CHAPTER 2

CHALLENGES OF GOVERNANCE IN ASIA: Significance for Regional Security and Stability

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Overview: Rethinking Assumptions About the Sources of Regional Security and Stability in the Asia-Pacific Region

The end of the Cold War at the close of the 1980s and the near simultaneous extension of financial sector liberalization to the more advanced Asian developing countries have together given us reason to rethink the bases of security and stability in Asia. Both of these developments have had major impacts on regional security and stability, but in very different ways. The impact of the end of the Cold War can be viewed as creating a major qualitative change in regional security dynamics, but one that still could be addressed by traditional responses—i.e., alliance relationships and forward deployed military forces. Financial sector liberation and other aspects of what is loosely termed economic liberalization, on the other hand, have created a wholly different dynamic in which regional stability and security have been adversely affected by weaknesses and outright failures in governance. These failures were most apparent in regard to the effects of the politically destabilizing effects Asian financial crisis of 1997, and continue to the present in less severe form.

Weaknesses of governance, especially in Indonesia and Thailand, even have impeded the regional response to the September 11, 2001, terrorist attacks, and hence represent an additional threat to stability and security. The Philippines' long-standing problems with Muslim separatist movements, some with links to pan-Islamic extremists and terrorist groups, can be laid at the feet of poor governance. Likewise, because political dissidence in Suharto's Indonesia was most safely pursued under the banner of Islam, the Islamic parties have emerged as more powerful forces than might otherwise have been the case. One consequence is that the elected Megawati government feels inhibited in its response to American requests for stronger action against extremists with ties to Al Qaida.

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"Old" and "New" Threats to Regional Stability and Security in the Era Following the End of the Cold War

The collapse of the Soviet Union had very different effects in Asia than in Europe. Although these effects are not the primary focus of this paper, the synergistic way in which they interact with the new issues of governance warrants a brief description of the main consequences for traditional state-to-state relations. It is now widely acknowledged that in Asia the end of the Cold War tended to increase some sources of regional tension, in sharp contrast to the rapid decrease in East-West tensions in Europe.

With the relaxation of the rigid system of alliances and alignments created by superpower rivalry, a number of potential sources of conflict, which once were contained by the larger interests of U.S.-Soviet strategic stability, now can grow and intensify. To date, potential state-to-state conflicts in most of the Asian region have been moderated by regional organizations such as the Association of Southeast Asian Nations (ASEAN), the ASEAN Regional Forum (ARF), regional economic interdependence, and other motivations for seeking engagement rather than conflict. In some cases, however, these influences have not been strong enough to prevent potentially destabilizing events.

The collapse of bipolarity has had several negative consequences for regional stability and security. For instance, greater tension has been introduced into the U.S.-China-Taiwan relationship by the fact that neither Washington nor Beijing needs each other as strategic counterweights to the U.S.S.R. Likewise, the Korean Peninsula has become more unstable as a consequence of the loss of economic assistance and a restraining hand from Moscow, Pyongyang's main Cold War era patron. For a number of reasons, China has been both unwilling and unable to substitute for the former role of the U.S.S.R.

Some other potential sources of conflict currently are kept in check simply because of the interest calculations of the respective countries—not because of the influence of Washington, Moscow, Beijing, or Tokyo. A number of potential ethnic/territorial conflicts in Southeast Asia come to mind in countries—Indonesia most notably—which currently are experiencing a decline in control over restive regions.

Less well recognized as a threat to regional stability is one particular aspect of the triumph of western-style capitalism—the revolution in international financial transactions. Beginning with the Plaza Accord of September 1985 and spurred by the congressionally-inspired Omnibus Trade and Competitiveness Act of 1988, the United States undertook the aggressive promotion of financial sector and capital account liberalization in Asia. The campaign by the Reagan and George H. W. Bush administrations also enjoyed support from the IMF and World Bank thanks to the major U.S. influence in those bodies dating from the end of World War II, which has been styled the "Washington Consensus." The U.S.-led campaign for exchange and financial sector liberalization had several interrelated objectives. One was to compensate for a huge merchandise trade deficit by promoting the interests of a sector in which the United States, with the most developed capital markets and financial services industries, enjoyed a strong competitive advantage. Since, all other things being equal, capital flows tend to cause appreciation in the currency of the receiving economy, the goals were ingeniously mutually reinforcing.

Traditional Security with a Twist: Governance and External Threats to Security and Stability in the Asia-Pacific Region

Although the issue of governance is often seen as being most relevant to "new" concerns about security and stability arising out of the globalization phenomenon, some of the more traditional aspects of the post-Cold War security environment in East Asia and the Pacific also are affected by weaknesses in the governing capacity of states. This can be best appreciated noting some of the main changes in the structure of the post-Cold War power balance in East Asia and then considering how weak governance can work to increase instability and raise the risk of state-to-state conflict. This is one reason why the Cold War era military posture of U.S. forces in East Asia and the Pacific, and the U.S. alliance systems, largely remained relevant following the collapse of the Soviet Union.

