focusing on manufactured goods promoted by a strong, autonomous and developmentally oriented state -- was on the verge of attaining the status of the new development orthodoxy.

However, the "sudden" and dramatic collapse of their financial and property markets two summers ago not only changed their material fortune but also their intellectual popularity. As a sign that theorizing in international and comparative studies often gets unduly dictated by daily events, many begin to blame these countries' misery on, more or less, the same factors that had contributed to these countries' earlier success. Was the developmental state model intellectually hypocritical to begin with? Or it had outlived its usefulness when national economies became increasingly enmeshed with one another through the activities of the global market? Answers to these key questions require an exploration into the causes of the Asian crisis.

What caused the crisis? This is obviously a very important question. However, in the limited space of this paper, I can only make a few general remarks. Although the precise causes in each country were slightly different, most analysts generally agree that the causes of the crisis included both external forces and internal weaknesses: (1) financial-sector weaknesses (corruption and nepotism, lack of credit-worthy criteria for lending, "moral hazards," excessive speculative investments in real estate), (2) external-sector problems (overvalued currencies due to "pegging", speculative buying and selling by international financiers, excessive borrowing abroad, and a substantial portion of short-term debt) and (3) the "contagion" effect.\footnote{1}

The ease with which international financiers could move huge sums of money in strong signs of recovery in 1999.
and out of a country -- thanks to modern IT technology -- also played a big part. The frustration and resentment of Asian nationalism against the devastating results were captured by Malaysian Prime Minister Mahatir's war of words with George Soros, the international financier: "All these countries have spent forty years to build up their economies and a moron like Soros comes along" (Loh 1997).

Because most of these Asian countries embrace capitalism, does their collapse imply structural flaws of capitalism? Gill (1999: 4-5) compares what he considers two different varieties of capitalism. In the Anglo-American capital-market system (or "fluid" capital system), the supply of capital is provided mainly by stock and bond markets, and this in turn reflects the interests of shareholders or investors: that is, the private property owners call the shots. In such a case, if a company fails, it is made bankrupt, workers are let go, and the assets are liquidated.

By contrast, he calls the Japanese and East Asian financial systems "credit-based" or dedicated capital systems. Historically these have tended to be bank-centered, highly concentrated, and state-directed systems. In a crisis, the government generally negotiates adjustments among affected groups ("stakeholder") within the society, including workers. In other words, the government works, through informal workouts, to socialize risk.

In this sense, he criticizes the IMF bailout packages as "socialization of private debts" and questions the class bias of the whole process.

The IMF assured foreign investors and banks that their debt would be repaid, and it moved to roll over short-term into long-term debt, compelling various governments in effect to socialize private debts…. [This] shows the limit of the commitment of pure free-market policies when the interests of Western capital are endangered (Gill 1999: 6).

11 For more detailed discussions, see Goldstein (1998). Jackson (1999b) provides country chapters that compare the similarities and differences of causes in various countries.
Meanwhile, what started out as a financial crisis turned into a full-fledged political crisis. Because most of these Asian countries were ruled by authoritarian governments, which lacked legitimacy. These governments had relied on delivering economic growth to build an alternative reservoir of legitimacy as a substitute to such traditional sources as attribution, charisma, ideology, party, or military. Consequently, the economic crisis actually undermined the very foundation of several authoritarian governments. It is thus understandable why since the crisis began, there has been change of government in Indonesia, Thailand, the Philippines, and South Korea (Suharto's downfall in Indonesia was the most spectacular). The embattled Mahathir of Malaysia managed to hang on by turning against his reformist deputy, Anwar Ibrahim, increasing repression, rejecting IMF package, and limiting capital movements.

If the Asian crisis has dealt these countries a big economic blow and has ushered in a promising new era of democratization, does it mean that the developmental state is dead? Does the prevalence of IMF bailout signify -- to use Fukuyama's phrases -- the "unabashed triumph" of, and the "exhaustion of viable alternatives" to, neoliberalism? Or it underscores America's unparalleled power? Is the Asian economic miracle merely an ephemeral fluke? What kind of government (or governance) does Asian countries need in order to cope with the internal and external challenges of the next century?

WHITHER (OR WITHER?) THE DEVELOPMENTAL STATE?

