Political Structures and Financial Liberalization in Pre-Crisis East Asia*

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East Asian economies differed dramatically in their vulnerability to the financial shocks of 1997-98. In the current literature on the Asian crisis, one key factor commonly adduced to explain the uneven crises is different national approaches to liberalizing the financial market. While extant analyses have yielded important insights into the correlation between divergent liberalization patterns and uneven crises, they have failed to deal with the crucial question of why East Asian economies diverged in their respective paths to financial market liberalization. To account for differences in liberalization approaches, this article develops an institutional explanation of financial policy choices. It posits that variations in liberalization patterns stem from fundamental differences in the organizational structures of the private sector, the bureaucracy, and the party system that shape the economic interests and political behavior of social groups and state agencies in the policy-making process. In making this argument, the article focuses on Korea, Singapore, Taiwan, and Thailand, the four major East Asian economies that pursued different liberalization strategies during the 1980s and 1990s and had contrasting performance in the recent financial crisis. It argues that cross-national differences in the above-mentioned domestic political structures within the four economies are the primary sources of their divergent liberalization approaches and outcomes, which, in turn, impacted financial stability to differing degrees and generated varying abilities to withstand external shocks.

East Asian economies differed dramatically in their abilities to withstand the financial turmoil of 1997-98. In the current literature on the Asian crisis, one key factor commonly adduced to explain the uneven crises is divergent national approaches to financial market liberalization and associated differences in the performance of corporate and financial sectors (Alba et al. 2001; Cho 2001; Noland 2000; Yin 2000). While these studies have yielded important insights into the correlation between different liberalization patterns and the varied vulnerability of national economies to regional contagion, they

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have failed to deal adequately with the crucial question of why East Asian economies differed in their respective paths to financial liberalization. The basic premise of the argument in this article is that the answer to the above-mentioned question lies primarily in the interaction between institutions, politics, and policymaking. A tight focus on differences in domestic political structures within which financial policy choices are made offers a key to understanding divergent national responses to market liberalization.

Extant analyses of financial liberalization and crisis in East Asia have largely taken the form of single-case studies. This narrow empirical focus has made it difficult to identify the common causal variables of policy differences and to weigh the explanatory value of these variables in broader national settings. This article makes the case that the sources of financial liberalization differences in East Asia can best be illustrated in a comparative perspective. It focuses on Korea, Singapore, Taiwan and Thailand, the four main East Asian economies that provide a strong analytical and methodological basis for comparison. These economies implemented significant financial reforms over more than two decades up through the late 1990s. However, approaches to these reforms varied across the four cases, as did outcomes in the major areas of domestic and external liberalization. Not surprisingly, they had contrasting vulnerabilities to the financial shocks: Korea and Thailand were among the most severely affected whereas Singapore and Taiwan were left largely unscathed. A comparison of their reform experiences can help us to understand the causes of divergent liberalization patterns and uneven crises in East Asia.

Divergent Patterns of Financial Liberalization

In Korea, Singapore, Taiwan, and Thailand, the governments followed different liberalization patterns, although they moved to liberalize the financial system in response to similar external market and political pressures in the 1970s and 1980s. In exploring cross-national differences in financial liberalization, this article focuses on four key dimensions: the deregulation of barriers to market entry, the removal of competitive restraints that create sectoral segmentation between banks and non-bank financial institutions (NBFIs), foreign exchange and capital decontrol, and the improvement of prudential regulation. These dimensions were chosen because the current literature shows them to have had direct effects on financial stability and because the ways in which these reform measures were designed and implemented crucially differentiated the East Asian economies in their contrasting vulnerability to external shocks. The typology used to compare these reform measures systematically, as well as the liberalization patterns of the four cases, are summarized in Table 1.

Korea removed entry barriers at an early stage of financial liberalization and did so in an across-the-board manner. From the early 1980s, the government began to license more NBFIs and opened the banking sector for domestic and foreign entrants. In the other three cases, the governments exercised more caution with entry deregulation and imposed restrictions on new entry, albeit in different market segments. Although Singaporean authorities allowed well-capitalized banks and NBFIs to get into offshore businesses in the Asian dollar

Table 1
Divergent Patterns of Financial Liberalization

	Liberalization Patterns	Key dimensions of financial liberalization			
		Timing and pace of entry deregulation	Approach to functional desegmentation	Sequence of liberalizing the capital account	Market liberalization vs. regulatory improvement
Korea	Poorly regulated, unbalanced, improperly sequenced	Early, extensive, relatively rapid in banking and NBFI sectors	Rapid, not even-handed, more favors to NBFIs	Overseas borrowing and short-term flows liberalized first; sectoral limits on FDI, portfolio investment	Significant liberalization without consistent efforts to improve regulatory rules and capacity
Singapore	Well guarded, carefully managed, balanced, properly sequenced	Relatively late, gradual in the domestic financial sector	Slow, wary, largely balanced	Early, rapid deregulation of FDI restrictions; controls over short-term and portfolio inflows into domestic market	Sustained efforts to upgrade and strengthen regulatory framework in parallel with financial market opening
Taiwan	Cautious, well-considered, highly regulated, prudently sequenced	Late, cautious, regulated in both banking and NBFI sectors	Gradual, prudent, more favors to banks	Relatively swift moves to liberalize long-term capital flows; extensive limits on foreign borrowing and portfolio inflows	Financial liberalization implemented in sync with efforts to improve system of prudential regulation
Thailand	Ill-designed, poorly managed, unbalanced, haphazardly sequenced	Late and cautious in banking sector; early and rapid in NBFI sector	Relatively rapid, favors to banks and finance companies	Enhanced access to foreign borrowing and short-term external funds through BIBF	Efforts to improve regulation preceded market reform, but prevalent supervisory forbearance

market, they were reluctant to issue new full and restricted banking licenses.[1] Taiwan did not move to reduce entry barriers to the banking sector until its reform process had been well under way for a decade, and virtually closed the NBFI sector to new entrants. While Thai authorities kept tight reigns on access to the banking sector through late 1997, they adopted a more permissive position on the establishment of new NBFIs.

The four economies also display significant differences in their approaches to liberalizing the regulatory barriers that functionally segmented the financial sector. Until the early 1990s, the Korean government had strictly limited the operations of commercial banks, but encouraged NBFIs to broaden their product range. In Thailand, the government also permitted financial institutions to diversify their business scope as part of its overall reform efforts. But it invariably gave more policy favors to banks and, to a lesser extent, finance companies when removing competitive restraints. In Singapore, the ongoing reform process did not weaken the regulations that demarcated the business lines of banks and NBFIs. Restrictions on transactions clearly delimited the business scope of various financial institutions (Montes and Tan 1999: 242). In Taiwan, the amendment of the banking law in July 1989 enabled banks to diversify into new business areas but denied NBFIs the same privilege.

Divergent approaches to desegmentation produced corresponding differences in the financial structure. As indicated in Table 2, while the growth of NBFIs overshadowed that of banks in Korea, and Thai finance companies acquired an

increasing market share in the 1980s and 1990s, the dominant position of banks was not seriously challenged by their NBFI rivals in Singapore and Taiwan. Haphazard deregulation in Korea and Thailand not only provided ample opportunities for malfeasance and fraud arising from the considerable overlap of product offerings among banks and NBFIs, but also allowed poorly capitalized and even insolvent institutions to obtain licenses (Haggard 2000: 36-8; Nam 1994). Equally problematic, the multiplication of financial institutions, particularly in the NBFI sector, intensified inter- and intra-sector competition and created a strong incentive for private financiers to engage in risky investment and lending. In Singapore and Taiwan, limits on new entry and a cautious approach to desegmentation facilitated government efforts at ensuring the soundness of the financial system (*FEER* 31 May 1990: 42-3; Lall and Liu 1997: 635-8).

