

SGRA Report

No.0014 English Version

SGRA Forum #8<sup>th</sup> in Karuizawa

# A New East Asia in the Era of Globalization



*Sekiguchi Global  
Research Association*

**SGRA**

関ログローバル研究会

### ■ What is SGRA?

Sekiguchi Global Research Association was inaugurated in July, 2000, from a core of foreign students who have long resided in Japan in pursuit of their doctoral degrees in various fields. They form SGRA's driving force through their active participation in SGRA's various activities, irrespective of whether they remain in Japan or go abroad. Research teams are formed from such an international network of researchers to address various issues from multidisciplinary and multinational perspectives. In addition to this network of researchers, SGRA registered members and other interested parties cooperate with SGRA in various ways. SGRA hopes to widen its circle of activities and network through its activities. In the end, SGRA aims for the realization of good global citizenship through the principle of harmony in diversity.

- ★ SGRA is now accepting members. Those interested, please contact the SGRA secretariat. ([sgra-office@aisf.or.jp](mailto:sgra-office@aisf.or.jp))
- ★ This report is available in Japanese, Chinese, and Korean versions. Those who would like a copy sent, please contact the SGRA secretariat.

## The 8<sup>th</sup> SGRA Forum (in Karuizawa)

# A New East Asia in the Era of Globalization

July 20, 2002 (Saturday) 1:00 to 6:00 PM

Hotel Maison Karuizawa

Organized by : ◆ Sekiguchi Global Research Association(SGRA)

Sponsored by : ◆ Atsumi International Scholarship Foundation

◆ Kajima Foundation

◆ Center for Human Resource Studies, Korea

With the Cooperation of :

◆ Economic Research Center of the Graduate School of Economics,  
Nagoya University

◆ Department of Economics, University of Asia and the Pacific, Philippines

◆ The Asahi Shimbun Asia Network (AAN)

### **Purpose of SGRA Forum #8 in Karuizawa**

The eighth SGRA Forum is being organized by SGRA's "Japan in the Era of Globalization" Research Team. In February 2001, the second SGRA Forum was held with the theme of "A New East Asia in the Era of Globalization: Reflections on Economic Cooperation". In that forum, we considered a new mechanism of economic cooperation that emerged after the East Asian financial crisis. Marking the fifth anniversary of that crisis, this upcoming forum plans to build on the discussions in that previous forum, and to promote further discussions on economic cooperation in the East Asian Region, while bearing in mind the developments in the global situation since then.

In July of 1997, the East Asian Financial Crisis erupted, prompting Japan to undertake several initiatives so as to enable the East Asian region to recover as quickly as possible from the crisis. Despite resistance to its initial proposal for the establishment of an Asian Monetary Fund (AMF), Japan was unwavering in its pursuit and successful implementation of countermeasures, which included the New Miyazawa Initiative. This stance of Japan to transform a crisis into an opportunity to create a structure of cooperation in East Asia, needless to say, should not be put to waste. We would like to once again look into the vision and process of that time, the developments since then, and the future of cooperation in East Asia in various areas such as a free trade agreement and a currency union.

## Program

1:00-1:10	Moderator : SGRA Management Committee Chair Shimazu Tadahiro Greetings (On the Forum's Objectives) : SGRA Director Imanishi Junko
1:10-1:40	What has the Asian Currency Crisis Brought to East Asia? Hirakawa Hitoshi (Professor, Economics Research Center of the Graduate School of Economics, Nagoya University) Commentator : Li Gangzhe (Researcher, SGRA and Tokyo Foundation)
1:40-2:10	Corporate and Banking Restructure after IMF Crisis in Korea Lee Jin Kyu (Professor, Korea University; Director, Human Resource Research Center ) Commentator : Kim Woong He (SGRA Researcher; Assistant Professor, Inha University, Korea )
2:10-2:40	Economic Crisis, Market Concentration and Efficiency in the Banking Industry: Indonesia Experience Gatot Arya Putra (Senior Analyst; Indonesian Bank Restructuring Agency, Indonesia) Commentator : Ferdinand Maquito (SGRA Researcher, Adjunct Professor, Temple University Japan)
2:40-3:00	Coffee Break
3:00-3:30	Current Status and Prospects of Economic Integration of Asia Meng Jianjun (Professor, Tsinghua University, China) Commentator : Jin Xianghai (Researcher, SGRA and Social Science Research Institute, Chuo University)
3:30-4:00	Competing and Cooperating with China Bernardo M. Villegas (Professor, University of Asia and the Pacific, Philippines) Commentator : Xu Xiangdong (Researcher, SGRA and Nikkei Research Center)
4:00-4:50	Free Discussion ▪ Questions from the Floor
4:50-5:00	Closing Remarks
5:00-6:00	Free Discussion with Former Prime Minister Miyazawa Kiichi
6:00-8:00	Reception
8:00-11:00	Open Discussion

Note : Japanese, Chinese, and Korean names are written in their traditional style, that is, family name are followed by first names.

# Greetings

SGRA Representative Imanishi Junko

Thank you, everyone, for coming all this way to Karuizawa. This past month, I have been keeping a close watch on the weather report. We had the monsoon rains, two typhoons came, and today I have been nervously watching if the weather would clear up. Because you are all doing such a good thing, we are having this very good weather. If this holds, you can expect to have today's reception at the open garden.



Let me explain briefly SGRA's history. It all started with Atsumi Foundation (Atsumi International Scholarship Foundation). In 1993, my father passed away, and following his last will, the foundation was created that would assist foreign students studying in Japanese universities. Since the start, the intention was not just scholarship assistance, but also to form a network. We decided to support those who were studying for their doctoral degree in Japan. We are now on our 8<sup>th</sup> batch of scholarship recipients. We have a very active network of a little less than 100 former scholarship recipients. This is particularly due to the internet age, where through e-mail everyone could communicate no matter where they are in the world. However, we realized that we wanted to do something beyond simply networking, and in July 2000 we formed the Sekiguchi Global Research Association (SGRA—pronounced as SEGRA). In SGRA, we hold four forums a year, publish reports, and basically provide a venue through which young foreign researchers familiar with Japan can raise issues and express their opinions. SGRA's official language is Japanese, and even today allows us to use Japanese as our medium of discussion.

SGRA is now on its second year. Through today's forum, we would like to widen our network circle a little more by having with us the professors of SGRA researchers. Coming all this way to Karuizawa, despite their busy schedules, I would like the guests to spend a relaxing time amidst the woods as we continue on with the forum.

There are six research teams in SGRA. Focusing on economic issues, the "Japan's Peculiarities Amidst Globalization" research team is in charge of today's event. In this research team, we have today's commentators Mr. Maquito and Mr. Li Gangzhe, who both recommended Professor Hirakawa of Nagoya University. Professor Hirakawa's concept of "Asia and Asian peoples working together" is exactly the same as that of SGRA. The professor has kindly included Mr. Maquito and Mr. Li Gangzhe in the co-writing of a textbook on economics. In the second SGRA forum, Professor Hirakawa gave a keynote address, and since then we have been in his debt.

Professor Lee Jin Kyu of Korea University is with today's commentator Kim Woong He, who after returning to Korea became a member of the "21<sup>st</sup> Century Research Group". The sponsor of that group is Korea's Human Resource Research Center, from which the Atsumi Foundation received an offer to hold an exchange program. Last year, we started a program of Japan-Korea exchange, which rotates between Japan and Korea. This is our second one activity together. Professor Lee is the founder of the Center. His main work is being a professor at Korea University. He has taken pains to be with us today to give a talk.

Then, our third speaker is Mr. Gatot Arya Putra of the Indonesian Bank Restructuring Agency. When I requested SGRA researcher Josaphat san, who is from Indonesia, to introduce a speaker for the forum, he made a call for papers through a mailing list of Indonesian researchers. We received several applications, from which Mr. Gatot was selected.

Professor Meng Jianjun of Tsinghua University in Beijing, China, was a student of Japan's Tokyo Institute of Technology. Last February in a symposium that was organized by Professor Hirakawa at Nagoya University, I was able to talk about today's forum with Professor Hu Angan of Tsinghua University, who is the so-called "Heizo Takenaka of China", and has been giving policy recommendations to the Chinese government. At that time, he said that he might be in Tokyo at this time, but due to his busy schedule, he could not leave Beijing. Instead, he introduced Professor Meng as a perfect speaker to take his place. Professor Meng, since joining Tsinghua University last year, spends half of the year in Tokyo, and the other half in Beijing.

Lastly, Professor Villegas was the professor of Mr. Maquito, who is the head f of today's research team. He is the dean of Economics of the University of Asia and the Pacific in Manila. After going back home in the Philippines from his studies in the U.S., he formed, together with a friend, a research institute, which has grown into a university. I am very happy to have such guests as Professor Lee and Professor Villegas who have created research networks. Thank you very much for coming.

Today, after listening to the presentations of our guests, we might not have enough time but as much as possible, we would like to take ample time for questions and answers.

And finally, in the evening, we will have former Prime Minister Kiichi Miyazawa. The Honorable Miyazawa was most respected by my father, who was deeply indebted to him. Especially, here in Karuizawa, I have known him since I was a small child, as we often had family get-togethers with him. In a SGRA forum this year, I was deeply impressed when I heard Professor Hirakawa's opinion that in Japan's response to the Asian currency crisis, Mr. Miyazawa name was prominently mentioned as the sponsor of "The New Miyazawa Initiative". And that this initiative is now popularly becoming the driver for the creation of an Asian common entity. Mr. Maquito requested and was very much eager to hear from Mr. Miyazawa about the story behind those events. Mr. Miyazawa kindly granted my request to come to the forum, in Karuizawa.

This is the background of today's forum. Please listen to the presentations by our guests and enjoy the discussions. Please carry on with the forum.

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Free Discussion with  
Former Prime Minister Miyazawa Kiichi



(Miyazawa) As introduced, I am Kiichi Miyazawa. Junko Imanishi's father and husband of Mrs. Atsumi, Mr. Takeo Atsumi, past president of Kajima Construction, passed away early and was really a good friend of (Miyazawa). I often thought of how I could be of service to Mrs. Atsumi and Ms. Imanishi. This spring, Junko Imanishi visited me and requested me to give a talk and participate in this event. However, these days my memory has been failing perhaps due to my age, and I am not confident in giving a talk, but I would be available anytime for a free discussion. So here I am. I would also be happy to participate in your discussion, and honored to have been invited. Please feel free to ask whatever question you may have.

(Hirakawa) I am Hirakawa of Nagoya University. It is my great honor to be able to meet you, sir. I always see you in the television.

My specialty is the theory of the Asian economy. It is my view that after the currency crisis, the initiative that you took played a very big role in regional cooperation and mutual understanding in Asia. Personally, I have heard of favorable reactions. When I went to Korea in 1999, it was when your initiative came out, and quite a number of



people were in favor. Later when I went to Thailand, people would say, "We don't know who Miyazawa is, but this Miyazawa Initiative is fantastic!" I think that through your initiative, sir, the opportunity has been created for Asians to change.



I have wanted to ask you about the significance of "new" in the "New Miyazawa Initiative". If we say "new", then that means that there is an "old", and obviously we have in mind the Latin American crisis of the 1980s. At that time, although you, sir, took the initiative, ultimately this was practically taken away by the US, without any credit to your name. When we think about this, I thought that there must be some sentiment either yours or the Japanese government's underlying the word "new". I would appreciate it if you, sir, could shed light on the sentiment underlying "new" and the background regarding the proposal of the initiative.

(Miyazawa) When I came here today, I was given the documents of the meeting, and I saw Professor Hirakawa's paper. It is a highly professional work, and really I do not have anything to add. But, I am grateful of your evaluation of my work, and am aware that you have kindly written of its possible usefulness to the bonding of Southeast Asian countries.

The crisis occurred in 1997 in Thailand, and then spread here and there. At that time, Japan was not in a very good fiscal condition, but it had an ample stock of foreign exchange. I thought that this could be useful to various countries with which we have had special relations. This was the motivation, and it is a very natural one.

Prior to this, in 1997 the Asian Monetary Fund (AMF) was at one time put up, but realistically the problem was that this could not be implemented rapidly. Moreover, when I thought of offering \$30 billion, I did not think that it would materialize so quickly. To be extremely frank, I am a person of the pre-war period. Before the war, Japan was earnestly trying to do something for Asian countries. However, I feel very pained that this ended in utter failure. So, I am very much happy to be of some assistance.

Then there was the Chiang Mai initiative in 2000. This came from the idea that the slowly-developing relationships could be expressed in the form of swaps. Since the meeting was held in Chiang Mai, it was only thought that it would be named as the Chiang Mai initiative. It is a fact, I think, that through such process, the relationships among countries were made even closer.

The "new" in the New Miyazawa Initiative is as Professor Hirakawa has indicated. At the time of the Latin American crisis, bonds came to be issued in what was later called as the Brady bonds. It is because of this, I think, that "new" was added to the later initiative. There is no special meaning to this. I am glad if this was of any use. What I am hoping is that this would lead to a multinational contact among countries [in Asia], wherein they get to know each other better.

The Chiang Mai Initiative was such [a contact]. A recent development is "ASEAN+3", in which my country, China, and Korea have entered to dialogue with ASEAN. That is basically the background.

Europe's ability to form a common currency is, I think, the result of the many centuries of contact among the different countries. It was mostly quarrels, but this is also part of contact. In this sense, common elements in Asia are very few.

Even in terms of history or religion, there is very little commonality, so a movement to create something in

common would not rapidly come about. However, since this is an audio-visual age, what took many centuries in the past should not take many centuries from hereon. I would be very happy if, through such contact, the kinship that Professor Hirakawa speaks of should emerge. But, we perhaps should look at it as a long-term development.

(Gatot) Good afternoon. My name is Gatot Arya Putra, and I come from Indonesia. I work at the Indonesian Bureau of Bank Structural Reform. Earlier, I asked a question to Professor Hirakawa, who told me that it would better to ask you. IMF ...Horst Koehler has stated that the IMF would support the AMF. If this is true, can Japan lead the AMF?

(Miyazawa) In connection with the currency crisis in 1997, the IMF, in various senses, was involved in many activities. I think that there is the assessment that, in general, these activities did not necessarily do well. It is different from country to country, but in Indonesia's case the crisis was on a large scale, and we both know that Indonesia had and still are having difficulties in dealing with the IMF. Indonesia is a case, which I want most to go more deeply. With a new administration, Indonesia has made significant advances, but the resolution of its problems will still take time. However, even the IMF is finally looking at the present situation with an open disposition. It is fine that the IMF seems to be working together with the Indonesian government and central bank.



If the meaning of your question is about the aggressive consideration of the AMF, as I have mentioned earlier, this in actuality may

not be easy. The necessary kinship among Asian countries is not there. Moreover, there will be actual problems, for example, when the IMF and AMF both deal with a situation, the two responses would naturally be different. There is also the matter of conditionalities. The conditionalities of the IMF and the AMF would likely not be the same, so that things would not go well. The IMF will be problematic, finding it hard to do its job as the AMF applies softer conditions. With such problems, I personally think it may be more realistic to move forward gradually. For example, bilateral swap agreements, if many of these are made, can become multilateral agreements.

(Villegas) Your honor, I am Bernardo M. Villegas, Dean of the School of Economics of a private university in Manila. I hope that you do not mind if I remind you that you are 83 years old, and I hope that you can live all the way up to 100 and more. And that means that you are a part of the senior citizens of Japanese society. And my question will be on the aging problem of Japan.

In Japan, there is a problem of aging and the very low birth rate, so there is an imbalance between the labor force and the people who are retiring. And this is a concern that many of us outside Japan have, because Japan used to be an engine of growth together with the United States in this part of the region. But one of the reasons why we think - and we may be wrong - that Japan is having a difficult time getting out of more than ten years of recession, is this demographic problem. Now, from specifically the financial point of view, because it has a lot to do with pension systems, it has a lot to do with getting Japanese to work beyond 65 and make them productive all the way to 83, like you are very productive, this requires a redesign of the whole pension and labor system. Do you have ideas about

how to address this Japanese problem?

(Miyazawa) Our predicament is exactly as you have stated. Your question can be answered only by a yes. However, if it actually turns out as you say, we become aware of things previously not considered. If it actually becomes so, senior people will in general be considered as liabilities. I think that it was also from this perspective that you were asking your question. But, surprisingly, there can be a way of considering them as assets.

For example, ordinarily an old person is considered as weak, a liability, a kind of heavy burden, who does not contribute to economic development. However, at Japan's present stage, surprisingly those with the most money are the elderly. Young people are full of vitality, but they do not money (laughter).

So in terms of consumption and investment, the old are neither a weak class nor a liability, but an asset. Even from the standpoint of labor, whether it is Japanese or Filipino, I think it is the same: they relatively do not dislike working. Accordingly, Japanese, when they reach 50, cannot just go to the pasture and play around. There is no pasture anyway (laughter). They all want to do something. Even though they cannot do hard labor, they certainly have the urge to do something, and be involved in social movements. I have come to think that such a sector could also be exploited. At one time, I thought that once we become a country of the old, this sector would be useless and a burden. But, surprisingly, it is not so. Or rather, we should think that it would not be so. I think we could cite instances of such thinking coming out.



(Song Bok) I am a sociologist teaching at Seoul's Yonsei University. I would like to your opinion, sir, based on your knowledge and experience up to now. In his presentation, Professor Villegas stated that 40% of the loans to state-owned enterprises in China are bad loans. This is also perhaps because of the huge bad debt of private firms. The high bad-debt ratio is I think about the same as that of Korea when it was thrown into the IMF crisis in 1997.



Considering this, my question is essentially about your sentiments, sir, regarding China's future.

(Miyazawa) Before I answer your question, I have been very interested about how Korea has been hit by this foreign exchange crisis. From around Christmas of 1997 to New Year of 1998, Korea was in a severe pinch. However, it carried out unwavering reforms, and now Korea's economy has already largely exceeded the pre-oil crisis level. It is growing at a positive rate. Given that Japan has been nothing but bad performance, Korea's good performance is very prominent. Having gone through such reforms, Korean banks and firms are not having an easy time. A professional golfer would quickly cure a bad golfer. But in the case of a very good golfer, he would not find it easy to throw away his personal style. Korea's economy is a very strong and big economy. I think that it was truly grand of it to carry out reforms under IMF conditionalities. The economy, which was dominated by chaebols, must have changed. I just wanted to

say how I am very interested in this development.

As things have turned out since then, China's accession to the WTO is I think a very big event. There are lots of problems. There is issue of banks and the non-performing loans to state-managed enterprises. There is the problem of severe competition, due to the liberalization of prices of agricultural products.

China's entry into the WTO is, I think, an extremely daring move. I am often awe-struck when I think about it, to the point of thinking that the initiator of this move should have stayed around longer to witness its consequences. So, as you have said, there are a lot of problems. It is not going to be easy. Anyway, the scale is also huge, so if you ask me what I think, my brief reply is that forward-looking decision is extremely bold.

(Lee Jin Kyu) My name is Jin Kyu Lee from Korea University. This is kind of a double interpretation, so my understanding may be wrong. But I would like to have some questions. First of all, it is a great honor for me to have this opportunity to discuss with you some issues. You mentioned an Asian alternative to the Asian Monetary Fund proposal, and that this alternative is the New Miyazawa Initiative. However, there is still a need for an Asian model to challenge or tackle some future monetary and financial crisis, and my understanding is that this model is the ASEAN+3. “Plus 3” means the three countries China, Korea, and Japan, right? Is that correct? Okay. I understand that the economic motives or economic interests of these three countries may be very similar. However, their political systems are totally different from each other. This is not like the NAFTA system comprising Canada, the United States, and Mexico, which are all democracies politically and capitalist economically. It is an entirely different political situation in the +3 countries. China is a communist state, right? Korea is a democracy, but with an autocratic, dictator-style, presidency; the Daitoryo is a very powerful person. The Japanese system is a parliamentary system. So even though they have real commonalities in terms of economic motives, these three countries are totally different in terms of their political systems. I think economic motive is okay, but how can you harmonize or reconcile these different political systems among these three countries, so that we can achieve the ASEAN+3 objective?



(Miyazawa) In short, the meaning of your question is as follows. The “3” in “ASEAN+3” is Korea, Japan, and China. Adding the 3 is a good thing, but the three are significantly different countries in terms of politics. You are asking if it is possible for political harmony to come out from the three countries. It is indeed a problem. Based on my own experience, creating a political harmony among these three countries is extremely difficult. In fact, in international conferences, each country meets on the basis of economic issues only. There is no talk of politics (laughter). When the talk comes to politics, it is good if it is just praises, but the discussion becomes critical. To avoid this, we just talk about the economy. Being a scholar, Professor Lee could say it straightly, but for politicians, it is difficult to answer (laughter).

(Lee Jin Kyu) My apologies (laughter).

(Miyazawa) But you have asked a very good question. The same thing could be said not only of the “three” but of ASEAN, as well. In that sense, the market from hereon will be very problematic. As you know, the European Union

is not moving only in terms of economics. Politics is also involved. It is not sufficiently included, but in appearances it is. However, in the case of ASEAN or the +3, it would be very difficult to look for commonalities if we include politics. Given this, I often think that, in various senses, something like the AMF or, further along the line, a union like the EU cannot be achieved. Your question has touched on the crux of our problem.

(Meng Jianjun) I work at Seika University in Beijing. I used to be with the Ministry of Economy and Industry. Now, I am a faculty fellow at the Economy and Industry Research Institute.



As you know, the relationship between Japan and China in the past one to two years, from my point of view, is very difficult to describe. For example, last year the trend in Japan was about trade safeguards against China. Suddenly, at the start of this year, there have been active discussions about reports regarding forming an FTA with China. In April, Prime Minister Koizumi participated in the Boao Asia Forum in Hainan Island, China, where he proposed an all-out cooperative initiative, as against a China-as-threat argument. Japan and Singapore have already formed a bilateral FTA. Japan and Korea are now considering another one. I would like to ask you about relations between China and Japan, and the possibility of an FTA between China and Japan.

(Miyazawa) You mentioned safeguards. Last year, Japan activated safeguard measures against onions, mushrooms, and mat rush.

This is extremely embarrassing. Japan should not be doing these things. It was because of domestic circumstances that brought this out. However, what was extremely astonishing was ordinarily, in such a case, even if the producers are in agreement, the Japanese consumer would be against it. Surprisingly, however, the consumers were not against it. Onions and mushrooms are inexpensive items. Consumers were thinking about agricultural chemicals, and preferred Japanese goods even though a little more expensive than the problematic items from outside. It is something involved in the issue, which China should also consider.

Now, as for what I think about the main issue of Free Trade Agreement (FTA). I think it is an extremely good question. Japan has tied, for the first time ever, an FTA with Singapore. The reason why this was possible is that Singapore is not an agricultural country (laughter). Japan is not worried about cheap agricultural goods coming in from Singapore. There is some worry, however, about marine goods. So, the Japanese agricultural sector need not worry about a thing. In the case where the other country has agricultural goods, forming free agreements is hard. This is the position maintained by Japan's agricultural sector. So even if the government is saying that it will form a free trade agreement somewhere, it is not an easy task to do. Somewhere along the way, it will say that agricultural products are a different story, to the consternation of the other party. Now there is talk of doing it with Korea, but it is difficult, isn't it? There are a lot of issues such as marine goods. Will the marine goods industry accept liberalization? It is highly unlikely, I think. Then, there is talk of doing it also with Mexico. It is not easy to do. There are issues like what to do with prawns. Japan has its weak economic sectors.

In connection with this, I find Zhu Rongji, a great man of your country interesting. He has proclaimed that he will do it with ASEAN within ten years. If you think about it, this is amazing, given that there are a lot of farmers in China. Most likely, the domestic prices of corn or wheat would be about 20 to 30 percent higher than international

price standards. There could be domestic subsidies, but even this would have its limits. Once there is real liberalization, even China will have serious problems. Perhaps, China has thought about various possibilities. Asian countries have a lot of tropical plants, but these are a small part of trade with China. It is really amazing, I think. Japan, if it comes to it, can say it is in favor of trade liberalization, but it hardly has the confidence of carrying it through. This is my answer.

But this is something that often comes out in the newspaper, and is said by politicians. I wonder if they really are going to do so (laughter). It is good if they can implement the talk. Even if we think so, we can not say anything significant in the face of safeguards against mat rush and onions. Mat rush and mushrooms (laughter). There is really not much that can be done.

(Lee Hyun Seung) My name is Lee, and I come from Korea. I have met you in the ASEM meeting in 1998, and it is a great honor to meet you again.

My question, simply put, is which would be the next engine of economic growth? For example, Korean firms are now beleaguered from the challenge posed by Chinese firms. China has put in a precarious situation the competitiveness of Korea's corporations and industries. I think that this is perhaps the same situation in Japan. Under such circumstances, I would like to ask what is the plan for a growth engine that would stimulate the economy.

(Miyazawa) To be extremely honest, my answer is "I don't know." Japan's economy is completely in bad shape. One thing that makes it problematic is that Japanese firms have been going to China. This is often called as hollowing out. Not only small firms, a large number of big firms are also going out. Given such a situation, I think that this is a difficult problem. I think that a similar thing is occurring in Korea.

