

The Political and Social Implications of the Asian Crisis

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Economic development has been a pivotal force for stability and regime legitimacy in Asia, the author notes, and the economic collapse of the region has showcased the complexity of the interrelationship between economics and security. The crisis has already affected domestic stability which may lead to the return of military regimes. Unemployment and poverty are transforming the apolitical middle class into a more militant one. Violence against ethnic minorities and even high ranking government officials and a growing intolerance against foreign guest workers will have serious implications in the region. Widespread strike action by unions was just the tip of the iceberg. There is uncertainty in the region's security, due to the absence of effective regional security or economic organizations wherein crisis and crisis-related issues can be resolved. The U.S. has mainly used the International Monetary Fund (IMF) as the primary agency for crisis management but this may no longer be sustainable in the future.

Asia's political stability and the cohesion of its societies have been underpinned by the region's spectacular economic growth. Beginning with Japan in the 1950s, Asia's "economic miracle" resulted not only in rapidly rising standards of living and the emergence of a vibrant middle class, but also seemed to suppress serious racial tensions in such multi-racial societies as Indonesia and Malaysia. Semi-authoritarian leaders have been able to stay in power for decades by basing their political legitimacy on their economic record.

China, after emerging 20 years ago from more than three decades of domestic turbulence and poor economic performance, has given priority to economic development and market forces. Vietnam has also emerged from the straitjacket of central planning and opened its market to limited free enterprise.

By mid-1997, the whole of Asia — with the exception of Cambodia, Laos, Myanmar, and North Korea — had become a showplace for economic success, political stability and, generally, social cohesion. For Asia as a whole, over the last decade GDP has grown by over 50% and per capita GDP has risen by about one-third. If Japan's slow growth is excluded, figures are more impressive: GDP grew by 120% and per capita GDP doubled. This colossal economic growth inspired cultural confidence in Asian minds — what Singapore's Kishore Mahbubani calls the "Asian Renaissance."¹

Political and Social Implications on Asian Regimes

But Asia's economic confidence has now been undermined. The crisis will have profound effects on the political and social cohesion of key Asian states. Between 1996 and early 1998, Indonesia's economy shrunk in dollars by almost four-fifths, Thailand's by nearly 50%, South Korea's by close to 50%, Malaysia's by almost 25% and the Philippines by 20%.

These would be catastrophic outcomes for any economy, but they are particularly damaging to one-party regimes that have built their reputation not on democracy or human rights but almost entirely on delivering economic growth year after year, decade after decade. As the *Economist* correctly points out, however, these numbers are somewhat deceptive — suggesting, as they do, that for the countries involved, their incomes in dollar terms are no higher than their level in late 1970s.² On this measure, the economic gains of a whole generation have been wiped out by the financial crisis, as Malaysia's Prime Minister Mahathir has suggested. But converting a local currency GDP into dollars at market exchange rates does not accurately measure the volume of goods and services produced on the true value of locally produced inputs.

There is no doubt that the bad news for Asia's leaders is that, except possibly for China, the era of high economic growth is over, at least for the next few years. The situation is complicated by the fact that, except in HongKong and Singapore, there are no formal legal processes for bankruptcy: insolvent banks and private companies continue to trade even though they are technically bankrupt and have made their labor forces redundant. The recent plan by the Japanese government to use taxpayers' money to recapitalize Japanese banks is a case in point. This does not also address the issue of moral hazard: socialization of private business losses while profits are private!

The fundamental tenet of Asian political leadership is now at risk: the promise to deliver unending economic growth and material benefits to the people. This has become tarnished in Japan when the property bubble burst in 1990.³ But, until the 1997 crisis, unending growth remained an article of faith in South Korea and it is still the general expectation today in China. In Southeast Asia, the crisis poses a major challenge to the so-called "ASEAN model," under which security is conceived of in economic

and political, rather than conventional military terms. The central feature of this model is the concept of “national resilience,” pioneered by Indonesia. This ideal condition would be achieved by creating a stable domestic political order that would encourage fruitful economic development. In turn, this economic growth would reinforce the underlying political order.⁴ Thus the collapse of economic prosperity in Asia will threaten the basis for political stability across the region.

