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East Asia in the New Economy: Problems and Challenges

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By

Edwin Heng Mok Han

SUMMARY

This paper addresses fundamental issues facing East Asia arising from the dawn of the new economy.

The first industrial revolution transformed the global landscape from one subsisting on agricultural output to one driven by the pillar of manufacturing. Likewise, the second industrial revolution, spanning the twentieth century, enabled the advent of technology which was to usher in the third wave of industrial revolution or what is now commonly known as the “new economy”.

In light of the above, this paper defines the new economy as the political, economic and social landscape of a country or region characterized and shaped by globalisation opportunities brought about by technological innovations and space-shrinking telecommunication improvements. Interactions among these factors reinforce and stimulate further developments. The result is an economic system in which the whole is greater than the sum of its parts. Using this holistic approach, the East Asian region, as defined by both Northeast and Southeast Asian nations, is examined.

New economy regardless, this paper recognises that issues of a political nature inherently resurface. Political instability hinders economic

development and progress. In this regard, the new economy with its characteristic interconnectedness and interdependence presents opportunity for achievement of regional political stability via positive contagion effect. Political stability of each nation would enhance the attractiveness of the region collectively. There are vested interests for each nation. Confidence draws more confidence at a sweeping speed as a result of new economy globalisation. An East Asian Political Forum (EAPF) is proposed to enable the convergence of such confidence.

The idea of new indigenous innovation is also mooted. In light of a knowledge-based economy, an East Asian Regional Research Portal is proposed to capitalise on the strength of each nation. The best of both physical inputs and intellectual capital, derived from differing sources within East Asia, are gelled together to make industrial production of such innovative ideas a reality. These are supported and safeguarded by appropriate intellectual property rights. The realisation of these indigenous innovations will result in tremendous spin-offs on both down-stream as well as up-stream industries across virtual borders within the East Asian region. Competition with the rest of the world in the new economy requires nothing short of such synergised innovative capacities.

Closer economic integration via policy co-ordination is the last proposal addressed in this paper. Volatility and fluctuation of general economic indicators are naturally enhanced in the new globalisation game of “integrated” economies. To enable control of “hot money” flows and hence financial instability in the new economy, the “fixing” of economic fundamentals is crucial to enable convergence of policies towards more prudent management of regional economies.

EAST ASIA IN THE NEW ECONOMY:
OPPORTUNITIES AND CHALLENGES

1. INTRODUCTION & OVERVIEW OF THE EAST ASIAN LANDSCAPE

Economic growth is a modern invention. Based upon Gross National Product (GNP) per capita, it is often used as an unquestioned yardstick of national well-being. Rooted narrowly on such growth statistics, the ascendancy of the Pacific Century has been proclaimed ever more fervently since the mid-80s[1]. The spectacular industrialization of various regional economies is also increasingly represented as a trend which is carrying Asia-Pacific towards a new era of prosperity. Notwithstanding, the recent Asian crisis took the East Asian[2] economies by storm. However, opportunities and challenges arise not only in the economic realm, but also in the socio-political domain. Adopting this holistic approach, the use of economic statistics is, but one of the many factors used to determine survivability and sustainability of any nation in the new economy.

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1 Linder (1986), Aikman (1986), Kelly & London (1989), Elegant (1991), Winchester (1991), McCord (1991), Gibney (1992), Borthwick (1992), Abegglen (1994), Naisbitt (1995).

2 Most sources use 'East Asia' to loosely signify only four economies, namely, the four 'Asian Tigers' – Singapore, Taiwan, Hong Kong and S. Korea. Rightfully, East Asia encompasses both Northeast as well as Southeast Asia. This paper considers both regions. Northeast Asian nations under consideration would include: China, Taiwan, Hong Kong, S. Korea and Japan. Southeast Asian nations include: Singapore, Thailand, Malaysia, Indonesia and the Philippines.

Together with China and Japan, East Asia's collective population base, export/import market and hence economic size will be larger than those of the United States, European Union, Latin American or African continents. Agents of change in the new economy include the shifting geo-political landscape, increased investment in universal education skewed towards biotechnology and the biomedical sciences, increased interdependence/inter-linking of regional economies and the continuous evolution of regional trading blocs and relations.

