

Latecomer Countries and the Global Market Economy*

The risk of premature international integration
disrupting the development process

The age of international integration

For developing and transitional economies, the 1990s was a decade in which external pressure for liberalization and international integration increased considerably. We now live in a world where acceptance of global—in fact, often American—standards has become the pre-requisite for participating in the world economy. In the economic sphere, these standards include adoption of various market-based systems, privatization of public enterprises and external opening. In non-economic areas, achieving human rights, free election and parliamentary government is now the condition for being recognized as a worthy member of the international community. Latecomers are also told to conform to the models of the more advanced countries in the fields of environmental protection, intellectual property and the like.

Of course, external pressure to conform is not unique to our age. Throughout history, dominant civilizations always towered over neighboring cultures, presenting their local principles as the global standards of the age. However, it is well to recognize that, in our post-Cold War age, disintegration of the Communist bloc permitted the Americans to impose with little restraint their systems based on liberalism and individualism on the rest of the world. Disappearance of the competing ideology means that latecomers irritated by American demands can no longer seek refuge in the other political camp. Also, delays in political and economic liberalization which were quite permissible in developing countries in the past have now become increasingly unacceptable.

Latecomer countries are not always forced to participate in the international society against their own will. Certainly, conditionalities imposed by the international financial institutions and donor countries have played a very important role, but many latecomers also have opened up on their own or under peer pressure from neighboring countries. Many of the countries in systemic transition willingly adopted the big bang strategy. The trade and investment liberalization processes of ASEAN can be considered a natural response to the fierce competition to attract FDI in the Asian region, with China as the most formidable rival.

The key issue I would like to raise in this essay is this: most latecomer countries are unable to properly manage the process of liberalization and integration now engulfing the whole world and, as a result, they have suffered an increasingly large number of severe economic and political hardships

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due to ill-managed international integration. The speed and manner with which latecomer countries should integrate with the global market economy is now the central issue in their development strategy. It also provides a new flash point for political tug-of-war between industrialized and developing countries. To realize the nature of difficulties faced by countries in systemic transition or emerging economies beset by recent currency crises, this historical perspective is absolutely essential.

The danger of financial opening without preparation

There are three crucial decisions that latecomer countries must make regarding external economic relations which, if not properly managed, will entail great risks: opening of financial markets, exchange rate management and trade liberalization. Let us consider them in turn.

Asia was the epicenter of the currency and financial crisis that began in 1997 and then spread to Russia and Latin America. By now it is clear that contagious currency crises are not unique to Asia but a problem inherent in the global financial system. Since the Asian crisis was an international phenomenon, detailed analyses of domestic political economy of one crisis country alone will not reveal the true cause of crisis contagion and its severity. The emphasis in policy debate has already shifted from the evaluation of the Asian model of development to the need to reform the international financial system.

To fully understand the Asian crisis, we must first briefly review the history of development finance. From the 1970s to the early 80s, commercial bank loans originating from industrialized countries were the primary source of private funds in developing countries. However, the Mexican debt crisis which broke out in the summer of 1982 and spread to other countries brought this type of capital flows to a sudden halt. During the next ten years or so, international financial institutions and the Paris Club (a group of official bilateral creditors) provided official aid to highly indebted countries in exchange for implementing “structural adjustment”—namely, economic liberalization and external opening.

The debt crisis was finally over by the early 1990s. Thanks to sustained structural adjustment effort, macroeconomic improvements and external economic liberalization were achieved, creating a seemingly favorable investment climate. Large amounts of private capital again began to flow into developing countries as well as those countries which had just begun transition to the market economy. This time, inflows were not in the form of long-term commercial bank loans. Rather, new funds were provided through highly marketable instruments in equity and bond markets and offshore banking facilities. The developing countries and countries in systemic transition that established these financial markets and encouraged foreign investors to invest were called “emerging markets.” These were a relatively recent phenomenon of the 1990s. Latecomer countries which until then had only a minor role in global financial markets now became an integral part of that grand mechanism.

