The Political Economy of Financial Development in Southeast Asia[*]

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I. Introduction

Over the past half century, the emerging economies of Southeast Asia—Indonesia, Malaysia, the Philippines, and Thailand—have seen substantial growth and deepening in their financial systems. Today, Malaysia has one of the world's most dynamic equity markets, along with a large and deep banking sector that has grown rapidly since the 1960s. Thailand's financial system has also seen impressive growth since the 1960s, although it lags somewhat behind Malaysia. Indonesia and the Philippines remain relatively underdeveloped compared to their neighbors, but viewed in historical perspective, financial development in these countries has been nevertheless impressive.

In this chapter I propose a political economy perspective on financial development in Southeast Asia that can explain differences across countries and changes over time. I focus on two issues: first, the origins of cross-national variation in financial development, and second, the institutional changes in national financial systems in Southeast Asia since the 1980s. Variation in financial development outcomes in Southeast Asia is the product of the political constraints and challenges facing regimes in the region. For various reasons that I outline in this chapter, financial development is potentially threatening to political regimes, especially fragile or newly consolidated regimes. But financial development also can promote economic development, something that political leaders throughout the region have been keen to harness for their own benefit. To manage this dilemma between the potential economic benefits and the potential political costs of financial development, political elites embedded financial orders within political orders as they jointly construct both. To explain the changing nature of financial development in Southeast Asia since the 1980s, this chapter focuses on the origins of political orders in the early postcolonial period and the strategies through which political regimes struggle to maintain them.

Variation in the political exigencies facing postcolonial regimes explains the variation in the financial systems that they constructed. This gives us leverage over the *origins of* financial systems. Malaysia's mobilizational regime, for instance, created the foundations for broad and deep financial development. In Philippines, by contrast, a more personal style of rule was inimical to such a pattern of financial development. Facing a set of common external shocks in the 1980s, regimes in each country liberalized their financial sectors to a substantial degree, but they did so in different ways; the different regimes in turn responded to the subsequent 1997-98 financial crises in different ways as well. This explains *change and continuity* in financial systems across time.

This approach that I take in this chapter suggests that different constellations of economic and political power—which originate in the historical conditions of state formation and regime consolidation—are more important drivers of financial development than are institutional logics. What is striking, in terms of the typology of East Asian "capitalisms" outlined by Walter and Zhang (this volume), is in fact the broad similarity in the various financial architectures in each capitalism (see Table 1). Each variety of capitalism in East Asia features a pattern of corporate governance dominated by insider connections, each relies heavily on bank-based finance, and in each financial regulation is shaped by the state and private interests. These factors are indeed common to all four of the Southeast Asian financial systems surveyed in this chapter. The more interesting variation across these countries is in the depth and pace of financial development in Southeast Asia.

Putting that variation in financial development aside, there are of course other important differences among the varieties of East Asian capitalism: relative to state-led and personalized varieties, equity markets are more important in networked and co-governed varieties, while financial regulation features less private influence in the state-led variety than in the other three. These differences allow us to classify the four countries into different cells in the 1980s and the 2000s, as shown in Table 1. Malaysia and Thailand, as I will discuss below, have deeper equity markets than do Indonesia and the Philippines. The state's role in directing finance regulation was larger in Indonesia prior to the 1990s than in any of the other three. But note that in contrast with Walter and Zhang's classifications, while Malaysia's broader economy could be described as state-led in the 1980s, its financial architecture has more resembled that of a co-governed variety of capitalism throughout its independent history. Likewise, Thailand's financial architecture closely approximates a networked variety of capitalism than it does a personalized variety, even though the latter is perhaps more appropriate for studying other institutional spheres of Thailand's economy. Altogether, the argument in this chapter suggests that a political rather than an institutional logic best explains the origins and persistence of the cross-national variation in financial development in Southeast Asia.

II. Financial Development, 1960-2007

A proper accounting of financial development must take into account changes in both debt and equity markets, while also capturing the importance of the various functions of financial systems, from the mobilization of deposits to the assets of financial institutions to the provision of private credit to the domestic market. Financial development also implies an increase in capital market efficiency and a decrease in the cost of capital. Here, I draw on the most recent data available regarding key components of the financial systems of the four major Southeast Asian economies to provide an overview of financial development in Southeast Asia from 1960 until today.

Figure 1 begins with an overview of banking sectors from 1960-2007, drawing on data from the 2009 update of the Beck et al. (2000) database of financial structure and development (Beck and Al-Hussainy, 2010). Each panel captures a different indicator of development: the ratio of private financial sectors assets to public financial sector assets (Panel A), the assets of the banking sector relative to GDP (Panel B), the deposits in banks and other financial institutions relative to GDP (Panel C), and private sector domestic credit to GDP (Panel D). Most obvious in Figure 1 is that each of the four countries was significantly more financially developed in 2007 than it was in 1960 (or when data first became available). Also apparent is the dramatic setback in all indicators of financial development that corresponds to the 1997-98 Asian Financial Crisis. This downturn is so severe that most countries have yet to return to pre-crisis levels of financial development.

Despite these broad similarities, though, there are differences across countries in patterns of development over time. Today, **Malaysia** has the most developed banking system in the region (save Singapore). Note that while Malaysia's ratio of deposit money assets to central bank assets has always been higher than its neighbors, it reached independence with a banking system that by other measures was similar to the Philippines and Thailand. By contrast, **Indonesia** and the **Philippines** score consistently lower in terms of banking system development than other countries today, even though they began at a similar point as did Malaysia.[1] **Thailand** lies between the two groups of countries. While in the 1960s its level of banking system development was roughly comparable to those in Indonesia and the Philippines, it has since developed in a way that brings it closer to Malaysia.

Figure 2 examines equity market development, using data from the same source, and capturing stock market capitalization to GDP (Panel A), total share value to GDP (Panel B), share value relative to market capitalization (Panel C), and listed companies as a share of national population (Panel D). For each of these indicators, higher values correspond to

[1] The figures from Indonesia are absent from prior to the 1980s, but extending these series backwards to 1960 would likely not change these conclusions.

higher levels of financial development. The patterns in each of the four panels reinforce the conclusions reached from Figure 1. All countries display substantial increases in equity market development between the mid-1970s (when data first became available) and today. As before, there is also clear evidence of a significant setback in three of the four indicators that corresponds to the Asian Financial Crisis in the late 1990s (the exception is in the number of listed companies, which continues to increase steadily in each country).

As before, there are also cross-country differences in equity market development. The contrasts are less apparent in the stock market turnover ratio (Panel C) but the other three panels demonstrate them well. **Malaysia** has the most developed equity markets in terms of numbers of listed companies, stock market capitalization, and total share value; this was also true in the 1970s. **Indonesia** and the **Philippines** have always had significantly less developed equity markets. **Thailand's** equity markets remain relatively underdeveloped as well. They more closely parallel those in Indonesia and the Philippines, unlike its comparatively more developed banking sector. In all, then, these indicators of equity market development in Southeast Asia suggest patterns of cross-national variation that are roughly analogous to those observed in banking sector development.

