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East Asian Economic Growth and Crisis: Some Lessons

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Abstract: East and Southeast Asian successful economies such as South Korea, Taiwan, Singapore, Hong Kong, Malaysia, Thailand, and Indonesia were considered "miracle economies" by many economists and scholars due to their rapid economic growth in the 1960s, 1970s, and 1980s, up until the 1997 East Asian financial crisis. Even though some economists predicted a gradual decline in competitiveness and growth in this region before the 1997 financial crisis, no one anticipated such a sudden and serious economic and financial crisis. Several scholars predicted that East Asia needed many years to be fully recovered. However, the East Asian economic recovery was also quick and impressive. East Asian economies started to grow again within a few years after the massive financial crisis they experienced. As scholars had opposing views about East Asian economic growth and as well as crisis, they were also divided on what factors propelled East Asia's quick recovery. The research aims to answer a few questions: first, how do East Asian countries achieve rapid economic growth? What are the causes of the East Asian economic crisis? What factors facilitate rapid economic recoveries in East Asian countries? Moreover, the study discusses the lessons other developing countries can learn from East Asian economic growth, crises, and rapid economic recovery.

1. Introduction

In the 1970s, 1980s, and up until the East Asian financial crisis in 1997, East and Southeast Asian economies, such as South Korea, Taiwan, Singapore, Hong Kong, Malaysia, Thailand, and Indonesia, were considered miracle economies because of their high economic growth faster than any other region in the world. Prior to the financial crisis in 1997-98, East Asian economies also enjoyed low inflation, a strong trade orientation, and high savings and investments. A large proportion of production and exports take place in high-tech, labor-intensive, high-skill industries such as automobiles, chemicals, and semiconductors. Compared to other developing countries, these successful economies have been able to reduce poverty substantially and improve human welfare, such as healthcare, education, and other social services. Until their economic crisis in the mid-1990s, those highly successful East Asian economies became models for other countries to emulate because of their rapid economic growth and social development (Sharma, 2003). The East Asian financial crisis in 1997-98 surprised everyone. Before the crisis, most economists projected long-term economic growth for East Asian countries (World Bank, 1993). Although before the East Asian crisis, some economists (Krugman, 1994) predicted a gradual loss of economic competitiveness and decreasing growth, still they could not anticipate such a sudden and abrupt financial crisis in the late 1990s. Several scholars forecast that East Asia needed many years to be fully recovered.

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However, the East Asian economic recovery was also quick and impressive. East Asian economies started to grow again within a few years after the massive financial crisis they experienced. As scholars had opposing views about East Asian economic growth and as well as crisis, they were also divided on what factors propelled East Asia's quick recovery.

The paper discusses major arguments offered by various scholars about East Asian economic growth and crisis. It also discusses what lessons other countries, particularly South Asian countries, can learn from East Asian economic growth, crisis, and subsequent economic adjustment after the crisis. This paper is structured as follows: section one discusses different explanations of East Asian economic growth; section two explains the causes of the East Asian financial crisis; section three discusses the reasons for rapid recoveries of East Asian economies after a serious economic crisis; and the final section points out some lessons that can be learned from the last three decades of the East Asian economic growth, its crisis, and the economic recovery the region experienced.

2. Different Explanations of East Asian Economic Success

There is no consensus among scholars on what factors caused rapid economic growth in East and Southeast Asian countries. There are broadly two kinds of explanations of East Asian economic success: 'neo-classical' and 'statist' explanations.

i) Neo-Classical Explanations:

During the 1950s and 1960s, most of the post-colonial and other so-called southern countries including big economies like China, India, and Brazil adopted state-guided and import-substitution industrial strategies for their rapid industrialization and modernization. Such strategies are based on various inter-related elements: first, import-substitution industrialization (ISI) sustained using a tariff and non-tariff barriers that protected domestic industries from international competition; second, this strategy was based on extensive state intervention in the financial market to prevent financial and currency crisis; third, significant dependence on state-owned enterprises for rapid economic growth and job creation; fourth, a preference for detailed planning and regulations by state agencies for a sustainable rapid economic growth and equal distribution of the wealth (Islam and Chowdhury, 2000:3-4). During the 1950s and 60s, most development thinkers regarded the state as the engine of growth within the context of inward-oriented industrialization for developing countries. Development economists argued that due to a lack of entrepreneur class, capital, and market imperfection, the state needed to play a key role in industrialization. Similarly, dependency theorists also proposed state-guided and import–substitution industrial strategies for the economic development of developing and least-developed countries. They argued that the unregulated operation of a free world economy was an agent of oppression that perpetuated the dependence of poor nations at the periphery of rich nations at its core. Initially, import-substitution industrial strategies worked well in some countries. However, after some initial successes in the 1950s and 1960s, most of the countries that adopted import-substitution strategies faced serious economic problems due to inefficiency, lack of innovation, limited domestic market, and corruption.

