BASC News

Berkeley Asia-Pacific Economic Cooperation Study Center
University of California, Berkeley

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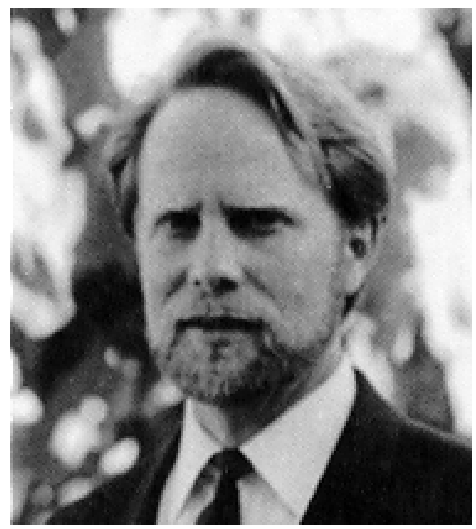
In This Issue

BASC Interview

Frost and Sullivan's David Frigstad Sees Emerging Crisis Opportunities

As Chairman of Frost and Sullivan, David Frigstad has led the company's expansion into various emerging markets. Even amidst the Asian Crisis, Frost and Sullivan continues to successfully expand in East Asian and other emerging markets around the world. Based in Mountain View, California, Frost and Sullivan is an international strategy consulting firm that advises clients in manufacturing and the provision of services throughout the world. Founded in 1961, the company has established a reputation in international marketing and since that time has become the world's largest publisher of marketing consulting studies covering over 1000 different high technology sectors. It employs over 500 consultants and has offices around the world, including Singapore, Tokyo, Beijing and Mumbai.



Frost and Sullivan's View of the Asian Crisis

BASC: From your position as a world leader in unbiased market consulting, what is your view of the Asian Crisis aftermath? And what growth potential do you foresee for the region?

Frigstad: The Asian crisis was a necessary recalibration of the economic, legal, and political situations in Asia. The crisis was a great problem for many individuals and companies. However, it has had virtually no impact on the long term potential of the region. During the crisis, our consulting revenues grew over 300% per year, so we have clear evidence that the region still holds great interest for the business community. The restructuring that has gone on in Asia now makes investing in Asia even more attractive than before the crisis.

BASC: What are some of the problems your clients in the Asia-Pacific have faced since the crisis?

Frigstad: Our clients have certainly experienced problems with canceled projects, slow payments, and a reduction or flattening of sales growth. Many investors and several businesses abandoned their programs in Asia. This is a common mistake made by people who typically buy high and sell low. Most of our clients have not been heavily reliant on Asia for growth and therefore have not made major changes in their strategies.

The biggest problem created by the crisis is a loss of confidence in the region by executives in Western countries who don't really understand what is going on in Asia. Their opinions on investment potential are largely formed by the popular trade press. This is a big mistake as it makes it difficult for business development executives to develop long

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Director's Notes

WELCOME TO THIS ISSUE of ***BASC News***. As anticipated in our last issue (Vol. 1, No. 2), the Asian financial crisis has continued to have a corrosive effect on the global economy and institutions. While some countries such as South Korea and Thailand have begun the slow road to recovery, others such as Indonesia and Malaysia remain at considerably greater risk. The crisis has manifested itself in growing conflict between the U.S. and the EU over "burden-sharing" for imports from these countries, which became a key focus of contention at the Trans-Atlantic Business Dialogue meetings in November 1998. As I argue in our ***BASC Analysis*** section, APEC continues to face grave dangers, with its liberalization agenda coming to a standstill. Efforts to work toward sectoral liberalization that would then become multilateralized in the WTO were blocked by Japanese reluctance to move forward in the area of fisheries and forestries.

What are the implications of the Asian crisis for corporate strategy? We take up this question in our ***BASC Interview*** with David Frigstad, Chairman of Frost and Sullivan, a leading marketing firm. Frigstad identifies major Asian sectoral and country potentials, and provides advice on long-term investment strategies.

Our ***Worldview*** section takes an insider's look at the impact of the crisis on China. Two APEC specialists from the PRC critically discuss flaws in the East Asian model of rapid growth, and the effects of the crisis on China's trade balance, FDI prospects, and financial health.