Finally, because the indicators in Figure 1 and Figure 2 are more properly indicators of financial depth than financial development, Figure 3 presents two measures of banking sector efficiency, average cost-income ratio (Panel A) and net interest margin (Panel B). For both of these measures, *lower* values should be considered indicators of greater efficiency (Demirgüç-Kunt and Huizinga, 1999), and hence *higher* development.[2] These data exhibit far more variation year-to-year than do the indicators in Figure 1 and Figure 2, and the crises of the late 1990s yield large spikes that reflect unique market conditions more than fundamental

[2] The logic is that higher cost-income ratios and net interest margins indicate that banks are able to realize super-ordinary profits from segmented, incomplete, or illiquid markets.

system efficiency. But the trends indicate that, as before, **Malaysia** has on average a more efficient banking sector than do **Indonesia**, **the Philippines**, and **Thailand**.

Together, these data on financial development over the past fifty years illustrate important variation in financial development both across countries and across time. There is clear divide between relatively larger, deeper, and more efficient financial markets of Malaysia, and the relatively shallow and less efficient markets of Indonesia and the Philippines. Thailand is in some ways similar to Malaysia, and in others closer to Indonesia and the Philippines.

It is not obvious how to explain this variation. There is a relationship between the average level of financial development and general economic development across the four countries, but financial development may be a cause of economic development rather than a consequence of it (Levine, 1997). Moreover, economic development fares less well as an explanation of variation *within* countries over time in their level of financial development. Other common explanations for variation in financial development—colonial legacies, financial openness, property rights, and others—suffer from similar problems. Even if there is a relationship between one or more of these variables and financial development in a global sample, the experience of emerging Southeast Asia indicates that there is more variation within the region than can be explained by these factors alone.

Walter and Zhang (this volume: 31-36) argue that political coalitions, policy discourses, and state action will play important roles in shaping how economic institutions change and develop. These comprise the analytical building blocks upon which I build my account of change and continuity in the wake of external shocks such as decolonization and economic crises. But a focus on political coalitions or state action requires a principled account of why states and coalitions vary across countries. This is the task that the framework I outline below will address. Likewise, policy discourses on financial policy are alone incapable of explain institutional change unless understood alongside the concrete political and economic events that give ideas currency and policy credibility. Policy discourses favoring financial liberalization, for example, only gained traction in the wake of the economic slump of the mid-1980s, and only survived until the 1997 financial crises. The following sections will make explicit the role of these events in shaping the changes in national financial systems since the 1980s.

III. Embedding Finance

The political approach to financial development that I propose here begins with the understanding that financial development is both politically valuable and politically dangerous. Developed financial markets are valuable because they are the foundations upon which economic growth occurs. Moreover, for leaders seeking to construct durable political orders, money is the “sinews of power.” But developed financial markets are dangerous because they can never be subject to full political control. In the limit, a financial marketplace that efficiently channels funds to “any entrepreneur or company with a sound project” and which “can gauge, subdivide, and spread difficult risks, letting them rest where they can best be borne” (Rajan and Zingales, 2003: 9) is one in which the holders of power can no longer use financial policy and preferential access to credit to reward politically favored groups. Furthermore, financial development is potentially dangerous to incumbent politicians over the medium to long term because it may empower societal actors who will later turn against the incumbent regime. Rajan and Zingales’ (2003) interest group theory of financial development, for instance, holds that market actors who have prospered prior to financial development will block policies that increase the ability of their competitors to access finance, thereby hamstringing financial development. It is not hard to extend this logic to political competition: where existing political orders depend on the ability of political elites to direct credit to favored constituents (demographic groups, business allies, or others), politicians will resist adopting policies that effectively undermine their ability to do so.

Moreover, in developed financial systems and underdeveloped ones alike, owners of capital retain important structural power through their ability to refuse to invest. They may withhold investment because they do not see opportunities for profit, or because they oppose the terms under which their investments take place. Politicians understand capital's structural power and this shapes their behavior. This point is most frequently made with respect to international capital (see e.g. Winters, 1994), but the logic clearly applies to domestic capital as well.

Financial development is thus problematic. Financial development can foster economic development, and therefore it is potentially valuable. But financial development *by its very nature* opens the door to challenges to existing political systems. It might seem that the political dangers of financial development might outweigh whatever political benefits it may bring, suggesting that financial development must occur for reason that are unrelated to regimes' strategies for consolidating and maintaining power. An examination of the historical record of financial development in Southeast Asia that I will present in Sections IV and V, though, indicates that regimes are not as cowed by the political challenges that financial development entails as might be expected. Rather than simply resisting the challenges of financial development, they have disciplined their financial systems. Of course, this has not gone unnoticed by political economists who have noted the interdependence of powerful political and economic actors across these countries, or by those who detail the resilience of economic elites to the challenges of modernization, economic change, and neoliberalism, in the financial sphere as elsewhere (Rodan et al., 2005). Yet these broad observations have not been matched with closer attention to the differences in national experiences.

In sum, the choice facing politicians is not to promote financial development or not. The choice is how to develop a financial system that contains within it safeguards against the challenges that financial development will present to the existing political order. This suggests that it is critical to focus on what Polanyi (1944) called the “embeddedness” of economic systems in broader social orders, for political intervention is the “essential prerequisite for the formation of market relations” (Evans, 1995: 29). Quite naturally, different forms of political intervention in the financial sector will produce different financial development outcomes.

Close attention to the processes through which political orders are created will therefore shed light on the origins of financial development. This draws on insights from Chaudhry (1993) and Waldner (1999), both of whom saw interventionist economic policies as motivated (in broad terms) by the political exigencies that accompanied statebuilding. Understanding changes over time, then, requires close attention to the ways in which rulers endeavor to reproduce their system of rule and the challenges that they face in doing so. Chief among these challenges in Southeast Asia are systemic pressures and international market conditions.

This sensitivity to the embeddedness of market relations in larger systems of power and influence comports well with the insight that “state organisation of economic activity in the region takes place within broad social contexts and are [sic] shaped and mediated by various societal institutions” (Walter and Zhang, this volume: 21). Where my approach differs is in its analytical focus: rather than “the state” and “society” conceived as forces that are either organized or not, I study the groups that construct political orders and the constituents that they mobilize or repress in doing so. This allows me to interrogate the interests and beliefs of the central political actors in each country, something that a state-and-society approach to comparative capitalism is ill-equipped to do.