High interest rates, rapidly rising prices and soaring unemployment are a potent mixture: in Indonesia alone, unemployment is forecast to increase in 1998 from about four million to as high as 14 million. We have seen the mounting violence of the demonstrations against rising prices, and the violence against ethnic Chinese, especially against the women, which threatens the social relations in a culturally diverse nation. In Thailand and Malaysia, there is a growing anger about the presence of foreign guest workers; this has serious implications for Asean and especially for the Philippines. In South Korea, trade unions are threatening widespread strike action over unemployment. These reactions have occurred even before many of the IMF-sponsored reforms in these countries have been implemented.

Given these developments, the question is whether the crisis will propel Asia back towards political suppression: In Indonesia, the violence and social disruption has been directed, so far, against the ethnic Chinese rather than the government. In Malaysia, we may well be seeing the beginning of the end for Prime Minister Mahathir. We are witnesses to the spectacle of Anwar Ibrahim, former deputy prime minister and finance minister being brought to court with bruises on his face and his neck in a brace. If the police can do this to Anwar, what are the prospects for an ordinary Malaysian? There seems to be a rising anti-IMF-style capitalism as well as an anti-ethnic Chinese business community within Asean. What will be China’s response to the continued anti-Chinese activities in Indonesia and Malaysia?

Will these kinds of sentiments arise in other Asian countries? Perhaps not in the extreme form that can be seen in Indonesia. But anti-Western and anti-capitalist views are also being expressed elsewhere in the region. And, as Amitar Acharya has observed, the state of civil-military relations remains a crucial factor in regime stability.⁵ The recent decline in the military “influence” in the Philippines, South Korea and Thailand

should not be viewed as an irreversible phenomenon — particularly if the current economic crisis is prolonged and seriously disrupts their societies. The specter of popular revolt may tempt military forces to intervene. And the economic and political crisis in Indonesia is already raising anxieties in Malaysia, Australia, and Singapore about its potential spread to neighboring states — for instance, through an exodus (voluntary or otherwise) of ethnic Chinese.

Throughout the region, the status and well-being of the middle class have been eroded, seriously so in Indonesia, South Korea and Thailand. Rapid economic growth has kept the middle class from being too restive politically: indeed, because of the demonstrable economic gains they have made under their current political systems, they have had a vested interest in political stability and regime continuity.⁶ They have not had any major interest in actively campaigning for democracy. But confidence in long-established political leaders has now been shaken. Thus the basis for a challenge to regime legitimacy has been laid.

Nayan Chanda argues that another era of prosperity is possible in Asia, but only if the crisis-stricken countries learn the lessons of how their economies went wrong: what the region needs to put in place is a political system that places value on accountability and transparency, that controls corruption and sets up an administrative and regulatory system that is suited to the age of globalization.⁷

The implementation of such policies in these Asian nations hit by the current crisis could lead to a relatively quick turnaround in their circumstances. With the possible exception of South Korea, however, fundamental (as distinct from cosmetic) change in the financial and banking institutions and business practices is distant. Transparency — in financial, political or security matters — is not an Asian tradition.⁸ We are not confident that real progress will be made in this area nor that the IMF should insist on it as a short-term goal.

Failure to change the most obvious of the region's opaque and corrupt business practices, though, will only prolong Asia's economic agony. In the post-cold war era, there are plenty of other attractive investments in North America and Western Europe. Asia has become so used to being the center of world economic attention that this will be a bitter reality for it to face.

These investment effects will be exacerbated by the uneven impact of the crisis in the region: Singapore has been relatively unaffected (which will stir up Malaysian resentment) and the Philippines and Malaysia are in better shape than Indonesia or Thailand. Thus ASEAN solidarity will be tested. And in South Korea any serious and widespread social upheavals will have serious consequences not only for regime stability, as that country seeks to build a sense of democracy, but also for relations with the North, as well as with Japan — which is seen in Seoul as an unhelpful neighbor economically.

