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## China and the Development Setback in East Asia:

### Holding the Crisis at Bay?

One should not underestimate the power of greed, for when it comes to it, even geniuses can be fools... We succumb to folly the moment we throw prudence and common sense to the wind. Zeal may be a virtue, but overzealousness is a vice that springs from a simplistic mindset, which gives rise to the periodic pendulum swings in economic policy. Whether it is blind faith in market-driven solutions or reverent belief in government as the sole arbiter on the production and distribution of goods, both suffer from the naivité that there are simple prescriptions to complex societal problems.

(Anwar Ibrahim, former vice-premier of Malaysia, *The Asian Renaissance*, 1996)

It is not too soon to argue that the system could be improved... But that would require questioning some of the most cherished tenets of the business community. To argue that financial markets in general, and international lending in particular, need to be regulated is likely to outrage the financial community... But the private sector is notoriously inefficient in the international allocation of credit. It follows that international capital movements need to be supervised.

(George Soros, Personal View, *Financial Times*, Dec. 31, 1997/Jan. 1, 1998)

## I China: Under the Spell of Uncertainty

In recent years a number of Chinese „socialist patriots“ have come to distinguish themselves. Strongly enticed by the lure of national grandeur they felt obliged to instruct their contemporaries across the world that „China is seventy per cent of East Asia“. In some ways, this assertion undoubtedly is correct, even if not with respect to its aspirational nationalist thrust.

China belongs to East Asia, and this holds true not only in geographical terms. Thus, it stands to reason that general developments, in particular protracted maldevelopments, which take place in the overall region cannot but have a more or less serious impact on the Chinese subcontinent. In fact, it has increasingly been realised in China's intellectual as well as political domains that the chain of crisis events in other East Asian countries has the potential to seriously aggravate long-existing systemic constraints. Ministerial think tanks and other policy-oriented research organisations came to be entrusted with a new

field of work, that of crisis analysis. And the numerous Party/State bodies also felt forced to demonstrate that they were bent on reacting to the unexpected new challenge. But after some initial bursts of energy it gradually became clear that the patterns of reaction lacked consistency.

Some time ago Berkeley's senior Asia scholar Robert Scalapino claimed in one of his numerous stimulating essays, written under the suggestive title „China's Multiple Identities in East Asia“, that „predictions regarding China have always been hazardous and never more so than today“. Needless to say, even coming from a highly authoritative source such a sad dictum is not exactly satisfying. Unfortunately this author, nonetheless, feels compelled to largely concur with Scalapino's educated conviction and to become more or less resigned to it.

On the one hand, to forecast that things will evolve well in China and that the country will successfully master the immense destructive pressures associated with forced and rapid modernisation may easily prove to be a reflection of grossly insufficient astuteness. But, on the other hand, to predict that China is heading towards a stage of „arrested development“ would not appear to be reasonable either. In order to make such an extremely gloomy prediction it is not enough to rely on one's own foreboding. Instead, one rather should have solid evidence, and this author simply does not have the kind of knowledge needed for that. He knows a number of Chinese students and scholars and even a couple of diplomats and administrators. But what does he really know about the prevailing state of mind of the average Chinese peasant, worker or shop attendant!

However, having confessed that, due tribute shall, nonetheless, be paid to the usual reality-check commandments. What can be ascertained is that the general climate of bureaucratic arbitrariness and individual as well as organisational corruption is as oppressive as ever. One just has to recall recent reports which sadly elucidate how a legion of so-called red „robber barons“ are engaged in the business of extortion, overtaxation and embezzlement. For them „reform“ amounts „to a process in which power-holders and their hangers-on plunder public wealth“. (Liu Binyan, Perry Link, „A Great Leap Backward?“, Review of: He Qinglian, *China's Pitfall*, Hong Kong 1998, in: *New York Review of Books*, October 8, 1998)

There can be no doubt that such destructive activities surpass all conceivable notions of different cultural environments to which never-tiring Western „Asianists“ like to refer when arguing that there is no basis for a clear-cut transcultural understanding of corruption. Somewhat surprisingly, even among economists there are some people who maintain that there is no objective yardstick, first, to define what constitutes corruption and, second, to decide with respect to concrete cases whether corruption is promoting or stunting growth. In fact, for various reasons, in particular owing to inherent problems of obtaining reliable data on corruption-related activities, it is hard to demonstrate the effects of corruption. Nonetheless, even conceding that there may be occasional efficiency-increasing acts of corruption opening a way around inefficient political and administrative rules, this can only hold true under conditions of what has been called „organised cor-

ruption“ which is predictable and, thus, makes it feasible to factor the respective input into one's costs. But China is not only top-runner (together with Indonesia) of the Asian league of corruption. Corruption in China also is judged to be heavily „disorganised“ which implies that factual costs cannot reliably be calculated in advance.

Apart from that, there is a much more authoritative way to settle this ethically disagreeable issue. The proverbial Chinese preparedness to bear with resignation the ramifications of these systemic evils has been declining among growing societal segments of the urban and rural population alike. Recently there has been considerable social unrest and in a sizeable number of localities and districts eruptions of peasant violence have shaken the authorities. Peasant embitterment is as extensive as is urban worker resentment caused by strong feelings of social insecurity and the abolition of attested guarantees of lifelong employment. But up to now local turmoil has never reached the stage to seriously jeopardise national security and the survival of the political regime. Fear of chaos and disorder appear, for the time being, to be more lasting than the desire for radical political changes. Whether this assumption will hold valid for the future as well is, of course, a different matter.

## II Asian Crisis: The Experts and the Puzzle - Who Takes On Opinion-Making Leadership?

Until early 1997 the East Asian „miracle economies“ boomed and almost everybody in the West and East Asia alike seemed to believe in the rapid steady progress of the region. Casting doubt on „Emerging Asia's Bright Prospects“ (Asian Development Bank) was viewed as unprofessional. In retrospect - and only owing to the benefit of hindsight - it can be claimed:

The bubble was created by an over-extension of credit by foreign lenders and investors to these Asian countries. When you are part of the problem, the chances are you cannot have predicted it... A Wall Street Journal roundup of economists in June 1997 reported that more experts picked Asian stock markets, excluding Japan, to be top performers in the following 12 months than chose the United States, Europe and Japan.

(„The Lionized Tigers Are Bears - Oh, My! How the Experts Missed Wildly on Asia“, *The Washington Post*, January 11, 1998)

Since mid-1997 it has only been the Asian crisis that „booms“ (which shows that the famous Asian dynamics works in all directions), the one major exception being China (plus Taiwan) which up to now has been capable of keeping the crisis at bay. But even in China strongly lingering concern can clearly be discerned that growth may decline sharply in the wake of the regional crisis and owing to the concomitant lack of intraregional demand stimuli for Chinese export production. Chinese representatives were, for example, apprehensively listening at the World Economic Forum in Davos early last year when C. Fred Bergsten predicted: „The 'strong center' will re-

main insulated to some extent from the countries on its northeast and southeast flanks, but it too will experience a considerable slowdown.“ (<http://www.usia.gov/regional/ea/asiafn/bergsten.htm#note1>) The lingering concern about a potential loss of national economic dynamism has been reinforced in March 1999 by prime minister Zhu Rongji whom many hold to be the best „economic brain“ among the „strong center's“ top leaders. Most party cadres were struck by Zhu's alarming prognosis at the National Party Congress when he predicted a very problem-ridden year ahead and opined that the regional crisis impact on China has gradually proved to be much more serious than anticipated in the early months of the crisis evolution.