IV. The Origins of Financial Systems: The 1950s through 1980s

The origins of financial development in Southeast Asia are attributable to three different political configurations after colonialism. In **Malaysia**, a mobilizational regime sought to incorporate broad sections of its population into the new post-independence political order. The financial system became a site for state-directed dispensation of wealth that would tie the regime's constituents to the political status quo. In **Indonesia** and **the Philippines**, a more personalist style of rule (under Marcos in the Philippines and Soeharto in Indonesia) also relied on heavy political intervention in the allocation of credit, but rather than mobilizing popular wealth, regimes protected various particularistic economic interests among each regime's supporters. In **Thailand**, a relatively autonomous and conservative bureaucracy combined with rapid political turnover produced a political order that was relatively inattentive to the financial system as either a tool of high-level patronage or popular wealth mobilization.

The Dutch left **Indonesia** without even basic financial infrastructure, but the greater challenges facing Indonesia following independence were rampant corruption and incoherent policy planning, which produced by the early 1960s skyrocketing inflation and a near collapse of the economy. State institutions dominated both public and commercial financing throughout this period. Soeharto's New Order regime (1966-1998) oversaw a shift in economic policymaking that allowed for significant deregulation of both the financial and real sectors. Foreign banks were permitted to enter the domestic market, and private domestic banks also saw their operational autonomy widened significantly. But this deregulation was halting and selective, and subservient to the broader goal of constructing a durable political regime. The New Order regime's political base relied in part on the support of a set of business cronies, many (though not all) of whom were members of the country's politically vulnerable ethnic Chinese minority. Preferential credit rules allowed the state to channel favoritism to the cronies in exchange for cooperative relations with the military's business interests (Pepinsky, 2009: 42-61). State banks, moreover, remained critically important non-competitive portions of the Indonesian financial market throughout this period. The consequence was a financial system that retained significant government controls over basic banking functions, and one that could not effectively mobilize deposits or channel credit to economically viable ventures (unless they happened to also be politically valuable).

The Philippines at independence faced the challenge of managing conflict between the entrenched landed elites and the poor and marginalized Filipinos in the subsistence and informal sectors. Policymaking remained fundamentally subservient to the interests of the oligarchs, who continually sought and achieved "favorable access to state machinery" (de Dios and Hutchcroft, 2003: 48). After independence, the oligarchs ventured into the financial sector, founding commercial banks with direct links to their own corporate empires (Hutchcroft, 1993: 174-182). The result was a financial system marked by chronically weak and undercapitalized financial institutions whose primary purpose was to direct credit to related firms. Regulatory institutions were so eviscerated by the oligarchs that official oversight was almost non-existent. Unlike the New Order's hierarchical, top-down model of state intervention, economic policymaking remained subject to the particularistic demands of elites and their increasingly diversified conglomerates, and insulated from the interests of the majority of Filipinos. Ferdinand Marcos seized power in 1972 intending to restore political and economic order, but rather than rationalizing the country's disorganized, inefficient, and uncompetitive financial system he simply centralized the system of patrimonial accumulation that had formerly been divided across many different families (Hutchcroft, 1998: 110-142).

Malaysia did inherit a relatively functional financial system at independence. This is due primarily to the British policy of emphasizing legal institutions in the Straits Settlements (Hamilton-Hart, 2002: 66-79), which allowed local banks aside from those controlled by the

British to establish a commercial presence in the territory. The central political problem facing the newly independent government in Malaysia was the interethnic disparity in wealth between the relatively impoverished but numerically superior Malay majority and the relatively wealthy ethnic Chinese minority. Following a brief experiment with parliamentary democracy, the ruling United Malays National Organisation (UMNO, the main Malay party) took the lead in a creating more durable authoritarian coalition known as the National Front (Barisan Nasional, BN), founded in 1971. That coalition, which still rules today, espouses a pro-*bumiputera* economic agenda under the New Economic Policy (1971-1990) and several successors policies. These policies shift wealth towards Malays, with the expectation that they would in turn come to see UMNO as their patron. The country's financial markets are instrumental for this task: the regime provides preferential credit facilities, maintains *bumiputera*-only unit trusts that provided affordable and easy-to-access access to the country's equity markets, and encourages Malay corporate ownership. Despite obvious problems of cronyism and inefficiency that these policies spawned (Gomez and Jomo, 1997: 117-165), the BN's mobilization of its Malay political base using the financial sector encouraged the development of a broad and deep financial system.

For **Thailand**, which avoided European colonization, the main challenge was managing the intense factionalism of Thai elite politics. The main sources of financial policy remained in the Thai bureaucracy, especially the relatively conservative and autonomous Bank of Thailand. The contrast with the Philippines is instructive: while the Philippines suffered from political instability much as did Thailand, and while both countries faced vexing problems of rural backwardness, Filipino economic governance was indistinguishable from the whims of oligarchs. In Thailand, perhaps due to the bureaucracy's institutional continuity from the mid-1800s, financial policymaking institutions were never so subordinated to particularistic interests (Doner and Unger, 1993). Moreover, under the conservative Sarit Thanarat and Thanom Kittikachorn regimes, abundant foreign aid from the United States made feasible a private sector-led export-oriented development strategy that did not require the state to mobilize financial resources. Consequently, private financial institutions were free of both state interference or state competition, and allow private banks' market presence grew substantially. Yet absent a political impetus to mobilize the wealth of the broader populace such as that found in Malaysia, Thai banks retained a bias towards urban consumers and commercial financing, leaving the system less developed than its southern neighbor.

By the early 1980s, then, the seeds of today's pattern of financial development had been sown. Descriptively, it is relatively straightforward to locate the four countries' financial systems in the typology of East Asian capitalisms proposed by Walter and Zhang (see Panel A of Table 2). Malaysia best approximated a co-governed economy in which the state and private business both played central roles in financial regulation, equity markets were relatively well developed, and insider practices prevailed in both private and public firms (the latter comprising a significant component of Malaysia's economy but never reaching the economy-wide penetration found in Indonesia). But Malaysia's co-governed type of capitalism was not the result of an organized state confronting an organized society, rather it was the natural consequence of post-independent elites' strategy to cement their claim on political power through economic populism. Indonesia, by contrast, was closest to the state-led model, due primarily to widespread state enterprise ownership. However, even this obscures certain features of Indonesia's political economy, for state domination of the economy under Soeharto still allowed domestic financiers wide latitude for investment and capital accumulation. The New Order state always cooperated with private financial interests, it never fully controlled or dominated them.

The Philippines matched the personalized variety of East Asian capitalism quite well. A disorganized society confronted a hollow state, meaning that the financial regulation was captured by private interests, banks dominated relationship-based financing, and insider connections plagued corporate governance. Thailand represents an interesting case that Walter and Zhang consider closer to a personalized system in the 1980s, but its financial architecture even at this time more closely resembled that of the networked variety. But as the only substantial difference between the financial architectures of these two types is in the relative importance of capital markets in networked varieties of capitalism, this distinction is perhaps inconsequential.