Vietnam and China will scrutinize closely the impact of Asian economic crisis on regime stability in other parts of the region. It remains to be seen whether the reaction in Hanoi and Beijing will be to tighten political control. But there is no doubt that anxiety in Asia as a whole is now likely to refocus (as it did in the days of communist insurgencies) much more on domestic, political and social issues than on key external issues, such as the future of U.S. military commitment to the region and regional-security cooperation.

There has been a general expectation in the West that the spread of capitalism in Asia would lead to democracy, even though the majority of governments in the region are what Robert Scalapino terms “soft authoritarianism.” The uneven, yet promising, move to greater political freedom and participation in much of Asia may now be at risk. Social cohesion and domestic discipline have moved to the top of the agenda for the region’s leaders.

Implications on Regional Security

The economic collapse in Asia has important strategic implications. It will increase uncertainty in the region’s security outlook and challenge regional cohesion. It will also alter the regional balance of power, affect domestic stability and undermine the view that growing economic interdependence will prevent international conflict in Asia. The comfortable prediction of a Pacific 21st century — based on the ASEAN mode of consensus and cooperation — is now largely discredited.⁹ And the limitations with regional institutions, such as the Asia Pacific Economic Cooperation (APEC) and the Asean Regional Forum (ARF), have been starkly demonstrated by the inability of the region to work together on this crisis.

Recent events invite reconsideration of the major theoretical models that have been applied to the emerging regional-security structure in Asia: the balance of power model; the institutional-cooperation model and the idea of a regional-security “complex.” Within the region itself, the latter has employed increasing popularity as the appropriate (non-Western) solution to the region’s security problems.¹⁰ There is a risk now that regional-security cooperation will falter.

The relationship between economic development and security has traditionally played a large part in regional-security deliberations, especially in Southeast Asia. In Northeast Asia, too, there has been a perception that China’s preoccupation with economic modernization has deflected it from a greater military build-up. Moreover, as Gerald Segal notes, radical economic reforms are not only transforming the Chinese economy, they are also starting to affect its political system.¹¹ For detached observers, it remains debatable whether increasing economic interdependence with the rest of Asia, and with the world trading and investment community, will make China a cooperative and peaceful great power and act as a restraint on its use of force. This belief, however, is widely held in ASEAN (and it has been reinforced by China’s behavior in the current crisis).

Japan’s policy of becoming an economic but not a military superpower has also been a fundamental element in the generally peaceful Asia-Pacific security environment of the last 50 years. And the economic prosperity of both South Korea and Taiwan has enabled them to assert their sovereignty and to develop democratic institutions.

Thus economic development has been a pivotal force for stability in Asia. Is the region about to enter a period of turmoil because of the traumatic impact of the economic crisis? It is important not to exaggerate this issue: there is still a strong sense in the region that economic growth will return, sooner rather than later. And as long as sound economic policies are implemented with firm backing by political leaders, growth should indeed reassert itself. As already noted, however, there is a tendency in some countries to believe that the crisis amounts to a short-term economic problem only, and that there is no need to change fundamentally “the Asian way” of business or government. If this attitude does not change, the crisis will last longer.

Regional-security arrangements are not well-organized to handle a prolonged socio-economic shock. There is no overarching regional-security or economic organization where political and security issues raised by such a major economic crisis can be resolved. Neither the ARF nor APEC is well enough established or has the confidence of their large membership — which in each case extends well beyond Asia — to formulate common policies on such matters. The ARF is only at the earliest stages of discussing military confidence building measures (CBMs) and preventive diplomacy.¹² APEC, where leaders discuss economic issues, has not been able to develop any security mechanisms. Thus Asia seems likely to stumble along without a well-defined path of security cooperation — at a time of deep economic and political crisis.

With increasing strategic uncertainty, traditional allies should — at least in theory — look to each other for greater support.

The U.S.-Japanese alliance and Washington's other alliances with South Korea, the Philippines, Taiwan, and Thailand may assume greater importance, as could the Five Power Defense Arrangements among Australia, New Zealand, Malaysia, Singapore and the United Kingdom, as well as Australia's security arrangement with Indonesia. But in practice, the economic crisis seems more likely to increase rather than remove strains in security agreements and alliances. Such tensions are already evident between the U.S. and the governments of Japan, South Korea and Thailand. And if demonstrations in Indonesia are suppressed bloodily by the military, then Australia's 1995 Agreement on Maintaining Security with Indonesia could come under pressure.

