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Choosing the Direction

Financial Market Reforms in South Korea and Malaysia

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ABSTRACT

The Asian financial crisis in 1997–1998 constituted a major economic shock to the countries in the region. This article seeks to analyze financial market regulation in South Korea ('Korea') and Malaysia after the crisis using the 'most similar systems design' (MSSD) for comparison. Based upon the theoretical pieces 'second image reversed' and 'state-market condominium', the main argument brought forward is that Korea and Malaysia resided in different positions within the international economic system at that time, which resulted in a specific set of feasible policy options in each case. Korean policymakers were forced to agree on an International Monetary Fund (IMF) financial aid package due to high foreign debt exposure. Under that program, market opening was sped up considerably. As political actors in Malaysia primarily had to regard the pivotal role of inward foreign direct investment (FDI) for economic development, their set of feasible policy options was less confined. Malaysia's pattern of market opening was therefore quite erratic, with selective temporary capital controls as a response to the crisis eventually imposed after first unsuccessful attempts to do so and a short 'shadow IMF' phase.

KEYWORDS

South Korea; Malaysia; Asian financial crisis; financial market; second image reversed

Table of Contents

List of Notations iv

1 Introduction 1

2 Methodology 4

2.1 Material 4

2.2 The Design of the Comparison 4

2.3 The Choice of the Cases 5

3 Theory 10

3.1 Between Convergence and Divergence 10

3.2 States and Markets 11

4 Financial Market Regulation 13

4.1 The Korean Case 13

4.1.1 Until the Asian Crisis: The Incremental Approach 13

4.1.2 The Speeding up of Market Opening 14

4.2 The Malaysian Case 18

4.2.1 Until the Asian Crisis: Courting FDI 18

4.2.2 The Return of Capital Controls 19

5 Conclusion 23

Bibliography 25

List of Notations

ABBREVIATIONS

ADB	Asian Development Bank
BIS	Bank for International Settlements
BN	Barisan Nasional
BNM	Bank Negara Malaysia
BTI	Bertelsmann Transformation Index
FDI	foreign direct investment
GATT	General Agreement on Trades in Services
GDP	gross domestic product
GNI	gross national income
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
MDSD	most different systems design
MSSD	most similar systems design
NBFI	non-bank financial institution
NDP	National Development Policy
NEP	New Economic Policy
NERP	National Economic Recovery Plan
NIC	newly industrialized country
OECD	Organization of Economic Cooperation and Development
UMNO	United Malays National Organization
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

TABLES

1	Major Economic Indicators of Korea and Malaysia	7
2	Similar Cases – Korea and Malaysia	9
3	External Indebtedness	16
4	Top 30 Companies’ Average Debt-equity Ratio (%)	16
5	Inward Foreign Direct Investment	21

1 Introduction

Financial markets have thus far come to form an increasingly relevant field of study for political scientists in recognition of financial markets' lying at the heart of politics for reasons related to the promotion of economic growth, social security issues, or power relations within and across national states (see Gottwald 2003). Distinct policies (e.g., so-called financial market liberalization, above all in member countries of the Organization of Economic Cooperation and Development (OECD), its commencement dating back as far as to the late 1970s), several severe financial crises, the most prominent one probably being the Asian crisis in 1997–1998, and corporate scandals associated with names like 'ENRON' or 'Parmalat' have not only attracted a great deal of public attention but also contributed to the insight that issues of financial markets are anything but apolitical. Stated pointedly, "[m]oney is politics" (Kirshner 2003; see also Kirshner 2000); in an even more pronounced fashion, capital markets have recently been labeled the "'central nervous system'" (Heilmann 2003: 1) of today's political economies.

So, when recalling the grievance made by Sbragia (1986: 311) some twenty years ago, namely that "[…] treatments of state-market relations tend to evince an essentially 'economistic' approach", one could now well reply that a lot has changed ever since. Three aspects are indicative of this development: Firstly, there is an ever-growing body of literature addressing state-market relations from a more political perspective;[1] secondly, the theoretical scope of the field has been considerably broadened because authors committed to different schools of thought offer a diversity of concepts, models, and theories,[2] which corresponds well with the historical evolution of political economy that involved "individuals as diverse as Adam Smith, John Stuart Mill, and Karl Marx" (Frieden and Lake 2000: 3); finally and most importantly, scholars – as exemplified above by Kirshner's words – by now widely assume politics and finance, a central part of each economy, to be inevitably intertwined and to affect one another so that the former cannot be understood properly without the latter and vice versa (E. Helleiner 1995:

[1] This alone is hardly surprising as the amount of any kind of literature will gradually grow over time. What matters more is that new journals of political economy have been released: For one, *Review of International Political Economy* (first volume in 1994) and *New Political Economy* (1996) supplement primarily quantitatively (mathematically) oriented journals such as the long-established *Journal of Political Economy*. There have also been several issues entirely devoted to a special topic, like "The World of Money: The Political Economy of International Capital Mobility" in *Policy Sciences* (1994) 27 (4) or "States and Markets: Essays in Trespassing" in *International Political Science Review* (1999) 20 (3); further examples can be found in *Global Governance* (2001) 7 (4) and in *International Organization* (2002) 56 (4). And last but not least, we have been witnessing the foundation of research groups like the "Financial Markets Group" (FMG; established in 1987) at the London School of Economics (LSE) (http://www.fmg.lse.ac.uk) or the "Research Group on Equity Market Regulation" (REGEM; 2000) at the University of Trier, Germany (http://www.regem.org).

[2] For example, see Amin and Palan (2001) for an instructive non-rationalist approach.

334–337; E. Helleiner 1994a: 296–297; Underhill 2003: 765; Underhill 1995: 255; Underhill 1991: 200; MacKenzie 2004: 328; Martínez and Santiso 2003: 365; Story 2000: 139; see also, among many others, Lütz 2004).

As a consequence, they are very concerned with the development of financial markets and its political implications for distributional patterns (see Frieden 1991) or the aforementioned power configurations. Examples abound, but lots of attention has lately been paid to the role private actors like credit-rating agencies (see Sinclair 1994, 2001; Gras 2003; Rosenbaum 2004) play for financial market regulation. Of particular interest and great importance are also various other actors, including the 'classical' international organizations of the 'Washington consensus', the World Bank Group and the International Monetary Fund (IMF), as well as even more 'finance-minded' organizations like the G 20, the Bank for International Settlements (BIS), or the International Organization of Securities Commissions (IOSCO) (see Underhill 1995). In short, analyzing the mutual relationship of politics and finance has, for good reasons, become more and more popular.

It is no overstatement to say that financial market deregulation[3] has constituted one of the most interesting and quite often discussed aspects (see E. Helleiner 1993, 1994b, 1996; Goodman and Pauly 1993). For the purpose of this paper, it is to be asked whether or not this 'liberalization wave' has mainly been confined to the OECD area. This question is markedly vital to the contemporary era, which is commonly said to experience trade as the 'servant' in inter- and transnational affairs – not finance, as was the case under the Bretton Woods regime. E. Helleiner (1993), a well-known advocate of this argument, asserts that finance has instead got the upper hand and emerged as the 'master', so to speak. If the 'finance-as-master thesis' applies, we can reasonably expect market-orientated reforms (as a substitute for the term 'liberalization') to be pervasive in other than OECD countries, too. Such reforms then also need to resemble each other in design, pace, and scope to a high degree owing to uniform pressures carried out by 'footloose global capital' or 'hot money'; that is, it eventually generates convergent policies. This leads us to the salient convergence-divergence debate.

