Acta Oeconomica, Vol. 52 (2) pp. 265–280 (2002)

BOOK REVIEWS

Lukaustas, A. J. – Rivera-Batiz, F. L. (eds): *The Political Economy of the East Asian Crisis and Its Aftermath: Tigers in Distress*
Cheltenham, UK, Northampton, MA, USA: Edward Edgar, 2001, 272 pp.

The main purpose of the volume is to provide an assessment of the causes of the recent East Asian financial crisis and its consequences.[1] The rapidity and severity of the crisis in Thailand, Malaysia, the Philippines, Indonesia, and the Republic of Korea caught both academics and policymakers by surprise. In summary, traditionally acknowledged symptoms (usually in the form of deteriorating macroeconomic fundamentals[2]) of a financial crisis did not appear to be evident in the East Asian case. Within a short period of time, however, there were numerous attempts to explain the phenomenon. The present volume advocates the view that the crisis and its aftermath were the reflection of political and economic forces.

The content of the contributions is not easy to fit into a single framework. There is a surface structure in the volume, with a general and well-organised introduction by the editors and a roundtable discussion of the policy lessons, which serves as a conclusion. Chapters in Part I discuss the crisis from historical and geographical perspectives, while Part II analyses the domestic political economy of the crisis, and Part III focuses on the international political economy of the crisis. There is, however, a hidden structure in the volume (with or without the intention of the editors) which cuts through most of the chapters but is manifested more clearly in Chapters 2 and 7.

A look at key macroeconomic indicators in East Asia before the crisis does not readily uncover any compelling signs of distress or potential trouble (pp. 40–45). Overall, economy was growing rapidly and did not appear to be threatened by any major force. Price instability was of no concern either. Inflation rates were high by the standards of advanced countries, but they were much lower than in

[1] Most of the chapters of the volume were presented at a conference entitled "The East Asian Crisis: Tigers in Distress", held in March 1999 at Columbia University.

[2] Among others, these are acute public budget deficits, high rates of money supply creation, chronic inflation, capital flight and currency instability.

most other developing countries, and were declining. Currency values had been remarkably stable for many years. All five countries intervened heavily in foreign exchange markets during the 1990s, seeking to sustain currency values within a narrow range. Moreover, there was great diversity in the type of foreign capital entering East Asia (foreign direct investment, portfolio equity, bank lending or private bonds).

The growing current account balance deficits raised fears regarding the financial soundness of the economies. But was this one indicator perceived as being capable of bringing about trouble? The accumulation of current account deficits in the 1990s and their financing through private capital flows made the East Asian economies the biggest debtors in the world by the end of 1996 (p. 57). The experience of Latin American economies suggests that mismanagement of the maturity structure of debt lies at the core of financial crises (p. 59). The rapid expansion of bank lending as a component of external debt was potentially troublesome because of the weak and imperfect state of the banking systems of these economies (p. 60). Inadequate project evaluation and risk-assessment techniques were also a serious problem (p. 61).

Above all, when there are distortions in domestic markets, capital flows can have severe negative effects on countries that liberalise their capital account and may result in a contraction of GDP (p. 5). The East Asian "tigers" were plagued by domestic distortions. There were market imperfections such as government-generated protectionism, imperfect or asymmetric information in financial markets, negative externalities in goods markets, corruption, cronyism and structural problems in the labour market.

Analysing the case of Thailand, where this all started, Alba, Hernandez and Klingbiel (Chapter 5) focus on the triggers of the crisis in Thailand and elsewhere. Financial sector weaknesses combined with financial and capital account liberalisation contributed to the build-up of vulnerabilities by creating incentives for excessive risk-taking among financial institutions. Weaknesses in the governance of corporations induced risky investments. The macro-policy mix that combined a tight monetary policy with an inflexible exchange rate created strong incentives for residents to expose themselves to excessive foreign exchange and liquidity risks. Alba, Hernandez and Klingbiel conclude that opening the capital account and integrating with global financial markets should be contingent on adequate domestic institutional development (pp. 152–153).

