IB 460 Course Pack

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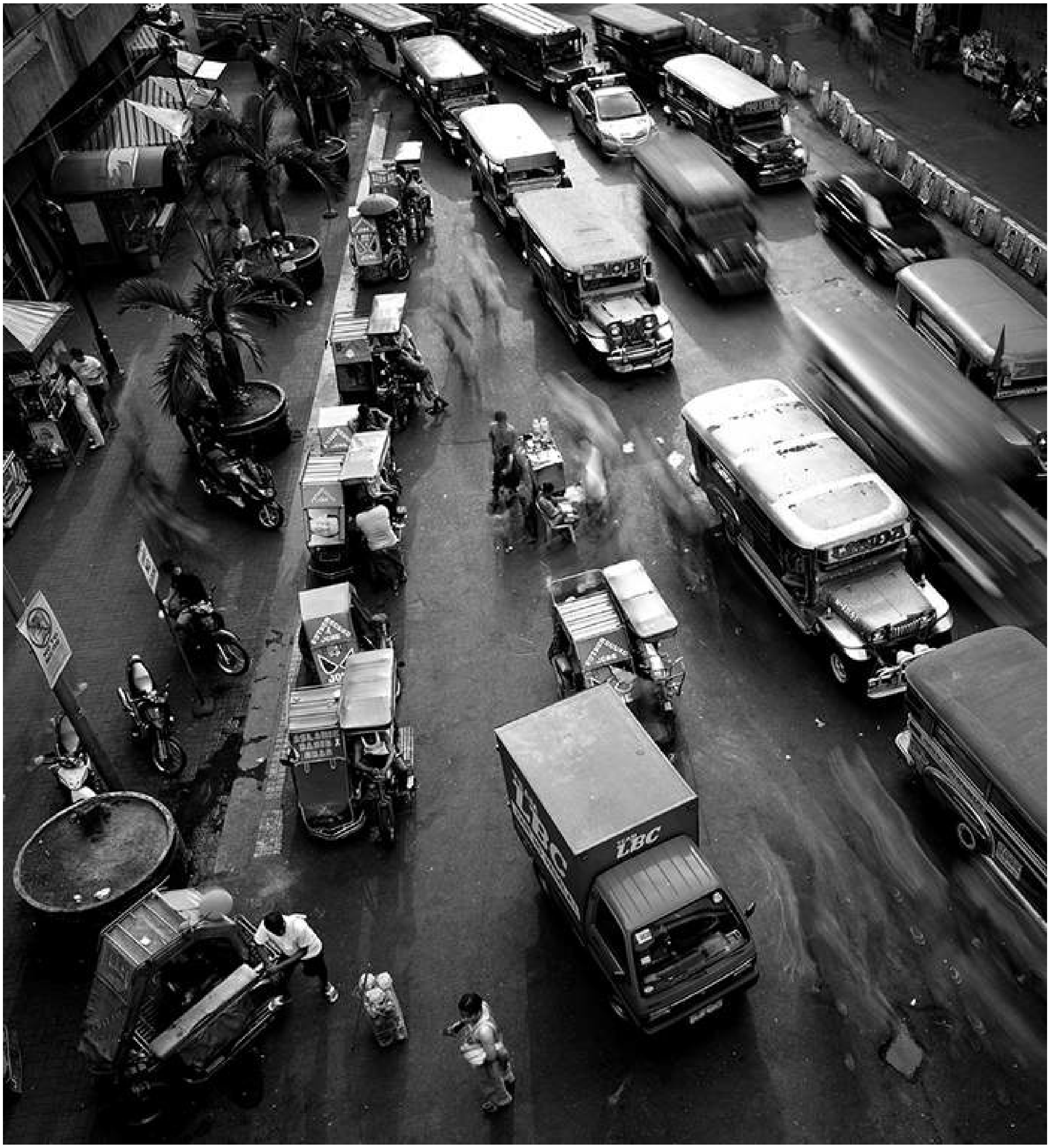
On the Tiger Road

The Commodity Economy That Works

There is no visible sign left of the riot zone in Jakarta. The fires, set by Indonesians demanding the end of the Suharto regime and seeking revenge against all its allies, have long since burned out. The stick-built construction projects, abandoned half-finished and skeletal when the mobs came looking for Chinese businessmen, targeted as friends of the regime, have been completed. The children, sent abroad for schooling by Chinese parents scared for their safety, have long since returned. Semanggi Junction, where protesters halted army troop carriers trying to reach the burning buildings of Chinatown, is now the placid home of a lavish new mall and the Ritz-Carlton Hotel.

The Asian financial contagion that rolled out of Thailand in 1997 sparked protests across the region, but none nearly so angry or violent as the fiery street revolts that brought down Suharto, after thirty-two years in power. On Jalan Sudirman, the main drag and "money street" of the capital, money fled after 1998, and properties like the legendary Hotel Indonesia, where the 1982 hit *The Year of Living Dangerously* (with Mel Gibson) was filmed, fell into seedy disrepair. It has since been rehabilitated as the Hotel Indonesia Kempinski, where the breakfast room is adorned with photos of Suharto's predecessor, Sukarno, alongside John F. Kennedy and Marilyn Monroe.



With things looking up under a new leader, maybe Manila will replace the World War II–vintage "Jeepney," which is still a staple of public transportation.

But the Suharto years are not forgotten. The overwhelming sense one gets in Jakarta today is of a nation governed by a desire never to go through that experience again. Indonesia was the country hardest hit by the crisis of 1997–1998, suffering a drop in GDP of around 20 percent during that period. That is why the protests were so violent. But because Indonesia also learned the deepest lessons, it was best positioned to thrive after the crisis of 2008. In fact by late 2011 Indonesia was one of the very few economies growing faster than it did during the global boom from 2003 to 2007, with growth accelerating from 5.5 percent during that period to over 6 percent.