BASC continues to examine European corporate strategies in the Asia-Pacific. We were recently awarded a major grant to undertake comparative research on American, European, and Japanese firms' market and nonmarket strategies in East Asia. We welcome participation and inquiries about this project and we hope to work together with current and future board members on these issues. This spring also marks the inaugural issue of *Business and Politics*, a BASC-sponsored journal devoted to examining the intersection of corporate strategy and public policy.

—Vinod K. Aggarwal

BASC Projects

Project Update

Trevor Nakagawa

1998 WAS AN EXTREMELY busy year for the Berkeley APEC Study Center (BASC). Our research projects continue to progress on schedule, resulting in several working papers in progress. On March 5, 1999, we will hold a second research conference for a project entitled ***Asia Beckons Europe*** funded by the Center for German and European Studies at the University of California. Shortly thereafter, we plan to have the full set of working papers available on-line. In addition to hosting Dr. Gregory Noble from ANU until mid-January of this year to do research here at Berkeley, BASC Senior Research Affiliate Shujiro Urata made a planning and research visit as well.

Second, we are pleased to report that the Japan Foundation Center for Global Partnership has agreed to provide a grant to extend our current ***Asia Beckons Europe*** project to include an American and Japanese firm component. Collaborating with Japanese scholars, this project will compare Japanese firms' strategies and responses to recent changes in the global political economy with their American counterparts. We plan to launch this research project in January 1999.

Third, BASC Director Vinod Aggarwal and fellow Research Affiliates continue to present their research and promote Asia-Pacific cooperation at various academic, business and policy fora. In addition to making research and policy presentations to trade associations and councils, BASC Director Aggarwal has also presented our research on the Asian Crisis in Europe and at the World Bank.

Finally, we continue our collaboration with our fellow APEC centers. In late September, we hosted the East-West Center's Eighth New Generation Seminar in the Bay Area; and currently we are collaborating with Zhao Chunming, Director of the APEC Policy Research Center in Beijing, to coordinate two research conferences. In addition to a BASC co-sponsored book, *Asia Pacific Crossroads* (now available in paperback from St. Martin's Press), a related volume, *Institutional Designs for a Complex World*, was recently published by Cornell University Press. We are currently applying for funding to extend the framework used in this book on reconciling multiple institutions to the study of Asia-Pacific regionalism. We welcome anyone interested in this research topic to contact us.

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Withering APEC? The Search for an Institutional Role

By Vinod K. Aggarwal
Director, Berkeley APEC Study Center (BASC)

THE ASIAN CRISIS that began in 1997 has affected countries throughout the region. At the same time, it has thrown the Asia-Pacific Economic Cooperation forum (APEC) into an institutional crisis of its own. Created in 1989, APEC currently groups 21 countries in the region with the professed aim of liberalizing trade and investment in the region.[1]

As a trade liberalization forum, APEC began to take on a significant role in 1993 when heads of states met in Seattle, giving the Uruguay Round of negotiations a strong boost. By indicating that the U.S. was willing to move forward with trade liberalization in what was then the most dynamic region of the global economy, the U.S. was able to encourage the European Union to be more forthcoming and willing to conclude the long-delayed trade negotiations.

In November 1994, the members of APEC issued the Bogor declaration at their annual meeting in Indonesia. This agreement set APEC members on the road to trade liberalization with a target for achieving open trade for developed nations by the year 2010 and developing nations by 2020. In many respects, considering all of APEC's norms together, APEC in its present relatively embryonic state is more oriented toward openness than the World Trade Organization (WTO) itself. APEC leaders met in November 1995 in Osaka, Japan to hammer out details of how to reach the free-trade goal.

In 1996 in Manila, an important development for trade liberalization took place with the notion of using APEC to leverage trade liberalization in the WTO. Specifically, in an effort to push negotiations forward in information technology, APEC members agreed to an APEC-wide liberalization program in this sector. Following agreement on a liberalization schedule in products in this area, they then successfully pressed to multilateralize this agreement at the WTO's December 1996 Singapore Ministerial meeting. The agreement calls for the phasing out of tariffs on several categories of equipment by the year 2000, including computers, selected telecommunications equipment, software, semiconductors, and printed circuit boards. This effort can be seen as using sectoralism *regionally* to pursue sectoral liberalization *globally*.