In the wake of the East Asian crisis, political factors undoubtedly played a hindering role in the lack of a stringent regulatory regime (p. 8). Governments had good political reasons to avoid stringent regulations because of the pressure of groups, such as banks and corporations, which faced great costs in abiding to the rules. In addition, building administrative capacity to supervise financial markets is costly and demanding. Thus, establishing a sound regulatory regime was normally a low priority on the agenda of most governments.

In Chapter 4, Haggard MacIntyre, looking at the cases of Indonesia, Korea, and Thailand, and claim that moral hazard was at the centre of the Asian financial crisis. The authors argue that uncertainty was a crucial element in the onset and depth of the crisis, as investors came to question the nature of government's policy commitments. More specifically, in Thailand it was the fragmentation of the party system, in Korea the breakdown of party coherence due to electoral competition, and in Indonesia the fundamental scepticism of the viability of the authoritarian Suharto regime, that induced uncertainty with respect to the government's stance toward the financial sector (p. 106).

The final chapter of the volume presents a round-table discussion on the policy implications of the East Asian crisis. Three major issues were in focus: capital account liberalisation, the type of exchange rate, and the response of the international policy community to the multitude of emerging market crises in the 1990s. Pesenti argues that local weaknesses and not globalisation have to be blamed for the trouble. Thus, the essential issue is the enforcement, not the formal adoption of new rules concerning international financial standards (p. 252). Also high priority should be given to measures preventing the currency and maturity mismatches.

Fishlow asserts that in the aftermath of the financial crises, it has become evident that out of the entire exchange rate paradigm, only two solutions are viable for a country: either the national currency must float freely or it must be very tightly (if not irrevocably) fixed (p. 256). Thus, the issue of currency boards and dollarisation is high on the agenda.

Finally, one of the striking features of the aftermath of the East Asian crisis has been the emergence of a global debate on the international financial architecture, with specific steps proposed not only in exchange rate management but also in areas such as strengthening domestic banking systems, reforming the Bretton Woods institutions, improving the transparency of financial markets, setting standards for financial reporting by countries and establishing international banking standards. The debate is itself a contribution to the understanding of financial crises and their prevention.

The sequence of extremely severe currency crises is an empirical fact, just as that pre-crisis macroeconomic management looked unusually good, economic performance looked stable, and growth was unprecedented, all providing the essential framework for private investment. Should we expect to find some mysterious reasons behind the occurrence of the two seemingly incompatible facts? In Chapter 2, Rivera-Batiz argues that the reason is not mysterious at all. Instead, the fact is that the investment and economic boom in these countries is precisely the cause of an eventual slowdown, or a bust, which reverses some, if not all, of the economic progress.

Rivera-Batiz refers to this phenomenon as "the emerging market disease" (p. 33). Emerging markets seek to achieve high rates of economic growth through rapid expansion of domestic investment accompanied by macroeconomic stabilisation and full liberalisation of international finance. The flood of capital inflows allows economies to boom, providing "an aura of everlasting prosperity". The seeds of a future crisis, however, are being planted at this very moment through the upward pressure on the value of domestic currency. A persistent currency appreciation eventually slows down export growth, increases imports and worsens the current account balance. A sluggish export sector will reduce output growth and undermine the confidence of investors on the future of the economy. Furthermore, a widening current account deficit leads to an accumulation of external debt, which raises the risk of default. The sustained real appreciation also means that expectations of devaluation will inevitably materialise. These developments eventually precipitate a withdrawal of funds from the country and a credit crunch, which plunge the economy into recession. If the domestic banking system is fragile, and if the capital flight is aggravated by the unwillingness of policy makers to devalue, the result is a crisis.

This is exactly what happened in East Asia. In the aftermath of the crisis, all five East Asian countries faced high interest rates, stock market collapses, banking debacles, and a deepening recession. Of all the countries swept up in the Asian crisis, Indonesia's case is the most dramatic. In 1998 the country's GDP decreased by 13.2% (p. 50). The social impact of the crisis was devastating because the recession resulted in a sudden increase in unemployment.