At first glance the official economic data for 1998/99 do not seem to lend too much credence to Zhu's gloomy forecast. After all, it is reported that in 1998 the economy expanded by almost eight per cent and that high growth continued to shape the national economic landscape during the first half of 1999. However, when taking a close look it becomes apparent that there exists a notable gap between the positive impression which the official figures convey and the confusing picture of the country's factual economic evolution. Under such circumstances it would appear reasonable to comply with the demands of skepticism.

Firstly, in the course of time this author has come to believe that China's politico-economic leadership does not tend to favour an administrative environment in which the outcome of statistical work seriously hampers „optimistic“ policy targeting. „China's future is bright!“

Secondly, it is largely agreed among specialists on the Chinese economy that the official figures overstate the country's true output position. Real GDP growth tends to be lower by up to two percentage points than the official data suggest.

Thirdly, the notion of sustained dynamics seems to be proved wrong by a number of basic features of China's current factual reality which, among others, is being characterised by lasting deflation and continuous slackness of demand.

Fourthly, when assessing the different sources of GDP growth it turns out that more than half of the overall growth performance originated (and continues to originate) from good (or bad?) old public deficit spending. Put differently, self-generated growth merely amounted to three per cent or a bit more. At present it still cannot be ascertained whether the strong outburst of „Keynesianism with Chinese characteristics“ will really lead to improving the foundations of the national economy or whether the vast commitment of scarce means will end up in more or less useless „investment waste“. Irrespective of that, it does not appear feasible that deficit spending of such giant scale can be sustained for long. In addition, it is no viable alternative to basic structural reforms and the streamlining of the country's governance setup.

Turning back to the regional crisis scenario: How could all this happen? How could a global region the dynamics of which (high growth based on structural change) was as much admired as feared in the world turn into an economic disaster region with almost no advance warning? The crucial point in this context is that there exists no

conventional wisdom to provide satisfactory answers in which all or most of the Asia experts believe. Paul Krugman is frequently alleged to have predicted the Asian crisis although he himself categorically denies that he really did so:

One thing I did not do, however, was predict the current crisis. In fact, I went out of my way to avoid predicting any imminent crisis... what I thought I saw coming was nothing like the catastrophe that materialized. (<http://web.mit.edu/krugman/www/suisse.htm>) To this „confession“ he added: Anyone who claims to fully understand the economic disaster that has overtaken Asia proves, by that very certainty, that he doesn't know what he is talking about... The truth is that we have never seen anything like this.

Once again, the experts continue to walk on different paths of explanation, and it is hardly surprising that all of them claim that empirical evidence supports their views. The evidence available is sufficiently varied so that everyone can come to quite diverging conclusions to what has been essential in triggering off the „crisis avalanche“.

In the end, however, this state of affairs is not all that remarkable. For thirty years various scholarly generations of economists, social scientists and historians have tried hard to find convincing theoretical explanations and to establish consistent models for East Asia's astoundingly rapid emergence in the global economy. These meritorious endeavours have unfortunately been only of rather limited success. The frontlines between the different schools of thought remain as fortified as ever. As a rule the representatives of three great „factions“ - institutionalists (governance and policies matter), neoclassical economists (prices and the(!) market matter), adherents of culturalist approaches (history and culture matter) - tended to dismiss rivaling theoretical models as theories of minor significance, if not as outright irrelevant.

At present comparable dissention also seems to prevail with regard to what is relevant for disentangling the „crisis puzzle“ and what bitter medicine is to be prescribed for East Asia to recover from the current malaise. Put differently, one despairing (or perhaps disparaging?) pundit has even spoken of the „Asian financial crisis and the conceptual muddle surrounding it“ (Karel van Wolferen). Thus, it stands to reason that East Asia (including China) will remain an intellectual battleground for some time to come. Incidentally, this is not really something to be deplored. If all of us were to hold the same opinion and come up with the corresponding judgements, the taxpayers would soon realise that then they need only one of us.

More seriously put, in a way the debates on East Asia - debates on miracle and debacle alike - do constitute a special case of intellectual division which, among others, indirectly reflects a much broader issue of great socio-political significance in the world at large. It has been argued with provocative strength that modern-day economics, i.e. post-Keynesian economics, has lost its „vision“, i.e. its value-imbued ideologico-political appeal emanating from its „bold ascription to government of a central role in the determination of the momentum of the system itself“ (Robert Heilbroner, William Millberg, *The Crisis of Vi-*

*sion in Modern Economic Thought*, Cambridge University Press, 1995, p.17).

By the way, it appears as though this very role ascribed to politics (one of the essential underpinnings of the Keynesian vision) has, in the course of the Asian crisis debates, generated the momentum to revive Keynesian ideas of crisis management long thought to have withered away once and for all. People in Asia have always known that money matters. But what has been at issue since the outbreak of the crisis is the crucial question whether only money matters. In China, for example (as well as in other Asian countries), the standard term to summarise the course of critical maldevelopments since 1997 is *dongya jinrong weiji*, i.e. East Asian financial or monetary crisis. This term seems to implicitly refer to the real or perceived international preoccupation with programmes of strict monetary policies to the detriment (again real or perceived) of programmes for boosting industrial production in order to combat rising unemployment. Of course, East Asian usage of this term does by no means imply that political and economic actors in East Asia really agreed with this harsh order of priority forcefully prescribed by the IMF and other international financial institutions. They just felt pressured to comply with the monetary demands attached to the various bail-out agreements even if this entailed the strongly feared risk to see the real economies go into a tailspin. But since mid-1998 national debates in East Asia on what constitutes the appropriate ingredients of efficacious crisis management have gradually shifted back to favour views of qualified but strong politico-administrative support activities. To East Asians (and not merely to them) Keynes simply sounds more convincing than Milton Friedman.

Turning back to the perceived loss of vision in economic thought, this loss has been followed by a sharp division of discordant camps who have no common denominator to suggest the direction into which economic thought should move if it is to win back practical societal relevance. In particular, there exists a fundamental division between the camps of neoclassical economics and political economy which seems to be unbridgeable, mainly because it results to some substantial part from diverging „worldviews“.

The mark of political economy is a visible concern with the connection between theory and reality while modern-day economics tends to show an almost scholastic indifference to the real-world application of its analytical content. „Unreality“ is not held to be a serious professional handicap. More than ten years ago a survey of graduate students in America's leading departments of economics, for example, showed that sixty-eight per cent of the respondents were convinced that profound knowledge about the real economy was not important for being successful in the profession of economics. (David Colander, Arjo Klamer, „The Making of an Economist“, *Journal of Economic Perspectives*, Fall 1987) By way of contrast, political economy is grounded in the contingent historical and political circumstances of the prevailing socio-cultural order, i.e. it does not search for a „natural law“ model for a resource allocation machine called „the market“ but views markets as social constructs. This is why political economy analysis holds it to be essential to incorporate such

non-economic influences as political systems, basic socio-cultural characteristics, social structures as well as such elements as technological and organisational change. In short, political economy does not claim universality. There exists, however, the latent risk that the commendable efforts to link technical analysis with historical placement can end up in the elaboration of rather „imaginative“ assessments. In other words: Both ways of analysing complex reality have to cope with in-built risks. Whereas classical economists are in danger of overemphasising consistency to the detriment of relevance, political economists often focus on what they view as relevant to the neglect of consistency.

