# CAPITAL MOBILITY AND COALITIONAL POLITICS
## Authoritarian Regimes and Economic Adjustment in Southeast Asia

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### I. Introduction

IN a world of global finance, economic crises confront countries with stark policy dilemmas. These dilemmas strike at the heart of political coalitions, as regimes use controversial adjustment policies to steer their way through financial meltdowns and restore economic growth. Across time and space, adjustment policies to economic crises vary markedly. This is particularly apparent in the cases of Indonesia and Malaysia during the Asian Financial Crisis (AFC) of 1997–99. These two countries—both highly open financially, neither democratic, and neither with substantive checks on executive decision making—adopted radically different adjustment policies. Indonesia, in combating its crisis, floated the rupiah and tightened macroeconomic policy, while maintaining an open capital account and seeking IMF support. The regime later attempted to repeg the currency at a more favorable rate but, in order to gain control over macroeconomic policy, refused to restrict cross-border rupiah movement. Malaysia, by contrast, floated its exchange rate but retained loose macroeconomic policies, courting the IMF while its leaders condemned currency speculators. It later broke with IMF orthodoxy by deinternationalizing the ringgit and pegging it to the U.S. dollar, imposing controls on capital outflows, and further loosening macroeconomic policy. Why did these two countries adopt such different reform strategies in the face of a common shock?

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I argue that variation in policy responses stems from variation in the preferences of regime supporters over economic adjustment. I uncover these preferences by focusing on the distributional consequences of "twin" crises—simultaneous currency and banking crises. Regimes can tighten macroeconomic policy to counter rapid currency depreciation; or they can restrict capital flows and fix the exchange rate to make expansionary macroeconomic policy feasible; or they can adopt mixed policy measures. Facing currency depreciation with financial sector vulnerability, differences in capital specificity lead to different preferences over economic adjustment. I argue that regimes that depend on the support of labor in alliance with fixed capital sacrifice capital account convertibility for expansionary macroeconomic policy and a currency peg. Regimes that depend on the support of both mobile capital and fixed capital prefer a currency peg but face contradictory demands over capital account restrictions. The result is incoherent adjustment policy marked by factional struggles over economic measures.

This approach explains varying adjustment policy choices across Indonesia and Malaysia, choices that had important consequences for two regimes threatened by dramatic economic meltdown. Indonesia's attempt to repeg the rupiah and political conflict over capital account closure reflect contradictory preferences for adjustment policies among the regime's supporters—fixed and mobile capital—which ultimately helped to bring down the New Order in May 1998. Malaysia's implementation of capital controls and an exchange rate peg reflects the regime's dependence on an alliance between Malay fixed capital and Malay labor, which had complementary preferences over adjustment policy. This facilitated Mahathir's task of remaining in power despite Malaysia's economic crisis, for the regime chose policies that its supporters demanded.

Based on the experiences of Indonesia and Malaysia, this article makes two contributions to the literature on the political economy of reform and adjustment. First, it specifies the distributional implications of twin crises and studies how different adjustment policy responses can exacerbate or ameliorate the costs borne by domestic actors. Twin crises have become a recurrent feature of the world economy as financial internationalization has linked emerging market economies to global capital flows. Nevertheless, these crises have received no systematic attention as a distinct type of economic crisis with clear distributional implications. In particular, existing literature on currency crises and international monetary relations has missed a critical aspect of adjustment policy: the fragility of the domestic banking sector.

With monetary authorities as both guarantors of financial sector health and determiners of macroeconomic policy, financial meltdowns interact with the Mundell-Fleming trilemma to create new distributional coalitions.[1] These differ markedly from established understandings of sectoral preferences over international monetary relations. Developed to explain policy in Indonesia and Malaysia, these insights illuminate political conflict over adjustment measures aimed at addressing financial crises around the world.

The second contribution is to link these preferences to policy outcomes via the political coalitions that support authoritarian regimes. By allowing the support coalitions of authoritarian regimes to vary, I capture the simple intuition that responses to economic crises vary because the political coalitions that support authoritarian regimes vary. Although this article concentrates on adjustment policy choices, I return in the conclusions to the broader implications of the argument for policy choice and regime behavior.

## II. Explaining Adjustment

Explanations for particular adjustment policy choices in Southeast Asia remain scarce. But the literatures on economic adjustment and authoritarian politics contain insights that point to several candidate hypotheses. Besides interests alone, competing political explanations include international pressures, ideology, institutions, cognitive frames, and technocratic competence.[2] The many differences between Indonesia and Malaysia necessitate care in assessing the explanatory power of preferences and coalitions. I divide rival explanations into four camps: institutions, economics, international factors, and ideology. I adjudicate the alternative explanations by testing their causal logics against each country's empirical record, finding them either to be incomplete without an account of coalitions and preferences (the institutional hypotheses) or simply to be inconsistent with country experiences (the remaining three).

[1] R. A. Mundell, "Capital Mobility and Stabilization Policy under Fixed and Flexible Exchange Rates," *Canadian Journal of Economics and Political Science* 29 (November 1963).

[2] See Robert H. Bates and Anne O. Krueger, eds., *Political and Economic Interactions in Economic Policy Reform: Evidence from Eight Countries* (Cambridge, Mass.: Blackwell Publishers, 1993); Stephan Haggard and Robert R. Kaufman, eds., *The Politics of Economic Adjustment: International Constraints, Distributive Conflicts, and the State* (Princeton: Princeton University Press, 1992); Anne O. Krueger, *The Political Economy of Policy Reform in Developing Countries* (Cambridge: MIT Press, 1993); Joan M. Nelson, ed., *Fragile Coalitions: The Politics of Economic Adjustment* (New Brunswick, N.J.: Transaction Books, 1989); Joan M. Nelson, ed., *Economic Crisis and Policy Choice: The Politics of Adjustment in Developing Countries* (Princeton: Princeton University Press, 1990); Kurt Weyland, *The Politics of Market Reform in Fragile Democracies: Argentina, Brazil, Peru, and Venezuela* (Princeton: Princeton University Press, 2002).

Indonesia's New Order was far more repressive than Mahathir's Malaysia, and the dominant party in Malaysia, the United Malays National Organisation (UMNO), is more representative of constituent interests than Indonesia's Golkar Party was under Soeharto. However, levels of government oppression themselves reflect the coalitions supporting these regimes: the New Order repressed labor in order to minimize its threat to capital, whereas Malaysian governments have been less hostile to (unorganized, Malay) labor because it is a key political ally. Furthermore, the New Order relied on the open participation of military leaders, whereas Malaysia's does not. It is unclear, though, why a military regime would have preferred Indonesia's policies to Malaysia's nationalist response. Standard accounts of military involvement in politics hold that military regimes favor interventionist economic policies that support military-industrial linkages. Of course, in Indonesia this was the case, but the regime simultaneously also relied on the support of mobile capitalists, suggesting a role for the coalitional theory that I outline below.

Recent work on authoritarianism distinguishes between regimes with formal institutions such as legislatures and political parties and regimes without them; both Malaysia and Indonesia have figured prominently in this research.[3] The effect of such institutions on aspects of authoritarian politics aside from regime survival has received little attention. The arguments in these works, however, would suggest that institutions should facilitate policy coordination during hard times by making long-term commitments credible among disparate interests. Indonesia's institutions failed dramatically in this regard. Authoritarian institutions suppressed open political conflict over political succession in May 1997 and March 1998, as the literature suggests they should have.[4] But I show below that they failed either to convince mobile capital to keep funds in Indonesia to ride out the country's financial turmoil or to prevent indigenous business groups, official "opposition"

[3] Jason Brownlee, *Authoritarianism in an Age of Democratization* (New York: Cambridge University Press, 2007); Jennifer Gandhi and Adam Przeworski, "Cooperation, Cooptation, and Rebellion under Dictatorships," *Economics and Politics* 18 (March 2006); Barbara Geddes, "Authoritarian Breakdown: Empirical Test of a Game-Theoretic Argument" (Paper presented at the annual meeting of the American Political Science Association, Atlanta, 1999); Dan Slater, "Iron Cage in an Iron Fist: Authoritarian Institutions and the Personalization of Power in Malaysia," *Comparative Politics* 36 (October 2003); Benjamin Smith, "Life of the Party: The Origins of Regime Breakdown and Persistence under Single-Party Rule," *World Politics* 57 (April 2005).

[4] Interview with Emil Salim, former state minister for population and environment, Jakarta, March 6, 2006; Stefan Eklöf, "The 1997 General Election in Indonesia," *Asian Survey* 37 (December 1997); R. William Liddle, "Indonesia's Unexpected Failure of Leadership," in Adam Schwarz and Jonathan Pris, eds., *Politics of Post-Suharto Indonesia* (New York: Council on Foreign Relations, 1999), 20–21.

parties, the regime's Islamist arm, or military leaders from steadily turning against speculators, bankers, and ethnic Chinese in general.[5]

Even without the apparent failure of institutions in Indonesia, appealing to institutions is insufficient to explain substantive policy decisions. In a model of policy choice, institutions are analytically secondary to preferences over policy outcomes. An institutional explanation for Malaysia's policy choice predicts policy coordination on only *some* policy, but it cannot explain why factions coordinated specifically on capital account closure, an exchange rate peg, expansionary monetary policy, additional redistributive subsidies, and corporate bailouts. Likewise, if Indonesia's political institutions failed, this cannot explain the specific character of policy conflict—over capital outflows and the interest rate/exchange rate nexus, rather than over some policy schism. For understanding policy outcomes for each, it is vital to achieve an accounting of who the regime's supporters are and what it is that the different groups demand.

The economic differences between the two countries may also confound the comparison. Malaysia's banking sector was vulnerable, but Indonesia's was more so—nonperforming loans exceeded 40 percent of total loans in 1998 in Indonesia, compared with 20–25 percent in Malaysia.[6] But Malaysia's stock market collapse was just as devastating for Malaysia's economy as was Indonesia's banking sector collapse, as development financing (and cronyism) in Malaysia flowed through the stock market rather than through the banking sector. Malaysia's stock market capitalization was 227 percent of GDP in 1995, compared with just 19 percent of GDP in Indonesia, and the KLSE tumbled an astonishing 79.3 percent before the imposition of capital controls.[7] Because portfolio capital played such an important role in Malaysia's stock market as compared with that of Indonesia, this should have made Malaysia even less willing than Indonesia to restrict cross-border capital movements because of their negative consequences for domestic holders of mobile assets; most studies find that larger financial sectors produce more consistent support for financial openness.[8] Likewise,

[5] Benjamin B. Smith, "'If I Do These Things, They Will Throw Me Out': Economic Reform and the Collapse of Indonesia's New Order," *Journal of International Affairs* 57 (Fall 2003).

[6] Figures cited from Andrew Berg, "The Asian Crisis: Causes, Policy Responses, and Outcomes," IMF Working Paper WP/99/138 (1999), 8.

[7] Jomo K. S. and Natasha Hamilton-Hart, "Financial Regulation, Crisis and Policy Response," in Jomo K. S., ed., *Malaysian Eclipse: Economic Crisis and Recovery* (London: Zed Books, 2001), 81.

[8] Stephan Haggard and Sylvia Maxfield, "The Political Economy of Financial Internationalization in the Developing World," *International Organization* 50 (Winter 1996). See also the positive correlation between financial sector size and capital openness in Sarah M. Brooks, "Explaining Capital Account Liberalization in Latin America: A Transitional Cost Approach," *World Politics* 56 (April 2004).

the rupiah's deep collapse—far more severe than the ringgit's—should have made Indonesia more likely to adopt Malaysia's strategy of capital controls to make an exchange rate peg feasible. Economic conditions alone therefore yield little insight. Only by understanding the political coalitions underlying authoritarianism can one understand why Malaysia's regime adopted policies that so clearly ran counter to the interests of mobile capitalists and why Indonesia's regime refused to take decisive action to halt the rupiah's collapse.