Shift in the Post-Cold War Power Balance in East Asia

The end of the Cold War set off a major shift in the power balance in East Asia, but one that was not immediately apparent. As the Soviet Union broke into Russia and newly independent republics in Europe and Central Asia, U.S. policymakers and regional security analysts actively debated whether the post-Cold War order in Asia would be more or less dangerous to peace and stability than the era of U.S.-Soviet bipolarity. Many analysts saw the East Asia region as less likely to be the scene of conflict, now that the risk of conflict with Russia had all but evaporated.[1] In late 1991, even the always volatile Korean Peninsula appeared to be stabilizing, when North and South Korea signed declarations on denuclearization of the peninsula and North-South dialogue. Others urged the United States to maintain a strong military presence in the region and expand its economic role, despite the absence of new security concerns on a par with the threat from the former USSR.

Japan, at the beginning of the 1990s, was still in the flush of its rising power status despite indications that the economic "bubble" of the late 1980s had broken. Few at the time foresaw the onset of what would proved to be a decade-long period of little or no economic growth, or that the ruling Liberal Democratic Party (LDP) would split and that the public would lose confidence in their institutions of governance. Analysts tended to see the fall of land and stock prices to forty percent of their late 1980s value as a temporary adjustment. Observers focused on Japan's growing offshore manufacturing empire in Southeast Asia and speculated about the possibility of the emergence of a "Yen bloc" that would challenge the United States and Europe.

[1] In early 1991 one of the most distinguished American academic experts on international relations, albeit one with a Euro-centric focus, barely mentioned Asia in speculating on the post-Cold War structure of power relations in an article in *Foreign Affairs*. In the very same issue Retired Admiral and former Chairman of the Joint Chiefs of Staff, William J. Crowe, Jr., and Alan D. Romberg, directly addressed the future security situation in Asia, but still deemed the military forces of the Soviet Union as the main threat, and described China as only a potential threat to the U.S. and its allies in the comparatively distant future, with whom relations needed to be "fine tuned." John Lewis Gaddis, "Toward the Post-Cold War World," *Foreign Affairs*, Vol. 70, No. 2 (Spring 1991), 100-122, and William J. Crowe, Jr., and Alan D. Romberg, "Rethinking Security in the Pacific," ibid., 123-140.

Many voices in Japan, and some in Southeast Asia, called on Japan to move beyond checkbook diplomacy and play a larger international political role and even a regional military role in keeping with its economic strength.

The Japanese government and some other U.S. allies and friends in Asia, meanwhile, worried more about the continuing "decline" of American regional influence and prestige. Even the demonstration of American military prowess in the 1990 war against Iraq created concern about future U.S. staying power, since Operation Desert Storm had required the redeployment of significant military forces from Japan, the western Pacific and Southeast Asia, and also a cash subvention from Japan of some $13 billion.

Effect of Weak Governance on "Old" Security Issues

Governance issues in several Asian countries coinciding with, or arising out of, the end of the Cold War have affected "old" state-to-state security relations in a number of ways. One effect has been to cause former Soviet client states, which were not really economically viable, to seek other ways to acquire hard currency to pay for critical imports. In the case of Vietnam, the result was positive. Hanoi intensified its pursuit of economic modernization and in the space of a decade achieved membership in ASEAN. Vietnam concluded a bilateral trade agreement (BTA) with the United States, its old enemy, which Congress ratified on October 3, 2001, and which entered into force in December 2001. Vietnam also has obtained temporary normal trade relations (NTR) status with the United States in exchange for agreeing to introduce a package of market liberalization measures in coming years, following a time-table yet to be negotiated.[2]

North Korea's response to the end of the Cold War and the loss of support from the former Soviet Union, on the other hand, has been destabilizing. Pyongyang sought to compensate for its failure of governance and loss of economic viability by seeking to develop nuclear weapons, and by developing and exporting missiles and other weapons of mass destruction.

Likewise, because of China's own problems of governance, the collapse of Communism in the Soviet Union also had a negative demonstration effect on the Chinese leadership, and led to the May 1989 Tiananmen Square massacre. It is not coincidental that the ranks of student demonstrators calling for reform and democracy swelled to 50,000-100,000 during the May 15-18 Summit visit of Soviet leader Mikhail Gorbachev, who had decided—of necessity in view of a collapsing Soviet economy—that political opening had to be a precursor to reform, rather than the other way around. This course was anathema to the conservative hard-liners in the Politburo of the Chinese Communist Party (CCP), who had the upper hand in a power struggle that had broken out in anticipation of the retirement of Deng Xiaoping.[3]

China's decision to crack down on the democracy movement while concentrating on economic liberalization had significant ramifications for regional stability. The

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[2] Office of the U.S. Trade Representative (USTR) press release, 10 December 2001.

western and Japanese reaction to the Tiananmen massacre poisoned Beijing's external relations for several years, and especially hardened U.S.-China relations. Over time, pragmatism prevailed in both countries regarding the need for engagement, and especially for integrating China into the global economy, but the fact remains that from Tiananmen onward China acquired the status of a successor to the USSR as the main potential enemy of the United States.