The foregoing remarks have been advanced mainly because there has emerged an intriguing tendency in some parts of the Western world to lecture East Asians (including China) on the alleged existential need for secular change and to give „free advice“ to them how to skillfully embark upon Western economic ways of life, actually meaning American ways. The respective motto is:

Asia Needs a New Model. Why? The „Asian model“ is itself the problem... The new model needs financiers who know a good business from a bad one and who are not corporate or political cashiers. It requires officials to formulate the rules but stay out of the game. And it needs political leaders to explain what went wrong, why the new model is better and to trust their countrymen to get on with it. If the new model looks Western that's because it is. It also works and it's the only model which does.

(*Asian Wall Street Journal*, December 9, 1997)

Most assuredly, such sermonic lectures on the highly beneficial universal power of the Western model do not only aim at admonishing East Asian leaders to abandon their mistaken economic strategies. They also are to teach a private lesson to the numerous intellectual „heretics“ in the West who dared to profess that there is sufficient room in this world alongside the (neoclassical) theoretical and practical Western model for other forms of capitalism and who have claimed that the world economy represents „an interdependent but nonconvergent global system“. But much to the distress of the true believers in „market fundamentalism“ (term introduced by George Soros, *The Crisis of Global Capitalism*, December 1998), a number of heretics simply do not want to repent. To give a sample:

East Asia, especially Japan, greater China, and Korea, has developed the first successful societally rooted model for sustained economic growth other than Western democratic capitalism. It is in this broader historical context that the full meaning of economic crisis can be grasped. Whatever institutional reforms under the International Monetary Fund (IMF) tutelage are implemented..., it is totally unrealistic to expect the fundamental and rapid transformation of patterns of economic and political interaction that are rooted in the values and practices of Asian societies.

(Donald C. Hellmann, „An Interdependent but Nonconvergent Global System: American Leadership and International Institutions“, Conference Paper, Conference on Regionalism and Global Affairs in the Post-Cold War Era,

Brussels, March 26-27, 1998)

In fact, over the past decade much research has been done on the supposed existence of different types of capitalism and this author certainly has contributed his share to it. Since then „spirits“ have been roaming about: Spirit of (liberal or democratic) American capitalism, spirit of Rhine valley capitalism, spirit of Japanese capitalism, spirit of Chinese capitalism etc. The major differences between these types of capitalism were demonstrated to be, first, the different role of the state vis-à-vis the economy (corporatist argument), second, the different relative weight placed on the respective roles of individuals and groups for the common economic endeavour (traditional culture argument), and third, different degrees of emphasis on short-term and long-term orientation („huntsman-style“ capitalism versus „peasant-style“ capitalism).

After the outbreak of the crisis the mentors of the neoclassical craft succeeded in reentering centre-stage in a very self-conscious (and sometimes gloating) manner to enlighten people with good news. Neoclassical economists never felt comfortable about the claim that „states“ can effectually play more than a minimum guardian role vis-à-vis the economy. They, thus, have a vital academic interest in firmly rejecting the notion that political induction („administrative guidance“) of economic development can be of major benefit to the economies concerned. But does the beauty of the economically passive and non-intervening state, perhaps, merely lie in the eyes of neoliberalist beholders? In the eyes of East Asians who have been educated in a conservative tradition the liberalist axiom of political abstention from economic affairs must appear somewhat strange. For *jingji* or *keizai*, the Chinese and Japanese terms, respectively, for the Western word „economy“ etymologically reflect the meaning of political economy in the literal sense of the word. *Jingji/keizai* consists of two parts with different connotations, i.e. *jingshi/keisei* and *jimin/zaimin*. *Jingshi/keisei* means „maintaining order in the world“ and *jimin/zaimin* „caring for the welfare of the people“. In addition, *jingshi/keisei* is the traditional Chinese/Japanese term for „statecraft doctrines“. In contrast to the Western „economy“, the traditional Chinese and Japanese terms, thus, are essentially imbued with the idea of political governance.

The gist of the foregoing considerations may help to expound why quite a number of East Asian scholars (social scientists, historians, philosophically minded thinkers) and members of ministerial administrations as well as prominent journalists have initiated intensive discussions which in a simplified manner can be identified as a discourse on notions of a „third way“ between the old pre-crisis ways and Anglo-Saxon-style capitalism which is believed to be deeply amoral in socio-cultural dimensions. Under the heading „Not Thatcherism, But a Third Way“ some of the critics, for example, allege that the „traditional culture of Asian capitalism is under attack. The new god is profitability, not the people.“ (Newsreview, *Korea's Weekly Magazine*, June 19, 1999). This discourse still is in the stage of intellectual fermentation. And it is by no means clear where it will lead. Perhaps it will run out of steam in the course of time, but this author would not want to make a bet on that. Anyway, the fact that

such an intriguing discourse takes place at all shows that there are grounds for assuming that the crisis of vision in modern economic thought and reality is not over yet. A number of critics profess that it has not even reached its zenith yet.

Returning to the subject of admonitory lectures exhorting East Asians to stop deviating from the path of economic and political truth: Blessed is he who has the gift of selective memory. It is certainly correct that East Asians will not be in a position to go on with their development undertakings as though the crisis never happened. But as they have proved that they are „fast learners“ it stands to reason that most of them have recognised the new situation. They will have to find new ways and approaches to achieve a sustained breakthrough to overall modernisation, but it is at least doubtful whether they really have no alternative other than copying the American mode of economic management in order to achieve their basic long-term objectives. Did America never suffer from the notorious savings and loan debacle of 1987 which cost the American taxpayer more than 100 billion dollar? Where were then the much-praised institutions which now are said to stand out so favourably against the „crony economies“ on the Pacific Rim? And how successful were the „Western model“ institutions when they were challenged „to know a good business from a bad one“?

### III Asian Crisis: Who Is to Be Blamed?

As regards the impressive load of evaluations of what and who were the essential shaping factors and shaping actors involved in the making of the Asian crisis, it shows, among others, that in contrast to East Asian reality the dynamism of the professional community writing on East Asian affairs is as high as ever. Apart from that, for the sake of simplicity one can sort out the existence of three large camps. One camp tries to make sense of what happened by cultivating nonsense ideas such as conspiracies and sinister Western plots. As this author lacks the needful expertise in the art of psychoanalysis these views will not be taken into consideration. The second camp is occupied by advocates who plead that the East Asians are innocent or that they are to be blamed only for a minor share of guilt. Correspondingly, they pursue approaches which focus on the doubtful role of the international financial community and the instability of the global financial system. The third camp, in turn, is manned with observers who lopsidedly like to find fault with East Asia. They, thus, primarily charge East Asian governments and business leaders with irresponsible systemic mismanagement of their national economies. It follows that their crisis diagnoses focus on structural flaws and bad policies in the crisis-ridden countries themselves. Motto: Punishment for sins! In the eyes of these critics the crisis essentially is the upshot of serious failure of politics, in particular inappropriate macro-economic governance.

*The Economist* („East Asian Economies, Tigers Adrift“, March 7, 1998), one of the most prominent media-voices with a missionary bent on disseminating neoclassical tenets, has conveniently summarised the gist of these „they-had-it-coming-to-them“ arguments by first

sternly reproaching the East Asians for having committed „six deadly sins“ and then mercifully showing them the corresponding „paths to salvation“:

First, sin of managed exchange rates, i.e. the peg argument.

Second, sin of corruption, lack of transparency and disregard of the rule of law, i.e. the crony-economy argument.

Third, sin of reckless financial speculation and wasteful investment activities leading to the devastating boom-bust cycle in the asset markets, i.e. argument of negligent capital meltdown.

Fourth, sin of permanent disruptive political interference in the financial sector resulting in poor corporate governance, i.e. the moral-hazard argument.