My answer to your question would be that high value-added firms would stay put. However, China would be doing the same thing, so it is inevitable that China will be a competitor. It is a fact that it is not clear as to which high value-added industry will remain. So Korea, having overcome the currency crisis so quickly, is perhaps also thinking about the same predicament.

(Li Gangzhe) My name is Li, and I am involved in policy research at The Tokyo Foundation. The foundation is now about four years old, and its director was Professor Heizo Takenaka<sup>1</sup> until he became minister. In this foundation, a team of 10 foreign experts from different countries, including myself, is making a feasibility study about the idea of creating a new Northeast Asia Development Bank. This study also addresses the Northeast



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<sup>1</sup> Professor Heizo Takenaka was a member of the Faculty of Policy Management, Keio University. He was a director of The Tokyo Foundation in 1997 and became its president in 1999. In 2002 he became Japan's Minister of State for Economic and Fiscal Policy.

regional cooperation issue.

One reason for doing this study, simply put, is that in the Northeast Asian region, in which Japan is located, there have been various movements on northeast Asian regional cooperation. This envisioned regional cooperation includes Japan, China, Republic of Korea, North Korea, Mongolia, and the Far East region of Russia. As you, sir, have said earlier, Japan holds a lot of foreign exchange reserve. Now, China also has a lot of foreign exchange. Combining these foreign exchange reserves with that of the Republic of Korea, these three countries alone hold a total of \$700 billion of foreign exchange. It is our theory that there should be a system by which funds of the region would be circulated within the region, and that these funds should be used to promote regional peace and stability, as well as sustainable development of developing countries in the region. Our approach is that Japan should be more aggressive in playing a role in the creation of a new development bank in this region. I would like to ask you, sir, about your thoughts on this matter.

(Miyazawa) How about giving a little more money to the Asian Development Bank? Is there any problem with that?

(Li Gangzhe) Actually, there is at the same time the thinking to create a northeast Asian fund within the ADB. Of course, the ADB president and some parts of the Japanese government hold such an opinion. However, the ADB, being a development bank for the whole of Asia is believed not capable of effectively catering to the specific development needs of northeast Asia considering this region's own peculiar circumstances. Moreover, there are a number of sub-regional development banks in the US, Africa, and Europe. Asia constitutes 50% of the world population of developing countries. From either a population or developmental perspective, the issue of development of Asia a very geographic area.. So, ADB alone cannot cover the entire region. Expand the resources of the ADB cannot be done, since from an institutional framework, this bank cannot expand its capital resources beyond that of the World Bank. Hence, a development bank, which targets a new sub-region, that is, northeast Asia is necessary.

(Miyazawa) By northeast Asia, which countries are you thinking of?

(Li Gangzhe) Japan, China, Republic of Korea, North Korea, Mongolia, and tentatively Far East Russia.

(Miyazawa) That is quite an ambitious plan. I see.

(Moderator) Thank you for telling us about one case study.

(Baek Insoo) I am afraid we have used a lot of your precious time, but there is one thing that I would really like to ask you. I am now a graduate student at the Commerce Institute of Waseda University. I am a foreign student from Korea.

Listening to you, sir, I felt that you have been extremely modest. You mentioned earlier that before the war, Japan's actions failed in Asia, and through the New Miyazawa Initiative you wanted to be of some assistance to Asian countries. In response to the question regarding Japan's new economic growth engine, you used a low-profile

expression of “to tell the truth, there is nothing.”

As for my question - if we look at today’s theme, it says “A New East Asia in the Age of Globalization”. I think that this theme and discussion are not merely a response to the so-called American globalization, but, in a more aggressive sense, provide a forum for us to articulate and enunciate Asian values and the meaning of a common Asian body. In this connection, I would like to ask you, sir, briefly, what your thoughts are about Asian uniqueness, or about what new ideas that East Asia could articulate.

(Miyazawa) Since this is a different issue from the Japanese economy, I am not extremely modest about Asia, but actually realistic. I think it will be difficult for us to go beyond the bounds of the economy and together do common undertakings. This is because each country has various political circumstances. Depending on the country, the political administration may not stable. Faced with this, I think, there is not much mutual awareness about common things. It would be good if such awareness would emerge from globalization. But it is not much comfort to know that the reason we are going to unite despite having nothing else in common is that we are facing globalization in common.

However, since we, fortunately, have been able to maintain peace, we might be able to find it unity. But, I personally cannot be optimistic about this. In particular, I am not in favor of Japan taking up leadership in this issue. I feel that it would be too much exposure for Japan.



(Moderator) Thank you. I would like to end here (applause).

(Miyazawa) Thank you very much, everyone (applause).



# What does the Asian Currency Crisis bring to East Asia?

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## Introduction

How will economic historians of East Asia account for the Currency Crisis of 1997 in the future? East Asia has experienced hyper-growth for more than thirty years, since the 1960s due to an export-led industrialization that originated in the Newly Industrializing Economies (NIEs). In the process of globalization, it was thought that East Asia reaped the maximum of benefits for both itself and others. However, it was thrown into severe economic crisis by the currency crisis, which started in Thailand.

Was this only a passing episode in East Asia's history of economic development? Or was it a major crisis that would bring a fundamental change in the history of East Asia? Nobody knows the answer. Nevertheless, it seems that the crisis was a turning point in the economic and social history of East Asia.

East Asia's currency crisis could become the opportunity not only to create a new organization in the economy, but also to create a new regional community in East Asia. It may thus further the progress of regional co-operation in East Asia. There appears to be some hope for a new regional economic community, which, allowing for much diversity, would promote a common regional sense that has been lacking up to now. This can be achieved through economic cooperation in the region.

In his presentation, this speaker will consider new trends appearing after the currency crisis in East Asia, as well as their background and significance for the region.

## Globalization and the East Asian Currency Crisis

### 1 The Eruption of the Asian Currency Crisis and the US/IMF Prescription

As soon as the currency crisis erupted in July 1997 in Thailand as the baht currency crisis, it quickly spread to East

Asia like a contagious disease. In that summer, it hit the ASEAN countries of Indonesia, Malaysia, and the Philippines; and from the fall of the same year spread to Hong Kong and South Korea, evolving into an Asian currency crisis. If we let the level of each country's currency in June 1997, before the crisis, be 100, we could see a trough in January 1998 into which the currencies experienced a steep dive: Singapore had a relatively shallow depreciation of 20%; South Korea, the Philippines, and Malaysia fell by about 50%; and Indonesia fell by 80%. Although the countries thereafter were on a steady recovery path, another trough emerged for Indonesia only in June to July 1998, as the Suharto regime collapsed causing a political crisis. By the end of 1999, Indonesia alone had a depreciation of 70% while the other countries were able to bring down their depreciation to between 20 and 30%. It was the large outflow of short-term capital that directly triggered the crisis.

Incidentally, it can be said that the features of the crisis were not fully understood, particularly at the beginning, not only by the crisis-stricken East Asian countries, but also by the US government, the IMF, the World Bank, and other policy makers and economists who shouldered the heavy responsibility for the policies later on to find a solution for the crisis. In August 1997, the Thailand crisis was considered as a one-country crisis. Early in that month, in a Tokyo meeting convened by the IMF, a financing package for Thailand of \$16.2 billion was agreed upon<sup>1</sup>, in which a total of \$3 billion came from Hong Kong, Singapore, and Malaysia (\$1 billion for each), and \$1.3 billion from Indonesia, South Korea, and China. Needless to say, these countries later on will, themselves, either fall into a currency crisis or be greatly affected by the crisis. It appeared that at this point, these countries were in agreement that the assistance came more from the sense responsibility to help out a neighbour in need, rather than from an anticipation that they themselves will be engulfed in the shock waves of the crisis. The understanding was that the Thailand crisis was, most of all, caused by internal factors such as weak fundamentals and policies.

Such an understanding became firmer in the U.S. government and in the IMF. The U.S. government refused to participate in the Thailand Assistance Package in August of the same year (1997). Moreover, it did not extend any assistance to South Korea, which was struck by the crisis at the end of that year, and it stopped altogether all official efforts to assist that country. In November of the same year, in an attempt to avert the crisis, the South Korean government tried to establish a \$15 billion back-up facility from a consortium of financial institutions, such as Citibank and Banker's Trust, as well as form a currency swap agreement with the Bank of Japan. However, due to resistance of the U.S. government, this attempt was not successfully concluded, and South Korea was forced to depend on the conditionality-based financing of the IMF [Ko 2000:16]. This was because the US thought that its self-designed structural reform was the only solution to the crisis .

The Asian Monetary Fund (AMF) initiative taken by the Japanese government at the Thailand assistance meeting in Tokyo was ultimately not implemented due to the strong resistance of the US and the IMF. The same initiative was repeatedly proposed in various venues such as the Finance Minister Asia Europe Meeting (ASEM) held in Thailand in September 1997, the Japan-ASEAN Finance Minister informal meeting in Hong Kong, in the IMF-World Bank annual assembly, and in the G7 meeting. However, due to the strong resistance of the US and the IMF, the initiative

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<sup>1</sup> The IMF convened a Tokyo meeting, on August 11, 1997 of interested governments and multilateral institutions to discuss a Financing Package in support to Thailand's policy efforts [IMF News Brief No.97/17, August.7, 1997].

was abandoned in the 14-country finance minister and central bank directors representative meeting held in Manila in November of the same year. Instead, the Manila Framework represented the consensus on strengthening the response capability of the IMF, and the establishment of an intra-regional surveillance mechanism [Council on Foreign Exchange and Other Transactions 1998:13]. The reason for the IMF's resistance to an AMF is that if the latter's creation would lead to huge financing based on terms that are more lenient than those of the IMF, then this would increase the risk of a moral hazard. Another reason is that an AMF bears a philosophy which is in conflict with that of the US and the IMF, and this may make difficult coordination with the IMF, and worsen the potential of conflict risk [ADB 1999:44]. At the same time, this will lead to an enhancement of the competitive leadership status of Japan in East Asia, heightened regionalism, and a perceived decline of US dominance in the region.

According to the Wall Street Journal, the abandonment of the AMF initiative put an end to Japan's Asia-centric proposal. "A victorious Mr. Summers declared afterwards, 'U.S. economic leadership is crucial to avoid a descent into the kind of regionalism and protectionism that we saw in the periods between the first and second world wars' " [WSJ, Sep. 24, 1998].

As far as US and IMF policy makers and economists were concerned, the crisis at the start was a reflection of the internal defects of East Asian economic systems and organizations, collectively labeled "crony capitalism", hence the strong call for a structural reform by the IMF. From such a perspective, a regional cooperative solution or prevention to the crisis was regionalism or protectionism that had to be stopped as it was considered a threat to the free trade system as well as a challenge to American supremacy.<sup>2</sup>

As postulated by Harvard professor and concurrent National Bureau of Economic Research director Martin Feldstein, on the other hand, held the view that IMF's biggest mistake was to deviate from its traditional role (of extending financial assistance to distressed member-countries) and to treat the crisis as an opportunity to carry out structural reforms [Nikkei, May 7, 1998]. The IMF insisted that East Asian countries undertake fundamental changes in economic and institutional structures, as it demanded, and got, the same changes from the former Soviet Union and Eastern Europe as a condition for receiving IMF funds. This approach was highly questionable as it ignored the fact that the basic cause of the crisis in these two areas was very different from each other. In the Soviet Union and Eastern Europe it was 'a case of temporary illiquidity rather than fundamental insolvency' (as was the case in East Asia). [Feldstein 1998:22 &25].

The conditionalities of the IMF financing were the traditional prescriptions, which include reduction in government spending and increases in tax and interest rates. According to the IMF the crisis stemmed from weaknesses in financial systems and, to a lesser extent, bad governance. A combination of inadequate financial sector supervision, poor assessment and management of financial risk, and the maintenance of relatively fixed exchange rates led banks and corporations to borrow large amounts of international capital, much of it short-term, denominated in foreign

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<sup>2</sup> Mr. Robert Rubin (Treasury Secretary) and Mr. Larry Summers (Deputy Treasury Secretary) feared that the fund (AMF) would offer big loans with less-stringent conditions than the IMF's and would threaten U.S. economic supremacy [WSJ, September. 24, 1998].

currency and unhedged. As time went on, this inflow of foreign capital tended to be used to finance poorer-quality investments' [IMF 1999].

Based on the IMF traditional conclusion and the application of common prescriptions, the crisis that hit Thailand led to the loss of confidence in the other East Asian countries, which are thought to have the same economic structure. As a result, the Thailand problem ultimately developed into the East Asian currency crisis. Moreover, the response of the US government and the prescription of the IMF worsened the crisis. An UNCTAD report clearly pointed out that the high interest rate and fiscal contraction prescriptions of the IMF jeopardized the otherwise robust export-oriented manufacturing industries due to the ensuing credit crunch [UNCTAD 2001:131]. Former World Bank vice Governor Joseph Stiglitz also expressed a similar assessment of the IMF role in deepening the crisis.

Such criticisms steadily became stronger as the crisis went beyond the boundaries of East Asia in the middle of 1998. In response, the IMF started easing up on its contractionary policies, and came to emphasize the sequencing of liberalization concerning the cause of the crisis. The crisis was not caused by liberalization itself, but rather the problem was that liberalization was carried out before a robust financial system could be set up. Nevertheless, even in such an interpretation, there was no change whatsoever in the preaching of the necessity of structural reforms [Hirakawa, 2002a].

## **2 Excessive Mobility of Capital and the East Asian Crisis**

The US and IMF interpretation, which emphasized the weaknesses of the East Asian systems and organizations, lost its influence starting early 1998 as the crisis spread to Russia and Brazil and developed into a global crisis. In September of the same year the legendary hedge fund, Long Term Capital Management (LTCM), was forced to the brink of collapse due to losses from its operations in Russia, prompting the Federal Reserve Bank of New York to organize a bail out. This led to a rapid growth of support for the belief that speculative transactions triggered the crisis. In actuality, fearing that an LTCM bankruptcy will cause anxiety over the American financial system, the New York Federal Bank gathered in one of its offices the directors of 16 major banks and security companies, and obtained commitments of assistance totaling over \$3.5 billion [New York Times, Sep.24, 1998]. This incident presented the critical opportunity to reveal part of the hedge fund's huge asset management and strongly speculative capital transactions, which until that time were largely unknown. It came to be considered that the crisis could have been caused by hedge fund speculations and the excessive mobility of short-term capital that allow such speculations.

Malaysian Prime Minister Mahathir immediately espoused the view that speculation was the culprit behind the crisis. He strongly criticized the famous investor George Soros. In the IMF-World Bank Joint Seminar held in Hong Kong in September 1997, he presented his own proposal that foreign exchange transactions, which are not accompanied by trade flows, should be made illegal. The proposal was simply laughed at [Financial Times, Sep.23, 1997]. However, as the Asian currency crisis deepened and spread globally, in the spring of the following year, Columbia University economics and political science professor Jagdish Bhagwati and then vice governor of the World Bank Joseph Stiglitz mentioned the danger of short term capital transactions [Bhagwati 1998; Stiglitz 1998].

MIT economics professor Paul Krugman also expressed his views that the Asian crisis was basically not due to economic fundamentals but a self-fulfilling crisis brought about by speculative investments and psychological anxieties. [Krugman 1998]. It is in the midst of all these discussions that the drama of the LTCM bankruptcy, as a threat to the international financial system, unfolded in the international community.

Despite the widespread criticisms of dangerous speculations in international financial transactions, the US remained adamant against the control of financial markets. In the fall of 1998, Japan considered the excessive mobility and excessive reliance of Asia on the dollar as causes of the currency crisis, and implemented controls on large speculative capital transactions as well as stressed the regulations of financial institutions. In November of the same year, at the APEC leaders meeting in Malaysia, various Asian countries emphasized controls on speculation but this position was met with resistance from the US. This problem became one of the agenda in the IMF and G7 meetings later on. The issue of controls of hedge funds came under intense consideration by the Basel Banking Monitoring Committee of the Bank for International Settlements (BIS), but direct controls on heavily-leveraged institutions (HLIs) - financial institutions carrying out financial transactions aimed at procuring large amounts of capital based on the principle of leverage - did not materialize. The US repeatedly stressed that the problem of HLIs, like hedge funds, can be avoided by the information provided by banks using such funds. East Asia and developing countries have no recourse but self-defense.

### **The Lessons of and Responses to the East Asian Crisis**

The most prominent feature of the Asian currency crisis was its being a global contagion able to transcend regions., As such, and it could not be explained by the internal factors of one country alone or the general characteristics of Asian systems or organizations. The crisis had its roots in the boom of financial liberalization and globalization that were driven by the strength of the US, IMF, and US banks and security firms in the second half of the 1980-1990 decade [Pempel 1999:70].

In actuality, at the onset of the 1990s, many East Asian countries made an all out thrust at liberalization. The risk of the resulting huge inflows of short-term capital was not only underestimated, but also favorably evaluated, by international risk-rating institutions. [BIS 1998:125-127]. In a report published one year before the crisis occurred, the World Bank even counted Thailand as an exemplary country that was able to successfully process the large inflows of capital [World Bank 1996:71]. Largely unaware of the dangers and, in fact, praised for their readiness to receive large inflows of such short term capital, East Asian countries, as the so-called emerging markets, became easy destinations for short term speculative investments for many decades. These investments consisted mainly of funds managed by banks, security companies, and hedge funds of the US and other advanced countries. The result of the virtually unrestricted inflow of funds is the systemic risk of a currency crisis. The crisis, when it occurred, did not, at all, faze the US and the IMF both of which one-sidedly saw it as a responsibility to be borne by the countries that were hit by it.

Of course, there were institutional defects or policy mistakes in the countries that were struck by the crisis. The Asian Development Bank [ADB 1999:27] observed that the currency crisis may, at first, look like it was unrelated to

fundamentals, but a closer look reveals certain faulty practices and policies. For example, it was noted that short-term credit was used to finance long-term projects; domestic banks lent to domestic firms in domestic currency while borrowing unhedged funds in foreign currencies; and the easy use of trust funds led to the expansion of investments in high risk assets. However, it cannot be said that the main causes of the currency crisis were internal factors; but, ADB's observation should be used as basis for reflection by the crisis-stricken countries. It was inevitable that these countries had to accept the conditionalities in order to avail of IMF funding. At the same time, these countries would use this foreign pressure to push forward major structural reforms to overcome their internal defects. In particular, for as long as they pursue further growth, which they have already achieved to a certain degree in their industrialization and economic development amidst globalization, the East Asian countries cannot avoid the issue of structural reforms that are necessary in order to improve their international competitiveness. Regardless of the cause of the crisis, the realization of the need for structural reforms is one lesson learned by the East Asian countries from the currency crisis. Another lesson is the recognition of the importance of regional cooperation, which will be discussed more in the next section.

Structural reforms have been led and driven by the World Bank, and have been packaged as financial sector reforms and corporate governance. Financial sector reforms include banks and non-bank financial companies, which did not have the prospect of restructuring due to their huge bad loans, and were closed down. For the other financial institutions that were restructured, bad loans were securitized and sold, additional capital was invested, and the institutional framework for capital infusion when needed was created. With respect to corporate governance, the lack of transparency of management and the lack of accounting standards or monitoring and control were identified as problems. Appropriate institutional strengthening and information dissemination to promote transparency were sought as solutions. What is interesting here is that the strengthening of corporate governance was limited to companies that were listed in the stock exchange. The IMF, the World Bank, and the US were concerned with the improvement of the security transaction technicalities and not with the East Asian corporate legalities. It is noteworthy that a research report on the legal reforms of Asia following the crisis concluded as follows: "the corporate governance that they (IMF, World Bank and the US) are thinking about is that of big domestic firms for the benefit of European-American institutional investors." In fact, Thailand's new accounting and monitoring system jointly created by the World Bank and the Thailand association of certified public accountants stipulates adherence to US accounting standards, the establishment of monitoring committees, the election of outside directors for publicly traded companies, and the preparation of financial reports in English. Clearly, structural reform was directed towards US standards for the benefit of American investors [Suzuki 2000:73].

Despite the implementation of reforms along the lines called for by the World Bank and the US, crisis-stricken countries began to pursue their own policies. In Thailand, the policies set up at the end of 2000 for the socio-economic restructuring was different from that proposed by the World Bank. At the same time these policies highlighted the industrial structural adjustment and small-medium scale enterprise projects supported by Japanese assistance [Suchiro 2000:101].

With economic recovery starting at the end of 2000, Thailand and Indonesia moved towards partly controlling their foreign exchange system. In January 2000, the Takshin administration was inaugurated in Thailand, and the rescue

of financial institutions began through the administration's buying of bad loans of private financial institutions. In South Korea, movements were observed of the financial assistance towards zaibatsu firms and the strengthening of government spending measures. [Nikkei 01.2.5] In Thailand and Indonesia, controls were implemented on foreign exchange transactions between non-residents.

Such developments have been generally criticized as impeding structural reforms and leading to a loss in international competitiveness. However, the IMF was later forced to admit that the capital controls that were implemented in Malaysia in September 1998 functioned effectively [IMF Public Information Notice No.99/88]. This showed that the recommendations advocated by the IMF and mainstream economists were not the only policy solution. In fact, the countries that were able to escape a serious currency crisis were countries that exercised controls on foreign exchange transactions: China, Taiwan, and Singapore [Abe/Sato/Nagano 1999; Jin 2000].

In the ASEM Financial Ministers meeting in Kobe in January 2001, Holst Koehler, the new managing director of the IMF, revealed that under certain conditions developing country exchange rate systems can shift from a flexible exchange rate system to a fixed exchange rate system [Koehler 2001]. This admitted the possibility of basket currency system proclaimed by Malaysia and the Japanese government as a foreign exchange system for East Asia.

It is impetuous, however, to reject outright the structural reforms being pushed by the US and the IMF, or to simply neglect or delay necessary reforms. Perhaps, it is more important that we should search for reforms that are appropriate for each country. This is not because of a desire by East Asian countries to separate from the global economy, but because these countries are precisely in the process of joining the globalized economy. However, it is necessary to minimize social friction; and the possibility, of aiming for a construction of a system representing the constraints of a particular society should not be rejected.

## **The Development of a Regional Economy/Financial Cooperation in East Asia**

### **1 Two Shocks: The Currency Crisis and the Birth of the Euro**

A major development in the international perspective of East Asia after the Asian currency crisis was the birth of a framework for regional cooperation and the start of discussions and deliberations regarding economic integration. As previously mentioned, this is also one lesson learned from the currency crisis. In general, the rise of regionalism or regional cooperation in Asia has been explained as simply a reaction to the European and US regionalism, unrelated to the currency crisis. There is also widespread understanding that the reason for the appearance of East Asian regionalism after the currency crisis was the boom in the second half of the 1990 decade.<sup>3</sup> However, the

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<sup>3</sup> The GATT/WTO reports showed that there was a small boom in the 1970s, but the current boom was the biggest for the 1990s. According to the 2001 version of Japan's Ministry of Economics and Industry "Trade White Paper", there were 113 FTAs, of which 17 were concluded in the 1970s and 66 were signed after 1995. Based on regional distribution, 80% of the FTAs were concentrated in Europe. The Market Integration Report of 1985 was also cited as having contributed in inspiring the boom in the 1990s. In line with this market white paper, the EU achieved full market integration in 1993. The US followed. In 1989, the US-Canada Free Trade Agreement was signed, and in 1992 the North American Free Trade Agreement (NAFTA) that included Mexico was concluded. Both these economic blocs continued to expand: the former to

currency crisis was a powerful internal force leading towards regionalism. For as long as the Asian currency crisis was a systemic risk that accompanied globalization, natural decision of the countries involved was the avoidance of a crisis by going beyond the capabilities of one country. However, the US and the IMF, as a rule, did not believe this reasoning.<sup>4</sup> Moreover, the crisis-stricken Asian countries could not expect the kind of strong assistance that the US and the IMF extended to Brazil and Mexico during the Latin American crisis. The opportunity was ripe for regional cooperation towards currency and financial cooperation in order to avoid the recurrence of a currency crisis.

The birth of the Euro in January 1999 in the European Union was crucial to the movement towards a common currency in East Asia.<sup>5</sup> The birth of the Euro was a welcome development in the light of East Asia's quest for a common currency after the region had gone through the currency crisis and realized the impact of currency problems. On the day the Euro was born, Japan's Finance Minister issued a statement praising the event as "one step towards a tight economic financial federation", and at the same time mentioned the internationalization of the yen. Thereafter, at least for some time, the internationalization of the yen was seriously considered.

In other Asian countries, as well, interest intensified towards the establishment of an Asian currency, analogous to the euro. In an interview with a journalist, Malaysia's Prime Minister Mahathir stated that it is also necessary to have an international currency in Asia, and supported the internationalization of the yen [Mainichi, January.12, 1999]. Top-level officials in Thailand have similar views. Some central banks in the region began talking about a common currency, even though its realization is still in the far future [Japan Times, January12, 1999].

The confirmation of the importance of the currency problem rapidly expanded the opportunity towards regional cooperation and regionalism in East Asia.

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Eastern Europe, and the latter to the whole of the American continent. In 1994, agreement was reached at the American leaders meeting to form a Free Trade Agreement of the Americas. It is in the midst of such developments that the rapid growth of regionalism in East Asia can be explained.

