KWR Advisor
Global Economic, Political and Financial Analysis

THE KWR INTERNATIONAL ADVISOR

September 2003 Volume 5 Edition 4

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U.S. Markets and Economy: The Bulls Want To Run, Baby!

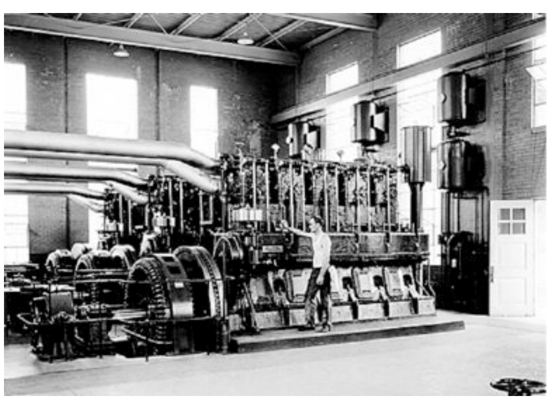
By Scott B. MacDonald

Summer is over and it is time to go back to work. We think that September is going to be a good month for the equity and corporate bond markets. The bulls clearly want to run. Despite the summer meltdown in U.S. Treasuries, the power blackout and the vacation season, corporate bond spreads were driven tighter in August by a combination of good economic news, the possibility that the new bond issue pipeline could be relatively light due to incrementally higher borrowing costs and the absence of any major negative geo-political news. This combination also proved to be a tonic for the stock market, with the Dow consistently staying above the 9,000 mark for several months now – and recently even surpassing 9,500. The NASDAQ has also perked along, reflecting renewed investor interest in technology. Equally significant, the IPO market is beginning to show signs of life. According to Bloomberg, IPOs over the last two months totaled $10 billion, four times the first quarter of 2003 and higher than the $9.1 billion seen in the second quarter. We expect these trends to continue through the fall -- possibly into next year. At the same time, we also see a lot of things that remain problematic and portend tough challenges later in 2004.

First, at least on the surface, the outlook for the U.S. economy is looking better. Durable goods orders are up; new home sales reached their second highest level in history during July and early August; and manufacturing in August expanded at the strongest pace in eight months. Inventories are also being depleted at a faster pace than earlier thought. Even global semiconductor sales are up, rising 10.5% in July, the fifth straight monthly gain. All of this is reflected in GDP numbers: real GDP for Q2 was revised from 2.4% to 3.1%, well above consensus. We think real GDP will be in the 3.6% range for the rest of the year, moving our estimate of growth from 2.4-2.6% to around 3%. There is something to be said about pumping liquidity into the system. Even the World Bank is more bullish, looking to stronger growth next year based on a revival of world trade, stronger domestic demand in most countries and an ebbing of international tensions.

In addition to more positive economic data, the geo-political environment – while remaining fraught with peril – has not heated up to the point that it is disturbing the fervor of investors who remain intent on bidding up equities – which continue to trade at historically high valuations. Yes, terrorist attacks are occurring in Southeast Asia and the Middle East, and North Korea remains a challenge. However, negotiations with North Korea continue, key Islamic radicals were arrested in Southeast Asia and Saudi Arabia, and some form of Israeli-Palestinian dialogue continues. We also expect the United Nations will eventually assume a greater role in Iraq, which could help to stabilize the situation. From equity and corporate bond market standpoints, the improvement in economic data and a perceived reduction in international tensions are sending the signal that the recovery is sustainable.

Nevertheless, while we think that economic growth has room to run, not everything is positive. For a full-fledged recovery we still need to see sustainable gains on the employment front. We take note of a recent statement by the National Association of Manufacturing that the recovery for U.S. manufacturers is "the slowest on record since the Federal Reserve began tracking industrial production back in 1919." Some 2.7 million manufacturing jobs were lost over the past 36 months. What is needed to reduce unemployment and stabilize manufacturing employment is a long awaited and still anemic return of capital spending. If this occurs during Q3, the recovery could gain further momentum in Q4 and 2004. In addition, the U.S. deficit is heading into record numbers. While this is not a concern in the short-term, it could have long-term consequences, especially if measures are not taken to deal with the situation.