In this way, long-term syndicated loans by commercial banks were replaced by funds in equity markets and short-term borrowings which can leave the country very quickly. What transpired as a result of this shift is enormously increased instability. In the case of long-term bank loans, a debtor country can negotiate a rescheduling if it faces difficulty in repayment. But when one deals with markets, such relaxed and structured negotiations are impossible. A large number of anonymous investors will withdraw funds at the first sign of trouble, causing stock prices to plunge and igniting currency attacks. In financial markets where herd behavior often rules, it is extremely difficult to prevent overborrowing, capital reversal, speculative bubbles and crisis contagion.

In countries which have abolished capital control, enterprises and financial institutions are free to borrow from abroad while the government is unable to effectively monitor the situation. This has led to the accumulation of a vast amount of private-sector external debt not backed by sound business plans or ability to repay. When the currency plunges as confidence in that country evaporates,

there is a sharp increase in bad debt leading to system-wide defaults—revealing the fragility of economic growth based on a weak financial system and excessive foreign borrowing.

The Asian crisis was a phenomenon in which countries that had previously achieved high growth suddenly and completely lost the ability to control their macroeconomies due to inadequate speed and sequence of external financial integration. In the developing world, serious currency crisis contagion has already occurred twice in this decade including the 1994-95 Mexican crisis and this one. We must say the pace is rather quick. Crises of this type are likely to occur in the future too, unless the present international system is significantly reformed.

The Asian crisis did not end with just collapsing currencies; it was further aggravated by the poor policy response of the international financial institutions, causing credit crunch, paralysis of the financial system, and immense damage to the real economy. At the height of the crisis, the IMF called for fiscal tightening, higher interest rates, and bold restructuring of corporations and banks. This had the effect of severely hurting relatively sound companies and banks and amplifying panic. The IMF was accustomed to the crisis characterized by budget deficits and a depletion of international reserves, but it had never dealt with financial panic in the private sector.

A crisis of this type requires a skillful combination of short-term rescue measures to calm fears on the one hand and financial and corporate restructuring to improve the system on the other. As markets were shaken, the IMF should have provided a large amount of liquidity immediately. The IMF however got the timing completely wrong. The Asian crisis turned out to be much more persistent and severe than many had initially anticipated. Had the Fund not blundered this way, the crisis would have been much less persistent and severe than it actually was. (Recall that in the 1994-95 Mexican crisis, a \$50 billion international bailout package was quickly assembled under American leadership, preceding the Mexican government's announcement of New Economic Policy.)

Some people contend that the Asian crisis was caused by the structural or systemic weaknesses of the countries involved. According to this view, Thailand, Korea and Indonesia each had serious internal problems that made the crisis inevitable. But where can we find a developing country without any structural or systemic problems? Arguing that these three countries were particularly bad performers in the pre-crisis period, without comparing them with other LDCs, is a false hindsight. International comparison would show that the performance of Thailand, Korea and Indonesia was among the best in the developing world. The only mistake committed by all of them was that they opened up too carelessly to global financial markets.

After this unpleasant experience, each country should reflect on its weaknesses inherited from the past. Crisis provides a good opportunity to do so. But it would be unrealistic to expect a developing country to adopt international best practices in information disclosure, transparency, sound banking, fiscal oversight, macroeconomic management etc. in a short period of time. If these were possible at all, we would not need development economics. It is safer to assume that these achievements would take a very long time even with maximum effort, and we need to design policies for international financial integration accordingly, at least in the near future. It is extremely risky to hop on the bandwagon of liberalization without good domestic preparations. The best and most responsible advice that one can give to those countries with undeveloped banking systems and inadequate prudential regulation is “do not rush to external financial opening while these situations persist.”

Exchange rate management in the storm

Rigidity of the dollar peg exchange rate system is often cited as one of the causes of the Asian crisis. According to this view, Asian currencies were fixed too tightly to the dollar before the crisis although Japan, US and EU were equally important partners in their trade and investment

relations. Therefore, the rise of the dollar during 1995-97 also appreciated their currencies and invited speculative attacks. They argue that post-crisis developing Asia should shift to more diversified currency arrangements reflecting its multifaceted economic relationships.