<sup>4</sup> The IMF Director of Research, Kenneth Rogoff recently wrote an open letter to Joseph Stiglitz, and criticized him because in his recent book, "Globalization and its Discontents", Stiglitz criticized the IMF for misguiding currency crisis-hit countries in East Asia [<http://www.imf.org/external/np/vc/2002/070202.htm>].

<sup>5</sup> Incidentally, the exchange of the old currency with Euro in January 2002 was initially met with a lot of anxiety, but it turned out that the exchange was done successfully. The twelve EU countries that introduced and are now using the euro are Germany, France, Italy, Spain, Belgium, Luxembourg, the Netherlands, Austria, Portugal, Finland, Ireland, and Greece.



## 2 Development of a Regional Financial Cooperation and Its Framework

Following the set back of the AMF initiative in 1997, the New Miyazawa Initiative (a new attempt to overcome the Asian currency crisis) was announced in October 1998.<sup>6</sup> This was an alternative proposal of the Japanese government, in lieu of the AMF initiative, which was abandoned in the previous year due to resistance from the US, and eventually was postponed for implementation in December. The New Miyazawa Initiative was an assistance package consisting of \$15 billion of short-term funds for economic recovery and \$15 billion of medium term funds for economic restructuring. This initiative also pushed for the internationalization of the yen.

It is noteworthy that when the Miyazawa initiative was proposed, criticism of IMF's contractionary policies was growing even in the World Bank. At the same time, the Japanese proposal was supported by professors Joseph Stiglitz Jeffrey Sachs<sup>7</sup>. The main reasons for the criticism were the strong belief that the severity of the crisis could have been alleviated if the AMF initiative was realized, and the recognition that the IMF alone could not handle the East Asian crisis. In the aftermath of the severe crisis, these were viewpoints that the US and the IMF could only reluctantly admit. From December 1998, assistance through the New Miyazawa Initiative was promised to Malaysia, Thailand, Indonesia, the Philippines, and South Korea, and by February 2000, the total amount of committed assistance reached \$21 billion.

The New Miyazawa Initiative was received well by the crisis-stricken countries, and was highly praised as the East Asian countries steadily recovered. It can be said that the New Miyazawa Initiative succeeded in enhancing Japan's role in the East Asian region, and once again expanded opportunities for a regional cooperation. However, the initiative was forced to adopt a bilateral approach to avoid US resistance; but, this approach had a different implication for the ASEAN and East Asian countries, which apparently preferred a regional approach. In any case, the new initiative rekindled interest in the AMF, which was earlier set aside.

Progress in the field of currency financial cooperation has since been steady. In the ASEAN+3<sup>8</sup> Financial Ministers meeting in May 2000 in Chiang Mai, Thailand, the Chiang Mai Initiative was agreed upon. This initiative was an agreement on currency swap arrangements designed to prevent the recurrence of a currency crisis. It was one step towards reviving the AMF and restored the prospect of establishing a single currency for the region.

It was at the ASEAN + 3 meetings that the pace of the progress of financial/currency cooperation was accelerated. Evidently, the currency crisis presented a singular opportunity for a determined effort to seriously deliberate on financial/currency cooperation, but there were prior supportive steps to be taken. The first of these steps was to consider the proposal of Malaysia's Prime Minister Mahathir in December 1990 for an East Asian Economic Group

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<sup>6</sup> This initiative is called the "New Miyazawa Initiative" after Kiichi Miyazawa who was Japan's Minister of Finance when the initiative was promulgated. This was called "new" because a first initiative of the same name was made in the mid 1980s to assist in the Latin American crisis.

<sup>7</sup> Joseph Stiglitz, Professor of Economics (Emeritus and Senior Fellow, Hoover Institution) retired professor of Stanford University. Professor Jeffrey Sachs is a member of the Harvard Econometric Society and the World Economic Forum's Global Leaders of Tomorrow.

<sup>8</sup> ASEAN, China, South Korea, and Japan.

(EAEG)<sup>9</sup>. Due to resistance from the US and Australia, the name of the group was changed to East Asia Economic Caucus (EAEC). Japan, in deference to US wishes, later opted not to join the EAEC. Thus, despite having its importance confirmed in the 4<sup>th</sup> ASEAN Summit Meeting in 1992, the EAEC ceased to function, after a brief existence, amidst criticisms that it could cause the breakup of the Asia Pacific Economic Cooperation<sup>10</sup> (APEC).

An attempt to establish a free trade economic area was first made in an agreement of the ASEAN members to form an ASEAN free trade area (AFTA) by 2008 (later accelerated to 2003) as a countermeasure to the rapid emergence of China as an industrial product exporting country. However, such a development did not extend into Northeast Asian regions.

In actuality, the five Northeast Asian countries/regions (China, Taiwan, Hong Kong, South Korea, and Japan) had chosen not to join any free trade agreement until 2000 [Ishikawa 2002:16]. The official reason given by Japan was that it preferred GATT's multilateral trading system, recalling that it was the grouping into economic blocs that precipitated the Second World War. Nevertheless, the facts are that the history of Japan's invasion of Asia and the East-West Cold War made dialogue difficult, and that despite this background Japan's sound economic growth was maintained [Hirakawa 2002b].

The institutionalization of the EAEC was, nevertheless, vigorously pursued by ASEAN. In March 1996, in the first ASEM meeting in Bangkok three countries - Japan, South Korea, and China - were added as members of the Asian side, and so the meeting had the same members as the proposed EAEC. Also, in January 1997 during his visit to Southeast Asia, Prime Minister Hashimoto Ryutaro proposed an ASEAN + Japan summit meeting in order to gain understanding for the review of the US-Japan security agreement guideline which was then being pushed by Japan. While the proposal was met favorably, there were cautious opinions, and ASEAN in the 30<sup>th</sup> anniversary of its establishment in December 1997 responded with a proposal to invite not only Japan but also China and South Korea. Apparently, ASEAN thought that the strengthening of relations with Japan will undermine relations with China which has a cautious attitude towards the Japan-US security treaty. As it was in the EAEC's case, the exclusion of China from the summit meeting was also considered not appropriate in the context of the effort to form a regional cooperation framework for the member countries of EAEC [Hirakawa 2002b].

Thus, the leaders of Japan, China, and South Korea were invited to the first ASEAN + 3 Summit Meeting which was held in December 1997 in Kuala Lumpur. Needless to say, the meeting was held in the midst of the Asian currency crisis. Naturally, the currency problem was discussed and the necessity of regional cooperation was confirmed. In the second ASEAN + 3 Summit Meeting in December 1998 in Hanoi, agreement was reached to hold the summit meeting regularly.

It was, however, in the third Summit Meeting in Manila in November 1999 that the framework for ASEAN + 3

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<sup>9</sup> Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand, South Korea, China, and Japan

<sup>10</sup> Formed in 1989. Member economies: Australia, Brunei, Canada, Chile, PROC, HK, Indonesia, Japan, Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Chinese Taipei, Thailand, United States, Vietnam.

underwent a very favorable development. In this meeting, for the first time in history, a joint declaration on regional cooperation in East Asia was made. The declaration called for the strengthening of regional cooperation in a wide range of disciplines, including East Asian politics, economics, culture, and security. In contrast, the first and second ASEAN + 3 Summit Meetings were held rather quietly. The reason perhaps was a concern regarding the US position on regionalism. However, more than anything else, it was necessary for Japan to decide to put itself at a determined distance from the US. At the same time, it was very significant that the three Northeast Asian countries, historically divided, decided to start cooperating with each other. By first doing away with such hurdles, the ASEAN + 3 cooperation framework could swiftly move forward.

In the 4<sup>th</sup> ASEAN + 3 Summit Meeting in November 2000 in Singapore, the proposal was made to convert the summit from an ASEAN invitational meeting to an Asian leaders meeting. In addition, the meeting's chairman Go Chok Tong, Singapore's Prime Minister, proposed the creation of an East Asian Zone. There was agreement for the establishment of an operation group to work on the proposal. The proposal was actually an alternative plan to the ASEAN-China Free Trade Area proposed by China's Premier Zhu Rongji. but it was quite significant as it was the first time in history that a proposal for a Free Trade Area in an East Asian scale was made in a meeting of Asian leaders. Moreover, in this meeting, agreement was made to start the ASEAN Integration Initiative, which involved the assistance to slower developing countries by the more developed or faster developing countries through projects such as the training of information technology personnel, development of skills, and training of labor.

Outside the Summit Meeting, there was also progress in the institutionalization of regular meetings within the ASEAN + 3 framework. From 1999, there was the annual financial ministers meeting; from 2000 the economic bureau meeting; and from 2001 there was the labor ministers meeting. The field of cooperation covered a wide range of activities, including trade, investment, finance, information technology, e-commerce, small and medium scale enterprises, Mekong delta development, and environment.

Moreover, in the 1999 ASEAN + 3 Summit Meeting, a luncheon meeting among Japan, China, and South Korea was held for the first time. From the 2000 Summit Meeting, the three countries met regularly, and in this way, gradually the Northeast Asian summit meeting materialized. This is possibly the first step in forming a Northeast Asia subregional cooperative body.

### **3 New Developments in the Free Trade Agreements**

As was discussed in the first section of this chapter, regional economic integration or Free Trade Agreements originated in Europe, expanded to the US, but was not aggressively pursued in Asia. However, the currency crisis provided impetus to new developments.

During his visit to Japan in October 1998, South Korea President Kim Dae Jung proposed and initiated deliberations on a Japan-Korea Free Trade Agreement. The first proposal for an FTA with Japan was made by Mexico in May of that year. In December 1999, subsequent to Kim Dae Jung's proposal, Singapore followed up with another proposal. The Singapore proposal prompted Japan at that time to gradually embark on a change of policy. The 2000 issue of

the International Trade White Paper reported that FTA was under consideration and was being promoted. This could be said as a policy shift for Japan, which had stressed a multilateral trade system centering on the WTO, and had not joined any bilateral agreement. The first FTA was signed with Singapore in January 2002.

The South Korean proposal for a Japan-Korea FTA was disclosed in a research report by two research institutions of both countries in May 1999. After that, both Korea and Japan for a while lapsed into passive stances. But the impact of the research report was so compelling that it led to the FTA proposal by Singapore at the end of that year. Moreover, China in the ASEAN + 3 Summit Meeting in November 2000 proposed an FTA with ASEAN. The proposal was agreed upon a year later i.e., 2001, in the 5<sup>th</sup> ASEAN + 3 Summit Meeting in Brunei, for implementation ten years later. In these negotiations, China made concessions such as import liberalization, firstly, of tropical products, as it searched for an agreement on other products. In response to this, South Korea promptly agreed to set up an FTA with ASEAN [Nation, Nov. 7, 2001]. During Prime Minister Koizumi's visit to ASEAN in January 2002, Japan proposed a Comprehensive Economic Partnership Initiative. The Philippines was very positive to an ASEAN-China FTA, and showed great enthusiasm for an East Asian Economic Zone in the future [Nikkei, May 21, 2002].

China, at present, has initiated formal talks on an FTA with Macao and Hong Kong, which have, in turn, initiated talks with New Zealand and have been approached by Singapore for similar talks. Taiwan has started research with New Zealand, as well as with Japan and the US [Nikkei, April 12, 2002]. South Korea, in the meantime, has started negotiations with Chile, New Zealand and Singapore. Currently, in the entire Northeast Asian countries/regions policy shifts regarding FTA in one form or another are taking place [Ishikawa 2002:16].

In East Asia, Singapore is the most aggressive country about FTA. It entered into an FTA with New Zealand in November 2000, with Chile in 1999, and from 2000 has initiated negotiations with Canada, Mexico, the US, and Australia. Under the Takshin administration, Thailand has also become more aggressive in pursuing FTA, and in November 2001 proposed one with Japan.

East Asian FTA is not necessarily limited to the region, which is targeting negotiations with its main markets such as the US, Mexico, and Chile. These planned negotiations should be helpful for the development of intra-regional markets, while strengthening beneficial relationships within the region, as well as initiating a countervailing capability against the anxieties that emerge from the growing regionalism and instability in the rest of the world.

### **The Issues and Challenges of East Asian Regional Cooperation**

With the currency crisis as an impetus, an East Asian regional cooperation order has been created, and remarkable progress towards economic integration can be observed. However, there are also huge obstacles in actualizing such an order.

Even concerning Singapore's aggressive pursuit of FTA not all ASEAN countries are in agreement. Barely noticeable in the greater flow of events are criticisms from countries such as Malaysia and Indonesia that

Singapore's policies create a backdoor to the ASEAN market, breaking up ASEAN's solidarity. [Nikkei, Nov. 11, 2000; Mahathir 2001:33]. As is evident in Malaysia's 3-year extension of automobile tariff reductions to protect the local car manufacturer, Proton, countries, which have uncompetitive industries, are viewing with anxiety the rapid market integration [Nation, Nov.2 & 7, 2001].

Certainly, FTA has an effect on the structural reform of each country. This will entail pain. Japan, in this respect, is at this point also indecisive. Japan agreed to an FTA with Singapore because the latter basically does not have an agricultural sector. The fact has been brought up that agriculture is effectively sacred ground, which cannot be liberalized even for a single agricultural product [Shigeoka 2002:40].

Even in the Comprehensive Economic Partnership Initiative proposed by Mr. Koizumi, liberalization of the agricultural sector was not given serious consideration. China has set a deadline for the signing of the ASEAN-China FTA, as well as promised the early reduction of tariffs on agricultural products, but Japan has not made any such proposal. In April 2001, Japan installed a temporary safeguard (emergency import restriction) on onions, raw mushrooms, and rushes, to which the biggest exporter, China, retaliated with tariffs on cars and mobile phones. It is said that behind the installation of the safeguard were pressures from Diet representatives from the regions producing the above three items [Wada 2002:88-93]. As is symbolized in Japan's liberalization of agricultural products, Japan's priority is to push structural reforms and the required political reforms through FTA (rather than liberalizing agriculture).

In the WTO meeting in Qatar in December 2001, China's membership was approved. However, the impact on China's agricultural sector of imports of cheap international products will be severe. According to a research comparing China's prices with international prices, in 2000 domestic wholesale prices of wheat, corn, soybeans, and cotton were 10 to 30 percent higher than the corresponding import prices (CIF). These price gaps are expected to grow even wider with membership in the WTO [Li 2002:4]. The FTA with ASEAN will force on China an even larger difficulty. These are some of the issues that countries have to individually confront with regards to FTA.

East Asia Regional cooperation, itself, has also brought about changes in extra-regional relationships, particularly with the US. According to a Far Eastern Review article on the Chiang Mai Initiative, although the initiative is said to be one step towards East Asia financial integration, the system established by it cannot be used freely. For instance, provision of funds for international transactions in amounts exceeding 10% of the agreed swap amount has to be cleared with the IMF whose decision in the matter is binding. The article also criticized Japan as the biggest promoter of, as well as the biggest obstacle to regionalism in view of its ambivalence. [Dieter 2001:29]. Professor Walden Bello of the University of the Philippines encourages Japan to put its feet in Asia and argues that the currency crisis was made even more severe because Japan did not stand up to the US or the IMF [Bello 2002]. This may just be the general attitude in Asia towards Japan. The US stands to protect its supremacy in Asia. However, for its own development and that of Asia, Japan has to assert and explain its similar position as that of the US.

Even though the Chiang Mai Initiative was not without problems, it has provided a possible starting point for the establishment of a regional common currency in the future. However, the currency for swap transactions, except for

those between Japan and China, remained the US dollar and not the yen. China's approval for the use of the yen for the swap arrangements in other countries could not be obtained [Asahi, Nov. 25, 2000]. This was because of China's strong suspicion towards Japan. As Asia's division of labor deepens, a stable currency becomes indispensable. For a stable currency, a coordination of policies among countries becomes necessary. However, in Japan there is an emerging sentiment of being threatened by China's rapid industrial development and increasing competitiveness. ASEAN also has a growing anxiety over the concentration of foreign direct investments in China. Without mutual trust, it is difficult to achieve much progress towards regional economic cooperation.

For the purpose of fostering regional economic cooperation, it is necessary for East Asia to have a common vision. Just as Europe created EU and a common currency, East Asia needs to also create a common community. In this respect, the setting up of the East Asia Vision Group in the 3<sup>rd</sup> ASEAN + 3 Summit Meeting is revolutionary. The Vision Group submitted to each of the leaders of the participating countries a report entitled "Towards an East Asian Common Body" [ASEAN+3 Summit 2001]. Although the envisaged common body is difficult to compare with Europe's common community, an East Asian common community has become a popular policy-discussion topic recently. The possibility of a new Asian society has become closer to being realized.

With the East Asian currency crisis, the movement towards regionalism has gained momentum. This revitalized movement, however, brings with it important issues at the domestic, intra-regional, and extra-regional levels. Moreover, it becomes even more necessary to avoid the large systemic risk that comes with globalization, and to understand better regionalism and regional cooperation in order to guarantee development. It is not a closed movement. It can be considered as a necessary process to guarantee development and the building of a diversified community in a region that has such a diverse history, culture, and language. While the movement entails great difficulties, it holds the potential as a departure point. In order to build a new community, not only the state but also the citizens should play an important role.

## **Question and Answer with Professor Hirakawa**

(Li Gangzhe) I have been in touch with Professor Hirakawa through three organizations, and have also received advice from him so it is very difficult for a disciple to comment on the professor. I am not quite sure if I could do a good job, but for the purposes of education, I would like to join the Professor in thinking about the issue of future East Asian cooperation.

There are several evaluations regarding the Currency Crisis. Professor Hirakawa's basic thinking is, I think, an all out criticism of the view which is skewed towards the so-called American Standard underlying globalization. However, as the Professor has also indicated, I think that, together with external factors this currency crisis has been caused by internal factors. My point is that internal factors are the lessons of the currency crisis, and should be changed through structural reforms. If we only emphasize the external factors, we ignore internal factors and effectively neglect reforming ourselves.

For my first question, one important issue that has been raised is for the internal structural reform of East Asia. What does the Professor think should be the direction to which structural reforms should be made?

The second one is on regional cooperation. It is edifying to note that ASEAN+3 has progressed rapidly after the

currency crisis. But, is this ASEAN+3 framework sufficient? When we think about regional cooperation, we can see that there are countries where we live (particularly Northeast Asia formed by Japan, China, and Korea), such as Mongolia and North Korea, which are being left behind by the market. These two countries practically do not have any connection with the currency crisis. I would like to hear the Professor's opinion about how to deal with such separated countries when we talk about regional cooperation with neighboring countries.



For the third issue, concerning future integration in East Asia, including currency integration, Asia has its own features and diversity, distinct from the Euro and dollar zones. Considering these, it is my opinion that an Asian style of East Asian integration which exploits the unique features of Asia should be deliberated.

May I request the professor for his comments?

(Hirakawa) Thank you very much, Mr. Li.

First of all, I think without internal structural reforms, Asia would face extreme difficulties in pursuing further development. In carrying out structural reforms, the problem is firstly the strengthening of strong firms or sectors, but this means that a heavy burden is forced upon the weak sectors. It becomes a structure that imposes a bigger load on weak people. This is a problem that should be seriously deliberated as a form of regional cooperation. Consequently, the target should be to think about what to do with the part that is separated from the economy's market. I am for the unrelenting implementation of structural reforms. However, because of this, each society would have to bear an extremely heavy burden. I think, if we do not seriously think how to bring this about with the least injury, then we inadvertently form a society for the strong.

As to the second point, regarding the issue of Northeast Asia regional cooperation. Actually, concerning Asia's formation of a common awareness as a group, we should consider this matter at different levels. When thinking about Japan-China-Korea, this naturally is part of a bigger framework that should be pushed. NGOs that transcend national borders will be very powerful, societies will be democratized, cities will be connected, mutual awareness deepened. These deliberations at different levels should be recognized as something like a summit meetings. Levels will be different for each case, but if this approach is not made to develop as much as possible, then creating an East Asian society would, I think, be difficult. In this respect, I think it is extremely important to form Northeast Asian cooperative relationships.

On the third point, about currency integration. It was necessary for the EU to go to a common currency at the same time it was forming the European Union. Since the 1980s, the forming of a European Union has been understood as a conservative stance based on a nationalism of weak countries or uncompetitive regions. This understanding is particularly true, I think, of Japanese researchers. However, as Europe was going through its economic development, it became necessary to maintain a stable exchange rate. At the same time, EU's origin or basis, was that it developed as an extension of EEC which was formed from the necessity to develop trusting relationships among peoples who have gone through the first and second world wars. It is said that this would be difficult to achieve in Asia, but I

think that Asia should once again seriously consider Europe's experience. Europe has a long history of integration, but until now this has been considered as a story out of this world, and that it is difficult or impossible to duplicate in Asia. But this does not mean that it cannot be done, but rather it should be done, otherwise it would be extremely difficult to build a development-oriented society or a stable and peaceful order in Asia. Through the currency crisis, I think, we finally recognized the European experience, as we form beneficial economic relationships that transcend national borders.

This is a rather brief reply, but given the time constraint I would like to pause here.



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# Corporate and Bank Restructuring after the IMF Crisis: The Korean Case

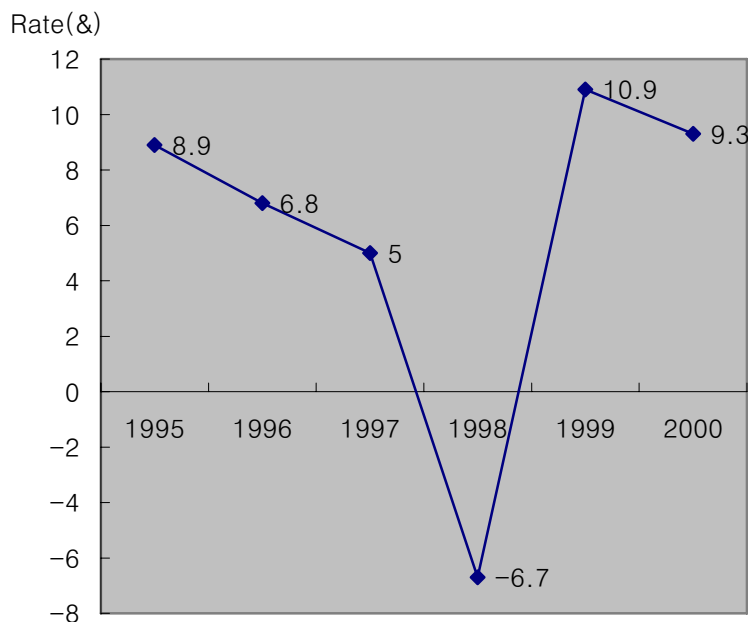
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The financial crisis in 1997 gave the Korean economy and people a great shock because they were used to a high-rate economic growth for the last three decades. The crisis caused not merely economic damage but also inflicted psychological frustration for the Korean people. Three years later, the world media praised Korea's successful recovery from the crisis in such a short time. The Korean economy recovered remarkably fast to 10.9% GDP growth in 1999 from a

negative 6.7% GDP growth in 1998.



GDP Growth Rate 1995-2000

As of April 2002, the foreign reserve in US dollar amounted to US \$108 billion having rose from US \$ 3.9 billion at the beginning of the financial crisis in 1997. Some western media criticized Japan's slow movement

toward economic reformation in contrast to its Korean neighbor's remarkable turnaround from the IMF crisis.

It is a correct statement that Korea has not yet completely freed itself from the aftershock of the IMF financial crisis. Rather we can evaluate that Korea is in the process of overcoming the crisis and looks successful so far.

Two striking achievements while getting over the crisis are : Corporate and Bank Restructuring. The purpose of this paper is to show some examples of the corporate and bank restructuring executed successfully for the last 3-4 years in Korea.

### **(1) Corporate Restructuring**

The rapid industrialization of Korea has been attributed to a remarkable performance of the Korean conglomerates (Chaebols). It was a persistent problem in Korea that the Chaebols had been involved in over-leveraging and over investing. On a vicious circle, the Chaebols became "too-big-to fail" even if they were in trouble. Apparently, many Korean companies including big Chaebols had a weak corporate structure, non-transparent financial conditions and bad corporate decision-making process. When the IMF crisis occurred, some corrections were taken belatedly.

The three main areas of the corporate sector reform are in corporate governance, corporate financial structure, and competitiveness. In corporate governance, the chaebols were required to comply with international accounting standards, to respect voting rights of the minority shareholders, and to elect outside directors of the board.

The Korean government has taken various measures to improve the corporate financial structure. On December 7, 1998, Korea's five largest Chaebols and their creditor banks agreed that they would try to lower the corporate debt ratios to the level of international standard. As a result, the debt-to-equity ratio of the top five Chaebols, excluding Daewoo, which is in bankruptcy, is now down to 200% from nearly 500% in 1997. The average debt-to-equity ratio for the nation's manufacturing sector as a whole is also down to around 240% from 400% in 1997. Chaebols were required to publish consolidated financial statements. Cross-debt guarantees among Chaebols' affiliates were also prohibited.

To enhance competitiveness among the big Chaebols, they were encouraged to concentrate on their core-competence areas by slimming down their non-core business units. "Big Deals" representing consolidation, mergers and acquisitions (M&A), and business swaps were promoted and, at times, imposed on troubled companies. The nation's top five Chaebols spun-off 549 subsidiary or affiliated companies between 1998 and 1999. The Korean government allowed competitive company hostile takeovers since 1999. These chaebols were also encouraged to have major business swaps and mergers and acquisitions among themselves.