In Chapter 3, Bordo notes that capital flows to emerging markets have historically been subject to booms and busts. Yet the East Asian crisis suggests that today's globalised capital market may be inherently less stable and prone to reversals than in the golden age. Moral hazard weakens incentives for lenders to monitor the performance of private and public sectors. By contrast, in earlier times, presumably both borrowers and lenders learned to be more cautious.

The cross-sectional and historical evidence suggests that quick financial opening substantially raises the probability of a major crisis (p. 196). In Chapter 7, Wade explicitly blames financial liberalisation sponsored by the US for the East Asian crisis. With the Cold War over, the US claims to be the only power able to conduct domination and intellectual and moral leadership (p. 203). This is precisely the reason why the US has secured financial opening and liberalisation in East Asia. This contributed to high growth in the region, but the point here is that it was in complete harmony with the US goals.

A major ideological goal was to assert a new neoliberal world order, with finance being a last frontier. A major material goal had to do with rapidly increasing finance of the US economy. Investors sought to diversify their portfolios geographically, in such a way that they could move in and out from different financial markets. Furthermore, the great blessing of financial opening for the US foreign economic policy agenda is that it does not have domestic costs (p. 220). Pushing other countries to open up just about any other sector does have domestic costs because other countries may demand more access to the US markets in related products. Because no emerging-market financial services company is able to compete in the US, the latter can remove all barriers to entry and claim the same for its firms in emerging markets. In this respect, the US government and the US financial community could form a successful coalition. Consequently, the US has imposed its decisions on smaller states and maximised its interests defined by the sectoral interests of finance. The danger then is not that foreign capital inflows will not return to pre-crisis levels, but that they will (p. 222). They might as well blow out another speculative bubble. If a second crash occurs, governments will be in much worse fiscal shape to respond than they were the first time.

This argument by Wade seems logical and coherent enough; however, we can ask whether the argument is plausible in terms of being supported by facts. What Wade described is nothing more than a boom–bust production cycle. As Gourevitch (1986, p. 9) noted, the biblical story of "seven fat years and seven lean ones" expresses the concept of economic cycle. Applied to today's economies, the Pharaoh's dream may not serve as a reliable predictor concerning the length of each particular phase, but in the notion of cycle it captures an essential aspect of reality.

The two identified themes of the volume sharply contrast each other. The formal theme is generally well outlined but does not add much to our understanding of the East Asian crisis. For example, this theme often moves along the same lines as Corsetti et al. (1999). The hidden theme is more interesting and may indeed be considered to be in the stream of dependence theory echoing the famous Latin American structuralist school.[3] Interests of emerging markets and of advanced countries coincide in achieving full financial liberalisation. This harmonisation of interests results in "the emerging market disease", for which there does not seem to be an effective remedy, and in turn leads to a crisis. The crisis is accelerated and its impact is greater if domestic financial institutions are fragile and do not have the ability to handle a credit crunch.

[3] To analyse how close the presented picture is to reality is beyond the scope of this review.

In addition, policy prescriptions suggested by the authors are very weak and only contribute to pessimism. Once capital outflows begin in earnest, and expectations of devaluation become widespread, devaluation cannot be delayed (p. 66). Devaluation, however, does not seem to be a solution for developing economies. Once the possibility of self-fulfilling crises is taken seriously, market psychology becomes crucial – even the prejudices of investors become economic fundamentals (Krugman, 1999).

The issue of imposing capital and exchange controls is controversial. Undoubtedly, controls will lead to the formation of black markets, widespread evasion, and corruption. Then we can observe self-perpetuation of distortions. Also, the effectiveness of capital controls is undermined by the East Asian experience itself since they were in place in East Asia and were unable to avoid the crisis. In general, capital controls cannot effectively deal with long-term disequilibria (Edwards, 1999).

To introduce adequate regulatory and supervision systems in the financial sector (p. 67) is a sound advice. It is also necessary to engage in strict audits of institutions and impose severe corporate and managerial penalties for the violation of rules. Equally important is to increase transparency and reduce corruption (p. 106).[4] Exposing the nature of private political commitments in itself is likely to generate opposition to their cost. Yet where corruption and cronyism are rooted in broader institutional structures, addressing financial market policy and corruption may not be enough, and more fundamental constitutional changes are required.