The U.S. chose this path with enthusiasm, employing this model to promote liberalization in a variety of other sectors. In Vancouver in 1997, Ministers agreed to consider nine additional sectors: chemicals, energy-related equipment and services, environmental goods and services, forest products, medical equipment, telecommunications equipment, fish and fish products, toys, and gems and jewelry. The U.S. led a movement to make the nine-sector liberalization a package in order to discourage countries from picking and choosing sectors based on domestic concerns. But in Kuala Lumpur at the 6th Leaders' Summit in November 1998, Japan, supported by other Asian countries who were concerned about moving forward with liberalization in their weakened economic state, refused to liberalize fishing and forestry products.

Meanwhile, the deadline for reaching a final accord on extending the scope of ITA to additional products was postponed several times in 1998, and is continuing this year. An ITA-2 pact was intended to remove duties on 200 high-tech products by 2002 (2007 for some poorer countries). But this idea, pushed by the U.S. and EU, met considerable resistance from some Asian developing countries, especially Malaysia and India. India was concerned about dual use technology that might damage its defense interests while Malaysia wanted to protect its printed circuit board manufacturers. As a result, the product list has been more than halved in search of consensus; currently it includes printed circuit board-making equipment, radar and navigation goods, certain components of IT equipment, and some consumer electronics.

These developments have thrown the U.S. strategy of using APEC as the vanguard for sectoral liberalization into disarray, forcing the participants to send the whole package to the WTO for negotiation. Thus, for the moment, as a result in large part of the Asian crisis, APEC's role in trade liberalization has stalled.

Indeed, in Vancouver at the 1997 meeting of APEC members, the financial crisis overshadowed trade liberalization efforts. But the possibility of an active role by APEC in resolving the financial crisis came to naught. In fact, many institutions in the Asia-Pacific have attempted to play an active role. But in an effort to maintain its dominance, the IMF continues to resist. Beginning with its first key Asian program after the crisis began (a total package of $17 billion to Thailand in August 1997), the IMF, supported by the U.S., attempted to deter any rival institutions from taking a significant role. With the U.S. failing to financially participate in the Thai rescue package, the Japanese took the lead in September 1998 with a proposal for an Asian Monetary Fund (AMF), to be backed by $100 billion that they had lined up in commitments in the region. But the IMF and U.S. attempted almost immediately to quash this initiative, with the U.S. Treasury leading the charge. The U.S. viewed such a fund as undercutting the conditionality imposed by the IMF. In addition, it expressed concern about the relationship that any such fund would have to the IMF.

Three positions quickly emerged: the Japanese argued for some division of labor and parallel linkage between the two funds, with an AMF playing a role in crisis prevention as well. A second view, expressed by Malaysian Prime Minister Mahathir, was to have an AMF that would be independent of the IMF, thus creating a clear institutional rivalry. The third view, the IMF and American position, was that any Asian fund should be fully nested within the purview of the IMF.

The success of the U.S. and the IMF in forestalling creation of a rival financial institution was embodied in the November 1997 Vancouver APEC summit meeting leaders' endorsement of the so-called Manila framework, agreed to by APEC financial ministers shortly before the start of the summit. The Manila framework called for the International Monetary Fund to take the lead in

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[1] Australia, Brunei Darussalam, Canada, Chile, People's Republic of China, Hong Kong, China, Indonesia, Japan, Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Republic of the Philippines, Russia, Singapore, Chinese Taipei, Thailand, United States, and Vietnam

David Frigstad Interview

(continued from page 1)

term investment plans for Asia.

BASC: What prompted F&S to expand in the Asia-Pacific at this time? Which countries do you think offer the greatest opportunities in the next year? In five years?

Frigstad: Our strategy for Asia is as optimistic and aggressive as our management team can manage. Since our business is largely client driven, we are struggling to keep up with our clients' needs for more consulting on expanding into the Asia region.

Frost & Sullivan has been doing business in Japan for over 25 years. In 1999, we will expand our operation in Japan to include our conference program and a full high technology research center to support our Western clients as well as some of our Japanese clients.