Since 1997 government-initiated restructurings have been launched in 97 companies. Of this total, restructuring is still going on in 35 companies and has been carried out in 62 companies. Of these 62 companies, 36 companies successfully overcame their difficulties and got out of government-controlled initiative; 15 went into M&A ; and 11 went bankrupt. Here I want to introduce some examples of the corporate restructuring by 6 companies which overcame the crisis by their own efforts without government interference: Hankuk Electric Glass Co. Ltd, Pacific Corporation, Samsung Electronics, Humax, Shinhan Life, and Korea Agricultural & Rural Infrastructure Corporation (KARICO).

### Restructuring work & Key success factors

Companies	Restructuring work	Key success factors
Hankuk Electric Glass Co. Ltd	<p><b><u>Increase manufacturing efficiency through labor-management cooperation</u></b></p> <ul style="list-style-type: none"> <li>- Stability in industrial relation</li> <li>- Efficiency in organization structure and production</li> <li>- High value in products</li> </ul>	<ul style="list-style-type: none"> <li>- CEO leadership</li> <li>- Shared value between labor and management</li> </ul>
Pacific corp.	<p><b><u>Restructuring through strategic choice and focusing strategy</u></b></p> <ul style="list-style-type: none"> <li>- M&amp;A and slimming</li> <li>- Development of high-profit products</li> <li>- Restructuring and downsizing</li> </ul>	<ul style="list-style-type: none"> <li>- CEO decision</li> <li>- Right time for restructuring</li> </ul>
Samsung Electronics	<p><b><u>IT revolution and downsizing</u></b></p> <ul style="list-style-type: none"> <li>- Focus on IT business</li> <li>- Elimination of low-profit business</li> <li>- Adoption of global standard</li> </ul>	<ul style="list-style-type: none"> <li>- Restructuring focusing on growth-oriented business</li> <li>- Innovation-based management</li> </ul>
Humax	<p><b><u>Early positioning in growth-oriented market through R&amp;D</u></b></p> <ul style="list-style-type: none"> <li>- Leading technology in hi-tech products</li> <li>- Focus on core-business</li> <li>- Efficiency through outsourcing</li> </ul>	<ul style="list-style-type: none"> <li>- Capitalizing the opportunity for a single product</li> <li>- Venture spirit</li> </ul>
Shinhan Life	<p><b><u>Improving management efficiency for Profit</u></b></p> <ul style="list-style-type: none"> <li>- Turnaround from the management of Growth strategy</li> <li>- Building a autonomous system of Marketing</li> </ul>	<ul style="list-style-type: none"> <li>- Shift from profit-oriented strategy</li> <li>- Proactive crisis management</li> </ul>
KARICO	<p><b><u>Consolidating all agricultural business and organization in public sector</u></b></p> <ul style="list-style-type: none"> <li>- Restructuring with minimal conflict</li> <li>- High efficiency after restructuring</li> </ul>	<ul style="list-style-type: none"> <li>- Moral justification of Consolidation work</li> <li>- High drive of CEO</li> </ul>

## (2) **Bank Restructuring**

As of April 2001, the government poured public fund in restructuring the banks and the financial system with a minimal and limited success . The main direction of the bank restructuring was to get a bigger size in assets, to restructure redundant functions through M&A, and to improve the financial structure by eliminating the bad debts.

Korea's financial system had been under the direct control of the Korean government which has led the nation's industrialization for the last three decades. The Korean government directed and controlled the nation's financial resources even those owned by the commercial banks. In fact, Korean commercial banks operated as if they are rationing agent of the national financial resources under the auspices of the Korean government.

There has been a general perception among banks that the Korean government would bail them out when they run into financial trouble. This relationship caused moral hazard and corruption on the part of both the government and the banks.

On top of problems pertaining to the environment in which Korea's financial system was immersed, the nation's financial sector, particularly the banking sector has been caught up in its structural weakness. To name a few of the problems of Korean banks: lack of capability in risk management; operating with low capital base; owning non-performing assets; and a serious exposure to risks without proper hedging.

When the crisis broke out it was found that Korea did not have an appropriate regulatory and supervisory infrastructure. As a result, Korea was in a financial state of overborrowing from abroad and over-extending credits without proper hedging. The financial sector borrowed short and lent long resulting in a total external debts at the end of November 1997 amounting to US \$161.8 billion, most of which were short-term (64.4% of total debts in 1996).

This is a typical example of the so-called term-structure mismatch. When the Hong Kong stock market reported a sharp decline in October 1997, foreign lenders stopped rolling-over their short-term loans to Korean borrowers and drove Korea to seek the IMF rescue loan.

The reform of Korea's financial sector has two major objectives: improving the nation's financial regulatory and supervisory infrastructure and restructuring the financial sector.

The first objective was realized when the legislature passed a law to establish the Financial Supervisory Commission (FSC) in April, 1998. The FSC took various measures to enhance transparency and accountability in financial institutions. The number of the commercial banks was reduced to 17 from 27 and the number of employees was reduced by one-third. Out of 12 troubled banks, five were liquidated and merged with other banks and two were sold to foreign investors. In 1997, there were 30 commercial banks and 31 investment trust companies in business. At present, 19 commercial banks and seven trust companies have been either closed or merged into other institutions. These restructurings were made possible when the Korean government put up a huge amount of the public fund to clean up the balance sheets of the troubled financial institutions.

Now, Korea's financial market is fully open to foreign competition. All regulations on foreign investment, direct or indirect, had been eased toward full liberalization of foreign transaction by 2000. With these reforms and the united efforts by the Korean people, the economy was able to recover from the foreign exchange crisis in just one

and half years.

The Korean economy is still experiencing the corporate and bank restructuring resulting from the IMF crisis and much remains to be done before it completely gets out of the aftermath of the crisis.

Despite an optimistic view of the economic recovery from the IMF crisis, uncertainties still exist in the Korean economy and in the world financial market. Right now the Korean economy is on the way to a full recovery and is trying to improve in many areas to reach the goal. The Korean government sets restructuring programs in four main sectors: (1) corporate restructuring, (2) financial restructuring, (3) public sector restructuring, and (4) labor restructuring. Here I've covered the first two areas.

## Question and Answer with Professor Lee



(Kim) Thank you for a compact and easy to understand presentation, Professor Lee. I think it was very interesting. Since we do not have much time, let me simply ask you about three points.

In your presentation, professor, you raised issues on the two reforms, namely, that of the corporate sector and the banking sector. In Korea's case, the reform of the corporate sector is more advanced than that of the banking sector. You mentioned that this approach was useful in overcoming the currency crisis. What do you think is the

reason for the structural reforms of firms to be more advanced than the structural reforms of banks?

As for the second point, you divided the structural reforms of the successful firms into three areas: firstly, corporate governance; secondly, the firms' financial structure; and thirdly, maintenance of competitiveness. Of course, I think that these three are interrelated. Of these three areas, which do you think is relatively at a more advanced or delayed stage in the reform effort?

Lastly, the third point is about something that I think you explained in your presentation. In the short span of merely three years, Korea was able to recover very speedily. I would like to hear the professor's opinion about what could be the most important factor that could explain this fast recovery.

(Lee) I asked him, yesterday, "Please give me easy questions." But these are very difficult questions!

First, why corporate restructuring is more effective than bank restructuring, right? It means that government officers mostly control bank-restructuring work, but as far as corporate restructuring is concerned, the government gave corporate employees more freedom to implement reforms. So that is the difference. Corporate reform is more liberal and the government gave corporations more freedom to undertake reforms. In contrast, the banks are still controlled by the Korean government.

On the second question, maintaining selective and focused competitiveness has been the most successful. The reason is the same: in contrast to the relatively controlled first and second areas of corporate governance and financial structure, maintenance of selective and focused competitiveness has been more freely reformed.

(Lee) The last question is: how can Korea recover from a crisis in such a short time? Yes, there is some secret. First, the crisis we had was just a cash flow problem. Which means that we had too much short-term debt. So, we were not able to pay back on time. Sometimes you have a lot of money in the bank, but you do not have money in your pocket; you cannot buy anything, right? Even though you have a lot of money in the bank - that kind of cash flow problem. And also, the second reason is that the fundamentals of our economy were pretty good. So we came back rapidly. Our fundamentals are very good.

(Original in English)



# Economic Crisis, Market Concentration and Efficiency in the Banking Industry: Indonesia's Experience

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## Why consolidate?<sup>1</sup>

This paper is well-timed given the talks on banking sector consolidation in Indonesia in recent days. Consolidation adversely affects competition, among other things, because it increases market concentration (and reduces competition). When market concentration becomes higher, market entry may be limited and oligopolistic behavior would tend to intensify. This is not to say that consolidation should not proceed. However, when considering concentration, decision-makers should carefully deliberate on its effect on the sector's efficiency performance, particularly on the quality of service to bank customers.



Banks have always been the most important financial intermediaries in all economies. Even after the recent financial crisis, the banking sector continues to be the dominant players in East Asia's financial industry. As of the end of 1998, bank assets made up 91% of total financial sector assets in Indonesia, 78% in Malaysia, 77% in Thailand, 71% in Singapore and 38% in Korea (Source: Bank for International Settlement (BIS)). Given its central role in virtually all economies, it is therefore not surprising that banking is one of the most regulated industries.

The structure of the banking industry differs greatly across nations (see table 1). [Few nations have unconcentrated banking industries while more than half other nations have highly concentrated ones.] A report published by BIS concluded that concentration of the banking industry tended to increase during 1990s due to intense consolidation within the industry. While some of the consolidations<sup>2</sup> took place as response to globalization of financial and real markets, others are arose from resolution of the banking crisis which occurred repeatedly in the last decade.

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<sup>1</sup> Unless otherwise cited, the opinions expressed in this paper are solely those of the author. Likewise, all errors are the sole responsibility of the author. This paper was presented at the 8<sup>th</sup> SGRA Forum, July 20, 2002 at Karuizawa, Japan.

<sup>2</sup> Include mergers, acquisitions, and strategic alliances.

**Table 1 Structure of Banking Industry as of end-1998**

	Number of large and medium domestic bank <sup>1</sup>	Concentration in the banking industry <sup>2</sup>	Bank Claims on government <sup>3</sup>	Share of state-owned banks <sup>4</sup>	Share of foreign-owned banks <sup>4</sup>	Median BFSR Rating <sup>5</sup>
in percentages						
Hong Kong	21	29	7	0	77	C
Indonesia	..	45	2	22	12	E
Korea	14	50	3	28	6	E+
Malaysia	15	40	7	7	20	D
Phillipines	14	60	23	..	..	D+
Singapore	5	39	17	0	..	C+
Thailand	9	62	0	29	13	E
Australia	7	69	6	0	17	C
Germany	87	17	44	47	6	C
Japan	116	22	11	15	2	D
United States	182	35	15	0	20	C+

Source: BIS, IMF, Moody's Investor Service

<sup>1</sup> Number of banks ranked in world's top 1000

<sup>2</sup> Five largest banks' assets as a % of total assets

<sup>3</sup> Bank holdings of government paper as a % of banks' deposits

<sup>4</sup> As % of total banks assets

<sup>5</sup> Bank Financial Strength Ratings measure the likelihood that financial institutions will require assistance from third parties

In the case of Indonesia, the country has been severely hit by the currency crisis which led to the banking crisis in the second half of 1997. Since then, the Government of Indonesia (GOI), with IMF prescription, has tried to resolve the crisis by interventions in banking sector<sup>3</sup>. Since late 1997, sets of bank resolution programs have been launched, and as a result, up to December 2000, the number of banks in Indonesia has declined from 238 to 151 (see table 2).

Seventy banks were closed and 11 banks nationalized during the course of the crisis. As a result, the GOI now holds significant stakes in the private recapitalized banks (75% of total bank assets are now being controlled by the GOI, including the 11 nationalized banks. (Source: Indonesia Central Bank/Bank Indonesia (BI)). The GOI has acknowledged the need to consolidate the banking sector in order to restore the viability of the financial sector. In the short-run, the GOI has pledged to restore profitability in the banking sector and to improve supervision while in the medium term, it realized the urgency to develop a strategy to reduce state's involvement in the financial sector. As we take a look at the country's banking industry, there has been significant change as described in table 3.

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<sup>3</sup> Interventions may be through "closures" or "open bank" resolution where bank remains open for business, but under new rules for the conduct of business or maybe as part of another institution.

**Table 2 Number of Banks**

Group of Banks	October 1997	Changes during November 1997-November 2000			December 2000
		Liquidation <sup>1</sup>	Merger	New Bank	
State-owned	7		4	2	5
Private Forex	115	34	14		67
- Category A					28
- Recap					6
- BTO					4
- Others (ex. JV)					29
Private Non-Forex	79	35	1		43
- Category A					42
- Recap					1
Regional Development Bank	27	1			26
- Recap					12
- No Recap					14
Foreign	10				10
<b>Number of Banks</b>	<b>238</b>	<b>70</b>	<b>19</b>	<b>2</b>	<b>151</b>

Source: Bank Indonesia

<sup>1</sup> including frozen operation, frozen banks

**Table 3. Some Characteristics of Indonesia's Banks , 1998 & 1999**

	1998	1999
Concentration in the banking <sup>1</sup>	45.31	62.68
Bank claims on GOI	2.00	47.33
Share of state-owned <sup>2</sup>	21.59	74.81
Share of foreign-owned <sup>2</sup>	11.15	8.18
Real bank credit <sup>3</sup>	0.43	-33.81

Source: Bank Indonesia and IFS,

<sup>1</sup> % Five largest banks' assets to total banks'

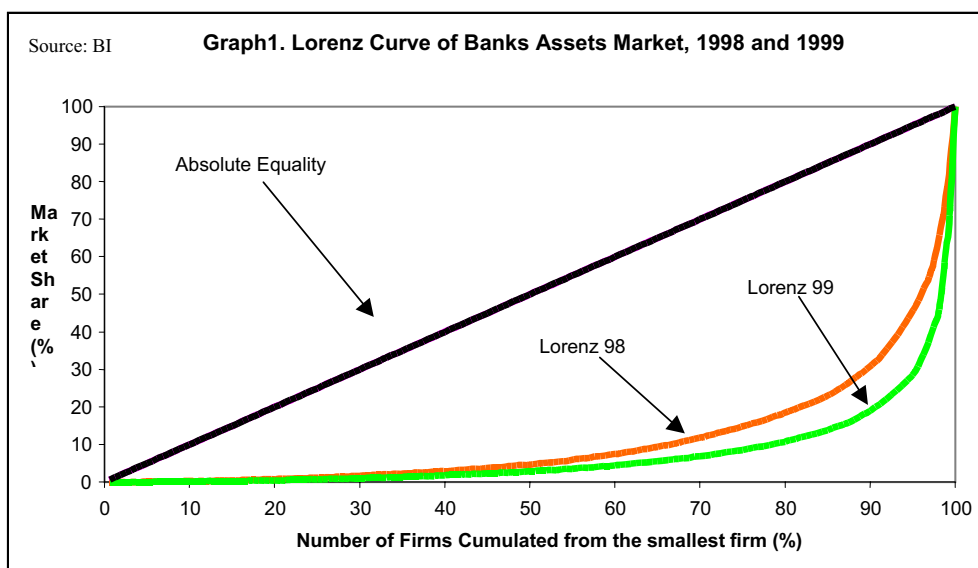
<sup>2</sup> as a % to total banks

<sup>3</sup> deflated by CPI index

### Consolidation, asset and deposit

First we will examine the concentration ratio in banks' assets market. We compare the banks' assets at the end of 1998 and 1999. All banks data used here were compiled by BI (the central bank). As of the end 1998, the total assets controlled by the banking sector in Indonesia was Rupiah 454,000 billion and increasing to reach Rupiah 772,000 billion at the end of 1999.

The Lorenz Curve in the assets market showed that in 1999, absolute inequality has risen compared to one in 1998. Table 4, below clearly demonstrates three indicators (Gini Coefficient, C1 to C10, and HHI) that concentration in banks' assets market has increased during the course of the crisis, 1998-99.



**Table 4 Market Concentration in Indonesia's Banks Assets Market**

	1998		1999	
		Bank Rank <sup>1</sup>		Bank Rank <sup>1</sup>
<b>Gini Coeff.</b>	<b>55.67</b>		<b>69.71</b>	
C1	14.90	1. BCA	29.00	1. Bank Mandiri
C2	26.70	2. BNI	41.52	2. BNI
C3	34.19	3. BRI	53.98	3. BCA
C4	40.94	4. BII	58.73	4. BII
C5	45.31	5. Bank Danamon	62.68	5. BRI
C6	48.48	6. Lippobank	66.05	6. Bank Danamon
C7	51.48	7. Citibank, NA	69.13	7. Lippobank
C8	54.14	8. Bank Niaga	71.52	8. Citibank, NA
C9	56.45	9. BTN	72.98	9. Bank Panin
C10	58.74	10. Bank Panin	74.98	10. Bank Universal
<b>I<sub>HH</sub></b>	<b>551.54</b>		<b>1235.62</b>	

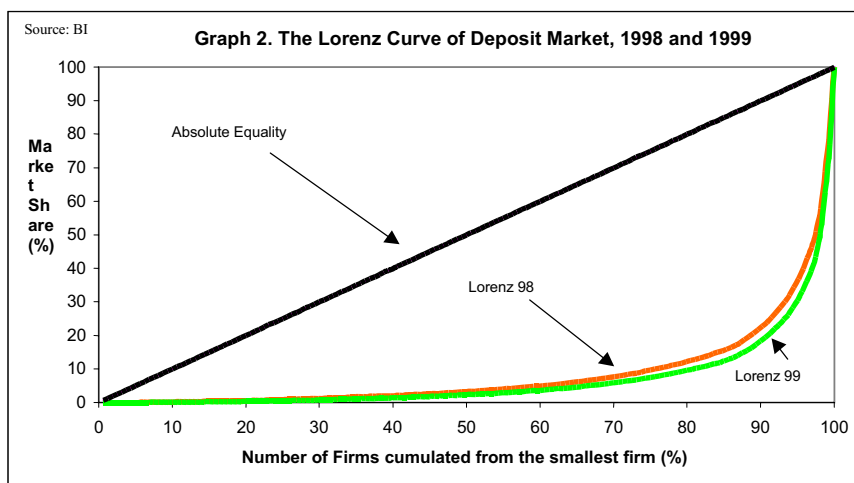
Source: Bank Indonesia

<sup>1</sup> ascending order of the banks assets controlled

Gini Coefficient for assets market increased from 55.67 to 69.71 meaning inequality has worsened after the GOI's bank resolution programs started in early 1998. The concentration ratio also showed significant increases. At the end of 1998, BCA controlled about 15% of total banks' assets; followed by BNI which was the largest state-owned bank at the time, controlling about 11.8% of total banks' assets. Seven of the largest banks in the banks' assets market controlled more than 50% of total banks' assets. The picture is quite different at the end of 1999 where Bank Mandiri, a new state bank established from a merger of four state-owned banks (BBD, BDN, Bapindo and Bank Exim) held 29% of total banks' assets. While it took seven banks at the end of 1998 to control more than 50% of total banks' assets in the country, at the end of 1999, it only took three banks to obtain the same percentage. The HHI greatly increased from 551.54 to 1235.62, which means there are more firms with unequally large market shares in the market in 1999.

We get a similar picture of concentration in the banks' deposit market. In total, deposit market in the banking industry at the end of 1998 amounted to Rupiah 391,500 billion, while at the end of 1999, the banking sector controlled over Rupiah 600,000 billion of third-party deposits.

There is a slight difference between inequality conditions in 1998 and in 1999, since the Lorenz curve only narrowly moves further away from the absolute equality line. The table below shows how concentration in deposits' market changed during 1998-99. Just like in the case of banks assets market, post-consolidation concentration indicators seems to confirm that the deposit market became relatively more concentrated in 1999 than in 1998.



**Table 5 Market Concentration in Indonesia's Banks Deposit Market**

	1998		1999	
		Bank Rank <sup>1</sup>		Bank Rank <sup>1</sup>
<b>Gini Coeff.</b>	<b>64.91</b>		<b>69.72</b>	
C1	17.89	1. BNI	23.21	1. Bank Mandiri
C2	31.31	2. BCA	37.47	2. BCA
C3	42.21	3. BRI	49.73	3. BNI
C4	49.05	4. BII	56.63	4. BRI
C5	53.79	5. Lippobank	60.72	5. BII
C6	57.00	6. Bank Danamon	63.81	6. Bank Danamon
C7	60.14	7. Citibank, NA	66.84	7. Lippobank
C8	63.02	8. BTN	69.55	8. Citibank, NA
C9	65.64	9. Bank Niaga	71.75	9. BTN
C10	68.00	10. Bank Bali	73.82	10. Bank Niaga
<b>I<sub>HH</sub></b>	<b>753.50</b>		<b>1009.36</b>	

Source: Bank Indonesia

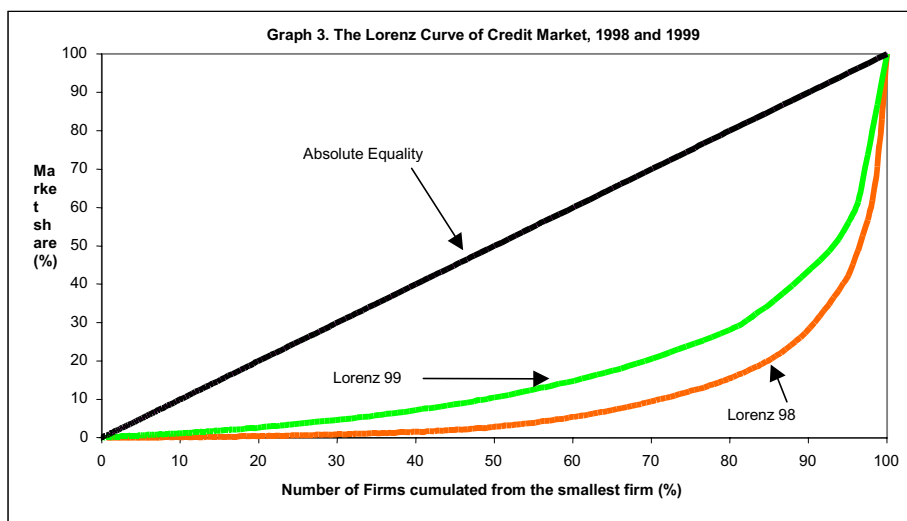
<sup>1</sup> ascending order of the banks deposit controlled

Again, the newly-established Bank Mandiri stood alone at the highest rank in deposit market at the end of 1999, controlling almost a quarter of the total deposits in the market. BCA came in second place controlling 14% of total deposits in the market in 1999. Concentration in deposit market has not changed substantially during 1998-99, partly

because the GOI has provided blanket guarantee for depositors and creditors of all domestic banks on January 26, 1998. Before 1998, bank runs which earlier had been largely a flight to perceived quality became pervasive as concerns over banks' safety merged into broader concerns over the currency and the stance of economic policy overall—earlier, transfers of deposits occurred from weak private to state banks but in later days there were withdrawals of deposits from the banking system altogether (except for foreign banks).

### Consolidation and credit flow

In the banks credit market, concentration has surprisingly declined after the GOI's bank resolution programs. The graph shown below describes how the area of concentration was reduced and the Lorenz curve was moving towards absolute equality line.



Source: BI

Table 6 below clearly shows some improvements regarding market concentration at the end of 1998 compared to one at the end of 1999. However, there is one important note that should be taken into account in analyzing bank credit market in Indonesia during 1998-99. The availability of credit flows has been greatly reduced by the crisis. At the end of 1998, the volume of credit flows in banking industry was approximately Rupiah 233,800 billion while at the end of 1999, it was only Rupiah 163,126 billion. The crisis has had profound impact on the banking system capacity to lend, since most banks' balance sheets are now dominated by recapitalization bonds in order to fulfill standard capital adequacy ratio of 8 percent. [The GOI's recapitalization program aimed at achieving half the international standard Capital Adequacy Ratio (CAR) for banks]. To start lending again, banks must regain profitability and build their CAR. This should be the government's priority in the near future.

Consolidation in the banking industry has raised concerns of a reduction in the availability of credit to small and medium-sized enterprises due to the decrease in the number of small banks that specialize in this type of lending.