In capital account liberalization the four cases also differed significantly. The Korean government adopted an incremental strategy for capital decontrol

Table 2
Shares of Total Assets of Financial Institutions, 1983 - 1997
(percentage)

	1983	1987	1991	1995	1997
KOREA					
Deposit money banks		56.0	45.6	38.0	39.4
NBFIs					
Development institutions		10.3	8.9	7.1	10.3
Merchant banks		1.5	1.4	4.6	5.3
Savings institutions		19.2	25.1	32.7	29.4
Insurance companies		5.9	7.6	6.7	6.3
Others		7.1	11.4	10.9	9.3
SINGAPORE					
Commercial banks	64.1	67.0	67.4	67.2	67.6
NBFIs					
Merchant banks	21.5	17.9	14.9	15.0	15.6
Finance companies	6.8	5.3	6.2	6.3	5.2
Insurance companies	1.9	3.7	4.9	6.1	6.5
Post office savings bank	5.7	6.1	6.6	5.4	5.1
TAIWAN					
Banking institutions	68.2	67.0	63.0	65.0	67.1
NBFIs					
Postal savings system	12.6	15.9	11.4	10.2	10.4
Investment and trust companies	4.0	2.5	4.7	1.9	2.0
Credit cooperatives	8.2	7.8	9.3	8.7	5.4
Insurance companies	2.1	3.1	4.3	6.4	7.6
Others	4.9	3.7	7.3	7.8	7.5
THAILAND					
Commercial banks	69.6	69.0	69.8	65.5	
Government institutions	11.4	13.8	9.9	8.3	
NBFIs					
Finance companies	13.9	12.0	15.6	20.8	
Agricultural cooperatives	1.3	0.8	0.5	0.5	
Savings cooperatives	1.1	1.8	2.1	2.5	
Insurance companies	1.6	1.9	1.8	1.6	
Others	1.1	0.7	0.3	0.8	

Sources: The CBC (*Financial Statistics Monthly*, various issues); The MAS (*Annual Report*, various issues); Nam et al. (1999: 86); Vichyanond (1994: 6-7); Watanagase (1996: 22).

in the 1980s and geared up its efforts to open the financial system in the early 1990s. But liberalizing efforts were highly selective: overseas borrowing by domestic banks and short-term trade-related flows were liberalized whereas foreign investments in domestic fixed-income assets were restricted and portfolio inflows only partially opened (Cho 2001). Thailand, which had maintained relatively relaxed controls over external financial transactions, began to remove the remaining restrictions in the late 1980s. The strategy had been largely balanced until early 1993, when the Bangkok International Banking Facility (BIBF) was launched.[2] This facility opened the door to greatly expanded external borrowing and enhanced access to foreign short-term funds. The asymmetrical and perverse liberalization in Korea and Thailand, coupled with the pegged exchange rate, resulted in the steady accumulation of foreign debts and, more significantly, in the bias in the maturity structure of their debts towards the short-term (see Table 3).

The process of financial opening in Singapore was initiated in 1968, when the Asian dollar market was established, and culminated in 1978 when capital controls were removed. Given the presence of an ever-growing offshore market and the high degree of capital mobility, the government made painstaking and successful efforts to stem the flows of speculative and volatile funds into the domestic financial system. As a result, foreign capital inflows took the form of long-term and stable direct investments rather than offshore bank loans and portfolio investments (MAS 1999: 6-12). Similarly, Taiwan adopted a care-

Table 3
The External Position: Foreign Debt and Maturity Structure, 1990 - 96

	Foreign debt as % of GDP	Short-term debt as % of total external debt	Short-term debt as % of foreign reverses
KOREA			
1990	13.79	30.87	72.13
1992	14.34	26.99	69.62
1994	14.32	25.47	54.07
1995	23.80	51.60	171.45
1996	28.40	50.20	203.23
SINGAPORE			
1990	11.23	17.51	2.65
1992	9.47	19.91	2.35
1994	10.79	13.28	1.75
1995	9.84	14.56	1.78
1996	10.74	19.81	2.60
TAIWAN			
1990	11.04	88.31	21.56
1992	9.37	86.93	21.00
1994	10.87	76.75	21.76
1995	10.40	72.18	21.64
1996	10.07	68.44	21.31
THAILAND			
1990	32.80	29.63	62.55
1992	37.51	35.22	72.34
1994	33.31	60.67	99.48
1995	33.78	72.36	114.21
1996	50.05	41.41	99.69

Source: Adapted from Corsetti et al. (1999: 335-6).

fully designed strategy for opening its financial market to foreign capital and investors, although capital movements were liberalized much later. Financial authorities moved more quickly to reduce barriers to direct investments and other long-term transactions but constantly held offshore borrowings and portfolio inflows on a tight leash. In Singapore and Taiwan, the well-guarded approach to capital decontrol, combined with abundant international reserves, contributed to the stronger external position, as captured by the numbers in Table 3.

The final aspect that differentiated the four cases is the way in which the regulatory system was reformed in the process of market liberalization. In Korea, significant financial reform over the 1980s was not matched by consistent efforts to establish an effective institutional framework of regulation. Although the government moved to tighten supervisory rules amidst mounting banking problems in the early 1990s, these efforts tended to be partial in scope and inefficient in implementation (Baliño and Ubide 1999). The early 1980s financial crisis in Thailand stimulated initial attempts to rectify institutional and legal flaws in the regulatory regime. Like their Korean counterparts, however, Thai financial authorities were often unable to strictly enforce existing rules and tended to exercise regulatory forbearance (Traisorat 2000). In parallel with the long-running process of financial market liberalization, the Singapore government persevered in its efforts to strengthen the regulatory framework. These involved not only the introduction and enactment of stringent rules but also the enhancement of supervisory skills and institutional capabilities on the part of financial regulators (Lall and Liu 1997). Taiwan authorities also made sustained efforts to improve the system of prudential regulation. Financial institution failures in the early 1980s led to initial moves on this front; further steps were taken to tighten supervisory rules in the late 1980s and early 1990s when the banking law was amended and new banks were licensed.

It may not be surprising that the divergent approaches to improving prudential supervision led to significant differences in the national regulatory environment of the four economies. Several comparative reviews by rating agencies, market observers, and academics ranked the prudential systems of major Asian emerging market economies on their regulatory framework, rule enforcement, and supervisory quality in the early and mid-1990s. Korea and Thailand were evaluated as weak on all these counts, as summarized in Table 4. While the two countries conformed with the Basle convention that designated the ratio of capital to risk-weighted assets as 8 percent for banks in the mid-1990s, lax rules for making provisions against bad loans indicate that the asset position of Korean and Thai banks was precarious. In the same rankings, Singapore and Taiwan were rated very strong or strong on the three indicators of bank supervision.[3] Variations in the national regulatory framework are reflected in the different asset positions of banks (see Table 4).