Challenges and opportunities and hence priorities differ within each country. Some of which are listed in brief as follows:

- The need for Singapore, Hong Kong, Taiwan and Korea to continuously invest in high-end sectors.
- The struggle of the 'next generation tigers' - Thailand, Indonesia, Malaysia and the Philippines in regaining investors' confidence by realigning their economic fundamentals and managing political and social order.
- The pressing need for Japan to recover from her economic sluggishness of the past decade.
- China's obligation to live up to expectations as the next regional economic powerhouse.

The following 'New Economy' definition is provided as a point of departure for further analysis:

> *" 'New Economy' is the political, economic and social landscape of a country or region characterized and shaped by globalisation opportunities brought about by technological innovations and space-shrinking telecommunication improvements. Interactions among these factors reinforce and stimulate further developments. The result is an economic system in which the whole is greater than the sum of its parts."*

Collectively, though, drivers of regional success in the new economy hinge heavily upon accurate identification of challenges and how these can be leveraged as opportunities. In this regard, section 2 examines socio-political and economic issues facing East Asia on a collective basis. How these are resolved remains pivotal to further regional progress. Regional prospects and opportunities in the new economy are addressed in section 3. This section also looks at long term strategies beyond the horizon. Section 4 concludes the paper.

2. THE UNITY MYTH: CHALLENGES IN THE HORIZON

2.1 In Search of Stability: Political Disunity & Economic Crisis

The foremost challenge for regional economies in the new economy is political stability, competency and continuity. In as much as economic prudence ensures political survivability of astute leadership, political stability instills internal and external confidence and influences economic viability. New economy opportunities can only be reaped when regulatory, political and governmental institutions are long-standing. Directional thrust of policy objectives and implementations cannot be clearly set out and implemented with the frequent turn-over of ruling parties or civil strife. This induces a sense of uncertainty and hence economic unsustainability.

According to Montgomery and Rondinelli (1989), nations with successful economic reforms have effective guidance systems that arise as a result of prudent governance and stable political constancy. The characteristics can be summed as follows:

- Controlling role of the State in guiding both public and private activities in strategic policy areas.
- Display of strong political leadership and a substantial period of political stability.
- Flexible and pragmatic leadership which is responsive to changing economic circumstances.
- Under the influence of strong leadership, institutions are created to carry out developmental policies.
- The effective formulation of policies in four domains – economic growth, social equity, international transactions and public sector management.

How does East Asia measure up?

The irony is that some East Asian economies were not destined to be politically or economically impoverished. In this respect, the Philippines is representative. The Spanish, who controlled the country for over three centuries, called it ‘Pearl of the Orient’ because of its rich agriculture and resources. At the time of President Diosdado Macapagal (1961 – 1965), Gloria Macagapal Arroyo’s father, the Philippines was second only to Japan in East Asia. Political scientists then predicted that Philippines would be an economic super power in half a century. It contained resources, was an American colony, had American investments, was pro-American and some of its common masses spoke English which facilitated trade and commerce. What caused its demise was political mismanagement, beginning with the Marcos administration. Nevertheless, under the Ramos administration from 1992 to 1998, the country was set on a path of economic reform. It was opened to increased foreign investment and tariffs were accordingly lowered. During this period, the economy went from being one of the most protectionistic to one of the most open in Asia. Yet somehow, the Philippines never had the right national strategy or leaders to achieve its promise. Despite Asia’s economic recovery, the Philippines began to trail behind. Even Indonesia, Vietnam and Burma are expected to do better. The Estrada scandal reinforced negative sentiments. Such challenges cannot be resolved by politicians with short-term policies, no matter how charismatic they may be. A short term of political mismanagement is sufficient to cripple the economy in the long term. In fact, Gloria Macagapal Arroyo inherited from Estrada an economy ridden with a budget deficit of 136 billion pesos (the equivalent of US$ 2.8 billion)[3].

Parliamentary impeachment and subsequent disposition of leaders are not unique only to the Philippines. For 18 months since his ascendancy to the helm, Abdurrahman Wahid, like Indonesia's ex-President Suharto, did nothing to alleviate the country's debt ridden banks. Unsold industrial assets and banks languished in the bank-restructuring agency. Negotiations with the International Monetary Fund (IMF) have come to a stand-still and the currency is remarkably feeble. Widespread violence is perpetuated by an ineffectual justice system. With the prevalence of factional politics, Megawati Sukanoputri might yet be slated as the next President. Even she may not succeed in establishing control of the situation in a country so accustomed to civil unrest due to intra-political and factional interests.