Led by Indonesia, the nations of Southeast Asia are experiencing a reversal of the process that triggered the financial crisis of 1997–1998. Unlike the global meltdown of 2008, which originated in the United States, the Asian crisis began in Thailand with the fall in the value of the baht, and spread across the region, which is why it is still seen as the formative event of recent Southeast Asian history. The roots of the crisis are complex and hotly debated, and its causes and consequences varied from country to country, but one common factor was that in the early 1990s newly and incompletely deregulated banks in Southeast Asia started borrowing heavily from abroad to fund increasingly speculative borrowing at home, often by politically well-connected "cronies" with close ties to the banks. The bank borrowing was fueled by the fact that many of the Asian currencies were "pegged" to the dollar, which was rising in value and taking the baht, the ringgit, and the won up with it against rival currencies such as the Chinese yuan and the Mexican peso. When Southeast Asia's exports began to falter in 1996, and its high-flying stock and property markets started to wobble, locals started to flee and foreign lenders withdrew abruptly. The result was a snowballing crisis in which the flight of capital put downward pressure on the currencies, which made it more difficult for the banks to repay foreign debt, further stoking capital flight.

The damage was catastrophic—much worse than what the West suffered in 2008. The value of the Korean won and the Thai baht fell by half, and the Indonesian rupiah by 80 percent. Regional stock markets plummeted by as much as 90 percent, turning Malaysian and Thai billionaires into millionaires. The incomes of millions of ordinary citizens dropped below the poverty line, fueling revolts that toppled leaders in Thailand, in South Korea, and most dramatically in Indonesia. The contagion swept across global markets, dropping oil prices to ten dollars a barrel and precipitating a domino-effect collapse of the ruble in Russia, though fears that the economies of Europe and the United States would be derailed, too, proved overblown. At the time the East Asian economies were just not big enough to bring down the West. Though the recovery came quite quickly, the fall was so sharp that most of Southeast Asia was still poorer, in per capita dollar terms, in 2005 than in 1998, and none of these nations have yet recovered their old position as market darlings in the West. That status would shift quickly to others, including China and India.

Today, however, many big businessmen in Southeast Asia say the tables are starting to turn against China. One catalyst of the Asian crisis was China's 1994 decision to battle a severe downturn by sharply devaluing the yuan, and then holding it there for the next decade. That single move, perhaps more than any other, undercut the competitiveness of exports from Southeast Asia, which could not respond to the Chinese devaluation because their currencies were pegged to the dollar. Now, however, all the Southeast Asian currencies are floating and relatively cheap, while China has been allowing the yuan to rise slowly, and Chinese wages are increasing quickly, making manufactured exports from Southeast Asia much more competitive in global markets.

The cost of hiring a factory worker in China has risen significantly, to an average of $450 per month in 2010 from less than $200 in 2005. In 2010, labor costs in China were almost twice as high as those in Thailand, roughly three times higher than those in the Philippines, and four times higher than in Indonesia. Businessmen in Thailand and Indonesia are saying it is like the 1990s played in reverse, and they can feel themselves gaining momentum in competition with the Chinese. As global markets start to recognize that the cost advantages are tilting back in favor of Southeast Asia, money could flow into countries such as Indonesia as fast as it flew out in the late 1990s.

While Beijing's leaders are feted as economic wizards for dodging the global downturn of 2008, the Indonesian president Susilo Bambang Yudhoyono, widely known as SBY, managed the same trick—without the massive spending binge China employed. Indonesia got through the crisis largely unscathed, with less debt than when it started, and rewarded SBY with reelection in 2009. He ran on promises to pursue economic recovery and signaled his seriousness by picking a respected technocrat over the favorite sons of allied parties as his running mate. SBY is the first leader in Indonesia to serve two terms since the fall of the Suharto dictatorship in 1998, and he is bringing the stability and the flexibility the country needs to sustain a new phase of rapid growth.

Indonesia is now by far the best-run large commodity economy. A large population and a wealth of natural resources—once viewed as a curse, a source of easy money that sapped a nation's will to produce and excel—are now seen as providing a competitive advantage, benefiting countries such as Brazil and Russia. Indonesia is the only Asian economy blessed in both respects: As the world's fourth-most-populous nation, the country has a large enough domestic market to generate demand even when global demand is weak. It also has vast untapped reserves of crude oil, coal, palm oil, and nickel.

Indonesia is one of the few emerging markets where leaders have come to accept the new normal and are not taking dangerous (big spending, easy money) steps in an attempt to return to the unusually high growth rates of the last decade. As a result Indonesia has less of a post-crisis debt problem than any other big emerging market. It has not blown through the profits of the commodity boom of the last decade, as Russia and Brazil ultimately did, and has the savings to increase investment in the economy. In fact it is the only Southeast Asian country in which investment as a share of GDP, now 32 percent, has surpassed its pre-1998 high. Investment so far has been primarily in the commodity sector but is spreading to other, more productive parts of the economy. What Indonesia has not reinvested it has saved, paying down public debt, which has fallen from 97 percent of GDP in 1998 to 27 percent now.