The Theoretical Framework

To account for liberalization differences among Korea, Singapore, Taiwan, and Thailand, this article develops an institutional explanation that has an inte-

Table 4
Main Features of Bank Regulation and Performance in the 1990s

	Korea	Singapore	Taiwan	Thailand
Regulatory rules	Lax:	Very strict:	Strict:	Lax:
Capital ratio	8-10 %	12-18%	12%	8-10%
Liquid ratio	5%	18%	9.5 %	7%
Time to NPL status	6 months	3 months	3 months	12 months
Minimal provisions against losses	20% of loan value	50% of loan value	40% of loan value	15% of loan value
Limits on loan exposure to risky sectors	Permissive	Stringent	≤20% of deposits	No explicit limits
Rule enforcement	Weak	Very strong	Strong	Very weak
Supervisory quality	Low	High	High	Low
NPLs/total loans (%)				
1996	8.00	2.80	3.80	13.00
1997	16.00	3.80	3.82	15.00

Sources: Comparative data on bank regulatory framework are taken from *Asiamoney* (May 1999: 21), Caprio (1998: Table 1), Claessens and Glaessner (1998: Table 9), Dekle and Kletzer (2001: Table 1), Reisen (1999: Table 4). NPL ratios are taken from Corsetti et al. (1999: Tables 21 and 22), Ngiam (2000: Table 4) and Yu (1999: Table 12).

grated focus on the political sources of financial policy choices. It posits that divergent liberalization patterns originate from cross-national variations in the domestic political structures that shape the articulation of private preferences for, and programmatic government interests in, financial reform. The theoretical framework builds on three variables—the organization of the private sector, the balance of authority over financial policy among state agencies, and the structure of party systems.

The article takes the structure of private-sector preference formation on financial policy as its main point of departure. The basic principle underlying the discussion of social influences is that financial liberalization, like any other economic reforms, has distributive consequences. While improving financial system efficiency through liberalizing measures may be desirable for society as a whole, the costs and benefits of such measures are not distributed equally among different social groups, which is the reason why they generate both anti- and pro-reform pressures. Liberalization programs are unlikely to be effectively implemented unless governments respond to these pressures and develop a social base of support (Haggard and Webb 1994: 16-25). While governments may choose to ignore distributive demands in designing liberalization policies, such behavior normally hinders their efforts to build coalitions for reform and remain in office (Becker 1983; Waterbury 1989). The approach adopted here is to treat policy change as a function of the constraints imposed upon policy makers by the demands of private actors and to identify the socio-political parameters within which state officials must operate to achieve their policy objectives.

While the policy impact of social constraints is important, not all social groups are expected to significantly influence financial market policy. Policy choices are in the first instance affected by the preferences of what are termed "primary constituencies" in the supply-and-demand theory of regulation (see Noll 1985). Primary constituencies are economically and politically the best endowed social actors on which state officials rely for various modes of support. The most powerful of these constituencies in the financial reform process tend to be big industrialists and private financiers (Haggard and Maxfield 1993; Zhang 2002a). Their interests in particular reform measures correlate with, among other things, their different positions in the domestic and international economic systems, sector-specific industrial characteristics, intercorporate relations, and legacies of government policies.[4] The ability of industrial and financial sectors to transform their interests into political power and to assert themselves in the policy-making process is a function of their organizational capabilities.

Private-business actors have substantial leverage over state officials by virtue of their control over physical and financial assets. This in itself may help to increase the capacity of these actors to advance their interests vis-à-vis the state. Structural power, however, may not be automatically translated into political pressures on policy processes without explicit lobbying efforts on the part of private actors; the effectiveness of such efforts is contingent on how cohesive they are as organized groups. Group organization, being the public good, is notoriously subject to the problem of free riding. The logic of collective action suggests that industrial concentration would potentially offer a small-group solution to the problem (Olson 1965; Stigler 1974). When the level of industrial concentration in a sector is high, entry barriers tend to be great, thus allowing the sector to avoid free riding relatively easily (Shafer 1994). Equally important, the small-number industry may also find it easier to detect and deter cheating and to maintain internal cohesion (Osborne 1976). Conversely, in a large-number industry, the level of industrial concentration is low, and competition is likely to prevail. The large number of small firms poses no barriers to entry and free riding is prevalent. In such situations, collective-action problems are likely to be insurmountable.

Although the organization of private-preference aggregation is important in understanding how government policies are socially constrained, they do not fully explain how financial policy change is initiated and reform processes are pursued. Private-sector preferences and actions do not by themselves produce liberalizing measures; state agencies make policy choices and formulate reform strategies in line with political and economic interests that are partially independent from social demands (Haggard and Kaufman 1992a; Nordlinger 1981). Equally important, while sectoral collective action may significantly influence financial policy, private groups, no matter how cohesive and powerful, have to act through the government to achieve their policy objectives. Whether they can translate their material interests into policy outputs hinges on not only the organization of the private sector but also the institutional features of the state that define the avenues of private access to public policy arenas. For these reasons, the role of states as both political actors and institutions should be examined.

The state is not a monolithic entity and should be disaggregated into its constituent agencies. Among state economic institutions, central banks are at the core of financial systems and form key agencies in economic policy-making processes. The respective programmatic interests of central banks and line ministries in financial policy and liberalization may not converge, manifestly because they have diverse institutional histories, dissimilar bureaucratic cultures, different constituency bases, and divergent policy objectives (Moran 1990).[5] To the extent that these different ministries and agencies have divergent policy interests, their relative strength and status within the policy-making hierarchy of the state will affect the direction of financial policy (Haggard and Maxfield 1993: 305-8). More specifically, the degree of central bank independence or the balance of authority over financial policy between central banks and other economic ministries influences which state agencies are more likely to set the basic line of financial liberalization strategy.

The institutional status of central banks also determines the extent to which the actions of private actors and politicians affect financial liberalization. Central bankers, being generally financial technocrats, tend to have narrow and specific interests in financial and monetary policies. Their policy behavior is motivated more heavily by technical concerns than by political considerations. Government politicians and line ministries, by contrast, have a broader set of policy objectives with regard to financial market policy, mainly because of their wider range of interests and responsibilities (Henning 1994: 62-6). They tend to maintain closer ties with constituent interests and are thus more responsive to their demands. If central banks are subordinate to governments and if planning and industrial ministries have more authority over financial policy, the course of market liberalization is likely to reflect the interests of bureaucrats, politicians, and private groups. If central banks are independent and enjoy a powerful and autonomous status within the state, on the other hand, the financial policy process is expected to remain relatively insulated from distributive pressures.

Central bankers are not the only key institutions in the financial policy arena; finance ministries also constitute important agencies in the macro-economic policy process. Typically, finance ministries not only have the sole jurisdiction over budgetary decisions but also share authority with central banks over external financial matters, although the institutional division of that authority varies from country to country. Furthermore, with the exception of some industrial nations and emerging market economies where supervisory functions are brought together within a single organization, finance ministries and central banks share the overall responsibility for regulating financial markets. Given that these two state agencies have shared powers over financial and regulatory policies, the nature of their relationships impinges on the direction of financial liberalization. A close working relationship between central banks and finance ministries is likely to reinforce institutional authority (Maxfield 1991) and, more importantly, to facilitate cooperation in the formulation of financial reform strategies. If central banks have arms-length or antagonistic ties with finance ministries, there is an implicit assumption that they are not in basic agreement regarding the approach to financial market reform. In this case,

interbureaucratic disputes in the design or implementation of the reform would undermine its coherence and effectiveness.

Societal and state actors contend for control over financial policy beyond the organizational parameters of the public and private sectors; they operate in broader political structures that mediate the ways in which financial policy changes are initiated and pursued. Not all these structures are directly relevant to the central concern of this article, however. The policy effects of regime types—authoritarian polities versus liberal democracies—are ambiguous. The ambiguity is reflected in the fact that although Korea, Singapore, Taiwan, and Thailand had been largely authoritarian until the late 1980s, they followed divergent liberalization approaches. The four countries, with the possible exception of Singapore, have since moved towards greater democratization, but their reform strategies were far from convergent. Similarly, there is no clear pattern that distinguishes presidential rule in Korea and Taiwan and parliamentary government in Singapore and Thailand with respect to their liberalization approaches.[6] Financial reform differences within the four cases actually cut across the presidential-parliamentary distinction. Explanatory weight is thus given to political party systems that assert the most direct mediating effects on the process of financial market liberalization, as will be shown below.