International factors similarly differ, particularly each country's sources of foreign aid during the crisis. But choices of how to accept foreign support were themselves part of each regime's adjustment strategy. By seeking IMF support, Indonesia attempted to access foreign capital as had been received by South Korea and Thailand during the crisis, with the aim of reassuring foreign investors of the country's investment worthiness.[9] We will see below that across policy areas, from fiscal and monetary policy to trade and corporate policy, the regime proved remarkably unwilling to implement the IMF's conditions.[10] Importantly, the only IMF reforms that Soeharto's regime faithfully adopted were those that shifted the burden of adjustment to the urban poor (labor), excluded from the New Order's political coalition. This suggests that the IMF had little effect on adjustment policy choice. Malaysia's resistance to IMF aid, by contrast, was intimately related to Mahathir's refusal to accede to its conditions for economic reform. In his own words, accepting IMF support "is not possible as we have Bumiputeras and the non-Bumiputeras."[11] Of course, Malaysia's regime was no less eager than Indonesia's to access other foreign funds without such conditions, from the Asian Development Bank, the World Bank, and other foreign donors.[12] Accordingly, each country accepted substantial sums of international aid, albeit in different ways that reflect adjustment policy choices rather than having independent causal effects on these choices.

A final possible explanation for differences in adjustment policies centers on ideology. Some observers have linked Malaysia's radical adjustment policies to Mahathir's own brand of economic national-

[9] See, e.g., Hadi Soesastro and M. Chatib Basri, "Survey of Recent Developments," *Bulletin of Indonesian Economic Studies* 34 (April 1998), 10.

[10] Richard Robison and Andrew Rosser, "Contesting Reform: Indonesia's New Order and the IMF," *World Development* 26 (August 1998).

[11] Mahani Zainal Abidin, *Rewriting the Rules: The Malaysian Crisis Management Model* (Petaling Jaya: Pearson Malaysia Sdn. Bhd., 2002), 275.

[12] *Business Times (Malaysia)*, April 3, 1999.

[13] I thank an anonymous reviewer for raising this point.

ism.[13] By implication, Soeharto was less nationalist and hence less ideologically open to a nationalist response to financial meltdown. Yet Soeharto had presided over a political system that for thirty years had pursued the economic nationalist ideology of "Pancasila economics" to justify extensive state interference in the economy.[14] Moreover, as the crisis progressed, Soeharto increasingly surrounded himself with identifiably "nationalist" policy makers, from Vice President B. J. Habibie to Finance Minister Fuad Bawazier, dismissing more liberal technocrats such as BI governor Soedradjad Djiwandono and Finance Minister Mar'ie Muhammad. These policymakers pushed Soeharto toward nationalist policy responses and in particular toward capital controls to enable the same sorts of expansionary macroeconomic policies that Malaysia implemented in September 1998. Additionally, Soeharto himself consistently used economic nationalism and the Indonesian constitution to justify resistance to IMF-mandated policies.[15] Far from forgetting or neglecting his nationalist credentials, Soeharto openly embraced them.

### Understanding Twin Crises

The four candidate explanations for adjustment policy just reviewed are unsatisfactory. More critically, each ignores the economic logic of adjustment—why individual actors might support or oppose the choices that governments make. To capture this, I begin with the specific character of the crises that faced Indonesia and Malaysia. The literature on currency and banking crises emphasizes the causal linkages between them.[16] Such crises have unfortunately been common; Table 1 shows their incidence across countries from 1975 until 1997, including crises in both authoritarian and democratic regimes. This article concentrates solely on authoritarian regimes, where the logic of coalitional politics is easiest to observe and where current theoretical work is particularly unsuited to explaining adjustment policy. I note in the conclusion how my insights may travel to democratic regimes.

Currency crises can cause banking crises when domestic borrowers hold large foreign exchange debt under a (quasi-) fixed exchange rate

[14] Mubyarto, *Ekonomi Pancasila: Gagasan Dan Kemungkinan* (Jakarta: LP3ES, 1987).

[15] *Kompas*, March 9, 1998; *Suara Pembaruan*, March 16, 1998.

[16] See, e.g., Sebastian Edwards and Carlos A. Végh, "Banks and Macroeconomic Disturbances under Predetermined Exchange Rates," *Journal of Monetary Economics* 40 (October 1997); Graciela L. Kaminsky and Carmen M. Reinhart, "The Twin Crises: The Causes of Banking and Balance-of-Payments Problems," *American Economic Review* 89 (June 1999); Victoria Miller, "The Double Drain with a Cross-Border Twist: More on the Relationship between Banking and Currency Crises," *American Economic Review* 88 (May 1998).

TABLE 1
TWIN CRISES[a]
(1975–97)

| *Country* | *Year* | *Country* | *Year* |
|---|---|---|---|
| Argentina | 1982–83, 1989–90 | Korea (Rep.) | 1997 |
| Bolivia | 1986–88 | Lao PDR | 1995, 1997 |
| Botswana | 1996 | Madagascar | 1988 |
| Brazil | 1990–91, 1995–97 | Malaysia | 1986–88, 1997 |
| Burundi | 1997 | Mexico | 1982–87, 1995–97 |
| Cameroon | 1994–96 | Mozambique | 1993–97 |
| Chile | 1985 | Nepal | 1988, 1991–95 |
| Colombia | 1985–87 | New Zealand | 1987–91 |
| Ecuador | 1982–83 | Nicaragua | 1993–95 |
| Egypt | 1980–81, 1991–93 | Nigeria | 1993–94 |
| El Salvador | 1990 | Norway | 1987–88, 1992–93 |
| Finland | 1991–94 | Peru | 1983–90 |
| Ghana | 1983–89 | Philippines | 1983–87, 1997 |
| Guatemala | 1991–92 | Romania | 1990–93 |
| Guinea-Bissau | 1996–97 | Spain | 1977–79, 1982–84 |
| Guyana | 1993 | Sweden | 1992–93 |
| Hungary | 1991, 1994–95 | Thailand | 1983–86, 1997 |
| Iceland | 1985–86, 1993 | Trinidad and Tobago | 1985–90, 1993 |
| India | 1993–97 | Tunisia | 1993–95 |
| Indonesia | 1997 | Turkey | 1982, 1994–95 |
| Italy | 1992–94, 1995 | United Kingdom | 1976, 1984, 1986 |
| Jamaica | 1994 | Uruguay | 1982–84 |
| Japan | 1992 | Venezuela | 1984–86, 1994–97 |
| Jordan | 1989–90, 1992 | Zambia | 1995 |
| Kenya | 1985–87, 1993–97 | Zimbabwe | 1995–97 |

SOURCE: Compiled from Reuven Glick and Michael Hutchison, "Banking and Currency Crises: How Common Are Twins?" Working Paper (Department of Economics, University of California-Santa Cruz, 1999).

[a]A country experiences a twin crisis when it experiences a banking (currency) crisis within two years of the onset of a currency (banking) crisis.

regime. Believing the peg to be credible, borrowers borrow in foreign currencies without hedging against exchange rate fluctuations.[17] If an exogenous speculative attack leads to currency depreciation, corporate borrowers find that the costs of debt service have risen, while indebted financial institutions must use their assets to pay down debt rather than to lend to the domestic market. Severe currency depreciation may lead to systemic illiquidity or insolvency, causing a banking crisis. Reversing

[17] Ronald I. McKinnon and Huw Pill, "International Overborrowing: A Decomposition of Credit and Currency Risks," *World Development* 26 (July 1998).

the causal arrow, an exogenous bank run may signal that an economy is unhealthy. Investors and speculators then update their prior beliefs about financial sector health, leading to a self-fulfilling currency crisis as investors exit in search of quality.[18] Moreover, measures to combat a financial crisis—emergency liquidity support, monetary tightening—may be inconsistent with a commitment to a currency peg. Under such conditions, speculators will anticipate that the peg is unsustainable and launch a speculative attack that ensures that it is. The interdependence of currency and banking crises means that decisions to manage one have consequences for the other. It also means that the crises can be self-reinforcing: a deteriorating financial sector can cause exchange rate depreciation, which in turn exacerbates financial sector weaknesses.[19]

Political analyses of the AFC focus largely on either the causes of the crises or on the political fallout that resulted from them.[20] Both Indonesia and Malaysia's political systems were highly centralized, with no institutional constraints on executive authority. As a result, adjustment policy decisions were easily reversible as political events unfolded and economic conditions deteriorated.[21] Yet as noted previously, institutions alone cannot account for the *content* of policies that the countries enacted. The existing literature suggests several helpful clues. Inspired primarily by Latin American crises in the 1980s, researchers have recognized that politicians will tailor their reform packages to minimize the costs borne by their political supporters.[22] As most independent variables that researchers employ in studies of economic adjustment are quite similar in Indonesia and Malaysia, or yield indeterminate hypotheses, I focus tightly on the costs of adjustment and the preferences of regime supporters.

[18] Ilan Goldfajn and Rodrigo O. Valdés, "Capital Flows and the Twin Crises: The Role of Liquidity," IMF Working Paper WP/97/87 (1997).

[19] For formal treatments, see, e.g., Giancarlo Corsetti, Paolo Pesenti, and Nouriel Roubini, "Paper Tigers? A Model of the Asian Crisis," *European Economic Review* 43 (June 1999); Paul Krugman, "What Happened to Asia?" http://web.mit.edu/krugman/www/DISINTER.html (1998) (accessed February 15, 2005).

[20] See, e.g., Stephan Haggard, *The Political Economy of the Asian Financial Crisis* (Washington, D.C.: Institute for International Economics, 2000); T. J. Pempel, ed., *Politics of the Asian Economic Crisis* (Ithaca, N.Y.: Cornell University Press, 1999); Shanker Satyanath, *Globalization, Politics, and Financial Turmoil: Asia's Banking Crisis* (New York: Cambridge University Press, 2006).

[21] Andrew MacIntyre, "Institutions and Investors: The Politics of the Economic Crisis in Southeast Asia," *International Organization* 55 (Winter 2001).

[22] For similar perspectives, see Alberto Alesina and Allan Drazen, "Why Are Stabilizations Delayed?" *American Economic Review* 81 (December 1991); Peter Gourevitch, *Politics in Hard Times: Comparative Responses to International Economic Crises* (Ithaca, N.Y.: Cornell University Press, 1986); Dani Rodrik, "Understanding Economic Policy Reform," *Journal of Economic Literature* 34 (1996); Hector E. Schamis, "Distributional Coalitions and the Politics of Economic Reform in Latin America," *World Politics* 51 (January 1999).

## PREFERENCES AND COALITIONS

Adjustment policy responses differ in the short-term costs for actors in economies hit by crises. Table 2 distinguishes capital owners by the cross-border mobility of their assets, listing adjustment policy preferences for capital account openness and domestic macroeconomic policy. Preferences for exchange rate levels depend on a firm's particular mix of external debt and export exposure, while preferences for exchange rate regimes during a period of financial turmoil will likely be the same, favoring a currency peg to reduce volatility.