As an alternative to political liberalization, China responded to the erosion of the Communist Party's legitimacy with a two-pronged approach. The first, and thus far most important to stability in Asia, was to accelerate economic liberalization. This was symbolized by Deng Xiaoping's celebrated tour of southern China in early 1992, during which he exhorted the Chinese people to "get rich" under the mantle of "market socialism." The other tack, which has more immediate implications for regional stability and security, was a decision by the Chinese leadership and conservatives in the military to stoke the fires of nationalism in a bid to shore up support for the established political order. The latter approach was symbolized by the adoption by China's National People's Congress later in the same year of the Law on the Territorial Sea and the Contiguous Zones, which not only asserted China's claims to most of the islands in the South China Sea, including the Spratlys, but also asserted sovereignty over the Senkakus, occupied by Japan, in addition to Taiwan and the nearby Pescadores (Quemoy and Matsu), which are under Taipei's control.

By the middle of the 1990s, a clearer image of the emerging East Asian power balance began to appear, with China at the center. Boosted by its ability to attract a major share of total global foreign direct investment and high domestic savings rates, the Chinese economy surged ahead with growth rates estimated in the 7–9 percent range, while its main regional rival, Japan, languished in economic stagnation and internal political disarray. By 1998 China's total Gross Domestic Product (GDP), as measured in terms of purchasing power parity, totaled $4.4 billion—nearly half that of Japan's. Symbolic of its rising status as an export superpower, China's trade surplus with the United States surged ahead of Japan's in 2000 ($83.8 billion for China vs. $81.3 billion for Japan).

China carried out a smooth power transition following the death of Deng Xiaoping, and enhanced its regional status by not moving to devalue its currency following the onset of the Asian financial crisis that began in Thailand in July 1997. Beijing's forthcoming role in the financial crisis contrasted with other moves by China that unsettled its neighbors, and underscored its ability to become a force for regional stability or a source of instability and threat. These latter included, prominently, the construction in 1995 of logistical facilities on Mischief Reef in the Spratly Islands, claimed by the Philippines, and efforts to intimidate Taiwan in late 1995 and early 1996 with provocative military exercises and launches of ballistic missiles that landed in the sea not far from Taiwan's main ports of Taipei, in the north, and Kaohsiung, in the South. In both instances, China's Asian neighbors were particularly disturbed by Beijing tendency to flout internationally accepted standards. In the case of the Spratlys and other South China Sea territories, China has asserted historical claims that are at variance with international law.[4] In the case of its efforts to intimidate Taiwan, China has asserted that the confrontation was an "internal matter," and hence of no concern to outsiders.

U.S. Reaction to the Changing Regional Power Balance

By and large, the United States has reacted to the changing regional power balance with a characteristically multi-faceted approach. The Administration of George H. W. Bush appears never to have doubted that the United States should remain committed to its alliance system in Asia and the maintenance of a forward military presence. For a time the Administration showed evidence of lacking a new strategic concept, but the Tiananmen Square incident of May 1989 and the continuing risk of conflict on the Korean Peninsula generally served to stave off pressures in Congress to reduce the U.S. regional military role.

The Clinton administration adopted a number of responses to the changing power balance in East Asia. The first, following much in the same vein as the Reagan and Bush administrations, campaign rhetoric notwithstanding, was to seek to engage with China with a view to promoting changes in its behavior in regard to human rights, trade and economic policy, and China's regional political and military role. At the same time, beginning with the so-called Nye Initiative of 1995, named after the then Assistant Secretary of Defense for International Security Affairs, the administration sought to highlight the intention of the United States to maintain a regional military presence of about 100,000 troops and related ships and combat aircraft, mainly in South Korea and Japan.

In 1997, the United States and Japan negotiated a new set of defense cooperation guidelines, which paid dividends in unexpected fashion following the September 11, 2001, terrorist attacks in New York and Washington. The guidelines and subsequent Japanese legislation strengthened Japan's ability to provide non-combat, logistical support to U.S. forces in the event of a regional contingency or conflict, including the unprecedented October 2001 dispatch of a naval flotilla and C-130 transports to the Indian Ocean region.

Both the George W. H. Bush and Clinton administrations were open to multilateralism that appeared to benefit U.S. interests, but the first Bush administration showed suspicion of any initiatives that appeared to dilute U.S. freedom of action and remained wedded to the "hub and spoke" relationships with the Asia-Pacific—Japan, Australia, Thailand, and (less importantly after the 1992 withdrawal from Subic Bay and Clark Air Base) the Philippines. The Bush administration would have preferred to retain bases in the Philippines but Manila's demands and prickliness made a withdrawal look like the best course—and a required one after the Philippines Senate voted in 1992 not to renew the basing agreement.