In the extant literature, the structures and internal organization of political parties are considered salient for understanding their policy consequences (Alesina 1987; Haggard and Kaufman 1992b; Haggard and Kaufman 1995: 170-81; MacIntyre 2001; Weaver and Rockman 1993). The structures of party systems are typically differentiated by the degree of their fragmentation and polarization, the former being defined as the number of effective parties (Powell 1982: 80-4), the latter as the ideological distance among parties (Sani and Sartori 1983: 316-29). The comparative focus here is on the effects of fragmentation, mainly because party competition is seldom based on ideology in East Asia (Blondel 1999; Haggard and Kaufman 1995: 166-8). Intra-party organization generally falls along a strong-weak continuum, with strong parties being characterized by cohesive internal structures, broad bases of support, and robust leaderships, and weak parties by prevalent factionalism, precarious electoral support, and narrow constituent bases (Blondel 1999: 31-8; Haggard 1997: 139-41).

In the policy-making process, these structural features are manifested in their effects on the representation of private interests, the exercise of executive authority, and policy coordination within the government. Political parties in fragmented structures tend to move towards the formation of narrowly based coalitions, mainly due to the fact that competition is organized among a large number of small parties. They also maintain close links to special socio-economic groups in order to maintain the allegiance of their narrow constituencies. This has the effect of facilitating the access of particularistic interests to the policy organs of parties and, if these parties are in power, to the center of economic policy (Blondel 1999: 38-42; Mainwaring and Scully 1995: 22-4). In cohesive party systems, where a small number of large, broad-based parties compete for power, competition tends to be structured around broad policy programs and take place in the context of more encompassing political blocs.

Particularistic interests are unlikely to prevail in such blocs in which diverse interests are represented. There is thus less likelihood that politicians operating in cohesive party systems will become beholden to special constituencies. This reduces the prospects for narrow interest groups to obtain effective access to public policy arenas (Haggard 1997: 137-8).

The different configurations of party systems also have differential impacts on the exercise of executive authority in policy processes and on executive control over the behavior of bureaucrats. Party fragmentation, particularly in combination with presidential systems, is likely to politically isolate and immobilize executives—due to the possibility that executives may face strong opposition in legislatures when different partisan groups control the two branches or when separation of purpose prevails (Linz 1990; Mainwaring 1990: 168-71). While presidents can bypass legislatures by pursuing their policies through bureaucracies, this option raises a serious question about the ability of politically weakened executives to delegate policy-making power effectively. Particularly in the areas of financial and regulatory policies, where interbureaucratic coordination is a prerequisite for coherent design and implementation, presidents, enervated by divided government, would find it difficult to exercise control over different state agencies and to resolve possible disputes among them. The problem is likely to be compounded if the ruling parties are fractionalized and undisciplined.

Similar problems also exist in parliamentary systems, albeit in different forms. In such systems, fragmented party structures pose difficulties for the stability of coalition governments and policy coordination among coalition partners for two principal reasons. To form multiparty governments, ministerial positions have to be distributed among contending parties that may have different constituent bases, programmatic interests, and policy objectives. This produces inherent constraints on the ability of prime ministers to undertake the coordinated implementation of policies that can satisfy each and every coalition partner (Haggard 1997: 135). Furthermore, when individual partners do not like certain policy changes, they will veto such changes; even small parties can block policy initiatives by dint of their capacity to defect and thus break up the coalition (Roubini and Sachs 1988: 21-7; Tsebelis 1995: 301-5). To keep the coalition together, central authorities would have to resort to compromise, leading to the incoherence and inconsistency of economic policy.

More cohesive party systems, by contrast, tend to strengthen executive power and facilitate coordination within the government in both presidential and parliamentary regimes. In two- or three-party systems, there is a real possibility that presidents may enjoy a majority or at least a substantial plurality in the legislature. Presidential majorities promote unity of purpose and help to maintain stable legislative coalitions that support the executive (Shugart and Haggard 2001: 91-5). Similarly, when a small number of large parties operate in parliamentary systems, these parties tend to rule by absolute majority. Where majority coalitions prevail, there is greater prospect of reducing veto points and less likelihood that key cabinet posts will be divided among contending parties. This enhances the chances for a stable government that allows prime ministers to govern effectively. The power of presidents and prime ministers

can be enhanced further if their own parties are disciplined. This is likely to be the case in cohesive systems where politicians tend to maintain party loyalty, develop broad constituent bases of support, and support party platforms rather than particularistic policies (Mainwaring 1999: ch. 2; Mainwaring and Scully 1995). A strong executive authority is well positioned to control the behavior of bureaucrats and contain interagency conflicts, thus creating a propitious institutional environment for effective and coherent policymaking.

In sum, the organization of private preferences, the division of governmental powers, and the structure of party systems constitute three different yet interrelated aspects of the institutional analysis of financial policy choices. While state agencies can shape financial market reform with their own policy preferences, powerful private interests are integrated into reform processes by virtue of their organizational capacities and their interactions with state officials. The articulation of private and public interests in financial liberalization is contingent on the configurations of social-economic organizations, state institutions, and party systems. Cross-national variations in these configurations provide a primary explanation of divergent liberalization patterns in Korea, Singapore, Taiwan, and Thailand. Comparative case studies such as those conducted here are typically plagued by the problem of few cases and many variables. It is thus important to exercise caution in positing a general causal link between political institutions and financial policy. The findings reported here should be appropriately viewed as exploratory and configurative.

Political Structures and Liberalization Patterns

The political structures of Korea, Singapore, Taiwan, and Thailand, defined by the institutional dimensions outlined above, are summarized in Table 5. On the

Table 5
Political Structures and Liberalization Patterns

	Political Structures			**Liberalization patterns**
	Private-sector organization	**Internal structure of the state**	**Systems of political parties**	
Korea	Highly concentrated, *chaebol*-dominated private sector	Subservient status of BOK vis-à-vis planning/industry ministries; conflictual BOK-finance ministry ties	Relatively fluid, unstable party system; internally divided, narrowly based political parties	Poorly regulated, unbalanced, improperly sequenced
Singapore	Weak, dispersed industrial sector; relatively strong financial sector	Autonomous, privileged position of MAS; close, cooperative MAS-finance ministry relations	Dominant-party rule; centralized, cohesive intra-party organization; strict internal discipline	Well-guarded, carefully managed, balanced, auspiciously sequenced
Taiwan	Fragmented industrial sector, state-controlled banking sector	Higher degree of central bank independence; largely smooth CBC-finance ministry working relationship	One party-dominated system until late 1990s; well-organized, hierarchical internal party structure	Cautious, well-considered, highly regulated, prudently sequenced
Thailand	Highly oligopolistic banking sector; bank dominance in economy	Diminished influence, authority of BOT; increasingly strained BOT-finance ministry relations	Highly fragmented, inchoate party system; weak, incohesive intra-party organization	Ill-designed, poorly managed, unbalanced, haphazardly sequenced

basis of the argument developed in the previous section, the section to follow illustrates the causal links between financial liberalization patterns and national political structures, starting with the two crisis countries.

Korea and Thailand

In Korea, private preferences bore strongly on the direction of financial market reform. Industrial conglomerates or *chaebols*, represented by the powerful Federation of Korean Industries, were the most influential private actors in the reform process. They were able to wield direct influence over financial policy primarily by virtue of their organizational strength, the main source of which was the spectacular concentration of their industrial structure, the direct result of previous government efforts to achieve rapid industrialization by fostering the growth of big business. Equally, the *chaebols* occupied an oligopolistic position in the Korean economy. As the development of the national economy varied with the performance of these industrial giants, they enjoyed powerful leverage over government policy. The transition to democracy in the late 1980s and the increasing integration of the Korean economy with the international system served to expand the political space for big industrialists and reinforced their role as crucial economic agents.