The distinction between mobile and fixed capital is critical in this analysis. Mobile capital refers to capital assets that owners can move across national borders. The archetypical example of mobile capital is money. Besides money, other examples of mobile assets may include gold or other precious materials, as well as an individual's skills and expertise. By contrast, fixed capital comprises assets that owners will not move across national borders, either because it is impossible to do so or because the ownership of physical stock is more highly valued that is its liquidation into cash. The customary example of fixed capital is land, which owners simply cannot move; other examples include industrial assets such as factories or equipment.

Capital mobility is distinct from capital liquidity. In modern economies, all assets are potentially liquid. The owner of a cement-processing plant can sell that plant, converting physical assets into liquid assets. Likewise, many publicly traded companies are controlled not through personal ownership of a firm's assets but rather through share ownership, meaning that the effective owners of fixed capital stock may be able to liquidate them. This means that while money is the archetype of mobile capital, all liquid assets (that is, shares) are not mobile capital. Nor does the fact that all assets are potentially liquefiable mean that all assets are mobile. This distinction becomes particularly important when discussing the behavior of majority shareholders of industrial firms in Malaysia; their ownership of shares gives them effective ownership of fixed assets and leads them to behave accordingly. This contrast between mobile and fixed capital accordingly mirrors the distinction often made between "financial capital" and "industrial capital," although these terms are rarely defined in a rigorous fashion.[23]

[23] For a review of studies of *Finanzkapital*, see Jeffrey A. Winters, "Power and the Control of Capital," *World Politics* 46 (April 1994). Applications include Sylvia Maxfield, *Governing Capital: International Finance and Mexican Politics* (Ithaca, N.Y.: Cornell University Press, 1990); Jeffrey A. Winters, *Power in Motion: Capital Mobility and the Indonesian State* (Ithaca, N.Y.: Cornell University Press, 1996).

TABLE 2
ADJUSTMENT POLICY PREFERENCES WITH FINANCIAL SECTOR VULNERABILITIES

| | *Cross-Border Asset Mobility* | |
|---|---|---|
| *Policy Area* | *High* | *Low* |
| Capital account | open | restrictions |
| Macroeconomic policy | tight | loose |

It is necessary to inspect both sectoral characteristics and behavioral investment strategies to distinguish fixed from mobile capital empirically. While sectors provide some clues, they are themselves not determinant. Within the same sector, some capital owners may be fixed while others are mobile, as in the contrast between property developers and property speculators. It is also possible in the case of joint ventures or publicly traded corporations for one company to have owners who fall into each group. In New Order Indonesia many ethnic Chinese owners of mobile capital entered into joint ventures by providing investment funds to military-controlled corporations, whose assets are physical ownership of fixed capital stock. In Malaysia foreign portfolio investors (whose assets are highly mobile) invest directly in Malay-controlled or government-controlled firms trading on the Kuala Lumpur Stock Exchange, becoming minority shareholders in industrial firms whose majority shareholders are fixed in Malaysia.

To see why varying levels of capital mobility yield different preferences regarding adjustment policy, consider the effects of severe, unexpected currency depreciation in a small open economy. While exporters benefit and importers suffer as in standard accounts of exchange rate politics,[24] actors in the financial sector also face differing impacts. Firms that borrow abroad without hedging their exchange rate risk, but whose assets and revenues are denominated in the local currency, suffer from their heavier debt burden. All else equal, that firm will prefer the fixed exchange rate, for a float implies depreciation.[25]

Assuming no capital account restrictions, a government can combat currency depreciation by tightening monetary policy in order to at-

[24] J. Lawrence Broz and Jeffry A. Frieden, "The Political Economy of International Monetary Relations," *Annual Review of Political Science* 4 (2001); Jeffry A. Frieden, "Invested Interests: The Politics of National Economic Policies in a World of Global Finance," *International Organization* 45 (Autumn 1991).

[25] Even if some firms purchase hedging instruments, such instruments are costly. Risk-taking firms that succeed in the short term despite imprudent borrowing may outcompete prudential firms, forcing them to adopt the risky, no-hedging policy; see Krugman (fn. 19).

tract foreign capital back into the country and protect the exchange rate. This was the essence of the IMF's orthodox adjustment strategy for Asian recovery, because monetary austerity and economic reform increase demand for the country's currency. But monetary tightening has the other, familiar effect of depressing real economic activity. Firms may find that currency appreciation decreases their foreign debt burden but that their cash flows suffer more under the deflationary effects of tight monetary policy. Higher interest rates help domestic banks through increasing savings and decreasing foreign debt burdens but may harm them if domestic debtors become insolvent. Loosening monetary policy through lower interest rates or emergency liquidity support leads, in turn, to renewed capital flight and currency depreciation. Spending cuts are made to signal fiscal prudence but will be opposed by their beneficiaries. Even if firms and consumers prefer an overall contractionary stance, they may prefer different mixes of spending cuts; cronies will prefer cuts in subsidies to the poor, while the poor will prefer cuts in wasteful infrastructure development projects.[26]

Controls on capital outflows free the government from the restriction of interest rate parity, so the government can implement expansionary policies and fix exchange rates without capital flight upsetting them. Ideally, this move will jump-start the real economy, thereby saving the financial sector—this was the logic behind heterodox policy solutions proposed as alternatives to the IMF's plan.[27] Domestic firms with foreign currency debt can settle their debts at a more favorable rate. Stock and currency markets would be free from "unproductive" speculators. Industries in the tradable sector—a large group in highly open Asian economies—could anchor their expectations of future import and export costs.

But capital account closure has costs. Both foreign and domestic currency and stock traders will oppose restrictions on cross-border capital flows, as this removes their ability to short and speculate freely on stocks and currencies. Other holders of mobile assets will oppose capital controls, which prevent them from seeking safer or more profitable rates of return overseas. In general, any actor who may wish to convert domestic currency assets to foreign currency will oppose capital account closure. Furthermore, restrictions on capital outflows can discourage capital inflows even if regulations explicitly welcome them, for

[26] Compare to Alesina and Drazen (fn. 22).

[27] Paul Krugman, "Saving Asia: It's Time to Get Radical," *Fortune*, September 7, 1998. Similar early views include Max Corden, *The Asian Crisis: Is There a Way Out?* (Singapore: Institute for Southeast Asian Studies, 1999); Manuel F. Montes, *The Currency Crisis in Southeast Asia*, Updated ed. (Singapore: Institute for Southeast Asian Studies, 1998).

investors may be unwilling to bet on an economy's investment profitability without the ability to cut their losses.

For this reason, some firms may favor an exchange rate peg without capital account closure. These are likely to be the firms that prefer an open capital account to protect capital's exit option, but whose debt service costs are so burdensome that they cannot operate without a "quick fix." That is, they wish to pay down their existing foreign debt quickly at a more favorable exchange rate. Of course, a repegged exchange rate without capital controls re-creates the initial problem—a fixed exchange rate, an open capital account, and downward exchange pressure. With evidence of financial imbalances within the economy, a speculative attack would remain likely.

Asset mobility accordingly conditions actors' preferences over adjustment policy. Regimes, in turn, choose responses that depend on the coalition of political supporters that back them. In an authoritarian context, supporters are groups that (1) benefit from existing policy choices, (2) voluntarily bestow upon political leaders financial, coercive, and/or ideological resources, and (3) favor the reproduction of the political and allocational regime.[28] Such exchanges of resources for political support exist alongside formal institutions in authoritarian regimes, giving substance to policy choices. Modern approaches to authoritarianism assume that regimes' supporters are "the rich," broadly construed.[29] But this is hardly an accurate representation of many populist or ethnically constituted authoritarian regimes throughout the world,[30] and it ignores a wealth of experiences of sectoral conflict in authoritarian regimes.[31] Because supporters of an authoritarian regime can defect in favor of the regime's opponents, adjustment to economic crises is a critical issue for incumbent regimes. And facing a crisis with multiple kinds of supporters, regimes may face a critical dilemma in attempting to placate their supporters. Given multiple reform possibilities, a regime chooses only reforms that do not cause its supporters to defect. But supporters may have mutually incompatible preferences for adjustment policies, forcing the regime to navigate among contradictory

[28] A related concept is patrimonialism, "the exchange of resources…between key figures in government and strategically located individuals…in return for…economic and political support"; Robin Theobald, "Patrimonialism," *World Politics* 34 (July 1982), 552.

[29] See, most notably, Daron Acemoglu and James A. Robinson, *Economic Origins of Dictatorship and Democracy* (New York: Cambridge University Press, 2006).

[30] For a review, see Ian Lustick, "Stability in Deeply Divided Societies: Consociationalism versus Control," *World Politics* 31 (April 1979).

[31] In the Latin American context, see, e.g., Jeffry A. Frieden, *Debt, Development, and Democracy: Modern Political Economy and Latin America, 1965–1985* (Princeton: Princeton University Press, 1991).

policies and ultimately to alienate one or more supporters and propel them to defect from the regime.

Given interest-group preferences during twin crises, varying support coalitions have powerful effects on adjustment policy. Indebted domestic firms with fixed capital investments prefer to minimize currency depreciation and to loosen macroeconomic policy to protect revenue streams. This is only feasible with restrictions on capital outflows. But mobile capital will demand that the government maintain capital mobility, as it will demand an exit option. This conflict will prevent a regime dependent on both mobile and fixed capital from adopting a coherent set of adjustment policies. A coalition between fixed capital and labor faces no such irreconcilable policy demands. Fixed capitalists find a natural ally in labor, which prefers subsidies and expansionary policies that protect employment. Because neither requires capital mobility, both will sacrifice capital account openness to make expansionary macroeconomic policies possible.

## III. Coalitions in Indonesia and Malaysia

The different coalitions of supporters in Indonesia and Malaysia explain the differences in adjustment policies. In the broadest terms, the distinction between holders of mobile capital and holders of fixed capital follows the divide between ethnic Chinese and indigenous business groups, respectively. Under Soeharto, Indonesia's New Order relied on a coalition of ethnic Chinese financiers with extensive mobile assets and military-linked enterprises whose assets were rooted in Indonesia. Malaysia under Mahathir Mohamad relied on a coalition of Malay capitalists, also with fixed assets, and Malay labor, marginalizing most ethnic Chinese Malaysians. But such a reductive approach is far from sufficient to explain the texture of relations among factions of capital in each country. Joint ventures between Chinese *cukongs*—financiers—and military business abounded in Indonesia. Importantly, there are also important exceptions (noted below) of ethnic Chinese business interests in each country with fixed assets. Such groups in Malaysia, in fact, forged close links directly to the regime. These exceptions in both countries allow us to witness the power of asset specificity in shaping adjustment policy preferences in situations where ethnicity might otherwise have dominated.