There is also the issue of the state of U.S. utilities. The August power outage that hit the United States and Canada was a major shock to the American public and demonstrated that the North American utility sector has problems. In fact, the blackout indicated that the U.S. system of regulating utilities, a mix of feudal-like local authorities and a less than forceful federal regular, the FERC, combined with some poor management teams sprinkled across the country, is dangerously offline. The result was that billions of dollars of business was lost, either in closed restaurants, spoiled grocery store goods or powerless factories. Idle factories do not produce durable goods. It is now estimated that $60-100 billion is needed to upgrade the U.S. utility system.

While everyone agrees the system is in need of repair, consensus ends when it comes to who should pay and want kind of system is required. For much of the U.S., utility industry times are hard. Many of the companies already have large debt loads, are cutting costs, and selling non-core assets. Rating agencies have been bearish. While these same companies often purchase energy on deregulated markets, they sell power at controlled prices (and are unable to pass on any price increases). Local political establishments are active in protecting the consumer. Consequently, Washington has the potential to be a gridlock on utility reform – with the Democrats declaring that the Republicans are in the pocket of greedy utility companies and want to pass reform legislation that will open up federally protected lands to oil and gas exploration. For their part, the Republicans are grousing that the Democrats want state intervention and control – basically a socialist approach to an already troubled industry. To some extent both sides are right. Therefore, we expect a lot of talk over the utility industry in the months to come, but real action with big price tags will be slow. In this case talk is indeed cheap – at least until the next power outage.

Despite the concerns over unemployment (still in the 6% area), growing budget deficits, and potential energy problems, the Bush administration is geared on pushing enough liquidity into the system to make certain the recovery gets its feet and moves – at least until the November presidential election. As we have stated all along, the impact of the federal government pumping billions of dollars into the economy will stimulate growth. The trick is to have enough stimuli to allow the consumer an opportunity to consolidate debt and rebuild savings, which must be balanced with renewed capital spending. The latter is beginning to happen very gradually. For the Bush administration the bottom line is to grow the economy and win re-election. Beyond that policy priorities are focused on the war against international terrorism and stabilizing Iraq. Dealing with the federal deficit is a low priority, though this could become a major drag to the economy in the medium to long term. However, the Bush administration's request for emergency spending of $87 billion to finance operations in Afghanistan and Iraq and the probability that the budget deficit could be equal to 4.7% of GDP, are not positive signals on fiscal management. This puts the upcoming fiscal deficits in the same ball park as the record fiscal deficits of the early 1980s. Fiscal prudence is being sacrificed for political expedience.

The bottom line is we are constructive on both the equity and corporate bond markets in the short term. For the latter the probable scenario is one shaped by generally tighter spreads, a modest new issue pipeline, and generally positive economic headlines. Although some companies have probably opted not to go to the market to issue debt due to slightly higher rates, we think that rates remain historically low and are likely to go up as the year continues. While the improving economy is likely to pull money out of the bond market and into equities, there will still be enough money in bonds to make September a positive month for bond market returns.

As for the stock market, the bulls want to run and they will in the short term. If the momentum continues through September and sentiment becomes firmer in the belief of a sustainable recovery, the bulls could continue to run through the end of 2003 and 2004. By early 2004, the main concern for economic policymakers will no longer be deflation, but the possibility of looming inflation. Indeed, in 2004 the U.S. economy could be heading into a period of stagflation, in which a rising fiscal deficit and rising prices are matched by little or no growth in the employment area. Consequently, we say ”Viva los toros!”; at least for now.

Asian Business Watch
Japan Views You Can Use

Japan’s China Card

By Darrel Whitten

Investors who are doubtful of the budding economic recovery in Japan point to the fact that the recovery is almost entirely export-driven. If the U.S. economic recovery sputters, they fear, Japan's recovery will also be nipped in the bud.

The debate about the sustainability of Japan’s economic recovery revolves around the fact that the growth in the April-June quarter was driven by exports (+0.4% Q-Q), that domestic demand continues to shrink (-0.3% Q-Q), and therefore whether Japan's economy can continue recovering if the U.S. recovery sputters. This is to a degree true for the tech space, where Japan's major electronic majors, with a few exceptions, turned in a very disappointing April-June quarter. Indeed, Sony's nasty earnings surprise and the downgrading of Fujitsu's credit to junk status by Standard & Poor's shows that the recovery of earnings and cash flows has been much slower than investors had hoped.