Most business development executives we meet are far more excited about some of the new markets in India and China. India remains our favorite area for expansion. We believe that the political changes, the economic climate and the population make it the most exciting business environment in Asia. If I were just graduating from college today, that is where I would go.

BASC: Along with China and Singapore then, does F&S plan to use these offices as a regional hub for development in the region?

Frigstad: We are using our entire group of Asian offices as a regional business center for the company. We have already learned that Asia is not really a market segment, but merely a geographic grouping of countries for convenience. We initially began our business in Asia by producing pan-Asian reports on differences in high technology emerging markets. We quickly learned that our clients looked at business opportunities on a country-to-country basis and rarely looked at Asia as one market segment. Therefore, today each office is its own client and research center and the regional grouping is much less important to our business strategy.

BASC: Which sectors in the Asia-Pacific do you foresee having the highest potential growth in the near future?

Frigstad: There are several very interesting sectors we are monitoring for future growth potential in Asia. We believe medical devices and other health care products in India and China show significant potential for both development, production and, in the longer term, distribution. There is also solid potential for many industrial electronic and chemical products with higher value added labor potential. IT hardware, software, telecommunication services, and pharmaceuticals all have potential in the Asia region for companies who know how to utilize the economic and labor advantages available.

BASC: What are the opportunities of the crisis, in terms of asset or manufacturing capacity acquisition and market liberalization?

Frigstad: The crisis has obviously created market chaos, which in turn has created many new market opportunities for informed investors. The crisis has changed the basics of many of the Asian markets. These changes have made the current information from which international businesses run obsolete. For the investors who take the time to closely monitor the markets and the disparities in asset value, market economics and labor rates between countries will yield many great opportunities to grow their current businesses and expand into others through investments. Every crisis stimulates new opportunities and the Asian financial crisis is no different.

> ***"The restructuring that has gone on in Asia now makes investing in Asia even more attractive than before the crisis."***—*David Frigstad*

BASC: What is the typical client profile of Frost & Sullivan? What does F&S do for them? Have F&S's methodology and resources changed since the crisis?

Frigstad: A typical Frost & Sullivan client is based in Europe or North America and is engaged in the high technology industry. These clients are typically engineering focused and exhibit a great lack of understanding of the market place and especially a great lack of understanding of Asian markets. These clients are all struggling to maintain operating profits and to find new opportunities to grow. They have a very short-term time perspective and have difficulty focusing on Asian markets once they discover a longer-term investment is needed.

We spend a lot of time with our clients in training them on the opportunities in Asia and with cultural training specifically focused on some of the key cultures and business practices in Asia. The lack of education and understanding of these Asian cultures and markets is the key deterrent to expanding business in Asia for our clients. This is where we are focusing our time at the moment. We believe that in the future we will become more involved with higher level marketing consulting with our clients in terms of mergers and acquisitions, end user analysis, competitive analysis and brand equity strategies. This will have to come after the basic education on the market is completed.

Frost & Sullivan's business strategy for growth is now heavily focused on becoming a true international marketing consulting company. Our clients are focused now on becoming global players in the market place and this means we must be able to provide market analysis throughout all the major regions of the world. In order to do this we have invested the majority of our profits into developing four fully operational research and sales offices throughout Asia.

Our consulting and research methodology has changed since the crisis in that we now fully integrate all our Asian offices in each consulting project design strategy. Once this is completed, our Asian offices will be fully involved with developing specific research methodologies customized to that country. Previously all our consulting assignments were designed, implemented and performed exclusively through our London or California offices.

BASC: How is the entry investment climate in Asia different from a few years ago, for small and medium businesses, as well as for larger MNCs?

Frigstad: The great advantage for medium-sized companies like Frost & Sullivan is that investing in Asia is easier than ever! Most countries have liberalized their investment laws, making it far easier to invest. A few years ago we would not have considered investing in India, China or Japan. However, today we are moving full speed ahead. The MNCs have a mixed track record in Asia. It appears that the majority continues to underexploit their market potential and investment opportunities in Asia. There are many, however, who are accelerating their investigations into opportunities and increasing their investment in the region. The companies with more stability in their investor relations appear to be taking longer-term investment strategies in the region.

BASC: Thank you for an illuminating interview!