A very notable focal point in the whole discussion has undeniably been the late 1990s East Asian financial crisis. Disagreeing about the ultimate causes of the crisis, researchers typically take up two different positions (Nixson and Walters 2002: 97–98) with opposing judgments on the feasibility of a however to be defined particular 'East Asian way' of late development: Viewing the crisis as caused by endogenous factors like certain policies or general region-specific economic weaknesses despite some variations among the countries affected, some are deeply skeptical about its future distinctiveness and predict relative convergence towards or adaptation to the supposedly dominant 'Anglo-Saxon model' over time. By contrast, others first and foremost account such exogenous factors as excessive speculation in volatile financial markets for the outbreak and spread of

[3] It is worth noting that the term 'deregulation' with its negative prefix 'de-' is quite misleading in that it implies something very close to a 'retreat of the state' (Susan Strange). In reality, though, it is rather about 're-regulation' understood as a "reorganization of control" (Vogel 1998: 269). As a somewhat paradoxical result, deregulated, i.e., freer markets may well entail even more rules (see ebd.). Thus, deregulation is as much a procedural part of liberalization as is re-regulation. A very similar view is held by Cerny (1993: 52; 2000: 303–304).

the crisis and therefore consider convergence evitable.[4] These standpoints revolve around 'Asian values' in general and around 'Asian capitalism(s)' in particular, which are touched on in connection with the cases of South Korea (hereafter referred to as 'Korea') and Malaysia.

Studying the causes of the crisis is certainly an important task, and much work has been done on it. Yet, the exploration of its consequences pertaining to financial market regulation in comparable countries seems even more rewarding. Hence, the research question to be addressed in this paper is as follows: How has the financial market been regulated in Korea and Malaysia, especially *since* the financial crisis? Very generally speaking, the introduction of market-orientated reforms in Korea has been slow but gradual while Malaysia's pattern proves much more erratic. Given the different regulatory outcomes despite both countries' similar characteristics, the appropriate methodological design for this puzzle would be one capable of distinguishing the key explanatory factor(s) for the differences in outcome.

There are only few studies comparing them, whether along with other countries or not. However, they are, for instance, preoccupied with how economic crises and regime types are related to each other (see Freedman 2004; Haggard 2000). S. Lee (2004: 26), who examines the politics of the Asian crisis in Korea and Malaysia, claims that "[…] political leadership was the key explanatory factor for different policy choices […]". Lee, I argue, implicitly looks at the research problem from a theoretical angle which is in line with the 'second image reversed' tradition without using that term. From my point of view, this is actually a highly suitable perspective for the comparison of financial market regulation in Korea and Malaysia because it incorporates international and domestic factors likewise.

The study is organized along the following lines. Section 2 gives methodological comments, i.e., briefly outlines the nature of the material employed, elucidates the general ideas behind comparisons, and seeks to justify the choice of the cases. Section 3 introduces the 'second image reversed' perspective and the concept of a 'state-market condominium'. Section 4 then moves on to analyze the cases in question, but not without having given a short historical overview of the processes before the crisis, respectively. In Section 5, finally, I draw some conclusions and try to link them to the ongoing debate about global governance.

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[4] For example, Weiss and Hobson (2000), Moon and Rhyu (2000), Haggard and Mo (2004), Heo and Kim (2000), Kuo (2000), as well as Y. Lee (2000) are more in favor of the former perspective whereas Winters (2000) and Meow-Chung (2001) rather subscribe to the latter. Surely, such a dichotomy does not leave much space for a nuanced categorization, for most analyses do in fact comprise both domestically and internationally induced causes of the crisis in a quite balanced way, like Gilpin's (2001: 267–271) really brief overview; Nixson and Walters (2002) themselves, stressing the potential instability of markets, belong to the second group. But by contrasting polar perspectives, this dichotomy is nevertheless a helpful analytical tool.

2 Methodology

2.1 Material

The nature of the material used in this study is composed of exclusively secondary literature which covers a broad range of different forms of literature, from books to essays published in journals or anthologies as well as articles published in magazines to online-documents. It deals with both topics located in the field of political economy in general and those concerning the political economy of Korea and Malaysia in particular; at a general level, while the former group of material is mostly theoretical in its nature, the latter is more empirically orientated.

Another group of sources regards official economic statistics released by institutions like the World Bank or the Asian Development Bank (ADB); besides, the Bertelsmann Transformation Index (BTI) 2003, a ranking that evaluates the progress of countries in transition with respect to economic and political indicators, is utilized. The use of the data from these publications is due to my aspiration to provide empirical reasons for the selection of Korea and Malaysia as the cases in this paper. For the sake of some methodologically relevant illustrations, the books by Landman (2003) and Bryman (2001) are taken into account as well.

2.2 The Design of the Comparison

To briefly touch on the question of *why* countries should be compared at all, one can give the following four reasons, or main objectives of comparative studies, in accordance with Landman (2003: 4–10): Comparing countries basically focuses on contextual description, classification, hypothesis-testing, and prediction with the degree of emphasis placed on each aspect depending on the scholar's ambitions.[5] What is more, 'we' as human beings have within living memory always sought to structure our environment by means of comparison, thereby reducing its overall complexity to an acceptable and understandable level (Landman 2003: 4).

The next question is then *how* to compare countries appropriately. There are two fundamental types of system design: 'most different systems design' (MDSD) and 'most similar systems design' (MSSD). Based upon J. S. Mill's method of agreement, MDSD compares countries which do not share any common features other than the political outcome to be explained (ebd.: 29). On the contrary, resting upon Mill's method of difference, "MSSD seeks to identify the key features that are different among similar countries and which account for the observed

[5] Bryman (2001: 52) reminds us that the logic of comparison cannot only be applied to comparative country studies but to a variety of situations in political science research.

political outcome" (ebd.: 29). Thus, the approach to either design is different (see, for a general overview including examples of conducted comparative analyses, ebd.: 29–34, especially 30); that is why one's choice for the appropriate design crucially depends on the countries to be compared.

As already stated, we observe different outcomes in financial market regulation (*dependent variable*) although Korea and Malaysia share a good many basic economic as well as political features (see Section 2.3), but they do differ in their respective strategic position within the international economic system (*independent variable*[6]). The suitable comparative design for this two-country comparative study must therefore be MSSD.

Some remarks on the research strategy are needed: "The comparative design may be realized in the context of either quantitative or qualitative research" (Bryman 2001: 52). Official data solely employed to some extent, it is fair to say that the methodical focus is on qualitative methods, which generally aims at understanding the particular traits of the objects of inquiry and comes at best along with a comparison of a small number of cases (Landman 2003: 19). Comparing few cases, as shall be done here with two countries, only requires a fairly low level of abstraction. This, in turn, makes inferences which can be drawn from the analysis likely to be enriched by contextual specificities rather than global findings (ebd.: 24–26, 35). Nonetheless, I insist on connecting contextually informed results to global governance at the end of the paper. As far as theory is concerned, the principal orientation must be called empirical and deductive (see Bryman 2001: 9–11; Landman 2003: 15) given that the 'second image reversed' serves as a theoretical point of departure for the analysis of the cases. This might not be perfectly compatible with a qualitative research strategy, as Bryman (2001: 20) notes, but generation of new theory is beyond the scope of this work.

It should be acknowledged that using comparisons, regardless of the aforesaid merits, is not exempt from scientific problems. For one thing, a selection bias may occur on account of intentional as opposed to random selection (Landman 2003: 46–51; for other shortcomings, see ebd.: 39–59).

2.3 The Choice of the Cases

The use of a MSSD comparative framework demands the exposition of those features shared by both countries. This is meant to make the selection of the cases comprehensible in terms of their comparability under MSSD. Being a conscious choice, any criticism that the selection has been made on an intentional basis and not at random would be entirely correct. On the other hand, it brings about the advantage of examining different political outcomes in deliberately chosen countries of comparable economic and political conditions. As outlined below, several basic features roughly depict Korea and Malaysia as similar countries – at least sufficiently similar for the purpose of MSSD comparison.