Korea's swift move towards the deregulation of entry barriers in the banking sector partly signified the desire of the *chaebols* to control commercial banks (Choi 1993: 42). Similarly, the uneven approach to functional desegmentation in favor of NBFIs reflected the fact that the *chaebols* owned much of the non-bank financial sector and relied increasingly on NBFIs for their investment needs. Selective capital decontrol, which biased capital inflows towards short-term maturity, was also congruent with the preferences of big business. The *chaebols* opposed the move to liberalize FDI activities and allow foreign entry into the domestic market for fear of increased competition and diluted ownership controls, but they supported those deregulation measures that enhanced their access to cheap, short-term foreign funds (Haggard and Maxfield 1996: 56-60). Access to such funds was particularly important in the early 1990s, when *chaebol* firms were desperate for low-cost financing to counteract the deterioration of industrial performance that resulted from rising wages and diminishing productivity.

The structure of state interests and institutions also crucially affected the nature of Korean financial reform. The subordination of the central bank, the Bank of Korea (BOK), to the government was a defining feature of financial policymaking. Successive post-war governments had a direct stake in bringing the BOK under their control and in mobilizing the central banking system for rapid industrialization. The macro-economic policy process was dominated by the Finance Ministry and the Economic Planning Board (later the Ministry of Finance and Economy, a merger between the two institutions) and influenced by the spending-oriented Ministry of Trade and Industry. This institutional arrangement affected financial reform in two important ways. First, the weighty position of major line ministries within the state hierarchy preordained that their interests would dominate the reform process. Second, the ministries of

trade and industry and of finance had close ties with constituent interests in the industrial community. Given that these ministries had a dominant say in financial matters, this eased the way for the *chaebols* to project their preferences into the official policy arena.

The rapid deregulation of entry barriers to domestic and foreign institutions, while consonant with *chaebol* preferences, reflected the state's intention to improve the ability of the banking sector to mobilize more investment funds and induce external capital inflows. The pursuit of public policy objectives was not completely divorced from the play of bureaucratic interests, specifically in the process of functional desegmentation. The uneven approach reflected the fact that the Finance Ministry supervised most categories of NBFIs and relied upon them for the execution of its supervisory functions. Furthermore, Finance Ministry officials were eager to promote the development of NBFIs because many of them retired into top positions in the sector in a process known as *amakudari*.[7] These interests prompted financial bureaucrats to be more responsive to the needs of NBFIs and their *chaebol* owners and to repudiate the demands of central and private bankers for a more balanced approach to removing regulatory restraints (Interviews, Seoul: 14 and 31 July 1997).

In capital account liberalization, the impact of programmatic government interests was equally substantial. While the *segyehwa*—the internationalization policy initiated by the Kim Young-Sam government in a bid to join the OECD—accelerated the process of capital decontrol in the early and mid-1990s, it was not directly responsible for the selective manner in which such decontrol was implemented. Selective capital account liberalization, which mirrored the desire of the *chaebols* to gain access to overseas funds and to contain foreign competitors, also signified the policy concerns of the government. Fearful about undue external influences on the economy, the government was reluctant to open the domestic industrial sector and capital market for greater foreign participation. But the authorities considerably liberalized short-term capital inflows in the early 1990s when they needed foreign funds to finance growing current account deficits and to help industrial firms to bolster their faltering performance. Government and private interests supportive of selective liberalization were so powerful that they obviated any efforts to open the capital account in an auspicious order.

The problems of financial liberalization in Korea also rested with regulatory weaknesses, which stemmed from institutional constraints as much as from technical deficiencies.[8] One major constraint was strained interbureaucratic relations. In Korea, the central bank and the Finance Ministry shared responsibility for supervising the financial sector. Effective regulation was thus contingent upon the smooth coordination between the two institutions. In the late 1980s and early 1990s, when the accelerated process of market liberalization put a premium on such coordination, relations between the BOK and the Finance Ministry/Ministry of Finance and Economy came under severe strain. Serious conflicts began to surface in the late 1980s, when central bankers sought more equal footing with the Finance Ministry in the policy-making process, and culminated in the mid-1990s, when the two institutions clashed over the

extended right to financial regulation. The continuous interagency rivalry undermined the efforts of the government to implement a coherent reform policy in general and to establish a more unified and effective regulatory framework in particular.

The protracted bureaucratic infighting and the poorly managed financial liberalization partly sprang from the often crippled authority and leadership of the executive, which in turn reflected the fluid and unstable organization of political parties in Korea. Ruling parties have usually been internally divided and organized around personal cliques; they are not based on a national social cleavage, and the bond between them and their electors is typically clientelistic and localized. These features have led to growing factionalism, weak internal discipline, and greater penetration by particularistic interests (Ahn and Jaung 1999: 148-53). Moreover, conflicts between the president and the legislature and resulting policy stalemates, which had been common under authoritarian rule, continued during the transition towards democracy (Mo 2001). Lacking the adequate organizational and legislative support, the presidents in much of the democratic era were vulnerable to the problem of the lame duck. They thus failed to resolve long-running bureaucratic disputes and, equally important, to effectively direct the course of financial market reform (Moon and Rhyu 2000).

In Thailand, the structure of private-preference articulation impinged heavily on the pattern of financial liberalization. Unlike in Korea, however, private influences stemmed from powerful interests centered in the banking community. Largely as a result of the previous government policy that severely restricted new entry, the Thai banking sector was highly concentrated. In terms of asset holdings, the market share of the largest three banks accounted for more than half of the entire banking industry in the 1980s and 1990s (Zhang 2002a: Table 3.3). Equally important are the ownership links between private banks and the banking families that have been at the center of diversified business groups. By the end of 1995, the control of equity shares by these families in many commercial banks ranged between 20 and 44 percent (*Asiamoney* March 1996: 40-50). The concentrated organization of the banking sector and its dominant position in the economy suggested that Thai private bankers could deploy large political resources to influence policy makers and to orient financial reform towards their preferences.

Thai private banks had long enjoyed the advantages of the oligopolisitc financial structure and thus developed a high stake in the policy that kept the banking sector closed to new entrants. Under the leadership of the influential Thai Bankers' Association, they successfully resisted efforts by liberal technocrats, local industrialists, and foreign firms to reduce entry barriers in the 1980s and early 1990s (Zhang 2002a: ch. 5). By the same token, banks also opposed the expansion of non-bank financial institutions into commercial banking business. But intra-sector ties complicated their preferences for desegmentation. While banks were loath to see expanded opportunities for the NBFI sector as a whole, they were disposed to promote the interests of finance companies, mainly because many of these companies were their affiliates. Private bankers also advocated capital decontrol, as they were likely to benefit from such decontrol in the form of enhanced access to foreign funds and arbitrage opportunities.

They thus constituted an important driving force behind the decision of the government to further liberalize capital flows and to establish the BIBF (*Banker* June 1992: 80; *FEER* 31 December 1992: 73-4).

Private influence over financial policy was facilitated by institutional changes in the state structure, more specifically, the declining status of the central bank, the Bank of Thailand (BOT). During much of the post-war period, the BOT had retained considerable authority, vis-à-vis line ministries and politicians, over financial and monetary matters (Doner and Unger 1993). The power of the BOT, however, began to erode in the 1980s. Its independence came under threat as politicians gained a growing hold on macro-economic issues against the backdrop of the ongoing, though not smooth, transition to democratic rule. In the meantime, market liberalization undercut the ability of the BOT to control the behavior of financial institutions through direct means and rendered central bankers increasingly dependent upon private financiers for policy support (Unger 1998: 83-108). These changes, coupled with the outmoded management structure and the sprouting factionalism within the BOT (*Asiamoney* February 1997: 11-28; Siamwalla 1997), undermined the prestige and influence of central bankers in the policy community.