But it is a misperception that that the recovery in Japan's is being driven entirely or even mainly by the U.S. recovery. Looking at Japan’s cumulative exports for the January-June period, total exports were up a strong 13.9% YoY, but exports to the U.S. actually declined by 0.3% YoY, and accounted for 27.1% of the total. Exports to the EU were 15.9% of total exports, and contributed 3.2 percentage points to the overall 13.9 percentage point gain. Conversely, exports to Asia accounted for 9.4 percentage points of the 13.9 percentage point rise, with China alone accounting for 4.4 percentage points of this growth, in surging 49.4% YoY and accounting for 11.6% of Japan’s total exports. Moreover, exports to Asia have accounted for the majority of the growth in Japan's exports this year and for the past several years, and they now account for 45.1% of Japan's total exports.

On the other side of the coin, the U.S. reported total import growth of 9.7% YoY during the first six months of calendar 2003, with imports from Asia rising 10.4% YoY, and the trade deficit with Asia rising to $267.7 billion versus $232.7 billion a year earlier. Imports from China rose by 25.0% YoY, and the U.S. trade deficit with China rose to $107.9 billion, versus $86.3 billion a year previous. Conversely, imports from Japan fell by 0.5% YoY, and the trade deficit shrank from $66.2 billion a year ago to $64.4 billion.

In addition, the claim that exports to Asia are really derived from U.S. demand is also no longer true. Some 34% of the output of Japanese companies in China, for example, is sold in China, while 34% is sold back to Japan. Only 32% is exported to third countries, ostensibly the U.S. and Europe.

The Japanese media has changed its tone regarding China's position–from portraying China as "the world's factory" to describing it more as "the world's market," following China's entry into the World Trade Organization. This is because that, while China figures very large indeed in U.S. and Japanese imports, China's imports are actually growing faster than exports. The People's Daily is reporting that imports are expected to grow 12% to 15% percent to $330 to $340 billion, while exports are seen rising between 8% and 13% percent to $350 to $360 billion in 2003. This compares to growth in imports and exports of 21.2% and 22.3% percent respectively last year.

Indeed, China's Commerce Minister has been quoted as saying that China will import over $1,000 billion worth of goods in the next three years. This growth of course is attracting throngs of foreign companies. By 2002, over 420,000 foreign and overseas funded enterprises were registered in China, and the total volume of actually used foreign direct investment hit $448 billion.

The top imported items into China include; industrial and power generating equipment, electrical/television and radio goods, textiles/fibers and fabrics, iron and steel, plastic articles, mineral fuels, fertilizers, cereals, optical/clocks and precision goods, and organic chemicals. By far the two largest import commodities for the first half of calendar 2003 are mechanical & electrical equipment and high-tech products, where imports are growing at around 50%. Imports of crude oil, rolled steel and TV components, while smaller, are also soaring between 80% and 100% YoY.

The Japanese media's shift from describing China as the world's factory to describing it as the world's market reflects the shift in perception by Japanese companies, particularly after China's entry into the WTO. The media is getting their cue from Japanese firms, who are shifting the focus of their business with China from utilizing it as a production base for exports to selling their products locally.

As of 2002, some 60 Japanese companies had local production in Asia, of which 20 were in China/Hong Kong. As of the first quarter of 2003, China sales of the local operations of Japanese companies accounted for 8% of total overseas sales; 34% of which was sold in China, 34% of which was exported to Japan, and 32% of which was exported to third countries, according to METI data. Sales within the China market were up 12.4% YoY during the quarter, while exports back to Japan were up 10.9%. Exports to other countries were up 19.6%.

This "China Card" appears to be having an impact on Japanese stock prices, if not as noticeably on Japan's GDP growth. For example, the second up-leg of the current rally in Japanese stocks is noticeable for its lack of "New Japan" companies, ostensibly because the weak April-June quarterly numbers have made investors leery of the traditional tech stocks.

Instead, there has been a focus on cheap "domestic-oriented" companies. But a look at the top gainers of these "domestic-oriented" companies indicates that the real play in these stocks is not their domestic orientation, but China-related demand–particularly in mature industries where the China business is: a) a life-saver for the company/industry, and/or b) the Japanese company has a competitive edge vis-à-vis their global competition that is also flocking into China.

Site-By-Site !
Global and Domestic Investment Information

Snow in Beijing and What it Means for Gold

By Michael R. Preiss

U.S. Treasury Secretary John Snow visited Beijing recently to raise the Renminbi (RMB) re-valuation issue with China's senior leadership. While the media focus was on currency values and unfair trade advantages, what is sometimes overlooked is the potential implications it has for gold.