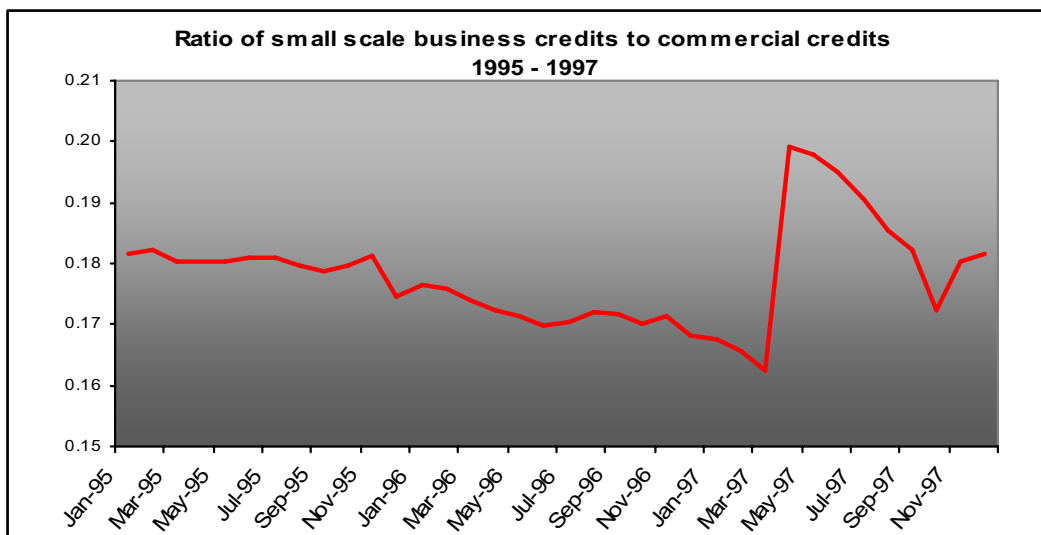
There are two reasons as to why this may occur. First, larger and more complex credit institutions have a lower propensity to lend to small firms. Second, the dynamics of consolidation may cause a permanent disruption of credit relationships. To the extent that credit relationships between banks and small firms are characterized by soft information, which is less transferable than hard information such as balance sheet and income statement, small firms could face difficulties in finding credit from other sources. Nevertheless, some improvement in the credit market in Indonesia showed that a significant part of the new credit (which has been hesitantly made available by banks) seems to go to SMEs rather than to the traditional, large borrowers that are still deeply in debt<sup>4</sup>. See graphs below.

**Table 6. Credit Market Concentration Ratios**

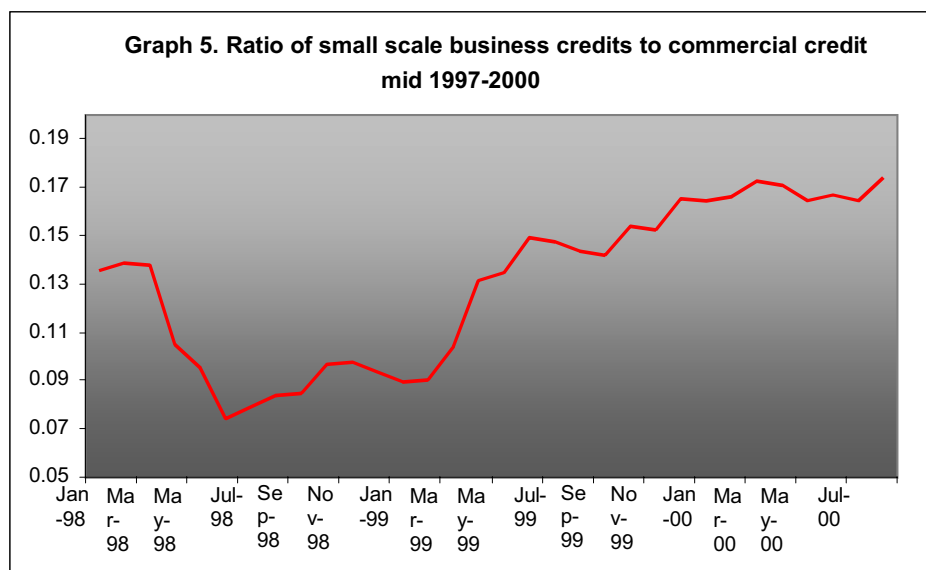
	1998		1999	
		Bank Rank <sup>1</sup>		Bank Rank <sup>1</sup>
<b>Gini Coefficient</b>	<b>58.94</b>		<b>53.03</b>	
C1	17.02	1. BCA	13.26	1. Bank Mandiri
C2	29.44	2. BNI	26.41	2. BRI
C3	38.24	3. BRI	38.48	3. BNI
C4	43.24	4. Bank Danamon	43.92	4. BII
C5	47.27	5. Bank Niaga	48.19	5. BTN
C6	51.18	6. BII	51.36	6. Citibank
C7	54.83	7. BTN	53.69	7. BCA
C8	57.76	8. BPD	55.99	8. Bank Niaga
C9	59.70	9. Bank PANIN	58.19	9. Bank Universal
C10	61.63	10. Lippobank	60.30	10. Bank PANIN
<b>I<sub>HH</sub></b>	<b>638.36</b>		<b>605.38</b>	

Source: Bank Indonesia

<sup>1</sup> ascending order of banks' credit volume



<sup>4</sup> See progress report CGI (Consultative Group on Indonesia), September 2000



It is also worthy to note about the impact of merger in the Indonesia banking system on credit flows. Will a newly merge bank increase the provision of credit to small and medium firms? This question is very important because most big companies are not being able to borrow from banks because of huge debts on their balance sheets. Failure to solve this debt problem quickly, plus the bad impact of consolidation in the banking system on providing credit to small and medium companies will create very difficult problems in channeling credit to the economy in the future.

A merger increases the size and complexity of the credit institutions involved. Smaller banks are constrained to lend to large firms, while large banks get access to a wider pool of borrowers and to a different mix of assets and financial products. Once the size constraint is eased, a newly merge banks might shift its loan portfolio in favor of larger borrowers or even shift their assets composition away from traditional lending activities. A second point could be that in providing credit to small borrowers, characterized by large information asymmetries, small banks enjoy a cost advantage over larger banks both in loan origination and monitoring. Therefore, once small banks are replaced by larger ones, a decrease in small business credit may be observed because loans that were profitable are no longer so. Small firms (which are most of the firms in Indonesia) are considered significantly more opaque than larger ones; since they do not have traded securities on public markets and the requirements on their financial statement are looser. Consequently, the quality of these firms may be more difficult to assess.

Banks develop relationships that allow them to overcome asymmetric information problems because detailed knowledge of the firms is gained over time through contact with them. Small bank may have a comparative advantage in issuing relationship-based loans and in monitoring small firms' activities. Due to their knowledge of the community in which the firm operates, these banks may have access to soft information on the entrepreneur and on local market conditions. As banks consolidate, their organizational structure tends to become more complex, and the lending decisions may be made at corporate headquarters located far from the firms' activities. It may not be



efficient to combine the provision of retail services to small customers with the provision of wholesale capital market services to large customers.

Moreover, mergers and acquisitions usually involve deep organizational restructuring and changes of branch managers. The reassessment of the loan portfolio by new managers who might not possess the related soft information may disrupt some of the existing relationships. Borrowers demanding relationship based-credit will find it difficult to convey their quality requirement to other banks due to adverse selection problems and may end up being denied credit.

### **Consolidation, profitability and efficiency**

As mentioned earlier, market concentration could suggest degree of competition in an industry. In all three cases above, we found the ongoing consolidation in banking industry in Indonesia has increased concentration in banks' assets and banks' deposits market. The BIS 70<sup>th</sup> Annual Report argued that the final effect of consolidation on competition depends on the likelihood of market entry and on firm behavior. Baumol (1982) claimed consolidation increases market concentration but there would be no effect on competition when the market is contestable. In the case of the financial industry, contestability fails to hold as a result of different types of entry barriers. Lack of contestability in retail bank market is mostly caused by relatively inelastic customer demand. For example, customers find it convenient to buy all their financial services from a single financial provider. As such, they may become less inclined to switch to other providers in response to favorable price offers. Another source of rigidity of demand is the complexity of products, which may increase the difficulty of comparing the services of different providers. Given the fact that a contestable market could not be established in the financial industry, higher concentration in the market could jeopardize competition in the industry.

Domestic mergers and takeovers often constitute the least costly way of consolidation in the financial sector. In the case of a systemic banking crisis, governments tend to intensify their efforts to promote mergers. However, it is an open question whether merging two weak banks can create a strong single bank. When these weak banks are large, mergers among them will create institutions whose failure is potentially damaging to the stability of the industry. Forcing a healthy bank to assume a heavy burden of bad loans from a weaker bank may be counterproductive. Nevertheless, if the new entities are managed more efficiently there should be benefits for the consumers and no threats to the stability of the industry.

The below shows the average rates of growth of total banks' assets, operating cost and personnel expenditure as well as the average inflation in Indonesia from January 1997 to August 2000. It is well indicated that the period of financial repression<sup>5</sup> was a period of high asset mobilization while operating cost and personnel expenditure almost moved together with inflation. The result of relationship between financial repression and asset mobilization is quite strange. This odd relationship is caused by the issuance of government bonds. Government bond is injected into the

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<sup>5</sup> interest rates are held below market-clearing levels

banking industry as a part of a restructuring program. For example: Turkey experienced a different result with this relationship (see Rocha: Cost of Intermediation in Developing Countries). In Turkey's experience financial repression was negatively related with high asset mobilization. In terms of cost, financial repression has caused high asset mobilization in two countries (mention these countries). Low inflation rate proves to be one of the solutions to reduce cost in banking sectors. In our case, the ability of Bank Indonesia to curb inflation by raising interest rate will help the banking sector avoid high personnel and operating cost.

Period	Rate of Growth (%)			
	Inflation	Total Assets	Operating Cost	Personal Expenditure
Jan-Des'97	11.1	39.6	126.3	23.4
Jan-Des'98	77.6	29.0	311.4	17.6
Jan-Des'99	2.0	-8.8	-62.4	-7.9
Jan-Agt'00	9.3	18.9	-51.7	-25.3

We would like to know the behavioral relationship between market structure and profitability by using ordinary least square (OLS). For this purpose, we tested elements of the structure such as asset, credit and deposit with return on asset. First, we regressed Return on Asset (ROA) with structure based on asset (the Herfindahl index of asset). The result was in line with what we expected on the rationale. The quantitative influences of this relationship are relatively small but very significant. Structure negatively influenced profitability. Second, we regressed ROA with the Herfindahl index of credit. The result showed that structure of credit market influenced ROA negatively, accompanied by small value of coefficient numbers. The third, market structure based on deposit, negatively influenced ROA. These three tests prove the existence of a negative relationship between market structure and profitability (see Putra and Setiati August 2001).

It is quite interesting to note that more concentrated market structure has a negative influence on the profitability of Indonesia's banking system. The rationale says that a structure with a few firms and high entry barriers facilitates a pricing conduct that is aimed at achieving joint profit maximization through collusion, price leadership or other tacit pricing arrangements. But this rationale does not work well in Indonesia's banking system as proven by the negative relationship between structure and profitability. It does not work well because of at least three reasons. First, the effect of inter-institutional competition is not well understood. Although banks may be relatively few, they may suffer from competition from other financial institutions, both domestic and foreign, or from competition from the commercial paper and bond market. Most of the short-term debts and long-term debts in Indonesia were provided by non-financial corporations. Second, there might be a critical level of concentration, in the sense that a reduction in the number of firms below this critical level leads the participants to collusion and to form a cartel. Thus, above that level the monopolistic objective has already been attained. More concentrated market is still far away from the critical level of concentration. Third, The bank closures in Indonesia provoked a financial panic and a run on the

entire private-sector banking system other than the foreign-owned bank. The IMF's actions in Indonesia were particularly egregious. Sixteen commercial banks were suddenly closed with the explicit proviso that deposits over Rupiah 20 million would be unprotected (i.e, not covered by deposit insurance). This was a recipe for panic (Radelet and Sachs, April 1998). Banks faced negative interest spread that reduced substantially banks' profitability and capital.

Following the Rocha studies to obtain a rough estimate of the potential misallocation, Putra, Setiati, and Damayanti August 2001 compared the gross margin and operating cost ratios calculated earlier with the ratios obtained for OECD countries (3.9% and 2.3% of assets, respectively). Note that these figures came from the Rocha studies (1986)). Multiplying the differences by the ratio of assets to GDP gave an estimate of the excessive costs of intermediation as a percentage of GDP. Table 8 below demonstrates the result:

**Table 8. Assesment of the Efficiency of the Financial Systems,**

Group of Banks	Year	Total Asset/GDP	Deviations from OECD average values* as a % of GDP	
			Gross Margin	Operating Cost
10 Largest	1996	5.71	-0.80	0.04
Second 10		1.28	1.58	1.31
Third 10		0.51	-0.61	0.51
10 Largest	1997	6.93	-0.87	0.08
Second 10		1.57	2.36	2.14
Third 10		0.71	1.00	1.26
10 Largest	1998	5.73	-14.84	10.58
Second 10		1.30	3.45	16.26
Third 10		0.60	2.26	12.41
10 Largest	1999	5.58	-4.13	4.57
Second 10		0.77	-2.49	9.88
Third 10		0.37	-2.87	11.20

Source: Bank  
\* from Rocha studies

From the result of the studies, we see that none of these groups of banks had been able to maintain a monopoly rent even before the crisis started in late 1997. It is particularly noted that the ten largest banks in the country have demonstrated their ability to manage cost of intermediation<sup>6</sup> at the cost of its gross margin. It should be noted, however, that this exercise is only illustrative (especially if we observe that the OECD standard was taken from 1986 studies. These figures may have changed by now). The primary objective (in citing these studies) is to provide an idea of loss in efficiency which could be substantial. These studies may actually underestimate the overall loss in efficiency since they are limited to the banking system only.

<sup>6</sup> One of most probable causes why operating costs in Indonesia have been significantly different from the ones in OECD is its lower standard wages.

Putra, Setiati and Damayanti July 2001 examined significant influences of various traditional factors of production, credit, technical progress on efficiency (progress), and scale economies of Banking Industry in Indonesia based on a Translog cost function approach. A cost function was estimated for 109 banks in Indonesia over the period from December 1996 through August 2000. This period analysis of banking costs helps to ensure that the model is identifying long-run cost differences between banks rather than short-run anomalies. It is also helps to captures the period before the economic crisis began and economic crisis period. Every bank was included in the cost function as long as it had been in existence since December 1996, remained in existence through August 2000, and reported monthly all the information needed for the cost efficiency model to BI. One of this study's results showed that, in term of efficiency, the policy to create bigger-sized of banks was were not an appropriate policy. The smaller the size of the banks the better for the banks' efficiency, but this trend indicated that banks failed to maintain their smallest efficient size of production scale from time to time.

### **Concluding remarks**

As mentioned on above results, consolidation of banking sector under IMF which has been ongoing in Indonesia has increased concentration and decreased profitability in the sector. In general, in a competitive environment only the most efficient and innovative firms survive, thus ensuring that the industry remains healthy and that firms pass on the benefits of competition and innovation to their customers. Consolidation increases market concentration and thus may lessen competition.<sup>7</sup> When concentration becomes higher, market entry may be limited and oligopolistic behavior tend to intensify, possibly leading to non-competitive levels of prices (or interest rate in the case of banking sector) and volumes. But, none of these groups of banks had been able to maintain monopoly rent even before the crisis started in late 1997. ROA's perspective also had shown that, in general, banking performance was getting worst. Translog cost function estimated that banks failed to maintain their efficiency. The suggested policy to curb inefficiency in the banking system is encouraging greater competition between banks and in the labor market for bank employees, and encouraging the separation of industrial and financial groups.

The opening of the financial sector to more foreign direct investment should probably be undertaken much more quickly and forthrightly. More foreign banks would almost surely have helped to calm the financial crisis. Radelet and Sachs April 1998 gave the following reasons. First, branches of major international banks would have been much less subject to depositor panic (in Indonesia, depositors fled from Indonesia national banks to the few foreign banks). Second, these foreign banks would have been less likely to withdraw their own loans to local customer than they were to withdraw their cross-border credit to Indonesian Banks. Third, these banks would have raised the general level of competition in the banking system, and would probably have helped to limit the politicization of bank ownership and lending. All of these measures could be difficult to be implemented because of political

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<sup>7</sup> It is worth noting the fact that high market concentration does not necessarily mean lack of competition or market power abuse. As long as the market is contestable (see Baumol, 1982), high concentration may also be associated with high degree of competition. Low market concentration can be associated with lack of competition when firms engage in collusive behavior such as forming a cartel. In reality, banks market's contestability is very scarce because of inelastic customer demand.

consequences involved. In order to encourage greater competition, foreign banks and foreign expertise should be allowed to enter the domestic financial market. Ongoing financial service negotiations at the WTO give Indonesia the very valuable opportunity to commit to this opening up, with built-in adequate safeguards.

### Question and Answer with Mr. Gatot



(Maquito) Thank you very much, Gatot-san, for coming from such a far distance to join us here in Japan. My question is about the basic policy of IMF, which was consolidation as a measure to control the crisis that was raging on in Indonesia. And of course in exchange for this, the Indonesian government had to swallow some conditionalities. In your frank and honest evaluation, I would say, you said that this policy of the IMF was not good for Indonesia, basically, on two points. One, efficiency of banks went down because this led to an overcapacity. Second, profits of banks, even though they were not already earning monopoly profits before that, after the crisis, again went down. So in your evaluation, that is not good. Can you give some background on why IMF proposes such a conditionality?

The second question: In your opinion, do you think that there is a need for an alternative framework in East Asia to handle what has been the traditional role of IMF?

(Gatot) Thank you very much for a very tough question and a very smart question. The original IMF prescription actually, in my opinion, it is basically because of not the economic motive, but the political motive. At that time, when the crisis began, Thailand is the first country hit by the crisis, but Indonesia, micro-fundamental, is still the best. I think not the best, but better than Thailand. But IMF did not like Suharto. I did not like Suharto, too. But, at the time, the reason why IMF consolidated the banking sector in Indonesia, they want to make a panic. As you may know, the bank that were actually closed and consolidated at that time belonged to the Suharto family. So it is very ridiculous that IMF came to Indonesia, not with economic motives, but with political motives. If it is a political motive, it is not IMF's job. So that is why I am always questioning IMF. Because if IMF does not like the President, not only in Indonesia, maybe it does not like Mahathir, too, he can replace the President, by making such kinds of prescription. And because Malaysia is different from Indonesia - fundamentally, Malaysia is better than Indonesia, and Mahathir is smarter than Suharto, they cannot dictate to Mahathir, but they have been dictating Indonesia until now.

And for the second question, it is a very good question, also. Based on that background, I think that Asian nations should have an alternative. Not only rely on IMF alone, but also have another alternative. Maybe it is an Asian Monetary Fund, and so on. But basically, the motive still needs to be an economic motive, not a political motive. For example, in the case of Indonesia, IMF does not function well, it functions as a lender of last resort. That is why the panic, not only in domestic side, but also in terms of the other side, happened to Indonesia. So if an Asian Monetary Fund can function well, can deliver its function as a central bank, that is, lender of last resort, I think the crisis will not be like this. Thank you very much.

(Original in English)

## Appendix:

### Some methodologies on margins' definition

The aggregation of the items in the income statements is the one used by Revell (1980) and later by Passacantando (1983) in their studies of costs and margins of the commercial banking system in the OECD countries. The aggregation is as follows:

$$\begin{aligned} \text{Interest Received} - \text{Interest Paid} &= \text{Interest Margin} \\ \text{Interest Margin} + \text{Other Income (net)} &= \text{Gross Earning Margin} \\ \text{Gross Earning Margin} - \text{Operating Cost} &= \text{Net Earning Margin} \\ \text{Net Earning Margin} + \text{Other Credits (net)} &= \text{Profits Before Tax} \end{aligned}$$

The first line of equation contains only interest received and paid on loans and deposits, respectively. Interest received on investments (securities etc.), gains or losses in foreign exchange operations and commissions and fees received and paid are added up under the Other Income item. Gross Earning Margin is broadly defined as margin perceived by banks in their financial operations. In more familiar term, this is called the banker's mark-up or the banker's spread.

Net Earning Margin is obtained by subtracting all operating costs (personnel, administrative, rents (net), insurance, contributions and indirect taxes) from the Gross Earning Margin. Other credits (net) include all revenues, which are not considered the "normal business" of a banking institution, such as depreciation and provisions. This item usually enters with a negative sign since it is dominated by provision.

We can also write the equation system above in a single line as follows:

$$\mathbf{IR - IP + OI = GM - OC - OCR = PBT} \quad (1)$$

Where IR	= Interest Received
IP	= Interest Paid
OI	= Other Income (net)
GM	= Gross Margin
OC	= Operating Costs
OCR	= Other Credits less Provisions and other debits
PBT	= Profit Before Tax

8. When the gross margin is obtained by the addition of the items on the right-hand side of the identity, it is commonly referred to as the costs of financial intermediation.

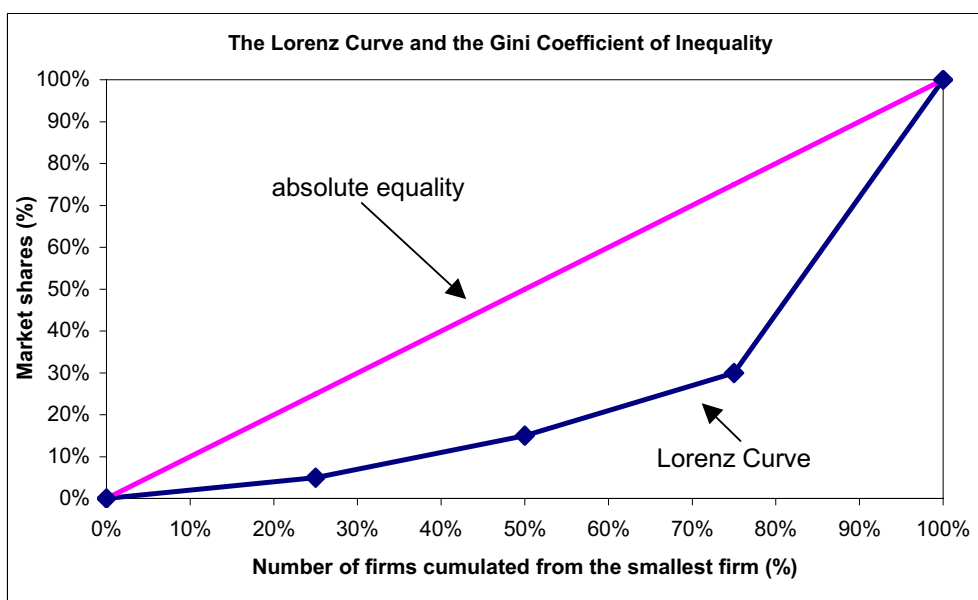
In the study, we constructed the ratios by dividing the flow variables from the income statements by the arithmetic averages<sup>8</sup> of the end-of-month values of total assets. Table 1 provides average total assets of first, second and third group of banks with largest assets by end-of-year.

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<sup>8</sup> The use of Geometric averages is the correct procedure if assets follow a constant geometric growth trend throughout the year. Although assets grow more irregularly, that is still the best procedure when there is only information on end-of-year values for the stock variables. In this study, we used arithmetic average since information on banks' balance sheets (the stock variables) is available on monthly basis.

## Lorenz Curve and Gini Coefficient

In the standard industrial organization theory, there are some indicators used to measure market concentration in an industry. The Lorenz Curve and Gini Coefficient reflect relative concentration. An example will be provided here to get the idea of these two measures. Imagine four firms in a market with the following percentage shares of market sales (of some other indicator of size, such as assets or employees): firm A, 5%; firm B, 10%; firm C, 15%; and firm D, 70%. The key computations that generate the Lorenz Curve are (1) the percentage of market sales, cumulated from the smallest-sized firm, and (2) the percentage of the number of firms, cumulated from the smallest-sized firm to the largest. Thus, beginning with A, which is the smallest, 5% of market sales are accounted for by 25% of all firms, 15% of the sales are accounted for by 50% of the firms (A plus B), and so forth. When we connect all these points, we get the Lorenz Curve for the industry. The Lorenz Curve may be compared to the straight diagonal line. If each of the four firms had 25% of market sales, the Lorenz curve would match this diagonal line; then 25% of the firms would have 25% of the sales; 50% would have 50% and so on. Thus, the diagonal line indicates an equal size distribution. And the more unequal the distribution of sales, the greater the divergence between the Lorenz curve and the diagonal line. The area between the diagonal line and the Lorenz curve is called area of concentration.



The Gini coefficient summarizes the degree of inequality. This statistic is the ratio of the area of concentration to the total area under the diagonal. The total area under the diagonal is always  $5000^9$ . It should be clear now that as the Lorenz curve approaches the diagonal (more equal distribution), the area of concentration shrinks and the Gini coefficient approaches 0. Greater inequality expands the area of concentration so the Gini coefficient approaches a value of 1. However, these indicators have some serious drawbacks<sup>10</sup> so industrial organization literature sought other indicators that would better describe market concentration in an industry. One of them is concentration ratio. This is a percentage of market sales accounted for by an absolute number of the largest firms in the market—for example, the 4, 8 or 20 largest firms. The four-firm concentration ratio was once a measure used for merger guidelines purposes from 1968 to 1982. We define concentration ratio by

<sup>9</sup>  $\frac{1}{2} \times (100 \times 100) = 5000$

<sup>10</sup> see Adelman, "The Measurement of Industrial Concentration," *Review of Economics and Statistics* (November 1951).

$$I_i \equiv \sum_{i=1}^i s_i$$

The table below will demonstrate the value of  $I_4$  for four imaginary industries

% share	S <sub>1</sub>	S <sub>2</sub>	S <sub>3</sub>	S <sub>4</sub> , S <sub>5</sub>	S <sub>6</sub> ...S <sub>8</sub>	S <sub>9</sub> , S <sub>10</sub>	I <sub>4</sub>
Industry 1	60	10	5	5	5	0	80
Industry 2	20	20	20	20	0	0	80
Industry 3	100/3	100/3	100/3	0	0	0	100
Industry 4	49	49	0.25	0.25	0.25	0.25	98.5

Note: S<sub>i</sub> in percentage

There is something unsatisfactory about the  $I_i$  ratio. In industry 1, firm 1 has 60% of the market. Industry 2 has five firms, all have equal market shares of 20%. However, the four-firm concentration ratio yields  $I_4 = 80\%$  for both industries. It is because the measure is linear so it does not differentiate between different firm sizes as long as the largest four firms maintain most of the market. Comparing industry 3 and 4 shows the same problem where an industry equally shared by three firms is measured to be more concentrated than an industry dominated by only two firms.