General Soeharto seized power in 1965 with the support of anticommunist elements in the Indonesian military (ABRI). He nurtured his relationship with ABRI throughout his rule, expanding the military's involvement in politics and business through the doctrine of *dwifungsi* (dual function) that painted the Indonesian military as having a role as both a security force and a sociopolitical organization.[32] Business activities were a primary source of military funding, constituting around half of its budget in many years and becoming an area deeply vulnerable to corruption and cronyism.[33] The capital assets owned by ABRI and related enterprises were overwhelmingly fixed in Indonesia. These included such natural resources as petroleum, run by a series of military leaders under the national petroleum company Pertamina,[34] as well as a number of military-linked conglomerates with interests in fields as diverse as forestry management (Tri Usaha Bhakti) and flour milling (Berdikari).[35]

Equally important were local affiliations between military representatives posted throughout the archipelago. ABRI officers from regional commanders down to local garrison chiefs took part in a decentralized, informal, and hierarchical system that channeled funds up to the highest levels of political authority in exchange for political favoritism. In this way, the New Order approximated a franchise system that linked local military figures and their business associates (the franchisees) to Soeharto and other top elites (the franchisers).[36] Because the relationship satisfied the interests of both parties to the transaction—top leaders obtained funds and loyal subordinates, local leaders obtained state patronage and protection—both had an incentive to perpetuate it.[37]

Wealthy Chinese Indonesians formed a second pillar of support for the New Order, based in part on their own political vulnerability. Chinese Indonesians have long suffered from charges that they refuse to assimilate to Indonesian national culture, that their business activities are exploitative, and that they have divided loyalties.[38] While the ma-

[32] J. Soedjati Djiwandono, "The Military and National Development in Indonesia," in J. Soedjati Djiwandono and Yong Mun Cheong, eds., *Soldiers and Stability in Southeast Asia* (Singapore: Institute of Southeast Asian Studies, 1988); Soebijono, A. S. S. Tambunan, Hidayat Mukmin, and Roekmini Koesoemo Astoeti, *Dwifungsi ABRI: Perkembangan Dan Peranannya Dalam Kehidupan Politik Di Indonesia* (Yogyakarta: Gadjah Mada University Press, 1997).

[33] Harold Crouch, *The Army and Politics in Indonesia* (Ithaca, N.Y.: Cornell University Press, 1978); Indria Samego, Ikrar Nusa Bhakti, Hermawan Sulistyo, Riza Sihbudi, M. Hamdan Basyar, Moch. Nurhasim, Nur Iman Subono, and Sri Yanuarti, *Bila Abri Berbisnis* (Bandung: Penerbit Mirzan, 1998).

[34] Khong Cho Oon, *The Politics of Oil in Indonesia: Foreign Company-Host Government Relations* (Cambridge: Cambridge University Press, 1986).

[35] Yoon Hwan Shin, "Demystifying the Capitalist State: Political Patronage, Bureaucratic Interests, and Capitalists-in-Formation in Soeharto's Indonesia" (Ph.D. diss,, Department of Political Science, Yale University, 1989).

[36] Ross H. McLeod, "Government-Business Relations in Soeharto's Indonesia," in Peter Drysdale, ed., *Reform and Recovery in East Asia: The Role of the State and Economic Enterprise* (London: Routledge, 2000).

[37] Harold Crouch, "Patrimonialism and Military Rule in Indonesia," *World Politics* 31 (July 1979).

[38] Charles A. Coppel, *Indonesian Chinese in Crisis* (Kuala Lumpur: Oxford University Press, 1983); Yusiu Liem, *Prasangka Terhadap Etnis Cina: Evaluasi 33 Tahun Di Bawah Rejim Soeharto* (Jakarta: Djambatan, 2000).

jority of Chinese Indonesians are not wealthy, under the New Order some well-placed individuals exploited political connections to became fantastically rich. Individuals such as Liem Sioe Liong, an acquaintance of Soeharto since the 1950s, and others founded vast business empires under the protection of Soeharto and ABRI. In exchange for protection provided by Indonesian security forces, these businessmen enriched both themselves and their military patrons. In many cases, the two groups participated in joint ventures, with the latter providing investment capital and business expertise and the former ownership of physical stock and physical protection; Liem was a participant in many such partnerships.[39] Such joint ventures grew prominent after the Malari riots of 1974, which demonstrated widespread popular opposition to the perceived domination of Indonesia's economy by foreign and ethnic Chinese capital. But far from marginalizing ethnic Chinese entrepreneurs, these new alliances allowed them to leverage their investment capital into political influence by financing their military patrons' business ventures.

Yet differences between ABRI and ethnic Chinese *konglomerat* extended deeper than simple ethnicity. Largely constrained by their dependence on indigenous patrons, ethnic Chinese entrepreneurs concentrated on short-term business ventures and financial sector dealings and diversified against the risks inherent in long-term joint investments.[40] An open capital account was instrumental for this strategy. Scholars have long noted the high cross-border mobility of ethnic Chinese cronies' assets, concentrated in liquid investment capital and ready to funnel abroad at the first sign of political turmoil.[41] Close links to the overseas Chinese business community provided ethnic Chinese entrepreneurs with a ready network for the redeployment of capital assets overseas.[42] In fact, Indonesia's openness to international capital movements provided an important check on the potentially rapacious desires of ABRI commanders.[43] As scholars previously cited have noted,

[39] Adam Schwarz, *A Nation in Waiting: Indonesia in the 1990s* (St. Leonards, Australia: Allen & Unwin Pty Ltd, 1994).

[40] Jamie Mackie, "Changing Patterns of Chinese Big Business in Southeast Asia," in Ruth McVey, ed., *Southeast Asian Capitalists* (Ithaca, N.Y.: Southeast Asia Program, Cornell University, 1992).

[41] Winters (fn. 23, 1996); Andrew MacIntyre, "Institutions and the Political Economy of Corruption in Developing Countries" (Discussion paper, Workshop on Corruption, Stanford University, January 31–February 1, 2003).

[42] Jamie Mackie, "Entrepreneurship and Institutions: The Southeast Asian Experience," in Collin Barlow, ed., *Institutions and Economic Change in Southeast Asia: The Context of Development from the 1960s to the 1990s* (Cheltenham, U.K.: Edward Elgar, 1999).

[43] Andrew MacIntyre, "Indonesia," in Ian Marsh, Jean Blondel, and Takashi Inoguchi, eds., *Democracy, Governance, and Economic Performance: East and Southeast Asia* (New York: United Nations University Press, 1999).

it is impossible to assess clearly the extent of ethnic Chinese *konglomerats*' mobile investment capital under the New Order. But these authors consistently stress the fundamental contrast between the mobile assets of the *konglomerats* and the fixed investments of ABRI generals and other indigenous entrepreneurs.

Cross-border asset mobility accordingly distinguished ABRI- and state-linked businesses from ethnic Chinese *konglomerats*. For most of Soeharto's rule, cooperation between ethnic Chinese financiers and ABRI—facilitated by members of Soeharto's own family—cemented an alliance between holders of mobile and fixed capital.[44] And in similar ways, Indonesia's halting steps toward liberalization in the late 1980s benefited both ethnic Chinese *konglomerat* and current and former ABRI leaders, both of whom employed private access to the regime to secure valuable contracts and licenses and thus to capitalize on denationalized sectors of the economy.[45] Yet owing to their political vulnerability, ethnic Chinese Indonesians never entered into the same kinds of "complex patterns of intertwined share-holdings in overlapping groups of companies" with indigenous entrepreneurs, as found in countries such as Thailand.[46] Different asset profiles were a continual a source of tension, even given Chinese-ABRI business partnerships. These tensions became critical when the country faced the twin pressures of rapid currency depreciation and financial sector weakness.

In contrast to Indonesia's alliance between fixed and mobile capital, Malaysia's political system rests on a cross-class coalition defined through Malay ethnicity. The British left Malaysia in 1957 with a multiparty parliamentary democracy led by the Alliance, a coalition of three ethnic parties. Ethnicity has since then been the dominant political cleavage, especially since the formation of the Barisan Nasional (BN) ruling coalition in the wake of ethnic riots in 1969. UMNO dominates the BN, its president and deputy president serving as prime minister and deputy prime minister. UMNO's original constituency was rural Malays, teachers, and public servants. But since the early 1970s, its supporters have come to include the Malay business class created under the regime's extensive pro-Malay redistributive program known as the New Economic Policy (NEP).

[44] Mackie (fn. 40); Kian Gie Kwik, *Saya Bermimpi Jadi Konglomerat*, rev. ed. (Jakarta: Gramedia Pustaka Utama, 1999).

[45] McLeod (fn. 36); Andrew Rosser, *The Politics of Economic Liberalisation in Indonesia: State, Market, and Power* (Richmond, Surrey: Curzon Press, 2002).

[46] J. A. C. Mackie, "Property and Power in Indonesia," in Richard Tanter and Kenneth Young, eds., *The Politics of Middle Class Indonesia* (Clayton, Victoria, Australia: Centre of Southeast Asian Studies, Monash University, 1990), 85.

The NEP was created in response to the perceived failure of liberal economic policies to promote Malay welfare and reduce interethnic inequality, despite extensive pro-Malay social and development policies during the 1960s.[47] To support the rural Malays, the NEP upgraded and expanded large-scale rural development schemes that targeted Malays for discounted loans and grants.[48] To increase Malay equity in the economy, the government founded during the 1970s several investment corporations such as Permodalan Nasional Bhd (PNB), a quasi-government corporation headed by the prime minister. PNB offers Malays and other *bumiputras* (a term signifying all Malaysians not of Chinese or Indian ancestry) a wide range of investment options open only to them, including the *bumiputra*-only unit trusts that consistently offer high returns.[49] Other development policies that favor the Malay masses include favorable university entrance requirements, hiring guidelines, lending rules, restrictions on corporate equity ownership, discounted stock allocations, and government tenders. "National champions" among government-owned industrial firms, most notably the national oil company Petronas (National Petroleum Limited) and the national automobile corporation Proton (Malaysian Automobile Corporation), provided employment and training.

The redistributive policies of the NEP helped to ameliorate interethnic inequality but simultaneously fostered a class of Malay entrepreneurs closely tied to government patronage and the Malaysian state.[50] Throughout the late 1970s and into the 1980s, heavy industrialization drives and state-led development (through bodies such as Proton and Petronas) were the guises under which corporate empires developed. Such firms were overwhelmingly tied to fixed capital investments (heavy machinery, production, property ownership and development, natural resources, and others). With the regional move toward privatization in the late 1980s, in Malaysia, as in Indonesia, government-owned firms became formally private but no less dependent on political favoritism. Government tenders and privatization drives went almost exclusively to firms run by Malays, in particular those close to

[47] Just Faaland, Jack Parkinson, and Rais Saniman, *Growth and Ethnic Inequality: Malaysia's New Economic Policy*, 2nd ed. (Kuala Lumpur: Utusan Publications & Distributors Sdn Bhd, 2003); Edmund Terence Gomez and Jomo K. S., *Malaysia's Political Economy: Politics, Patronage and Profits*, 2nd ed. (Cambridge: Cambridge University Press, 1999), 14–15.

[48] Edmund Terence Gomez and Jomo K. S., "Malaysia," in Marsh, Blondel, and Inoguchi (fn. 44).

[49] Gomez and Jomo (fn. 47), 34–38.

[50] See Joel S. Kahn, "Growth, Economic Transformation, Culture and the Middle Classes in Malaysia," in Richard Robison and David S. G. Goodman, eds., *The New Rich in Asia: Mobile Phones, Mcdonalds and Middle-Class Revolution* (New York: Routledge, 1996).

UMNO, without public bids.[51] Regulations mandating discounted share offers for *bumiputras*, taken either by connected firms or through PNB, give UMNO a direct interest in the performance of the stock market and many domestic firms. Relations between Malay entrepreneurs and UMNO began to challenge the party's traditional base with the Malay masses, in particular rural Malay farmers, but never supplanted these relations—more than half of all Malays by the 1990s owned shares in PNB subsidiaries and thus directly benefited from tight UMNO-business linkages.

