



**LIBERALIZATION
and
GROWTH IN ASIA**

21st Century Challenges

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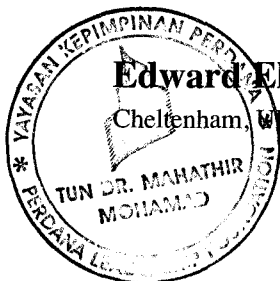
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Preface

This book is about sweeping new thinking spreading in Asia (and elsewhere too) on liberalization *and* what such economic and financial liberalization could do to the well-being of peoples of poor nations. The authors are indeed pleased to document, in this carefully analysed book, the myriad liberalization steps undertaken by eight Asian nations with potential lessons for other nations pondering how to improve the human conditions in the newer, increasingly globalizing world in the twenty-first century. It is not entirely unthinkable that some readers from nations not included in it may seek to emulate the success stories in Asia and even be forewarned to avoid the mistakes suggested from a careful study of the included countries.

The authors have been researching the new thinking among Asian elites since 1996. They reported in a separate publication in 2000 some very interesting findings about the liberal reform experiences of thirteen countries over a span of 35 years ending in 1998. Those findings are extended in this later book by covering just eight countries as core cases of some very successful nations, while also describing equally interesting examples of a few nations that could not secure the prosperity through liberalization attempts because of conditions that prevented them from focusing on progressive ideas in the face of external and internal threats. Readers will find this book to be a good reference for a comparative understanding of how neoclassical liberal economic and financial reforms could be planned and executed in order to secure prosperity while also noting what pitfalls may prevent smooth transition to sustaining the prosperity in the face of major crises.

The paths trodden by eight countries over about forty years were selected for study. Their experiences as evidenced by reliable statistics tell us it has not been smooth sailing, with some countries jolted by severe sidelining of liberalization because of internal and/or external threats. For example, Pakistan's attempts to get its economy on the right path were thwarted by a lack of good neighbourliness on its left and right while the Cold-War-related interventions in its affairs led to costly and catastrophic war preparedness. Both these conditions naturally resulted in resources being directed to making weapons and *not* civilian goods. This nation failed to put reforms to work for her people's benefits. Then there is the other example of China, which, motivated to preserve the Communist controls and aspirations of the controlling elites of that country, latched on to neoclassical economic and financial

reforms to return its production processes more and more to the dictates of the market, instead of the whims of the central planners in that command economy. The reforms produced an economic revolution, some would say a miracle. This led this once foreign-currency-starved nation to boasting in year 2003 the world's largest reserves on the back of a policy of cheapening its currency value to gain trade dominance: foreign reserves in 2004 were close to US\$400 billion. That country's experience could perhaps be matched, as it is very close to the economic miracles achieved by a few Fascist regimes in Europe in the 1930s and the early 1940s.

There are other middle-of-the-road cases such as those of Malaysia and Thailand. With a long period of years spent on building peace bridges with neighbours to prevent hostility, these two nations secured sustainable prosperity over two decades at growth rates twice as high as in many countries while also democratizing the management of their countries based on one person one vote and multiparty democracy. GDP per capita in Malaysia went from 10 per cent of US GDP per capita to 40 per cent in just 20 years. Of course these two countries were not spared problems: they faced a major crisis, which was the 1997–98 Asian financial crisis. That crisis and the subsequent ongoing fight against religious terrorism following the September 11 incident left these economies in pretty bad shape and shaved half the hitherto-growth momentum and what they achieved over a quarter century before the crisis and before the terrorism-related crises in these countries.

One salient finding is that these eight nations had mixed experiences on how reforms could alleviate economic woes of their peoples. Yet, overall, the early reformers and the later-reforming China and India had more successes than failures to secure improved well-being of their citizens. The financial crisis that pushed back the gains in some financially more open economies very severely – the case of Indonesia is one – suggests that there was something essentially wrong with these economies to have such severe effects from that crisis. It revealed that there were issues of (a) over-dependence on foreign capital flows, and (b) overvalued currencies, which, relative to China, were severely curtailing their ability to maintain competitiveness in the international marketplace for consumer goods as well as low-value consumer durables. The right thing happened by accident to them with the collapse of currencies of several of these countries, which rearranged their competitive positions in their favour thereby improving their trade after the crisis.

The issue of how these countries are coping with the loss of competitiveness while also being willing to undertake wide-ranging reforms are two interesting questions to which the authors turn their scrutiny in this study. The seriously affected ones (Indonesia, South Korea, the Philippines and Thailand) underwent market-opening efforts under the tutelage of the Asian Development Bank, the IMF and the World Bank. Others (Malaysia and

Singapore) managed to bring in similar reforms without the IMF oversight. The important thing is that all these eight nations undertook, and are continuing to undertake, reforms to secure the growth momentum lost in some cases after the systemic regional crisis in 1997–98 and also after the September 11 incident.