[4] "Divide and Rule: Beijing Scores Points on the South China Sea," *Far Eastern Economic Review*, 11 August 1994, 18. In direct and "Track Two" meetings with countries of the Association of Southeast Asian Nations, China has mentioned vague formulas for resolving the issues peacefully and sharing the area's resources, but has refused to make any firm commitments. China refused to agree to a South China Sea code of conduct during an informal heads of state/government between ASEAN and China in Manila in November 1999.

President Bush and Secretary of State James Baker reacted suspiciously to the promotion of the Asia-Pacific Economic Cooperation (APEC) forum by Australia and Japan, sensing the creation of a possible coalition against U.S. trade and economic pressures. The Clinton Administration more clearly embraced the process, starting with the President's decision to organize the first APEC leaders summit at the 1993 meeting on Blake Island, near Seattle. The Administration exercised vigorous influence in the runup to the 1994 meeting in Bogor, Indonesia, which adopted the goal of regional free trade by 2010 in the case of the developed economies and 2020 in the case of the less developed Asian economies. By the mid-1980s it was becoming apparent that the response to U.S. initiatives remained more rhetorical than real, as meetings in Osaka, Manila, Kuala Lumpur, and Vancouver between 1995 and 1998 saw hesitation to push ahead with concrete measures. The Administration's most important success in its efforts to move APEC forward took the form of an agreement by APEC countries to support early liberalization of the information technology sector in the Uruguay Round that concluded in the telecommunications sector—an area of Asian strength.

Relations with ASEAN have been uniformly strong and positive, but owing to some resistance in the military services, especially the U.S. Navy, the United States has remained of two minds about the ARF. So long as ASEAN was using the ARF to show solidarity against China's incursions in the Spratlys, for instance, the United States applauded. Washington also generally supported initiatives for greater transparency of military programs, and expanded military-to-military relations, but was less enthusiastic about confidence-building proposals by China that might have required the U.S. Navy to announce beforehand its transit of countries' Exclusive Economic Zones (EEZs.)

"New" Issues of Governance As Factors in Asian Stability and Security

Although economic integration and related phenomena that are associated with globalization generally have contributed to regional stability and security, problems of poor governance in a number of Asian countries have undercut these benefits and even contributed to new sources of threat. At a minimum, rapid globalization requires internal socioeconomic adjustments that are inherently destabilizing. Hence, good governance is a critical requirement for preventing the benefits of globalization from being overshadowed by the inevitable dislocations.

Impact of the Asian Financial Crisis of 1997-1998

The nexus between issues of economic performance, governance, and regional security and stability became more prominent following the onset of the Asian financial crisis in July 1997. Among other effects, the collapse of the Thai baht:

- brought into question earlier predictions of a coming Asia-Pacific century with expanding-sum benefits for all,
- unleashed significant political changes with cross-cutting implications for stability,
- largely eliminated "economic performance" as a source of legitimacy for Southeast Asian governments.

The spreading crisis, which eventually grew to global proportions, also tarnished the reputation of the IMF, raised questions about U.S. leadership, and showed the limits of ASEAN and APEC.

The financial crisis and related economic contraction imposed a harsh social cost on the most affected economies. The impact varied from country-to-country, but in general it hurt the urban poor and middle classes more than the residents of rural areas. In the most developed crisis country, South Korea, and in the cities of the developing countries of Southeast Asia, especially Bangkok and Jakarta, the distress was most palpable. Because the value of many tropical cash crops is determined by world prices, the currency devaluations tended to raise the incomes of farmers relative to their urban counterparts. Many urban workers in Southeast Asia returned at least temporarily to the villages from which they had once come looking for a better life, an option that South Koreans workers generally did not have due to their country's more advanced state of development. Conversely, because of South Korea's significantly greater wealth and resources, its government was able comparatively quickly to install a social safety net of unemployment benefits and other relief measures, while those of Thailand and Indonesia lacked both the means and the necessary administrative infrastructure to provide much income or consumption support.

Although it now appears that incomes in the crisis countries did not fall as much as was initially estimated, the social impact was serious in every affected county. The World Bank calculated in mid-1999 that in South Korea the incidence of urban poverty more than doubled in the months after the crash—from 8.6 percent in 1997 to 19.2 percent in 1998—and that the overall urban standard of living declined by 21.6 percent. The Bank estimated that in Indonesia, the percentage of the population living below the nationally established poverty line nearly doubled—from 11.0 percent before the crisis to 19.9 percent afterward—and that the overall standard of living fell by 24.4 percent, or almost one-fourth. Rural areas in West Java and some other parts of Indonesia were also affected during 1997 and early 1998 by a severe El Nino-influenced drought, which added to the general economic distress and created widespread hunger. In Thailand, by contrast, the crash appears to have mainly affected the urban middle classes, who are still a relatively small proportion of the total population, with the effect that the overall incidence of nationally defined poverty increased only moderately—from 11.0 to 12.9 percent between 1997 and 1998—while overall incomes dropped by 13.6 percent.[5]