Indonesia knows its own weaknesses: 55 percent of its export earnings come from commodities, leaving it highly vulnerable to swings in commodity prices. The president of one of Indonesia's largest banks recently told me the cautionary tale of how Indonesia flourished in the 1950s, when exports of rubber and tin took off as the United States built up strategic reserves at the start of the Cold War. Once those drivers stalled, the price of commodities collapsed, and Indonesia got slammed. The experience seems to have ingrained in Indonesians a farsighted commitment to learn from past disasters. Furthermore total exports account for just 25 percent of the economy, making Indonesia one of the few East Asian nations that is not trying to export its way to prosperity, despite a global slowdown.

Sensible Caution, Efficient Corruption

Indonesian banks and corporations now operate with a caution uncommon in most emerging markets. Most of the big-business figures who were prominent in the late 1990s are still around, including the Salim, Riady, and Bakrie family business empires, all highly diversified with interests ranging from mining to motorcycles to instant noodles. They seem to have reinvented themselves out of necessity. Hit hard in 1998, many had to claw their way back from some form of bankruptcy, or buy their companies back from the government repo man. As the growth in investment shows, however, big Indonesian business is exercising a sensible caution, neither too eager nor too afraid to take on risk and make things happen. It is not the paralyzing kind of caution that is currently stunting domestic investment in Brazil.

Indonesia under Suharto had become a case study in why conglomerates should not be allowed to own banks—because combining lender and debtor under one roof is a debt crisis waiting to happen. As a result, many big

Indonesian conglomerates are out of the bank business and are working hard to build clean balance sheets and professional corporate governance. The newly independent banks are very careful about whom they make loans to, and companies are very careful about where they invest. Since many of these tycoons were struggling to regain control of their companies for many years after Suharto's fall, memories are fresh, and vigilance is still high. Tycoon Anthony Salim, who was forced to give up one of Indonesia's largest private banks and other holdings in the credit meltdown of 1998, today tells investors that survivors of the crash no longer see wealth in terms of assets obtained on credit; now the definition of wealth is "cash flows, cash flows, cash flows."

Although Indonesia still scores very poorly on global surveys of corruption, there's a growing realization (at least in the region) that the country has a lot of good, clean companies now. Indian entrepreneurs say it's a lot easier to open a cement plant in Indonesia than back at home, thanks to "efficient corruption" of the kind businessmen often encounter in China. They may have to pay someone off, but it's relatively quick and easy to figure out whom. And once they get to the right person—or find the right government partner—the payoff is not just pocketed, the job gets done. Some investors even note with approval that to cut through Jakarta traffic, there is a number to call to hire a police motorbike escort, which will clear the way for a price of around a hundred dollars. During downtown rush hour—when traffic rules say there must be at least three people per vehicle—mother-and-child teams can be hired off the sidewalk to fill the requirement. A dubious service, yes, but locals say it works, providing the mothers with a reasonable living.

To outsiders, Indonesia is an easy place to do business, sometimes almost too easy. While India and China are starting to challenge new projects on environmental or social grounds—a desire to protect indigenous people, for instance—Indonesia is still pretty much an environmental anything-goes zone. Foreign direct investment in Indonesia is reasonably strong, at $10 billion a year in a $650 billion economy. Indian and Chinese investors are all over

Indonesia, looking for coal, palm oil, and other investments, and not only because regulations are loose. One reason why Indonesian coal is so attractive is because much of it is close to the surface, and therefore easy to access.

SBY's landmark presidency has gotten relatively little attention around the world, in large part because he perfectly expresses the nation's sober post-Suharto ethos. A former general with an overwhelmingly popular mandate, he has mystified some observers by failing to use his clout to force reforms through the legislature. One of the big debates in Jakarta as of late 2011 was why SBY was not pushing more aggressively to gain passage of a land acquisition bill that would speed the pace of development. The most credible answer seems to be that SBY does not want to remind anyone of Suharto by ramming through business deals. He wants to build institutional credibility. There's not much flash or drama—just a steady move in the direction of greater stability.

The Rise of Second Cities

A rule of the road: check the size and growth of the second city, compared to the first city. In any big country the second-largest city usually has a population that is at least one-third to one-half the population of the largest city. This ratio reflects regional balance in the economy, and it holds true for many of the nations that were breakout stories in recent decades: São Paulo and Rio de Janeiro in Brazil, Seoul and Busan in Korea, Moscow and St. Petersburg in Russia, as well as Taipei and Kaohsiung in Taiwan. It's a red flag if a country is stuck in violation of this rule, but it's a good sign if a capital-centric nation is moving toward greater balance. It's even better if the country is producing new cities with populations of one million or more, which suggests that growth is lifting all regions—not favoring the elite in the capital city. Indonesia fits both criteria: the second city of Surabaya, with a population of 2.8 million, has roughly one-third the population of Jakarta, and there are four other cities with almost two million people or more, and eight with nearly one million or more.

Indonesia is emerging as a uniquely successful case of archipelago capitalism. While power struggles between the central government and provincial officials and tycoons threaten the ability of both India and China to manage growth, SBY is turning the conflicts of the world's most fractured population—245 million people representing dozens of ethnic groups and languages spread out over seventeen thousand islands—to his advantage by allowing more local autonomy. Suharto (and Sukarno before him) had worked hard to unite Indonesia under a nationalist "pancasila" philosophy that demanded consensus and harmony, and this philosophy was used to justify the often violent suppression of ethnic and regional differences. Under Suharto, the capital city of Jakarta was the focus of all political and business attention, but now a lot of new cities are opening up. SBY was one of the movers behind a key 2001 law that began the decentralization process, and as president he has given second cities confidence that they will be left free to flourish. As a result, SBY not only won a legitimate 70 percent of the vote in 2009 but also won broadly in twenty-nine out of thirty-three provinces, in part owing to the expanding economic freedoms he is granting the regions.