It may prove extremely difficult to implement the proposed policies. Furthermore, there may be a substantial trade off (albeit in the very short run) between institutional changes and high growth rates. Whether policymakers of the region will pursue these changes remains to be seen.

Dmitri Niarguinen

REFERENCES

Corsetti, G. – Pesenti, P. – Roubini, N. (1999): What Caused the Asian Currency and Financial Crisis? *Japan and the World Economy* 11: 305–373.

Edwards, S. (1999): How Effective are Capital Controls? *Journal of Economic Perspectives,* 13 (4): 65–84.

4 Corruption is a very tricky issue. It is always plausible to say that fighting corruption is necessary. Corruption is consistent with growth at boom times but can distort the response to a crisis and exacerbate its effects. The causal relationship that goes from growth to corruption levels appears to be as valid as the opposite causality.

Gourevitch, P. (1986): *Politics in hard Times: Comparative Responses to International Economic Crises*. Ithaca and London: Cornell University Press.
Kindleberger, Ch. P. (1989): *Manias, Panics, and Crashes. A History of Financial Crises*. 2nd ed. London: The MacMillan Press LTD.
Krugman, P. (1999): *The Return of Depression Economics*. New York: W.W. Norton & Company.
Krugman, P. (ed.) (2000): *Currency Crises*. Chicago and London: The University of Chicago Press.

Lal, D.: ***Unintended Consequences. The Impact of Factor Endowments, Culture, and Politics on Long-run Economic Performance***
London: The MIT Press, 1998, 287 pp.

The content of the book is based on the Ohlin Memorial Lectures that were delivered by Lal in 1995 at the Stockholm School of Economics. These lectures covered two major themes. The first theme, in accordance with the title, "the interaction of factor endowments, culture, and politics in explaining when and why intensive growth occurred" is analysed. The second major theme deals with the role of individualism in promoting growth, and, consequently, the "present day interaction between the West and the Rest" (p. 4).

The ancient civilisations of Egypt, Mesopotamia, Judea, India, and China are discussed first. This is followed by the introduction of Islam as the first challenge to the ancient cultures. In the description of the bases of the "European miracle", Lal explains the rise of the West from various aspects, such as religious, social structure, etc.

In the second theme, the emergence of individualism is traced through the great contributors from the period of Enlightenment to the present day. Having reached this point in time, Lal gets back to some of the great civilisations, notably India and China, to describe their present economic conditions and future opportunities. Their story is contrasted to the success of the Far East, the Four Dragons and Japan. In the final section the major differentiating features of the Western civilisation to the non-western ones are discussed.

Retrospective analyses

Before starting the actual discussion of different cases, the author presents one of its key theoretical distinctions, namely the apparently strange comparison of Smithian vs. Promethean growth. The first refers to Adam Smith, whereas the latter invokes the mythical hero. Both concepts explain the intensive way of growth, but the Smithian theory concentrates on the institutional dimension, notably the increasing division of labour in capitalism, while the Promethean approach is more "technologically based", stressing the importance of the "mineral-based economy" that manifested in the invention of steam-engine.

The retrospective analyses are presented in a chronological fashion. First, Lal briefly describes the invention of agriculture in the cradle of the great civilisations, and contrasts their story to nomad pastoralists, whose lifestyle reflected the ecological environment. Specifically, they were not settled, their animals and tribes had to be protected in an ever changing surrounding, and therefore they adapted a more violent attitude than their land-cultivating counterparts. So far these findings fit into the materialist postulate that infrastructure determines superstructure.

Stepping further into the comparison of ancient Mesopotamia, Egypt and Judaism, Lal points out the first example of culture- or ideology-determined difference that effects economic performance, though the direction of causation is not obvious. A similar conclusion can be drawn by the analyses of ancient India and China. In the former case the major manifestation of the "core principal" or the "moral code" was the caste system. The function of this system was the settlement of complex order by the mechanism of shame. The origin of castes, just as by the cases described above, could be derived from the ecological reality of India, notably the large plains, and, thus the need for maintaining rural labour supply. The durability of this system was demonstrated by the fact that it was only altered or abolished by the enforcement of an external power, the British colonists, who slowly substituted castes, by the "equality in the eyes of law".