APEC Update

Early Liberalization Plan Referred to the WTO

Compiled by ***Moonhawk Kim***

Precarious cooperation in the 1998 Meetings

LAST YEAR, APEC TRADE Ministers failed to reach an agreement on Early Voluntary Sectoral Liberalization (EVSL) and entrusted the responsibility of making progress to the senior officials of member economies. Thus, the 10th APEC Ministerial Meeting held on November 14-15 and the 6th APEC Economic Leaders Meeting held on November 17-18, 1998 in Kuala Lumpur, Malaysia, carried a significant agenda. As many industries continued to suffer from the lingering effects of the Asian economic crisis, discussion of trade liberalization was naturally predicted to be difficult and secondary to discussion of recovery policies. The results of the 21-economy summit—now joined by Russia, Peru, and Vietnam—however, were mired by economic and political friction.

During a meeting of trade ministers, Japan and the U.S. exchanged angry accusations, as the U.S. and other industrial countries pressured Japan to cut tariffs on forestry and fisheries while Japan continued to resist. Negotiation on EVSL had been hampered by Japan's resistance to opening up the industries and culminated in the ministers agreeing to transfer the liberalization proposals to the WTO. U.S. Trade Representative Charlene Barshefsky views the outcome positively in that the effort at regional sectoral liberalization is now set to follow a pattern of global liberalization established by APEC and the precedent of information technology agreement. Progress in the WTO's information technology agreement (ITA-II), however, has been delayed by resistance from some developing countries, such as Malaysia and India, to support the proposed list of additional products.

In addition to the discord over liberalization that pitted the Asian economies against the Anglo-Saxon economies, political conflicts divided the APEC member economies. This year's APEC summit was already overshadowed by the turmoil in Malaysia caused by the arrest of former deputy prime minister Anwar Ibrahim and by the country's nascent reform movement. Vice President Al Gore galvanized this precarious situation in a speech supporting the reform movement against the 17-year rule of Mahathir Mohamad. The speech elicited harsh disapproval from the Malaysian government, but Mr. Gore refused to apologize. This international row sparked by Mr. Gore carries the risk of causing an anti-U.S. backlash in Asia, which could deepen divisions within the region and undermine the confidence needed to facilitate economic recovery.

> ***"Japan and the U.S. exchanged angry accusations, as the U.S. and other industrial countries pressured Japan to cut tariffs on forestry and fisheries"***

Looking to 1999

A preparatory Senior Officials Meeting (SOM), chaired by New Zealand, was held in Singapore on December 10-11 to set APEC's agenda for this year. The Singapore meeting extracted the outcome of discussions in Kuala Lumpur and allocated responsibilities within the APEC apparatus for carrying out the tasks arising from the outcome. In 1999 APEC will continue to work on Individual Action Plans (IAPs), Collective Action Plans (CAPs), EVSL, and other tasks. In addition, the two major items on APEC's agenda for this year are addressing finance-related issues in the region and ameliorating the social impact of the crisis. The United States offered to lead a Task Force on a Social Framework for Growth.

The senior officials agreed in principle to commission the Pacific Economic Cooperation Council (PECC) to assess the progress on IAPs. On EVSL, they agreed on the need to develop the economic and technical cooperation (ECOTECH) and facilitation elements of the nine sectors as their tariff elements were being prepared to be taken to the WTO. Moreover, following up on the concerns raised in Kuala Lumpur, the senior officials agreed to a proposal by Japan to hold a Y2K awareness week in March. The year will start off with the First Senior Officials Meeting in Wellington, New Zealand in February, which will be followed by a Finance Ministers Meeting in May, Trade Ministers Meeting in June, and Economic Leaders Meeting in September.

Withering APEC?

(continued from page 3)

providing emergency loans to Thailand, Indonesia, and South Korea, with APEC member nations taking only a secondary role, if necessary, to supplement IMF resources on a standby basis without any formal commitment of funds. Thus, with the APEC action providing a seal of approval for the U.S.-IMF backed plan, the AMF idea was put on hold.