Decentralization is also creating a vibrant new business culture outside of Java, the province that hosts the capital city of Jakarta. In the last years of the Suharto era the bank system controlled by his cronies was funneling credit back to companies owned by the same circle, based mostly in Jakarta, which received 66 percent of the loans issued in 1995. Since then that share has dropped steadily, to 33 percent today. The same decline in crony control is clear in the central government, which accounted for 73 percent of all public spending in the late Suharto years, but accounts for only 48 percent today.

The rise of provincial power has brought a surge in construction and investment. Growth in cement consumption is now much faster in the outlying provinces than in Java, and in the last five years foreign investment has risen 23 percent in the provinces, compared to 10 percent in Java. This is further greasing the wheels of efficient corruption, businessmen say, because local authorities are starting to compete for the growing pot of investment dollars by lowering the price of bribes and tips. Since bribes collected locally are spent locally, the decentralization of corruption tilts the upside of even ill-gotten gains away from Jakarta.

Employment and minimum wages are rising much faster in the hinterlands too, attracting a flood of internal migration. The number of households is growing nearly two times faster outside Java than inside. As of 2010 the fastest-growing province in the country was no longer Java; it was Sulawesi, the third most populous, located at the center of the Indonesian archipelago. This shift represents a kind of punctuation mark, an end to the Java-centric Suharto era.

What Curse of Oil?

Indonesia is one of the few commodity-driven economies where you don't get the sense that a lot of people are living way beyond their means. Jakarta has few of the nouveau-riche excesses of Moscow, and prices are a small fraction of what one encounters in Rio. Indonesia has much lower structural inflation than Russia (6 percent, compared to 10), and because it is investing (rather than consuming) more than both Russia and Brazil, it should be able to grow at a faster pace in the years ahead. (Indonesia's investment rate of 32 percent of GDP compares to 20 percent in Russia and 19 percent in Brazil.) It's a commodity economy that works.

The Philippines Is No Longer a Joke

There was a time when the Philippines was seen as an Asian trendsetter, and fashionable young Malays would sport the barong, the formal embroidered shirt favored by Filipinos, to look cool. But that was back in the 1960s, when the Philippines had the second-highest per capita income in Asia, behind only Japan. The nation's fortunes have shifted dramatically since then. By the 1970s South Korea and Taiwan had passed the Philippines in per capita income terms. Malaysia and Thailand followed in the 1980s and China in the 1990s. Then in 2009, in a moment the Manila elite thought it would never see, Indonesia's boom made Indonesians richer than Filipinos for the first time in modern history.

When I visited Manila in early 2010, returning for the first time in twelve years, the Philippines was still the undisputed laggard of Asia, a nation mired in chronic incompetence. My overwhelming impression was of how little had changed. The contrast to the frenetic progress of China and India could not have been starker. The same handful of family-owned conglomerates still dominated local markets, running everything from malls and banks to airlines and breweries, with no new players to be found. Forget high-speed trains: "Jeepneys," which trace their origin back to World War II, remained the preferred mode of public transportation. While nearly all other major Asian cities boasted fancy new airports, most international visitors to Manila had to trudge through a graying terminal commissioned in the 1980s.

The failure of the Philippines is typically attributed to chronic political instability since the fall of the dictator Ferdinand Marcos in 1986, but that explanation is not enough. Thailand has been even more unstable, but its economy outperformed the Philippine economy through the 1990s. In the last seventy-five years Thailand has seen eighteen coup attempts and seventeen new constitutions; the Philippines has had around a half-dozen coup attempts and one constitution. The difference is that at least until the 2000s, Thailand's unstable leaders made better economic choices—from controlling debt and restraining crony capitalism to making the country more attractive to foreign investment, as Japanese car companies turned Thailand into their Asian factory-away-from-home.

Now, at long last, the Philippines looks poised to resume a period of strong growth. The new president, Benigno "Noynoy" Aquino III, probably has just enough support, and looks likely to generate just enough reform momentum, to get the job done. The Aquino name is still virtually synonymous with the promise of change: Benigno III's legendary father, Benigno junior, was the opposition leader whose assassination by Marcos supporters sparked the

People Power Revolution that brought his mother, Corazon Aquino, to office in 1986. Benigno III was originally dismissed in foreign circles as an unimpressive fifty-one-year-old bachelor who had lived most of his life with his mother and had not made much of a mark in a low-profile career as a Philippine senator. However, Filipinos saw him as an honest figure who could deliver on the Aquino mandate for change, and they were desperate after nine years of drift and decay under outgoing president Gloria Macapagal Arroyo. Following his mother Corazon's death in 2010, Noynoy Aquino won the presidency on a wave of public sympathy. His victory margin was unprecedented, and his task daunting at a time when it seemed like the whole country was in disrepair. At a conference in Manila in December 2010, put on to attract foreign investors to new infrastructure projects shortly after Aquino took office, the electricity went out in the middle of a speech by the minister in charge of power.

Aquino is delegating power to competent technocrats and seems to understand what needs to be done to get the lights back on. To begin with he needs to revive investment in perhaps the only Asian nation that consumes way too much of its income—consumption accounts for an outrageous 80 percent of GDP, 10 percentage points higher than in the United States, and over 40 percentage points more than in China. That leaves little savings to invest in building up the nation's industrial backbone. In a telling sign of the long investment drought, the Philippines now uses no more cement than it did twenty years ago, even though population has risen from seventy million to ninety million.

The old caricature was that Asians are culturally more inclined to save money than Americans, but in this respect, the Philippines is far more American than Asian, perhaps in part a legacy of the fact that the Philippines was once a U.S. colony. The savings problem tends to spill over into debt and deficit trouble, but Aquino is starting to take this on too. By 2011, the administration was ahead of its own aggressive debt-busting schedule, which aims to bring the budget gap down from 4 percent of GDP in 2010 to 2 percent by 2013.