The coalitional background of Malaysia's regime thus leaves it hostile to ethnic Chinese Malaysians, whose per capita share of wealth still exceeds that of Malays. Chinese business has responded in several ways. Chinese Malaysians with mobile capital investments have retreated from active politics, engaging in high-risk, short-term speculative ventures and diversifying overseas,[52] mirroring the behavior of ethnic Chinese Indonesians with mobile assets but without their political favoritism. Malaysia's richest man, Robert Kuok Hock Nien, who has diversified interests across Asia and currently resides in Hong Kong, is emblematic of this strategy. Those whose assets are fixed seek direct ties with UMNO, actually mimicking the new Malay rich and bypassing the official Chinese party in the BN coalition, the Malaysian Chinese Association (MCA).[53] Key examples include Vincent Tan Chee Yioun of property and gambling conglomerate Berjaya Group and Ting Pek Khiing of the property and industrial development group Ekran Holding. On Malaysian Borneo ethnic Chinese businesses with fixed capital investments like property development and plantation farming have overtaken majority ethnic Chinese regional parties, such as the Sarawak United People's Party, a key BN component party.[54] The MCA has not been an effective tool for Chinese business organizing, especially as its political strength has steadily waned since 1971 and even acceler-

[51] Edmund Terence Gomez, *Political Business: Corporate Involvement of Malaysian Political Parties* (Townsville, Queensland, Australia: Centre for South-East Asian Studies, James Cook University of North Queensland, 1994); Jomo K. S., ed., *Privatizing Malaysia: Rents, Rhetoric, and Reality* (Boulder, Colo.: Westview Press, 1995).

[52] Kok Fay Chin and Jomo K. S., "Financial Liberalisation and System Vulnerability," in K. S. Jomo, ed., *Malaysian Eclipse: Economic Crisis and Recovery* (London: Zed Books, 2001), 97; Harold Crouch, *Government and Society in Malaysia* (Ithaca, N.Y.: Cornell University Press, 1996), 208–11; Pek Koon Heng, "The Chinese Business Elite of Malaysia," in McVey (fn. 40), 143; James V. Jesudason, *Ethnicity and the Economy: The State, Chinese Business, and Multinationals in Malaysia* (Singapore: Oxford University Press, 1990), 147–52.

[53] Gomez and Jomo (fn. 47), 44–49; Peter Searle, *The Riddle of Malaysian Capitalism: Rent-Seekers or Real Capitalists?* (St. Leonards, NSW: Allen & Unwin, 1999), 190–221.

[54] Chin Ung-Ho, *Chinese Politics in Sarawak: A Study of the Sarawak United People's Party* (Kuala Lumpur: Oxford University Press, 1997).

ated after its party-held Multi-Purpose Holdings Berhad came into conflict with UMNO-linked firms in the early 1980s.[55]

The Indonesian and Malaysian regimes that faced the Asian Financial Crisis in 1997 thus differed markedly in the coalitional bases of regime support. Indonesia's regime depended on holders of both mobile and fixed assets operating in a coalition that excluded labor from political power. Organized labor especially suffered under the New Order, and rapid economic growth along with repression ensured a relatively quiescent labor force.[56] Malaysia's regime relied on ethnic divisions to forge an alliance between state-linked Malay businesses and the Malay masses, at the expense of primarily Chinese holders of mobile financial capital as well as ordinary non-Malays. While the regimes in Indonesia and Malaysia differed along a number of other dimensions as well, this variation in the economic profiles of regime supporters had powerful implications for adjustment policies in 1997–98.

## IV. Empirical Evidence

The comparison between coalitions and policy outcomes, with other relevant variables roughly constant across countries, is preliminary evidence supporting this account. Both Indonesia and Malaysia had neoliberal technocratic elites, and in each regime the leader remained the sole veto player, wielding extraordinary authority to direct policy and remove opponents. In fact, both Soeharto and Mahathir removed their finance ministers and central bank governors for opposing their adjustment proposals. Both countries courted the IMF—Indonesia through several poorly implemented loan agreements and Malaysia through the deputy prime minister and finance minister Anwar Ibrahim, who experimented with neoliberal adjustment policies. In both countries, the primary source of development financing and patronage collapsed spectacularly. In Indonesia it was the banking system that gave way, and in Malaysia it was the stock market. Yet Indonesia pursued incoherent adjustment policies until the New Order regime collapsed, while Malaysia fixed the ringgit, banned capital outflows, and embarked on major macroeconomic expansion.

More compelling evidence comes from the evolution of distributional conflict in each country as economic conditions deteriorated and from the proposed solutions to the crisis as articulated by members of

[55] Bruce Gale, *Politics and Business: A Study of Multi-Purpose Holdings Berhad* (Petaling Jaya: Eastern Universities Press (M) Sdn Bhd, 1985).

[56] Vedi R. Hadiz, *Workers and the State in New Order Indonesia* (London: Routledge, 1997).

each polity *outside* of each regime's support coalition.[57] Figure 1 plots exchange rates for the Indonesian rupiah and the Malaysian ringgit against the U.S. dollar for 1997 and 1998. The data show the dates on which each regime decided to float its currency, in mid-July for the ringgit and in mid-August for the rupiah. Malaysia adopted a hard peg of the ringgit to the U.S. dollar on September 2, 1998. The data also give some impression of the magnitude of the currency shocks that hit each country during the course of the crisis.

The data also reflect currency movements in response to political developments in each country during the crisis. The spike in Indonesia's exchange rate in mid-January reflects investor uncertainty amidst budget disagreements and subsequent tense negotiations with the IMF. The smaller spike in February reflects negotiations over a proposed currency board system, and the spike in mid-May reflects mass anti-Chinese violence in Indonesia that led to Soeharto's resignation. The single spike in Malaysia's exchange rate deterioration corresponds with Mahathir's most vitriolic outbursts, and its return to the baseline rate of currency depreciation reflects government reassurances that Malaysia would prudently manage its adjustment.

Interest rate movements provide a gauge of each country's monetary stance (Figure 2). Spikes in both countries in the early summer of 1997 correspond to attempted interest rate defenses of their currencies. The dramatic increase in interest rates in Indonesia beginning in September 1997 marks the beginnings of Indonesia's struggle to manage depreciation through monetary tightening while avoiding the contractionary consequences of such tightening for connected interests. By contrast, the very limited tightening of Malaysian interest rates over this same period reflects the government's concern with contractionary policies, and the dip of approximately four percentage points in early September 1998 reflects the government's imposition of even looser monetary policies after having fixed the ringgit and closed the capital account. This contrast between high and vacillating (Indonesia) versus low and stable (Malaysia) is particularly instructive.

### Indonesia

Adjustment policy decisions in Indonesia between September 1997 and May 1998 reflect the competing demands of mobile and fixed capital. Indonesia's decision to float the exchange rate on August 14, 1997,

[57] On this enterprise of process tracing, see Andrew Bennett and Alexander George, *Case Studies and Theoretical Development in the Social Sciences* (Cambridge: MIT Press, 2005).

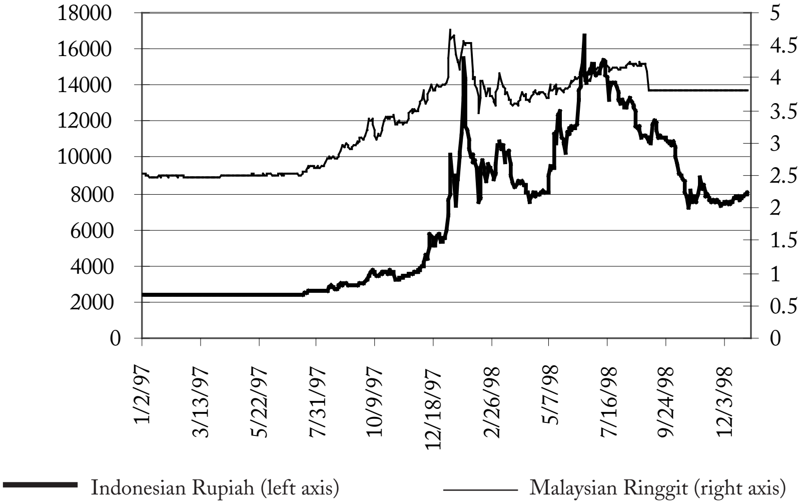


FIGURE 1
EXCHANGE RATES TO THE U.S. DOLLAR
(JANUARY 1997–DECEMBER 1998)

SOURCE: Datastream and Bank Negara Malaysia.

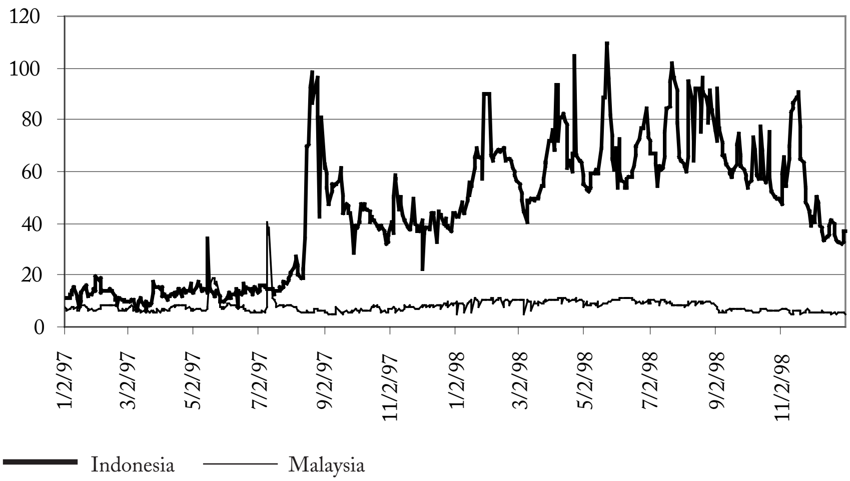


FIGURE 2
DAILY OVERNIGHT INTERBANK CALL RATES

SOURCE: Datastream and Bank Negara Malaysia.

earned the respect of many international lending agencies and foreign economic analysts.[58] The rupiah float removed the fixed target for currency speculators, but to discourage capital flight and inflation Bank Indonesia (BI) raised interest rates sharply.[59] In turn, Indonesian holders of fixed capital complained of tight monetary conditions and unpredictable exchange rates, arguing that currency depreciation increased the costs of debt service at the same time that tight money harmed business profitability. These complaints went directly to Soeharto and BI governor Soedradjad Djiwandono.[60] In response, BI backed off of high interest rates, with the consequence that capital flight increased further. This conflict between tight money policies to discourage capital flight and loose monetary policies to protect business profits would continue throughout Indonesia's crisis.

Fiscal reforms were another area of contention. Numerous public investment projects in various stages of planning were clearly inefficient uses of public funds. In early September, with widespread support from the international financial community, the regime announced it would postpone or reevaluate the biggest of these "megaprojects."[61] However, just as the first IMF agreement was reached, the government quietly gave the go-ahead to restart these projects. Tellingly, each project was connected to the interests of the first family, a close crony, or the military.[62]

As part of the first IMF agreement in November 1997, Soeharto also promised to close failing banks and consolidate others. Immediately, the regime closed sixteen banks, with no indication of the criteria for closure and no explicit deposit guarantees.[63] This led to bank runs—without criteria for bank closures or deposit guarantees, it was impossible to assess which banks would survive a future round of closures. Yet these closures targeted marginal banking sector actors, and the owners of two banks—Soeharto's son Bambang Trihatmodjo, partial owner of Bank Andromeda, and Soeharto's half-brother Probosutedjo, owner of Bank Pacific—sued the finance minister and the governor

[58] *The Australian*, October 14, 1997.

[59] J. Soedradjad Djiwandono, "Bank Indonesia and the Recent Crisis," *Bulletin of Indonesian Economic Studies* 36 (April 2000).

[60] J. Soedradjad Djiwandono, *Mengelola Bank Indonesia Dalam Masa Krisis* (Jakarta: Pustaka LP3ES Indonesia, 2001), 44.; anonymous author interview with a former adviser to the Indonesian government, Jakarta, March 17, 2006; author interview with M. Chatib Basri, director of Lembaga Penyelidikan Ekonomi dan Masyarakat, Jakarta, March 17, 2006.