Firstly, let's us consider the background behind the pressure for RMB revaluation, and why for the foreseeable future, both U.S. and China's interest are interlinked. At the root of the international unhappiness with China's currency level is the country's rapidly growing trade surplus created by its "rented economy". The term "rented economy" applies since foreign investment controls much of China's low cost production. China is becoming the "workshop/factory" of the world and is holding down global inflation.

China's senior leadership might still call themselves "Communists", however, in reality the country is run the like a holding company along strict reporting lines with one clear objective, namely 7 to 8 % annual growth. The currency peg between the RMB and the U.S. dollar is facilitating this growth objective while at the same time it results in lower interest rates in the United States. This is because, in order to keep the RMB at the 8.3 % level, China needs to buy up surplus dollars and re-invest them abroad, foremost in U.S. Treasury bonds. The peg is mutually beneficial to both China's growth target and Alan Greenspan's need to keep long-term interest rates and inflation low.

As of last month China's holdings of U.S. Treasury bonds rose to a record $122.5 billion, less then Japan's but far more than any other country. Together Japan and China hold 41.9% of the $1347.2 billion debt the U.S. government owes the world.

Even though hot money is not allowed in, an unprecedented amount of foreign currency is flowing into China, to buy land, construction material and to pay workers to build new factories. These factories start producing, much of their production is exported and sold for U.S. dollars, while the raw materials used and the workers' wages are priced in RMB. As more foreign exchange flows into the current account, the People's Bank of China (PBC), buys up these dollars because the government is committed to keeping the exchange rate stable.

If it were to stop buying the dollars, the value of the RMB would quickly appreciate. But the PBC has a problem. If it simply uses new RMB – creating a liability on its balance sheet against the dollar assets – the extra money in circulation within China would soon cause inflation, as indeed happened in the mid 1990s. That would damage the economy and eventually hurt China's export industries, since the prices of Chinese goods would rise.

So instead of causing inflation inside the country, China is exporting deflation.

This in turn allowed the Fed to spark an economic revival by lowering interest rates to 45 year lows without risking inflation.

One weak spot of the recovery, however is the stubbornly high U.S. unemployment rate. And this is where Mr. Snow comes in. President Bush has already seen 2.7 million factory jobs disappear on his watch and he needs to be seen to be doing something about it in order to be re-elected. Viewed from this perspective, Mr. Snow's visit to Beijing is more about U.S. domestic political issues rather than seriously forcing China to un-peg the currency.

All of the above leads us to the question what full RMB convertibility eventually means for gold prices.

China can press onward toward convertibility on the capital account, which would allow Chinese people more freedom to move their savings abroad, counterbalancing the inflow of U.S. dollars. In many ways that is the best option and it is already being implemented, but it would threaten the steady increase of savings put in low interest accounts at the state banks. This is the one thing that keeps China's financial system stable at the moment. Historically, the less trust there is in the financial system the more demand there is for gold.

In addition, strong capital inflows and rising Forex reserves are already sharply boosting official demand for gold in China. This is because if the PBC is to retain its proportion of gold holdings at the current 2.4% of total reserves (European Central Bank standard: 15%), it would need to increase its gold holdings by an estimated 120 tons or 60% of gold consumption in China in 2002.

China already enjoys with 40% one of the highest savings rates in the world. The closer we get to revaluation, the more USD dollar savings will be converted into gold.

In order to pave the way, the PBC last year relinquished its monopoly on imports and exports of gold, the Shanghai Gold Exchange was established and many Chinese commercial banks are planning to launch personal gold investment businesses.

The way forward for China's central bank and savers in the coming years is, surely, to diversify out of their huge dollar holdings and move to back its currency by gold as it heads slowly but surely towards convertibility on the capital account.

After the Beijing Olympics when the snow falls in the winter of 2008, Gold might truly glitter.

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"Zaibatsu" and "Keiretsu" - Understanding Japanese Enterprise Groups

By Andrew H. Thorson

Anybody who is familiar with Japan will recognize the words zaibatsu and keiretsu. Few, however, know of their meaning and historical significance. This is the first of several articles that will explain the origin, historical significance and the current circumstances of Japan's enterprise groups, all of which we loosely tend to refer to as zaibatsu and keiretsu.

This initial article explains the origins of the zaibatsu.

Zaibatsu Formation in the Meiji Era (1868 – 1912)

Zaibatsu generally refers to the large pre-WWII clusterings of Japanese enterprises, which controlled diverse business sectors in the Japanese economy. They were typically controlled by a singular holding company structure and owned by families and/or clans of wealthy Japanese. The zaibatsu exercised control via parent companies, which directed subsidiaries that enjoyed oligopolistic positions in the pre-WWII Japanese market. These economic groupings crystallized in the last quarter of the 19th century during the Meiji Reformation.