Turning to the analysis of the Islam, Lal introduces the origin of this religion and "core principle" as a sudden and unexpected development in the 7th century. Arabs were nomadic pastoralists by that time, and no one would have expected that after a rapid rise they would conquer the Middle East. The true power of this new religion was the combination of Judaic religious insights, such as monotheism, with the religious articulation of the ethnic identity of the Arab followers.

Applying the same analytical framework that was utilised in the earlier cases, the materialist approach to the rise of Islam provides many valid explanations. Occupying the crucial geographical position between Europe and Asia, members of this community became involved in trade. As a result, not merely commodities but ideas and techniques of Greece, India, and China circulated in the region and fundamentally effected the Muslim way of development that was fuelled by "Smithian" intensive growth, i.e. economic integration through common Islamic culture.

Under the heading of "The Closing of the Muslim Mind", Lal describes the process that started sometime between the 9th and the 11th century. From this period Europe began to gain considerable advantages in ideas and technology. Scholars explain that, unlike Christians, Muslims were not able to solve the tension between conceptual universes between Greece and the Hebrew tradition. After a brief period of "Smithian" growth, this closing of mind resulted in economic stagnation. Lal also warns about the danger of interpretation of the Islamic teachings, as a threat that could "confuse the Islamic mind". Merely taking into account the recent experiences of the Taliban regime in Afghanistan provides a convincing demonstration of the author's concern.

The final stop of Lal's retrospective journey analyses the reasons behind the rise of the West. Contrary to other civilisations explored so far, he claims that Promethean intensive growth remains a European phenomenon. The key materialist characteristic was the scarcity of labour that triggered the need to tie down cultivators to land. Thus, a new, quasi-contractual relationship emerged between the states and their constituents. In the framework of the Industrial Revolution, mineral-based industrial economies occupied the place of the organic-agrarian ones. This was the path of Promethean intensive growth that became a norm in the West.

Going back to the problem of material environment, Lal describes Europe as a "diversified portfolio of resources". Therefore the small political units could not hinder the trade of basic commodities by predatory behaviour as opposed to the Asian cases of large empires. Europe was politically divided but culturally united under the flag of Christianity.

European dynamic, the force of self-generating expansion began in the 11th century. The papal revolution played an important role in this process: the development of both the canon and the legal law was the product of the Roman Church that developed itself into a church state. According to Lal, the creation of the first modern government and legal system by the church resulted in the split between the apparently similar Hindu and Christian paths.

Probably the most provoking part of this section has the title of "Love, Sex, Sin, and Guilt". Lal gathers the anthropological findings of being "in love", and the cross-cultural pattern of emotional activities. The most crucial figure is that the average duration of a marriage finished by divorce is four years, and the mean frequency of births is also four years. To Lal this is an evidence of the original human nature that would force individuals to change partners in this pace. However, the requirements of settled agriculture altered the picture: without permanent households with married couples, the system could not function.

The church offered the solution: love and sex had been separated. With the invention of original sin, a guilt-culture was built, and this seemed to be an effective tool against divorce. As a result a religion of anxiety emerged as opposed to the Eastern religions of "tranquillity". The power of this guilt-culture also contributed to the rise of the West just as did other factors, such as institutions or material interest of the church.

Understanding the present differences

Having reached the present time in theoretic considerations, Lal starts his actual case analyses with India and China. As described in the previous section, the economic history of both countries was determined by the "high level equilibrium trap" that could only be left by a "Promethean" growth. While their development strategies share this goal, the tools differed: in China it was Communism, and in India it was Fabian socialism that was the ideological background. Both featured heavy industrialisation and taxing discrimination against agriculture.

In the case of China, the most important development is the diminishing administrative and fiscal authority of the centre, as provincial leaders get stronger. Lal refers back to the theoretical consideration of power recognition by the masses. In this respect, Chinese dictator might lose its power, as people would believe that he lost the Mandate of Heaven.