Fifth, sin of insufficient competition and widespread collusion, i.e. lack-of-creative-destruction argument.

Sixth, sin of severely inappropriate political institution-building, i.e. „death-of-Asian-model“ argument.

It cannot seriously be disputed that this „sin count“ contains obvious elements of truth to it. No doubt, these „sins“ have been taxing the developmental strength of the countries concerned. And to varying degrees, they have had strain-creating repercussions polluting the political as well as psychologico-intellectual climate. In fact, since the early 1990s they increasingly hypnotised growing segments of the political and economic elites dulling their sense of reality and making some of them believe that they were living in the coming land of milk and honey. Awareness of flaws and constraints gradually came to be blotted out by rampant self-assertiveness and overconfidence. The road to the future was falsely held to be a one-way road - up, up and away on the historical ladder of success. But all this is not unique to East Asia. It just is one more typical case in the long history of individual and societal upstart-psychology. Probably, there is hardly anyone who has described the working of this historico-psychological mechanism more vividly than Kishore Mahbubani:

It is difficult for a European or North American to understand the momentousness of the psychological revolution in East Asia because they cannot step into East Asian minds. Their minds have never been wrapped in colonialism. They have never struggled with the subconscious assumption that perhaps they were second-rate human beings, never good enough to be number one. The growing realization of East Asians that they can do anything as well as, if not better than, other cultures has led to an explosion of confidence.

(Kishore Mahbubani, „The Pacific Way“, *Foreign Affairs*, Winter 1993/94)

From this kind of historical elation at the newly gained international standing it is only one short step to a perceived state of affairs which, for example, in late imperial Germany was held to be a „quasi-natural law“: „In der Sittlichkeit sind wir ihnen über“, meaning: In the (realm of) morality we are on top of them. „Them“, of course, comprising the rest of the world! Nonetheless, as to the question of what were the essential elements in triggering off the crisis it must firmly be emphasised that focusing on the minute registering of maldevelopments within East Asia is apt to lead to inadmissible or at least dispropor-

tionate conclusions. Even the most meticulous account of home-made malpractices definitely would not cover the whole spectrum of crisis-creating factors and forces, probably not even the major range of it.

After all, over the past three decades the East Asian economies have written strong performance records. One should not overlook that in 1968 Gunnar Myrdal had published his famous magnum opus *Asian Drama*, to which he added the significant subtitle *An Inquiry into the Poverty of Nations*. Myrdal, then, concluded that pervasive failure of development was in essence due to what he termed „soft state“, i.e. inadequate and misleading implementation of political planning and organisation. Twenty-five years later the World Bank published an extensive standard study on the same region called *The East Asian Miracle*, i.e. an assessment of the origins of the new „wealth“ of East Asian nations. What matters in the context of the crisis is that the „miracle“ did happen. It was neither a mirage nor a „myth“. What the current crisis demonstrates is no more than the fact that even miracles are not always „failproof“. Again quoting Paul Krugman:

On the other hand, even though I am generally known as the guy who didn't believe in the Asian miracle, I never said that Asian economies were paper tigers. The huge growth in productive capacity over the past generation may not have been miraculous, but that doesn't mean it was a fake: these economies are not Potemkin villages, facades with nothing behind them. So the potential for fairly high growth is still there. Remember that earlier in this talk I pointed out that there is no relationship between good long-run economic performance and vulnerability to crises - that the United States before World War II was both the most productive and the most panic-prone of advanced nations. (*Ibid.*)

Almost needless to say, this author cannot but readily agree with Krugman's judgement. As much as he recognises that the region's economic dynamics did not save it from the crisis, he is, nevertheless, convinced that most of the East Asian economies have not lost their foundations, the one possible exception being Indonesia. Scenarios of long-term collapse rather smack of wishful thinking. Stating this is not to suggest that recovery will set in soon. Maybe it will, maybe not. At least in the short term the future still looks murky. Hope and uncertainty run side by side. Caution against premature complacency still is the watchword among governments and in the world of business, and for the time being foreign interest remains muted even though assets are valued in US dollars at low percentage shares of what had been their worth before the crisis.

What is it that makes it so strenuously difficult to come up with a clear representation of the anatomy of the crisis? Probably there are many reasons, but a major one certainly is that the crisis process was first set into motion and then severely aggravated not by one or two factors which can clearly be lined out, but by the complex interaction of a large number of factors which owed their impact potential to three different layers or dimensions of the whole crisis environment. By way of repetition: „The truth is that we have never seen anything like this.“

The first crisis dimension or lowest crisis layer is the

national (domestic) one. At this domestic level is the correct place to analyse the ramifications of the above-mentioned „sins“. Moreover, referring to this lowest crisis level permits to speak of the emergence of several national crises which had different repercussions on the national societies and economies concerned.

The second dimension or layer is the regional one. Since the mid-1980s East Asia witnessed a strong and much-discussed trend towards growing transnational economic interdependence, in particular the build-up of transnational manufacturing networks. After the outbreak of one national crisis after the other these otherwise constructive tendencies unfortunately contributed to blend the various crisis processes into one big regional crisis (contagion argument). Consequently, no individual country was (or is) in a position to take advantage of strong demand stimuli emanating from other countries of the region in order to cope with its own crisis problems.

Here, reference must be made to the „non-role“ of Japan in regional crisis management. Up to now Japan has not provided substantial „inputs“ for overcoming the crisis and initiating an early recovery. Japan has supplied a sizeable share of credit capital, but what the other East Asian countries expected from their former „look east“ model was for it to serve as „market of last resort“. They were heavily disappointed in their expectations. It will not be discussed whether Japan did not want to shoulder this burden or whether it was not able to do so. In fact, since 1989-90 Japan faces its own brand of crisis created by retarded adjustment to a vastly changed global economic environment. *Nihongata keiei*, the „Japan mode of economic management“, evolved in the course of Japan's spectacular post-war economic recovery. Gradually the system was perfectly adapted to the requirements of rapid economic catch-up development. But by now the catch-up period belongs to the past. The new stage requires to embark upon new ways and strategies. The critical state of affairs can, of course, be overcome, but success will not be achieved without making inroads into the old ideology of national uniqueness.

The third crisis dimension or layer is the global one. This global crisis dimension suggests to this author that the Asian crisis is the first precedence case of a completely new type of crisis which essentially owes its destructive potential to the accelerated historical trend towards economic globalisation which has found its most condensed expression in international finance. By now, global turnover of highly volatile short-term capital has reached the incredibly giant volume of 1.3 trillion U.S. dollar per day. It follows as a matter of course that the logic of this situation tends to exert strong pressure on all global financial actors to search for ever new opportunities which promise even the slightest capital gain. In the course of the 1990s these „cyberspace capital“ movements were increasingly bringing about a confused configuration. In the jargon of finance: The international financial community was blowing up a huge financial „bubble“ which in the end came to burst at the weakest point. This point was East Asia. Thus, it may well turn out that further „Asian crises“ will in future also erupt at different weak points outside of Asia, and this risk is apt to grow as long as tendencies of globalisation are somewhat naively viewed

as an inevitable „natural phenomenon“ which does not lend itself to efforts of international governance. These remarks provide the opportunity to come back to the above-mentioned camp of pundits who claim that the global dimension is the most significant one in analysing the origins of the Asian crisis. To the surprise of this author, George Soros was one of the most outspoken advocates of reform of the international financial set-up:

We tend to idealize the market as something that can take care of everything. And just as Marx claimed communism was based on a scientific theory, market fundamentalism relies on an allegedly scientific economic theory. Basically, I think it was Ronald Reagan and Margaret Thatcher who were the prime movers in adopting a vulgarized version of *laissez-faire* economics, turning it into a kind of fundamentalist position... But financial markets deal with quantities that are not only largely unknown but unknowable. They discount a future which is contingent on how the financial markets assess it at present. The appropriate concept, in my view, is reflexivity, not equilibrium. Reflexive processes are not just unpredictable, they are genuinely indeterminate because the outcomes depend on the predictions that investors have made.