In terms of its effects on ASEAN, the economic crisis may well make the association more distracted, inward-looking and less cohesive. Long-standing rivalries within ASEAN may resurface and the substantial economic weaknesses now revealed within the ASEAN states will make

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the group as a whole more susceptible to penetration by external powers especially China.

This raises the issue of how the crisis might affect the distribution of power in Asia. The economic turmoil in the region assists China's ambitions to become the leading regional power.¹³ Assuming that China manages not to be directly threatened by economic instability in other parts of Asia, then its status and influence in the region will grow. Already, there is a perception that by not devaluing the yuan and proclaiming that it will refrain from doing so as its contribution to regional security, China is providing leadership in a way that Japan has failed to do.

As Vice-Premier Li Laquin declared at the DAVOS World Economic Forum in February 1998, the competitiveness of China's exports will come under pressure from the drastic depreciation of Southeast Asian currencies. However, China will not and need not resort to Renmimbi devaluation to stimulate exports. This is not only in our own interest but also a contribution to the recovery of stability and confidence on the Asian currency markets.¹⁴

Li also pledged a large increase in infrastructure spending to stimulate growth and compensate for weaker exports.¹⁵ If, however, China itself is sucked into the maelstrom, the regional crisis will worsen considerably. China's bad loans may be proportionately twice as serious as South Korea's financial problem.¹⁶ A series of competitive devaluations in order to sustain market shares would spell disaster for Asia. Economically and politically, the Asian economic crisis presents a greater challenge to Beijing than the Soviet Union's collapse: The success of the region's state-directed capitalism was seen as proof that China can have market reforms and yet operate safely with strong central control. But the Chinese model of development has the same characteristics that have undone most of the region: rampant corruption and cronyism; state direction of investments in spectacular projects; a feeble banking system; and — in China's case — a huge state-owned enterprise sector in urgent need of modernization. If the economic crisis spreads to China, it will fundamentally weaken the region for a prolonged period.

The current crisis will have a greater effect on Japan's position and status in the region than on any key player. Japan's weak and vacillating approach to the Asian economic crisis, plus the revelation in January

1998 that poor performing loans in Japan exceeded \$600 billion, as well as Tokyo's inability to pull its own economy out of stagnation, have disappointed those in the region expecting an Asian financial solution to the crisis.¹⁷ The recent revelation that Japan's banks are now undercapitalized further exacerbates the problem.

While simplistic, there is a view in Southeast Asia that Japan has exploited the region's cheap labor and natural resources to make itself rich over the last 30 years. There is resentment, too, at the perceived superior attitude of Japan towards other Asian nations. And Japan's continuing refusal to apologize fully for its role in World War II still rankles.

In this context, a failure by Japan to properly assist Asian economic recovery would seriously harm its standing influence in the region. In early 1998, the region was still waiting for a major Japanese recovery package. As Australia's former foreign minister, Gareth Evans, said: "The decision by Japan not to give a major budgetary tax stimulus to its own economy (to assist an export-led recovery in the region) is desperately disappointing."¹⁸

The implications of the Asian crisis for Washington's role and influence in the region are ambiguous. The U.S. successfully used its influence over the IMF to promote significant economic reforms in South Korea which will substantially open trade and investment markets in that country, not least to U.S. corporations. There is real risk, however, that Koreans will come to resent the widespread foreign takeovers that will occur as a result of this new policy. In Thailand, the Clinton administration's refusal to participate in the August 1997 IMF bailout package has caused harm to bilateral relations. In Indonesia, U.S. pressure to ensure compliance with IMF conditions has had impact, serving merely to associate Washington in Jakarta's eyes with anti-Indonesian forces seeking to impose inappropriate economic and social policies on the country. It is notable that, in contrast to Korea, there has been no U.S.-led push for international banks to reschedule Indonesia's vast private sector debt.