Because of certain characteristics of Asian social systems and labor markets, unemployment levels do not reveal the true depth of the crisis. In a 1999 year-end assessment and forecast the World Bank found that because of the "flexibility" of Southeast Asian labor markets, i.e., willingness to work for subsistence wages, if necessary, incomes fell further than actual employment. In Indonesia, by this account, employment actually rose slightly after the crisis while wages fell by 42 percent.[6]

Currently, the unemployment picture in East Asia is very mixed, with Indonesia by one account now showing a record high of 50 million in a workforce of less than 200

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[5] The World Bank, News Release 99/2214/S, 2 June 1999 (http://www.worldbank.org/html/extdr/extme/2214.htm).

[6] Martin Wolf, "Asia's Future Burning Bright," *Financial Times*, 23 February 2000, 23.

million.[7] Most countries are suffering substantial unemployment and underemployment, facts reflected in historically low levels of price inflation and interest rates, despite healthy fiscal deficits running on the order of 4-5 percent of GDP. Even Japan, as is well known, suffers from the highest levels of unemployment since the end of World War II, and serious deflationary pressures.

The crisis also surprised some observers by generally reinforcing a preexisting trend towards greater openness to the global economy. Despite sometimes harsh criticisms of foreign investors and lenders, the IMF's initial fiscal austerity requirements, and perceived U.S. dominance of the international economic system, the wrath of most Asians was turned more at their own leaders, economic managers, and corporations, than at the impersonal forces of economic globalization. In general, Asians appear to have accepted, reluctantly in many cases, that their economic salvation will have to come mainly from adopting reforms aimed at more transparency in the management of their economies, more prudential financial sector behavior, and better corporate governance. Therein lies the rub—these necessary reforms are not yet much in evidence.

The willingness, however reluctant, to accept the IMF's policy conditionality rather than oppose it, appeared to go hand-in-hand with public support for political leaders who promised to end abuses such as favoritism towards well-connected individuals and corporations, generally referred to as "crony capitalism," and the desire to punish those associated with practices that had brought their national financial systems to the point of collapse. Even Malaysia, whose prime minister had railed against George Soros and other foreign "speculators," the IMF, and alleged U.S. wire-pulling, unilaterally adopted IMF-style austerity measures to restore foreign confidence in its economic management, while also imposing controls on capital flight.

The comparatively mild reaction to the downside of economic globalization in Asia thus far may also reflect the fact that, until the crisis, the growing involvement of East Asian countries in world markets generally had been viewed as beneficial by the affected populations. In many Asian countries, authoritarian leaders justified their rule by delivering the benefits of rapid economic growth and rising living standards, gains that would not have been possible without attracting foreign manufacturing investment and plugging into world markets. Opposition to globalization has tended to come mainly from non-governmental organizations (NGOs) that champion causes such as workers' rights and environmentalism, agendas that have received relatively weak public support. The markets of the crisis countries had remained comparatively closed to all but capital goods, high technology, and industrial inputs such as chemicals and raw materials. Thus, following a path of openness to foreign capital and technology generally had produced more gains than losses in terms of domestic economic interests and employment.

Also, after what were perceived as some initial missteps in the direction of excessive fiscal austerity, the IMF moved relatively quickly to loosen its constraints to allow deficit spending to bolster consumption and provide a social safety net.

[7] "Indonesia's Economic Future Grows More Murky," *Asia Times* online, 29 January 2002 (www.atimes.com/se-asia/DA29Ae02.html).

Indonesia and Thailand successfully bargained with the IMF to allow progressive increases in counter-cyclical deficit spending, while accepting other aspects of the IMF reform program.

Ramifications of the Crisis for the Structure of Regional Relationships

The Asian financial crisis not only weakened the affected countries but also damaged the institutional and structural underpinnings of regional stability and security. Among other consequences, the crisis cast doubt on the willingness of the United States to play its expected post-World War II role as the main pillar of the international economic system, it cast serious doubt on Japan's ability to play the role of regional economic leader, and revealed the Asia-Pacific Economic Cooperation forum (APEC) and ASEAN as ineffective talk shops, with no ability to coordinate a regional response.