[3] The Economist, 24/3/01 – 30/3/01.

Leaving aside all other complex issues, it is noteworthy that economies in political disarray are also often economies suffering from constant economic troughs. The feedback loop is tremendous. Political disarray leads to loss of investors' confidence. This instills a sense of uncertainty and hence retraction of foreign investment funds. This outflow of 'hot money' induces adverse current account trade balances, plunging currencies and rising interest rates, which in turn leads to domestic bank instability and financial recession as liquidity in the economy dries up. Dissatisfaction with the economic situation leads to a more severe spell of political upheaval. The reverse circular logic holds true. The vicious cycle is difficult to break. New economy regardless, this challenge is here to stay.

The above political scenes are somewhat characteristic of the 'second generation tigers'. On the other end of the scale are other relatively stable economies characterized by political stability. These countries include South Korea, Taiwan, China, Japan, Singapore and Hong Kong.

For achievement of regional political stability, there must be vested interests for each nation in the region. The new economy presents such opportunities. In the post-Cold War era, the establishment of a new economic order takes centre stage. Herein lies the vested interest. Recall the feedback loop. Each nation that maintains political stability adds confidence to the region on a collective basis. More investment funds would hence pour in to the region again on a collective basis. The herd mentality whereby foreign investments draw more foreign investments into the region is set in motion. This positive contagion effect should be leveraged upon. Vested interest in the economic performance of each nation would ensure that each individual nation would put her own house in order. In a perfect world, this would work. Nevertheless, 'political synergy' should be pursued despite complex realities. To this end and for this purpose, an East Asian Political Forum (EAPF) is proposed. In such a forum, political issues are freely discussed and shrewd political advisory services are offered. 'Politically successful' nations may be 'employed' as economic and political advisors just as Lee Kuan Yew, Singapore's Senior Minister, was the economic advisor to China. Again, vested interests would ensure that neighbouring countries would obtain all forms of political assistance, advisory or otherwise, in enabling the continuation of political stability in the region. However, as political matters are dicey issues and national sovereignty is at stake, the final decision would inevitably rest with the leadership of the individual countries.

2.2 The North-South Divide

The challenge in the new economy is not complete. Correspondingly, it also lies in the economic realm. The old economy mind-set of economic development revolves around the adoption of either import-substitution industrialisation[4] or export oriented industrialisation. The speed of growth depended very much upon which strategy was adopted. While Malaysia adopted a moderately outward looking policy, export oriented industrialisation was pursued aggressively by Singapore, Hong Kong and South Korea since the 1960s. These economies had strong government industrial policy influence.

Throughout the 1960s to the 1980s, the Philippines remained inward-looking. For a sustained period of time from 1973 to 1985[5], Indonesia too, was inward-looking. China was still languishing in her centrally planned economic model and her belief of self-sufficiency before her adoption of an open door policy under the reign of Deng Xiaoping.

Japan was way ahead of her time with annual growth of 10% per annum[6] as a result of her pursuing a strong export oriented

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4 Import substitution industrialisation involves the production of goods which would otherwise be imported. This was later acknowledged to be an inferior strategy with questionable rationale. Tariffs or quotas were often instituted to prevent imports. Locals industries were protected from external competition and hence methods of production were inefficient.

5 Dicken P. (1992).

6 Boltho (1975).

industrialization programme after the war, through the 1950s, 60s, 70s and 80s.

The late start to an export oriented strategy together with the political instability inflicted upon various Southeast Asian nations is currently causing a 'North-South divide'. The GDP growth of Northeast Asia is fast outstripping that of Southeast Asia. Year-on-year, Hong Kong, South Korea, China and Taiwan registered GDP growth of approximately 14%, 13%, 8% and 8% respectively in first quarter 2000[7]. This compares extremely favourably with Southeast Asia's growth figures. Year-on-year, Malaysia, Singapore, Thailand, Philippines and Indonesia registered GDP growth of approximately 12%, 9%, 5%, 3% and 3% respectively in first quarter 2000. The external debt problem in Southeast Asia compounds the issue. With the exception of Singapore, the Philippines, Thailand, Indonesia and Malaysia all have total external debt of at least 50% of GDP in year 2000[8]. An imbalance of this magnitude does not bode well for regional economic integration in the new economy. In fact, the then Head of Economic Research at DBS Bank in Singapore, Friedrich Wu, noted that Northeast Asia would outperform Southeast Asia over the near term and Southeast Asia would be hard put in catching up[9].