In the mid-1960s, some East Asian countries adopted export-oriented, labor-intensive, private-sector-based, and market-friendly economic policies and were very successful in terms of economic growth and social development. Some East Asian economies such as South Korea, Taiwan, Singapore, and Hong Kong not only achieved higher economic growth and economic stability but also were able to reduce poverty significantly and provided better social services to their citizens. Neo-classical economists described East Asian economic success as the 'magic of the market,' and 'the virtue of the global capitalist system'. Most of the neo-classical economists argued that sound macro-economic policies such as low inflation, high investment ratio, small public sector, competitive labor market, export expansion, and investment in human resource development were the key factors to the East Asian success compared to those of other regions (Table - 1). Similarly, East Asian countries were able to reduce their poverty due to their sound macroeconomic policies (Table 2) and people-centric growth strategies.

Table 1: Foundations of Economic Growth, by Region (Select Years, the 1980s -1990s)

Indicator and Period	East Asia	Latin America and the Caribbean	South Asia	Sub-Saharan Africa
Inflation (Percent)				
The 1980s	6.7	23.8	8.6	9.8
1990-1997	5.6	25.7	9.2	17.9
Trade as a percentage of GDP				
The 1980s	107.0	26.1	20.2	54.4
1990-1997	121.6	28.6	26.4	55.2
Gross domestic savings as a percentage of GDP				
The 1980s	31.5	22.9	16.8	18.2
1990-1997	33.7	20.1	19.1	15.8
Gross fixed capital formation as a percentage of GDP				
The 1980s	28.2	20.2	19.6	19.9
1990-1997	31.6	19.2	21.6	17.1
Gross enrollment rate (percent)				
Primary, 1996	102.6	113.2	93.7	73.7
Secondary, 1996	74.9	59.0	43.9	25.6
Tertiary, 1997	30.5	19.5	6.5	3.6

Source: Yusuf, Shahid, 2003

Table – 2: Investment, Growth, and Poverty Reduction, by Regions (Selected Years, 1980-1990s)

Indicator and Period	East Asia	Latin America and the Caribbean	South Asia	Sub-Saharan Africa
Percentage of global FDI (Foreign Direct Investment) Inflows				
The 1980s	7.47	8.11	0.32	1.37
1990-1997	17.14	9.65	0.65	1.15
Annual growth of GDP				
The 1980s	6.53	1.92	5.85	2.23
1990-1997	6.76	3.33	5.21	1.94
Change in the number of people living below $ 1 a day (millions)				
1987-1998	-261.2	2.9	-49.8	-84.5

Source: Yusuf, Shahid, 2003:3

East Asian countries, according to neo-classical economists, kept price distortion to acceptable levels, opened their economies to foreign technologies and ideas, and eliminated all trade and import barriers, which were necessary for export-oriented industrial development. The macroeconomic management of successful East Asian economies was also sound and stable, which had a positive effect on both domestic and foreign investments (World Bank, 1993). Bela Balassa and John Williamson argue (quoted in Landsberg and Burlel, 2001:76) that East Asia outperformed Latin American countries because:

The scope of administrative control was much more limited in the four Asian NICs [Newly Industrialized Countries] than in Latin America, and even more in India. In the latter case, there was pervasive control on investment, price, and imports, and decisions were generally made case by case, thereby creating uncertainty for business and opportunity for corruption, which has remained comparatively limited in East Asia…capital markets, too, were freer in East Asian NICs than in Latin America and India.

Similarly, the World Bank (World Bank, 1993) asserts that East Asian economies grew by relying on market forces and minimal, appropriate, and generally market-supporting government interventions.