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[6] The *dependent variable* can alternatively be named the outcome variable, endogenous variable, or explanandum; the *independent variable* is often alternatively referred to as the causal variable, explanatory variable, exogenous variable, or explicandum (ebd.: 17–18).

To begin with, economically, Korea and Malaysia belong to the group of newly industrialized countries (NICs). Put in alternative terms, they may also be named 'emerging market economies', 'late industrializer', or, with special reference to their regional origin, '(East) Asian tigers'. Both countries show an impressive record of average annual growth of gross domestic product (GDP): Korea had an average annual growth rate of 8.9 % from 1980 to 1990 and still 5.6 % from 1990 to 2002; the respective figures for Malaysia were 5.3 % and 6.2 % (see Table 1).[7] Regarding the impact of the Asian crisis, they both had high growth rates up to 1998, when the impact of the crisis became fully visible (see S. Lee 2004: 18–19 (Tables 5, 6)); as for the post-crisis years, Malaysia's and all the more Korea's growth rates quickly stabilized on a fairly high level again (see Table 1). Equally importantly, the process of industrialization is reflected in the steady development of the industrial sector, notably in the growth rates for manufacturing and the ever-growing importance of the export sector (see World Bank 2004d: 183; World Bank 2004a, 2004b). The data presented above greatly supports my general argument that both countries have developed considerably in economic terms over the past 25 years in spite of their experiencing an economic recession as a result of the Asian crisis.

A decisive distinction needs to be drawn, however. As is indicated by its higher average annual growth rate throughout the 1980s, Korea 'took off' earlier than did Malaysia. In absolute terms of GDP (measured in US$ billion), this means that the size of the Korean economy more than quadrupled between 1983 and 1993 (from 85.1 to 357.5) while at the same time the Malaysian economy doubled in size (from 30.7 to 66.9). By 2002, Korea's economy (then 546.7) had remarkably expanded to a size well about six times as big as in 1983; Malaysia's economy (then 95.2) had approximately tripled during these 20 years (see Table 1). As some kind of anecdotic evidence in support of these findings, intensive economic state-activity can be traced back to the 1970s in Malaysia (see Teik 2000), but to the early 1960s in Korea (see Kim and Hong 2000).

Clearer insights are gained from data relating to gross national income (GNI) per capita: In 2002, Korea with a GNI per capita of (US)$9,930 ranked 53th in the world, Malaysia's respective figure of $3,540 equaled rank 84. Korea's GNI per capita ratio rose again significantly the year after, to $12,030; Malaysia's did so mildly, achieving $3,880 (see Table 1). Hence, Korea falls in the group of high-income economies (more than $9,386) whereas Malaysia belongs to the group of upper middle-income economies ($3,036 to $9,385).[8] In other words, not only did the Korean economy industrialize earlier than the Malaysian, but also grew faster thereafter so that Korea possibly does not fit in the category of an emerging market economy any more.

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7 The overall pattern does not change with two World Bank (2004a, 2004b) country data collections using slightly different time frames: Korea had an average annual growth rate of 8.6 % (1983–1993) and 5.0 % (1993–2003); Malaysia offers 7.0 % and 4.7 %, respectively.

8 This is according to the World Bank's country classification into income groups, for which economies are divided along threshold values of GNI per capita, calculated using the World Bank Atlas method (see http://www.worldbank.org/data/countryclass/countryclass.html).

TABLE 1 Major Economic Indicators of Korea and Malaysia

Indicator	*Korea*	*Malaysia*
Gross domestic product (GDP)		
Average annual growth (%)		
1980–1990	8.9	5.3
1990–2002	5.6	6.2
Growth for particular years (%)*		
1999	9.5	6.1
2000	8.5	8.5
2001	3.8	0.3
2002	7.0	4.1**
2003	3.1	5.2**
Overall ratio (US$ billion)		
1983	85.1	30.7
1993	357.5	66.9
2002	546.7	95.2
Gross national income (GNI) per capita (US$)		
2002 (world rank)	9,930 (53)	3,540 (84)
2003	12,030	3,880
Income group	High-income	Upper middle-income

Sources: World Bank (2004a, 2004b (both prepared by country unit staff); 2004c: 15; 2004d: 183). *Figures for this indicator according to ADB (2004: 174, 193). Evidently, these figures may vary slightly due to different publishers (see World Bank 2004c: 15) or dates of publication (see ADB 2003: 206, 225). **Preliminary figure.

The differences in the time-frame and pace of industrial development may conceptually be expressed by putting forth a dividing line between two generations of East Asian tigers: Being one of the historically 'classical' exponents of East Asian NICs (along with the three other 'little dragons' Hong Kong, Taiwan, and Singapore), Korea represents, from a present-day perspective, a first-generation NIC, or, metaphorically speaking, an 'early tiger'. Unlike Korea, Malaysia (besides Indonesia, Thailand, and the Philippines), with an even longer way to go so as to catch up economically, is a second-tier NIC, a 'late tiger'.

Turning to the role of the state in the development process reveals another striking similarity. Korea and Malaysia have in common a very pronounced role of the state as a socio-economic actor on the developmental path with an inclination towards grand 'national' economic projects (Kim and Hong 2000: 63, 72 (Table 3); Pohlmann 2003: 44; Dent 2003: 261; Dent 2000: 279–283; S. Lee 2004: 11; Trezzini 2001: 345; Teik 2000: 214–223; Teik 2001: 138–140; Beeson 2000a: 346–348). This observation is generally appropriate notwithstanding the differences in economic development, its varying pace and outcome, all pointed at

above, or some deviations from the ideal-typical 'East Asian success model', as clearly visible in the Malaysian case (see Trezzini 2001).

Albeit variations in its concrete structure, a 'developmental state' features, at least in theory, three institutional characteristics: Emulating Japan, "the Asian archetype of successful late development" (ebd.: 326), it is vested with, first, 'strength' defined as capability to effectively implement policies, second, 'autonomy' understood as independence from societal pressures, and, third, a commitment to promote the development project (Clark and Jung 2002: 19).[9]

This approach of state-led development has several far-reaching implications. One is that Korea and Malaysia have used financial repression as a means of channelling funds very selectively for the promotion of rapid industrialization. Although the degree of control might just have been limited according to older samples by Giovannini and de Melo (1993: 958–961), there surely exists a restrictive tradition in both countries (Lukauskas 2002: 388–398; Bernard 1997: 228; Clark and Jung 2002: 30–31; Haggard and Mo 2002: 202; Haggard 2000: 137; Menon 2001: 32–33). Moreover, close ties between economic and political actors which benefited 'national champions' like the *chaebols* (large, family-run Korean industrial conglomerates) or capitalist *bumiputeras* (indigenous Malays) are widespread; there have been noticeable incidents of corruption and corporate scandals, which, on top of things, high-ranked politicians were recurrently believed to have been involved in (Dent 2003: 261; Clark and Jung 2002: 30–32; Haggard and Mo 2000: 200–208; Haggard 2000: 136–137; Trezzini 2001: 339–340; Beeson 2000a: 339–341; Teik 2001: 136–140; Teik 2000: 214; see also White 2004; *The Economist* 2001, 2003a, 2003b, 2004a, 2004b). This "'relationship-based capitalism'" (Johnson and Mitton 2001: 25) could ultimately take the form of 'cronyism' or not. Rather, it is of significance that the reportedly high autonomy of a developmental state tolerates exceptions. In this sense, autonomy should better be interpreted as independence from popular pressures.