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7 Goldman Sachs' report.

8 Ibid.

9 *Far Eastern Economic Review* (29/6/2000).

Regardless of the new economy characteristics of extensive interdependence and blurred economic borders, uneven development is seen as an opportunity. The role of complementarity comes into play. Indeed, with the advent of internet where geographical spaces shrink, the issue now does not lie in the adoption of either policy (import substitution or export orientation). Rather, as one come to terms that uneven development between economies is an inherent nature of economic growth and little can be done, one would realise that complementarity, co-operation and policy co-ordination on a collective basis would lift the region towards a higher plane of development in the long term.

3. DESIGNING LONG TERM STRATEGIES: PROSPECTS FOR REGIONAL COMPLEMENTARITY & NEW ECONOMY OPPORTUNITIES

The following debate of designing long-term strategies are driven by two phenomena that arise as a result of the new economy. The first is the dawn of the “knowledge economy” whereby pivotal survival tools are not so much the possession of physical assets as innovative ideas and the accompanying intellectual property rights that direct their utilisation which will give the East Asian region a competitive advantage. In addition, as a result of the birth of new technologies such as microelectronics, computers, telecommunications, designer materials, robotics and biotechnology[10], the third industrial wave and revolution forces upon us another phenomenon – “globalisation”.

With the political challenge addressed within the EAPF as discussed in the previous section and in view of the foregoing two phenomena, two strategic areas are proposed for regional complementarity in the new economy - indigenous innovation and research, and economic stability via policy coordination.

3.1 Source of New Economy Growth Opportunities: Indigenous Innovation

Development strategies must evolve in order to stay ahead. When Japan started her miraculous growth spurt in the 1950s[11], engineers were sent in hordes to Britain to observe the development of various products. Upon their return, the end products were imported, dismantled and re-assembled (Bhatt, 1980). Processes, like hard-wares, were likewise replicated almost in entirety. This is backward engineering. Industrialisation via such means served East Asia well for the past half

[10] The 6 new technologies are adapted from Thurow L.C. (1999).

[11] The post-war period of the 1950s to the 1970s saw Japan’s economic growth averaging 10% per annum, well above any other developed country during that period (Boltho, 1975:8).

century. No longer can such means sustain and ensure the continued survivability of economies in this new era.

Mere transfer of technologies will not suffice. Technology, whose specifications are now more technically intricate, has become more complex. Hence, technological absorption is not only more difficult but has also become an increasingly dicey issue. In fact, the politics of innovation today is more unyielding than in the past. Social and cultural conditions have also become less compromising. Comparatively, modern technologies make greater demands on society than its forerunners. Conversely, societal requirements are increasingly difficult to fulfill (Montgomery, 1974). As part of the ‘economic development cycle’, *new indigenous innovation* is required.

The conditions for cultivating a critical mass of indigenous technopreneurs are stringent:

- The initial outlay is often large. As a proportion of total national investment, the benefits which accrue to the few at the onset are grossly misrepresented. The latent potential of these projects is often oblivious to the masses as the gestation period is long and uncertain. Government policies skewed towards these sectors are thus often seen to be favouring the rich at the expense of the majority common masses who live in abject poverty. This costs political votes. It thus proves politically and economically unviable in the less developed East Asian countries like the Philippines, Indonesia and Thailand.

- The prevailing socio-economic conditions in the less developed East Asian nations do not induce a conducive environment and does not therefore give reason enough for investment by foreign funds.
- The wavering and inconsistent public policy sentiments fuel uncertainty and is thus inconsistent with the prerequisite of such investments which require long periods of national interest.
- Fulfillment of basic needs takes priority in many regional economies. Straddling between these needs, both national budget and government attention are strained in opposing directions.

Being higher on the developmental cycle, Japan, Singapore, Hong Kong, Taiwan, Korea and, to a lesser extent, Malaysia, have met the stringent criteria. For these economies, the competency to conceive a balanced environment conducive for indigenous research and development is the main hurdle to a host of opportunities that lay ahead. What can these East Asian economies learn from the industrialised West?