Aquino also needs to create an environment in which businessmen are confident enough to invest—which in return requires tamping down corruption, taking on the family tycoons who still dominate the economy, and enforcing contracts fairly. All those goals are combined in Aquino's first big initiative: an invitation to private investors from all over the world to join in open bidding on a series of public-private projects to rebuild the highways around central Manila, begin a commuter rail network, and upgrade its dilapidated airport.

Indeed the Manila international airport is a prime example of how cronyism and ineptitude has retarded economic growth. Recently voted one of the worst airports in the world, Manila has three terminals, but only the 1980s terminal is fully open to international airlines. The second terminal dates to the 1990s and is used by a local tycoon who doesn't want to share it with foreign airlines; the third was finished in 2002 but did not open until 2008, and then only to local airlines because of ongoing construction contract disputes that still scare foreign airlines away. Many investors saw the saga of the international airport that is open mainly to locals as a classic case of Third World incompetence. It's a big reason why foreign direct investment has been so low and why the Philippines has not been able to exploit its tourism potential. Even though the country boasts some of the world's most beautiful beaches spread across thousands of islands, it can muster only three million tourists a year, far fewer than the five million who visit the single Indonesian island of Bali.

In recent meetings with investors Aquino showed up casually dressed and smiling and did not make any tall promises: he emphasized his intention to keep his government clean, was attentive but not hostage to investors, and focused on giving talented Filipino expats a reason to come work at home. This is a critical priority. More than ten million Filipinos have left the country since the early 1980s for better prospects abroad and are now scattered across the world, from the United States and Japan to Britain and Germany, to Saudi Arabia and the United Arab Emirates. The cash they send home has been growing by double digits for the last decade, and now accounts for 10 percent of GDP, making these remittances the strongest growth sector in the Philippines. Many investment banks see this as a strength—remittances do help the balance of payments—but to have so many locals seeking work abroad is a major embarrassment, and it has created a subculture of entitlement among Filipinos who live off remittance checks rather than jobs. The stereotype of the Filipino expat is the maid in Hong Kong, but many also hold corporate and middle-class jobs. The country needs some of that talent to return home.

Indonesia's relative success over the past few years shows what the Philippines could become: it takes only a modicum of political stability and some basic economic sense. The Philippines has the world's fifth-richest store of natural resources, including oil, copper, nickel, gold, and silver. It has a large and young workforce—half of the population is under twenty-one, and two-thirds of them live in cities. That's a very high urbanization rate for a nation with an average income of only $2,500, and because the concentration of people and business drives growth, it's a big economic plus.

The Philippines also has some basic advantages over Indonesia—including a well-educated English-speaking population. For three decades it squandered those advantages, but there are signs of a turnaround, the most dramatic being the rise of the Philippines as a rival to India in "business process outsourcing"—the industry that provides the operators who answer calls for customer service at almost any major global company. Call centers did not exist in the Philippines a decade ago, and now it's a $9 billion industry employing 350,000 people. These centers are starting to open outside metro Manila and pop up all over the islands of the Philippines, to the point that some analysts think it may turn into another successful case of Southeast Asian archipelago capitalism. It could be made to happen, if the third Aquino can get the people-power revolution right.

Thailand's Code Red

There is no more dominant capital in Asia than Bangkok, where the ten million residents outnumber the population of the next-largest city in Thailand by more than 10 to 1. Normally, as a country grows richer, it develops more balance between the capital and the second cities. So for a nation of Thailand's wealth (the average income is around $5,000) to have not even one other city with more than a million people is astonishing. The residents of Bangkok account for 15 percent of the national population, and take home 40 percent of the national income. This lopsided picture is the bigger story behind the country's recent political chaos.

A running battle between the poor rural "red shirts" and Bangkok-centric, middle- and upper-income "yellow shirts" has defined Thai politics for the last decade, and is a direct result of the overwhelming power of the megalopolis and its elite. Even though Thai incomes are twice those of Indonesians or Filipinos, 70 percent of the Thai population lives in the countryside, compared to about 50 percent in Indonesia and 33 percent in the Philippines. Normally populations get richer as they move to the cities, so those numbers suggest there are serious political and cultural obstacles keeping Thais on the farm. Agriculture accounts for only 7 percent of GDP but almost 40 percent of the workforce, which sets the stage for the conflict between the rural voting bloc and the Bangkok elite.

When I visited Thailand in March 2006, the country was witnessing a unique, elitist uprising of the yellow shirts, a shifting coalition of big and small businessmen, royalists, and army officers. They were angered by then prime minister Thaksin Shinawatra's alleged abuses of power and his pandering to red-shirt voters. A former telecommunications tycoon, Thaksin had positioned himself as a champion of the rural poor and was first elected prime minister in 2001. He delivered aggressively with a populist menu of state support for his countryside constituency, including no-strings grants to rural villages, one-dollar hospital visits for the poor, and much more. The yellow shirts saw Thaksin as a pitchfork pointed at the heart of Bangkok's long-standing dominance, and in September 2006 they took action. An army coup—the eighteenth to rattle Thailand in seventy-five years—drove Thaksin into exile, prompting an escalating series of retaliatory protests by the red shirts. Over the next five years, four different yellow-shirt prime ministers tried to reestablish control, offering even more generous rural subsidies than Thaksin had, but none had any credibility with the rural majority, so nothing got done. Every time I visited Bangkok, the red shirts were stirring—shutting the airport down for a week in 2009, fighting police in battles that left more than one hundred Thais dead during the spring of 2011.