Investigating the underlying cultural reasons of the East Asian "miracle" economies, Lal finds that the Confucian family model's impact on economic performance has changed. In the past this model hindered economic growth by its nepotism, imitative-weakening patriarchy, and personal rather than universalistic value system. By the changing demand of production, i.e. leaving mass production (Fordism) behind, and getting to a new era highly flexible production, the small economic unit of Chinese-type family seems to be the optimal actor.

Discussing the causes of Japanese success, Lal claims that this country could properly accommodate the Western materialism without its social consequences. The first explanation of this outcome is that Japan applies "nationalistic" way of Confucianism rather than the Chinese "human" way. Second, Buddhism has become the religion of the merchants, thus they have adopted its materialistic views while having always in mind the interests of the nation. At the same time Japan is still a "shame society" without the Western consequences of material prosperity. However, some scholars claim that, due to consumerism, the cosmology of the two big regions will converge, whereas other students of the Japanese soul deny that the vastly different notion of self, that is unified in Japan and fractured in the West, could be shared.

As a summary of all the findings of the book, Lal compares the contemporary "West and the Rest". Generally he formulates the two major differences that can be derived from the dissimilar cement of societies, and from the presence or absence of individualism. About the former the author repeats the historical experiences that both shame and later the emotion of guilt contributed to the socialising process of the West, and this served as a crucial function of the economic development.

Present day phenomena, however, as so profoundly articulated by Nietzsche's "the death of God", erodes this cement of the society. The developments in this respect are presented by the case of the contemporary US. In this country religion has always been perceived differently from the European experiences. In fact, for Americans religion is more a complement of their liberty rather than a suppresser of it. As another form of "social glue" the American way of citizenship is presented as modern reconstruction of the ancient Greek notion. Lal considers NGOs or civil society in the US similar to the Greek tradition based on the duties of citizenship. This is eroded by the decline of certainty, demonstrated by the "growing reluctance of many American to die for the flag".

In general Lal is very pessimistic about the many "unintended consequences" of the welfare state. He considers it as not merely the product of nuclear family, but the destroyer of it, by offering assistance to teenage mothers or single parent families. Thus, the results of the Western culture are in danger due to the erosion of its fundamental unit, the family. In contrast, for the societies of the Rest, this procedure does not pose such significant threat. In the absence of organised churches, the "death of God" does not imply such substantial changes in the fundamental values as in the West. The Asian family continues to function as a social institution not provoking the need of extensive welfare state, hence the unintended consequences can be avoided more successfully.

Own reflections

Lal's book could be characterised briefly as the collection of new political economic arguments of conservatism. His whole concept reflects the fundamental teaching of the conservative school that culture and traditions are valued as much as material factor endowments. As it has always been a reflection of this side to constructivism or socialism, "core principles" or "cosmology" emerge to serve the need of the complex societies according to its original material environment, but later along with its rapid changing could not and should not be modified flexibly.

In order to verify this claim, Lal offered a thorough and convincing historical analysis. His intention was to demonstrate the role of culture and the rigid codes of morality in the relative economic success or backwardness of different civilisations. On these premises, he is sceptical about the modern achievements of the contemporary Western societies, notably about welfare state as the remaining, but in his evaluation, fading component of the socialist experiment of the 20th century.

On the one hand, his book can be evaluated as a fascinating piece of work, a definitely entertaining part of the political economic literature. The collection of all the relevant historical facts and processes, and the logical presentation of them demonstrate the author's deep and wide knowledge that cuts across disciplines from philosophy to economic sciences, from anthropology to psychology. This very dense mass of knowledge, however, is presented in an appropriate style that retains the interest of the reader throughout the whole volume.

On the other hand, one may note that Lal is sometimes much too bound by his very strong commitment to conservatism, and, hence, he presents the cases in a somewhat biased fashion. Nevertheless this does not diminish the value of the book, as this impact gets significant only by the last pages, when Lal passionately convicts welfare state with limited respect to the arguments of its advocates.

Ferenc Kumin

Csáki, Gy. (ed.): ***Befektetésösztönzés és működőtőke-bevonás. Lehetőségek az Európai Uniós csatlakozás előkészítésének időszakában. (Investment Promotion and FDI inflow. Opportunities in the Period of the Preparation for EU Membership)***
Budapest: Oktatási Minisztérium, 2000, 158 pp.