This paper proposes the conception of a “Silicon Culture” but with a twist. For better or worse, the present Silicon Valley culture[12] can be synthesized by nine features:

- The prevalence of centrality of work. Job satisfaction increases proportionally with the number of hours worked.
- Optimism towards work as the opportunity for innovation and development.
- Entrepreneurialism which creates a natural fertile breeding ground for start-ups and innovation.
- Aggressive competition which perpetuates improvement.
- Continued migration of global talent to the Silicon Valley.
- A culture of materialism directs the expectations of the young and as a consequence of which, segregation and stratification of those left out of the race are not understood, reinforcing selfish social norms and individualism.
- The relentless drive for achievement results in what is known as “techno-stress”.
- The emergence of corporate sub-cultures.
- As a direct consequence of “techno-stress”, a lavish, extravagant and *nouveau riche* behaviour results. It is a manifestation of the “work hard– play hard” syndrome.

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[12] Idea adopted and truncated from Castells M. & Hall P. (1994)

What is the twist? In the new economy with rampant internet technological access where there is ‘near perfect’ capital (human capital included) mobility, talents rove in search for the highest expected return. The concentration of such intellectual capacity and laboratory of innovation need not be focused on a physical location. A virtual, even ‘non-existent’ research space would suffice. The issue remains regional intellectual property rights which would have to be drawn up to safeguard individual interests. This freely mobile human capital would inevitably give rise to spill-over effects on both down-stream as well as up-stream supporting industries in all affected regional countries.

To this end, an old concept on a new idea is proposed - an East Asian Regional Research Portal. Economies of scale can be reaped. Benefits accrue to all economies concerned. Moreover, the social fabric of any nation in question would not be compromised with regards to the traditional ‘Silicon Valley Culture’ where selfish social norms, individualism and stratification of society are concerned. Both work on different planes. National and social values are localised on a physical plane/location while the congregation and meeting of minds are on the virtual plane. Regional countries on differing stages of development could offer a vast variety of hinterland research resources for innovation on a complementarity basis.

Malaysia's Multi-Media Super Corridor (MSC) at Petaling Jaya could offer the facilities, Indonesia and Philippines could offer low wage labour and acquisition of materials while Japan and Singapore could spearhead the research with intellectual inputs. These are then gelled on the East Asian Regional Research Portal supported by appropriate intellectual property rights. Funding could then come from the Asian Monetary Fund (AMF)[13]. Hence, indigenous innovation pertains to East Asian innovation on a collective basis.

3.2 Case for Closer Economic Policy Coordination & Integration[14]

All achievements in the new economy would come to naught without economic stability. In fact, the economic turmoil of the past does not naturally abate with the advent of the new economy. They continue to resurface and persist. In addition, new complexities arise. Collectively, these call for a new set of policy rules to govern the volatility of the new economic game.

In his recent trip to Singapore, Nobel Laureate Robert Mundell proposed that Indonesia and Malaysia should move towards adopting fixed

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13 The AMF was initially proposed by Japan during the Asian Financial Crisis in 1997. It was soundly rejected by the United States. It was once again raised by Thailand during a seminar in Bangkok on ASEAN economic cooperation on 19 September 2000.

exchange rates under currency board-type arrangements in which the monetary and fiscal framework is spelt out clearly (*The Business Times*, 5 Sep 2000). In fact, it was suggested that Asia should work towards a common currency somewhat similar to the Euro (*The Straits Times*, 7 Sep 2000). In the foreseeable future, this remains an ideal. What is required and is possibly achievable in this new economic age is the maintenance of exchange rate stability. Instead of outright pegging of exchange rates or forming a currency union similar to that of the European Union, it is proposed that East Asian nations peg their economic fundamentals. Countries could be given a certain grace period (such as five years) to conform to a set of "convergence criteria". This approach is, perhaps, more politically acceptable to the various countries' governments than outright pegging of exchange rates. On the contrary to currency unions, there is no loss of economic sovereignty.