During 1998, two additional formal meetings and one ad hoc one were held under the auspices of the Manila framework. Little significant change in the handling of the Asian crisis took place at these meetings, but prior to the last meeting held in Kuala Lumpur, the Japanese again raised the issue of an Asian Monetary Fund, but the U.S. again resisted this idea. It succeeded in watering down the effort to a $10 billion fund for Asian economies, calling for creation of a new $5 billion joint initiative of the US, Japan, the World Bank and the Asian Development Bank (ADB) with the U.S. contributing an additional $5 billion. Still, the Japanese continue to press forward with the notion of a separate AMF, and Finance Minister Kiichi Miyazawa this time called for regional funds in Latin America and East Europe as well. It remains to be seen if this idea will make headway, but in the current context, U.S. and IMF opposition seems certain.

In short, APEC now finds itself at crossroads, with its initiatives in trade stalled and its efforts to play a role in the financial crisis blocked. Yet as the only institution grouping together countries from the Americas and Asia, the forum continues to be an idea that would have to be invented if it did not exist. But unless APEC members commit to using and developing this institution to advance their collective interests, a valuable institution that could serve to stabilize the global economy in a time of crisis will wither away.

New Thinking in the Aftermath of the Asian Crisis

***Professor Chen Fengying**, Deputy Director of the China Institute of Contemporary International Relations (CICIR), Beijing, PRC*
(Translation by BASC)

Admitting the flaws in the East Asian Model

THE ASIAN CRISIS HAS provoked another wave of re-evaluation of the "East Asian Model" of economic growth. The difference from two years ago is that the weight of domestic opinion in Asian countries has shifted from a defensive stance to a self-critical one. The crisis renders moot any further denial of the need for fundamental, systemic revision of the growth model, with particular respect to governance mechanisms that mediate the disruptive effects of exogenous shocks on the domestic economy.

It has been widely noted that compared to plan-driven economies in the region, the relatively liberal economies of Hong Kong and Singapore have weathered the crisis well. Consequently, economists have suggested that excessive state intervention and counter-market institutions are the domestic sources of the crisis. One could fairly assume that corporate policy mistakes under a market economy would not have caused the inefficiency and immense losses that have occurred under plan-driven economies.

Another major tenet of the East Asian Model, that "social democratization is irrelevant to economic development," has also been debunked. Over the course of the crisis, calls for cleaning up "crony capitalism" have garnered a widespread, sympathetic domestic response. Indonesia and South Korea provide the prime examples of timely political reform in assistance of economic recovery.

The post-crisis Asia will not undergo a "lost decade" as Latin America did in the 1980s. While it will not regenerate the miraculous growth rates of past years, it may resume a deepened, balanced, matured pattern of development which could still bring Asia to the center of the global economy in the 21st century. The prevailing mood in Asia is that the crisis will be seen in the future as the "birth pains for the rise of the New Asia."

***Note by BASC Editor**: The East Asia Model discussed by Prof. Chen above refers to the notion of an authoritarian developmental state that actively intervenes in the economy with instruments of industrial policy. The East Asian Model also emphasizes the desirability of aggressive export promotion and domestic protection to boost trade competitiveness. In contrast, Prof. Chen's criticisms are consistent with neoclassical economists' interpretation of the "Miracle" as vindicating self-restrained states that allocate resources according to global market signals and their comparative advantage in the global economy.*

The Impact of the Asian Crisis on the People's Republic of China

***Professor Zhao Chunming**, Deputy Director of the Asia-Pacific Research Center at Beijing Normal University and Director of the APEC Policy Research Center of the Chinese Academy of Social Sciences*

Impact of the Financial Crisis on Chinese Foreign Trade

CHINA'S BALANCE OF TRADE is expected to deteriorate, due to a drop in Chinese export volume and an increase in imports from the region. Prior to the crisis, Southeast Asia was China's fifth biggest trading partner, but this regional market for Chinese exports has been shrinking. Capital flows that feed consumption have diminished due to the withdrawal of investment resources, and the past trend of growing import demand from East Asian economies has drastically halted. Since most of the crisis-afflicted countries have adopted tight budgetary and monetary policies by cutting expenditures and decreasing domestic demand across the board, their trading sectors are likely to be adversely affected. Above all, with a devaluation of 30-80 percent in most Southeast Asian countries, their export competitiveness has improved compared with that of China. This has led to a decrease in Chinese export volume to other countries and within trading blocs. The exact magnitude of these effects has yet to be determined.