[61] Ross H. McLeod, "From Crisis to Cataclysm? The Mismanagement of Indonesia's Economic Ailments," *World Economy* 21 (September 1998).

[62] Soesastro and Basri (fn. 9).

[63] *Media Indonesia*, November 3, 1997.

of BI. Bambang withdrew his suit after several days, but within weeks he had restarted Bank Andromeda under the new name of Bank Alfa. Probosutedjo pursued his lawsuit further, winning a judgment in late December that delayed Bank Pacific's liquidation. By the end of November the government announced an end to bank closures.[64]

Political conflict among members of the New Order's support coalition arose in the early months of 1998. As rioters in Java and elsewhere targeted Chinese Indonesians for hoarding and "causing inflation,"[65] military leaders, indigenous business leaders, and mass Muslim organizations increasingly turned against ethnic Chinese businessmen. Specifically, their opponents charged that ethnic Chinese financiers were both speculating on the rupiah's further collapse and funneling their cash reserves overseas in search of favorable deposit rates. Coordinating Minister for Politics and Security Soesilo Soedarman suggested using antisubversion laws to arrest speculators as early as August 1997.[66] In early January, Soeharto called together many of his close ethnic Chinese business associates, apparently to urge them to cease sending their liquid assets overseas.[67] Notably, retired general Syarwan Hamid and Golkar chairman Harmoko openly criticized the "rats" plaguing Indonesia's economy.[68] The meaning of "rats" in this context is clear: ethnic Chinese financiers. The regime accordingly faced pressures from owners of fixed capital to break the link between interest rates and exchange rates, and the ire of fixed capital owners increasingly turned toward holders of mobile assets.

One solution considered in mid-February 1998 was to repeg the rupiah with a currency board, fixing the currency at Rp5,000/U.S.$ versus the prevailing rate of Rp9,000/U.S.$.[69] Initially, the proposal met with widespread support from the regime's supporters, both holders of fixed capital and mobile capital. Some of the plan's public supporters included ethnic Chinese financiers such as Lippo Group deputy chairman James T. Riady and fixed capital owners such as indigenous construction magnate Aburizal Bakrie.[70] Holders of mobile capital favored the plan because it allowed them to exchange their rupiah holdings for foreign currency at more favorable rates (and park them overseas), while

[64] *Bisnis Indonesia*, November 5, 1997; *Kompas*, November 13, 1997.

[65] Michael Ocorandi, "An Anatomy of the Recent Anti Ethnic-Chinese Riots in Indonesia," http://www.fica.org/cs:analysis-mayriot-ocorandi, 1998 (accessed December 15, 2007).

[66] *Kompas*, August 29, 1997.

[67] *Media Indonesia*, January 14, 1998; *Jakarta Post*, January 15, 1998.

[68] *Suara Karya*, January 20, 1998; *Merdeka*, January 28, 1998.

[69] *Jakarta Post*, February 10, 1998.

[70] *Kompas*, February 19, 1998.

holders of fixed capital wished to pay down their foreign-denominated debts at that more favorable rate.[71] The plan even had support from exporters eager to anchor expectations.[72] Ultimately, however, sustained international pressure and some technocratic opposition derailed these plans. And of course, without some sort of controls on capital outflows, a fixed exchange rate would have necessitated high interest rates necessary to support the pegged currency.

What remained contentious were capital account settings. For despite mounting public criticism, throughout this period ethnic Chinese business leaders maintained their demand for capital account openness.[73] Long a foundation of Indonesia's political economy, free movement of capital across borders remained legal throughout the crisis. In fact, in February the regime lifted the ceiling on Indonesians moving hard rupiah currency abroad from Rp50,000 to Rp5,000,000. Additionally, individuals removing additional funds simply needed permission from BI in advance or to fill out paperwork upon departure.[74]

To combat currency depreciation without closing the capital account (opposed by holders of mobile capital) or further increasing interest rates (opposed by holders of fixed capital, as well as by the Indonesian masses), the regime resorted to clumsy attempts at moral suasion. At the same time as popular criticism of ethnic Chinese financiers emerged, the regime launched a "Love the Rupiah" campaign. A nationalist attempt to link rupiah holdings to Indonesian patriotism, the campaign encouraged citizens to donate their savings to BI and to convert their dollar holdings back into rupiah. Despite early pronouncements of united support, many ethnic Chinese *konglomerat* resisted this move, vowing to help the economy by increasing exports.[75] The campaign ultimately proved ineffective, providing BI with less than U.S.$500,000.[76]

Liquidity support for troubled financial institutions became another important issue as the crisis deepened. The banking arms of many large ethnic Chinese *konglomerat*, with substantial foreign-denominated liabilities and facing tight monetary conditions that eroded their own

[71] Robison and Rosser (fn. 10), 1603.

[72] Author interview with Zulhefi Sikumbang, head of the Indonesian Association of Exporters, Jakarta, March 13, 2006.

[73] Author interview with a Chinese Indonesian political observer, Jakarta, February 2006; Salim interview (fn. 4); author interview with Sri Adiningsih, former ombudswoman at the Indonesian Bank Restructuring Committee, Jakarta, March 9, 2006.

[74] *Kompas*, February 5, 1998.

[75] *Merdeka*, January 20, 1998.

[76] *BusinessNews*, May 13, 1998.

debtors' ability to repay their debts, experienced daily cash squeezes. To avoid a complete collapse of the banking sector, and having guaranteed deposits after the November bank runs, the regime provided billions of dollars in emergency liquidity support to financial institutions. Thirteen banks, each either a subsidiary of an ethnic Chinese *konglomerat* or owned by a member of Soeharto's immediate family, received truly staggering amounts of support, in excess of 500 percent of equity and 75 percent of assets.[77] By the time Soeharto resigned, emergency liquidity support totaled Rp119 trillion. Yet an open capital account provided the beneficiaries of liquidity support with a pernicious opportunity. Most of these beneficiaries, rather than paying down debts, simply converted emergency funds to dollars and parked them overseas.[78] Opposition from fixed capital owners, who pressured Soeharto to ban capital outflows and punish ethnic Chinese cronies for sending these funds overseas, was continual throughout this period.[79] Minister of Finance Fuad Bawazier, himself a noted indigenous businessman who pressured Soeharto strongly to arrest ethnic Chinese *konglomerat* and impose capital controls, stressed that BI liquidity support was a subsidy to mobile financiers, and those financiers were Chinese.[80]

Meanwhile, fiscal and corporate reforms stalled. Previously postponed infrastructure projects noted above remained in the works. In January 1998 Soeharto signed another IMF agreement that required extensive corporate reforms. But the regime immediately sidestepped many of these conditions, as they required abolishing subsidies to and monopolies held by close cronies. The plywood monopoly held by Muhammad "Bob" Hasan under the Indonesian Wood Panel Association (Apkindo), for example, was formally eliminated, but Hasan re-created the monopoly by directing all exporters to employ the Indonesian Shipping Association. In March 1998 Hasan became minister of trade and industry, gaining the authority to restrict plywood exports by ministerial decree, which he subsequently did in April.[81] Likewise, Soeharto's son Tommy was able to re-create his monopoly on clove exports after its formal dissolution, creating a new company from which

[77] *Jakarta Post,* September 23, 1998; Yuri Sato, "Post-Crisis Economic Reform in Indonesia: Policy for Intervening in Ownership in Historical Perspective" IDE Research Paper no. 4 (Institute for Developing Economies, 2003).

[78] Sato (fn. 77); anonymous interview (fn. 60); Basri interview (fn. 60); Sukowaluyo Mintorahardjo, *Blbi Simalakama: Pertaruhan Kekuasaan Presiden Soeharto* (Jakarta: Penerbit RESI, 2001).

[79] Adiningsih interview (fn. 73); author interview with Sjahril Sabirin, former governor of Bank Indonesia, Jakarta, March 17, 2006.

[80] Author interview with Fuad Bawazier, former minister of finance, Jakarta, March 6, 2006.

[81] *Asian Wall Street Journal*, February 10, 1998.

clove cigarette manufacturers were forced to purchase cloves in order to fulfill customs and excise requirements.[82]

But the regime did not resist all reforms. It did adopt a number of reforms whose distributional burdens fell upon the poorest Indonesians, shunting the costs of adjustment away from its key supporters and onto the Indonesian masses. Specific policies implemented without reservation include increases in excise taxes for alcohol and tobacco and price rises for fuel, electricity, sugar, wheat flour, corn, soybean meal, and fishmeal.[83] Moreover, consumer prices increased dramatically (Table 3), driven by high import costs and the jump in broad money that accompanied emergency liquidity support and credit facilities (M2 nearly doubled between May 1997 and May 1998). Responding to the hardship facing ordinary Indonesians, the third IMF agreement even stipulated an *increase* in food subsidies, but the regime failed to implement them.

For ten months, holders of mobile and fixed assets pressured the New Order regime to adopt favorable policy responses to the crisis. Sharp swings in interest rates, abortive attempts to peg the rupiah, and fierce conflict over capital account policy reflect the contradictory preferences of the two groups. Even so, corporate bailouts reflect the regime's attempts to placate each: public spending and corporate protectionism shielded the interests of fixed capital, while financial subsidies and an open capital account protected those of mobile capital. A final round of subsidy cuts, which increased fuel and electricity prices, led to massive riots by urban residents of Jakarta and other major cities on May 13–14, 1998. These riots largely targeted ethnic Chinese Indonesians, but also members of the first family. Observers disagree about who (if anyone) instigated these riots, but possible culprits were all members of ABRI's highest leadership.[84] These riots and the slow reaction from ABRI led Chinese Indonesian business magnates to flee overseas—taking their assets with them. This final exodus of ethnic Chinese Indonesians signified the ultimate fracture of the alliance between mobile and fixed capital that had supported the New Order regime.

[82] *Asian Wall Street Journal*, April 27, 1998.

[83] Government of Indonesia, "Memorandum of Economic and Financial Policies, April 10, 1998. Seven Appendices," http://www.imf.org/external/np/loi/041098.htm, 1998 (accessed December 15, 2007).

[84] Author interview with a figure in the Chinese Indonesian community, Jakarta, March 2006; see Kevin O'Rourke, *Reformasi: The Struggle for Power in Post-Soeharto Indonesia* (Sydney: Allen & Unwin, 2002); Takashi Shiraishi, "The Indonesian Military in Politics," in Adam Schwarz and Jonathan Paris, eds., *Politics of Post-Suharto Indonesia* (New York: Council on Foreign Relations, 1999).

TABLE 3
CONSUMER PRICE INFLATION, 44 LARGEST CITIES
(DECEMBER 1997–MAY 1998)

| *Component* | *% Change* |
|---|---|
| Food | 52.17 |
| Prepared food, beverages, and tobacco products | 46.29 |
| Housing | 27.03 |
| Clothing | 59.17 |
| Health | 47.19 |
| Education, recreation, and sports | 18.27 |
| Transportation and communication | 39.99 |
| General index | 40.06 |

SOURCE: Badan Pusat Statistik, *Indikator Ekonomi: Mei 1999* (Jakarta: Badan Pusat Statistik, 1999), 4–5.