The diminished authority of the BOT meant that central bankers could no longer possess the structural cohesiveness to pursue their policy objectives independently of distributive demands. This provided opportunities for powerful private actors to project their particularistic interests into the public-policy arena. The consequences of growing private capture manifested themselves in the frustrated official attempts to transform the oligopolistic structure of the banking sector, the uneven-handed approach to desegmentation that favored private bankers and their affiliates and, most conspicuously, the mismanagement of the BIBF. Aware of the potential negative effects of rapid capital inflows, the BOT had initially intended the BIBF to focus on offshore activities. Intense lobbying on the part of private bankers who were seeking quick profits through overseas borrowing, however, overwhelmed the ability of the BOT to contain BIBF operations within its original policy parameters (Overholt 1999: 1013-14). The distorted process of financial opening reflected the declining regulatory capacity of the BOT. The Nukul Commission, established to investigate the causes of financial crisis in Thailand, found the increasing tendency for central bankers to exercise supervisory forbearance that stemmed from the weakened power of the BOT to enforce regulatory rules in isolation from political pressures (Nukul Commission Report 1998: 169-71).[9]

The problems of financial sector governance were also compounded by the disintegration of the cooperative relationship between the central bank and the Finance Ministry throughout the 1990s. The resulting interbureaucratic rivalry had profound consequences for the design of financial reform. The accelerated liberalization in the late 1980s was partly spurred by conflicts over financial policy between the two agencies. The first reform program (1990-92), masterminded by top BOT technocrats, signified their counteroffensive against the attempts of the finance minister to sideline the central bank (Interviews, Bangkok, 14 and 28 March 1997; *SEAB* Summer 1989: 35-6). In the early and mid-1990s, the BOT and the Ministry each put forward liberalization plans in

quick succession, as they maneuvered for top positions on policy initiatives and tried to gain the upper hand in their continued wrestle for authority. These politically motivated plans were formulated in a haphazard manner, focusing on the areas where opposition was minimal and implemented out of sync with necessary institutional reforms. The strained relationship between the two key agencies responsible for financial supervision also compromised regulatory effectiveness. As revealed in the aftermath of financial institution failures in the mid-1990s, the BOT-Ministry conflicts hampered the exchange of information about the fraudulent activities of private financiers and prevented the coordinated efforts to nip the problem in the bud (*FEER* 21 May 1998: 62; *Nation* 22 February 1998).

The institutional weaknesses within the bureaucracy and the politicization of financial policymaking are a function of the structures of political parties. In Thailand, multimember electoral rules fostered intra-party competition and encouraged politicians to campaign on an individual rather than party basis. Coupled with unstable institutional loyalties, this rendered parties lax in discipline, incohesive in structure and weak in leadership (King 1999: 208-11). Further, the parliamentary regime and multiple weak parties combined to produce a fragmented party system and a concomitant pattern of shaky coalition governments (MacIntyre 1999, 2001). The effects of these structural problems, which had been largely suppressed in the authoritarian era when political parties were closed off national policy arenas, became manifest during the transition to democratic rule in the 1980s.

Weak intra-party organizations produced the tendency for politicians to maintain their own personal networks of support, especially in the business sector (Phongpaichit and Baker 1997: 25-32). This tendency, reinforced by individualized electoral strategies that spawned vote buying, rendered politicians dependent on big business for campaign funds. The narrow base of support increased the chances for private actors to capture political parties and to use them as vehicles for seizing control over policy processes. Precipitous financial liberalization in the 1990s represented the efforts of politicians to appeal to the demands of powerful financial interests (Phongpaichit and Baker 2000: 14-34). Furthermore, with inherently unstable coalitions of multiple contenders and veto points, Thai cabinets in the democratic era were prone to collapse. Associated with the instability of government is the fact that economic ministers were shuffled frequently. Between 1995 and 1997, when stability in the financial portfolio was most needed to manage the increasingly liberalized economic system, Thailand had no fewer than six finance ministers and three central bank governors. This led to ill-considered and erratic policy changes, eventually undermining the consistency and coherence of financial market reform.

Singapore and Taiwan

Singapore and Taiwan exhibited sharp differences in the configurations of the private sector, the state, and the party system. Unlike in Korea and Thailand, where industrial and financial groups emerged with formidable oligopolistic

power and political resources, domestic industries in Singapore were historically small in size and weak in organizational capacity. The development strategy of the government, which centered on the expansion of state-owned and multinational enterprises, further hampered the growth of domestic entrepreneurship. While local financial capital traditionally had a stronger position, the sector as a whole was pluralistic, consisting of private interests, government institutions, and transnational firms that were often locked in fierce competition. These organizational features preordained that the private sector would not be a significant political force in Singapore, and that its participation in the policy process was at the behest of the state. While the government began to involve private business in policy development in the 1990s against the backdrop of an increasingly diversified economy, the initiative did not alter the existing balance of power between private interests and public authorities (Rodan 1997).

The more important factor that rendered the government immune to private influences lay in the state structure, in particular the autonomous status of the Monetary Authority of Singapore (MAS). Established in 1971 as a result of government efforts to develop a more centralized approach to financial policy management, the MAS has enjoyed a prominent position within the overall state apparatus. The chairmanship of the MAS Board of Directors has always been the senior economic post in the cabinet. Successive MAS chairmen were chief lieutenants of, and had intimate relations with, Lee Kuan Yew, Singapore's all-powerful prime minister, and his successor, Goh Chok Tong (Ho 2000: 40-1). While central banking functions are divided between the Currency Board (the note issuer) and the MAS, the power of setting monetary policy rests squarely with the latter. More important, the MAS is entrusted with the exclusive authority to regulate all financial institutions. In the financial policy process, the MAS has thus traditionally outshone the Finance Ministry. But the fact that the MAS chairman is concurrently at the helm of the Ministry has contributed to the development of close relations between the two institutions.

The status of financial and regulatory authorities is a microcosm of the Singapore polity in which the ruling People's Action Party (PAP) has enjoyed continuous dominance over society. One-party rule has been the central feature of the Singapore polity since the early 1960s. The opposition has been too fragmented to challenge the hegemonic position of the PAP. The parliament has operated largely under the aegis of the ruling party and exercised little constraint on the authority of the prime minister, who is the secretary-general of the PAP. This has provided the government with the institutional resources to limit societal access to centers of policy-making power. Furthermore, the PAP has established an organizationally centralized and structurally cohesive party apparatus, characterized by strong leadership and strict discipline (Vasil 2000: 17-44). The systemic political dominance and intra-party organizational strength have enabled PAP leaders to wield virtually unrestricted command over the bureaucracy and to mold the hierarchy of state agencies in such a way that their policy interests can be effectively served (Ho 2000: 143-78). Seeing sound financial development and market stability as one of the most important

pillars of national security (Dent 2001), PAP leaders delegated autonomous power to the MAS and coalesced the leadership of the MAS and the Finance Ministry to ensure the smooth working relationship between the two key economic agencies.

These institutional arrangements have sustained the authority of the MAS to set the direction of financial market reform. The distinctive pattern of the three-decade-long liberalization process has primarily reflected the changing policy priorities of financial and political leaders in response to international market developments. The government has allowed foreign entry into the offshore market to bolster its efforts to develop Singapore into a global financial center. But it has been very reluctant to open the way for new entrants in the domestic banking sector for fears of excessive competition and regulatory problems (Lall and Liu 1997: 637; Lim et al. 1988: 351). Despite the constant lobbying on the part of foreign firms to reduce entry barriers, the MAS has refused to budge mainly because of its desire to safeguard financial systemic stability (*FEER* 2 August 1990: 32-3, 25 September 1996: 106-8). Similar considerations have also made financial authorities cautious with functional desegmentation. They have regularly warned banks and NBFIs not to venture into unauthorized business areas and have never been hesitant to penalize those which dared go beyond the prescribed bounds (*Asian Finance* 15 October 1991: 46-7; *FEER* 3 July 1986: 85; Tan 1996: 39, 86, 110-11).