I do not negate this argument completely. A close examination shows that there is still room for improvement in exchange rate policies in the region. But I must disagree if these authors are to insist that Asia's dollar peg had been utterly inappropriate and these countries should quickly adopt a much superior system of currency baskets. The situation is just not that simple.

The first thing we must realize is that today's developing and transitional countries must manage their currencies in global financial markets that are much more unstable than those in the 1950s and 60s. There is a great deal of volatility among major currencies of yen, dollar and euro, and capital flows originating in the industrialized countries are huge and highly unstable. The best that developing and transitional countries can do is to stay with the *average* of these fluctuating major currencies. Yet, when the yen/dollar exchange rate fluctuates greatly, how much consolation does "average" stability give to a company in Southeast Asia who must import from Japan and export to the US? Average stability does not guarantee stability of currency relations at the micro level. When major exchange rates are highly unstable, there is not much that developing countries can do with their exchange rate policies to offset it. No matter how one uses an umbrella during a storm, one will still get wet.

Though the Asian countries are sometimes criticized for the pre-crisis dollar peg, their currency management was in fact not so inflexible. Considering the dominant role of the dollar in the world economy, the extent of Asia's trade with the US and the dollar bloc, and American price stability since the 1980s, it is not unreasonable for developing countries in Asia to choose the dollar as an anchor currency. Based on the dollar standard, these countries were making additional rate adjustments when domestic and international financial shocks hit occasionally, ensuring that no significant loss would occur in overall competitiveness. A soft dollar bloc established this way has much to recommend it as a system of currency management combining stability with flexibility.

Of the NIEs4 (Korea, Taiwan, Hong Kong and Singapore) and ASEAN4 (Malaysia, Thailand, Indonesia and the Philippines), only Hong Kong and Thailand held their exchange rates consistently stable against the dollar during the pre-crisis period (defined here as from January 1990 to June 1997). Other currencies deviated from the strict dollar peg over the medium to long run through realignments, inflation slide and yielding to market pressure. Calculation of real effective exchange rates (most popular index of a country's inflation-adjusted competitiveness) using consumer prices shows that, in the pre-crisis period, Taiwan, Korea, Thailand, Indonesia and Malaysia maintained their currencies within plus or minus 10 percent of the weighted average of the Japanese, American and European currencies in real terms (of course, greater volatility was recorded against individual currencies, particularly the yen). In Hong Kong, Singapore and the Philippines, a tendency of real appreciation (competitiveness loss) was detected when consumer prices were used as a yardstick, though the Singaporean dollar was stable in real terms when wholesale prices were used. The Thai baht did appreciate prior to the crisis, but the size of real appreciation was only 9 percent relative to the period of stable competitiveness in the first half of the 1990s. By contrast, the Korean won was depreciating in real terms (gaining competitiveness) before the crisis!

In a world of exchange rate volatility among major currencies such as ours, it is highly doubtful if the Asian currencies could have achieved better stability in real terms. Let us make a counter-factual assumption that, during the pre-crisis period, the ten developing economies in Asia (NIEs4, ASEAN4, China and Vietnam) had pegged their currencies to a basket consisting of yen, dollar and ECU with weights reflecting trade amounts. According to my calculation¹, only four

¹ Kenichi Ohno, "Exchange Rate Management in Developing Asia," Asian Development Bank Institute Working Paper No.1 (January 1999), Tokyo (<http://www.adbi.org>).

economies—Singapore, Hong Kong, Taiwan and Malaysia—would have stabilized their competitiveness (based on consumer prices) relative to the actual, while the other six would have suffered greater instability. This conclusion would be the same whether currency weights were chosen by individual countries or regionally (the latter is called *joint float*). This surprising result—competitiveness is more stable under the dollar peg than with currency baskets—can be explained by two factors. First, each country already had flexible currency management even under the dollar standard. Second, for high-inflation countries such as Vietnam, China and the Philippines, the contents of the currency basket are less important than whether the country devalues as necessary in a timely manner.