Given the constant threat of street fighting, businesses were unwilling to make new investments. The economy, sluggish since the Asian crisis of 1998, continued to idle along, which only added to the political tension. As elections approached in July 2011, the thinking in Bangkok was that if the red shirts prevailed, the military would intervene again, setting off another cycle of confrontation. Thailand—the 1990s darling of global investors—had become a financial no-fly zone. A colleague of mine described the staples of the stagnant Thai economy as "rice, tapioca, and massage," and he wasn't entirely joking.

No one saw the new regime coming. Just a month before the 2011 elections, Yingluck Shinawatra, Thaksin's younger sister, wasn't even on the political radar. A businesswoman and major player in Thaksin's party, she had insisted she would not be a prime-ministerial candidate. When she decided to run, all one of her rivals could think to say was, "She's very good looking." Shinawatra stormed out of nowhere to win a victory so convincing that even the military did not dare overturn the results, even though she was widely seen as a proxy for her brother.

The new prime minister offers some hope of a turn in Thailand, as she looks to lift up the rural population. International investors are not too excited by the government agenda, with its focus on doling out more support for the red-shirt constituencies rather than sharpening productivity and growth. But there won't be any progress in the country with the vast majority allowed only a tentative influence on power, subject to military whim. Now that democracy appears to have worked, the military has stepped down, and it's possible that a new leader can produce enough stability to address the basic fault lines of the economy.

Exporting to Excess

One of the lessons of the Great Recession was that what goes up must come down—Thailand, though, never went up. While all its peers were big winners in the great global boom of 2003 to 2007, Thailand slipped into what felt like a recession, as growth downshifted from 6 percent to less than 5 percent. Much of the problem was that the running street battles brought commercial life to a halt, creating a second major imbalance in the economy. Alongside the growing rural-urban divide, Thailand's domestic market was going flat. As consumption went slack, exports came to play a larger and larger role in the economy. In fact, though domestic investment was falling sharply, the heavy investment in new roads and factories before 1998 had put Thailand in a strong position for an export boom. Car exports from the (mainly Japanese) plants along the eastern seaboard have surged from insignificant numbers before 1998 to more than a million vehicles a year, making Thailand the biggest auto exporter in Asia after South Korea and Japan.

This apparent strength would be exposed as a vulnerability by the crisis of 2008. Remember, it's all about balance, and a strength taken too far can become a liability. Many nations seem to think that more exports are always better, but in Asia, economies from Taiwan to Thailand are suffering from too much dependence on exports. The mere mention of Asia conjures images of booming growth, a surging middle class flocking to new malls, and buzzing entrepreneurial energy. The reality is that the consumer piece of that picture is missing in nations such as Thailand, Malaysia, and Taiwan. At the peak of its power in the mid-1990s, Thailand with its population of sixty million was one of the world's top consumers of luxury goods, such as Mercedes-Benz cars, Volvo trucks, and Johnnie Walker Scotch, but those days are gone. By the 2000s, the Thai consumer was in sharp retreat.

Japan, the original Asian export powerhouse, was able to break through the middle-income barrier in the 1970s and 1980s because it created the right conditions for domestic investment and consumption to take off, and exports as a share of Japanese GDP averaged only 10 percent during that period. In Thailand, exports as a share of GDP have risen from 20 percent in 1980 and 35 percent in 1998 to 72 percent today, even though per capita income is still $5,000 compared with $35,000 in Japan. This is way out of whack, and it has led to trouble. When the 2008 crisis hit, and demand from the United States and Europe started to collapse, export-dependent nations like Thailand and Malaysia (where exports also account for about 70 percent of GDP) saw much sharper downturns than the Philippines and Indonesia (exports for both represent less than 30 percent of GDP).

One of the more unusual signs of stagnation is that Thailand has failed to enjoy the standard payoff when women work. Thailand has a very large population of working women, which normally translates into a higher level of economic development. It stands to reason that the more people there are earning incomes, the richer the society will be. But Thailand's high rate of female labor-force participation (66 percent) has produced no boost in growth. This is perhaps particularly surprising given that in Thailand the groom's family must pay a dowry to the bride, and not the other way around as in many Asian cultures. The male dowry would seem to suggest a society that traditionally puts a high value on the earning power of women. One reason why women have little impact on national growth in Thailand may be that they land mainly in low-end or temporary jobs, with little chance to make an impact on productivity. Another possibility is that when national politics are this big a mess, the gender politics of the workplace can't provide much of a boost.

By now Thai leaders should have taken steps to rebalance the economy to rely more on domestic investment, but instead they just kept doing what they were doing. Thaksin tried all manner of subsidies and supports to boost rural incomes, and he did make a big dent in rural poverty, but those handouts are no substitute for new businesses creating real jobs. Neither he nor his successors were able to create the conditions that would have drawn new investment to the heartland.

What Thailand needs is a transformation similar to the one that has unfolded in Turkey under the AK Party. Founded a decade ago, the AK Party led its own red shirt–style movement of relatively low-income and rural voters to election victories over an entrenched elite, but with one big difference: while Thaksin alienated the urban elite with heavy-handed policies, the AK Party avoided a confrontation. It began by providing the macroeconomic stability needed to help revive investment. As the economy picked up speed, the AK Party was able to satisfy its rural base by steering some of the new investment to previously neglected provinces, thereby rebalancing an economy once dominated by Istanbul, Ankara, and Izmir. And it was able to start winning over some of the urban elite as well.