V. Crisis, Liberalization, Crisis, and Requilibration: From the 1980s to the 2000s

Since the 1980s, three events have shaped financial development in the region. The first is the global economic slowdown of the 1980s. The second is the resulting spate of financial deregulation. This, along with the economic boom that followed, contributed to further advances in banking sector development, and fed the growth of equity markets in Indonesia, the Philippines, and Thailand—the three countries where equity markets had previously been of only marginal significance. The third event, a consequence of the second, is the Asian Financial Crisis, which affected all countries but again in different ways. Together, these have been the major trends shaping the past thirty years of financial development in Southeast Asia.

High global petroleum prices along with high interest rates in the early 1980s generated a global economic downturn that was felt particularly in emerging regions such as Southeast Asia. Between 1983 and 1987, all countries registered at least one year of negative economic growth (see Figure 5). This crisis would prove transformative for trajectories in financial development. In **the Philippines**, the global economic slowdown interacted with the increasingly brutal nature of the Marcos regime to produce mass pressure for regime change.

The following years witnessed painful economic stagnation and the dissipation of the optimism that had accompanied the People Power movement that toppled the Marcos regime. Fidel Ramos was elected without a clear popular mandate, and consequently set about consolidating political support through skillful coalition-building and economic policy reform. Notably, his government undertook a series of major administrative and macroeconomic reforms to restore fiscal discipline (Bautista and Lamberte, 1996: 18-20), and built upon previous liberalization efforts—initiated under Marcos, but which had stalled—to promote financial deregulation (Hutchison, 2005: 46-47). Liberalization and deregulation generated the first sustained improvements in financial development that the Philippines had witnessed in more than a decade, although on the whole the financial system retained its urban, middle-class bias (Hutchcroft, 1999: 168-172).

In **Indonesia**, the early 1980s were somewhat less painful, and did not lead to the breakdown of political order. But the regime's supporters in the business community, starved of credit and chafing under what were still fairly onerous restrictions on private sector finance, sought relief in the form of deregulation. This they obtained in two packages, one in 1983 and another in 1988, which removed most of the restrictions on the operations of domestic banks and greatly diminished Bank Indonesia's supervisory role in day-to-day operations. These liberalizing reforms did nothing to overturn the regime's system of regime maintenance, and indeed were pushed for by the very business interests that they most affected (Soesastro, 1989: 861-863). This illustrates the continued influence of the New Order's logic of political reproduction through capital accumulation within a relatively closed network of business conglomerates. The effect of the 1980s economic slowdown was simply to push the regime to find new tools through which to accomplish this task, for which privatization and financial deregulation proved useful. Far more so than in the Philippines, though, Indonesia's financial deregulation—which took place absent the types of political upheavals that marked Filipino politics during this period—led to the rapid growth of local financial institutions along with the blossoming of Indonesian equity markets.

In **Thailand**, following the collapse of several important financial institutions in the 1980s, a series of financial reforms were implemented that were designed to streamline and rationalize Thailand's financial markets. Thereafter, the Thai government also liberalized the financial sector, removing most controls on interest rates and capital flows, and licensing the growth of new banks and other financial institutions (Pasuk and Baker, 2002: 164-168). Consistent with the historically "nondirigiste" approach of the Thai state to financial policymaking (Muscat, 1995: 113), financial liberalization was undertaken primarily at the behest of regulatory authorities in the Bank of Thailand and the Ministry of Finance. Liberalization occurred, moreover, during a period of some political instability, consistent with the earlier pattern in Thailand of frequent political turnover hampering the ability of particularistic interests to capture financial policymaking institutions (Doner and Unger, 1993: 116-122). Amidst the accompanying economic boom, equity markets flourished as well, providing powerful Thai business groups with new tools for mobilizing capital.

The early- and mid-1980s were also a period of slow growth in **Malaysia**, and prompted the state to reverse its course from emphasizing state-led industrialization to privatization. Yet privatization was carried out in a way that rewarded those very same Malay business interests that state intervention had previously nurtured (Jomo and Gomez, 2000: 291-292). Unlike the other countries, there was no particular impetus for financial deregulation in Malaysia, for the sector was already fairly liberalized. Privatization, though, put the financial sector to work in a new way. Politically connected business groups found that they could use Malaysia's equity markets to expand their newly independent corporate empires, while the BN found still greater opportunities to use the country's booming equity markets to promote mass *bumiputera* participation in the country's growing economy. In this way, privatization of previously state-owned institutions employed the financial system to support the political order. The result, as elsewhere, was an expanding financial sector.

The mid- to late-1980s, in sum, were a period of financial deregulation and privatization throughout the region. Growth rates in stock market capitalization during 1988-1996 far outpaced the average over the previous decade, making equity markets economic significant throughout the region, not just in Singapore and Kuala Lumpur. Banking systems continued to grow and deepen and credit flowed into the private sectors of all four economies. But liberalization and privatization was constrained by the political challenges facing each country in the wake of the mid-1980s economic slump. Tellingly, there was no appreciable change in banking sector efficiency in the years immediately following liberalization and deregulation (see Figure 3). Moreover, by all measures the rank order in levels of financial development across the region remained unchanged. Financial architectures therefore remained essentially unchanged despite the modest retreat of state finance in Indonesia and Malaysia and the emergence of new private financial firms in all countries. Throughout the region, insider practices remained prevalent, and political connections continued to shape lending patterns and equity investments alike. Financial systems changed in response to political and economic exigencies of the period, but never threatened broader political orders.

The broader consequence of these liberalization and privatization measures was a regional economic boom, one driven originally by strong export growth but eventually overwhelmed by financial overexpansion. The Asian Financial Crisis exposed the worst excesses of this over-expansion. The details need not concern us here (see, among others, Pempel, 1999; Woo et al., 2000; Haggard, 2000), but it is clear that the same political economy factors that contributed to the boom contributed to the eventual bust. The Philippines, which never enjoyed much of a boom due to its political and economic fragility, experienced the least of the bust, but growth ceased all the same. By all indicators of financial development, the four crisis economies experienced dramatic reversals. The follow-on economic contractions were severe as well (see Figure 5). And from the perspectives of individual governments, the politics costs were substantial, including to the collapse of the New Order regime in Indonesia, new democratic governments in Thailand and the Philippines, and the most severe political crisis in Malaysia since 1969. The decade since the crisis has seen some important changes but also a good deal of continuity. Governments in each of the four countries intervened to put their financial houses back in order, but this re-regulation was in no case a permanent change away from the largely privatized financial systems to which they later reverted (Hamilton-Hart, 2008).

A more interesting question is whether there has been fundamental change in the nature of either financial politics or overall financial architectures as a result of the crisis. Nothing significant has changed in **the Philippines**, where financial institutions retain their urban and upper-class bias and remain subservient to the corporate empires of the country's oligarchs. This is due to the relatively shallow crisis that allowed existing patterns of financial politics (and existing weaknesses in the country's regulatory authorities) to persist (Hutchcroft, 1999: 167-172). Absent any lasting changes to the fractious and oligarchic Philippine political system in the wake of the crisis, the existing pathologies of financial development in the Philippines have continued.