### The Herfindahl-Hirschman Index.

The Herfindahl-Hirschman index is a convex function of firms' market shares, hence it is sensitive to unequal market shares. We define this measure to be the sum of the squares of the firms' market shares. Formally,

$$HHI \equiv \sum_{i=1}^N (s_i)^2$$

From the same table above, the HHI for industry 1 is calculated to be almost twice the HHI for industry 2 (3850 compared to 2000). This follows from the fact that squaring the market shares of the large firms increases this index to a large value for industries with significantly unequal market shares. Comparing industry 3 and 4 shows that while the  $I_4$  measure indicates that industry 3 is more concentrated than industry 4, the HHI measure indicates that industry 4 is more concentrated than industry 3 (3333 compared to 4802). For this reason, the HHI is found to be the preferred concentration measure for regulation purposes.

The monitoring of merger activities in the US is in the hands of the Federal Trade Commission and the Department of Justice. The FTC issues guidelines to the DOJ recommending what types of mergers should be challenged. The guidelines suggest that a merger **should not be challenged** if the postmerger Herfindahl-Hirschman concentration index, HHI satisfies

1.  $HHI < 1000$ ;
2.  $1000 < HHI < 1800$ , and  $\Delta HHI < 100$ ;
3.  $HHI > 1800$ , and  $\Delta HHI < 50$

A post-merger concentration level of  $HHI < 1000$  classifies the market as unconcentrated. A post merger concentration of  $1000 \leq HHI \leq 1800$  is regarded as moderately concentrated. When post-merger HHI reaches 1800, the market is considered highly concentrated. Mergers producing  $HHI > 100$  in highly concentrated market raise significant competitive concerns depending on some additional factors set forth in section 2.5 DOJ and FTC Horizontal Merger Guidelines, 1992 since it is likely to create enhanced market power. This presumption may be



overcome by showing that the factors set forth in sections 2.5 of the 1992 guidelines make it unlikely that the merger will enhance market power.

Section 2.5 DOJ and FTC Horizontal Merger Guidelines, April 2, 1992 highlights potential adverse competitive effects of mergers, in addition to market concentration measured by the HHI. These effects include:

1. The likelihood of coordination among firms.
2. Conditions revealing implicit or explicit coordination such as common price, fixed price differentials, stable market shares, or consumer or territorial restrictions.
3. The likelihood that a merger between firms distinguished by differentiated products to cause a price increase for all differentiated brands.
4. Ability of rival sellers to replace lost competition.

**In the case of bank mergers**, the DOJ and the Federal Reserve Board modified looser HHI test<sup>11</sup> than the test suggested by the Horizontal Merger Guidelines (revised version, 1992 and 1997). In addition to HHI test, the DOJ's Antitrust division screens bank mergers based on availability of deposits held by banks—this is not surprising given the fact that antitrust division's approach prioritizes consumers (they will ensure that consolidation in banking industry does not hurt consumers by significantly weakening competition). The Antitrust division will not conduct full investigation unless:

- The post-merger HHI is at least 1800
- The merger must produce a change in the HHI of at least 200
- In the case of bank mergers, concentration in the relevant product market is computed for screening purposes on the basis of all bank deposits plus 20 percent of all thrift deposits in the relevant geographic market.

For further review, please see Bank Merger Competitive Review—1995

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<sup>11</sup> The basic reason is that banks face competition in virtually all of their services from non-banks, as well as from out-of-the-country (and/or out-of-the-state) banks.

# Current Status and Prospects of Economic Integration of Asia

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Faculty Fellow, Research Institute of Economy, Trade and Industry



I am actually pitching in for Professor HU An-Gang whom Director Imanishi initially invited. Professor HU An-Gang had to cancel all of his commitments during the three months that he was to be in Japan as he got tied up with his work in China. In the middle of June, while I was in the middle of a trip to the UK, I received an email from him asking me to take his place. It actually was more of an order to appear, and so here I am (laughter). Up to the end of June, I participated in conferences in the UK,

France, Germany, and East Asia. The day after I got back to Tokyo from Bulgaria, I had a preparatory meeting for this forum set up, since I was running on a tight schedule and I had to leave for Peking three days later. I just got back on Friday last week. It is with this introduction, that I will speak about "Asian Economic Integration: Its Status and Prospects."

While the other presenters have written a lot in English and Japanese, it is a little embarrassing to present my two-page summary of my power point slides, which I was able to make last Wednesday. Using data, I will talk today about three things regarding the reality or dynamism of China, from a Chinese perspective.

The first one is about the changes in China-Japan trade and investment relationships. The second one is about the FTA or free-trade scenario. Since 1999 we have started to consider this, and have submitted a report to the central government in December of 2000. At that time, we proposed to the leadership the China-Japan-South Korea plus Hong Kong Initiative, which in some sense had been accepted. In the following year, the proposal was partly featured in the February 15, 2001 issue of "Keizai Kyoshitsu" Economics Classroom of last year under the name of HU An-Gang. This year the realistic possibility of China's integration has been actively discussed. Although I am not a representative of the Chinese government, I will talk about prospective scenarios about China's future, as a researcher. The third one is in a sense a related scenario: flow of people and future policy. The most difficult problem is whether or not we can actually build an institutional framework. I think it would be a happy ending if we can go that far.

I will present a set of data, but fundamentally the topic for the past 10 or 20 years has been the economic development of China. There are two factors underlying this economic development. The first factor is economic reforms. Everyone is talking about economic reforms, but since the time of MAO Ze-Dong various trials and errors

have been done this past 30 years. Eventually, reforms that focused on the economy were initiated in 1978 during the time of DENG Xiao-Ping. Another underlying factor was the simultaneous initiation of "liberalization".

Looking at officially published data, the average annual growth rate (for what period?) of the Chinese economy is between 9.5 and 10 percent. Whether we are in England or Bulgaria, one issue, which has been popularly debated, is the accuracy of these numbers. (Laughter) But, even if the figure was 7%, that is still the world's highest growth rate. The fact that such figures have become a topic of discussion, I think, shows just how far China has come. It is not surprising at all that Asia, in this rich economic environment, should change. In my view, it is just natural that the responses of countries such as Japan and South Korea will change in step with the economic reforms and development in China. This is globalization or regionalization.

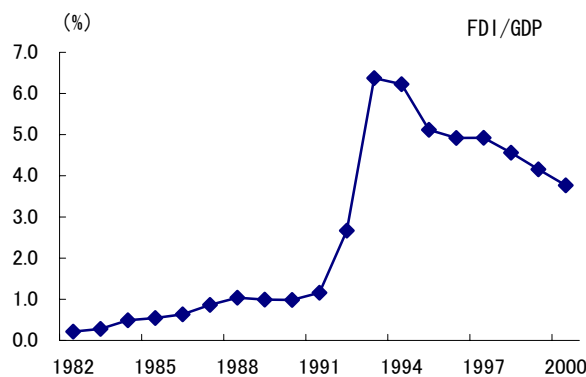


Chart 1 China's Dependence on FDI (1982—2000)

Let us look at some more official data. First, let us start with investment and trade. Chart 1 shows dependence on foreign capital and the share in GDP of foreign direct investments in China. In the early 1990s, FDI was around one percent of GDP, but later rose rapidly, reaching a peak of over six percent in 1994. There was also a period of devaluing the currency. China was basically engrossed in its own structural reforms. In some way, this preoccupation is said to be one of the causes of the Asian economic crisis. The 60% currency devaluation was based on the more important issue of standardizing the currency rather than on diplomatic relations with Asia or Japan. China's Convertible Note has become a dead word, but up to seven to eight years ago, China had two types of exchange rates: one for the Renminbi (RMB=Chinese currency) and another for the Convertible Note. I would like everyone to understand that in order to standardize the exchange rate it was necessary to devalue. Nevertheless, the outside world was basically not in the minds of the Chinese at that time. Hence, the sudden drop in value. With the high economic growth rate, however, expectedly the dependence on foreign capital has gone down. It is now more or less at the three percent level. Even after the Asian economic crisis, foreign investments from abroad into China are estimated to have been around \$45 billion to \$50 billion. This is an enviable achievement, indeed. As expected, this year it is exceeding \$50 billion, suggesting a stable Chinese macro economy.

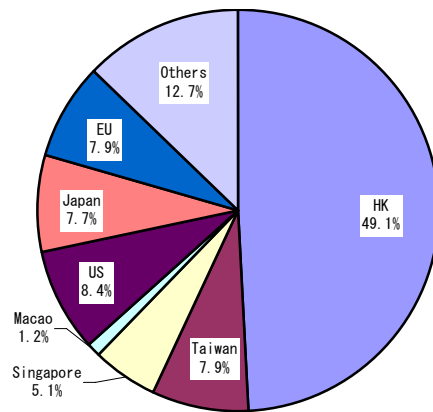


Chart 2 Country/Regional Distribution of FDI in China (1991-2000)

Looking at the regional breakdown of foreign direct investment in China (Chart 2), it can be seen that, as is often cited, Japan and the US are investing a lot, but if we combine the investments of overseas Chinese from Hong Kong, Taiwan, Singapore, and Macao, these amount to 63.3 percent of the total FDI. Over a period of ten years, it can be said that two-thirds of the investments are from Chinese.

The US, Japan, and the EU comprise 25 percent. These shares are based on a ten-year total. Last year's data has not come out yet, but the total FDI from 1990 to 2000 makes up 90% of the FDI since the liberalization [in the late 70s.].

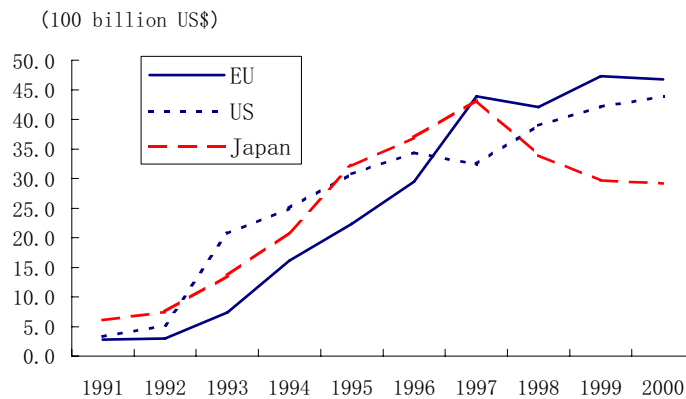


Fig. 3 FDI in China by Advanced Countries (1991—2000)

Let us take a look next at the investments of advanced industrial countries. A comparison of EU, Japan, and the US shows foreign investment to be rising every year. Japan's investment had been rising, but after 1997 up to at least last year it had been dropping. This year seems to be a boom for Japanese investments (laughter), and this usually means that one more obstacle in investments to China has been hurdled. Looking at the data, investments generally have been increasing. At the start, Japan's investment was the largest, at about \$600 million, while that of the US was at \$300 million and that of Europe was at \$250 million. Recently, however, the total investments of each of these three countries range between \$4 billion and \$5 billion. This means that foreign direct investments in China have increased by ten-fold in ten years.

Looking at Chart 4, we can see that together with the drop in investment amounts, Japan's share in total foreign direct investments has been rapidly dropping. Initially, Japan's share was 10%, but recently this has dropped to seven percent. In contrast, the US's and Europe's shares have risen to 10 and 12 percent, respectively. Particularly after 1997, investments from Japan have been rapidly decreasing, implying that China's economy has been shifting from quantity to quality. Looking at investments on a category basis, we can see that items which Japan has not entered into are filled up by the US and Europe.

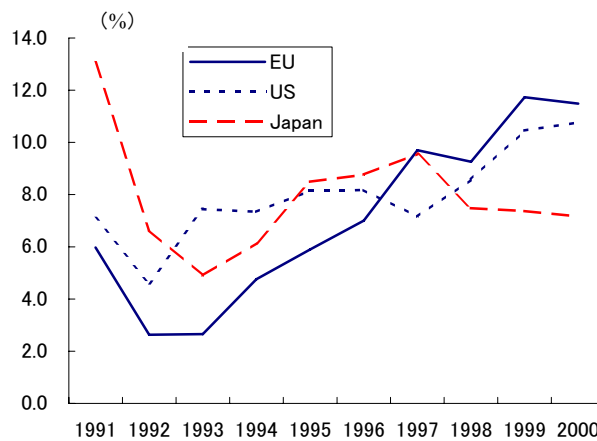


Chart 4 Share of FDI in China by Advanced Countries (1991—2000)

In other words, there is a pattern of competition among Japan, US, and Europe in their investments in China. One looks at China as a manufacturing base, and another as the bright market prospects. A combination of these views has, on the whole, led to Japan's losing market share to the US and Europe.

A simple example is the telephone industry. The standard for cell phones in China is completely European. Sixty percent of automobiles are Volkswagen. I am hesitant to say this, but to put it frankly we have reached a point where China can hack it without Japan. This is an important matter, and I would like [to stir up] a sense of crisis. Looking at what Japan is saying from the newspapers, it appears to be such a situation. If so, then Japan just misses a chance. Looking at it another way, this can be the basis of an FTA. China is so near, and the prospects after a policy shift are very promising. It can be seen by looking at investments that Asian integration is necessary.

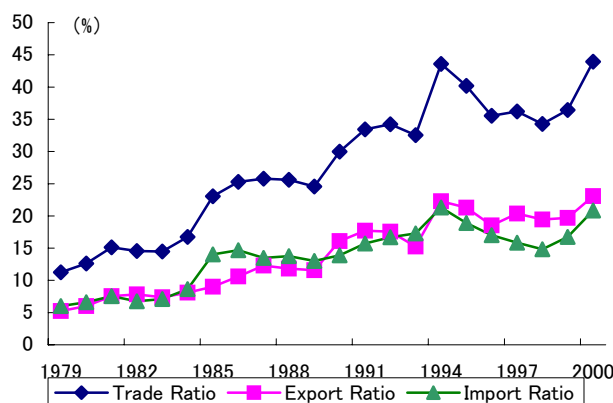


Chart 5 China's Dependence on Trade (1979-2000)

Chart 5 shows China's dependence on trade for the years 1979 to 2000. According to the other day's newspaper, the exports of Japan to China are now half of that of the US. In 2010, eight years from now, China will surpass the US and become the largest exporting country to Japan. This naturally implies a deepening of Japan's dependency on China. However, looking at this graph (PPT), China's dependency on trade in terms of share in GDP has been rising rapidly. Under the concept of "opening up", rapid interconnection with the world can be expected. China is not a country closing its doors, and it is practically impossible for it to return to a close-door policy. Broadly speaking, 40 percent to 50 percent of GDP consists of trade.

Looking at import and export dependencies, we can see that up to the middle of the 1980s huge imports of production materials created a large trade deficit. In the 1990s, the exports of labor-intensive goods, the so-called consumption goods, were performing well, so that China had a trade surplus since 1993-94. I would like to show more data, but owing to time limitations, I was just able to look at data for 2000.

Chart 6 shows the regional distribution of trade with China. Japan is the largest trading country. This is in terms of export and imports. Japan's share is 18 percent, the US has 16 percent, and the EU accounts for 15 percent. The Asian region including Japan, Taiwan, South Korea, the ASEAN, and Hong Kong constitute more than 50 percent.

Chart 6 Country/Regional Distribution of Trade with China (2000)

Furthermore, among the major trading partners, those with excess imports are Taiwan, South Korea, the ASEAN region, and others. Those with excess exports are Hong Kong, the EU, the US, and Japan. Japan has more or less a balanced trade, so it is neither significantly in surplus nor deficit. Basically, manufactured goods are imported from Japan, and consumer goods are exported to Japan. This sends an important signal regarding a FTA.

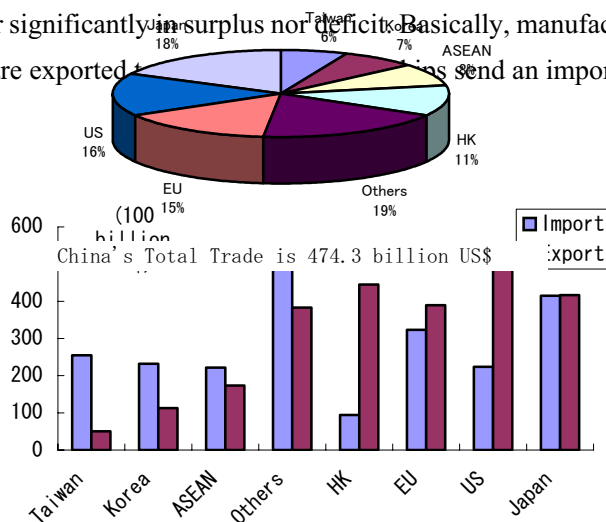


Chart 7 Trade Between China and Major Countries/Regions (2000)

As seen in Chart 8, China basically has a deficit with the Asian region: Taiwan, South Korea, and the ASEAN. This implies that China does not have to be too aggressive about a FTA. China's interest in FTA, however, can be explained by its complementary relationship with Japan. China's migrant workers mostly go to the US and the EU. On the whole, this situation leads to a surplus structure.

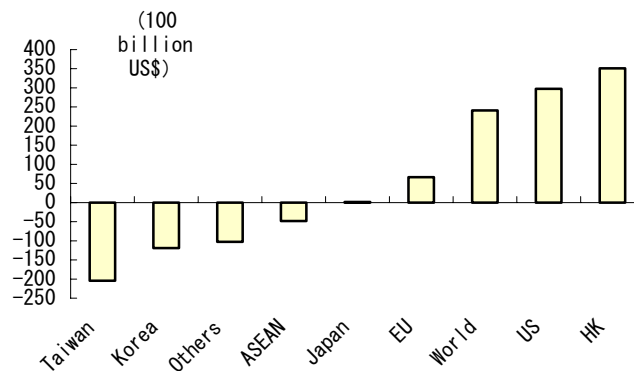


Chart 8 Trade Difference Between China and Major Countries/Regions (2000)

Looking at Chart 9 at the trade relationships with the ASEAN, we see the following structure; China has long experienced a trade deficit with the major countries of Malaysia, Thailand, Indonesia, and the Philippines. There is a minimal surplus with Singapore.

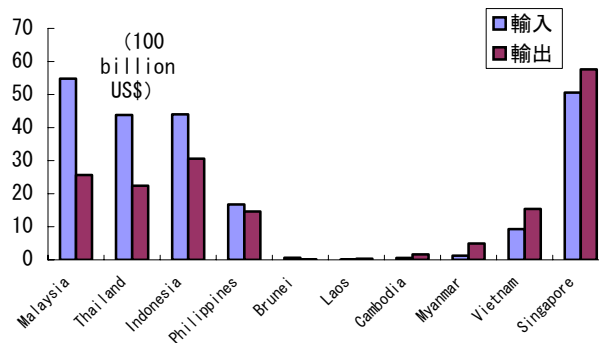


Chart 9 Trade Relations Between China and ASEAN (2000)

On a similar note (Chart 10), Malaysia earns about \$3 billion of trade surplus from China annually. The same

goes for Thailand and Indonesia. With regards to the "important signal" that I mentioned earlier, the Chairman has proposed ASEAN + China. This is important because I think that it is a thrust to gain strategic leadership in terms of national security and economic development while basically considering the US. Moreover, based on my own research, the western part of China has a relationship with ASEAN (10 + 1). I think this is part of creating an external environment. I will show some data later. As far as economics is concerned, China has yielded benefits to the ASEAN countries, and maintains a policy of avoiding friction. I will continue on giving such policy advice. This is because through a complementary relationship between China's western part and the neighboring regions including the Mekong River, Thailand, and Malaysia, further economic development can be achieved. The eastern part of China (Chart 11), including Shanghai, Peking, and Guandong, has a trade value per capita of RMB37,000, while Guizhou, Sichuan, and Yunnan have less than a hundredth of that at RMB350 per capita. From a national perspective, ASEAN will be more useful than investments from the eastern part.

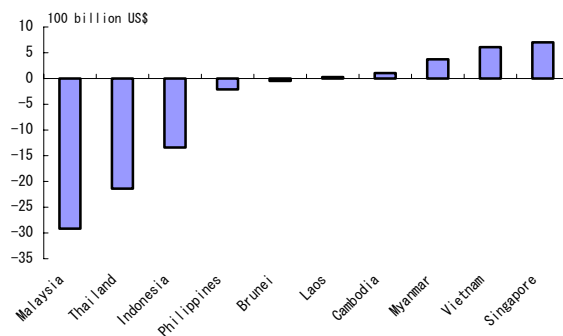
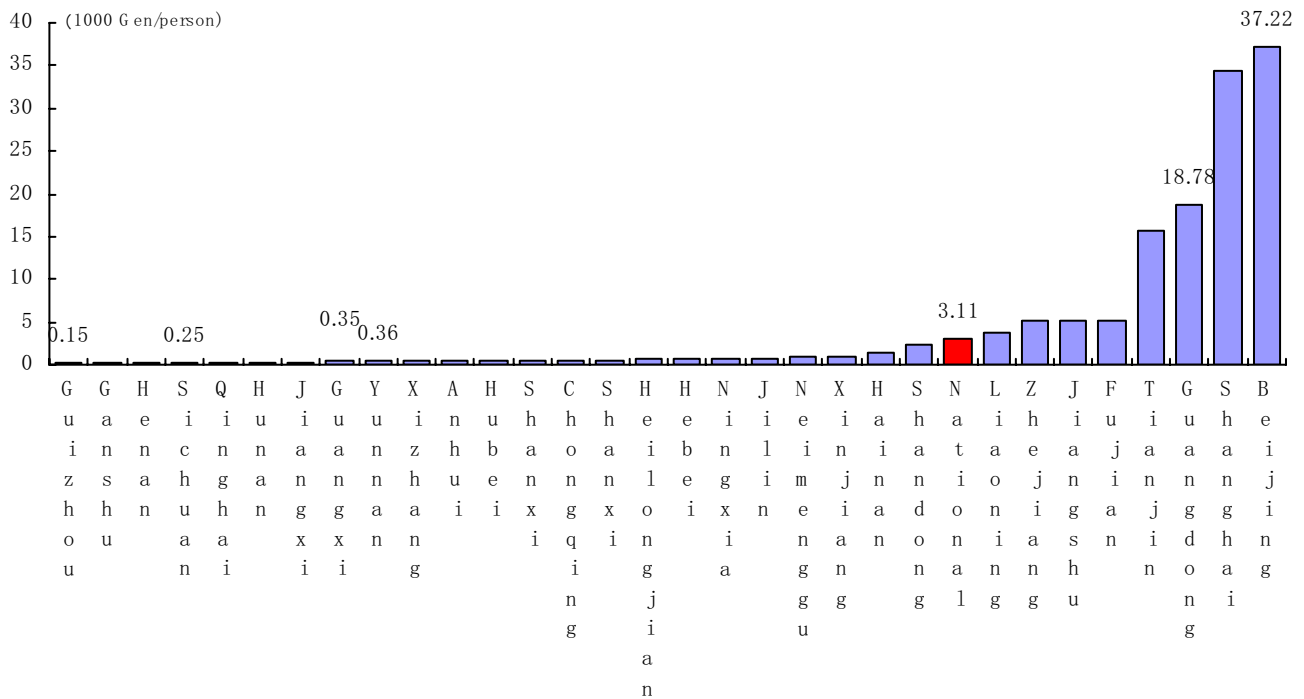


Chart 1 0 Trade Difference Between China and ASEAN (2000年)

With regards to China's FTA my proposal is to proceed from this approach: ①China actively promotes a free trade area through the ASEAN + 1; ②China initiates a FTA with Japan, South Korea, and Hong Kong. This will be a complementary relationship; ③In order to further spur development of the eastern part of the country, promote the integration of 10 + 3 above ① and ②; ④ China initiates free trade while considering the good relationship with India in terms of IT, and the most important issue of national security. Ultimately, we have the scenario of an Asia-Pacific Free Trade Area. I think we can still discuss the broad aspects of free trade, but for the moment I would like to end my thoughts on this issue here.



Chart 1 1 China's Regional Per Capita Trade (2000)



Lastly, I would like to touch on some other aspects. One is the movement of people. Earlier, I talked about the movement of goods and money. There are some examples. I would like to cite on the movement of high-skilled workers. Recently, it is said that senior Japanese skilled personnel, who have retired early or on time, are looking for jobs in Shanghai or elsewhere in China. This is one type of movement. This is particularly true in IT human resources. Whether in China or in Japan, the movement of high-skilled labor is an important issue. In May, when I was making an intensive lecture, the data showed that already 6000 people have entered Shenzhen, not as owner-investors but as staff or employees.