Despite the strongly positive American contribution to East Asian prosperity, Asian countries generally viewed the U.S. response to the crisis as disappointing. After all, it was the United States that had been the leading proponent of financial sector liberalization. Instead of rushing to the rescue, the U.S. Treasury Department appeared to view the issue as a regional matter of little significance to the U.S. or global economy, and declined to deploy financing available in the Exchange Stabilization Fund.[8] Subsequently, in early 1998, the United States announced some $1.7 billion in trade credits and aid, but Thais still view the United States, a treaty ally, as failing them in their moment of greatest need.[9]

By late 1997 the Clinton Administration began to take a more serious view of the crisis, when it appeared that South Korea, the world's 11th largest economy, might default on international loans amounting to tens of billions of U.S. dollars. The Administration provided about $5 billion in accelerated funding in support of the IMF's $57 billion rescue package, and helped negotiate the rollover of $15 billion in international loans that were coming due in early 1998.[10] As far as the U.S. image was concerned, however, the damage was done. In addition to disappointment with the direct U.S. response, a number of affected countries, rightly or wrongly, saw the hand of Washington in what was perceived as harsh and wrong-headed IMF conditionality.

Questionable Effect on Japan's Ambitions for Regional Leadership

The Asian financial crisis and Japan's own severe economic problems have seriously compromised Japan's ambitions of regional leadership, giving new openings to China to take what it sees as its rightful place in Asian power politics. Japan initially committed $44 billion in second-line financing and export credits and guarantees in support of the IMF-led rescue programs for Thailand, Indonesia, and South Korea. Subsequent commitments under the so-called Miyazawa Plan, named for the then

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[8] Paul Blustein, "Thailand Seeks IMF Bailout to Shore Up Its Financial System," *Washington Post*, 19 July 1997; Michael Vatikiotis, "Pacific Divide," *Far Eastern Economic Review*, 6 November 1997, 14-16.

[9] CRS Report for Congress (RL30312), "Thailand-U.S. Security, Economic, and Narcotics Cooperation Relations: Findings of a Congressional Staff Visit During August 9-15, 1999" [by Richard P. Cronin], 11.

[10] Paul Blustein, "$10 Billion in Loans Rushed to S. Korea," *Washington Post*, 25 December 1997, A1, A32.

Japanese finance minister, pushed Japan's total commitment to about $80 billion.[11] On the other hand, the withdrawal of Japanese capital and declines in Japanese imports from most Asian nations have had far more effect. Moreover, many of Japan's moves have been viewed as more aimed at protecting its offshore investments and joint-venture subsidiaries than in contributing to Asian recovery, even though the two objectives may be complementary.

On balance, Asians still value Japan's role and remain angry with the initial standoffish attitude of the U.S. Treasury Department and the Clinton Administration, and see the U.S. hand behind unwanted IMF prescriptions and conditionality. Among other points often made in Japan's favor, Japanese corporations generally did not flee the region and continued to carry out production for export, thus playing a key role in the ability of developing Asian countries to regain an export surplus. China, for its part, gained considerable applause for not devaluing the Yuan, which remains fixed at exchange rates determined by the financial authorities, and for a modest contribution of backup funds to the IMF-organized bailout.

Little Credit to APEC or ASEAN

Both APEC and ASEAN have substantially been found wanting in the crisis, though both have nominally continued to move forward with trade and economic liberalization agendas. The November 1998 APEC meeting in Kuala Lumpur was dominated by talk about the crisis but little concrete action. ASEAN has been wholly unable to achieve a coordinated response to the crisis, largely because most ASEAN countries export similar tropical products and are vying for the same kinds of foreign direct investment in export-oriented manufacturing. In addition, the then-expansion of ASEAN to nine members, including Vietnam, Burma, and Laos, has reduced the viability of the long-standing principles of consensus and non-interference in each other's internal affairs.

From Crisis to Incomplete Recovery

With the notable exception of Indonesia, the East Asian economies that were hardest hit by the financial crisis that began in Thailand in July 1997 have made a significant, though still incomplete, recovery. The impressive success of most countries in rebuilding their financial reserves and regaining a growth path has surprised many if not most analysts. The partial rebound has generated optimism within the international financial community, but also caution. A number of analysts and institutions warn that the regional recovery is uneven and incomplete, that important structural weaknesses remain to be addressed, and that incomes and living standards are still well short of pre-crisis levels in several countries. A March 2000 Asian Development Bank (ADB) report that described the recovery as cyclical rather than structural[12] may prove prophetic since the first recovery from the crisis was followed by loss of momentum in 2001. As of mid-2002, however, the ADB has estimated growth in developing Asia at about 4.8 percent, while the IMF has pegged 2002

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[11] Japan, Ministry of Foreign Affairs, "Asian Economic Crisis and Japan's Contribution," October 2000 (www.mofa.go.jp/policy/economy/asia/crisis0010.html).

[12] Asia Development Bank, *Asia Recovery Report 2000*. March 2000. Highlights (http://aric.adb.org).

growth at 5.9 percent for developing Asia and 3.6 percent for the newly industrialized economies of Southeast Asia. These results suggest that the social and political stresses resulting from the financial crisis itself are probably containable.