For very different reasons, little has changed in **Malaysia** either. The crisis did put severe pressure on the country's financial sector, but the Mahathir government responded to the crisis with a firmly anti-IMF policy stance gave authorities the policy space to recapitalize every fragile financial institution in the country. The unique configuration of political-economic interests in Malaysia—dependent on a thriving domestic financial market but unconcerned about the interests of international capital—enabled this policy response

(Pepinsky, 2009). Successful resolution of the economic crisis allowed the regime to survive its most serious political crisis since 1969. Since 1999, while there have been some regulatory changes that are aimed at improving financial institutions' capital adequacy ratios, the basic contours of Malaysia's political economy have not changed. Policies still favor the country's Malay majority, and the financial sector still plays a central role in distributing the state's largesse as a strategy for maintaining the BN's hold on power.

Changes were more dramatic in Indonesia and Thailand, which unlike Malaysia received IMF bailouts and experiencing the painful restructuring that followed. In **Indonesia**, no less than the entire New Order regime collapsed as a result of the crisis. The Indonesian banking system was forced to undergo fundamental restructuring and recapitalization. New prudential regulations have been imposed. The crony-affiliated financial institutions which flourished under the New Order were mostly closed or nationalized, and foreign actors increased their stake in Indonesia's financial sector substantially (Sato, 2005: 102-108). But while prudential reforms have almost certainly helped to increase the stability of the Indonesian financial sector and eliminated the worst excesses of political interference in banking and equity markets, over ten years on, these reforms have not generated substantial improvements in Indonesia's level of financial development. Although the increased presence of foreign banks in Indonesia has helped, the cost of capital remains high. The economically powerful still continue to dominate Indonesia's political economy, but they do so in a decentralized political system that is no longer amenable to the same logic of accumulation as before. In such a system, especially in one still plagued by endemic corruption, there remain few incentives for politicians to adopt a mobilizational strategy that produced the type of broad and deep financial system as seen in Malaysia. There is certainly also no incentive for politicians to leave the financial sector alone—something which almost never happens anywhere in the world, let alone in post-crisis Indonesia. Responding to the new reality of a dramatically decentralized political system, state-led finance in Indonesia has been replaced by the grabbing hands of individual corporate empires and provincially-based public banks. The result is continued financial underdevelopment, but now in a personalized rather than state-led system.

Thailand also suffered heavily from the crisis, and saw attendant political changes. Financial liberalization in the late 1980s had given new sources of capital to powerful domestic business groups, and the collapse of the financial sector generated momentum for political and well as financial reform. Also affected were those poor Thais, including the country's large rural population, who had never enjoyed much of the preceding economic boom but suffered from the bust anyway. Thailand's fractionalized political system contributed to a general view that its constitution impeded effective policymaking and policy implementation. The result was the rise of Thaksin Shinawatra and his Thai Rak Thai party, which Hewison (2005) argues embedded the interests of domestic capital within a political order that for the first time included a social contract that would generate tangible improvements in the livelihoods of the poor. This might have generated pressure for the creation of a more broad-based and inclusive financial sector, one similar to Malaysia's, but Thaksin's rule proved too short. Moreover, as Zhang (2007) argues, the inter-party factionalism that impeded financial development prior to Thaksin reappeared as intra-party factionalism under Thaksin. Since Thaksin's ouster, Thai financial politics has returned to its previous pattern. "Pro-bank policies for particularistic interests by elected politicians" have led to "systematic under-attention to the overall development of the capital market" (Zhang, 2007: 364), but regulatory authorities in the Bank of Thailand and Ministry of Finance remain relatively autonomous, thus avoiding the types of political interference that are the hallmark of the Philippines. If anything, this period has seen a setback in financial development as Thailand's endemic political instability continues to impede long-term policy planning.

Descriptively, the outcomes of these changes appear in the Panel B of Table 2, which characterizes the four countries at the end of the 2000s. Malaysia and the Philippines show no signs of change in their financial architectures from the 1980s aside from the decline in state ownership in Malaysia, and this is consistent with the absence of fundamental change in these countries broader political economies (aside from post-1980s privatization in Malaysia). Thailand's political economy has changed repeatedly since the 1980s, and might have completed a switch to a more co-governed variety of capitalism had Thaksin been able to consolidate power, but this did not occur. Only Indonesia has truly departed from the financial architecture of the 1980s with the nearly complete obliteration of state-led finance—a consequence of financial liberalization in the late 1980s and the collapse of the New Order in the late 1990s. While a strengthening of mass society might push Indonesia towards the networked or even co-governed variety of East Asian capitalism, as of the end of the 2000s Indonesia's financial architecture most resembles a personalized variety.

VI. Contemporary Financial Development and its Future

This chapter has taken a broad approach to financial development and proposed an analytical framework that focuses on the political logics underlying various trajectories of financial development across Southeast Asia. I conclude here by summarizing the central implications from this approach.

The central finding in this chapter is that different patterns of financial development are the product of different modalities of political intervention in the financial sector. The possible exception is Thailand's financial development from the 1950s until the 1970s, which was marked by political inattention rather than direct state intervention. This hands-off approach combined with a relatively autonomous central bank probably contributed to

Thailand’s relatively higher level of financial development as compared to Indonesia and the Philippines, but the absence of a direct state role in promoting domestic banking and equity markets kept Thailand’s level of financial development below that of Malaysia. Of course, the Thai government’s hands-off stance towards the Thai financial sector certainly did not prevent the build-up of significant financial vulnerabilities, either in the late 1970s or in the early 1990s. If Indonesia and Philippines demonstrate the detrimental consequences of state interference in the allocation of credit, then Thailand illustrates how financial markets can develop systemic vulnerabilities on their own. Moreover, this inattention does not reflect the victory of some rational bureaucracy over particularistic interest groups, or of market principles over state interventionism, but rather a unique confluence of political factors (rapid leadership turnover, a conservative and relatively autonomous central bank, Sarit’s political opposition to groups associated with state-protected industries, foreign support for the Sarit and Thanom governments, etc.) that rendered impossible any sustained or coherent plan for state intervention in the financial sector.

Taking a broader view of the lessons from these four countries, comparative political economists have suggested that differences across countries in the structure and function of capitalist economies can be attributable to different “models” of capitalism. Walter and Zhang (this volume) identify key differences in the varieties of capitalism found in East Asia based on the relative strength and organization of state and society. They emphasize variation across countries. By contrast, early examinations of capitalist Southeast Asia noted the importance of familial or other non-market relations in Asian economies (see e.g. Yoshihara, 1988), which to some suggested a particularly Asian mode of capitalism. Others noted the important differences between the successful developmentalist regimes in Northeast Asia and the more “pilotless” ones in Southeast Asia (Weiss, 1998). The reaction of this literature to the Asian Financial Crisis was profound, and questioned whether or not whatever model of capitalism the East and Southeast Asian economies were supposed to represent was fundamentally flawed.