(George Soros, „The International Crisis: An Interview“, January 14, 1999, <http://www.nybooks.com/ny-rev/WWWfeatdisplay.cgi?1999011436F>)

In the course of 1998 there was an astounding increase in the number of people who came to profess that the Asian crisis was not primarily caused by the crisis countries themselves, but essentially was the offspring of the blind work of rampant „animal spirits“. This term - coined by Keynes - refers to the basic psychological traits which the critics hold to be characteristic of most international finance managers. It is alleged that these „animal spirits“ are of „binary“ nature, i.e. they are said to know only two kinds of reaction: attack or stampede. According to the *International Herald Tribune* („Financial Community Contributed to the Mess, Too“, January 10, 1998) „the financial herd stampeded in July“ trampling entire economies into the ground. By now this view (although not the diction) is identified mainly with Harvard's Jeffrey Sachs and some other prominent American economists who regard what took place in East Asia as a self-reinforcing financial crisis triggered off by the defective logic inherent to financial panic.

#### IV China: A Never-Ending Story - The Gap Between Profession and Performance

What is „socialist market economy“? Posing this question actually means to ask two questions by one. First, the question is about the intellectual meaning of the term. Alas, as to the theoretical content „socialist market economy“ appears rather devoid of logic almost reminding of attempts to square the circle. But second and more important, in practice the term reflects an ongoing historical shift to new economic strategies/policies and a general orientation to lend priority to the „market“ as major

mechanism of national economic coordination. Compared with the previous strategic guidelines such as „planned economy as main instrument, market mechanism as supplement“ in the early 1980s and „socialist planned commodity economy“ in the late 1980s, the new term indicates a new reality entailing the acceleration of political tendencies to gradually downsize the weight of command planning in overall economic life vis-à-vis self-enforcing economic structures. In short, the term evinces that China moves at present through a historical period of transition the eventual outcome of which is still uncertain. Obstruction and opposition to the new economic way of life have grown less pervasive but, on the other hand, there has not yet emerged a viable consensus on how and along what lines to best effect future national development.

Verbal self-assessments by the country's leadership and elites of what is to be done frequently start from the notion of so-called „national configuration“ (*jiben guoqing*) which requires the recognition of essential elements of „Chinese uniqueness“. The general (professed) view is therefore that national socio-economic development, strategies as well as policy and organisational approaches must, of necessity, be *sui generis*. Accordingly it is said that China has to come up with its own development model. As is often the case in China, there exists, however, a remarkable lack of correspondence between ideologico-political profession and real performance. In factual reality it must be observed that major progress in China's recent development clearly deviates from these tenets of uniqueness. In particular, the current course of the economy in the country's coastal regions conveys a replay of the highly dynamic performance of the Northeast Asian NIEs during the 1960s, later also demonstrated by a number of Southeast Asian countries.

But at second glance this is not really surprising. Since the establishment of the People's Republic of China the Chinese Party/State leadership has struggled with great ideological fervour to forcefully implement the most diverse socio-economic strategies. All these ideologically inspired campaign endeavours, pushed through at great material and human cost, proved without exception to be spectacular failures, sometimes even national disasters. In the end, there seemed nothing left but to fall back on „conventional development wisdom“. In other words, the notion of socialist market economy basically constitutes a political euphemism for expressing the blunt fact that China has, by now, been forced to stake all its development options (if there ever was more than one) on the high-growth card. And that is why the economic turbulences in the surrounding countries of East Asia have created so much anxiety and concern in China. If growth is going to falter the Party/State leadership has no more conceivable position of strategic and political retreat. In fact, since late 1998 some warning bells have started to ring and caused alarm that China may not be able to keep leaping ahead in the year of the rabbit in the same strong way it did during the past six years.

A recent study published by the London-based Economic Intelligence Unit (Georgina Wilde, *China to 2010*, 1998; Summary in: *China aktuell*, August 1998, p.811) suggests that China would, in principle, be capable of sustaining high growth over the coming ten to twelve years,

provided that (a very essential precondition!) the speed of economic reforms and structural change will not lastingly slow down. The study assumes - this author shares the assumption - that the „fall-out“ resulting from the erosion of reform programmes would in the longer run seriously impair national growth prospects. Indeed, experience in other transformation countries such as the CIS countries tells that reform strategies which are not consistently carried through to the end leave the economies and societies concerned in a mid-way-through impasse which can be even worse than the pre-reform state of affairs.

Under conditions of rigorous reform-mindedness and market orientation GDP growth estimates for the first decade of the coming century amount to more than seven per cent per annum. But in case that reform policies are delayed or undermined average growth probably would range lower by about two percentage points. Measured in terms of purchasing power parity, till 2010 the difference in per capita GDP between reform-driven growth and low growth would widen to approximately 10.000 US\$ to 4600 US\$.

In addition, it does not seem to be a far-fetched assumption that in practice the gap between high and low growth would be even larger than the statistical estimates suggest. High growth in China has substantially been propelled by high shares of exports in GDP and high national savings rates, the two basic features of all East Asian development. In the end, it has been the extraordinary success in competitive export processing which truly testifies to China's economic ascendancy. But it is essential to realise that this success story owes its origins mainly to the non-state sector of the economy, i.e. joint-venture companies as well as domestic private and collective units. In contrast to that, low growth would, among others, implicitly indicate a less dynamic course of economic activities of the comparatively efficient non-state economy while chronically subsidised state enterprises would continue to operate at their usual loss-producing speed passing patterns of consumer demand largely by. Put differently, official Chinese value-added figures contain hidden elements of „value-subtracted“. And this holds the more valid, the lower the growth rate is.

#### *China's Development Prospects*

Period	High reform speed		Low reform speed	
	1996-2000	2001-2010	1996-2000	2001-2010
Average GDP growth in %	7.7	7.4	7.6	5.3
Per Caput GDP in US\$*	1090	2533	1089	1535
Unemployment in %*	5.5	4.8	2.7 (!)	3.0 (!)
Inflation in %*	9.0	7.6	9.0	9.4
Current Account in Bil.US\$*	20.55	-113.92 (!)	124.1 (!)	-98.46

Final year of period

Quelle: *China aktuell*, August 1998, p.811

Stunted economic dynamics would, in turn, imply that growth is apt to oscillate below the minimum level which is thought necessary to sustain the momentum of national development in general and the systems of human resources development, social provision and employment creation in particular. But - as can be deduced from the figures of the above table - even continuous high growth will not necessarily run along a smooth path. Serious im-

plications could above all result from mounting foreign indebtedness. In the context of the East Asian financial crisis the Chinese authorities were forced to realise that reliance on international capital flows in general and short-term lending in particular can entail serious risks evolving from the insufficient financial deepening of domestic finance institutions.