Given the unstable global economy, there is no single “international best practice” in currency management applicable to the entire developing world. In fact, any of the exchange rate systems that can combine stability and flexibility—including managed float, currency basket, crawling peg, adjustable dollar peg, etc.—is acceptable. The question is not which system to select, but how to manage the selected system properly. Many of the Asian developing countries were already conducting exchange rate policies sufficiently flexibly even before the crisis. Improvements to their policies are surely possible, but they would be incremental rather than fundamental. If the monetary authorities think that they will enjoy much greater currency stability by adopting a brand new system, they are in for disappointment.

Early commitment to free trade

The current members of the industrialized world (Japan, US, EU) consist of countries that have successfully caught up, since the late 18th century and step by step, with the achievements of the British Industrial Revolution. In the process, it was very common for a latecomer industrializing country to temporarily protect their markets in order to promote domestic industries and create new institutions. The Japanese and German systems of official industrial promotion are well known. Even the US, the standard-bearer for free-market economics, adopted protectionist policies against England as it gained political independence. The Americans also imposed stiff tariffs on silk imports towards the end of the 19th century.

In the context of the long and dynamic history of global industrialization, the development problem we face today is “how can we extend the market mechanism and implant modern industries to the next tier of countries waiting for their turn?” Would they succeed by instant trade liberalization, a method that none of their predecessors adopted? We must remember that those countries that have not yet industrialized at present are saddled with certain handicaps. The negative legacy of past colonialism is often pointed out, but a more serious problem is that their societies lack preparations for adopting the market economic principle.

The international community is now pressing these countries to accept free trade, whether or not they are ready for it. In developing Asia, three concentric circles of free trade commitments exist: WTO (global), APEC (Asia-Pacific) and AFTA (within ASEAN). Each country must present an official free trade implementation schedule consistent with these multiple international constraints. Can they really do it? Let us examine Vietnam as an illustration.

Vietnam had suffered many externally- and self-inflicted hardships including a long succession of wars, rigid economic planning and international isolation. The country was excluded from Asian dynamism for many years. In the 1990s, Vietnam's economy at long last emerged from stagnation and began to grow robustly. During 1992-97, an average growth rate of 8.9 percent per annum was recorded. This very impressive performance was made possible by two factors: Doi Moi (renovation), which is the policy of economic liberalization and opening adopted in the mid-1980s, and large capital inflows consisting mainly of ODA and FDI which began in the early 1990s. Trade

and investment links quickly integrated Vietnam with the rest of the world. During this process, the Vietnamese economy grew at an unprecedented rate.

Nevertheless, growth based on liberalization and opening to the outside world is a temporary phenomenon; it will not last forever. There were already signs of economic slowdown by early 1997. Now that the Vietnamese investment boom is over and the real estate bubble has burst, the question of whether Vietnam can maintain high growth in the future depends on how it will respond to such long-term development challenges as industrial promotion and institution-building.

Before Vietnam could begin to address these basic issues, however, two external constraints emerged: multiple commitments to free trade and the negative impact of the Asian crisis. This means that Vietnam must now implement their long-term development strategies in a manner consistent with announced free trade commitments while avoiding the risks of currency crisis and financial turmoil. The Vietnamese economy benefitted greatly from rapid international integration in the early 1990s, but more recently the risks and constraints of globalization also became apparent.

Vietnam joined ASEAN in 1995. At the same time and inevitably, Vietnam also began to participate in AFTA, the regional free trade movement already in progress within ASEAN. The primary goal of AFTA was to reduce intra-regional tariffs to 5 percent or less within ten years, and the deadline for Vietnam was set to 2006. Full membership in ASEAN was a great diplomatic achievement for Vietnam. However, from the economic viewpoint, free trade commitments that come with the membership may turn out to be a considerable burden on the Vietnamese economy.

What must be recognized here is that the Vietnamese economy is at a very early stage of development, even by ASEAN standards. Vietnam's per capita income of \$320 (World Bank preliminary estimate, 1997) is much lower than that of Malaysia (\$4,680), Thailand (\$2,800), Philippines (\$1,220) or Indonesia (\$1,110)—not to speak of Singapore (\$32,490) which is already an advanced economy. The export base of these ASEAN neighbors has rapidly shifted towards manufactured goods. Vietnam's major exports, however, are still dominated by primary commodities such as crude oil, rice, marine products and coffee. Its only manufactured exports, garment and footwear on a contract-manufacturing basis, are totally dependent on foreign technology and capital. Inside the domestic economy, many serious problems typically observed in a very latecomer country are evident: absolute poverty, low savings, insufficient infrastructure, a primitive financial sector and an undeveloped market economy.