Dependency theorists are critical of neo-classical arguments. According to them, the international division of labor and changes in the global product cycle made it possible for East Asian economies to grow at a high rate. Because of the high wages in developed industrialized countries, multinational companies moved their labor-intensive consumer goods manufacturing operations to semi-peripheral countries, such as East and Southeast

Asia, where wages were low and environmental regulations were flexible (Bruce Cummings, 1987). In addition, dependency theorists criticized this model for its artificial nature and enclave industrialization without direct connections to the national economy at large. They further argue that this type of economy is susceptible to swings in global economic conditions, particularly in major western economies in North America and Western Europe (Barrett and Chan, 1987).

ii) 'Statist' or 'Developmental State' Arguments:

The strongest attacks on neo-classical arguments came from a group of political scientists and regional specialists (Johnson, 1982; Amsden, 1989; Wade, 1988, 1990; Haggard, 1988, 1990). They challenged the empirical validity of the free trade theory of East Asian success. This group of scholars argues that state intervention was pervasive in Korea, Taiwan, and Singapore; only Hong Kong appears to approximate the neo-classical ideal. Moreover, they argue that neo-classical economists ignore the cultural, political, historical, and international relations of those countries as they develop their economies. To counter the neoclassical view of East Asian economic success, statist scholars advanced 'developmental state' arguments based on successful economies such as Japan, South Korea, and Taiwan (Wade, 1988, 1990; Haggard, 1988, 1990). The economic development of successful East Asian countries is closely related to state capacities, according to this group of scholars. Capable and strong East Asian states facilitate and guide the economic development of successful economies. On the other hand, weak states in various parts of the world cannot achieve economic growth and social and political stability because of their vulnerability to foreign interests and domestic partisanship (Chan, Clerk, and Lam, 1998). However, a strong state can overcome the collective action problem by standing up to the vested interests of a small but powerful elite (Chan, Clerk, and Lam, 1998). A strong and developmental state can also mobilize material and human resources for economic development. The World Bank (World Bank, 1993: 5-6), one of the main advocates of neoclassical economics, acknowledges the state's importance in economic development by arguing:

> 'In most of these economies, in one form or another, the government intervened systematically and through multiple channels- to foster development, and in some cases the development of specific industries. Policy intervention took many forms: targeting and subsidizing credit to selected industries, keeping deposit rates low and maintaining ceilings on borrowing rates to increase profits and retained earnings, protecting domestic import substitutes, subsidizing declining industries, establishing and financially supporting government banks, making public investments in applied research, establishing firm – and industry-specific export targets, developing export marketing institutions, and sharing information widely between public and private sectors. Some industries were promoted, while others were not' (World Bank, 1993: 5-6).

According to statist scholars, the capacity of the state to implement its long-term economic and social goals determines the development of a country. Institutions and culture rather than the market played a key role in the economic development of those successful East Asian countries. Merit-based bureaucracy insulated from political influences and pressure also played an important role in economic development (Ito, 2001).

Several empirical studies have shown that close government-business ties facilitated rapid economic growth in East Asian countries. In his classic study, Chalmers Johnson (1982) examined Japanese industrial policy and found that the Ministry of Economy, Trade, and Industry (MITI) played a significant role in formulating and implementing policies that facilitated Japan's industrial development. Due to the visionary leadership of MITI, heavy industrialization was possible in Japan. Johnson further argues that the state helped and guided industrial development in Japan, and Johnson called this model a “plan rational model”. Robert Wade (1990) argues, authoritarian states such as South Korea and Taiwan maintained a corporate relationship with the private sector, which enabled the private sector to develop while granting technocratic bureaucracies enough authority to implement long-term policy objectives. Similarly, Alice Amsden (1989) argues that the Korean state intervened in the market deliberately to distort relative prices to stimulate economic activities. She further claims that Korea's industrialization was a result of government intervention and active participation, not free market forces. Moon and Rhyu (2000:77) point out that East Asian capitalism is different from other traditions and especially western capitalism. Strong states in East Asia have been able to formulate and implement efficient, coherent, consistent, and flexible economic policies. Authoritarian politics, technocratic focus, bureaucratic competence, and close interaction between government and business were identified as growth-promoting attributes and became part of the practice of the developmental state in East Asia. Similarly, Beeson and Robinson (2000:11) argue that:

> The association between state intervention and rapid economic growth in East Asia appeared to justify that development is possible in peripheral countries that negated the basic tenets of dependency theory (which denied the possibility that states in peripheral nations could foster self-sustaining growth) as well as the neo-classical interpretation of only market-driven growth (In, Islam and Chowdhury, 2000: 40).