The perspective adopted in this chapter is consistent with approaches to capitalism in East Asia that emphasize differences across countries rather than similarities among them. The Southeast Asian experience suggests that while "models" of East Asian capitalism are handy tools for describing differences in financial architecture across countries, they do not offer much analytical traction over the more obvious variation across countries, which is not in corporate governance or financial regulation but rather in the level and pace of financial development. The features of the varieties of East Asian capitalism suggest why this is the case: insider practices in corporate governance, private influence on state regulation of finance, and bank-oriented financial systems are common features in each variety of East Asian capitalism. Malaysia and Thailand today illustrate the relatively more developed equity markets in co-governed and networked capitalisms, respectively, but the distinctions between the nature of private influence on state regulation of finance among networked, co-governed, personalized, and even (as Indonesia in the 1980s demonstrates) state-led capitalisms are imprecise even at a theoretical level.[3] The same is true for the prevalence or importance of insider connections in each of the four varieties.

Accordingly, it is possible to classify the four Southeast Asian countries into the different ideal-typical varieties of East Asian capitalism, but difficult to link these types to the actual variation that differentiates the financial systems among these countries. In Indonesia and in the Philippines, state-led and personalized varieties have both created underdeveloped financial systems, both as measured by banking sector depth/efficiency and by the relative importance of equity markets. Malaysia approximates the co-governed type and Thailand the networked type, but this does not explain why Malaysia rates consistently higher than

[3] See the fine distinctions among state-"guided," "controlled," and "influenced" in Table 1.

Thailand in *all* indicators of financial development. To explain this, a focus on how elites create and maintain political order proves more useful.

I have only implicitly addressed the "institutional complementarities" (Hall and Soskice, 2001) between national financial systems and other institutional spheres such as labor markets and business systems in this discussion. Financial systems naturally co-evolve with these other institutional spheres. In the Malaysian case, as Gomez (this volume) illustrates, the synergies between financial development and enterprise development are particularly clear, as capital markets are the tools through which the BN regime organizes political control over Malaysian enterprises and allocates patronage to its mass base. Under New Order Indonesia, too, the financial system developed in parallel with the *konglomerat* system; it is impossible to study one without the other. These two cases of strong state intervention suggest that institutional complementaries develop most easily when regimes have long term visions for economic organization and the capacity to implement them. Still, in Thailand, the Philippines, and post-Soeharto Indonesia, financial markets and enterprise systems have co-evolved (in particular, firms' reliance on financing from banks within the same corporate empire), but these are cases of informal and incidental co-evolution rather than planned, deliberate institutional engineering.

Institutional complementarities between financial and labor markets in contemporary Southeast Asia are more difficult to discern. Deyo (this volume) notes the weakening of labor's political efficacy in the Philippines, and that Thai labor's victories under Thaksin only came in concert with a broader populist agenda. In Malaysia, the same political order that has mobilizes Malay financial resources has methodically disempowered all organized labor in Malaysia (Jomo and Todd, 1994). Setting differences in formal legal protections aside, the unifying characteristics of labor markets in contemporary Southeast Asia are labor's weak political voice, a profound urban bias in policymaking, and unorganized or selective provision of quality social insurance. These commonalities do not vary in ways that parallel cross-national differences in the institutional architectures of national financial systems.

A political approach to financial development in Southeast Asia has implications for any purported future convergence on a single model of capitalism, Anglo-American, Asian, or otherwise. There appears scant evidence that this is true in anything more than the superficial sense that the most of the staff of regulatory institutions believe that prudential oversight is a good thing and that the worst distortions in financial sectors should be eliminated. Beyond this, there is hardly any agreement on how to engineer financial development, or on what sort of political structure would best produce it. There even less optimism that even if there were such agreement, the very real political constraints in each country could be overcome anyway. This does not foreclose the possibility that some countries in the region will converge upon a common model of capitalism at some time in the future. But if they do, it will not be because of some inherent pull or superior logic of that model, but because politicians find it in their own political interests to do so.

Figure 1: Banking Sector Development, 1960-2007
Source: Beck and Al-Hussainy (2010)

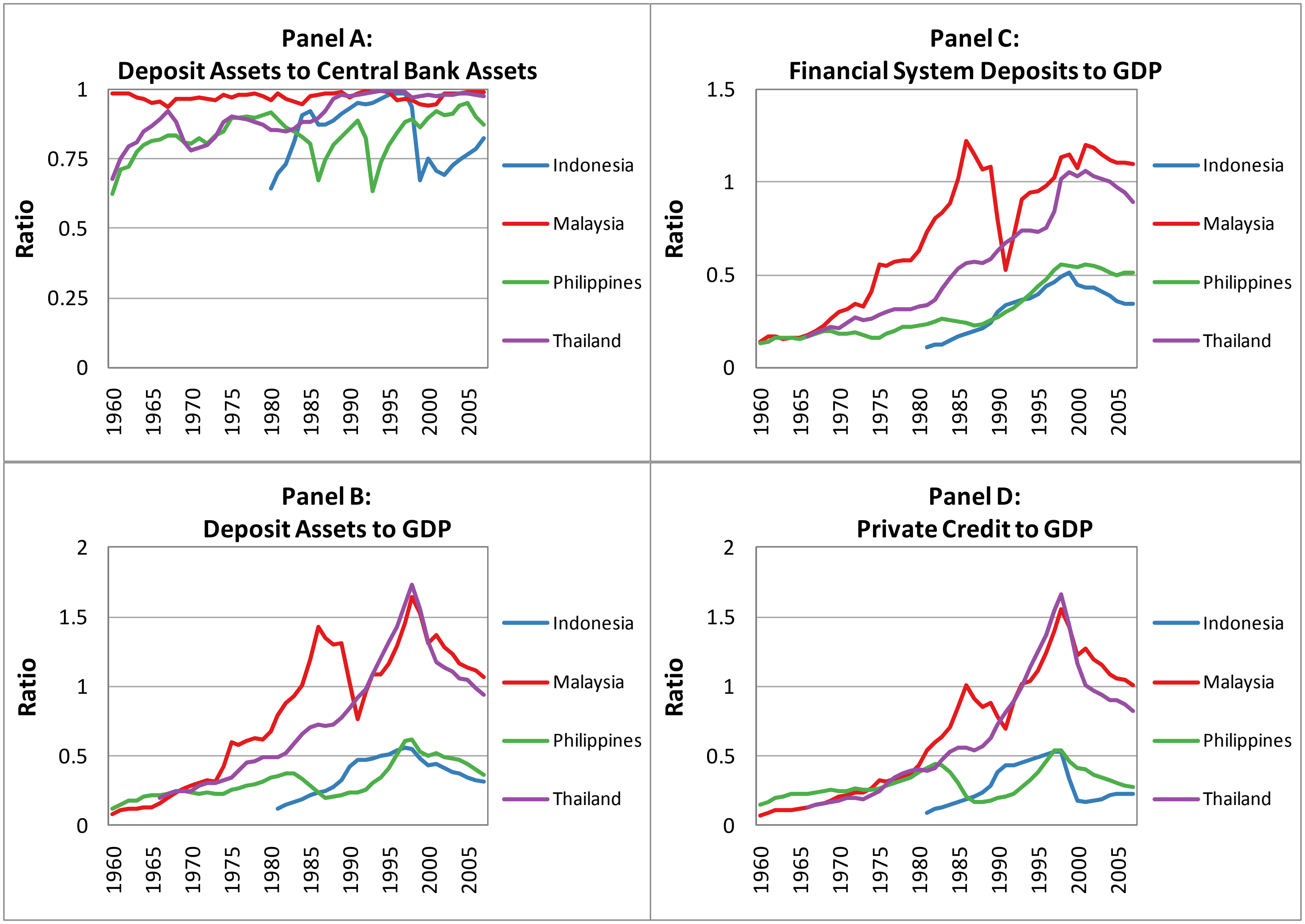

Figure 2: Equity Market Development, 1976-2007
Source: Beck and Al-Hussainy (2010)