In Vietnam, a large part of industrial output is attributed to state-owned enterprises (SOEs). This should not be construed as a proof of efficiency of the SOE sector; rather, it points to the extreme weakness of the private sector. Most of the SOEs are protected by import barriers. Except for joint ventures with foreign partners, SOEs are equipped with dilapidated machinery and can only produce products of very low quality. Few of them can compete squarely with the imports of neighboring countries. If regional trade liberalization proceeds as scheduled, Vietnam will surely face massive bankruptcies and unemployment. For private enterprises, the situation is no better. If tariff ceilings are set at as low as 5 percent into the future, there is a concern that new private industries which are expected to support Vietnam's development in the 21st century may not emerge. Free trade does not hurt very much while the country remains at the stage of exporting primary commodities and contract manufacturing. But will free trade not become a binding constraint when Vietnam is ready for the next stage of industrialization?

I would like to add a few words to avoid any misunderstanding. I am not saying that developing countries need not implement free trade policies. It is undeniable that free trade has major benefits. Competition from overseas eliminates inefficient enterprises and forces even surviving enterprises to improve its performance. But I do find it highly problematic that the Vietnamese government has already committed to AFTA's regional trade liberalization and is about to negotiate WTO membership (which is likely to constrain Vietnam's trade policy even more) even though the government does not have any comprehensive and concrete long-term industrial vision, any strategy

for restructuring corporations effectively, or any deep understanding of how free trade will impact the country's economy or society.

Although I have discussed this issue intensively with many officials in the Vietnamese government and also analyzed Vietnam's tariff reduction schedule submitted to the ASEAN Secretariat, the role of trade policy in the overall development strategy remains unclear. As it stands, Vietnam's trade liberalization is very different from Japan's trade liberalization in the 1960s which was highly integrated with a scrupulously prepared policy for industrial promotion. Compared to Japan in those days, Vietnam has considerably less time, freedom, and human resources to effectively design and implement development policies while integrating with the global economy. Maybe I worry too much for Vietnam. Despite my pessimism, the Vietnamese economy may continue to grow strongly in the future. But I cannot help wondering if politically committed free trade, without sufficient understanding of its economic and social consequences, will always lead to good results.

Introducing markets to latecomers

For non-Western countries including Japan in the Meiji period (1868-1912) and today's developing and transitional countries, economic development is *not* the process of fostering autonomous growth of productive capacity within the social structure unique and inherent to each country. Rather, it is a process of rushing to be included in the periphery of the pre-existing international system by adapting to foreign values, institutions and technology. In a famous speech in 1911, Soseki Natsume, the famous Japanese novelist, proclaimed that "Western development is endogenous [internally arising] but Japan's development is exogenous [externally imposed]." The concept of economic development can potentially have very broad and diverse meanings, but today it has become synonymous with such terms as introducing markets, Westernization, industrialization, globalization, modernization and catching up with the West. Come to think of it, this is a very odd situation. But that is the reality of our age, for better or for worse.

It is very understandable that latecomer countries wish to actively "import" the market economy; it is because the authorities want to raise national income and people's living standards. Compared with other economic systems, we can hardly say that the market economy is superior culturally, morally or environmentally. It is even likely that the market economy exhibits severe weaknesses in these areas. There is no guarantee that the advent of markets will enrich our spiritual lives. However, from the material aspect of greatly expanding productivity, and from this aspect only, the market economy is superior to any other systems. The market economy can unleash great economic powers, especially when it is accompanied by industrialization and global integration.

The global market economy invades every aspect of our life with irresistible force, and no society can escape its strong hold. Maintaining one's economic independence without becoming a part of this tempest is, for all practical purposes, quite impossible. As seen in Meiji Japan or former socialist economies at present, reform inevitably calls for external integration together with domestic changes. However, for today's latecomer countries, the process of external integration has been strewn with many risks, for the following reasons.