Important reforms included free floating of the currencies: Indonesia, South Korea, Pakistan, Singapore (still follows a managed float regime) and Thailand. Or some adopted the intermediate step of basket-pegging currencies in the hope that at a future date(s) their currencies could be free floated: China and India. Capital controls that were rampant were slowly eased to provide at least their real sectors with easy access to capital. Even in the case of Malaysia with a fixed exchange rate from October 1998, corporations were never in any doubt that their foreign exchange needs would not be controlled by the authorities. To the contrary, the rules were softened for the production sector.

Competition policy and exit policy for firms were promoted. Bankruptcy laws were honed carefully to ease exits for correct cases. Barriers to entry were removed as was done in the worst cases in South Korea with *chaebols* (powerful family or clan-held firms) forced to seek wider distributions of shareholdings. Some were broken up to promote competition. MacCarthy would have moved in his grave to note happily that others are following what he did similarly to break up the anti-competitive *zaibatsu* firms in Japan in the 1940s. This time it was the turn for South Korea to rein in the powers of the *chaebols*, which often interfered with democratic processes. Trade liberalization followed quickly. Imagine the inward-looking Indian government making huge reductions in tariffs ahead of its aspirations to be a member of WTO. Tariffs came down in many countries. Many countries abolished barriers to entry to all kinds of economic activities (not military ones), although in some cases, as in China, the only way is to enter the country through a joint venture, with state-owned firms increasingly being listed on stock exchanges or managed via private sector incentives, though not ownership, almost all the time.

The financial sector reforms were also undertaken after the crisis. The collapse of this sector respectively in Indonesia, South Korea, Malaysia and Thailand led to restructuring reforms that made the hitherto very weak financial institutions reform their ways of doing business after an initial period of financial recapitalization efforts to put them on the mend. Some countries in the sample have signed WTO services agreements under which the financial sector will be open to foreign participation. Fiscal discipline returned to the countries after having been lost for a while because of the crisis. Budgets are more in balance in these countries, and governments are reforming ways to return subsidized activities to the dictates of the marketplace (except perhaps in the health and education sectors).

Capital and money market openings along with efforts to build sound bond markets are seriously underway. Restrictions on ownership and entry are slowly being lifted. Some countries, Thailand is one, have made foreign ownership very easy. Monetary policy reforms took centre stage – given the high inflation after the crisis – in the forms of greater independence for the central banks, and setting up of good governance (Indonesia has an UNDP presence on this) framework. The prudential framework has been seriously re-examined with some countries attempting to set up separate prudential supervisory bodies as in Australia and the UK to improve the bad loans and banking supervision problems.

In short, the twenty-first century challenges for these eight countries are being confronted squarely head on. Once the world settles to a more orderly situation from its terrorism-related activities, and the people of the world return to normal activities, it is not unthinkable that these already-ready-to-go early reformers may well secure higher growth rates than they are stuck with presently. In that prediction, the authors are very hopeful that it will happen.

We see in this analysis very complex meshing of decisions in a coherent whole that secures growth and development, which brings prosperity to peoples of different doctrinal persuasions. We also note, in the case of those that failed to develop, a lack of consensus building to ensure peace with neighbours, a singular lack of a strong constituency for open liberal policies, and lack of open market signals, all of which only favours interest groups seeking to preserve the status quo profitable to these groups. The Communists have now returned to the market signals but they are still adamant where it really matters most. That is, to make far-reaching changes to private ownership, institutional changes on information freedom, freedom of association and to create a market-friendly environment for non-economic and non-financial activities of people.

We would like to take some space here to acknowledge our gratitude to many who made this study possible. This work would not have been possible but for the support of our publisher, Edward Elgar, personally, from the outset. Edward saw a book of this kind being useful for many purposes, and we thank him and his hard-working editorial staff for their assistance over the years. Second, but not less important, are the many persons who helped us selflessly by sharing information during our visits to all these countries, where we met bankers, professors, consultants, government officials, officers in the central banks, etc. These people – there are too many of them to name here individually – have a good feel for what policies were good for their respective countries, and were not unwilling to share their views with us authors of how things could have been improved in many cases.

Our research visits to these lands have endeared us to the attractions of these Asian countries as potential tiger economies of the future years in the

twenty-first century once events come together to pursue right policies. After all such things happened with Deng in China or Dr Mahathir in Malaysia or Rao in India, who were all responding to market demands of their times with single-minded pursuit of changes in broad directions to secure prosperity for their peoples through the dangerous road of liberalization instead of controls.

Finally, we would like to thank friends and scholars who have been very supportive of this study. Several research assistants helped us during the data collection and compilation phase: to them, our heartfelt thanks. Many scholars supported our efforts. First and foremost, we thank the anonymous referees in the UK for useful suggestions. David Cole and Betty Slade, formerly of Harvard University, encouraged this work as did the late economic historian, C. Manias Kindleberger. Limited research grants extended to the authors by the Monash University and the Bond University are greatly appreciated. Last, but not least, we thank our wives and children who have long supported our fascination with studies of Asia's resurgence.

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