On the other hand, China could take advantage of the depressed price and favorable exchange rate to import much-needed raw materials from Southeast Asia through favorable policies such as reduced tariffs and tax exemptions on imported equipment. According to research by IMF economists, a one-time 1% devaluation of currency by an APEC country results in a drop of .5% in its import volume. If that country's currency continues to appreciate by 1 percent, its imports will rise by 0.5 percent. As a result of devaluations in Southeast Asian countries and the relative appreciation of the Chinese currency (renminbi), Chinese commodities prices will rise, leading to a Chinese import growth rate of an estimated 3 percent.

The crisis will also alter the foreign trade structure of China. About 70 percent of Chinese export commodities are similar to those of Southeast Asian countries, including labor-intensive light industry products, textiles, electronic products, and agricultural products — most of which are exported to Europe, America and Japan. If full substitution were to take place, Chinese export volume would decrease by 5 percent. Consequently, some of China's foreign markets have been taken or carved up by Southeast Asian countries, forcing China to adjust the export proportion of these products and to avoid sell-

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ing them in the same markets as Southeast Asian countries.

Impact Of The Financial Crisis On China's Absorptive Capacity

China's absorptive capacity for foreign capital is challenged by the crisis in the following ways:

First, global and regional sources of investment are decreasing. America, Japan, England, France, Germany, and the "Asian Four Little Dragons" have been the major source of foreign capital for China. Of these, Hong Kong, Macao, Japan, Korea, and ASEAN together account for 85 percent of total inflows. Due to the devaluation of 30-80 percent in the Southeast Asian countries over the course of the crisis, the value of their corporate stocks have plunged. At present, since most enterprises are preoccupied with coping with internal problems, their investment plans for China have been scaled back dramatically. Meanwhile, the countries affected by the crisis are likely to introduce a variety of favorable policies to attract foreign investment, which will place competitive pressure on China to lean toward investments from the "Five Great Western Powers."

> ***"The greatest potential risk of an internal financial meltdown comes from the banking sector"***

Second, the uncertain regional environment after the crisis has slowed the utilization of foreign investment and loans. The crisis has hit European, American and Japanese enterprises in Asia, weakening investors' confidence in the developing countries of Southeast Asia as well as China. Many investors are taking a wait-and-see attitude. In addition, fear of the renminbi's devaluation has compounded the crisis. This has made it more difficult for Chinese state-owned enterprises to attract capital by issuing and selling stocks in European and American markets.

However, the crisis offers China opportunities in attracting a greater share of Asia-bound foreign capital. In terms of investment climate, the crisis has crippled both production and domestic consumption power in the stricken Southeast Asian countries, and has created destabilizing politics and policies which scare off global investors. In terms of industrial structure, Southeast Asia is highly dependent on export-oriented processing economy, and thus the rising cost of importing raw materials due to devaluation renders these sectors less profitable to foreign direct investment. In contrast, China's stable political situation, continuing growing economy, and reasonable structure and scale of foreign debt is attractive to foreign investors.

Impact of the Financial Crisis on China's Finance and Currency

The greatest potential risk of an internal financial meltdown comes from the banking sector. In particular, there is a sizable amount of non-performing loans held by banks. Of total bank assets, household deposits amount to two-thirds and enterprise deposits make up one-third, while the proportion of the bank's own capital has steadily decreased. In addition, state-owned banks lend mostly to state-owned enterprises that are slowly implementing organizational reform and still performing below expectation. This affects not only state assets' security and profitability, but also leads to illegal expropriation by those who are in charge. It is estimated that Chinese financial losses have amounted to 10% of total assets, equivalent to the sum of the state banks' added loans in 1995.

Meanwhile, financial crimes are so rampant that about 11,000 have been investigated and prosecuted since 1993 with more than 13,000 people involved. The amount of money involved in financial crimes is increasing. In 1995, more than 18 financial crimes involved over $12.5 million. As a result, bank integrity has been undermined and more bad debts accumulated. In addition, grave dangers are posed by China's backward financial architecture, including its underdeveloped financial markets, scarcity of qualified personnel, absence of risk awareness and calculation, and lax supervision system.