No doubt that the state played a key role in East Asian development. However, the statist theory ignores other factors in East Asian development such as the role of Foreign Direct Investment (FDI), and foreign aid from the west. Critics argue that due to geopolitical importance, South Korea and Taiwan received a huge amount of American foreign aid and easy access to the western and especially U.S. market during the 1950s and 1960s. Initially, foreign aid played a key role in South Korea’s and Taiwan’s economic development. The statist theory also ignores the negative effects of state intervention in East Asian development. Critics also argue that close links between government, banks, and businesses weak corporate governance, protect selected companies from market pressure, and obstruct the emergence of a competitive market (Stiglitz, 2001). Stiglitz (2001) argues that ‘getting the price wrong’ and ‘subsidy for export’ for a long time may create a high cost for the economy.

3. Explaining East Asian Economic Crisis

The cause of East Asian economic crisis is complex and multi-dimensional. Like the explanations of East Asian success, there are serious disagreements among scholars about the causes of the East Asian economic crisis. The crisis hit Thailand first, then it spread to South Korea and Indonesia very quickly. All these three countries were severely affected, and the crisis also impacted other southeast Asian countries such as Malaysia, Cambodia, and Vietnam. While the immediate causes of the crisis were financial in nature such as currency, banking, and external debt crisis. However, the structural weaknesses of these countries, both political and economic, also played an important role in the crisis. Scholars divided the causes of the East Asian economic crisis into two broad categories: endogenous or domestic factors and exogenous or international factors.

i) Endogenous or Domestic Factors

a) Crony Capitalism:

In South and Southeast Asian countries, the internal structure of state formation changed because of rapid economic growth in the 1980s and 1990s and the rise of big private sector companies. Due to huge economic leverage, big private sector companies started to influence decision making of the governments in favor of big corporations. East Asia's crisis demonstrates that the states were no longer rational, competent, unified, or insulated from vested interests. They have become increasingly dominated by social and political interests and have been trapped by their own internal powerful actors. As the internal structure of states has changed profoundly, efficient, coherent, consistent, and flexible economic policies have not only been hindered, but their effective implementation has also been compromised (Moon and Rhyu, 2000: 88). Almost all neo-classical economists believe excessive government intervention contributed to the East Asian economic crisis. Many scholars consider this type of economy as a crony capitalism as it encourages rent-seeking activities, nepotism, and corruption. Krugman (1998, 74) argues that:

> "Crony capitalism meant, in particular, that dubious investments – unneeded office blocks outside Bangkok, ego-driven diversification by South Korean chaebol – were cheerfully funded by local banks, as long as the borrower had the right government connections. Sooner or later there had to be a reckoning".

The crisis in the region also reflects a deeper problem of governance. Political patronage, financial sector weaknesses, weak corporate governance, and lax bankruptcy laws all contribute to East Asian economic crisis. In the event of capital account liberalization, a currency crisis and a financial crisis merge into one fatal problem (Islam and Chowdhury, 2000:51). According to neo-classical economists, because of the authoritarian nature of the regimes, there was no transparency and accountability in the economy and governance, which encouraged corruption and inefficiency.

b) Financial and capital liberalization without the framework of pragmatic regulation:

Most institutional economists argued that the root causes of the East Asian crisis were insufficient financial regulations rather than state failure (Johnson, 1998; wade, 1998; Tailor, 1998). According to institutional economists, adequate and effective financial regulations are important preconditions for capital liberalization. However, East Asian countries adopted liberalized policies in the banking and financial sectors like western countries without appropriate institutional and legal frameworks. There were inadequacies in legislation, judicious norms, accounting frameworks, and a general lack of adequate supervision. Among the major causes of the crisis, according to Kregel, are unsafe lending practices by local and international banks. These practices are enabled by an inadequate level of national regulatory oversight (Kregel, 1998). It was the under-regulated financial sector and over-guaranteed private sector that caused the financial crisis, according to Krugman (Krugman, 1998). It was assumed that financial institutions would never fail, and even when they did, the government would take the necessary measures to fix the problem.

c) Macroeconomic Mismanagement:

Other major causes that triggered the crisis were the deterioration of current account imbalances in the affected countries over the 1990s. East Asian economic development was based on export growth, mainly relied on western markets and foreign direct investments also played a critical role. On the way to attracting hot money, countries maintain high-interest rates and fixed currency exchange rates pegged to the U.S. dollar without considering future currency risks. However, due to the fixed exchange rate policy, corporates and the capital market were exposed to serious foreign exchange rate risks (Krugman, 1998). As a result of the economic recession and low-interest rates in the USA during the 1980s, many investors invested in Southeast Asian countries to take advantage of the high return on their investments. Business organizations in Southeast Asian countries borrowed money from foreign sources for their rapid expansion due to relatively low-interest rates of borrowing from foreign banks. Rapid inflow of foreign capital created asset price bubble (Krugman, 1998). However, the situation started to change in the early 1990s. The U.S. economy recovered during the 1990s, and the Federal Reserve increased interest rates to contain inflation. Due to high-interest rates, money flocked to the United States from East and Southeast Asia. Many western investors withdrew their money from East Asian countries within a very short period. Due to rapid capital outflow, East Asian countries faced a serious balance of payment crisis during the mid-1990s.

U.S. currency was also appreciated during the 1990s due to Inflow of money from other countries. Currencies of many East Asian countries were also appreciated because they were pegged to U.S. dollars. Currency appreciation seriously hurt the export sectors of several East Asian countries. Due to the decrease in exports and foreign investment, asset prices and the share market collapsed which created serious panic for foreign and domestic investors and foreign investors withdrew their money quickly before the financial crisis. The massive outflow of foreign capital created depreciation pressure for the currencies of many East and Southeast Asian countries (Krugman, 1998). Thailand was the first victim of serious macroeconomic miscalculation. In order to support its exchange rate, the Thai government floated its currency, resulting in the immediate collapse of the value of the Thai currency. The same happened in other East Asian countries such as South Korea and Indonesia, which triggered a serious financial and economic crisis in the entire region. Many economists argue that most of the crisis countries made the mistake of pursuing fixed exchange rate policies at a time of growing capital mobility and business. Krugman argued that "a balance of payment crisis (currency depreciation, loss of foreign exchange reserve, the collapse of the pegged exchange rate) arises when domestic credit expansion by the central bank was inconsistent with the pegged exchange rate" (quoted in Radelet and Sachs, 1998: 58).

Another important indicator of poor macroeconomic health is the size of non-performing loans (Table - 3). Many Asian firms borrowed heavily from home and abroad. The debt ratios of major industrial firms were higher than optimal leverage ratios. Much of the borrowing was made available in a system of 'Asian business model' that cements the relationships between bureaucrats, bankers, and businessmen. Bureaucrats provided incentives to bankers so that they could lend money to businesses based on relationship, collateral, or government guidance rather than an analysis of risk or business potential, which created severe non-performing bank loans (Table 3).

Table-3: Non-Performing Loans (Percentage of Assets)

Country	**1997**	**1998**
South Korea	16.0	22.5
Indonesia	11.0	20.0
Malaysia	7.5	15.0
Philippines	5.5	7.0
Thailand	15.0	25.0
Singapore	2.0	3.5
Hong Kong	1.5	3.0

Source: Robinson, Beeson, Jayasuriya, and Kim, 2000: 9

Excess government guarantees provoked the greedy behavior of firms. Lenders invested excessively in risky projects and borrowers make seemingly irresponsible borrowing and mainly from foreign banks (Table 4).

Firms in turn make political contributions and other payments to win friends in political offices. Bankers find no reasons to innovate or to be competitive (Choi, 2000:10). The ultimate consequences of this have been a serious misallocation of resources and structural imbalances of the economy because of investment decisions made based on the political decision rather than economic rationality (Jayasuria and Rosser, 2001:384). Most of the firms in crisis countries borrowed heavily from internal and external sources without assessing the risk to the business. They thought that the government would come forward to rescue them if they failed to generate enough income from their business.