First, if the imported market system and the basic structure of the society are not compatible, the merger of the two systems will not succeed. Even in the case where systemic merger is possible, substantial adjustments of both the domestic society and the imported system are required. The society of any developing country is not a blank canvas on which the market economy can be easily introduced. Each society has a very unique and complex structure with many layers of historical elements painted over one another. We cannot expect that new Western institutions such as business contracts and equity markets will always be assimilated into the existing systemic complex and

quickly start to function as intended. The only body that can responsibly manage this complicated blending process is the central government of that country.

Second, the global market economy with which latecomer countries are trying to integrate is a very rough place today. Needless to say, unregulated free markets are inherently unstable. Although the market system does contribute to improving efficiency and accelerating growth, we can hardly neglect its undesirable effects of increasing instability and widening the gap between rich and poor. Markets should always be regulated by appropriate social rules. Unfortunately in today's world economy, the inherent instability of the global economy is unleashed without restraint by the ideological worship of laissez-faire economics. If the global economy is highly unstable, there is not much that helpless latecomer countries can do to completely insulate themselves from external shocks. In fact, in such an environment a small policy mistake will be greatly magnified—rather than offset—and even threaten the very existence of the society.

Third, there is very limited capacity on the government side. On the one hand, the government of a latecomer country is entrusted with many important tasks, including smooth introduction of the market economy and management of the potentially dangerous process of international integration. On the other hand, as is well known, the government itself has many weaknesses to overcome such as poor training, corruption, collusion, inefficiency, political conflict, pressure from interest groups, abuse of power and rigid bureaucracy. This is as if the doctor who must heal the patient is sick himself. Regrettably, it is very common to see the government in a developing or transitional country lacking the capacity to design and implement development policies effectively. Clearly, improvement of government's institutional capacity is the pre-requisite for economic development.

In this context, one vitally important condition for overcoming these difficulties is that the government retain the capacity to safeguard the identity and continuity of the society as it integrates with the world economy. The policy option of non-integration is no longer available. But as a latecomer integrates, the right to determine what foreign systems to import, in what sequence to import them, how to re-interpret them, how the society will adjust to absorb them, how to cope with possible social friction, and the like, should ultimately rest with the home government. Surely external pressure will play a role, but foreign systems should not be unilaterally imposed. The receiving side of these systems should have the will and the responsibility to manage liberalization and external integration. In other words, the government of a latecomer country must “own” its integration process as the international financial institutions would put it. This is the key to the success and the failure of simultaneous systemic transition and international integration.

Keiji Maegawa, economic anthropologist, calls this process of accepting international systems without losing self-identity “translative adaptation”². From outside, systemic transition may appear as the process of a small country being absorbed into the powerful global market economy; but if the country in question can retain self-identity and continuity, the process is not passive submission. The inferior culture which is to be swallowed up by the superior one in fact becomes the master of the process, re-interpreting foreign systems according to its needs and preserving its social identity. The object of systemic merger becomes the subject. Despite Soseki's lamentation that Japan's development was externally imposed, we can still argue that Japan since the Meiji Restoration provides an excellent example of successful translative adaptation by a non-Western country.

What I fear is that the intensification of foreign pressure to liberalize and integrate in the 1990s may have robbed latecomers of the ability to control their own destiny. The authority to determine the contents and timing of crucial policies—such as law-making, political reform, labor policy, environmental protection, privatization, trade liberalization, FDI policy, financial liberalization,

² K. Maegawa, “The continuity of cultures and civilization: an introduction to the theory of translative adaptation,” *Comparative Civilization*, vol.10, 1994.

exchange rate management and so forth—is gradually shifting from the home government to the international institutions and donor community. Moreover, the reforms demanded by foreign groups tend to be highly uniform, ignoring the stage of development or the institutional capacity of government in each country. As a result, countries not yet prepared to accept foreign systems are plunged into confusion and crisis.