The Southeast Asian countries' move

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BASC Book Review

Institutional Designs for a Complex World
Bargaining, Linkages & Nesting

Edited by **Vinod K. Aggarwal**
Cornell University Press, 1998

THIS BOOK FILLS A hole in international regime theory that has long gone unrecognized. The authors invite us to abandon the preconceived idea that international institutions are created in—and designed to overcome—the institutional vacuum usually associated with the state of anarchy. As Vinod Aggarwal makes clear in his groundbreaking introduction, the post-war world is densely populated with international institutions. Thus, new institutions, to be successful, must do more than respond to a commonly perceived problem: they must also 'fit in' with old institutions. The purpose of this exceptionally coherent collective research effort is to explore the analytical consequences of this paradigmatic shift and offer four original empirical instances of this problem.

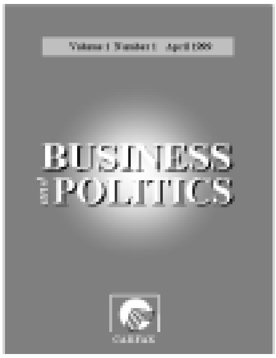
Each case study is a contribution in and of itself: Steven Weber's analysis of the 1992 EMS crisis as a case of successful institutional adjustment is innovative; Beverly Crawford's attribution of the diplomatic paralysis over Bosnia to the triumph of multilateralism is thought-provoking; and both Cédric Dupont's chronicle of the failed EU attempt to 'nest' EFTA countries in a parallel, yet linked, institution and Benjamin J. Cohen's study of the OECD's attempt to steal a march on the IMF in response to the oil crisis, shed light on unknown, and yet important events. The book will be especially relevant to students of European and other regional institutions.

—Daniel Verdier
European University Institute

Institutional Designs for a Complex World presents a perceptive theoretical analysis of the politics of coordination within and among international institutions, and includes richly detailed case studies of the politics of institutional design, innovation, and coordination involving several major European and Euro-American financial, trade, and military institutions.

—Joseph M. Grieco
Duke University

Business and Politics



This international journal analyzes corporate strategies in the new global political-economy. It provides a special focus on two areas. The first emphasis is on the integration of market with nonmarket corporate strategy, which includes organizational design, legal tactics, and lobbying. The second emphasis is on government efforts to influence firm behavior through regulatory, legal, and financial instruments. The first issue will appear in April 1999.

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Impact on China

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from pegged exchange rates to floating rates has increased the exchange rate volatility of the dollar in the region. Concurrently, Japan has taken the opportunity to place the yen in a central position by assisting the crisis economies. Thus Asian monetary centers may become increasingly regionally regulated, despite uncertainties over whether the dollar or the yen will dominate transactions in Asia. For China, the regional orientation leads to a favorable new environment to maintain Hong Kong as an international financial center while developing Shanghai into an international financial center in the Far East.

The turbulent international financial situation after the crisis compels China to strengthen its foreign exchange management and improve its foreign exchange rate system. The lesson of the crisis for China is that because the non-residents' possession of domestic currency creates more risk than residents holding foreign currency, the government must focus on tightening regulation of residents' possession of foreign exchange and strictly enforcing control and inspection over non-residents' possession of domestic currency. China's goal toward currency convertibility for capital projects should be phased in. The crisis has manifested the defects of the pegged exchange rate system and thus China should continue to maintain a floating exchange rate system by allowing the renminbi to fluctuate in a certain range according to supply and demand trends in the market. While the renminbi continues to face economic pressure, the political commitment to exchange rate stability appears firm.

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From Stephen Rudman, Director of External Relations

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To join Leadership Associates please contact Stephen Rudman or Vinod Aggarwal at 510-643-1071 or email BASC at basc@globetrotter.berkeley.edu.

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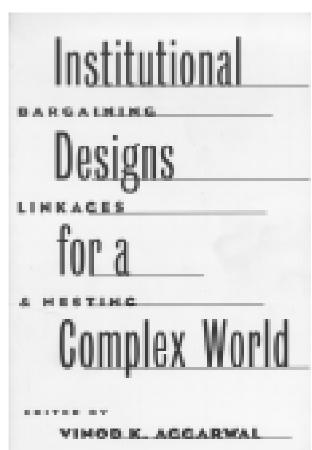

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