China's human resources tend to have the image of a Brain Drain. I do not think so. I think that Brain Circulation, implying personal choice, is most important. Everyone will come home if China's internal environment is good. The official data (Chart 12) show that the number of Chinese students going abroad to study was in the thousands in 1990, in the ten thousands in 1993, and 38,000 in 2000. Looking at actual data from the Japanese Ministry of Education, 37,000 [Chinese] students are in Japan. This is an underestimation (laughter). At least the actual number is about three times that. You should become alarmed when the number of Chinese studying abroad reaches one million. During the five or six years after 1995, the number of students abroad accounts for nearly 80 percent of the total number of students enrolled in China since the liberalization reforms. The same situation can generally be seen on the returning side. Hence, we are in the era of moving from brain drain to brain circulation. This is the first point.

Fiscal Year	Departing	Returning
1990	2,950	1,593
1991	2,900	2,069
1992	6,540	3,611
1993	10,742	5,128
1994	19,071	4,230
1995	20,381	5,750
1996	20,905	6,570
1997	22,410	7,130
1998	17,622	7,379
1999	23,749	7,748
2000	38,989	9,121
1995-2000	144,056	43,698
1990-2000	186,259	60,329
1995-2000/1990-2000	77.34%	72.43%

Chart 12 Number of Foreign Students

Fiscal Yr	Departing (A)	Tourist (B)	(A)/(B)
1996	758.82	241.39	31.8
1997	817.54	243.96	29.8
1998	842.56	319.02	37.9
1999	923.24	426.61	46.2
2000	1047.26	563.09	53.8
2001	1213.00		
1996-2000	8.4	23.6	

Chart 13 Number of Chinese Tourists (in 10,000)

One more thing that I would like to talk about is Chinese tourism. (PPT) Of course, this would vary in terms of length of stay. This is a big issue in China. The Chinese have also entered the era of tourism. Hong Kong is practically lost during “golden week” if the mainland people do not go out. The total number of people going out has been growing at 8.4% annually these past few years. The number of those traveling privately has been growing at a rate close to 25 percent. In 2000, the number of those privately traveling for personal and shopping trips for the first time exceeded those traveling publicly for business. In 2001, [the number of people traveling abroad] was 12 million while that of Japan was 15.6 million. In three years, the number of Chinese going abroad will certainly surpass that of Japan. Such is the immensity of the tourism era.

Last night, at a private meeting with a METI member, one proposal was raised. Looking at the World Cup soccer matches of last month, the METI personage proposed the formation of an Asia League of Japan, Korea, and China (laughter). I am not particularly keen about soccer, but the movement of the fans of this game, as the matches are played from one country to another, should lead to people interaction and understanding. Such constructive ideas might be worth thinking about. This is the so-called story of people movement.

Two last points. Most important is policy adjustments. We have made policy proposals to China’s leaders, and at the same time we have talked about this idea with the Japanese government. I think that it is through interaction that

there should be a constructive exchange of ideas. There is talk of China as a threat, as well as being wary about Japan. This basically comes from the lack of trust on both sides. We should shift to growth mechanism where everyone wins.

One more important matter is the building of an institutional framework. I think that beyond cooperation, the building of an institutional framework is important in order to assure a sustainable development and regional stability. How would this look like? In proposals to the Chinese government or in my personal view, a gradual integration without any set objectives would be preferable. I never think that something like that of the US or Europe would be good. That's all from me.

(Subscribed from the recording)

### Question and Answer with Professor MENG



(Jin Xianghai) I am JIN Xiang-hai of Chuo University, and I have a few comments about the presentation.

The professor teaches at Tsinghua University, which is the alma mater of Prime Minister ZHU Rong-ji 朱 and Vice President HU Jin-Tao. From your presentation, it is clear that you are able to link your research to state policy.

I think that you are doing very productive and enviable research. I have the strong impression that you are involved in frontier research and your

presentation has been very informative. I am not in a position to make a comment on the professor's presentation.

But since you have been in Japan, I would like to ask as a junior to a senior three questions.

The first overlaps a little with Professor MENG's three prospects. On policy adjustments: . In moving towards economic integration, how is China going to address the various political problems along the way? For example, how do we deal with the relationship with the ASEAN or its peculiarities? As we have seen in the Shenyang consulate incidents, how do we remove the friction among Japan, Korea, and China in Northeast Asia. Without solving these problems, the prospect of Asian economic integration remains a remote one.

On institutional framework: From what I understand, [I doubt if] it is really possible to achieve economic integration in East Asia. If my understanding is correct, I think that economic integration and economic cooperation are different. Economic integration has a very strong institutional aspect. It refers to a lowering of tariffs and an institutional linking of economies. Economic cooperation, I think, involves a lowering of tariffs and financial and technological cooperation. These are two [different] concepts. What is being suggested here is economic integration. But is it really possible to construct the high-level framework for an Asia that has different economic, cultural, and political systems? This is my second doubt.

On human resource flows: The third point overlaps with Professor MENG's. How do we build the framework for human resource flows as we move towards economic integration in East Asia? This, I think, is a very important point. Going one step further, I would like to ask what kind of institutional preparation is the Chinese government doing to deal with Chinese foreign student, and what kind of policies are needed? These are my three points.

(Meng) Thank you very much.

Regarding the first issue, today's theme of my talk was economic integration in Asia. I am Chinese, and about one-third of those seated here are Chinese. If we just recall our origins, we are actually doing economic integration. (laughter) This is one type of economic integration within a country. Historically, China has already a crisis-averse mechanism for economic integration. I can explain this from a traditional perspective. This is the result of thousands of years of managing different ethnic groups. Avoidance of conflict is not an easy matter. I think what is important is a certain psychology or leadership ability that has an overall view of systems.



Regarding the second issue of creating an institutional framework. Since Japan has a per capita GDP of \$30,000, it is clear that China needs to develop its economy one stage further. I therefore think, even within the METI, that it is precisely China's stable economic development that is the basis of good relationship between Japan and China.

Regarding the third issue of a network for human resource movement. I have not personally done any research on this recently. Up to last year [the Chinese government] focused on students in the US. This year it is also the same, but those coming back from Japan should be able to compete for as long as they have the capability. China now has entered the era of critical evaluation of everyone's capabilities. If you have the confidence, you can do it. There is the case of a PhD from the University of Tokyo who came home to China and is now the executive vice governor of the poorest province in China, Qinghai province. Last year, a junior from the Tokyo Institute of Technology became the vice mayor of a city. I respect very much individual choice, but what is important, I think, is having outside and inside networks, or the ability contribute to the region as a whole.

There is one more thing, which is now being promoted. Last July, I went to Beijing to attend a science and technology get-together being held in commemoration of the 30<sup>th</sup> anniversary of normalization of relationships between Japan and China. The realistic issue of setting up a center to follow up on Chinese students in Japan and Japanese students in China after their graduation was brought up and is being considered. I have to submit a proposal by September (laughter). So, I think that we are moving in the direction of economic integration from different aspects.

# Competing and Cooperating with China

**Bernardo M. Villegas, Ph.D.**

Professor, University of Asia and the Pacific, Philippines

Trade and Industry Secretary Manuel Roxas II has alerted the private sector about the need to prepare for the onslaught of competition for export markets with China as well as to explore opportunities to sell to the huge Chinese population as the largest country in the world enters the World Trade Organization (WTO). The possible code word for the strategy is *co-opetition*. How can the Philippines maximize the benefits to its people by both competing and cooperating with China. This paper will attempt to present some of the major components of such a *co-opetitive* strategy.

協力

kyou ryoku

cooperation

競争

kyou sou

competition

協争

kyou sou

co-opetition

## The Emerging Economic Powerhouse

Two major events dominated global economics in 2001. The first was the end of a ten-year economic expansion in the U.S. some time in March last year. The second was the formal admission of China into the World Trade Organization on December 11, 2001, signaling the passing of a protected economic system to one going global on the back of massive foreign investments and with at least the avowed intention of the privatization of state-owned enterprises (SOEs).

The U.S. recession will have only a temporary impact on the economies of East Asia. Sooner or later in 2002, a recovery of the U.S. economy is bound to happen, giving a much-needed boost to exports from such troubled

economies as Singapore, Taiwan and Hong Kong. Few doubt the ability of the U.S. to continue being the world's engine of growth for quite a while in the immediate future.

The accession of China into the WTO has elicited less unequivocal reactions. There are those who foresee that China will replace Japan as the second engine of growth of world economy, attracting the bulk of foreign investments in the Asia Pacific region, away from the other East Asian territories. It is also expected to outperform all other competitors in exports because of its massive labor force receiving some of the lowest wages in the region.



## **Major Strengths of China**

The following strengths of China are usually highlighted by the optimists: The industrial workers in China earn an average of about US\$90 per month, compared with US\$117 in the Philippines and US\$137 in Thailand. There is no serious upward pressure on Chinese wages because unemployment is still quite high at 10 to 12%.

China's domestic market is huge. There are 900 million Chinese in the rural areas still waiting for a consumer revolution. Personal consumption expenditures had been growing at about 7 to 9% per annum in contrast with the 2 to 3% growth among most of its East Asian neighbors. Especially explosive are the growth rates of consumer durable goods such as washing machines, T.V. sets, personal computers, and cellular phones.

An added factor that boosts foreign direct investments in China is the large ethnic Chinese communities spread out all over Asia. Ethnic-Chinese business people from the Philippines, Indonesia, Thailand and Malaysia have been responsible for bringing in some US\$600 million into China in 2000 alone. Such direct investments from East Asian neighbors are not reciprocated. According to the ASEAN Secretariat, a paltry US \$57 million was invested by Chinese enterprises in the whole of Southeast Asia in 2000.

In a knowledge-based world economy, China's volume of production of highly educated professionals is a distinct advantage. Far from being rich only in cheap labor, China turns out about 400,000 engineering graduates yearly, compared to only 160,000 in Japan. The Philippines, well known for its large university enrolments, graduates only 40,000 engineers yearly while Thailand has even a smaller 15,000 engineering graduates every year. China can, therefore, be a formidable competitor in technology-intensive products and services.

The optimists may be proven right in the next five to ten years. China's strengths will enable it to continue growing at 7 to 9% annually by using more capital and human resources even if there is no significant improvement in productivity, efficiency and good governance. It can replicate the success stories of the tiger economies of East Asia from the mid-sixties to the mid-nineties, about three decades of spectacular growth rates unprecedented in modern history.

## **Vast Opportunities for Investors**

The vast opportunities in China for investors from all over the world during most of the present decade can be gleaned from the following remarks of Zhu Rongji, State Council Chairman of the People's Republic of China. In a Foreword to the book *China's Century* of Laurence J. Brahm, the Premier described the bright future of China in the following glowing words: "China is accelerating the process of acceding to the World Trade Organization. I believe that accompanying this important turning point of WTO entry, will be China's opening to the outside, from which a new era will develop.

"We will accelerate steps to promote the opening of the energy, transportation, telecommunications, and environmental protection fields to the outside. At the same time, we will further open the service sectors, such as finance, insurance, tourism, commerce and trade. Moreover, we will actively absorb foreign investment to participate, through various forms, in the reform and restructuring of state-owned enterprises.

“We will follow the requirements stipulated by the World Trade Organization to adjust and amend existing foreign-related laws and regulations to rapidly establish an economic and trade system conforming with international practice, while reflecting China’s domestic conditions.

“China is the largest developing country in the world, possessing huge market potential. By raising living standards and upgrading the consumption structure of over one billion residents, a huge consumer demand will be created. Large-scale infrastructure construction, industrial structure upgrades, and development of the western regions will certainly bring about the need for even greater investment.

“Over the coming 10 years, China’s GDP is expected to grow at an average of 7% per year, fixed asset investments to grow at an average of 10%, and total imports to exceed US\$2,000 billion. The tremendous commercial opportunities that will be China’s in the future belong not only to Chinese entrepreneurs, but to farsighted and daring entrepreneurs from all over the world.

“Expanding China’s market will be an important element in promoting world prosperity. We warmly welcome and anticipate entrepreneurs from all countries in the world and international investment institutions to come to China and establish businesses. Hand in hand, we shall march together toward a brighter future.”

Premier Zhu Rongji has been a most active participant in and promoter of the Chinese economic miracle over the last twenty years. As long as he continues to be at the helm of China’s modernization efforts, the success story of the recent past will not come to an end. China will be attractive to investors for at least the next five to ten years.

### **Dangers of Irrational Exuberance**

It is difficult to resist the temptation of falling into “irrational exuberance” about the economic prospects of China. With a Gross Domestic Product still growing at more than 7 percent during the recessionary period of 2001, China’s prospects seemed to have brightened even more when it was finally admitted to the World Trade Organization (WTO) last December 11, 2001. A more open economy could further accelerate the already massive foreign direct investments that reached a total of US\$350 billion at the beginning of 2001. FDIs in China account for 80% of all flows into East Asia. Freer access to world markets under WTO terms will make China even a more formidable exporter of all varieties of manufactured products from shoes, toys and garments to washing machines, T.V. sets and personal computers. Indeed, whatever dangers lurk ahead, China can capitalize on momentum alone to continue growing at 7 to 9% annually for at least the next five years.

There are prophets of doom, however, who foresee the collapse of China before the present decade is over. Although the truth may somewhere lie between “irrational exuberance” and a “doom and gloom” scenario, it would be wise to examine the weaknesses of Chinese society that could put an end to the unprecedented growth of the Chinese economy over the last twenty years. In fact, one recent book entitled *The Coming Collapse of China* by Gordon Chang foretells the government’s fall through violent uprisings within the next five years.

### **China’s Major Weaknesses**

What are the major weaknesses of China that could lead to a collapse of the economy, if not of the whole society? The following are the ones most often listed by the pessimists:

The official figures about the economy are mainly fictional. To illustrate this point, a recent survey by China's Ministry of Finance revealed that one in ten Chinese companies, including listed firms, faked profits in 2000 when they actually made losses. It seems many Chinese enterprises do not need lessons from Enron in "creative accounting." In many instances, government officials themselves report exaggerated revenues in order to please Communist control planners. Some economists do not believe the government's claim to 7 percent growth in 2001. The critics think the growth is even below 3.5 percent.

The Chinese banking system is saddled with a high rate of non-performing loans, estimated at 40% of loan made to the state-owned enterprises (SOEs). Claude Smadja, Managing Director of the World Economic Forum, estimated the bad loans to be anywhere between US\$200 to \$300 billion, depending on the definition of a "bad loan." In an article that appeared in the *International Herald Tribune* (December 18, 2001), Thomas Crampton wrote that many Chinese companies have debt levels higher than those of the conglomerates of South Korea before the 1997 financial crisis. It has been a policy of the Chinese government to subsidize losing enterprises in order to ensure high levels of employment. With the entry of more efficient foreign banks as a consequence of China's accession to WTO, the domestic banking system could be at risk.

A highly publicized case of banking malpractice came to light when the president of Bank of China, Wang Xuebing, was recently charged of defrauding the bank of millions of dollars. Under the leadership of Wang, the Bank of China in the United States lent money to friends of its managers, ran fraudulent letter-of-credit and loan schemes, and carried out "other suspicious activity and potential fraud." As John Pomfret of *Washington Post* reported in an article published in the February 18, 2002 issue of the *International Herald Tribune*, "Wang's case underscores one of the major tensions in (China), the clash between attempts to establish a rule of law and the freewheeling and often illegal practices that have helped bring China record-breaking growth over the last two decades. Those tensions will only increase as China modernizes its economy and legal system and, with accession to the World Trade Organization, foreign firms demand a more rules-based system."

There is a widening disparity between the urban rich and the rural poor. Although reforms have lifted about 270 million people from poverty since 1978, the benefits are still heavily skewed towards a small elite. The income of the wealthiest grew about four times faster than that of the poorest during the past twenty years. In fact, spending by the rural dwellers actually dropped in 1998. Such inequities have already been generating so much social unrest that periodic bomb blasts across China already occur. It may just be a matter of time before such isolated protests could ignite a nationwide conflagration. The unrest could be aggravated by the unemployment that will be unleashed by the accession to WTO. As Claude Smadja wrote in the book *China's Century*, ". . . there is no underestimating the mind-boggling dimension of the challenge facing the government: According to the Labor Ministry, SOEs will have had to lay off 11 million workers between 1999 and the end of 2000, and if the process of industrial restructuring were to be fully conducted, it would mean altogether the redundancy of between 35 and 40 million people over the next few years. In addition, a huge number of township enterprises have also had to close operations because they are unable to adjust their production to the new expectations of the market and are going bankrupt. Add to that the fact that the ongoing crisis in the agricultural sector is forcing more and more people to leave the rural areas and try to find other alternatives in the urban centers. And then, there are of course the 15 million new people entering the job market every year.

As Gordon Chang wrote in his book *The Coming Collapse of China*, the most difficult period will be the next five years when China has to introduce very drastic structural reforms in order to meet world competition under the WTO



free trade regime. Unfortunately for China, the next five years will see the world struggling to get out of the recession that started in 2001. It will also be the time when China has to make a difficult political transition into the fourth generation of leaders who will have to succeed Zhu Rongji and the present crop of government officials. A combination of these adverse circumstances may lead to serious social dislocations.

Among the future top leaders is Hu Jintao, who now heads the Chinese Communist Party's School which trains future leaders. He also serves as state vice-president. Hu has a solid record of reformist accomplishments. He and his other technocrats of his generation will not likely follow their elders' recipe for economic liberalization. But as Charles Hutzler reported in the *Asian Wall Street Journal* (January 4-6, 2002); "But it is in the political realm where some of the biggest problems lie. The bureaucratic, authoritarian government is wrestling with guiding a dynamic economy and diverse society. And it is there that Mr. Hu and his colleagues have left intriguing clues to possible change. They have initiated programs to bring more-responsive government, if not democracy, by building a professional civil service and encouraging greater transparency."

The compliance with WTO requirements could be significantly retarded by the de facto devolution of power from the central government to the provincial entities. As Claude Smadja commented, "it would not be too much of an exaggeration to say that China has today a relatively weak central state. There have already been many instances of provincial governments procrastinating on policies that Beijing was keen to enforce. We might well see a number of cases of that sort in the future as provincial or local authorities will try to delay—or shelter themselves from—the impact of measures decided by the central government in the drive to adjust to the requirements of the WTO regime." As pointed out by University of Chicago economics professor Alwyn Young in an article appearing in the *Quarterly Journal of Economics*, local protectionism is acute among the 27 provinces and four province-level cities in China. The flow of goods from one province to another is restricted by trade barriers. Such protectionist measures will surely clash against WTO regulations. It is quite obvious that China's WTO membership will be encountering tough times in the next 3 to 5 years.

The above enumeration of the weaknesses and threats inherent to China's economic system in the next five years is meant to challenge the Chinese leaders to apply the necessary remedies and safeguards. It also can elicit the appropriate strategic responses from the other East Asian countries so that they can effectively compete with China in the global economy.

### **Converting Threat Into Opportunity**

China's accession to the World Trade Organization (WTO) poses a serious threat to Southeast Asian economies. The great "sucking sound" representing the concentration of foreign direct investments in China and away from Southeast Asia may become even louder. In the early 1990s, over 70 percent of FDIs in East Asia went to the members of the Association of Southeast Asian Nations (ASEAN), especially Thailand, Indonesia, Malaysia and Singapore, while less than 30 percent was poured into China. Today, close to 80 percent of FDIs in the region is in China. As China opens up even more under WTO terms, there may be nothing left for the ASEAN. With labor costs in China at one-fourth the levels in the ASEAN, export-oriented manufacturing may practically disappear from Southeast Asia.

The threats, however can be transformed into opportunities if ASEAN leaders move quickly to face the challenges of Chinese competition. The challenge from China may be a blessing in disguise if in the next five years the ASEAN

economies hasten regional trade cooperation under the ASEAN Free Trade Area and clean up more decisively their graft-ridden corporations. It will take at least the next five to ten years before China can put its act together to derive the full benefits from WTO membership. Governance in state-owned enterprises needs a great deal of reform; the protectionist practices of semi-autonomous provinces have to be overcome; bloated economic statistics have to be brought closer to reality; the Chinese banks have to bring down their very high rates of nonperforming loans.

The transparency that will be required of China under WTO terms may actually lead to a slowdown of foreign direct investments in the short run. The next five years could, therefore, be an opportunity for the ASEAN economies to capitalize on their headstart in trade, banking and governance reforms. It is especially providential that on January 1, 2002, the AFTA officially became reality, which means all of the goods traded within Southeast Asia will have tariffs of 0 to 5%. As reported by the Secretary General of the ASEAN, Mr. Rodolfo Severino, average tariff rate for intra-ASEAN trade is now down to a minimal 3.2%, as against 11.44% in 1993 when the AFTA process began.

With a market of 500 million consumers, the AFTA can be a formidable competitor to China in attracting FDIs from the U.S., Japan and Europe. The ASEAN has half the population of China with a combined GDP equal to China and thus with a per capita income twice that of China. ASEAN consumers can be a more lucrative target for producers of consumer goods and services. It is often forgotten by the enthusiasts on China that close to 900 million rural dwellers in China receive subsistence levels of income and hardly constitute, at least for the moment, a profitable mass market.

Given the pressure of competition from China in the WTO framework, the ASEAN may hasten the following reforms, as enumerated by Secretary General Severino:

- The removal of non-tariff barriers
- The simplification of customs procedures.
- The alignment of standards in a number of important product lines to international levels.
- Improvement of the efficiency of the supply chain or logistics in the distribution of goods. A major project is a railway line from Singapore to Kunming in China through Malaysia, Thailand, Cambodia and Laos, with spur lines to Myanmar and Laos.
- The liberalization of trade in services, such as business services, transportation, telecommunications, construction, finance and tourism.

An even more aggressive approach to transforming the Chinese competitive threat into an opportunity is the initiative of ASEAN leaders to begin negotiations with China to create the world's largest free trade area. Such a free trade zone will constitute 1.8 billion consumers within the next ten years in which markets for consumer products and services have potentials of double-digit growth for at least the next decade or so. It is at the per capita income levels of between US\$1,000 and US\$2,000 that the demands for such goods as processed food, fashion goods, furnishings, appliances, educational and tourism services, etc. tend to grow exponentially.

In the case of the Philippines, the immediate prospects for exports to China can be gleaned from a report from Dr. Thomas G. Aquino, Undersecretary, International Trade Group of the Department of Trade and Industry. The products for which the Philippines was able to negotiate freer access to China's market are:

- coconut oil, where initially a tariff-quota regime will exist, but will be replaced by a tariff-only regime by 2006. Tariffs on coconut oil will be bound at 9% the same as with other vegetable oils (e.g. soybean oil) thus reinforcing the historical advantage our coconut oil has enjoyed *vis a vis* soybean and palm oil;
- bananas, tariffs for which will be bound at 12% by 2004;

- shrimps and prawns, bound at 10% by 2004;  
mangoes, 15% by 2004; and pineapples bound at 25% immediately;
- LPG, at 3% immediately;
- Bathroom fixtures, at 15% by 2005;
- And float glass at 15% by 2001.

To help Filipino enterprises to prepare for doing business with China in the next five to ten years, Dr. Thomas Aquino provides the following very useful guidelines:

“In the course of its negotiations with other countries (from which the Philippines will benefit as well because of the *most favored nation* principle), China also committed to liberalize access for other products which are sensitive. Some examples are: distilled spirits, beer and wine, fisheries, and auto parts. For alcoholic beverages and auto parts, China has current applied tariffs of anywhere from 65% to 100%. These will be reduced to anywhere from zero (beer) to 10% (auto parts) by mid-2006. For fish, the current average tariff of 25% will be reduced to 10-11% by 2005.

“China has also committed to abide by WTO rules especially in respect of non-tariff barriers to trade (NTBs). This will reinforce the tariff-based liberalization measures promised by China as described.

“For example, China will eventually eliminate all quotas and quantitative restrictions through a phased expansion of the current trade levels. In 1992, China imposed non-tariff import controls on 1,247 tariff lines; today, that is down to 300. Depending on the products involved, the elimination of these NTBs can happen by 2002, but certainly no later than 2005. In the meantime, where quotas exist, such quotas will expand by 15% annually to ensure that market access increases progressively.

“In the industrial sector, China has taken immediate commitments to eliminate trade related investment measures (or TRIMS) that include local content, foreign exchange balancing, export performance and technology transfer requirements. China hopes that, through these measures, it will be able to improve even more its investment environment.

“Furthermore, in the area of sanitary and phytosanitary measures (SPS), China committed to fully abide by the terms of the WTO Agreement on SPS, which requires that all animal, plant and human health import requirements will be based on sound science.

“China will also eliminate all export subsidies to agricultural products (including rice) when it joins the WTO, and committed to cap and then reduce trade-distorting domestic subsidies to agriculture as well. In this regard, it would be important to note that the *de minimis* level of domestic subsidies that China can provide was set at 8.5% of production value. In contrast, developing countries in WTO, including the Philippines, have a *de minimis* threshold of 10% of production value. Under present WTO rules, trade-distorting subsidies (e.g., price support) kept within this threshold by developing countries are deemed integral to their development objectives and aspirations, and are therefore not subject to reduction commitments. Moreover, input and investment subsidies, which are also generally exempt from reduction commitments by developing countries, are not in the case of China.”