## V China: From Reform to Non-Reform and Back Again?

When in mid-1997 devastating financial turbulences began to wreak havoc in a number of seemingly well-ordered East Asian economies China was not under strong direct pressure to react to this alarming chain of events. The country had (and still has) a substantial stock of foreign exchange reserves. It was (and again still is) running a current account surplus. The ratio of foreign debt to GDP as well as the amount of debt service compared to total worth of exports was well below the danger line drawn by international risk rating agencies and other finance-related institutions. Moreover, when measured against other East Asian countries the share of volatile short-term capital in total flows to China ranged at the favourable low end. Above all, the absence of a deliverable forward market for the Yuan RMB or the lack of capital account convertibility, respectively, served as strong safeguard mechanisms against tendencies of „contagion“. There simply was no „fuse“ to ignite speculative attacks on the Chinese currency. Consequently, there were no patterns of „stampede“.

Nonetheless, optimism in progress (the future will be better, the future will be ours) became clouded, and with justification. China is inextricably linked with the regional crisis environment and, to borrow a phrase from a renowned American Asia specialist (John Frankenstein), it „is in vital need of political and economic Viagra“. Apprehension of this consequential matter of fact must have intensified towards the end of 1998 when it became clear that foreign trade turnover has stagnated for the first time (324 bil. US\$ = -0.4%, export 184 bil. US\$ = +0.5%) after

fifteen years of vigorous growth. Realised investment also declined to a significant extent, and the sensational collapse of Guangdong's International Trust and Investment Corporation as well as the feasible closing-down of some of the other „ten open windows“ of China's national finance building have given some impetus to conjectures that perhaps the worst still is to come. Nevertheless, China has enjoyed a privileged position. It has been able to buy time,



but if the time gained is not skillfully used the crisis will fully catch up with the country. More exactly, China will then produce its own distinctive version of crisis. Outward crisis symptoms might look different, but there would be comparable repercussions on the economy simply because the above-mentioned „deadly sins“ as well as accumulated structural impediments figure at least as prominently in China's economic world as in some of the other East Asian countries.

China faces serious challenges to downsize and revamp substantial segments of the bureaucratically (mis)guided domain of state-owned enterprises. Under the impact of the crisis and against the background of mounting unemployment problems reform-minded sections of the central leadership have repeatedly given the impression that they now regret to have shied away from resolutely tackling this most basic problem of „China's Unfinished Economic Revolution“ (Nicholas R. Lardy) when the preconditions were much more favourable. Such is the benefit of hindsight!

The systemic problems evolving from large-scale industrial loss-production were further aggravated by the implementation of policies to finance steadily growing losses through extraction of loans from the state-owned financial intermediaries rather than through budget subsidies. It is correct that this economically wrong approach had the political advantage not to test the limits of the regime's maximum resilience. But, by now, the banking sector is overburdened with heavy loads of non-performing loans that come near to the worst cases in other East Asian countries, except perhaps Indonesia. Protracted political failure to cope with these essential constraints does, of course, impair reform efforts in all other areas. It is granted that general awareness of the imminent need to stop and undo these systemic maldevelopments has visibly grown since the eruption of the regional financial crisis in mid-1997, but there still does not appear to exist common agreement on the scope, depth and speed with which the necessary reform programmes are to be established and implemented.

In view of this unsettled state of affairs it is in fact interesting to note that the time span since the outbreak of the crisis can be subdivided into two rather contrasting periods. The first period started with the XV. Party Congress in autumn 1997 which can with some justification be labeled as a congress of crisis-aroused „reform enthusiasm“. The culminating point of this period was reached in March 1998 when the National People's Congress passed a number of reform programmes such as the commercialisation of urban housing, the privatisation of small state enterprises as well as major organisational reforms to streamline the politico-administrative system in order to improve its operational strength. The much-applauded appointment of Zhu Rongji as new directing spirit of the central government seemed to further stabilise the crisis-induced climate of reform-mindedness.

In mid-1998, however, the second period gradually set in. Since then the pace of reforms has abruptly slowed down. Most of the organisational reform measures to revamp the state administration have formally been realised as far as the central level is concerned, but it is not at all clear whether these measures will really help to achieve the intended objectives, i.e. to weaken widespread

patterns of bureaucratic departmentalism and localism. Moreover, reform work at local levels has not yet begun, at least not in a meaningful manner. Privatisation policies were stopped or postponed. Various commentaries on the front page of *Renmin Ribao* indicated the abrupt political turn by admonishing the readership to beware of false and irresponsible „interpretations“ of what the XV. Party Congress had had in mind when it made the pro-reform decisions. As to the creation of a private housing market, in the first half of 1998 the officially propagated view was that housing development will be the new growth area for major parts of the Chinese economy largely offsetting any potential slowdown in external demand for Chinese goods. It was vowed that free housing for state enterprise employees would end in the second half of the year. But by that time retreat had set in and it was announced that commercialisation should not be pushed through in an unduly rash manner. In early 1998 the representatives of the country's financial sector had been exhorted to immediately make an end to unchecked pseudo-lending to industrial state enterprises. Half a year later the banks were again required to support their moribund „enterprise patients“ with new financial blood transfusions. In short, for a couple of months the course of events did not only suggest that China's economic revolution is still unfinished, but even more so that the forces of economic counter-revolution were regaining part of the previously lost territory.

Fortunately this did not happen. The orthodox backlash was strong enough to obstruct the timely and thoroughgoing implementation of reforms, but it did not generate sufficient propelling force to bring about a lasting countermovement. Nonetheless, as to the practical realisation of reform programmes for coping with systemic constraints the current state of affairs seems to be rather unsatisfactory. And this does not exactly come as a big surprise. The regime has frequently shown the habit to promise each and everything as long as it was about the future, but when faced with the pressures of the present it almost never delivered the promised goods.

When compared with the rather unpredictable and opaque decision-making processes characteristic of China's national Party/State leadership which some despairing Chinese contemporaries use to criticise as the regime's permanent „zigzag policies“ (*zheteng zhengce*), the patterns of reaction in the realm of social science institutions which are supposed to fulfil advisory work for political bodies show a relatively high degree of intellectual consistency. One can, of course, discern the existence of a variety of opinions.

There is one line of reasoning which has only very occasionally caught attention in the West. This line claims that the outbreak of the regional financial crisis was not only due to the financial maldevelopments featuring so prominently in international analyses but also owing to steadily worsening tendencies of industrial structure crisis in the entire region. According to this view, the countries concerned were all relying on the dynamic build-up of a comparatively small number of industries which were assessed as being of superior strategic significance to rapid national development. Moreover, these countries were heavily depending on decision-making processes in

the Japanese economy, and to a lesser degree in other advanced economies as well, to relocate industrial production facilities to the emerging economies. These relocation patterns, in turn, effected that the newly established industrial networks were existentially interconnected across borders through a „unique regional labour division system“. This author is prepared to recognise that this line of reasoning contains some truth to it as far as the past is concerned. In fact, elsewhere he has advanced a number of comparable arguments. But as to the present, it must not be overlooked that the long-drawn crisis did not only trigger off the much-discussed regional capital „melt-down“. It also resulted in large-scale destruction of industrial production facilities. This holds particularly true for Southeast Asia. Thus, it appears feasible that the notion of unchecked capacity build-up has, by now, lost much of its previous validity.

In the mid-1990s the spectacular process of industrial relocation was, however, clearly slowing down. And this is why it is thought that in East Asia

behind the financial crisis there hides an industrial structure crisis. The break of the chain of industrial transference in East Asia is the profound factor causing the region-wide crisis... the traditional labour-intensive and capital-intensive products such as electronic consumer goods, clothes, shoes, steel, automobile, exported by most East Asian economies, have been also overproduced. For the lack of new and promising industries, the local and foreign investors in the region rushed to invest in property and the stock market... International financial assistance may mitigate the crisis, but it cannot cure the structural disease in East Asia.