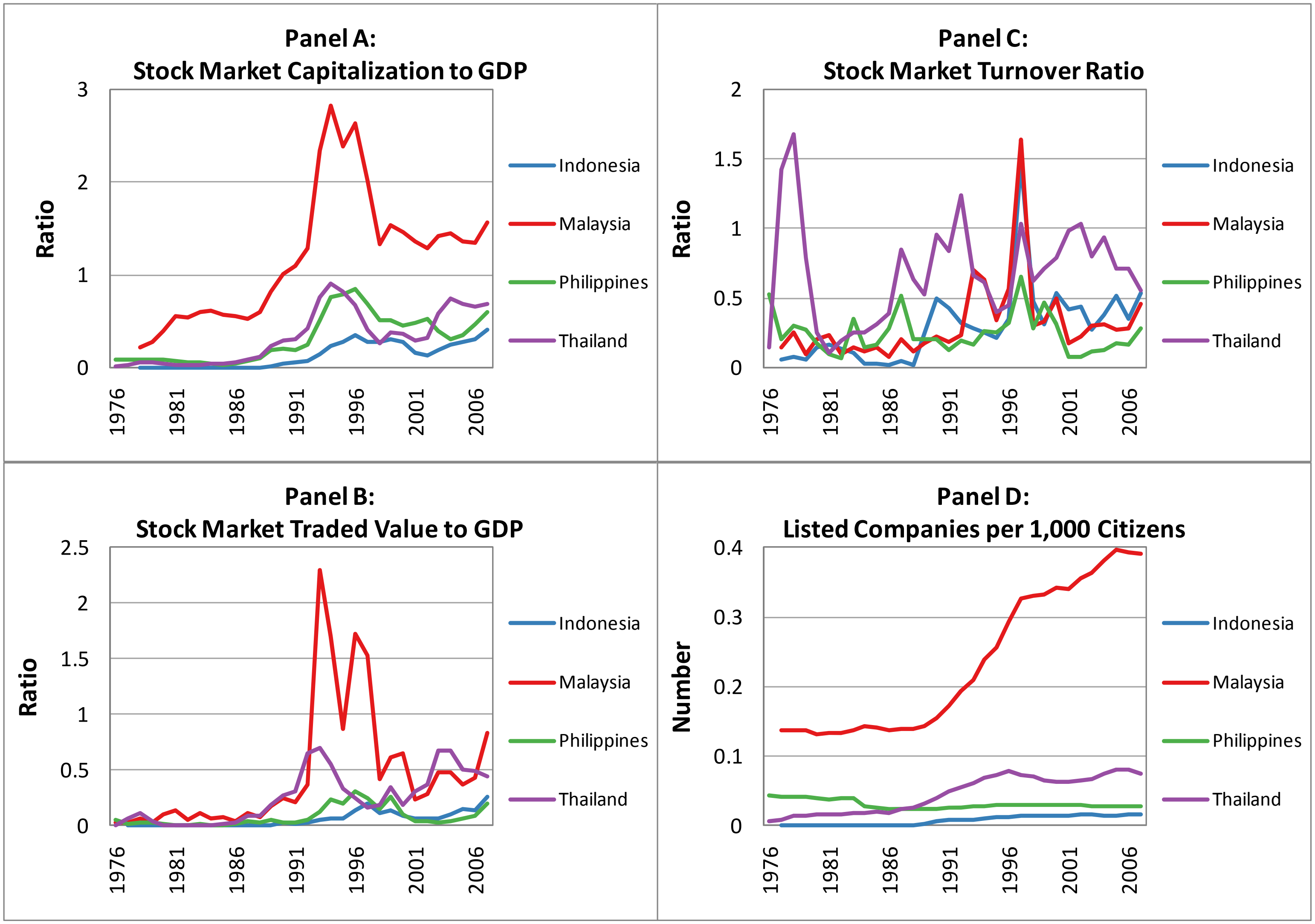

Figure 3: Banking Sector Efficiency, 1990-2007
Source: Beck and Al-Hussainy (2010)