Table-4: The stock of Debt to Foreign Private Creditors

Country	**1992**	**1993**	**1994**	**1995**	**1996**	**Mid-1997**
Indonesia	28.4	30.5	34.2	44.5	55.5	58.7
Malaysia	8.5	13.0	13.5	16.8	22.2	28.8
Philippines	6.9	5.8	6.5	8.3	13.3	14.1
South Korea	38.7	41.2	56.5	77.5	100.0	103.4
Thailand	23.0	29.6	43.4	62.8	70.1	69.4
Short-Term (Percentage of Total)						
Indonesia	60.5	61.7	61.8	61.9	61.7	59.0
Malaysia	48.1	56.8	48.8	47.2	50.3	56.4
Philippines	45.7	40.8	47.4	48.8	58.2	58.8
South Korea	71.4	70.8	71.1	70.0	67.5	67.9
Thailand	69.0	72.1	71.0	69.4	65.2	65.7

Source: Islam, 1999:9

4. Exogenous or International Factors

i) Rapid capital outflow:

Many economists (Radelet and Sachs, 1998; Stiglitz, 2001; Rodrik and Valesco 1999) argue that exogenous factors are the root causes of the East Asian crisis. They argue that policy fundamentals that characterized success in the past were impacted during the crisis. However, exogenous factors, especially the sudden outflow of capital, caused panic and created a serious economic crisis. This group of scholars argues that Vietnam and China both have deep and systemic problems in their banking and financial sectors, but they were much less hurt by the crisis because their financial systems were partially open to international flows. In the context of the highly liquid global financial markets of the 1990s, financial liberalization permitted the massive inflow of mostly short-term foreign capital that fueled the growth of foreign debt and then created such destruction when foreign investors withdrew their money even faster than it came (MacIntyre, 1999: 143).

ii) Loss of competitiveness in the international economy:

Some economists argue that the loss of competitiveness in the global economy was one of the major causes of the economic crisis. Most of the crisis countries lost their economic competitiveness in low-wage and labor-intensive sectors due to the rise of China as a major exporting country. Before economic reform in 1979, the Chinese economy was a backward and closed economy and foreign trade was only 7 percent of GNP (Sharma, 2003). However, at the end of the 1990s, foreign trade increased tremendously to an unprecedented $200 billion, or roughly 40 percent of the GNP (Sharma, 2003). Chinese wage was far less than in other East Asian countries, which created competitive disadvantages for other East and Southeast Asian countries. The traditional sources of economic growth (the availability of relatively low-cost high-quality labor) disappeared fast in East Asia and new sources of growth such as technology were not easily insight (Choi, 2000:6). Krugman (1994) mentioned that East Asian economic development was primarily input-driven rather than product-driven, and hence subject to limits of diminishing return. Yoshihara (1988) also argues that East Asian countries fail to promote indigenous manufacturing and technology that was essential for further economic growth (in Islam and Chowdhury, 2000:38).

Another reason for the loss of competitiveness is currency appreciation. Most of the crisis countries appreciated their currency during the 1990s because they were pegged to the U.S. dollar. However, at the same time, China, Japan, and other competitors devalued their currencies. China devalued its currency by 34% in 1994, and the Yen lost 60% of its value against the dollar from 1993 to 1996. Due to the loss of competitiveness and overcapacity of some sectors of the economy, export growth fell dramatically in crisis countries in 1996 which contributed to the crisis.

iii) Fall of external demand and lower price of key export commodities:

Immediately before the crisis was the fall of external demand and price of key export commodities because of slow growth in western countries and especially the American market. Prices of industrial goods have also fallen due to intense competition among East Asian states, including China. The decrease in the price of electronic goods and semiconductors severely affected the crisis countries because those are the key export items of these affected countries.

5. East Asian Economic Growth and Crisis: Some Lessons

Despite the differences in political and economic conditions among countries, there are still some common factors that facilitate or hinder economic growth. Countries can learn from each other regarding their economic success and failures. Amid a serious economic crisis, several South Asian countries can learn a lot from East and Southeast Asian countries' economic growth and crisis.

i) Governance Matter, Both Politically and Economically:

Before the East Asian crisis**,** some scholars (Haggard, 2000; Johnson, 1982; Amsden, 1989; Wade, 1988, 1990) argue that states of successful East Asian countries were insulated from vested interests and had the autonomy of independent policymaking. Furthermore, intimate government-business relations reduce transaction and monitoring costs, diminish uncertainties, reduce rent-seeking, and increase investment opportunities. However, the East Asian crisis shows that excess intervention of the state in economic policies, cozy government-business relations, and interconnectedness of the government and the business has some serious political and economic implications. Islam and Chowdhury (2000:51) point out some serious consequences of close government-business relations: first, the growing concentration of economic power to some large corporations may create serious governance problems; second, the government supports for the private sector generate moral hazard, corruption, and cronyism that were one of the root causes of East Asian financial crisis; third, patronage politics complicate real-world financial sector regulation, reforms, and supervision. Thus, private sector greed becomes institutionalized, resulting in a financial crisis. For example, in Korea, the expansion of the private sector, in particular the size and power of the *chaebols*, eroded the ability of the state to function with its former autonomy and strength. As a result, the growth-oriented policy network shifted to a rent-oriented policy network in which powerful private companies heavily influenced economic policy formulation and implementation (Kim, 2000: 108). In Indonesia, President Suharto's family owned roughly a fifth of the economy, including businesses in almost every sector including banking, hotels, chemicals, wood, cement, sugar, paper, and toll roads. During the Suharto era, doing business in Indonesia was extremely difficult without Suharto's family connections (Flynn, 1999: 63). Cozy government-business relations and connections may (or may not) benefit a country for a short period of time, but their long-term consequences are not optimal, and some instances seriously harmful for any county. The positive impact of the East Asian crisis is that it pushes East Asian countries closer to a free market economy. Global standards, transparency, removal of moral hazards, and the pushing out of the state in many areas of economic activities indicate the profound limits to Asian capitalism and values (Moon and Rhyu, 2000: 97-8). After the 1997 crisis, East Asian governments focus on regulations that support market development (World Bank, 2000:151).

Current economic crisis in Sri Lanka and Pakistan and economic and political challenges in Bangladesh and Nepal clearly indicates that good governance matters, both politically and economically. Sri Lanka's and Pakistan's current economic crisis is the result of bad governance, specifically patronage politics and overpoliticization of state and politics, which is also applicable to other South Asian countries. In Sri Lanka, there was no separation of power and rule of law, and President Gotabaya Rajapaksha had absolute power regarding key appointments, promotions, and other important decision-making of the state. There were several Rajapaksha family members who held key ministerial positions in Sri Lanka. Mismanagement of the economy and misuse of power seriously undermine government efficiency that created serious financial crisis in Sri Lanka. Similarly, political instability and bad governance are root causes of current financial crisis in Pakistan. Since Pakistan became an independent nation, ineffective governance has been a serious problem in Pakistan due to elite conflicts, lack of rule of law, and periodic military rules. Key ingredients of good governance are accountability, transparency, meritocracy, and the rule of law, which were always absent in Pakistan since its independence. Corruption was, and still is, rampant in Pakistan which seriously eroded the efficiency of the state institutions. State institutions such as the civil and military bureaucracy, the judiciary, the police, and other state institutions are essential to sound governance. As a result of dysfunctional politics and political instability in Pakistan, state institutions cannot ensure their efficiency. There are several countries in South Asia where politics is like a family business and there is no democracy within the political parties, and the selection of leaders is based more on family ties than on leadership quality, honesty, and effectiveness. In Sri Lanka, Pakistan, and Bangladesh and other South Asian countries, bad governance created an economic mess that will persist for a long time. Bad political governance creates dysfunctional market that leads to crony capitalism and rampant corruption. Without governance reforms, it will be very difficult for South Asian countries including Bangladesh to avoid future economic crisis.

ii) Macroeconomic Stability is Essential for Sustainable Economic Development: According to most neo-classical economists, one of the reasons for East Asian countries' economic success was sound macroeconomic policies such as low inflation, high investment ratios, a small public sector, a competitive labor market, export expansion, and investments in human resources development. However, the East Asian countries were unable to maintain sound macroeconomic policies over time, causing serious economic stress. Since the beginning of the mid-1980s, fiscal deficit was high in a number of East Asian countries. Due to fiscal deficit, countries try to fill up savings-investment gap financed by foreign direct investment (FDI) and public sector foreign borrowing. However, both of which declined rapidly from the mid-1980s onwards. A combination of Foreign Direct Investment (FDI) and foreign debt led to an outflow of investment income abroad. During the 1990s, short-term capital inflows were increasingly used to finance the current account deficit, with disastrous consequences later when such flows reversed (Sundaram, 2008). Before the financial crisis, both the government and private sectors borrowed money from external sources without considering long-term consequences. The expenditure of large amounts of money on economically unviable and non-developmental projects is not sustainable in the long-run.