To attribute first priority to the national development project thus means to give precedence to economic rights over all other rights, not least civil and political ones – a truly pivotal point in the 'Asian values' debate (Diokno 2000: 75–76; Stokke 2000: 139). In Korea, which constitutionally is a republic with a presidential system, the shadow of an authoritarian past may yet be influential, but democratic transition is underway, especially since 1987 (S. Lee 2004: 21–22; Buchanan and Nicholls 2003: 204, 235; Freedman 2004: 194). This can scarcely be said as regards the Malaysian regime type. Under constitutional monarchy (the king is elected among sultans) with a parliamentary system, authoritarian rule has now for a long time been prevalent: The extreme dominance of the United Malays National Organization (UMNO) since the first general election in 1955 and independence from Great Britain in 1957, limited press freedom in light of government-controlled media, and an eroded system of checks and balances all render the regime type, if anything, at the utmost rudimentarily democratic or 'semi-

[9] See also Wade (1990) as one of the most cited studies about the developmental state. There has been a lively discussion about the future of this kind of state activity among scholars, especially after the Asian crisis (see Jomo 2000; Moon and Rhyu 2000; Lee and Kim 2000; Jayasuriya 2000; Beeson 2000b; Haggard 2000; Dent 2000; Nixson and Walters 2002).

democratic' (Martinez 2001: 196; Freedman 2004: 194; Trezzini 2001: 332; Pant 2002: 392–394; S. Lee 2004: 21; Kuo 2000: 168; see also Singh 2000; *The Economist* 1998b, 2000, 2003b).

It has been shown that both countries share many basic features but that Korea has hitherto been more successful in economic as well as democratic transition. The evidence is supported by the BTI 2003 (Bertelsmann Stiftung 2004), which illustrates the progress made in two basic categories, 'status index' and 'management index' (10 being the highest grade): Korea (status: 9.2/management: 7.1) is assessed as a market-economical democracy in the process of consolidation; Malaysia (6.5/5.3) ranks somewhere between 'good chances' and 'defective'.

TABLE 2 Similar Cases – Korea and Malaysia

Feature	*Korea*	*Malaysia*
Economic performance		
Growth rates since the 1980s	Steady	Steady
Income group	High-income	Upper middle-income
State of development	'Early tiger'	'Late tiger'
Asian crisis?	Yes, downturn in 1998	Yes, downturn in 1998
Economic policies and politics		
Development	Developmental state	Developmental state
Finance	Tradition of repression	Tradition of repression
Ties between economy and politics	Close, *chaebol*	Close, *bumiputeras*
Political situation		
Constitutional status	Republic	Monarchy
Regime type	Towards democracy	Mainly authoritarian
Progress in transition		
BTI 2003 indices (rank)	9.2 (8)/7.1 (8)	6.5 (29)/5.3 (35)
Classification of status	In consolidation	Some defections

Sources: Own composition based on several items of secondary literature (as indicated by the references throughout this section).

Summarizing the main points of the review, Table 2 highlights the features which permit the comparison of Korea and Malaysia under MSSD. Needless to say, it glosses over some national peculiarities such as the Confucian heritage in Korea (see Hildebrandt 2002) or the paramount relevance of ethnic issues in Malaysia (see, for example, Trezzini 2001), but these differences, as I see it, have not affected financial market regulation very much.

3 Theory

3.1 Between Convergence and Divergence

There has been an intensive academic debate among political scientists as to how the relationship of domestic and international politics is best explained. The discussion can be reframed in terms of 'outside-in' and 'inside-out' explanations, a dichotomy in line with Waltz (1979: 60–78). Concretely, while one group of scholars points to 'structural' forces which seriously impinge on domestic politics by constraining their leeway of decision, domestic politics are considered more important by the other in shaping developments at the international level, and not vice versa. These polar types of explanations can be converted roughly into two opposing positions with virtually all 'outside-in' scholars attributing convergence in political outcomes to 'top-down' impacts like capital mobility (see Andrews 1994a, 1994b; Sinclair 1994; Cerny 1994; Webb 1991); in contrast, proponents of the 'inside-out' school take issue with any such view because they see 'bottom-up' forces as working for cross-national divergence (see Deeg and Pérez 2000; Schmidt 2003; Quinn and Inclán 1997; Pauly 1994; Verdier 1998). The question implied by this controversy is how much "[r]oom to [m]ove" (Mosley 2000: 737; for 'convergence vs. divergence', see ebd.: 738–739) is still left for domestic politics. It is about whether national policy autonomy is not only changing but also gradually withering.[10]

In the end, though, the relationship between international and domestic factors will neither be a collision course nor a virtuous circle (see Garrett 1998) but very probably something in-between. It is not a matter of either external or internal influence on a one-way street; in lieu thereof, it is a matter of two-way influence (Deeg and Lütz 2000: 377). This kind of reasoning goes back to what is usually referred to as 'second image reversed' (Gourevitch 1978, 1986), a theoretical lens that comprises both ways, based upon the idea of a *mutual relationship* of international and domestic politics.

> The international system is not only a consequence of domestic politics and structures but a cause of them. Economic relations and military pressures constrain an entire range of domestic behaviors, from policy decisions to political forms. International relations and domestic politics are therefore so interrelated that they should be analyzed simultaneously, as wholes. However compelling external pressures may be, they are unlikely to be fully determining […] (Gourevitch 1978: 911).

This perspective thus devotes attention to two levels of analysis (i.e., domestic and international). In understanding external realities as constraining but not de-

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[10] Cerny (1995) considers the role of the state to be changing as a consequence of a new logic of collective action. As for the causes of (allegedly) lost autonomy, the 'private' dispute between Notermans (1993, 1994) and Moses (1994) is especially noteworthy.

termining, it moves beyond placing emphasis merely on anonymous structural causes and leaves the concrete political choice of how to deal best with pressures, constraints, and opportunities to be made at the domestic level. From this it follows that, in the course of such a process of 'domestic mediation', outcomes can vary among countries even if they face similar external constraints. In the case of different constraints, the likelihood of divergent policies is then even higher.

Building upon this theoretical perspective, the differences in financial market regulation in Korea and Malaysia are analyzed in such a way that each economy's strategic position in the international arena is assumed to open up a very specific set of feasible policy options. While Korea exhibited a crucial reliance on short-term loans, foreign direct investment (FDI) was part and parcel of the Malaysian economy, with very interesting consequences in each case. To conclude with Gourevitch (1986: 64): "Generally, it is clear, countries do have some choice over how to deal with their position in the international system."

3.2 States and Markets

The theoretical perspective is completed by an assumption which does not treat states and markets as perpetual antagonists but as complementary parts of the socio-economic realm. It may be true, however, that states and markets sometimes face one another in a tug-of-war for power and that the state serves as a "powerful institution to channel and tame the power of markets" (Boyer 1996: 108). But this is not necessarily the case; neither is it helpful to look upon states as utterly benevolent institutions and upon markets as their evil counterparts.

This sort of argument is underlined emphatically by Underhill (2003), whose point of departure is a heavy criticism of the artificial state-market dichotomy so prevalent in our daily lives and reinforced by its use in the media. Instead of being "prisoners of our own rhetoric" (ebd.: 758), political economists ought to paint a more complex picture of the interaction between states and markets, that is, of "a continuous relationship between states and markets" (ebd.: 756).

> In this sense, states and markets are part of the same integrated ensemble of governance, a state-market *condominium*, and should be thought of as such. The regulatory and policy-making institutions of the state are one element of the market, one set of institutions, through which the overall process of governance operates. The structures of the market are constituted as much and simultaneously by the political processes of the state […] as by the process of economic competition itself (ebd.: 765; emphasis in original).