Within the region, there are other prospective shifts in the power balance. South Korea's economy is now considerably weakened relative to that of its long-term rival in Northeast Asia, Japan. It also now looks less capable of handling a potential reunification of the Peninsula: North

Korea probably perceives that it has an opportunity to put its own dismal economic house in order. South Korea will also find it more difficult to finance its large defense budget (which exceeds \$15 billion a year) and maintain the military balance with North Korea. Seoul's ambitious plans to develop a force structure that would enable it to project power well beyond the Peninsula will now have to be deferred.

In Southeast Asia there are three areas of concern. The most important is the prospect of political and social disintegration in Indonesia, the world's fourth most populous country. Indonesia's role as the natural leader of ASEAN is now in doubt. A major upsurge of anti-Chinese violence — one of the most likely characteristic of large scale instability in Indonesia — would have serious implications, not least for neighboring Singapore, Malaysia and Australia. The allegations that elements of the Indonesian military led or took part in the anti-Chinese rioting and rapes committed on ethnic Chinese further complicate the matter. Above all, it would affect Indonesia's relations with China — including the risk that Beijing might seek to apply some sort of political (or even military) pressure against Indonesia.¹⁹ China will probably be careful not to risk relations with other ASEAN members by raising their fears about its support for ethnic Chinese communities.

On mainland Southeast Asia, Thailand's economic collapse will undermine its ambition to be the predominant power vis-à-vis Vietnam and its hopes of fostering the Thai economic and political model in Cambodia and Myanmar. Indeed, Thailand's financial failure might well serve as a warning to its neighbors against too much penetration by international economic forces. China, Myanmar and Vietnam will be reinforced in their view of the need for firm central political control backed by ruthless military force.

In early February 1998, senior Singapore cabinet minister George Yeo described Australia's response to the crisis thus far as "correct but tentative." According to Yeo, "It is the reaction of someone on the margin, not an important player, not a crucial partner...if you stay on the sidelines then there is no bonding and you stay on the sidelines and you stay out permanently."²⁰ Canberra seems to have taken this message to heart. In February, Australia announced it would lobby the IMF to seek a relaxation of its strict reform program for Indonesia.²¹ This type of practical diplomatic support for Indonesia will enhance Australia's standing in the

region, although it seems to have imitated Washington. It amounts to a recognition of the extent to which Australia's vital national interest are bound up with the fate of Indonesia and its other Asian neighbors. Just as the Asian crisis as a whole is a defining event for the Asia-Pacific in general, so this action by Prime Minister John Howard's government might prove to be a defining moment in Australia's relations with Asia.

Asia's Crisis and the Global Order

Whatever its other effects, Asia's economic crisis will at least put the lie to Huntington's assertion that economic growth in Asia is by its very nature destabilizing and a threat to global order. As the crisis shows, an economically weak Asia should cause far greater strategic anxiety.²²

At the global level, Asia — which accounts for a third of world economic activity — suddenly seems radically diminished. There will be less anxiety about the global balance of power favoring Asia and about the impending dominance of the Asian economic model.²³ But gloating will not be in order. For the West, and particularly for the U.S. alliance system, a greater concern is to restore key western friends and allies — Indonesia, Japan, South Korea and Thailand — to economic health as soon as possible. Leaving the resolution of this crisis to market forces will not contain the growing instability and turmoil in the region which contains half the world's population and through which 40% of the world's maritime traffic passes. The future course of political and social events in the region will determine whether the friends and allies of the West prosper and regain stability, or whether extreme nationalist and repressive elements gain the upper hand.

None of the above suggest an immediate risk of international conflict as a result of the Asian economic crisis. Much will depend on the reaction of the major players to the present crisis. And exactly how the regional power balance will alter remains to be seen. Will China resist the temptation of a competitive devaluation? Can the forces of moderation in Beijing restrain the chauvinistic militarist elements if there is mass anti-Chinese violence in Indonesia? Can Washington control the increasingly vocal isolationist who rate financial assistance for Asia very low on the domestic political agenda? If the regional crisis hits a new low as IMF measures really start to take hold, to what extent will the governments

and people of Southeast Asia and South Korea blame the U.S. and the West in general?