A new book edited by György Csáki with contributions by the staff of GKI Economic-Research Co. and the Institute for World Economics of the Hungarian Academy of Sciences has just been published on Hungary's modified capital-import position. The book contrasts FDI theory with the empirical experiences of five selected countries in five chapters. Focusing on the changes in Hungary's FDI attraction capability, the contributions discuss empirical experiences of selected advanced transforming economies (the Czech Republic and Poland) as well as the experience of two developed countries (Ireland and Finland).

Chapter one analyses the main tendencies of FDI flows in the world economy of the nineties, and the emergence of Central and Eastern European countries (CEECs) among the recipients of FDI flows.

One of the most important qualitative changes of the last decades is the fact that CEECs have appeared on the map of international capital flows. The average of the amount of FDI flows has doubled in the 10 associated European Union countries since 1995. Almost 90% of the FDI inflows have actually been attracted by Poland, the Czech Republic and Hungary. It is interesting to realise that Hungary had attracted by far the largest amount of FDI in the first half of the nineties when its macroeconomic performance was almost the poorest in the region, whereas the Czech Republic, the macroeconomic policy of which was considered the most successful among the Central European transition economies, could not attract an important amount of FDI. Till the end of the nineties, Poland could not attract a significant amount of FDI either.

Since 1998–1999 this situation has changed: Poland could finally stabilise its leading FDI importer position in the region supported by its geographic-geostrategic position, its large and dynamically growing domestic market, as well as by its relatively highly qualified human resources. The Czech Republic has also increased its attractiveness as a host economy: in spite of its macroeconomic difficulties that have prevailed for 3–4 consecutive years now, the country does attract an exceptionally large amount of FDI. As a consequence, Hungary has lost its previously privileged FDI importer positions. The spectacular improvement of the Czech and Polish performance in terms of FDI attraction is certainly the direct consequence of the launch of market-based privatisation dominated by foreign investors. (Hungary applied this privatisation principle throughout the 1990s.)

The volume provides several examples and illustrations for the claim that FDI import in Hungary has been a success story both in terms of quality and quantity. TNCs' Hungarian-based affiliates account for two thirds of the whole manufacturing output in Hungary. Local subsidiaries are responsible for 88% of the growth of Hungarian exports. Considered by their dominant share in various performance indicators, foreign owned companies play an important role in Hungary's improved economic performance.

The other side of the coin is that economic performance of the corporate sector depends on ownership relations: the influence individual large companies exert on aggregate numbers is increasing. The GDP-share of partly or fully foreign owned companies has been growing. As opposed to the main investment motivation of the early 1990s of acquiring the local markets, today the majority of investments are export-oriented. Since 1996 more and more strategic assets seeker investors have appeared among transnational corporations, which certainly reflects a new period in Hungarian imports of capital.

As an introduction to the consecutive chapters of the book, Csáki elaborates on the ways and policy instruments to sustain Hungary's FDI attraction potential. Analysing the volume and the target of specific incentives aimed at strengthening TNCs' local suppliers, the author comes to the conclusion that promoting local linkages through supplier target programmes and supporting local medium-sized companies should be considered as two different programmes of identical importance. These programmes do not automatically target the same circle of potential recipients, still they can be easily confused though it is not at all necessary to make them related to each other.

In *Chapter two* Artner, Wisniewski and Csáki provide some international examples on the changing role of FDI and contrast the selected countries' investment promotion strategies.

Ireland is among the most open countries in terms of FDI inflows. The secret of its improved economic situation lies in the development of its information technology industry. Ireland attracts foreign capital into the quickly expanding knowledge-intensive industries. Currently, Ireland is the second biggest software exporter of the world. 70% of the capital-flow can be derived from the expansion of the electronic industry.

The engine of economic growth was high-tech development in *Finland,* too. The rate of R&D in GNP has doubled its proportion within the previous two decades. Finland is a net exporter of FDI. Three fourths of the established business investments come from the EU.