Within a free trade framework between the AFTA and China, the Philippines can be reasonably competitive in the export of such agricultural products as coconut oil, bananas and pineapples; processed food products and beverages; and home furnishings. On the broader scale of the world market, we may make Chinese competitive strengths in manufacturing irrelevant if we focus on knowledge-intensive services such as Information and Communications

Technology, health care, tourism, logistics, education, and entertainment. One thing is sure: China's accession to the WTO will require Philippine enterprises to sharpen even more their strategic planning and management skills.

### Question and Answer with Professor Villegas

(Xu) Thank you, Professor Villegas.

I think, professor, that you basically talked about two things. The first one is about how should China's economic development be assessed? You have stated, professor, that you are not personally a specialist about China, but I think that you have a very accurate grasp of China's economic development. The second one is about what strategy should ASEAN, especially the Philippines, adopt in response to China's development. You created the very splendid concept of "co-opetition", and Mr. Maquito made a very splendid Japanese translation of it.



About the first part of your talk regarding China, the padding of economic data in China, I think, cannot be denied. But, recently, I have been writing an explanatory article about how to look at China's economic data, so let me just make a small defense. Indeed, as have been said by the Western side, I think, that some part of the data reported by the regional governments have been bloated up. On the other hand, in China, small- and medium-scale enterprises, micro enterprises, and private firms comprise about 80% of the entire [number] of firms.

Professor Meng would probably be more precise, but the government practically does not have a grasp of the situation of micro enterprises. Moreover, such micro enterprises and private firms, in order to avoid or save on taxes, do not report as is their revenues. Hence, there is some over evaluation, but on the other hand, I think, it is necessary to be well aware that there is also under evaluation.

Hence, many things are being said such as threat, and collapse, but always I think that China is a big elephant, so each person will look at China from their respective stand points. A blind person feeling the body of the elephant will say that it is a round and big object. Another person feeling the trunk of the elephant will say China is a slim and long object. It is like this that most people cannot grasp the situation of China. Most likely, I think that Chinese people and Chinese economists do not know how China is actually doing. Last year, a certain social scientist of Seika University was discussing, and he said that the Chinese have the ability to make possible the impossible. I feel that this somehow describes the situation of China.

Now going to what you, professor, call as co-opetition with Southeast Asia. Related to what I previously said, China is a country with very many aspects. For example, I just came back to Japan from Shanghai yesterday, and I looked at a so-called IT venture company located right in the middle of Shanghai and having a workforce with an average age of 25. While we have such an IT-related and exciting part which has entered the so-called "Third Wave" world of Toeffler, there is also, for example, 1000 meters away from the town dubbed as Peking's Silicon Valley, a big iron and steel company. 1000 meters away, we enter from the third wave to the second wave world. Moreover, walking towards the suburbs of Peking about a 1000 meters, there is the first wave world of micro enterprises of the pre-modern era.

Now, you, professor, said that Asia is being deprived all the money by China, as the US and Japanese investments rapidly flow into China. Indeed it is so, but, for example, Japan and the US are only looking at the high-class consumers, and there is still the huge middle- and low-income markets. I cannot go into the details, but I think that the reason why Japan failed in the auto bike market is because it was not looking at the middle-income class. It is in such an area that Southeast Asia could still enter in a big way. On the other hand, the electric goods market in China has become so saturated that firms seek the chance to go out. In such a case, changing perspectives and thinking, there is also the possibility of the Philippines inviting Chinese manufacturers.

When we consider the Philippines' strategy of co-opetition, I have two questions to ask you, professor. First, compared to other Southeast Asian countries, what are the Philippines' comparative advantage when it enters and [co-opetes] with China? Second, how do you exploit the power or role of the overseas Chinese in the Philippines? I would like to hear about your comments on these two points.

(Villegas) Our advantage is in high value tropical products, and on page 13 of my paper, we already have a certain indication of what we can export to China. Coconut oil, for example, bananas, shrimp and prawns, mangoes, and even a few manufactured articles: LPG gas, bathroom fixtures, and float glass. These are some of the manufactured articles already being exported. And as we improve our own productivity, we can find certain comparative advantages, even in manufacturing. As you know, a lot of global corporations like Nestle, Proctor & Gamble, are deciding now to spread their production facilities all over East Asia, and are focusing their manufacturing in one product in one country, and then exporting them to the whole of East Asia. And we are farming out some of our English-speaking managers. For example - I visited Guangzhou a few months ago, and quite a number of the managers are Filipino-Chinese who have been recruited by Proctor & Gamble to run the business. So not only is it in agribusiness that we have some advantage, it is also in some types of knowledge workers who are working in China because of their knowledge of English. And they are already beginning to actually attract to the Philippines Chinese students, in the same way we are attracting thousands of Korean students. And what is our advantage? We are English-speaking. And many of these young people find that coming to the Philippines is a lot more cost-effective in learning English than going to the United States. And we are very impressed with the way some Chinese youth, I am sure, encouraged by their government, are already preparing for the Olympics of 2008. So the Chinese are already thinking of 2008, when the Olympics will be held there, and they need a big number of English-speaking people. And they are already using the Philippines as one of the areas for learning English. So that is definitely a cooperative way that we can deal with China.

And let me just say that every time I come to a symposium like this, I learn something new, and I must thank our speaker, Meng Jianjung, for talking about "brain circulation." Because we have seven million Filipino workers abroad, and we have always been referring to them as "brain-drain." I think when I go back to the Philippines, I will tell them "No, that is "brain circulation" and not "brain-drain." Thank you very much.

Yes, the second one is the overseas Chinese. We have a lot of overseas Chinese who have become experts in supply-chain management, logistics. As you know, in business today, that is one of the most glamorous and studied areas - supply-chain management. And for those of you who have been to Manila, you know that we have the biggest malls in East Asia. They are kilometers wide. And what has happened is that the owners of these mega-malls are Filipino-Chinese. They are investing already in China, especially in Amoy, because many of them come from there. So that the day will come, and because they are already invested in China, they will know what is the consumer profile, what are

the demands of products that the Chinese market will have, so that they will be actually bringing in products from the Philippines, and other parts of AFTA, for their retail outlets. That is one way the Filipino-Chinese overseas businessmen are preparing for the future of the consumer market in China - investing heavily in distribution, in retail, and some manufactured products. And I think it is the way we will have a win-win situation by our Filipino-Chinese investors in China.

(Original in English)

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## Free Discussion

(Moderator)

We shall now have a free discussion. First of all, we shall hear from the five presentors, after which, if there is still time, we shall take questions from the floor.

(Hirakawa) Let me ask an extremely simple question. In the second report, Professor Lee Jin-gyu commented that recovery from the Asian currency crisis took merely a little over two years. What is the significance of this, and why was such an easy recovery possible? A famous Japanese economics professor, who was also professor Meng's professor, Professor Toshio Watanabe has stated that the Asian currency crisis was an incident that proved Asia's strength, and ironically, it proved that the Asian economy "had" competitiveness. You mentioned in your comment that the fundamentals were good in the so-called cash flow crisis, or liquidity crisis. The way I understand it is that Korea's currency crisis, ultimately, as is implied by the words IMF crisis, was created by the IMF, and that the real crisis was caused more by foreign than domestic factors. I would like to ask the professor's confirmation whether or not my understanding is correct.

(Lee Jin-gyu) I agree with much of the professor's opinion. In Korea, we use the expression IMF crisis. As to why the Asian crisis occurred, there is the theory that this was created in a world led by the US. To be more specific, this is the [hypothesis] about how the Jews, who control the New York stock market, created [the crisis] so as to control the rise of the overseas Chinese. This has not been proven, but it is in this point that I agree with your opinion.



(Hirakawa) Thank you very much.

(Meng Jianjun) In listening to Professor Villegas' presentation earlier, I found it very educational and provocative to know that such a perspective exists in the Philippines. My question is about the Philippines. It is about cooperative relations. What is the Philippines' future strategy regarding China. Perhaps it is not clear, but I would like to know the professor's thoughts on his overall perception .

(Villegas) Thank you very much. Our view on China is very positive, precisely. We think that we can complement one another. We are clear that we will never be able to compete with China in things like Nike shoes, Barbie dolls, those types of products that just require cheap labor. And so our exporters are trying to see what products are distinctively high value in the Philippines. For example, in the case of furniture, not low price furniture but some of the very exquisitely designed pieces of furniture that we are still exporting to London and to Frankfurt, we can compete with China. We can say the same thing with garments. We will never beat China in low- priced garments. But we are very successful in ladies' lingerie, children's dresses that are embroidered, because they require skills of Filipinos that have been developed for generations and t cannot be replicated by China overnight. So, this is the way we are disciplining ourselves. Do not compete with China, Vietnam, even Indonesia in products, which are just labor-intensive. No way you can win. So that is somehow helping us hone our special skills.

We are also very confident that China will take a long time to compete with us in IT-enabled services. Call centers are now sprouting like mushrooms in the Philippines, because the Americans like the way we speak English. As you know, Filipinos can be very American in the way that we imitate them. And in a call center, you need to speak English according to the Americans, otherwise, they will not get you. And there are all kinds of other IT-enabled services like animation, medical transcription, and data-encoding, which will take some time for the Chinese to master, because it will take a long time for them to have millions of people who will speak English. Those are the types of market niches that we are trying to develop, so we do not compete with China. That is the way we are able to complement China within the East Asian region.

(Meng Jianjun) Thank you.

(Villegas) Yes, I would like to make a comment, if I could make a suggestion to Professor Hirakawa. Professor Hirakawa, you can probably include in some of your future studies about this Asian crisis, the bubble that happened both in Thailand and in the Philippines. I mean, it was not a major explanation, but a lot of businesses that had no interest or competence in real estate actually went into real estate investment, and then you had buildings and buildings and buildings all over Bangkok and Manila that are now empty. That explains part of what happened in 1997. But that is not new to the Japanese. You had your own bubble. So, it is not something completely unpredictable. When you have a cycle, usually real estate attracts a lot of investment unnecessarily, and so that was part of the problem of both Thailand and the Philippines. Now just a comment from all the discussion, especially Dr. Lee, about his saying that Korea had very strong fundamentals, and I agree with it. And that led me to the conclusion, which I have already made before, that there are different types of crony capitalism. And that is one area where the Americans and the IMF are not intelligent enough to see. Korea had its own crony capitalism, with Park Chung Hee, working together with the chaebols, and as he was saying, the banks were being dictated as to who and where to lend. But that type of crony capitalism was very effective in its time, when there was still not very much globalization, and the rest of the world did not have to scrutinize you as closely as they are now scrutinizing the countries. We can say the same thing with Japan. There was an unholy alliance, as now the others say, between MITI, the Bank of Japan, the zaibatsu, and, really, giving credit was not left to the market. It was completely coordinated by precisely that kind of cronyism that can be referred to as crony capitalism. But it was very effective while it lasted, even in Indonesia, as I was listening to the presentation. Many of us do not, let us say, like Suharto.



But Suharto had a cronyism that was different from the cronyism of Marcos, and not to mention, our recent experience, with Estrada. At least, a lot of the cronies of Suharto had been making investments inside Indonesia, and not in Switzerland or Vancouver or San Francisco. And there were actually very productive investments, for example, in food, with noodles and things like that. What was wrong with IMF perception was to put us all in the same basket. That crony capitalism is all bad, without making distinctions, and not realizing also that good governance - of course, right now it is a must - but because of globalization, right now, the whole world is watching you. If you continue to do today what Park Chung Hee did, or MITI did, or Suharto did, you are not going to attract any investment at all. That is because we are in a different world. But when the world was separated into several markets, that was an effective way of reaching eight, nine, ten percent growths. And China is still, in a way, doing it. To a certain extent, there is crony capitalism with state enterprises. But sooner or later, if they really want to be a part of the WTO, the world, they will have to modify that. And so this is where I think IMF could have been a little more discerning in talking about crony capitalism. Although, I do not know whether my friends from the other countries will agree.

(Lee Jin Kyu) Okay, I agree to some degree about those crony capitalisms, that crony capitalism is kind of a negative way of looking at Asian values. I would like to express that crony capitalism is like Confucius capitalism or Asian values. We have different values than Americans. So you talk about Japanese economic model, or Korean economic model, by the American standards. I would say globalization, making the whole world one community, is the American way of doing business. We do not have to follow the American way. We have our own way, right? So that is why the Asian people need to be one single community, according to Asian values, not American values. You may call it crony capitalism, but I would say that it is something else. We have our own way of doing business, right? We cannot say that is wrong, or right - that is cultural difference or something different. But I agree with you, that globalization that is by your definition, by American definition. But Asia has some different values. We have our own definition. That is my response.

(Villegas) We do not disagree. That is right.

(Hirakawa) I will reply to your question about the bubble economy in East Asia. In the bubble economy, both Thailand and Korea had high overproduction. I think that it was precisely such weakness that was one cause of the currency crisis. However, this cannot be considered at the same level as the liberalization for globalization that the US or the IMF demanded from the Asian countries. When the US and the IMF demanded liberalization, only the positive aspects of globalization were emphasized. In the case of Thailand, in 1996, for example, the World Bank stated that in Asia Thailand was the best country in managing short-term capital inflows. In the first half of the 1990s, a bubble occurred but both the IMF and the credit-rating agencies, in fact raised their ratings. I think that, in this sense, they were able to instill confidence in Asian countries, and thereby create a business opportunity for themselves.

Consequently, basically there were weaknesses within Asia, but should a crisis occur from this, there would be no reason for the crisis to spread quickly to the whole of Asia. It would have been good if the crisis was a crisis of individual countries. But, I think it is very important that it was not so. Hence, it was actually extremely difficult for

countries to embark on their respective reforms after the Asian currency crisis, and stay on the globalization track. Japan has been concerned for a long time about this problem. Undertaking structural reforms meant the alignment of existing development frameworks and economic structures to globalization. This is an extremely difficult task. The Asian countries were not aware of this. However, Asia cannot grow by separating itself from globalization. I think there is the determination among Asian countries to cooperate with each other while undertaking structural reforms.



Economists think on the premises that the IMF and the World Bank propositions are correct. But, more than that, the governments of each Asian country should undertake structural reforms from the policy maker's perspective of what should be done for Asian countries to continue developing in the era of globalization. At the same time, they should think of how to maintain Asia's stability. This, I think, is one of the lessons of the Asian currency crisis experience. The bubble, I think, is indeed one of the factors behind the currency crisis, but it was not a decisive factor for the crisis to have spread to the whole of the Asian region, the US, Latin America, and Russia.

(Villegas) Thank you.

(Gatot) I have one question to Professor Hirakawa. As you may know, the chairman of IMF, Horst Koehler, mentioned that IMF is ready to see an Asian Monetary Fund. In this case, if this is an honest statement of Horst Koehler, do you think Japan is ready to lead the Asian Monetary Fund? Thank you.

(Hirakawa) Regarding the AMF issue, I think, that the Honorable Miyazawa will perhaps answer if you ask him when he comes in later. During the currency crisis, the Japanese government basically took the stance that it was a liquidity crisis. In view of this, it was considered that providing foreign currency was an extremely important factor that can benefit both Japan and Asia. Naturally, at that time it would be possible to have an Asian version of the Euro. Before doing so, however, the internationalization of the yen would be necessary so as to maintain Japan's position within Asia. One means considered towards this would be the AMF.

However, the AMF basically differed from the Miyazawa initiative in that it was not a bilateral financing support. The AMF was to be a multilateral international institution. It would be extremely difficult for Japan to control, since Japan will also be inside cooperating with the other member countries.

From the side of ASEAN, the AMF initiative was torpedoed, and the Miyazawa initiative was actually implemented in December 1998, but at that stage discussions about the AMF were already being revived. The Philippine president proposed something like the AMF initiative. There is also the Chiang Mai Initiative which

could ultimately merge with the AMF proposal, even though which currency to be used is not yet clear. There are a lot of problems, but the Japanese government is, I think, thinking about these problems. My understanding is that if such a process is not followed, it would be extremely difficult for Japan to move ahead on this issue.

(Gatot) Thank you very much

(Moderator) Thank you very much, professors. I thought that we would have time to get opinions from the floor, but unfortunately we have run out of time. Allow me to end the free discussions at this point.

# Summary

(Shimazu) I would like to conclude the forum with a summary of the presentations and free discussions made earlier.

Today's forum has been under the charge of SGRA's "Japan's Uniqueness Amidst Globalization" research team. Professor Hirakawa is an adviser of this team, and has been very active in kindly providing guidance. In addition to which, we have requested him to be top batter for today's presentations. I would like to request the professor to make a summary of today's proceedings.

(Hirakawa) I do not think that I am capable of making a summary in a few minutes, but the intended person for this task was not able to come so I am taking his place. Allow me to talk briefly.

Looking back at the presentations of today, excluding my own, first of all in the second report Professor Lee Jing Kyu stated that Korea's case went well. It ably absorbed the IMF shock, and proceeded with structural reforms. However, I was extremely impressed when he said that at the same time the Asian currency crisis was not a decisive or essential crisis. I think that in the Korean case we can perhaps see an aggressive response to a globalizing economy, utilizing the currency crisis as a triggering factor.

As a contrast to that we had professor Gatot in the third session. He spoke of how the IMF prescription was completely ineffective in the Indonesian case. What was extremely interesting was that he made a clear indication that the IMF's reforms would never work when we consider the assistance towards small- and medium-scale enterprises within the context of Indonesia's development. However, at the same time, I was struck by his indication that in considering reform of the banks, it is important to have a more open economy, although this perhaps is debatable.

These two presentations, in one sense, form a set. What can be said here is that a uniform policy demanded of all countries need not necessarily lead to the same results. I think the lesson here is that, in Asia this point should be particularly taken into consideration.

In the fourth session, professor Meng has put forth a challenge to Japan. China can hack it even without Japan. This point has to be seriously considered. Although the direction is different, in my survey of trade statistics, I personally have arrived at basically the same conclusion that at this pace Japan's political power within Asia will be inevitably weakened. I was extremely impressed since [his conclusion] is the same as what I made in a presentation in a symposium held last February in Nagoya University.

He also indicated that Brain Drain is changing into Brain Circulation. In the first half of the 1990s, such a phenomenon was actually observed in the NIEs. Up to about the 1960s, Taiwan was experiencing Brain Drain. The people who left enmasse during the 50's and 60's were returning in the 70's and 80's. At that time, this was called Reverse Brain Drain. The same is also true with Korea and Singapore. I think the same thing is happening with China.

Regarding the issue of differentiation, I think that Asia will undertake regional integration in a gradual fashion, taking a different direction from that of Europe. However, I think that Europe's experience provides us with

extremely important suggestions.

In the fifth presentation, Professor Villegas submitted the new concept of co-opetition, which is neither competition nor cooperation but a blend of both. I think that was the keyword. At the same time, I think, he gave the message that, a free trade agreement between ASEAN and China must at all cost be formed, overcoming the numerous big problems that China has. In this respect, I think that very new concepts, for example, the keywords or key concepts of Brain Circulation and Co-opetition, were arrived at through today's meeting.

In conclusion, I feel that we have come to this meeting with a common perspective. I was extremely worried as I made the first presentation, about the possibility that the discussions will be in a different direction than that I laid out in my presentation. Since it is my responsibility to wrap up today's meeting, I would not have known how to do so in such a case. But, I think we very much had the same viewpoints. That is, the currency crisis has been an opportunity to move towards greater regional cooperation. In such a case, human network becomes a very important factor, and this is precisely what I think the Sekiguchi Global Research Association wants. As a member of Sekiguchi Global Research Association, I am extremely happy about this. Hereon, we should mutually think about co-opetition.

I have exceeded my time, so let me end here. Thank you very much (applause)

(Moderator) That was a splendid summary. Thank you. Let me end the first portion of today's forum. Please join me in thanking the professors, commentators, and translators. (applause)

## Speakers' Profiles

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BA, MA in Management Studies from Meiji University, Ph.D. in Economics from Kyoto University. Professor of Economic Research Center, Graduate School of Economics, Nagoya University from 2000, and Former Professor in Asian Economies at Tokyo Keizai University, Ibaraki University and Nagasaki Prefectural University.

Books: *NIEs: World System and Development*, Tokyo: Dobunkan, 1992 (in Japanese). *Japan and Singapore in the World Economy: Japan's Economic Advance into Singapore 1870- 1965*, London and New York: Rutledge, 1999 (in collaboration with Shimuzu Hiroshi). *New East Asian Economy*, Kyoto: Minerva Shobo, 2001 (Co-editor, in Japanese).

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Professor at College of Business Administration, Korea University. Dr. Lee is an expert in Human Resource Management, General Management, Organization Management, Future Studies. Ph.D. from the University of Iowa, in 1987, M.B.A. from Michigan State University, in 1982, and B.B.A. from Korea University, in 1979. His publications include: "Strategic and Ethical Human Resource Management" (2001) Pakyoungsa.

His service and professional association appointments include: President of the Korean Association of Personnel Administration, Vice President of the Korea Academy of Business Ethics, Director of the Labor Education and Research Institute Korea University. He is also a consultant for prominent firms such as Samsung, SK, LG, as well as the Korean Government.

Dr. Lee founded, with his colleagues, a private foundation "Human Resource Research Center," which by networking scholars deals in a wide range of global issues, including environment, longevity, gender, and regional studies. Currently he is the director of the foundation.

<Commentator>

### ■ Kim Woong Hee

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### ■ Gatot Arya Putra

Mr. Gatot Arya Putra received his bachelor and masters degree in Economics from University of Indonesia in 1993 and 1996, respectively. He became lecturer and researcher at Faculty of Economics University of Indonesia (1992 to 1996), Head of Microstructure at Jakarta Stock Exchange (JSE) (1996 to 1997), Head of Listing Evaluation and Development at Listing Division Jakarta Stock Exchange (1997 to 1999), President-Elect of JSE Labor Union (1998 to 2000), Head of Macrostructure at Jakarta Stock Exchange (1999 to 2000), Team Leader of Macroeconomic Analysts at Indonesian Bank Restructuring Agency (IBRA) (2000 to Present). He is also as columnist at Jurnal Magazine and Bisnis Indonesia Newspaper. He actively joins international economics activities, i.e. Asian Securities Executive Program, Wharton School, University of Pennsylvania (in collaboration with Kuala Lumpur Stock Exchange) (1997), Financial Executive Program, PACAP Research Center University of Rhode Island (1997), Harvard University Summer Program on Corporate Governance Summer (1999), Diploma on Small Medium Business from Gallilee College Israel (2001), Global Strategy Program by Gallilee College and Harvard University (2002).

<Commentator>

### ■ Ferdinand C. Maquito

Received B.S. Mechanical Engineer degree (Dean's List) in 1982 from the University of the Philippines. Received M.S. Industrial Economics in 1986 from the Center for Research and Communication (now, University of Asia and the Pacific). Received Ph.D. in Economics from the University of Tokyo. Currently a visiting instructor at Temple University Japan. Chief of the "Japan in the Era of Globalization" SGRA research team. Recent publication includes: "Japan's Economic Cooperation: Its Philosophy and Theory. In "New East Asia Economic Thinking: A Searching East Asia in Globalization" with Hitoshi Hirakawa, and Yoichi Ishikawa (eds); Chapter 13.

### ■ Meng Jianjun

Professor at School of Public Policy and Management, Tsinghua University in China, and a Faculty Fellow at RIETI in Japan. He is specializing in the Chinese economy and regional integration in Asia. His publications include: Economy Developing and Population Change in the Asia-Pacific Region (Keisoshobo, Japan, 2000).

His lectures at Tsinghua University include: (1) Trade and Investment Relations between China and Other Countries (advanced industrial countries, and East Asian countries) (2) China's Scenario for the Tying up of Free Trade Agreement (① China aggressively pushes 10 + 1, ② China initiates the China, Japan, Korea plus Hong Kong free trade area, with ① and ② as foundation, China pushes the 10 + 3 Asia Economic Integration, (3) Prospects of Asia Economic Integration (movement of people, policy coordination, institutional framework, etc.)

<Commentator>

■ **Jin Xianghai**

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■ **Bernardo M. Villegas**

Dr. Bernardo M. Villegas is one of the Philippines' most influential and widely known economists. He is an expert in development economics, business economics, and strategic management. He holds a doctorate in Economics from Harvard University and is currently the Dean of the School of Economics of the University of Asia and the Pacific (UAP). He is also one of the founding members of the Center for Research and Communications, from which the UAP basically emerged.

An active member of the private sector, Dr. Villegas serves as board member for leading national and multinational firms, including the Bank of the Philippine Islands, Globe Telecom, IBM Philippines, and MacDonald's. He is also a consultant on management development and strategic planning for numerous firms operating in the Philippines and the Asia-Pacific rim.

He is also involved in various non-government organizations, being a board member of the Makati Business Club, Parents for Education Foundation, and the Dualtech Foundation. His work with these organizations allows him to touch base with various sectors and interests. Dr. Villegas was also a member of the Council of Economic Advisers of former President Fidel Ramos, in which capacity he was asked to advise on numerous policy issues, particularly in industrial policy and rural development.

A widely published author, Dr. Villegas has written various economic textbooks used in Philippine schools and universities. He was a member of the Pacific Board of Economists of Time Magazine, and is a regular writer in both local and international newspapers.

Dr. Villegas is a graduate of Commerce and the Humanities (both Summa Cum Laude) from De La Salle University. He was a member of the Constitutional Commission that drafted the 1987 Philippine Constitution.

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