## MALAYSIA

In Malaysia similar interest-group pressures prevailed throughout the course of the crisis, but different coalitional alignments produced different policy outcomes. Initially, Malaysia pursued a more vigorous defense of the ringgit before opting to float in mid-July 1997. In contrast to Indonesia, where the regime remained officially silent, Mahathir immediately attacked mobile capitalists, both foreign and domestic, linking Malaysia's currency problems to actions by rogue Malaysian speculators and an international conspiracy of Western governments, the foreign press, and Jews.[85] As capital began to flow out of Malaysia, Bank Negara Malaysia (BNM), Malaysia's central bank, faced constant pressure to keep interest rates low. Mahathir insisted that BNM would avoid monetary tightening to protect the income streams of heavily indebted firms and similarly warned financial institutions not to raise interest rates on their own.[86] Nevertheless, to forestall capital flight BNM oversaw gradual interest rate rises throughout early 1998. Reactions from fixed capital in the Malay community were sharply negative. Nik Mohamed Nik Yaacob of the politically connected Sime Darby Group, for instance, insisted that its subsidiaries were unable to survive tight monetary conditions.[87] Responding to this pressure, other politicians began clamoring openly for looser macroeconomic conditions by early 1998.[88]

[85] *Utusan Malaysia*, July 22, 1998; *The Star*, October 11, 1998.
[86] *Utusan Malaysia*, December 1, 1997; *Business Times (Malaysia)*, January 1, 1998.
[87] *Utusan Malaysia*, November 10, 1997.
[88] *Business Times (Malaysia)*, July 1, 1998; *New Straits Times*, August 12, 1998.

Also as in Indonesia, the regime's initial attempts to restrict fiscal expenditures met with stiff opposition from business interests linked to UMNO leaders. At first, the regime postponed a number of clearly uneconomical megaprojects, but in subsequent months restarted many of them and compensated the beneficiaries of others. For instance, despite having postponed investment in Ting Pek Khiing's already wasteful Bakun Dam project, the regime announced in late November 1997 that it would take over the Bakun concession and compensate Ekran.[89] Other fixed investment projects that had been deferred earlier in the autumn of 1997, such as transportation and petroleum distribution infrastructure for the northern part of the Malay Peninsula and southern Thailand, were restarted as well.[90] Each of these protected the interests of politically connected Malay firms.

While monetary policy and discretionary budgetary outlays continued to protect the interests of holders of fixed capital who were unable to seek safer investments overseas, the regime did attempt to project its resolve in cutting wasteful spending. Deputy Prime Minister and Finance Minister Anwar Ibrahim, popular among observant Muslims and increasingly among foreign observers, led this effort. Shortly after the decision to bail out Ekran Holdings, Anwar announced additional spending cuts in an addendum to the 1998 budget.[91] The proposed adjustment measures contracted government spending by 18 percent, deferring several additional infrastructure projects and postponing imports for state-run firms. Yet spending cuts provoked the ire of UMNO politicians and the regime's allies in the business community. Already by November 1997, a move to supersede the policy-making autonomy of the Finance Ministry was under way in what later became the National Economic Action Council (NEAC), a body in the Prime Minister's Department with near complete discretionary authority over economic policy.[92] Importantly, the NEAC's executive director was Daim Zainuddin, a former finance minister with extensive fixed capital investments.[93] The NEAC both signaled Mahathir's dissatisfaction with Anwar's budgetary policies, from which Mahathir distanced himself, and created a channel through which Malay- or crony-run firms could directly influence policy-making.

[89] *New Straits Times*, November 21, 1997; *Utusan Malaysia*, November 21, 1997.

[90] Haggard (fn. 20).

[91] *New Straits Times*, December 6, 1997; *Utusan Malaysia*, December 6, 1997.

[92] Mahani (fn. 11).

[93] See Edmund Terence Gomez, *Politics in Business: Umno's Corporate Investments* (Kuala Lumpur: Forum, 1990).

Pressure from fixed capital for easy monetary conditions and additional spending ultimately prevailed against Anwar's attempts to cut spending. In late June, Mahathir appointed Daim as a minister with special functions in the Prime Minister's Department, signifying Anwar's further marginalization. Aware of expansionary demands from UMNO and Malay cronies and their implications for his political future, just prior to UMNO's General Assembly in June, Anwar announced an additional Rm7 billion in countercyclical spending and shortly thereafter introduced Rm5 billion in infrastructure development funds.[94] Meanwhile, Mahathir advocated ever stronger measures, linking spending projects and infrastructural investment that protected Malay business interests to the New Economic Policy.[95]

The regime's corporate arms also allowed it to rescue holders of fixed capital whose profitability evaporated during the crisis. The regime regularly used funds from the government investment company Khazanah to boost the prices of politically connected stocks.[96] It also used funds from its pension plan, the Employees' Provident Fund, to bolster United Engineers (Malaysia) Berhad (UEM), a firm under the corporate control of Daim's protégé Halim Saad.[97] Additional EPF funds supported connected Malay firms such as Sime Darby. The regime also used Petronas to bail out Konsortium Perkapalan Berhad (KPB), a shipping company majority owned by Mahathir's first son, Mirzan.[98] Each of these transactions reveals the regime's corporate intervention to protect politically influential holders of fixed capital.

The heavy favoritism shown to Malay corporate leaders could have generated a populist backlash without clear evidence that ordinary Malays, also key regime supporters, profited from these policies. The regime directed additional EPF funds into the Kuala Lumpur Stock Exchange (KLSE) in order to protect PNB's returns, placating many ordinary Malays without large cash savings. The move occasioned heavy protests by non-Malay political parties, even as it enabled the two largest Malay unit trusts to continue to pay over 10 percent in dividends despite the collapse in stock prices.[99]

Likewise, the regime continued to target the Malay poor and middle class with redistributive spending initiatives that expanded dramatically

[94] *New Straits Times*, June 19, 1998; *Utusan Malaysia*, July 2, 1998.

[95] *Berita Harian*, August 21, 1998.

[96] *Berita Harian*, September 20, 1997.

[97] Kit Siang Lim, "EPF Funds Used to Save Vips, Tycoons and Cronies," *Aliran Monthly* 18 (1998), 68–69.

[98] Subramaniam Pillay, "Bailout Blues: State Welfare for the Rich and Market Capitalism for the Poor," *Aliran Monthly* 18 (1998).

[99] *Utusan Malaysia,* October 17, 1997.

to deflect the impact of the crisis. These, unlike spending on big-ticket investment projects, were never contested between Anwar as finance minister and Mahathir and Daim. In mid-October 1997 the regime announced that Petronas would purchase a Rm1 billion bond from the newly formed government housing company Syarikat Perumahan Negara Berhad to support low-cost housing, later to be supplemented with an additional billion ringgit in April 1998.[100] Between November 1997 and May 1998, consumer groups as well as UMNO youth protested price rises for palm cooking oil, toll roads, sugar, chicken, wheat flour, condensed milk, onions, and eggs.[101] Where prices on imported goods did rise to reflect new costs associated with ringgit depreciation, Mahathir and Minister of Domestic Trade and Consumer Affairs Megat Junid Megat Ayob demanded investigations of traders who raised prices more than the permitted amount.[102] Additional social spending arrived on March 23, 1998, with a package from the Finance Ministry entitled, Measures to Strengthen the Stability of the Malaysian Economy, which pledged Rm1 billion for poor Malaysians,[103] and in early June, with the formation of the Fund for Bumiputra Entrepreneurs that pledged Rm500 million to *bumiputra* small businesses.[104] Moreover, the formerly government-owned power-generating firm Tenaga Nasional Berhad pledged that it would not raise electricity prices before the end of 1999, despite having experienced an 88 percent decline in profits in late 1997.[105] All of these moves contrast sharply with moves in Indonesia, which faithfully cut subsidies to poor citizens.

Redistribution and fiscal protectionism notwithstanding, pressure to ease monetary conditions remained strong.[106] Yet capital openness meant that monetary loosening would increase capital flight and exacerbate the collapse of the ringgit and the KLSE. Accordingly, as in Indonesia, there was an escalation of political conflict between the holders of fixed capital—largely, but not exclusively, the indigenous majority—and factions of the Chinese minority with mobile assets. Already in July 1997 Mahathir and other leaders gave cryptic warnings to domestic currency traders not to sabotage the economy.[107] Famously,

[100] *Business Times (Malaysia)*, October 10, 1997; *Utusan Malaysia*, April 28, 1998.

[101] See, e.g., *Utusan Malaysia,* November 19, 1997; *Mingguan Malaysia,* December 7, 1997; *Utusan Malaysia,* March 10, 1998.

[102] *Utusan Malaysia*, December 13, 1997; *Utusan Malaysia*, June 8, 1998.

[103] Ibrahim Anwar, "Penerangan Menteri Mengenai Langkah-Langkah Bagi Mengukuhkan Kestabilan Ekonomi Negara Di Dewan Rakyat Pada 24 Mac 1998," http://www.treasury.gov.my/index.php?ch=36&pg=126&ac=561, 1998 (accessed December 15, 2007).

[104] *Utusan Malaysia*, June 6, 1998.

[105] *Utusan Malaysia*, November 8, 1997; *Utusan Malaysia*, August 12, 1998.

[106] *Utusan Malaysia*, February 4, 1998; *Berita Harian*, March 16, 1998.

[107] *Business Times (Malaysia)*, July 30, 1997.

while delivering a keynote speech at a joint World Bank-IMF meeting in Hong Kong on September 20, Mahathir suggested that countries should eliminate capital movements, stating that "currency trading is unnecessary, unproductive, and immoral" and calling for countries to make it illegal.[108] While such statements exacerbated capital flight, they found a sympathetic ear domestically. By early 1998 Mahathir had begun openly attacking Malaysians who had moved assets abroad.[109] By March, UMNO's youth wing demanded that the government provide a list of names of unpatriotic Malaysians who had moved ringgit funds offshore, a thinly veiled threat against Chinese Malaysian entrepreneurs.[110] In May the multiethnic Gerakan party joined the effort, criticizing Chinese businesses for parking funds in Singapore.[111]

Pressure from fixed capital and the Malay masses for more radical adjustment measures was brought to bear in spring 1998. Interest rates gradually turned downward beginning in April. In late August 1998, BNM governor Ahmad Mohd. Don and deputy governor Fong Weng Phak resigned abruptly, each claiming to oppose lower interest rate policies. Subsequently, on August 31, the regime announced that on the following day, trade in Malaysian stocks in offshore markets would become illegal. The next day, the regime announced a ban on capital outflows, and mandated that all overseas ringgit be repatriated by October 1; the following day it fixed the ringgit at Rm3.80/U.S.$. After announcing these new measures, Mahathir sacked Anwar to secure his position in UMNO, later engineering his conviction on charges of corruption and sodomy.