What will become much clearer as the crisis continues to unfold is the relevance as well as the complexity of the inter-relationship between economics and security.²⁴ The Asian economic crisis has demonstrated the need for economic developments to be integrated much more effectively into security policies. For politicians in the region, the impact of globalization and economic interdependence, which were previously accepted unquestioningly as beneficial, will come under challenge.²⁵

Changes to the regional and sub-regional balances of power, as well as to relative status, influence and military capabilities of individual countries, will also require new analysis. Where specific countries in Asia are weakened materially and others perceive themselves as materially stronger, peace may be threatened.²⁶ There are historic links between economic deterioration, trade wars and military conflict.²⁷ Avoiding such outcome in Asia will be crucial to the continuing security of the region in the 21st century.

What To Do?

What should be done to avoid a security crisis? The challenge is that Asia's economic problems straddle the role of the region's very weak multilateral institutions — APEC and ARF. A further problem is that the major players are pulling in different directions.

What is needed now is to bring all these players together perhaps under Apec to devise a new solution to the problems of regional economic order. Since the end of the Cold War. The forces have collided: the rapidly increasing power of global capital movements and the divergent speed of over 200 states (especially in Asia) moving towards some form of market economy.²⁸ The Asian crisis resulted from an inefficient allocation of capital and misappropriation of risk by global capital markets, as well as from the inadequacies of Asian capitalism.

While it is easy to criticize many aspects of IMF policy towards Asia, the region's crisis has demonstrated more clearly than any other why the international financial system needs a lender of last resort to provide liquidity during periods of crisis. But the decline in the cost of global

capital mobility, the vast growth of most of retirement saving funds, and the emergence of highly leveraged speculative trading instruments suggest a need to reform the international financial system.

At the same time, there would have been less need for IMF intervention if the countries of Asia had already developed more effective forms of financial supervision. The IMF intervention was necessary to resolve the contradictions resulting from the interaction of a highly sophisticated global financial system with the far less developed financial systems of Asia.

The tragedy of Asia today is that bankers and investors failed to understand the magnitude of the cultural gap between the global financial order and the local one. The current financial trauma in Asia is a crisis of globalization, not only of Asia's own financial excesses.

The Asian economic crisis should be a catalyst for reform within the IMF, which needs to concentrate more on the key fiscal and monetary-policy adjustments that are needed to correct an external deficit, rather than far-reaching structural economic changes.²⁹ Indeed, the IMF's latest reform package for Indonesia in April 1998 seems to have moved in this direction. There is also need for reform at the global financial system which recognizes that large new capital flows and the greatly reduced capital mobility can generate economic and political shocks that are simply unacceptable.

The failure of the region's multilateral institutions, APEC, the ARF, ASEAN — to play any kind of leading role in addressing the crisis, shows that regional stability, economic and strategic — still depends heavily on the policies and initiatives of major individual players. The U.S. retains a key role in this respect: the crisis has clearly demonstrated its continuing economic and strategic dominance in world affairs. The patent strategic significance for the U.S. of an economic crisis on the Korean Peninsula had prompted timely remedial action for North Asia. In contrast, the inability of the U.S. system as a whole to fully comprehend the strategic significance of economic and social collapse in Indonesia has seriously delayed a solution to the Southeast Asian side of the crisis.

The U.S. has been determined to use the IMF as the primary agency for managing the crisis. It rejected proposals for a regional monetary fund

and used the IMF to impose numerous micro-economic policy changes in Korea and Indonesia which satisfied America's own trade/investment agenda. But as the U.S. Congress has so far refused to provide new capital for the IMF, it is unclear if the U.S. approach will be sustainable in the future. If the U.S. is unable to maintain IMF supremacy, the odds would increase for new regional groups emerging to play a greater part. In one such scenario, Japan might attempt once again to play a regional leadership role (although, given its current economic weakness, this is unlikely) or the U.S. itself might attempt to use APEC as an agency for promoting new forms of regional monetary cooperation. The U.S. launched an initiative during 1997 for more central bank discussions with Australia, China, Hong Kong, and Singapore, but this group did not play any role during the East Asian crisis. If the IMF's role fades because of political problems in Washington, there will inevitably be more discussions about regional alternatives centering on the U.S., Japan and China working together. ❁

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