The configuration of interests and institutions within the state has also been important in shaping the approach to capital decontrol. While Singapore began to liberalize external financial transactions in the late 1960s, the process was carefully sequenced and effectively regulated. Initial efforts focused on deregulating the FDI regime, in order to facilitate the achievement of long-term industrialization strategies. More significant liberalizing measures were taken in the late 1970s and the 1980s when the tertiary, notably banking and financial, sectors were identified as the new engine of growth following the debacle of the "Second Industrial Revolution" (Rodan 1987). Capital decontrol, however, ran in parallel with the sustained efforts of financial authorities to stem volatile inflows by restricting the activities of foreign banks in the local market, decoupling the onshore from the offshore operations of financial institutions, and controlling banking lending in Singapore dollars (Tan and Chen 1999). These efforts underlined the perennial concerns of MAS technocrats that unregulated capital movements would subject the domestic currency and exchange rates to speculation and endanger macro-economic stability (Cheng et al. 2000: 234-6; Lee 1984: 306).

The effective execution of reform policies has been a function of the admirable regulatory capacity of the MAS. Over the years, it has acquired comprehensive and sophisticated legal and informational resources with which to establish a rigorous and efficient supervisory framework (Lall and Liu 1997). More important than the technical competence, however, has been the ability of MAS officials to check private malfeasance and fraud in isolation from distributive demands. In the early 1980s, for instance, some twenty banks were heavily fined for dodging reserve requirements, and one finance company was closed down for conducting unsecured lending (*FEER* 24 December 1982: 30-

31, 21 April 1983: 76-8; Tan 1996: 114-5). The MAS has acted equally harshly towards rule violations by foreign firms. Significant cases in point lie in its high-handed approach to forcing several foreign bankers to leave the country in late 1982 for making illegal fund transfers, tightening onshore lending restrictions on foreign banks despite their resistance, and revoking the license of a foreign merchant bank in 1984 for failing to meet operational standards (*FEER* 9 February 1982: 56-8; 18 October 1984: 94-5; Tan 1996: 97). As Singapore became more closely integrated with international markets in the 1980s and 1990s, MAS regulators made consistent efforts to upgrade and tighten regulatory rules. As in the past, they showed little forbearance towards violators, both domestic and foreign (*EIUCR-Singapore* 3 1991, 25 and 3rd Quarter 1993: 23; Montes and Tan 1999: 242-5). In the presence of an independent and capable regulatory institution, financial liberalization did not created any opportunity for private actors to engage in rent seeking.

In Taiwan, the political structures of financial policymaking bear important resemblance to those in Singapore. One distinctive attribute of the Taiwanese socio-economic system was its fragmented industrial structure. The government did not pursue the highly concentrated approach to industrial development that many of its East Asian, particularly Korean, counterparts did.[10] The important corollary of this industrial fragmentation is that Taiwanese industrialists faced high collective action barriers. The decentralized organizational structure, together with the strong tendency among business elites to cultivate personal ties as the major conduit for policy influence, impeded effective efforts at group-based activities (Chu 1994; Chu 1999: 193-7). The argument is not that private firms remained passive in the face of policy changes. In fact, against the backdrop of the intensifying democratization in the late 1980s, business interests began to seize control over electoral and parliamentary processes and to challenge the dominant position of the bureaucracy in public policy arenas (Tan 2000; Tsai 2001). Private influences, however, were strong on sectoral and distributive policies rather than on broad economic strategies (Cheng 2001; Chu 1994). The industrial community as a whole had particular difficulty in pressing its demands on macro-economic issues that bore upon wide private interests but required concentrated organizational resources to achieve successful lobbying. With few exceptions, private actors were fragmented on macro-economic policies and deficient in policy-related information. The structural and cognitive handicaps hindered collective organization in the corporate sector and undermined coherent interest articulation on financial market liberalization. Equally, the influence of banks over financial policy was also limited. The limitation derived primarily from the fact that dominant banks were state owned; financial authorities were able to dictate the behavior of state bankers through budget control, appointive power, and regulatory oversight (Chu 1999: 190; Noble and Ravenhill 2000: 102-3).

The limited influences of private interests signify, in the final analysis, the organizational strength of the state structure in Taiwan. The most prominent feature of that structure was the high degree of policy-making independence enjoyed by the Central Bank of China (CBC). The origins of central bank inde-

pendence lay in the Chinese hyperinflation of the late 1940s that contributed to the defeat of the Kuomintang (KMT) on the mainland, and in the sustained efforts of political leaders to prevent the reoccurrence of financial chaos (Cheng 1993). Restored in 1961 and delegated extensive policy power, the CBC became the guardian of macro-economic stability, which the KMT regime equated with political survival and security in the face of the ever-present military threats from across the Taiwan Strait. The governor of the bank, appointed by the president for a renewable term of five years, always occupied the most senior economic portfolio in the cabinet. The CBC exercised broad authority over monetary management and financial regulation, with little legislative oversight of its operations (CBC 1996: 3-14, 259-71; Chu 1999: 189-93). The authoritative status of the CBC was further buttressed by its close ties with the Finance Ministry. Central bankers were thus able to conduct their macro and micro functions with considerable autonomy.

The organizational features of financial authorities conformed with and, indeed derived from, the structure of the party system. During much of the postwar period, the party system in Taiwan was highly institutionalized and stable. The ruling KMT party, which had dominated the political scene until the late 1990s, was unusually well organized and run in a hierarchical fashion. Together with the fact that the KMT had independent financial resources at its disposal and enjoyed extensive control over the state apparatus, this strength enabled the party to operate independently of social forces (Cheng et al. 1996: 6-11). Despite the growing factionalism within the KMT due to the impact of democratization, party leaders were able to maintain their political autonomy by dint of their ability to marginalize minor factions and because of the greatly strengthened power of the president (Chu 1999; Hsiao and Cheng 1999). The strong ruling party and the authoritative executive helped to create a clear sense of policy orientation and to minimize interagency conflicts. The continued dominance of the KMT regime, whose leaders had profound interests in macroeconomic stability, made financial technocrats largely impervious to societal pressures (Noble and Ravenhill 2000; Zhang 2002b).

The political independence of the CBC underpinned the ability of central bankers to define and pursue financial market reform in line with their policy interests. Central bankers were worried that intensified competition caused by entry deregulation and functional desegmentation would threaten financial stability, particularly when many NBFIs had increasingly shaky performance in the 1980s (Shea 1994: 260-1). Moreover, financial technocrats appeared to share the concerns of political leaders that deregulation would facilitate wider private ownership of financial institutions and compromise the long-established policy of preventing the rise of big business interests. While growing banking inefficiency and the chronic liquidity glut in the late 1980s eventually prodded the authorities to remove competitive restraints as a way to solve these problems, precautionary measures were taken to ensure that liberalization would not hamper the pursuit of overarching economic and political objectives. Financial authorities initially barred new banks from foreign exchange operations, set high minimum capital requirements, and strictly limited the ownership share of corporate investors (*Asian Finance* 15 July 1990: 32; *FEER* 4 April

1991: 36-7). These measures, implemented over the vociferous opposition from business groups and their political patrons, were designed to strength prudential regulation, preserve the dominance of state-owned banks, and keep the power of private business in check.