While the benefits of having stable exchange rates with close mutual trading partners is clear, it is disappointing to note that the governments of the East Asian nations have not made any co-ordinated intra-regional effort to maintain stable, non-volatile exchange rates for the purpose of maximizing these benefits. The Asian financial crisis has not only exposed

[14] This section draws fundamental ideas and theories from the Maastricht Treaty/Agreement. Crafted to the East Asian context, these ideas present tremendous promise for the region in the new economy.

weaknesses in regional economic policies but also shown us the opportunities in which the region can co-operate to reduce the likelihood of future crises. By adopting consistent intra-East Asian economic policies, East Asian countries could form common policies so that the exchange rates will find their own stability. When all countries manage to fulfill all the convergence criteria by a predetermined date in the future, the exchange rates will be stabilised to a "natural rate" since the economic fundamentals of the countries are consistent, i.e. it has achieved the FEER (fundamental equilibrium exchange rate). We do not fix the exchange rates, rather, by aligning economic fundamentals, exchange rates will be “fixed” by itself.

Now, to assess the degree of convergence and to decipher if it is sufficient, rules of good management must be set out and followed in a stringent manner. The “convergence criteria” would encompass sound economic principles like management of inflation, interest rates, international reserves, exchange-rate stability, government surpluses and reducing of debt to limits which can be reasonably contained. An example of the convergence criteria is shown below. The numbers are only illustrative. East Asian nations could decide to

(i) lower their inflation rates to no more than 5% annually

(ii) reduce fiscal deficit to no more than 2% of GDP

(iii) maintain current account deficits of no more than 5% of GDP

(iv) ensure that M2[15] growth rate should not be more than 15% per year

(v) Credit growth/bank lending should not exceed 15% per year

(vi) Non-performing loans should be kept in check so that it does not exceed 10% of total loans

(vii) The ratio of short-term loans denominated in foreign currencies to foreign exchange reserves should not exceed 80%.

However, for the exchange rate stability within East Asia to be credible and strong, it must encompass countries which are well managed economically. To this end and for this purpose, East Asian nations must undertake to improve the performances of their economies to match and benchmark themselves to those with the best track record in economic fundamentals.

The sound management of this step towards greater monetary co-ordination must be permanent. Compliance with the criteria set down is not merely a test for admission of membership to this vision of a greater co-

[15] M2 is a measure of money that comprises the more liquid assets such as currencies, money market deposit accounts, mutual fund shares, time deposits and savings deposits. It is the more commonly used measure of money supply.

ordinated union but a lasting commitment by member countries to adhere to economic policies conducive to sustainable development, continued employment opportunities and the maintenance of purchasing power. Only with this next logical step towards greater monetary and fiscal co-ordination then can the issue of a single currency be broached and be a reality. For now, however, a closer integration among East Asia in the foreseeable future is within reach and remains the next challenge for regional economies.

4. CONCLUSION

Three main fundamental areas were broached – closer political synergy via EAPF, the focus on indigenous innovation as the next source of growth and economic coordination by pegging of economic fundamentals.

This paper recognises the evolution of economic policy and trade practices in the new economy. In mid 2000, the Pacific Rim nations contributed 36% of total global exports to the United States. This heavy reliance upon a single source of export market compares unfavourably to other regions in the world where Western Europe, the EU-11, Eastern Europe and South America contributed 20%, 18%, 1% and 6% respectively of the total global exports to the United States in the same period[16]. Individually, approximately 25%[17] of East Asian exports find their way to the United States. In fact, the United States is the largest export market for all the East Asian economies. This unhealthy heavy dependence of the real sector on a single major source of export market, the United States, to an extent, affects the capital and financial markets of each East Asian nation. As a result of which, as the old adage goes, when Alan Greenspan sneezes, the Asian region catches a cold. In the new economy, though, the bustle would polarise around 3 main economies, namely, the United States, China and Japan. In light of these changes, it is important that East Asian countries compete on the basis of indigenous innovation and the realignment of economic fundamentals to ensure financial stability and economic progress in the region.

However, this paper also recognises that the realignment of economic fundamentals and cooperation on innovation as the regional source of growth will not materialise if the current political situation in the region remains unresolved. The EAPF was thus proposed. Inherent in the nature of politics, this will always remain a 'grey' area. Nevertheless, rapid new economy changes require the need for 'political synergy' on a common platform or forum where issues can be readily addressed and

[16] UN Statistics.
[17] Ibid.

resolved. Only then can the region gel as a single economic entity with a common voice.

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