It's not yet clear whether the current Thai government has the vision to provide that kind of strong leadership, or the maturity to avoid provoking another coup. Having cleaned up their debts since the crisis of 1998, Thai corporations have the money to invest; all they need for now is political stability and confidence. If the domestic market revives, guided by a red-shirt government, it's possible that Thailand may also see the emergence of real second cities in the years ahead. And that might even give Thailand a shot at becoming a breakout nation this decade.

The Acronym Nation

Mahathir Mohammed, one of the world's longest-serving leaders when he stepped down as Malaysian prime minister in 2003, has been blogging lately.

He's been complaining that the soft authoritarian regime he created is now too tough on bloggers like him. For the tenth anniversary of 9/11, he repeated the charge that the U.S. government orchestrated the attack to give itself an excuse for making war on Muslims. It would be easy to dismiss all this as the ramblings of a bitter retiree, except that Mahathir's views still shape a tiger economy that lost its claws in the crisis of 1997–1998 and has yet to grow them back.

What Really Happened after 1998

At the height of the crisis Mahathir defied the great Western powers and appeared for a time to win. He blamed the malicious conniving of foreign speculators for triggering the crisis, and the harsh belt-tightening imposed by the IMF for making it worse. He broke from the Asian pack, many of whom were willing to listen to the IMF's advice to cut spending and rewrite the banking rules to make them more open, more Western. Mahathir instead slapped on currency controls to keep the foreign speculators from fleeing, and ramped up spending to restart the economy. It worked for a time—Mahathir looked like a hero to some—but now the verdict of history is in.

Malaysia's economy slowed dramatically after the Asian crisis. The annual growth rate fell by nearly half, to 5 percent or less, about the same rate at which the economies of Thailand and the Philippines settled. However, not all 5 percent growth rates are created equal, and Malaysian growth is of lower quality than its neighbors'. There is a widespread sense in Kuala Lumpur that the economy has been growing because of extensive government spending and fortunate circumstances—rising global commodity prices have been a huge boost to its rubber and palm oil exports—not from smart choices.

The spending launched by Mahathir to battle the Asian crisis is still flowing. While its neighbors started to clean up the red ink and cronyism, Malaysia went from running a surplus to running a deficit every year since 1998. Fueled by revenues from rising commodity prices, government spending rose from 20 percent of GDP in 1998 to 28 percent now—one of the highest levels in East

Asia. Malaysia is the only Asian nation where government debt has risen as a share of GDP—from 20 percent to 50 percent over the last decade. Its large young workforce—60 percent of the population is under twenty-five—should be a competitive advantage, but so many are either not working or not employable that Malaysia has to import labor. The economy looks increasingly statist, slow-footed, uncompetitive, and the leadership adrift. The dramatic changes introduced in Indonesia, including the reform of the big conglomerates, the decline of public debt, and the shift of power to the provinces, have no parallel in Malaysia.

It is as if Malaysia were sliding backward. Instead of pushing itself to become more competitive in more advanced fields, Malaysia has been relying more and more on exports from its palm oil and rubber tree plantations, which were the core of its economy in the eighteenth century. Malaysia's share of global commodity exports is rising, but its share of global manufacturing exports has fallen by 26 percent in the last decade. Twenty years ago Malaysia's main exports were consumer electronics, which were assembled from components produced in other Asian countries for big global brands, and that is still the core of what remains of Malaysian manufacturing. But its manufacturing trade surplus has fallen sharply in the last decade, while China, Korea, Taiwan, and Singapore have all seen sharp increases.

The competitor that Malaysia seems to obsess about most is tiny Singapore. The rivalry goes back to the postcolonial period, when the British were pulling out, trying to figure out how to draw borders across a region with a Malay majority and a large Chinese minority. For a brief period the majority-Chinese enclave of Singapore joined in a federation with Malaysia, where Malays and other native people known as *Bumiputeras* comprised a 60 percent majority (with Chinese making up 25 percent of the population and Indians 7 percent). But ethnic tensions busted up the union. Mahathir was a critical player, charging that the Chinese business elites in Singapore were keeping the poor Malays down. Cast off on its own with few resources, the city-state of

Singapore nonetheless became a remarkable success as a regional financial capital under the leadership of Lee Kuan Yew. Since 1965, its per capita income has grown seventy-one times, to $37,000, while Malaysia's has grown twenty times, to $8,000. When the overall size of Singapore's economy surpassed Malaysia's in 2011, there was bitterness in Kuala Lumpur: Mahathir commented that Singapore had gotten where it is by focusing only on growth, not on "a fair distribution of wealth between races as we have in Malaysia."

Malaysia's problems go beyond race and old rivalries. Every nation in Southeast Asia has seen protests against the Chinese business class at some point in the postcolonial period, but only Malaysia keeps the fires burning as a matter of public policy. Even before Mahathir took power in 1981, Malaysia had created a program of affirmative action to give *Bumiputeras* greater ownership stakes in companies. Mahathir built that program into a sprawling system of racial quotas and subsidies for all walks of life, from schools to government posts. Even today the 60 percent Malay majority feels they do not have a fair share of the economic pie, but the 30 percent Chinese minority feels just as marginalized, trying to compete against favored Malay tycoons. Where everyone's a victim, it's a wonder anyone ever had the confidence to invest in the economy.

The racially charged political environment has made it difficult to open doors, to dial back the privileges for *Bumiputeras*. Feeling shut out, foreign and local investors started to move their money abroad. As opportunities dried up, talented Malaysians began to move abroad too, and the brain drain made Malaysia even less attractive to investors.