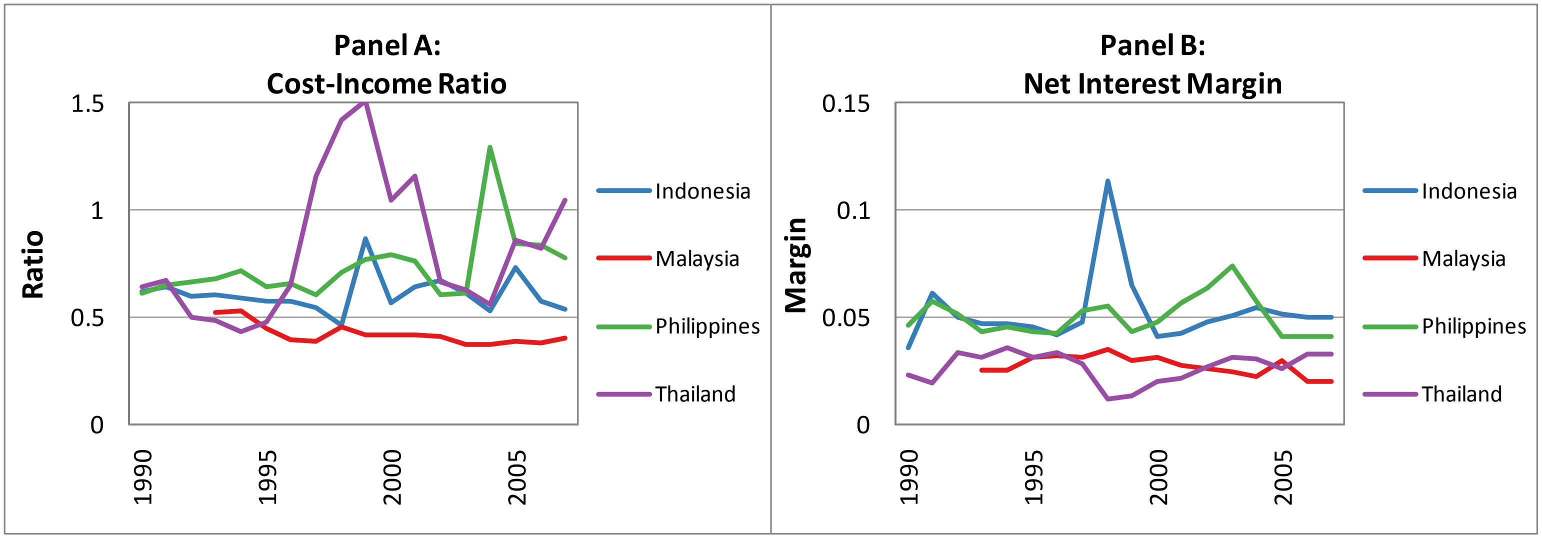

Figure 4: Growth in Real GDP Per Capita, 1965-2007 (3 Year Moving Averages)
Source: Heston et al. (2009)

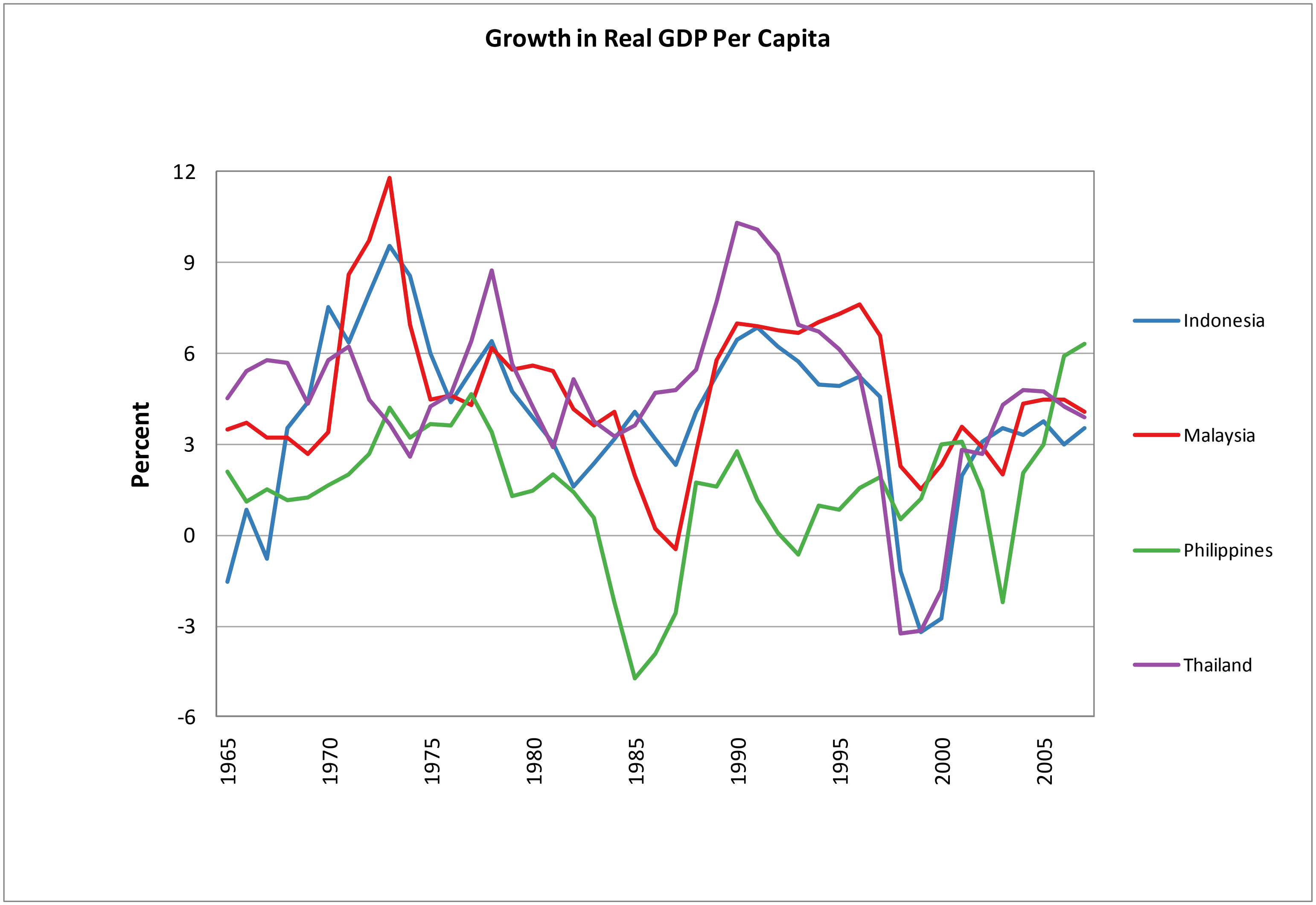

Table 1: Financial Architectures in Southeast Asia, 1980s and 2000s

Variety	Co-governed	State-Led	Networked	Personalized
State	Strong	Strong	Weak	Weak
Society	Strong	Weak	Strong	Weak
Financial Regulation	State-guided but with business influence	Heavily state controlled	State-influenced but significant business inputs and influences	State controlled but heavy private influence
Market Structure	Largely bank-based but better developed capital markets	Dominance of debt finance	Bank-based but more important capital markets	Relation-oriented finance; poorly developed equity markets
Corporate Governance	Insider model; insider practices in private firms	Highly bureaucratized in SOEs	Stakeholder/insider dominated	Insider model; dominated by owner-managers
National Cases (1980s)	Malaysia	Indonesia	Thailand	Philippines
National Cases (2000s)	Malaysia		Thailand	Indonesia; Philippines

Table 2: Financial Architecture, 1980s and 2000s

PANEL A: 1980s	Indonesia	Malaysia	Philippines	Thailand
Financial Regulation	State cooperation with private interests	State cooperation with private interests	State capture by private interests	Autonomous but ineffective state
Market Structure	Bank-based	Bank and equity-market based	Bank-based	Bank-based with important equity markets
Corporate Governance	Insider model in private firms, widespread state ownership	Insider model in private firms, significant state ownership	Insider model in private firms, some state ownership	Insider model in private firms, some state ownership
Closest Variety	State-led	Co-governed	Personalized	Networked

PANEL B: 2000s	Indonesia	Malaysia	Philippines	Thailand
Financial Regulation	State capture by private interests	State cooperation with private interests	State capture by private interests	Autonomous but ineffective state
Market Structure	Bank-based	Bank and equity-market based	Bank-based	Bank-based with important equity markets
Corporate Governance	Insider model in private firms, some state ownership	Insider model in private firms, lower state ownership than in 1980s	Insider model in private firms, some state ownership	Insider model in private firms, some state ownership
Closest Variety	Personalized	Co-governed	Personalized	Networked

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