Shielded from capital outflows and fluctuating exchange rates, the regime implemented further expansionary policies. These included additional loosening of interest rates, slashing statutory reserve requirements to 4 percent (down from 13.5 percent in January 1998), lifting ceilings on lending for property investment or for stock market purchases, directing financial institutions to achieve a minimum of 8 percent loan growth for 1998, and relaxing *bumiputra* equity requirements to tap non-Malay and foreign capital.[112] Nevertheless, the regime retained tight control over share issues to non-Malays, ensuring that the primary beneficiaries were in fact ethnic Chinese and Indian Malaysians with strong, long-standing UMNO links.[113] Capital

[108] Mahathir Mohamad, *Currency Turmoil* (Petaling Jaya: Limkokwing Integrated, 1998), 25.
[109] *Utusan Malaysia*, January 29, 1998.
[110] *Utusan Malaysia*, March 13, 1998.
[111] *New Straits*, May 10, 1998.
[112] *New Straits Times*, September 2, 1998; *Asian Wall Street Journal*, September 10, 1998.
[113] Edmund Terence Gomez, "Political Business in Malaysia: Party Factionalism, Corporate Development, and Economic Crisis," in Edmund Terence Gomez, ed., *Political Business in East Asia* (London: Routledge, 2002), 103–4.

controls, a pegged ringgit, and expansionary policies were overwhelmingly popular among all holders of fixed capital in Malaysia, as those individuals enjoyed looser macroeconomic conditions and predictable exchange rates.[114] Also popular were further corporate bailouts, such as the effective renationalization of Malaysia Airlines, under the control of Tajudin Ramli, another of Daim's protégés, through a stock purchase that paid Rm8 for shares trading at around Rm3 in a company that had posted Rm669.7 million in losses for the year ending March 31, 1999.[115] Several months later Petronas rescued Proton, to the tune of Rm1 billion.[116] Quantitative evidence suggests that share prices of firms with close ties to Mahathir systematically outperformed those of unconnected firms during Malaysia's recovery.[117]

The Malay masses benefited directly from post-September adjustment policies as well. Noting the negative impact of the crisis on "household income, employment opportunities, and *bumiputra* equity ownership,"[118] the regime implemented almost no new taxes to finance its fiscal expansion. The only exceptions were taxes on "sin" goods such as alcohol, gambling, and cigarettes—the first two of which are prohibited to Malays by law. Small business development funds specially reserved for *bumiputras* received additional injections.[119] The 1999 budget was "a budget close to the people,"[120] containing numerous spending measures that benefited poor Malays. Independent of the 1999 budget, the new Second Finance Minister Mustapha Mohamed announced an Rm2.678 billion development spending package.[121] The redistributive impact of spending measures and business conditions that protected employment was popular even among opposition parties,[122] removing part of the ideological basis of mass opposition that sped the collapse of Indonesia's New Order.

[114] Author interview with Mohamed Ariff, executive director of the Malaysian Institute for Economic Research, Kuala Lumpur, July 10, 2006; author interview with Shahrir Abdul Samad, former chair of the Barisan Nasional Backbenchers' Club, Kuala Lumpur, July 10, 2006; author interview with Ramon Navaratnam, president of Transparency International Malaysia, Petaling Jaya, Malaysia, July 17, 2006.

[115] *Far Eastern Economic Review*, December 7, 2000.

[116] *New Straits Times*, August 26, 1999.

[117] Simon Johnson and Todd Mitton, "Cronyism and Capital Controls: Evidence from Malaysia," *Journal of Financial Economics* 67 (February 2003).

[118] National Economic Action Council, "National Economic Recovery Plan: Agenda for Action," (Kuala Lumpur: National Economic Action Council, 1998),http://www.neac.gov.my/view.php?ch=9&pg=140&ac=959&fname=file&dbIndex=0&ex=1166396362&md=%22q+%97M%F4%18%E7%AF%B2%A6%B9%A3%5C%F6%9B (accessed December 15, 2007), 15–16.

[119] *New Straits Times*, October 26, 1998.

[120] *Utusan Malaysia*, October 24, 1998.

[121] *Berita Harian*, October 23, 1998.

[122] Author interview with Chandra Muzaffar, former deputy chairman of the National Justice Party, Petaling Jaya, July 5, 2006; author interview with Lim Kit Siang, former secretary-general of the Democratic Action Party, Kuala Lumpur, July 12, 2006.

Although capital controls and a ringgit peg made feasible a range of expansionary and redistributive policies that satisfied both holders of fixed capital and the Malay masses, the losers were owners of mobile assets. Investors with the inclination to redeploy assets overseas suffered, and strongly opposed these measures.[123] In Singapore outrage at the regime's restrictions on currency trading was particularly virulent from individuals with cross-border holdings.[124] Often overlooked in the wake of the fall 1998 crackdown on domestic political opponents was opposition to capital controls from the DAP, the largely Chinese opposition party, which criticized bans on capital outflows despite its otherwise social democratic political ideology.[125] Mobile capital's political marginalization in Malaysia, however, allowed Mahathir's regime to adopt dramatic measures that would be popular among its supporters, the Malay masses and holders of fixed capital.

Cross-nationally, a final piece of evidence supporting the argument comes from the behavior of ethnic Chinese cronies in each country with fixed capital investments. As the New Order collapsed in May 1998, most ethnic Chinese Indonesians with mobile assets fled the country. Most notable among the few who stayed was Bob Hasan (born as The Kian Seng), who held extensive timber concessions.[126] That Hasan remained in Indonesia reassures us that asset specificity rather than simply ethnicity is the key causal variable determining adjustment policy choice in Indonesia. In Malaysia, Chinese Malaysian entrepreneurs with fixed capital investments stood firmly by Mahathir. These include Vincent Tan and Ting Pek Khiing, each previously cited as Chinese Malaysians with fixed capital investments and tight UMNO links. Both profited handsomely.[127]

## V. Conclusions

To explain variation in policy response to financial crises in Indonesia and Malaysia, this article examines the distributional implications of twin crises and the support coalitions of authoritarian regimes. Supporters of Indonesia's New Order regime were fundamentally divided over adjustment policy, while Malay business, non-Malay owners of

[123] Ariff interview (fn. 5); *New Straits Times*, September 3, 1998; *Straits Times*, September 8, 1998.

[124] *Straits Times*, September 3, 1998.

[125] Lim interview (fn. 3).

[126] Christopher M. Barr, "Bob Hasan, the Rise of Apkindo, and the Shifting Dynamics of Control in Indonesia's Timber Sector," *Indonesia* 65 (April 1998).

[127] *Asian Wall Street Journal,* December 21, 1998.

fixed capital, and the Malay masses united behind capital controls and expansionary macroeconomic policy. By linking variation in support coalitions to preferences for adjustment policy, the account explains the political origins of adjustment policies in Indonesia and Malaysia, solving the riddle of policy variation and illuminating the critical links between asset specificity and political conflict during financial crises.

This argument about asset mobility, the varying supporters of authoritarian regimes, and adjustment policy preferences should travel to other countries facing financial sector meltdowns. And, indeed, anecdotal evidence suggests that this framework might usefully be applied to them. Struggles over adjustment in the Southern Cone during the early 1980s certainly reflect similar distributional concerns. Pinochet's regime in Chile had for years exacted high tariffs on capital inflows with short maturity structures.[128] While a number of financial conglomerates (*grupos*) grew fantastically wealthy under monetarist policies, none had the permanent ear of the regime.[129] Dependent primarily on domestic business groups with fixed capital investments, Pinochet's regime responded to its crisis by limiting capital outflows and adopting expansionary policies—and, unlike Malaysia, retrenching workers and slashing social programs. This stands in contrast to Argentina and Uruguay, both of which experienced massive capital outflows but failed to restrict them until after the breakdown of their military regimes. The key to understanding their experiences lies in the support their military regimes received from mobile capitalists—some of them generals themselves—who exploited high interest rate differentials and favorable business conditions to earn a quick profit under authoritarian rule.[130]

The perspectives on distributional conflicts over policy during twin crises should also extend to democratic states, although under democratic governments, political institutions mediate the link between preferences and outcomes. In fact, this framework captures quite simply the nature of conflict among workers, industrialists, and mobile financiers during past twin crises in advanced industrial democracies.

[128] Sebastian Edwards, "How Effective Are Capital Controls?" *Journal of Economic Perspectives* 13 (Autumn 1999).

[129] Frieden (fn. 31), 167; Carlos Fortin, "The Political Economy of Repressive Monetarism: The State and Capital Accumulation in Post-1973 Chile," in Christian Anglade and Carlos Fortin, eds., *The State and Capital Accumulation in Latin America,* vol. 1, *Brazil, Chile, and Mexico* (Pittsburgh, Pa.: University of Pittsburgh Press, 1985), 134, 85–89; Karen L. Remmer, *Military Rule in Latin America* (Boston: Unwin Hyman, 1989), 126–27, 58–60.

[130] Bernhard Fischer, Ulrich Hiemenz, and Peter Trapp, *Argentina: The Economic Crisis in the 1980s* (Tübingen: J. C. B. Mohr [Paul Siebeck], 1985); Paul H. Lewis, *The Crisis of Argentine Capitalism* (Chapel Hill: University of North Carolina Press, 1990), 462–63.

With full capital mobility, charges of treason against domestic speculators are common, and fears of the loss of national sovereignty often justify heterodox adjustment measures.[131] The postwar economic order in Europe relied on cooperation between industrialists and labor, for decades under Bretton Woods operating against the interests of global financiers.[132] Similar coalitional alignments also appear in new democratic governments elected in the wake of twin crises. An example from Southeast Asia is Thailand, where Thaksin Shinawatra's Thai Rak Thai Party rose to power in 2001 on an anti-IMF, populist, probusiness platform.[133] After the collapse of military rule in 1983, Argentina likewise embarked on its ill-fated Austral Plan, uniting populists with industrialists behind a pegged exchange rate and capital account restrictions to facilitate expansionary policies, albeit unsuccessfully.[134]

Beyond new linkages between coalitions and adjustment, this account suggests a return to older themes for the growing literature on the political economy of autocracy. Some recent approaches focus on appropriation and redistribution in the absence of property rights, with authoritarian regimes viewed as coalitions of the rich.[135] The approach here studies the preferences of regime supporters but does not make narrow assumptions about the groups that support autocrats. The assumption that all conflict within authoritarian regimes is class based neglects the fundamental sectoral struggles that often exist within authoritarian regimes. Other approaches to political development argue that high levels of asset mobility create incentives for democratization to ensure the legal enforcement of contractual rights.[136] Malaysia, along with Singapore and others, shows that some regimes are able to forge investment-friendly environments without adopting procedural democracy—and in the case of Malaysia, while repeatedly acting against the interests of mobile capital. New Order Indonesia illuminates how mobile capitalists can exploit weak juridical institutions through informal networks of patronage and exchange, while also highlighting that this entails predictable vulnerabilities to financial sector shocks.

[131] Charles P. Kindleberger, *Manias, Panics, and Crashes: A History of Financial Crises*, 4th ed. (New York: John Wiley and Sons, 2000).

[132] Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca, N.Y.: Cornell University Press, 1994).

[133] Kevin Hewison, "Neo-Liberalism and Domestic Capital: The Political Outcomes of the Economic Crisis in Thailand," *Journal of Development Studies* 41 (February 2005).

[134] William C. Smith, "Democracy, Distributional Conflicts and Macroeconomic Policymaking in Argentina, 1983-1989," *Journal of Interamerican Studies and World Affairs* 32 (Summer 1990).

[135] Acemoglu and Robinson (fn. 29).

[136] Robert H. Bates and Da-Hsiang Donald Lien, "A Note on Taxation, Development, and Representative Government," *Politics and Society* 14 (March 1985); Carles Boix, *Democracy and Redistribution* (New York: Cambridge University Press, 2003).

Other studies of authoritarianism explain regime survival by focusing on political institutions such as parties and legislatures.[137] Some authors have argued that Soeharto's neglect of Golkar as an institution for containing political factionalism helps to explain the breakdown of the New Order. But this article argues that institutions are secondary to preferences in explaining adjustment policy choices. This interest-based account suggests that for researchers interested in the wide variation in policies enacted by autocrats, a focus on sectors, factors, ethnic cleavages, and coalitions will yield powerful insights. It also helps explain why authoritarian institutions sometimes appear so successful in confronting economic crises, whereas they sometimes fail so spectacularly.

[137] Brownlee (fn. 3); Gandhi and Przeworski (fn. 3); Geddes (fn. 3); Smith (fn. 3).