Poland, whose market liberalisation was completed in 1995, is by far the largest market in Central Eastern Europe. Today it is the most attractive investment target for foreign investors in the region. Most of the profits are reinvested. Foreign owned companies provide almost 50% of total Polish exports and generate about 50% of import, but they are responsible for 62% of the foreign trade deficit. The tendency of increasing regional differences is also typical in Poland. Polish government tries to fight against this phenomenon by establishing special economic areas, but they have not received proper amount of FDI so far and the EU is definitely against establishing such "free trade zones".

In the *Czech Republic* a large amount of FDI is originated from Germany and Austria. The most recent success in attracting FDI is due to the results of investment promotion measures, which came to effect in 1998. Despite these measures, the lack of a transparent regulatory system is definitely an obstacle for attracting further foreign direct investment.

Chapter three discusses foreign investors' local linkages and the capabilities of Hungarian owned SMEs to become TNCs' suppliers. Carrying out a statistical analysis of a database including the balance sheets, and profit and loss accounts of Hungarian companies the chapter analyses the relation of corporate size and performance. The data show the unhealthy distribution of companies of various size categories in the Hungarian economy. Pitti calls for a concentration in the excessively fragmented dimension of micro-enterprises. The fact that a dominant part of micro-enterprises has come into being due to forced entrepreneurship constitutes the main hindering factor of concentration. Entrepreneurship today has a strong social foundation instead of an economic one characteristic to advanced economies. According to the author's forecast, a stabilisation process resulting from mergers among small enterprises would not only strengthen national competitiveness but would also allow emerging medium-sized companies to get access to EU-funds for SME development.

The data presented in chapter three reflect the duality of Hungarian economy: there are huge ownership related differences in performance. The author calculates value added per capita data in the main economic sectors, elaborates on ownership dependent differences in employment and equity data, size dependent differences in net sales, operating profit and net profit data as well as the regional and sectoral distributions of the individual size categories. One of the most informative tables (Table 36) summarises the changes in the share of Hungarian owned companies in selected aggregate national performance indicators in the period of 1996–1998. Data reflect the slowly, or in some cases rapidly declining share of Hungarian owned companies in net sales, export, value added, depreciation, operating profit, etc.

Chapter four summarises the results of a survey of interviews with representatives of county level regional development agencies. One of the findings is that the counties' priority order of development objectives is influenced by the development level of the county. Lagging counties consider infrastructure and public utilities development more important than investment promotion.

It is a well-known fact that although when choosing a particular location for investment investors favour locations with good transport connections, developing the infrastructure of small towns and villages is not enough itself.

Szalavetz blames the current system of regional development fund allocation that favours equality to efficiency. Existing funds are distributed in a fragmented way trying to make as many localities recipients as possible. This system favours internal infrastructure and locality development rather than regional development in terms of connections and synergies.

Various other institutional deficiencies that impede the Hungarian regional development system coming in line with EU-norms are also tackled in chapter four. Although the first steps have already been taken towards EU-harmonisation, many deficiencies prove to be persistent. One of the interesting examples is the issue of decentralisation. County Development Councils' decision-making power concerning the utilisation of the decentralised funds is rather limited. Besides the yearly increasing volume of decentralised funds, regional development projects can also be financed from the various separate state funds – administered by various ministries. The utilisation of these funds is not coordinated at all.

The chapter concludes that although the first (and easiest) steps of creating formal institutions, establishing a strong enabling environment for decentralization have been taken, the way from institution building to good local governance is not a short one. Still, the learning process that has taken place so far in the field of regional development planning programming and implementation enables the actors of regional development to capitalize on the future benefits of Hungary's EU-accession.

Claiming that Hungary has arrived to a quality threshold in terms of FDI attraction, *Chapter five* provides conclusions and policy recommendations. Hungarian economic policy cannot rely any longer on the familiar thesis of "investment breads investment" that has so far justified its passive policy stance. Privatisation is over and the targets of market-seeking investors have already been sold. At present the most important policy objectives are strengthening TNC affiliates' local linkages and supporting the competence accumulation efforts of potential Hungarian suppliers. Another key objective that could indirectly contribute to the sustainability of Hungary's FDI attraction capability is the development of the supply factors in locational competition: in the quality of local workforce and in transport infrastructure.

László (T) Vígh