Consequently, provided that state and market actors aim at opposing things or that their interests are at odds, they might pull in different directions in a tug-of-war situation. But just as well, they can pull together at the same end of the rope especially if they have compatible goals to attain, as is convincingly exemplified by the global integration of financial markets, where state agents, rather than having asserted themselves over market actors, have joined, supported, and facilitated state-market initiatives (ebd.: 771–774).

Correspondingly, one must put their reciprocal relationship at the core of political economy; that is consistent with the early foundations of the field, according to which the separation between the public domain of politics and the private domain of the market is nonexistent (ebd.: 762–763). This includes state actors' attempts to also pursue own private interests in a not purely benevolent or altruistic manner (ebd.: 777; Lukauskas 2002: 382).

In sum, the theoretical approach in this study is twofold. The first piece is the 'second image reversed' stressing the reciprocity of the international and the domestic level; the second is the 'state-market condominium' doing the same as regards states and markets. I draw upon these two pieces, each of which is based on a mutual relationship, hoping to survey as best as possible how political actors in Korea and Malaysia have regulated financial markets inasmuch as they have coped with the complexity of constraints and incentives derived from domestic and inter-/transnational forces.

4 Financial Market Regulation

4.1 The Korean Case

4.1.1 Until the Asian Crisis: The Incremental Approach

Korean financial market regulation in the pre-crisis time was characterized by two basic aspects: As a matter of fact, liberalization proceeded gradually over time, but remained quite partial (Zhang 2002: 412; Zhang 2003: 65–69; Lukauskas and Minushkin 2000: 712; Bernard 1997: 223). Its perceived slowness led *The Economist* (1995: 91), "an unabashed proponent of neo-liberal reforms" (Bernard 1997: 223), to complain about the incremental progress.

First comprehensive steps to open up the financial market were taken around 1980 (for efforts in the time before, see Zhang 2002: 412, plus endnote 5: 436) with the opening continuing in the subsequent decade. Cursorily, the Korean government relieved restrictions imposed on inflows first and later, in the mid-1980s, on outflows while it also began to lift some restrictions on FDI. Korea, embracing 'neo-liberal' ideas, to say the least, very hesitantly, saw a slight reduction of the degree of state control due to the reforms in the banking sector with bank privatization, the licensing of non-bank financial institutions (NBFIs), and limited liberalization of interest rates (Lukauskas and Minushkin 2000: 712; Bernard 1997: 230; Zhang 2002: 412–414).

The move away from state-monopolized to more market-oriented finance persisted and was accelerated in some respect thereafter. On the one hand, the stock market was opened to foreigners in 1992, and attempts at FDI reforms in a less restrictive direction were strongest in the early 1990s. The acceleration of financial liberalization has to be seen in the context of the bid to join the OECD, which Korea entered in late 1996, programmatically propelled by the Kim-Young Sam government's *Segyehwa* (globalization) policy. By the same token, the country's accession to the World Trade Organization (WTO) on January 1, 1995, will not have prevented such reforms either, taking into consideration the WTO agenda with strong emphasis on financial service liberalization. But on the other hand, the implementation of market-oriented reforms was constantly subject to an incremental approach whereby liberalization was predominantly promoted on a selective basis. The selectivity appears to have been in the *chaebols'* economic interest and considerate of a broader political objection to extensive foreign participation in the Korean economy (Lukauskas and Minushkin 2000: 712–713; Bernard 1997: 231–234; Dent 2003: 262–263; Zhang 2003: 76–78; Zhang 2002: 423–427; Cho 1999: 21–23; Y. Lee 2000: 125–129; S. Lee 2004: 19; Kim and Hong 2000: 70–71).

Korea started to loosen financial restrictions almost twenty years before the Asian crisis. But it did so in a shallow manner with several barriers to both market entry and exit retained in the 1980s and controls intended as barriers to entry kept in place from 1991 to 1997; in other words, the way financial market regulation proceeded in that period mirrors the fact that major economic and political actors opted for selective and step-by-step liberalization (Lukauskas and Minushkin 2000: 700 (Table 1), 712–714).

4.1.2 The Speeding up of Market Opening

The most immediate effect of the Asian crisis for Korea was its requesting financial help from the IMF on November 21, 1997, the same day it gave up supporting its national currency, the won. Following the IMF's swift approval of the request, the Kim Young-Sam government and the IMF arrived at an agreement on December 3, 1997. The financial aid package totaled approximately US$58 billion[11], inclusive of additional emergency loans from other international institutions (e.g., the World Bank, the International Bank for Reconstruction and Development (IBRD), or the ADB) and from foreign countries (e.g., the US or Japan).

In return for financial support, Korea had to adhere strictly to the conditions imposed by that program. In principle, the IMF program consisted of two main parts: macroeconomic and structural adjustment. As macroeconomic measures, the government was obliged to implement tight monetary policy and abide by fiscal austerity. The structural adjustment part rested on four complementary pillars: first, trade liberalization (timetable set in line with WTO-induced reforms); second, capital market opening and decontrol of foreign exchange; third, corporate restructuring; and fourth, financial sector restructuring (Cho 1999: 15–16, 24–26). Thus, not really surprisingly under IMF assistance, the policy response to the Asian crisis was economic orthodoxy (S. Lee 2004: 15–16). As the initial package quickly proved barely sufficient, plenty of money was needed once again. At the end of December, after emergency negotiations with the new Korean government (Kim Dae-jung had just succeeded Kim Young Sam as President), new conditions and terms were announced for a dozen major banks from around the world to restructure short-term debt by converting US$15 billion worth of short-term loans to Korean financial institutions into long-term sovereign loans; in addition, these banks urged many small banks to follow suit. This forms the backdrop against which financial market regulation in Korea since the onset of the crisis has to be seen.

As of mid-December 1997, the Kim Dae-jung government suddenly started to undertake truly comprehensive market-oriented reforms under IMF prescriptions at a good pace. The reforms encompassed policy changes concerning the financial market and related areas of interest in this paper. Financial market liberalization and promotion of inward FDI were integral elements of Korean financial restructuring. The government began to gradually remove many of the most rigorous

[11] The figures in the literature for the exact amount of financial aid range between US$ 57 and 58.3 billion.

restrictions on foreign access to the domestic capital and corporate bond market and later also facilitated the entry of foreign financial institutions, thereby increasing the economy's openness to FDI and foreign ownership. The final removing of the ceiling on total foreign holdings in 1998 and the abolishment of capital controls help to clarify the direction of the reforms towards accelerated liberalization (Cho 1999: 16, 22–23; Yang 2002: 268; Dent 2003: 264).

Generally, the government phased in market-led reforms, thus initiating a shift in policy incentives away from primarily government-led reforms (Yang 2002: 268–269). The change denoted a clear trend towards increased self-restructuring of the financial sector "in line with international best practices" (ebd.: 269). The thread of internationally approved practices or agreed standards was also followed in corporate restructuring, the enhancement of corporate governance through improved accounting standards being one of the major objectives (ebd.: 270–271; Cho 1999: 24–25). Putting into question the previous structure, corporate restructuring posed a great challenge to the *chaebols*' economic dominance, as did high-speed financial market opening.

Bearing in mind the development of Korean financial market regulation after the Asian crisis compared to the time before, one easily understands the effects of the IMF 'bailout' package. The program containing orthodox measures as to how to deal with the crisis formed the strongest impetus to overcome the incremental approach that had been fostered for such a long time. Therefore, it served as the ultimate trigger for accelerated capital account liberalization as well as general market opening. As residual entry barriers were abandoned and opening was applied to different forms of domestic markets (i.e., equity, bond, and so forth), financial market opening under IMF instructions was both broad and deep in the post-crisis time (for definitions of 'breadth' and 'depth', see Lukauskas and Minushkin 2000: 698–699). Those reforms effectively brought to an end the 'development contract' or 'adaptive partnership' between the Korean state and the *chaebols*, which had got used to being heavily assisted in their role as national economic spearhead (Dent 2003: 263–264; Dent 2000: 287).