Problems of Governance and the Prospects for Stability and Security in Asia

Although the picture drawn above could be said to reflect a mix of economic advances and setbacks, it would be difficult to assert that the cause of good *governance* has made major gains in any East Asian country, though financial management certainly has improved greatly in South Korea and Thailand. Nor, despite the status of governance–both public and corporate—as the development "flavor" of the first years of the new millennium, is the concept easy to promote from outside. As a consequence, problems of poor governance will likely remain important, if not the predominant, sources of threats to stability and security in this highly globalized region.

Mixed Picture Concerning Democratization and Political Stability

The effects of the financial and economic crisis have been mixed in regard to democratization and political stability, but in general, the crisis has tended to strengthen the move towards democracy in Asia, thus far. The election of former Korean opposition figure Kim Dae Jung as president in December 1997 strengthened South Korea's nascent democratic traditions, but Kim has had only limited success in pushing reform of the *chaebol* and his party is in disarray as new elections approach. Kim's "Sunshine Policy" towards North Korea probably has produced a paradigm shift, but has little to show for the effort and expense. More recently, corruption charges against his three sons, his wife, and close associates, have forced Kim to resign from his party in an effort to prevent a debacle in the presidential election scheduled for December 2002 (Kim is ineligible for another term.)

In the case of South Korea, poor governance could have important consequences for stability on the Korean Peninsula. First, the resident's current problems have all but destroyed the possibility that his so-called "Sunshine Policy" of almost unconditioned engagement with the North can have any impact. Nor does Kim Dae Jung have much political capital left to work to improve relations with Japan, all but insuring that the Japan-South Korea side of the American alliance triangle in Northeast Asia will remain weak. Finally, the corruption issue exacerbates an existing problem of party instability, which also translates into policy instability.

Thailand's democracy received a boost, with a peaceful transfer of power indicating that the emerging professional and middle classes preferred a more effective and more democratically-minded opposition leader, Chuan Leekpai. The Thai parliament also passed a new, more democratic constitution that had previously appeared headed for rejection. More recently, however, the dramatic, money-fueled rise of Prime Minister Thaksin Shinawatra's Thai-Rak-Thai party has raised questions about issues of corruption, governance, and press freedom.[13] Thaksin's populist economic program has boosted growth, but the end result may be a renewed

[13] Songpol Kaopatumtip, "Now Who's Head is Hurt?" *Bangkok Post*, 3 March 2002 (www.bangkokpost.net/030302_Perspective/03Mar2002_pers64.html).

economic crisis. Fiscal pump-priming has boosted property prices and fueled growth, but at the cost of rapidly increasing government debt. Given Thailand's precarious export competitiveness, government policies could lead to a new financial crisis.

In Indonesia, a rough kind of democracy has replaced Suharto's authoritarianism, but the roles and powers of the two parliamentary bodies and the president remain to be worked out. Freedoms of the press and of assembly have been accepted, and the Indonesian military, the TNI, has stepped into the background. The central government remains in disarray however, and the ugly specter of ethnic and religious violence, guerrilla warfare between separatists and undisciplined and poorly paid police, paramilitary, and military forces, and Islamic extremists—some with Al Qaida connections—stalk the provinces. Undeniably, Indonesians have made some progress towards a more democratic system. Parliament has flexed its muscles on a variety of important national issues, the president has popular support and a power base in a party that gained a plurality in elections, and both the Parliament and the president are likely to be directly elected in the next cycle.

Despite some progress in reshaping the country's political institutions, Indonesia remains essentially an oligarchy in which "crony capitalism" continues to thrive, and which the military, with all of its defects, remains the only institution with truly national scope. Especially because of its size and heterogeneous nature, Indonesia remains the Southeast Asian country in which weaknesses of governance have the most significant potential consequences for regional stability.

In Malaysia, many viewed the arrest and jailing of former Deputy Prime Minister Anwar Ibrahim, and the widespread use of police powers against political enemies as a setback for political freedom, but some critics also fear the consequences if Mahathir and the United Front were to falter and the PAS, the Islamist party, to make further electoral gains. Mahathir has succeeded in steering the corporatist-style Malaysian economy through a middle path between catastrophe and the surrender to the "Washington Consensus," and now finds himself a valued partner of the United States in the anti-terrorist campaign.

This new role also puts a sharper edge on ethnic and religious tensions in Malaysia, however. Pressures of globalization have progressively undercut the viability of Malaysia's three-decade old New Economic Plan (NEP), an effort to raise the economic standing of Malays through a kind of affirmative action, without imposing enough constraints on the educational and entrepreneurial aspirations of the ethnic Chinese minority so as to force them out of the governing United Front Coalition. For the time being, Mahathir's aggressive pursuit of Islamic extremists and terrorists may give him a political respite, but in the longer term the buildup of deep social and political contradictions continues. Meanwhile, Malaysia's longest serving leader is not getting any younger, and it seems that no tree can grow within the shadow he casts over the United Malays National Organization (UNMO), the core of the ruling United Front.