To speculate the future fate of the developmental state in the era of globalization, it is helpful to review the logic of the developmental state and the conditions under which
it is more likely to succeed. Table 7 is a stylized comparison between the developmental state (the Asian variant) and the regulatory state (the Anglo-American variant). Table 8 compares the U.S. and Japanese patterns of development (barely a decade ago many believed that the Japanese model would overtake America’s).\textsuperscript{12}

\begin{table}
\centering
\begin{tabular}{|l|l|l|}
\hline
Dimensions of comparison & Regulatory State & Developmental State \\
\hline
basis of rationality & market-rational & plan-rational \\
Focus & Rules & Outcomes \\
main goal & Regulation & Development \\
criteria for success & Efficiency & Effectiveness \\
explicit industrial policy? & No & Yes \\
pilot agency? & No & Yes \\
prerequisite for success & No & national consensus \\
better at coping with & Shocks & Routines \\
where decisions made & Parliament & (elite) bureaucracy \\
main actors & economists and lawyers & nationalists and bureaucrats \\
Examples & U.S.A., U.K. & Japan, Korea, Taiwan \\
\hline
\end{tabular}
\caption{Developmental State vs. Regulatory State}
\end{table}

\begin{table}
\centering
\begin{tabular}{|l|l|l|}
\hline
 & Japan & U.S. \\
\hline
Orientation toward economic matters & Long-term, strategic & Short-term, tactical \\
Emphasis on impetus to growth & High savings rates & High consumption rates \\
Natural resource endowment and sectoral emphasis & Poor resources base => necessity of industrialization & Abundant resources => "intersectoral neutrality" \\
Market orientation & ("conquest" of) international markets & ("indulgence" of) domestic markets \\
View on human capital & Labor is a capital, education is top priority & Labor is a cost, subject to cost-benefit analysis \\
Prominent careers & Engineering & Lawyers and financiers \\
How is social order achieved? & Through integration ("quasi-familial" ties) => egalitarian incomes & Through market forces => inegalitarian incomes \\
Foreign exchange earner & Manufacturing & Agriculture and service \\
Research and development & Civilian and commercial, more D than R & Defense-related, more R than D? \\
Model for such famed "disciples" & East Asian NICs & Latin American NICs \\
\hline
\end{tabular}
\caption{Comparing U.S. and Japanese patterns of development}
\end{table}

\textsuperscript{12} These two tables are distilled from Johnson (1982) and Fajnzylber (1990).
To summarize, the developmental state paradigm consists of three elements (or rather, observations or reification). First, the East Asian states place top priority on economic development, which is often operationalized in terms of growth, productivity, and competitiveness. Second, in order to achieve these broadly defined goals, the state actively intervenes in the market to guide, discipline, and coordinate the private sector through the strategic allocation of resources and the use of diverse policy instruments. Third, strategic intervention by the state and its success are ensured by rational and competent bureaucrats who are insulated from political and social pressures. And these insulated, interventionist states, contrary to neoclassical projections, have been relatively free from rent-seeking or predation (Moon and Prasad 1998).

At the heart of the debate over the developmental vs. regulatory state is the central issue -- and perennial scholarly controversy -- of the relative importance of the state and the market in economic development. Nowadays it is virtually impossible to find any serious scholar who completely dismisses any role for the state. Even the World Bank, the bastion of neoliberal ideology, has recognized the importance of sound policy and good governance (World Bank 1993, 1997).

By now most scholars and policy-makers accept that both the state and the market are key agents of economic development. This is a departure from some of the earlier theorizing on East Asia that depicts an adversarial relationship between the two. However, the precise formula, to a considerable extent, still depends on vogue. Current scholarship aspires to move beyond either and toward a third-generation theory (Chan, Clark, and Lam 1998; Rowen 1998).

A brief recap will help understand the evolution of scholarship (or vogue) in the field. The first-generation theory, espoused by neoclassical economists and the World Bank, attributes East Asia's dynamic development to the "magic of the market" -- *laissez faire* and open economy (Balassa 1981). State intervention, if any, is market conforming, aiming to "get the fundamentals right" (World Bank 1993).

In contrast, the second-generation theory, emerging in the late 1980s and early 1990s and advocated mainly by political scientists, argues that the key to East Asia's success is the "developmental state," which is said to be autonomous and strong, with a coherent corporate goal -- development. State intervention in "late industrializers" is pervasive, seeking to deliberately "set the prices wrong" in order to create competitive advantage for the developing country (Amsden 1989).