For this reason, the IMF program was not only "by far the most significant singular example of systemic support" (Dent 2000: 288) but also the most important cause for the liberal paint of the reforms. It remains to be asked why the Korean government, instead of pursuing some kind of alternative plan to handle the impact of the crisis, chose to divert from the thitherto so successful development path by asking the IMF for help. The answer to this puzzle lies in the economic position which Korea found itself located in on the eve of the crisis.

Short of inward FDI (see Table 5 below in Section 4.2.2) as long as access to entry was restricted, Korea relied on foreign loans. Its economic position at that time was characterized by heavy external indebtedness which had accrued over the years and resulted to a large extent from the Korean banks' praxis of combining short-term borrowings in dollars with long-term lending in won; the praxis of 'borrowing short' and 'lending long' was reflected in a rising share of short-term debt, worst in 1997 (see Table 3; see also Yang 2002: 257–258). Similarly, the growing mismatch between Korean bank's foreign liabilities and assets indicated Korea's general reliance on the foreign loans (Cho 1999: 11).

TABLE 3 External Indebtedness

	Korea	*Malaysia*
Total debt outstanding and disbursed (US$ million; as of end of year)		
1990	34,968	15,238
1995	85,810	34,343
1998	139,270	42,409
Short-term debt as % of total debt		
1990	30.9	12.4
1995	54.3	21.2
1997*	67.0	39.0
1998	20.2	20.0

Sources: ADB (2003: 210–211, 229). *Missing in the ADB sample, but too relevant to be omitted (Asian crisis 1997–1998), these figures refer to Noland (2000: 409 (Table 5), with further references).

Given the 1997 short-term debt/reserves ratio as well (see Noland 2000: 409 Table 5)), Korea definitely had a high foreign debt exposure and ran the risk of precipitating into a liquidity crisis especially because foreign creditors tended to demand higher premiums in recognition of the severe financial mismatches (Cho 1999: 11).

But it was not the financial sector alone that contributed to such a situation. The corporate sector, the *chaebols* in the first place, also had extremely high outstanding debts. Korean big businesses had borrowed excessively in domestic and foreign markets in the course of selective financial liberalization tailor-made for their purposes from the 1980s onwards. However, their real economic value had not been able to keep up (see Table 4).

TABLE 4 Top 30 Companies' Average Debt-equity Ratio (%)

	Korea	*Japan*	*US*
1996 (end)	387	193	154
1997 (end)	519	–	–

Source: Beck (1998: 1023 (Table 3), with further reference).

The potential problem of extraordinarily high debt thus loomed large in the financial and the corporate sector. It immediately became a real one when foreign banks refused to roll over short-term credits to Korean financial institutions. A liquidity crisis ensued so that Korea was in urgent need of 'fresh money' to fulfill its obligations. Since the won had depreciated and continued to depreciate to the dollar and the administration had made use of foreign reserves to prevent the de-

fault of Korean financial institutions, the usable foreign exchange reserves had plummeted drastically (Yang 2002: 255; Cho 1999: 14–15) – a possible source of money which had run dry fast. In this sense, Korea's strategic position in the international economic system had very concrete ramifications as it overly narrowed the scope of feasible policies down to a minimum given the extreme dependence on foreign capital in the form of short-term loans. Bearing the heavy burden of external indebtedness, the government had hardly any options left but to turn to the IMF as 'lender of last resort' and follow its restructuring program with the already described measures (S. Lee 2004: 20; Cho 1999: 15).

As crisis-ridden as capitalism is, I agree with Dragu (2004: 10; my note) that "[…] an exogenous shock [i.e., the Asian crisis] is a necessary condition to focus state actor attention on the financial market's efficiency and/or stability […]". But while speaking of 'policy options' meaning alternative choices, I do not assume actors to be guided by pure rationality; nor are outcomes and payoffs mentioned here. But it is reasonable to hypothesize that the members of the Kim Young-Sam administration contemplated the situation and deduced practicable policy options before the final decision to ask for IMF assistance was reached. As 'reason' allowedly has a strong intra- and inter-subjective dimension (Amin and Palan 2001: 564) and exerts influence on a person's standpoint, a leader's political philosophy is an additional variable which either enlarges or further constrains the scope of choices compared to the range available under 'objective' rationality.

In the Korean case, Kim Dae-jung's preference for neo-liberal economic policies apparently did not conflict with the IMF policy prescriptions, but were supportive of them (S. Lee 2004: 23–24; Dent 2003: 263; Dent 2000: 287). It may have led to a fortification of domestic neo-liberal advocacy and initiated a change as to the dominant cognitive-ideological approach (Dent 2003: 253, 263). This is to say that values, ideas, and thoughts do matter. Their influence, however, was limited to fine-tuning; it shaped the pace of financial market reforms, presumably the breadth and depth of them alike, but it did not determine the government's turning to the IMF. The Korean economic position in the international system was instead the primary source of change because it precluded many alternatives of how to address the crisis in advance paving the way for IMF help, which, in turn, stipulated extensive market opening. Interestingly, the Kim Young-Sam government – the same government that ultimately requested financial help as the crisis impacted on the Korean economy – had not moved much beyond the incremental approach to opening the market but more or less continued it during its tenure.

The reliance on short-term loans was partly a function of the way policymakers, alongside with the influential *chaebols*, had regulated the financial market by then; opening the market merely selectively, they had insulated the *chaebols* from domestic competition and created some sort of moral hazard problem. The position was thus generated by the international system through economic competition *and* domestic Korean politics through a specific mode of regulation simultaneously. Decisive was not a struggle between state actors and market actors or structural forces (see Dragu 2004: 7–11) but a more complex interplay of them. As Table 3 demonstrates, Malaysia did not face a debt exposure as extreme as Korea, a condition that made its position very different from the Korean.

4.2 The Malaysian Case

4.2.1 Until the Asian Crisis: Courting FDI

Malaysian financial market regulation up to the Asian crisis can be described as substantially liberal in that "[o]penness to trade and foreign direct investment appear as driving forces behind Malaysia's rapid economic growth" (Menon 2001: 42; see also Ariyoshi et al. 2000: 53). Seeing that, there is a need to somewhat revise the above statement that Malaysia has had a tradition of financial restriction; it is more applicable to rename it a tradition of relative openness, yet with recurring temporary restrictions (Menon 2001: 42).

The capital account was progressively liberalized after the floating of the Malaysian currency, the ringgit, in 1973. There was a clear general trend towards comprehensive market opening though some restrictions (mostly on short-term capital flows) were retained and even periodically intensified to serve 'national objectives'. Such national goals were at stake and to be served in case of an economic crisis like in 1986 or of pressure on the ringgit like in 1993–1994. Capital controls in response to pressures of that type figured prominently among temporary measures which the central bank, Bank Negara Malaysia (BNM), from time to time chose to impose (ebd.: 32, 42; Ariyoshi et al. 2000: 94–96). Apart from that, the liberalization of interest rates, foreign exchange and capital transactions were essential components of financial reform. Since Malaysia's joining of the WTO on January 1, 1995 (the same entry date as Korea), further liberalization in the financial sector has been bound to be pursued under the terms of the General Agreement on Trades in Services (GATT) (Piei and Tan 1999: 5).

A cornerstone of Malaysia's developmental path from the very beginning was without doubt inward FDI (Trezzini 2001: 328, 332–333). The country has a comparatively long history of encouragement of FDI by means of policies designed to this end; for instance, the Investment Incentives Act was enacted as early as 1968 to woo FDI through incentives like exemptions from various taxes. The 1970 New Economic Policy (NEP), directed to encourage foreign participation in export-oriented sectors, sets another example.