Continued Adherence to the "East Asian" Economic Model

Arguably, one part of the problem of governance in the region is the continued commitment of most East Asian countries to the so-called "East Asian" economic model, which relied on unrestrained debt and close government-business collusion. The hope of market-oriented economists and analysts, including U.S. and IMF officials, that the crisis would lead to a more transparent, more equity-based, and more fully entrepreneurial economic model seem likely to be disappointed, at least in the medium term. In fact, due to the use of public funds for bank recapitalization, governments are even more heavily involved in many Asian economies than in the past, and powerful vested interests continue to fight a rearguard action against needed structural reforms and efforts to reduce huge levels of non-performing debt.

Slow Pace of Corporate Reform

Likewise, politically influential corporate interests have resisted government efforts to force consolidation and industry restructuring. In South Korea, which has made the most progress, the politically powerful *chaebol* conglomerates and labor unions have fought tooth and nail against the Kim Dae Jung government's plan for a major rationalization and consolidation of major industrial sectors. The country's second largest *chaebol*, Daewoo, which alone reportedly has debts totaling $50-65 billion, resisted government divestiture and consolidation pressures almost to the point of bankruptcy. Had the government not intervened forcefully, according to one industry analysis, Daewoo's collapse would have brought down the already insolvent investment trust companies (ITCs) that are the chief source of financing for Korean companies and the dominant players in the country's equity markets.[14]

Because of the political sensitivity of the issue, the South Korean government has taken an inconsistent stance on bailouts of large debtor companies, such as Daewoo Motors and Hynix Semiconductor. In February 2002, in response to accusations that the government was still coddling bankrupt but politically important enterprises, the South Korea Finance Minister attempted to shift the blame for lagging reform of the *chaebol* onto the country's banks, which he said were not yet up to the task of imposing financial discipline.[15]

Some analysts despair of seeing significant near-term corporate reform in other Asian economies, except among already viable companies that are responding to global competition. The tendency appears to be for companies to find ways to stay afloat financially, often by defaulting on loans and postponing payments to suppliers, in hopes that a general economic turnaround will put them back into the black. A March 2000 report by the Asian Development Bank (ADB) warned against the dangers of a "growth first" strategy, in which financial and corporate restructuring is postponed until growth begins to restore asset values. The ADB found this approach "risky," given the uncertainties about future growth prospects, but also said it could "invite a recurrence of problems at a later date," when governments would have no flexibility to assume more debt.[16]

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[14] Charles S. Lee, "Last Gasp? Daewoo Receives a Debt Reprieve," *Far Eastern Economic Review*, 29 July 1999, 59, Nomura, *Korean Economics*, October 1999, 10.

[15] Don Kirk, "Korean Official Defends Seoul's Efforts on Economy," *New York Times*, 23 February 2002, B2.

[16] ADB. Tracking Asia's Recovery—A Regional Overview. March 2000, 17.

Persistence of Corruption

The current political instability in many Asian countries coupled with the inherent limitations of the East Asian model in a globalized economic and financial environment also make it difficult to make headway against corruption. Ultimately, politics is about power and money. Reform tends to be the luxury of rich, expanding economies, whereas the shrinkage of the economic pie tends mainly to increase the competition for control of scarce resources.

Implications for U.S. Interests and Regional Stability and Security

Despite signs of a general economic recovery, U.S. interests continue to be affected by several lingering aspects of the crisis and deeply imbedded problems of weak governance in most East Asian countries. U.S. military power and the importance of the U.S. economy to Asian and global growth cannot be gainsaid, and from a balance of power perspective, few challenges are evident to the U.S. position or to regional security. China's economic and military strength is growing, but its military forces in particular are outclassed by those of the United States and Japan. Moreover, its own crisis of governance, which may be deeper than in any other major Asian country remains serious. Its military limitations, and several sources of social and economic weakness, will likely prevent Beijing from breaking the peace in the foreseeable future.

Because of the economic prostration of Indonesia and fears that the vast and populous island republic might even break up, regional concerns about China's potential ability to project power and influence into Southeast Asia have grown considerably. Japan in particular is worried about the possible political disintegration of a region that it has long regarded as strategically important. Whether the countries of ASEAN bend towards China or re-coalesce under Japan's wing could have important implications for regional peace and stability. The ability of the ASEAN countries and Japan to overcome their current economic and financial difficulties would likely be a major determinant, as would China's own efforts to address its deep-seated structural problems.

In the end, the lessons of both the financial crisis and the September 11, 2001, terrorist attacks, appear to be that the greatest dangers to U.S. interests remain non-traditional ones not involving raw military or economic power. In this sense, how the United States deals with the problems of weak governance that are prevalent in the East Asian region could have great significance for U.S. regional interests and security. The challenge is to find ways to make headway on these issues of democracy, political stability, and governance in the face of current adverse economic trends and the complex rise of Islamic radicalism and terrorism in Southeast Asia.