Malaysia is the only Asian nation in which foreign direct investment is falling: the total flow of investment dollars went negative in early 2006 and is still flowing out fast, at a rate of –2.5 percent of GDP in the last quarter of 2011. One important thing economists look for in an emerging market is a strong "investment cycle," which shows that businesses have the confidence to spend money on new factories, new office buildings, new enterprises. In

Malaysia money from local and Japanese investors fueled the rise of heavy industry through the 1990s, and rising exports drove up the rate of growth in the economy to a peak of about 9 percent before the Asian crisis. Then came the bust, and after 1997 private investment fell from 40 percent of GDP to 20 percent. This is the biggest difference with other Southeast Asian markets such as Indonesia: Malaysia has fallen off the investment map.

The Truth about Those "Evil" Speculators

The tragic thing is that Malaysia's turn inward likely springs from a misreading of the role those "evil" foreign speculators played in the crisis of 1998. In the worst crises of the emerging markets, from Mexico in the 1980s to East Asia in the 1990s, politicians were always quick to blame the sudden draining of the national accounts on feckless foreigners and their "hot money." Mahathir took this argument to its low point when he blamed the 1998 collapse of the ringgit on a worldwide conspiracy of Jewish financiers, but the basic idea that rich foreigners are always the first to run in a crisis is widely accepted. The truth is that the first to flee are most often the well-positioned insiders. That's why there is now a small industry devoted to tracking the trades of corporate insiders, and the same principle applies to countries. A rule of the road: watch the locals, they are always the first to know; they will be bringing money home to a breakout nation and fleeing one in trouble.

When financial crisis looms, money tends to flee in three phases. The first to go are large local investors, who in many emerging markets must move money through underground channels because of rules limiting capital flows. The use of back channels means that this flight of money will not show up in the standard national accounting categories, but often produces a marked rise in the catchall category called "errors and omissions" in the balance-of-payments statements. Another common dodge is that companies, from small businesses to state-owned giants, will start under-reporting exports and over-reporting imports, as cover for the money flowing out to banks and investments abroad. It is generally the case that the best-connected tycoons will have the best information on troubles at the treasury, and will lead the pack heading for the door.

Foreign creditors are the second pack to go—at that point the flow of short-term interbank loans from foreign banks starts to slow or reverse. The surge of short-term credit in the boom, and the reverse in the bust, are easy to spot in specialized industry reports—but these sources are not widely followed in the press. In the case of Malaysia none of the available data are transparent enough to nail down exactly who left when in 1998.

Normally the last to go are the foreign investors in the local stock market, which is widely tracked in real time. They are also the easiest to spot, which is one reason why they attract so much blame from angry locals. The rules in many emerging markets now require foreign investors to report their holdings more fully than locals do. There is no crisis in Malaysia right now, but it is not a vote of confidence that both locals and foreigners are pulling money out of the country.

Grand but Unfinished Plans

Malaysia has an addiction to central planning that critics have likened to the Soviet model but that probably owes more to the watery British socialism of the early postwar era. Malaysia's first five-year plan dates to 1955, two years before independence, and its government has been planning with gusto ever since.

Officials greet visitors with a blizzard of acronyms, describing their many schemes to recapture growth, and as a whole they get the problems pretty much right. With manufacturing flagging, and corporations moving abroad, they understand the need to regain competitiveness, restart investment, raise the skill level of the workforce, even to make the ubiquitous affirmative action system more transparent and market friendly. These goals are all built into the NEM (new economic model), which was unveiled in March 2010 and aims to double Malaysia's per capita income by 2020. The NEM includes both an ETP (economic transformation program) and a GTP (government transformation program), which have targeted dozens of NKEAs (national key economic areas) for reform, and launched no fewer than 131 EPPs (entry point projects) to fix those targets. The army of civil servants devoted to writing these acronyms seems to reflect a culture of micromanaging that goes back to Mahathir, who never saw an issue too small to comment on. Only now the culture lacks a single strongman to get things done.

The issue in Malaysia is execution: the country has become famous for presenting grand schemes that don't get built, for announcing new "growth corridors" that appear only on paper. Many of these plans look very old economy; current prime minister Najib Razak, for example, has plans for an "Iskandar region growth agenda," which is essentially a rebranded version of plans first hatched by Mahathir twenty years ago as the "South Johor economic corridor." Nothing happened, which is why, for instance, the Eighth Malaysian Plan ended in 2005 with 80 percent of the funds unspent.

To be fair, some of these plans do yield results: one success was a financial master plan that has done a lot to strengthen and consolidate a sprawling and corrupt banking system over the last decade. Others have yielded partial results: Mahathir's Multimedia Supercorridor—stretching thirty-one miles from downtown Kuala Lumpur to the international airport—has fallen well short of his vision that it would become a new Silicon Valley. As of 2009 Malaysian papers were reporting that many of the new tenants were government agencies. Lately, and encouragingly, it has been booking major multinationals to use its space for data centers—still not the core of a modern innovation economy.

Over the years Mahathir faced a series of confrontations with key centers of power in Malaysia: the provincial royalty, the courts, and the civil service. He emerged victorious each time, creating new institutions that were loyal to him, but they now stand as obstacles in the way of his successors, Abdullah Badawi and Najib. Both created new agencies to try to control the old, and thus added a new layer of acronyms. Najib's is called the Performance Management and

Delivery Unit (PEMANDU). Staffed by private-sector consultants on contract and led by a turnaround specialist, its mission is to narrow the number of targets the government is shooting at, and to make sure it scores some hits. The fewer new acronyms they produce, the more likely they are to succeed. Malaysia needs to move on and rebuild the institutions damaged during the later stages of Mahathir's rule. Nearly a decade after his retirement, Mahathir should not be casting such a long shadow on the country.