Amid the Asian currency crisis contagion, Malaysia introduced new foreign exchange control and a fixed exchange rate system in September 1998. This was a deviation from the free-market principle and, not surprisingly, Western countries and international organizations sharply criticized the move. However, and the political intention of Prime Minister Mahathir aside, these temporary measures cannot be considered abnormal from the purely economic viewpoint. It is all too natural that countries want to protect themselves from wild markets and regain economic control. It is irresponsible to recommend to unprepared latecomers to jump into the global market economy when it is as volatile as today. What is needed is the reform of the world economy which necessitates such emergency exits. Some call the Asian crisis the “21st century-type crisis,” but should we not strive to create rules to avoid the recurrence of similar crises in the remaining time of this century?

Towards integration without crisis

Debate over globalization is often characterized by almost religious belief in the American-type market economy on the one hand and emotional rejection of it on the other. Every time a major event in the global economy—such as systemic transition of the former USSR and the Asian crisis—occurs, these two views diverge even more rather than converge. The first view says that markets must be introduced with full force to overcome the crisis while the second curses externally imposed systemic changes. This is a very unfortunate situation. Common sense tells us that the truth is somewhere between these two extremes. Fruitless debate over ideologies colored with emotions must be replaced by policy-oriented discussions evaluating alternative realistic options.

All I can say to the IMF and the American government which seem to be firmly entrenched in dogmatic market ideals is that they should regain common sense and intellectual flexibility as soon as possible. Understandably, however, it is difficult for players in the center of the world economy to reassess their own systems in a relative light. Intellectual initiative of this kind therefore must come mainly from the group of latecomer countries. With its historically unique position as both an industrialized economy and a non-Western latecomer, Japan should be particularly active in accepting this intellectual challenge.

Every country must adapt to the central values and systems of the age. Development will surely fail if the country refuses to deal with the global market economy. Yet, it is equally improper to force an unprepared country to integrate with the world economy. The problem lies not with globalization itself but with how it is carried out. Compulsory and uniform international integration imposed on all countries irrespective of different positions in the world economy or stages of development must be stopped, especially when the global economy lacks stability.

In the 1990s, the virtues of the market economy and international integration were clearly overplayed. It is time to regain balance, to correct the pendulum that has swung too far. We must formulate concrete policies that promote the merits of the market economy and dampen its demerits. Pressure on latecomer countries to integrate must be accompanied by the reform of the world economy so that countries can integrate without being seriously damaged.

For this purpose, I propose the following two principles.

First, instead of being uniform, international rules for liberalization and integration must be multiple, reflecting different status, stages of development and institutional capacity of individual countries. In particular, latecomers should be given the freedom to integrate with the world economy

gradually and in steps, rather than in a big bang. There should be different criteria for good economic conduct between developed and developing countries, and similarly diverse rules among different types of developing countries. Outsiders should be patient enough to let each country tread its own path of translative adaptation over a long period of time, rather than demanding rapid institutional reforms with unilaterally imposed policy conditionality.

Second, efforts to stabilize the global economy—especially its financial aspects—are absolutely essential. One way to do this is to monitor and regulate private capital movements. We must proceed beyond the abstract argument of whether capital control is desirable or harmful in general; instead, alternative methods of capital control should be evaluated pragmatically as to effectiveness and feasibility. Another critically important issue is the reform of the current international monetary system based on the floating of major currencies since the 1970s. Even partial stability of these currencies would go a long way to improve the world economy. In particular, a more stable yen/dollar exchange rate would be highly beneficial to Japan as well as developing Asia³. In the area of trade, abuse of aggressive bilateral trade negotiations and anti-dumping laws must be checked, and resolution of all trade disputes must be delegated to the WTO.

When both of these conditions—multiple rules for integration and stability of the world economy—are fulfilled, and only then, latecomer countries are given the opportunity to accelerate external integration without inviting crisis. My proposal for promoting globalization amounts to creating a better environment for integration rather than beating latecomers into submission. Long-term healthy development of the world economy can be better achieved if we have more patience today, not less. This is the message that I would like to deliver to those people who draft harsh conditionalities for crisis-hit countries.

³ For more details see R. McKinnon and K. Ohno, *Dollar and yen: resolving economic conflict between the United States and Japan*, MIT Press, 1998.