This lesson is also applicable to South Asian countries such as Pakistan, Sri Lanka, Bangladesh, and India. South Asian countries are experiencing the same crisis as East Asian countries due to deteriorating current account imbalances. Fiscal deficits are high in most of the South Asian countries. Populist macroeconomic policies adopted by governments in South Asia are one of the root causes of the financial and economic crisis. Before elections, political parties promise various things such as subsidized food, tax cuts, and a salary increase for government officials during election campaigns. After the election, the ruling party tries to implement these promises without increasing economic efficiency which enhances inflation and budget deficit. In general, tax revenue (% of GDP) is 15-20 percent in lower-middle-income countries and around 30 % in high-income countries. However, tax revenue (% of GDP) is extremely low in most of the South Asian countries. In 2020, the tax-GDP ratios in Sri Lanka and Bangladesh were 7.7% and 7% respectively (World Bank, 2022). Due to low tax-GDP ratio, South Asian countries have been borrowing money from foreign sources to finance their current account deficit. Sri Lanka's external debt was 21.68 billion in 2010, and in 2021 it would increase by 261% to 56.59 billion, Pakistan's external debt was 63.12 billion in 2010, and it reached 130.43 billion (207% increase) in 2021, and Bangladesh's external debt was \$26.3 billion in 2010, and it increased to \$109.43 billion (344% increase) in 2021 (World Bank, 2022, International Debt Statistics). Borrowing money from external sources to fuel economic growth is not sustainable in the long run, and debt accumulation creates a long-lasting crisis for any country. Persistent fiscal deficits have been associated with inflation, macroeconomic instability, and balance-of-payments crises. Governments of various South Asian countries borrow money from international institutions and friendly countries to implement mega projects and government officials, politicians, and a section of media declare them as successes and national achievements. However, reckless borrowing from various sources may create serious long-term economic crisis, and Sri Lanka and Pakistan are prime examples, and it is applicable for other South Asian countries. One Pakistani economists pointed out two decades ago:

> *Economic management in Pakistan has steadily deteriorated to the point where the economy has lurched from one financial crisis to the next. At the heart of the problem has been poor management of public finances and deep-seated unresolved structural issues in the economy that bad management and poor governance has exacerbated. The consequences are plain to see: macroeconomic instability, high inflation, poor public services, criminal neglect of the social sectors, widespread corruption, crippling power outages, growing unemployment, deepening poverty and a deteriorating debt profile"* (Quoted in Lodhi, 2023).

As of today, this observation still applies not just to Pakistan, but other South Asian countries as well.

iii) Western Markets Are Not Unlimited, and Regional Integration is Necessary:

Like the East Asian miracle economies, most other developing countries relied heavily on western markets for their economic growth before the East Asian crisis. However, it is obvious from the East Asian crisis that western markets are not unlimited, and it is already exhausted in some sectors such as garments, shoes, electronics, semiconductors, and other labor-intensive products. Demands are also not increasing in western countries due to limited economic growth and protectionist policies of western governments. Future economic growth will be difficult for many countries based on only western markets. For future economic growth, East Asian countries need to expand their domestic markets, and regional economic growth is necessary. The single greatest push for East Asian economic integration has been the Asian financial crisis (Sharma, 2003). The East Asian financial crisis worked as a catalyst for East Asian governments to rethink regional integration to prevent further economic and financial crises. Fortunately, Intra-regional trade and foreign direct investments have been increasing very rapidly. After the crisis, the East Asian economies initiated some trade agreements such as Japan-Korea Economic Partnership Agreement (EPA), China-ASEAN Free Trade Agreement (FTA, Japan-ASEAN EPA, ASEAN + 3 (China, Japan, and South Korea) are currently underway. Trade among East and Southeast Asian countries increased tremendously since 1990. In 1991, China-ASEAN trade was $8.36 billion and that reached $685.28 billion in 2020, a 16.5% growth per year since 1991. In 2020, China became the largest trading partner of ASEAN countries. Not only trade, but Chinese Foreign Direct Investment (FDI) also increased tremendously in ASEAN countries. Kaushik Basu (2007: 18), a renowned Indian economist, points out that "It is likely that in the not-too-distant future, there will be an effort to establish a common Asian currency area and a more united market across multiple Asian nations – these are natural concomitants of globalization." Unfortunately, trade and investment among South Asian countries are still low due to bad political relations and distrust. South Asian economies are also not enough integrated with other growing Asian economies such as East and South East Asian economies. Economic integration with other Asian countries will help South Asian economies to diversify and expand their export market and increase inward foreign direct investment, which will create further growth opportunities.

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