The liberal policy regime notwithstanding, even FDI policies were subject to national development and socio-political priorities. Again, the NEP serves as an example, for it aimed at increasing the share of *bumiputeras* in the corporate sector and preserving a certain Malaysian equity ownership ratio (later attenuated to fight off adverse impacts of the guidelines on inward FDI). Its basic idea shows that market opening was substantial in Malaysia, but decorated with some restrictive elements owing to the nationally specific circumstances of ethnic tensions (Menon 2001: 32–33; Kuo 2000: 162–163); Case (2003: 2) refers to this as "twin orientations". The National Development Policy (NDP) of 1991, which propagated *Wawasan 2020* (Vision 2020) as a blueprint for a new national project called 'Malaysia Inc.', was created along the same line of attention to ethnic issues. Compared to Korea, however, market opening in Malaysia was neither as incrementally nor as selectively pursued.

4.2.2 The Return of Capital Controls

The negative effects of the Asian crisis caused a totally different reaction in Malaysia than in Korea. While Korea, as described, requested help and pursued IMF dictated rapid market opening, Malaysia could radically deviate from that pattern because it was not forced to call for an IMF rescue package. Therefore, Malaysian policymakers enjoyed remarkable latitude in responding to the crisis. The way they exercised their political leeway was abnormally erratic insofar as financial market regulation oscillated between orthodox and unorthodox (heterodox) responses.

The policy volatility after the Asian crisis is closely associated with the rise and fall of a central UMNO figure in Malaysian politics: the then Minister of Finance and deputy Prime Minister, Anwar Ibrahim, who was so ambitious as to challenge the persistent Prime Minister Mahathir Mohamad (in office from 1981 to 2003). Anwar was obviously setting the pace in economic policy by introducing a 'virtual IMF program' with IMF-like restructuring measures as well as stringent austerity measures in fiscal and monetary policy; among many other things on the orthodox agenda, federal government expenditure was scaled down, and the BNM maintained relatively high interest rates both to curb inflation and prevent massive capital flight (Piei and Tan 1999: 12–13; Teik 2000: 223–226; Meow-Chung 2001: 49–50; MacIntyre 2001: 109). This was not without conflict. It took Anwar until December 1997 to finally get the orthodox reforms approved by the cabinet. Mahathir had to retreat from some unorthodox measures all of which had been implemented or announced some time after pressure on the ringgit had occurred in July that year due to the currency crisis in Thailand; the actions in the first experimental phase had been taken accompanied by Mahathir's harsh criticism of foreign investors whom he accused publicly of having caused the crisis. Anyway, Malaysia witnessed a short period of IMF-like economic policies from December 1997 to round about mid-1998, when Mahathir after all got his way (MacIntyre 2001: 107–110; S. Lee 2004: 15; Felker 1999: 48–50).

The reintroduction of capital controls on September 1, 1998 marked the end of the 'shadow IMF' phase and the advent of heterodox economic policies. Anwar's political fall was above all underlined by his demission from his political offices just one day later, his imprisonment, and subsequent charges of a couple of different crimes in court (see *The Economist* 1998a, 1998b, 1998c). Since tight monetary and fiscal policies had not restored macroeconomic stability and not prevented the economy from plunging into a deep recession, the policy reversal was meant to manage the consequences of the economic downturn more effectively. With the previously tight stance on monetary and fiscal expansion abandoned, the 'shadow IMF' phase was soon replaced by an expansionary stage. Not later than in July 1998, the policy reversal was already foreshadowed: The government initiated monetary and fiscal expansion by launching the National Economic Recovery Plan (NERP), which recommended the easing of monetary and fiscal policies with a view to facilitating economic recovery (Piei and Tan 1999: 13–15; Meow-Chung 2001: 51–53; Felker 1999: 50). With hindsight, the deflationary policy in

late 1997 and early 1998 remained a "brief experiment with IMF-style macroeconomic measures" (Piei and Tan 1999: 13).

Expansionary macroeconomic policy was one major part of the new heterodox program; the other major aspect was the aforementioned reintroduction of capital controls on September 1, when Mahathir announced that controls on capital flows were being imposed. Furthermore, the ringgit, traded at 4.0960 to the US dollar on that day, was pegged at 3.80 to the US dollar the next day.

The administrative mechanisms instituted by the BNM were selective in that they included controls on, for example, short-term capital outflows by requiring that inflows be held in the country for a minimum period of a year, but excluded FDI inflows and outflows from control. A number of auxiliary measures were taken in order to eliminate potential loopholes in the control regime which might have triggered further capital outflows. In February 1999, the controls underwent few modifications: The 12-month holding period rule (moratorium) for repatriation of portfolio capital was replaced by a graduated system of exit levy on repatriation, the levy decreasing in the duration of each investment, thereby penalizing earlier repatriation of investments made prior to February 15; as for those made after that reference date, a graduated exit levy solely on profits was installed. Additionally, the authorities relaxed other provisions afterwards as exemptions from the exit levy were granted (Piei and Tan 1999: 15–16; Ariyoshi et al. 2000: 53–55, 96–99, 102–103, particularly 98 (Table 9) for a detailed overview of the control measures from 1997 to 1999; Doraisami 2004: 243–245, especially 245 (Table 1) for an updated synopsis; *The Economist* 1999a: 83). It shall not be concealed that governmental actors repeatedly alluded to the planned temporality of the measures, which were to be removed as soon as the respective policy objectives had been achieved, and that all but some restrictions had in fact been gradually lifted by June 2001 (*The Economist* 2001: 87); yet, the ringgit's peg to the dollar has so far been kept in place (see also *The Economist* 2004c).

According to Doraisami (2004: 246), the government chose to implement capital controls with the twin objective of eliminating the offshore ringgit market and curtailing capital flight by residents and non-residents. Those two more specific goals were an expression of the consideration that speculative short-term capital flows constituted the greatest threat to regaining control over the value of the ringgit; to regain some degree of monetary policy autonomy was thus the primary goal. Accordingly, the policy reversal provided political actors with 'breathing space' to revive the domestic economy in a manner relatively independent of external pressures (Meow-Chung 2001: 52–53; Piei and Tan 1999: 15; Beeson 2000a: 345; Ariyoshi et al. 2000: 96–98).[12]

Financial and corporate sector restructuring has been conducted in ample accordance with market-driven principles meaning that direct governmental intervention in areas such as mergers were planned to be phased out in favor of more

[12] The effectiveness of the Malaysian capital controls in enabling economic recovery has been a bone of contention among observers: Some infer comparatively positive results from the empirical evidence (Ariyoshi et al. 2000: 100–102, 103–105; Doraisami 2004; Kaplan and Rodrik 2001) while others (Johnsson and Mitton 2001; *The Economist* 1999b) are critical of this positive evaluation. For scientific papers on the general nature, objectives, determinants, and results of controls see Capie (2002) and Leblang (1997).

self-regulation of market actors through improved corporate governance (Piei and Tan 1999: 16–19; Meow-Chung 2001: 53–54). Together with the temporary resorting to capital controls and the fixed exchange rate, it adds up to a mixed pattern of selective market closing in the short run but openness in the long run.

Directly after the 'shadow IMF' phase, however, "Malaysia chose an unorthodox policy whose key elements were state's capital control and expansionary macroeconomic policy [above all, the NERP]" (S. Lee 2004: 14; my note). It requires explanation why the Malaysian government then decided to take a "road less travelled" (*The Economist* 1999b: 75). For one thing, to chart such a course and impose capital controls in particular was of course more likely in the absence of an IMF reform program. The conclusive answer is, as in the Korean case, to be found in Malaysia's economic position at that time.