(Lu Jianren, Chinese Academy of Social Sciences, „The East Asian Financial Crisis and Its Impact on China“, Conference Paper, Conference on Regionalism and Global Affairs in the Post-Cold War Era, Brussels, March 26-27, 1998)

What does this analytical perception imply in political terms?

First, it helps to explain why China is no longer as eager to be granted early membership status in WTO as it used to be a couple of years ago. The idea seems to have lost much of its previous appeal. For, if there really exist industrial overcapacities in East Asia measured against overall demand on global markets, then the opening of Chinese domestic markets and corresponding policies of liberalisation, as required by WTO rules, would further narrow down the scope for the marketing of domestic industrial products. After all, the planning authorities for China's industrial targeting policies are not to be envied as they continuously run up against deeply hardened sectoral and regional vested interests bureaucratically defending their own existing production facilities vis-à-vis economically superior rivals, thereby reinforcing in-built tendencies of producing idle domestic capacities.

Second, Chinese assessments of the merits of foreign contributions to China's economic evolution will tend to be more critical than in the past. Foreign companies the China plans of which primarily aim at gaining access to the Chinese market will be exposed to more restrictive evaluations and greater political reserve. In fact, such ten-

dencies have already been observed by foreign analysts as well as by foreign companies producing in China. Various forms and methods of hidden and sometimes even open pressure on these companies to take Chinese interests (usually meaning a bigger share for the Chinese side) with more sympathy into account have been used on a „trial and error“ basis in 1998.

Third, in pre-crisis times China's industrial targeting planners have intensively studied the success story of the Korean *chaebol*, theoretically as well as practically in the course of numerous visits to Korea. The Korean conglomerates seemed to be viewed as the most promising precedent cases to be followed in reorganising China's major industrial state enterprises. The Korean government, business federations and the country's general public had long taken great pride in the „can-do“ achievements of their *chaebol* which according to their widely distributed public relations materials had discovered the strategic secret how to vigorously expand and climb to the top-ranks of the world economy by „octopus-like growth on a diet of debts“. Company names like Hyundai („Modern Age“) and Daewoo („Great Universe“) reflect the great ambition of the generation of *chaebol* founders. This is all over now. The *chaebol* do not only suffer from heavy debt burdens but also from loss-generating idle production capacity. In the eyes of Chinese industrial planners the *chaebol* have forfeited the respect which prior to the crisis evolved from their status as pseudo-models. After all, when it comes to the skills of loss-making it is hard to think of anyone who is superior to the lot of Chinese state enterprises. The crisis has left Chinese planners with two options. They must either look for a different model elsewhere (certainly not Japan, maybe Taiwan) or take their lyric of uniqueness seriously and rely on their own ingenuity.

A second line of intellectual (and political?) attention is devoted to questions of what are the appropriate components of good macro-economic governance to sustain or regain the necessary minimum stability of the national financial sector. A number of analysts hold it to be rather evident that the East Asian financial crisis would not have erupted with such disastrous force and it would not have produced the well-known catastrophic dimensions if there had existed sound financial systems. This fact is agreed everywhere across the world, but the conclusions drawn by some Chinese researchers from this assessment reach further. It is said that the critical chain of events shows ex post that globally induced policies of hasty liberalisation and ill-conceived deregulation should not have been implemented in the clear absence of institutions which are capable of efficacious management to cope with unanticipated side-effects. Put differently, the crisis is alleged to teach the dire lesson that deregulation does not only lead to the positive consequences associated with the English term, but is also apt to generate unwanted maleffects as associated with the French meaning of the term. „Dérèglement“ points to the destabilising loss of rules. The argument, thus, is that the chronological order between realising policies and building the respective governance institutions has proved to be harmfully wrong. The institutional architecture must come first and policies only second. In view of numerous reappraisals of this kind or assessments along comparable lines, it is to be expected

that noteworthy political measures to liberalise China's financial sector are likely to be implemented later rather than sooner.

The global (i.e. Western) financial community has in the past exerted strong pressure on East Asian governments calling for programmes of extensive financial liberalisation and emphasising the beneficial results to be expected from speedy implementation of deregulation policies. The crisis lessons now tell a different story. To a certain extent this recognition sounds like a reminder of Sir Karl Popper's reflection that all human institutions are like fortresses. They need strong walls, but even more they need to be manned with good troops. Since the outbreak of the financial crisis the IMF and other public as well as private-sector organisations of global finance management have never tired to come up with admonitory advice for the East Asian governments to build up again lost international confidence. But what about East Asian trust in the financial community? Should that kind of advice not also be heeded the other way round? There are people in China and elsewhere in East Asia who could certainly get to like the idea of „reciprocity“.

Sometimes the roles of Western rating agencies and the IMF are perhaps partially in doubt. The former tend to add fuel to the flame inadvertently at the mere rustle of leaves in the wind and the latter, whether deliberately or not, comes forward to clear up a messy situation by demanding unrealistic reforms or... (leaving) the victimized countries all on their own in the lurch to suffer the heavy social consequences.

(Su Jingxiang, China Institute of Contemporary International Relations, „Lessons from the International Financial Crisis“, *Contemporary International Relations*, October 1998)

A third line of arguments drawn from crisis analysis starts from the second line, but goes on to evolve a different thrust. It is claimed that the East Asian financial crisis does not really represent a totally new phenomenon unique to the region. In the past Western financial economies have been exposed to critical developments of the finance sector as well. But in contrast to East Asia and owing to the stability of Western financial institutions and the superior level of maturity acquired through long-term operational experience, the Western countries were in a much better position to cope with failures of the financial system. As outlined above, this author is not really certain whether this perception is true, but the essential aspect in this context is that it is concluded that Western institutional settings should be studied as potential models for improving the operational capacity of China's own financial sector.

In the west, stress has been focused on regulating the behavior of financial institutions. Some beneficial lessons can be learned from their thinking, experience and concrete measures.

(Su Jingxiang, „Lessons from the International Financial Crisis“, *ibid.*)

It is suggested that there are five major lessons to be learned in order to safeguard the stability of the financial sector.

First, the introduction of sound deposit insurance systems the purpose of which is „to boost the confidence of the citizens in the financial institutions so as to prevent a chain reaction induced by the failure of individual institutions“.

Second, the existence of a strict closure and liquidation process; it is interesting to note that the People's Bank of China serving as the country's central bank had publicly announced as early as in January 1998 that it would reshape its own set-up along the lines of the U.S. Federal Reserve System closing down local branches and replacing them with ten regional central-bank offices run by appointed heads of office. Apart from that, the U.S. seems to be viewed as the most convincing precedence case how to build an independent and profit-oriented financial system. As to the closure and liquidation system in particular it is said that „America established a set of objective criteria for determining insolvent financial institutions and demand their closure and liquidation so as to nip the disaster in the bud“. This procedural approach is expressively placed in positive contrast to Japan's so-called „convoy system“ under which technically insolvent banks have been allowed to survive irrespective of their financial ailments.

Third, high information transparency; again it is maintained that „America ranks first among the Western nations in ensuring transparency through the so-called 'Blue Sky law' under which financial institutions are required to make public all their bad debts“.

Fourth, an ensured equity ratio; „Western countries are drawing up their respective equity capital regulations in the light of such risk factors as interest rates and stock fluctuations“.

Fifth, a strict supervisory system; once more reference is mainly made to the U.S. example, in particular to the role of the Federal Deposit Insurance Corporation and to the Financial Service Competition Act of 1998.