The institutional status of central bankers bore most markedly on the process of capital account liberalization. The CBC was highly resistant to rapid capital account liberalization for a number of reasons. In the first place, macroeconomic policy consistently placed priority on monetary probity and low inflation. Central bankers worried that freer capital movements would weaken their ability to control money supply and produce price instability. Furthermore, capital decontrol would provide domestic financial institutions with the opportunity to develop their overseas operations and broaden their business linkages with international markets. Greater openness, financial regulators feared, was likely to expose banks to global market volatility and complicate prudential supervision (Liu 1997: 844-9). Finally, concerns of central bankers about capital decontrol represented long-running geopolitical considerations on the part of the KMT leadership. With diminishing diplomatic recognition and little representation in multilateral fora, the international position of Taiwan remained precarious. Coupled with the generally hostile relations with mainland China, this made financial leaders reluctant to loosen capital controls but eager to build up foreign reserves in preparation for the worst security situation (Anderson 1998; Chu 1999). While the capital account was gradually liberalized in the late 1980s, due to market and political pressures, the liberalization proceeded in a highly selective and regulated manner. The well-guarded approach undoubtedly prevented what would otherwise have been the speedier opening of the capital account and greater exposure to international market instabilities.

Not only were financial technocrats able to control the process of financial opening, they managed to maintain an effective regulatory framework in parallel with market liberalization. The efficacy of prudential supervision primarily resided in the technical competence and political autonomy of central regulators at the CBC and the Finance Ministry. They possessed adequate professional skills with which to formulate stringent regulatory rules and, more importantly, demonstrated the strong institutional capacity to enforce compliance with the rules (Yang and Shea 1999: 275-9). Throughout the liberalization process, financial authorities persisted with strict requirements on the capital adequacy, lending operations, and foreign exchange exposure of banks, in defiance of growing pressures for tempering these requirements (Noble and Ravenhill 2000: 95-7). Unlike their Korean and Thai counterparts who tended to exercise regulatory forbearance, Taiwanese supervisors were able to intervene forcefully and promptly to implement remedial measures. In the wake of major credit cooperative failures in the mid-1980s and the mid-1990s, they took decisive measures to restructure ailing institutions and strengthen the regulatory system (*FEER* 11 April 1985: 90-1,17 August 1995: 68). The ability of financial technocrats to maintain a rigorous supervisory regime, largely independent of political pressures, ensured the relative resilience of the financial system.

Conclusion

This article has sought to develop an institutional explanation of divergent liberalization patterns in Korea, Singapore, Taiwan, and Thailand. The comparative analysis has clearly shown that differences in liberalization approaches and outcomes stemmed from cross-national variations within the four cases in domestic political structures. The failure of market reform in Korea and Thailand was attributable, in the first place, to the growing capture of the policymaking process by the politically resourceful and structurally powerful industrial and banking groups. The capture problem reflected the fact that key state financial and regulatory agencies were unable to insulate themselves from particularistic interests. Equally, the increasingly divided bureaucracy not only created the opportunity for influential private actors to penetrate the state apparatus but also bred interagency rivalry and undermined the effective design of reform strategies. The inchoate and fragmented structure of political party organization aggravated the institutional deficiencies within the state and facilitated private influences over financial policy. The upshot was that the process of market liberalization, which was subject to recurrent distortion and rent seeking, generated malignant effects on financial system stability.

In Singapore and Taiwan, the more effectively managed financial market reform was underpinned by the distinctive institutional features of economic policymaking. The industrial fragmentation undercut the ability of private actors to organize effective group-based lobbying and to influence the reform process. The structure of the bureaucracy further limited private influences over the course of government policy. Financial technocrats in the CBC and the MAS displayed a relatively high degree of political autonomy and organizational cohesion, and were not beholden to special social groups. The systemic and internal strength of the ruling parties and the powerful executive reinforced the centralized and cohesive structure of financial authorities and helped to keep interagency conflicts in check. These institutional arrangements guaranteed that the play of particularistic interests could be minimized, the scope for rent-seeking activities curtailed, and financial reforms implemented in line with public policy objectives. Singapore and Taiwan were thus able to avoid the pitfalls of market liberalization and prevent the accumulation of severe economic problems that enveloped Korea and Thailand in the financial crisis.

This comparative account of financial market reforms in the four major East Asian economies carries important policy implications. In the aftermath of the Asian crisis, economists vied with each other to offer policy formulas for welfare-enhancing financial market liberalization, focusing on auspicious macroeconomic conditions, correct sequential order, and effective regulation as essential prerequisites. Although an emphasis on these technical issues is not misplaced, it is inadequate and even superficial. The fundamental reason that the Korean and Thai governments pursued unsuccessful reforms while their Singapore and Taiwanese counterparts achieved better policy outcomes rested not so much with their varying administrative capacities for designing reform strategies as with their divergent institutional abilities to limit private influences over policy processes. This illustrates that liberalization does not simply

involve installing optimal policy and regulatory frameworks but also developing and improving in a sustained manner the political institutions that can guarantee the realization of public policy objectives. Financial market reform in the absence of appropriate political and institutional preconditions is likely to run counter to what its proponents wish to achieve.

Notes

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1. Commercial banks in Singapore, both domestic and foreign, are classified into three groups according to the types of businesses they are allowed to engage in. Full-license banks may engage in all banking activities whereas restricted license banks can only offer wholesale services, and offshore licensed banks may operate mainly in the Asian dollar market.
2. Established as an offshore banking facility, the BIBF allowed local and foreign banks to engage in out-out operations (taking foreign-currency loans from abroad and lending the funds thus obtained to foreign clients) and out-in transactions (borrowing foreign-currency loans offshore and re-lending them to domestic borrowers).
3. While Taiwan's banking sector, under the supervision of the central bank, was able to maintain sound performance, the same cannot be said of local financial institutions, specifically credit cooperatives. Largely private owned and supervised by such peripheral regulatory agencies as the provincial government and line ministries, these institutions were periodically used to finance family businesses and local elections. Controls over the operations of credit cooperatives were so lax that illegal intercorporate transactions and politically connected lending were rampant, leading to the growth of non-performing assets (see Chou 2000; Noble and Ravenhill 2000).
4. Ex ante assessment of sectoral preferences is notoriously difficult. The preferences of the industrial and financial sectors are complex and crosscutting. Each sector can be divided into several sub-sectors; each sector or sub-sector can have its own interests that differ in both direction and intensity. To avoid the post hoc character that often plagues this kind of analysis, this article examines the preferences of the two sectors in the case studies where their interests can be more concretely and convincingly traced and assessed.
5. As with private sector preferences, the programmatic interests of different state economic agencies in financial policy reform will be specified in the case studies.
6. Although there is a president in Singapore, presidential powers are largely ceremonial. Policymaking authority rests squarely with the prime minister.
7. Literally, it means "descent from heaven" in Korean. The author is grateful to Chung-In Moon for drawing his attention to how the personal interests of Finance Ministry bureaucrats influenced their preferences for functional desegmentation.
8. The technical deficiencies of the Korean regulatory system include, among other things, weak accounting and legal frameworks, inaccurate financial information, and shortages of skilled supervisors (Baliño and Ubide 1999).
9. Nowhere is this problem more clearly demonstrated than in the debacle of the Bangkok Bank of Commerce (BBC). Subject to pressures from influential politicians and senior bureaucrats who were the beneficiaries of large loans from the BBC, the BOT first failed to take effective remedial measures against fraudulent activities at the BBC and then used enormous public funds to keep the bank afloat for quite some time as it tottered on the edge of bankruptcy.
10. The economic and political motives behind this policy choice are well established (see Cheng 1993; Fields 1995). State elites lacked the incentive to foster the growth of huge conglomerates because of the large state-owned industrial and banking sectors, the perennial concerns about the emergence of powerful private interests, and the ethnic division between the émigré government and the business sector dominated by long-term locals.

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