The outstanding importance of inward FDI to the Malaysian economy is more than striking, especially in terms of FDI stocks as a percentage of GDP; this share increased by as much as nearly 40 percent within two decades (between 1980 and 2000). By comparison, FDI flows to Korea never reached the same level until 1998, let alone FDI stocks in absolute and all the more in relative numbers, where Korea was not even close to outrunning Malaysia (see Table 5). Malaysia with a constantly higher and also faster increasing ratio of FDI stocks to GDP was much more integrated economically (see Prakash and Hart 2000: 101). These facts also demonstrate that Korea upheld many entry barriers while Malaysia only sometimes and on a temporary basis put up exit limitations (see United Nations Conference on Trade and Development (UNCTAD) 2004a, 2004b).

TABLE 5 Inward Foreign Direct Investment

	Korea	*Malaysia*
FDI Flows (US$ million)		
1985–1995 (annual average)	715	2,902
1996	2,325	5,078
1997	2,844	5,106
1998	5,143	5,000
FDI Stocks		
US$ million		
1980	1,327	5,169
1990	5,186	10,318
2000	37,120	52,747
% of GDP		
1980	2.1	20.7
1990	2.1	23.4
2000	7.3	58.5

Sources: UNCTAD (2004a, 2004b); S. Lee (2004: 21 (Table 8), with further reference).

It was precisely the enormous reliance on "FDI as one of the major sources of foreign capital" (S. Lee 2004: 20) that shaped the Malaysian response to the crisis. Less exposed to short-term debt than Korea, Malaysian policymakers faced a wider set of feasible policy options. Their greater latitude was reflected in the policy volatility of the early (post-)crisis time with first diffident attempts made by Prime Minister Mahathir at resuming control in mid-1997, the austerity program by his party rival Anwar in late-1997, and Mahathir's final and successful pull in an unorthodox direction in September 1998.

Policy volatility may be thought of as a quasi-inherent feature of Malaysian politics given the position of the UMNO as the most powerful party in the ruling coalition, Barisan Nasional (BN). BN is the sole collective veto player, the effective veto power centred in the UMNO leadership (MacIntyre 2001: 92–93); or: "Whoever leads UMNO rules Malaysia" (*The Economist* 2000: 61). But the intra-UMNO conflict between Mahathir and Anwar was certainly not the only reason.

Most crucially, Malaysia's economy was positioned within the international economic system in such a way that different alternatives of economic policies (like orthodox or unorthodox policy) were at least feasible, and external financial help was avoidable. By reason of the prime importance of mobilizing FDI, the pivotal concern had to be not to alienate inward flows. As a result, there appears to be a great pattern of continuity in Malaysian politics with regard to a 'general consensus' on courting FDI. The consensus will have been widely accepted by both many state and market actors because of the economic growth achieved through export-led industrialization. While politically constructed, 'Malaysia Inc.', with its sheer notion of the state as a company, highlights the government's view of domestic political and economic actors working to the same end. The imposition of temporary capital controls designed as exit barriers and the exclusion of FDI from control in reaction to the crisis underline this reasoning. But apart from that, the position was susceptible to very erratic regulation.

As many options were available in the Malaysian case, I believe that political leadership was indeed decisive for financial market reform. Here, Mahathir's pronounced 'nationalist' philosophy and his antipathy to 'foreign beasts' (e.g., speculators, investors, or hedge fund operators) come into play. Having defeated Anwar, he was able to implement restrictive policies instead of following an IMF-type adjustment program, which would not have been favorable to many in the UMNO support base either (S. Lee 2004: 22–26; Beeson 2000a: 343–345). He opted for exchange rate stability, monetary autonomy, but limited (short-term) capital mobility ('impossible trinity'; Doraisami 2004: 244) and thus for "voluntary semi-detachment from global finance" (Weiss and Hobson 2000: 73). A prime minister with a different ideology (like Anwar) would presumably not have realized the same policies.

In Korea, on the other hand, things were different. Constrained by the high debt exposure, even a Mahathir might finally have called the IMF for help, though grudgingly, for the simple reason that Korean policymakers did not have the leeway to tackle the problems 'creatively'. The regulation of the financial market in the years preceding the crisis had contributed to a specific position in each case.

5 Conclusion

Both countries were path-dependent in the sense that the way of regulating the financial market before the Asian crisis had formed a particular economic position which set the wider framework of alternative responses to the crisis.

Subject to an incremental approach in favor of the *chaebols*, market opening in Korea had been slow and extremely selective with focus on preserving entry barriers. That mode of regulation had been conducive to accumulating high foreign debt. As the crisis broke out, the high debt levels had clear repercussions on the range of policy options: It effectively ruled out any other option than to demand financial help from the IMF. Under the terms of the rescue package, market opening was sped up significantly compared to the pre-crisis time. In Malaysia, market opening had been rather comprehensive, but partially restricted by ethnic considerations or 'national' economic objectives; attracting FDI had come to play an increasingly more crucial role. Since possible liabilities like abnormal debt exposure were comparatively insignificant, political actors could chose from a wide set of feasible policy options as long as they regarded the role of FDI. Therefore, political leadership made the difference: The responses were oscillating between orthodoxy and unorthodoxy until Mahathir completely took charge of economic policies in mid-1998 and imposed selective temporary capital controls.

In sum, whereas entailing an accelerating moment for market opening in Korea, the crisis constituted a retarding moment in market opening in Malaysia, but not an actual regulatory turning point. These results have implications for the convergence-divergence debate. Even though sharing many basic features, Korea and Malaysia chose different directions in financial market regulation primarily due to economic position, but also due to domestic politics. In other words, "[…] it is still possible to respond to such apparently universal imperatives in distinctive, not to say idiosyncratic, ways" (Beeson 2000a: 336).

This possibility signifies some national policy autonomy and is a double-edged sword for global governance. On the one hand, the more 'room to move' political actors in national states retain, the more difficult it is to establish a broad consensus on a framework of general objectives (for concepts of governance, see Cox 2000: 35; Cox 2002: 18). One difficulty relates to the lack of a common normative set of principles or a standard which would embrace civilizations around the globe (Mozaffari 2002: 37). Yet, the belonging to the same 'civilization' does not necessarily imply congruence in interests and aims, as the cases of Korea and Malaysia have illustrated. Moreover, the existence of a variety of 'ideological' perspectives or the advent of new perspectives (see E. Helleiner 2000, 2003) increases such problems among and even within societies.

But on the other hand, by breaking with IMF-endorsed orthodoxy (see Soederberg 2004) in a situation where Malaysia's neighbors Korea, Thailand, and Indo-

nesia all requested IMF help, the Malaysian capital controls are evidence of the scope for political design of markets. In this sense, the Asian crisis is linked to any discourse about 'globalization' and governance (Felker 1999: 51; see Prakash 2001). 'Globalization' is a non-automatic process of *economic and political integration* generated by 'us' in our own environment (Marchand 2000: 219–220).

If incorporating such crucial aspects as democratic accountability or justice (see Falk 2002; G. Helleiner 2001), global governance means a clear deviation from classical economic theory. Knowing about the duality of benefits and risks associated with financial markets in particular (see Obstfeld 1998), 'we' need to rethink the role of states and markets in governance unless all major normative preferences are fulfilled by now (Underhill 2003: 755). In my view, this has to be a prime task for the future because it is in mankind's interest to make the benefits outweigh the risks and costs. The integration of today's financial and commodity markets is unprecedented (Bordo, Eichengreen, and Irwin 1999: 56–57), which causes global governance to be even more urgent in terms of non-economic objectives. Nothing is inevitable – *political* decisions will continue to define the wider framework of integration.

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