The Chinese analysts are, of course, aware of the fact that these five safeguard mechanisms do not provide a failproof safety net, „they are, nevertheless, beneficial for defending financial stabilization and guarding against financial crisis“. Thus, it is to be expected that these reform proposals can be of major significance to the political opinion-building process to reshape the financial sector and to establish appropriate programmes for national financial deepening.

## VI China: Open End

As has been outlined above, China has been in a position to keep the financial crisis at bay. But this is not to say that the Chinese subcontinent has been saved from being exposed to serious indirect repercussions, especially after the crisis started to spread from the financial field to the entire spectrum of the economy in a number of East Asian countries. Recently these negative implications of the crisis for China's export industries, national investment programmes and financial sector have come to stand out rather visibly. This has raised great concern that worse developments may loom on the horizon which, in turn, implies that for the time being reform-minded leaders are forced to keep their plans and programmes

shelved. Anxiety does not engender an atmosphere conducive to putting through bold political initiatives.

However, although at present things are not looking too promising this does not mean that the time has come to indulge in lopsidedly favouring worst case scenarios. It cannot be denied that under the pincers-like impact of external crisis eruptions and turbulent changes in the country's socio-political climate which, among others, was brought about by numerous acts of organisational malperformance to cope with the catastrophic floods along the Changjiang valley and in the Northeastern provinces, the Party/State leadership has executed an ill-conceived about-turn abandoning major reform work. Differently put, this sudden change in the political course was not the result of careful political deliberation. It rather reflects reactions of fear and concern about the regime's political survival. The reforms were stopped simply because the majority of Party leaders did not want to further rock the boat in which they were sitting. But this does by no means preclude the possibility that they may soon be prepared again to execute another about-turn in favour of renewed reform endeavours under less anxiety-arousing socio-political circumstances. This would confirm the validity of a Chinese saying that the Party is like the moon. In the middle of the month it occupies a position completely different from that in the beginning of the month. But irrespective of whatever lunar constellation prevails, in principle there is no reason why Chinese dreams on the „wealth of nations“ cannot come true. To make dreams come true, one must, however, be prepared to wake up and face the real world.

The actual issue at stake in this context is that at present China's real world severely suffers from the complex repercussions of three strong development-constraining tendencies - in the current U.S. social science jargon called „limitational factors“. Moreover, these constraining tendencies are apt to reinforce each other, thereby deepening the existing limits to an early successful breakthrough in overall national modernisation. Unfortunately, it is by no means certain whether China's political top leaders possess the powers of imagination needed to pursue opinion-building processes which take the great complexity of the country's current predicament adequately into account, the only possible exception being Zhu Rongji. Incidentally, from time to time this author is tempted to suspect that China does, indeed, show traits of „uniqueness“ albeit not the way many tradition-oriented sinologists profess to believe. One has to take the admittedly strange idea into consideration that China represents the singular case of a country in which the political regime's average level of intelligence ranges below that of the total society.

As to the three development-constraining tendencies - which may well lead to a configuration that has the explosive potential to overtax the underpinnings of China's long-term development endeavour - the workings of the Asian crisis represent only one of them and probably not even the most serious one. In fact, there exists sufficient evidence to reason that - other things being unchanged („*ceteris paribus*“ assumption) - the ramifications on China emanating from the regional crisis background might, indeed, have produced not much more than minor

ephemeral tremors. The actual significance of the devastating regional development setback results from the deplorable fact that the sudden discontinuance of East Asian demand for Chinese goods and services unexpectedly invalidated all otherwise feasible options to help overcome severe home-made development problems via strong external economic activities.

The second development-constraining tendency is the offspring of deteriorating overall conditions to attract foreign direct investment and credit capital. This trend, in turn, is owing to the general rating-down of emerging countries worldwide. China's international standing grew less favourable after mid-1997 when the international financial community stopped to believe that East Asia was Eldorado. Furthermore, most China specialists have stressed the (evident) fact that foreign interest in realising direct investment projects in China has visibly declined since 1997 and, as a rule, they explained the emergence of this downward trend by finding fault with a number of worsening domestic conditions which were alleged to render China much less attractive to foreign investors. This author is convinced that domestic barriers were much less crucial in causing the rapid decline in investment activities than changes in the international environment. Otherwise it would be difficult to convincingly expound why nearly all East Asian countries experienced comparable rates of decline. Even more significant: The partial drying up of direct investment flows had already begun in 1996, i.e. before the outbreak of the great crisis. The reason why this was going to happen is very simple. The much-discussed great intraregional „investment offensive“ had set in in 1987/88. In the course of this „offensive“ tens of thousands of industrial facilities were relocated from Northeast Asia (Japan, Korea, Taiwan, Hong Kong) to China and Southeast Asia, but after eight to nine years there was not much left to be relocated within the realm of those branches in which China and the Southeast Asian countries showed a comparative advantage. It was pure chance that the reduction in investment flows to China coincided with the slackening of the country's export dynamism. But the combined impact of these two harmful tendencies could not but have an alarming growth-stunting effect on the Chinese economy leading to a corresponding aggravation of social problems.

The third development-constraining tendency was set into motion mainly by a number of domestic factors including major structural weaknesses of China's „economic powerhouse“ as well as serious misjudgements of political governance which are hardly comprehensible. On the one hand it follows that these structural bottlenecks are immanently related to the stop-and-go patterns of the long-term course of politico-economic reforms signaling that the country is in urgent need of new dimensions of reform to further improve the unfinished structural setting. On the other hand, the series of events tells one of the many repeat stories on the „natural“ end of a spectacular boom period the beginning of which dates back to 1992. It stands to reason that the economic downturn was accelerated by external influences and aggravated by inappropriate political decision-making but it was not really provoked by these attendant circumstances. It is part of conventional economic wisdom that booms form „cycles“

which - without exception - are destined to come to a stop at their lowest point. The significant question is not if but when. Thus, the issue at stake is whether boom periods occur within a successful historical „spiraling-up“ process which is characterised by the fact that the low point of a given boom cycle still is above the zenith of the preceding cycle.

This author believes that China's economic development process of the past two decades has been propelled by strong „spiraling-up“ forces. In his judgement, the crucial point is what is to be done to trigger off another new boom cycle. Reviewing the entire reform period since 1979 provokes the simple question what has been the basic characteristic, what has been the essence of reforms. Irrespective of the numerous radical changes which the reform course brought about, in a nutshell one can claim that at the root of all reforms was the introduction of the principle of efficiency into the Chinese economy. And one may add that this venture in opening up new realms of thought and action was tantamount to a true „cultural revolution“.

Since 1979 China has witnessed three great boom periods, each one fed and propelled by new reform-tapped sources of efficiency. At present the third period clearly has exhausted its potentials. In order to create the pre-conditions for a new fourth boom period China will have to go through with further deep-reaching reforms. As outlined above, in principle this has been recognised since autumn 1997 at the latest. But even to suggest that the factual new reform work is only mid-way-through would be a highly benevolent way of interpreting the present state of politico-economic governance in China.

Having said that it would, nonetheless, appear to be advisable to keep a sense of historical proportions. To comply with this dictum this author enjoys using the opportunity to quote from his own former work:

If, for instance, any observer had in 1978/79 been rash enough to risk the prediction that China would in twenty years' time look the way it in fact now does, China specialists all over the world would simply have dismissed the forecast as being irresponsible. Such has been the power of economic reality.

Put differently, China has in the past shown the stamina to cope or at least to live with problems which had been much more serious than those of today.