However, no sooner was the statist theory being accepted as the new development orthodoxy was it seemingly discredited. The Asian financial crisis, which started in 1997 and quickly spread like a "contagion," prompted skeptics to quickly dislodge the East Asian model. Whereas earlier admirers championed the East Asian developmental state for other developing nations, today's critics scorn "moral hazard" and other undesirable collusive practices, especially financial sector weakness (Kaminsky and Reinhart 1998).\(^\text{15}\) The truth is that the developmental state was probably never as omnipotent as many enthusiasts had argued to be the *sine qua none* of East Asia's economic miracle. At the same time, it is also certainly not as guilty as detractors portray.

Nevertheless, globalization does pose special challenges to the developmental state and calls for its reform, if not transformation. First, the political milieu in most of

\(^{14}\) See Putterman and Rueschemeyer (1992) for an excellent theoretical discussion.  
\(^{15}\)
these Asian countries today and in the future are quite different from that of the take-off phase. Democracy has consolidated and is a stable form of government in most of these countries. After many years of suppression, distributional coalitions have formed, vying for the benefits of economic development. Moreover, more than three decades of pursuing single-minded growth, environmental degradation has cost a sad and irreversible price. Facing these new expectations and priorities, the developmental state will have to promote a form of development that is true to the meaning -- that is, balancing growth and sustainability, quantitative expansion and qualitative improvement, production and consumption (welfare), and foreign markets and the domestic market. In other words, development in a democracy should aim at improving security and physical quality of life, rather than being obsessed with quantitative expansion.

Walden Bello and Stephanie Rosenfeld, two critics of the East Asian developmental state, predicted in the early 1990s that "the old strategy of high-speed, export-oriented growth will not get the NICs through the 1990s" (1992: 337). They called for a comprehensive and coherent vision of an alternative mode of development. They then went on to portray the contours of this new comprehensive alternative paradigm: democratic participation, the growth and consolidation of the domestic market, equity, sustainable development, a selective export policy, and the development of equitable regional associations (1992: 338-341).

No doubt these elements will be anyone's good guide to development. The point about regionalization especially needs underscoring. This is because, as Hoogvelt asserts, "pressures of globalization frustrate the drive to maturity of the state-led capitalist development process, unless this drive is undertaken within a consciously pursued
regional framework. In the context of a globalized world economy, it becomes increasingly difficult for the state to subordinate business interests to its own strategic concerns (1997: 215).

In sum, it is increasingly doubtful whether a globalized world economy can afford a developmental state to pursue national interests in terms of maximizing relative gains.\textsuperscript{16}

Second, it is not clear whether the previous type of developmental state consisting of competent technocrats insulated by authoritarian politicians is either possible or desirable. For one thing, accountability is a prominent feature in the new politics. Globalization holds promise to even the playing field between decision-makers and those that are affected by the decisions. The computer and communication technology, in particular, can empower the citizenry. By facilitating participation, it enables efforts toward good governance without too much government dictate. It also encourages the emergence of a vibrant civil society. Many writers (e.g., Barber 1995) have always considered the civil society as the necessary (but missing) link and buffer between the state and the individual. In the global age, the civil society takes on a new role as the "human face" between global forces and individuals.

Third, even though globalization may bring many benefits directly to citizens, bypassing the state (especially a repressive regime censoring information)\textsuperscript{17} it can also expose people more directly to forces beyond the control of the state. In this regard, the

\textsuperscript{16} See Snidal (1991) for an exposition of cooperation among relative gains maximizers.

\textsuperscript{17} The power of the Internet is not lost for dissidents or dictatorships alike. Whereas Liu Qing, a Chinese dissident-in-exile, has adopted the Internet as "weapon of choice" in his campaign to challenge the Chinese government, the Communist uses the Internet to take on the grass-root Falun Gong and block out any harmful information from overseas (Laris 1999, Agence France Presse 1999).
developmental state should not "wither away," by abdicating its responsibility to the

  global market forces.

   For the foreseeable future, good alternatives to the imperfect state will still be
   lacking. Optimists like Friedman are remiss, because "corporate-like states" cannot
   provide many public goods. The capacity to take care of people during hard times is
   particularly important, as the Asian crisis sorely demonstrates. Unless and until the state-
   centered Westphalian system is fundamentally overhauled, the developmental state will
   retain its raison d'être, but it will have to become "kinder and gentler" (perhaps even
   slower). Since extrication from the global economy is not a viable option for the Asian
   states, the developmental state must retool itself to the still-unfolding movement, known
   as globalization.
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