Zaibatsu first became a popular term among management and economics experts when the term appeared in the book History of Financial Power in Japan (Nihon Kinken Shi) as published late in the Meiji Era. Even in Japan, the term was not commonly used until the mass media adopted it in the late 1920's.

The zaibatsu were formed from the Meiji government's policies of state entrepreneurialism, which characterized the modernization of the economy during that era. To understand the significance of zaibatsu, one must consider at the onset of the Meiji era, agriculture comprised 70% of Japan's national production, and approximately three quarters of Japan worked in farming related jobs. The government used land tax revenues to fund the state planning, building and financing of industries determined by bureaucrats to be necessary for Japan's economic development. Meiji bureaucrats did not rely on the free market in reforming the economy, but they also did not develop the economy alone.

In the 1880's the Meiji government sold some government-owned enterprises on special terms to a chosen financial oligarchy implicitly entrusted with the public interest in developing the national economy. These enterprises were entrusted to the influential concerns known as the Mitsui, Mitsubishi, Sumitomo, Yasuda, Okura and Asano groups.

These private parties and enterprises crystallized over time into large, integrated complexes steered by the government bureaucrats into areas of development desired for the reformation of Japan. To secure compliance, the government provided inducements such as exclusive licenses, capital funding, and other privileges. Although Japan badly needed foreign technology, know-how and capital, the government adopted a policy of shutting out foreign entrepreneurs with few exceptions in favor of domestic development.

After WWI, when Japan's economy made huge strides in economic reformation, the zaibatsu interests began to enter the political arena to support their interests. Their activities became entwined with the government in wartime Japan. Eventually, the Potsdam Declaration that was signed in 1945 required the liquidation of the zaibatsu as one step to democratize Japan's post-war economy.

Zaibatsu Control Structures

Unlike the current situation in Japan, it is said that the zaibatsu stockholders were relatively strong. While zaibatsu holding companies directed the enterprise complexes in a pyramid fashion, stockholding relations cemented together the companies within zaibatsu complexes. Characteristics of the complexes included holdings by members of more than half of the holding company's stock, and the position of the holding company as the overwhelmingly largest shareholder of companies within the complex. The stock of members was rarely sold by other members to third parties. Under this structure, zaibatsu and their leading holding companies drove the finance, heavy industry and shipping sectors that forged the heart of Japan's economy.

By the 1920's zaibatsu economic power engulfed the sectors of finance, trading and many major large-scale industries. From 1914 to 1929, three zaibatsu (Mitsui, Mitsubishi and Sumitomo) controlled 28% of the total assets of the top 100 Japanese companies. Even as of 1945, the same complexes possessed 22.9% of the total assets of all Japanese stock companies.

As will be explained in Part II of this series, subsequent to the liquidation of the zaibatsu pursuant to the Potsdam Declaration, new enterprise complexes and groups that resembled the zaibatsu were resurrected in Japan. There are, however, significant differences that distinguish the zaibatsu from the modern keiretsu. These differences and the subsequent formation of the keiretsu will be discussed in later articles.

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THE TIES THAT BIND

The (limited) significance of Thailand's withdrawal from the IMF

By Jonathan Hopfner

Thais are often quick to remind visitors to their country theirs is the only nation in Southeast Asia that escaped being colonized by a Western power. It thus comes as little surprise the early repayment of the $12 billion loan the country secured from the International Monetary Fund (IMF) in 1997 to cope with the devastation wrought by the Asian financial crisis was unveiled with such fanfare. This is because in the eyes of many Thais the terms and conditions that the IMF attached to the disbursement of the funds constituted a grave threat to Thailand's cherished sovereignty.

Against a backdrop of a massive national flag and patriotic theme songs, Prime Minister Thaksin Shinawatra announced that Thailand had repaid the loan in full on July 31, one year ahead of schedule. He swore to his rapt audience that this was the "last time the country would be indebted to the IMF" and remarked that the debt had been a "pain to the nation." Soon after, the IMF announced it would close its Bangkok office in mid-September. While it insists its officials will continue to visit Thailand regularly to discuss policy with local officials, there is little doubt the lender's influence here is on the wane.

Some of Thailand's more opportunistic lawmakers have seized on the country's recent freedom from the IMF's shackles. Calls have increased for the repeal of 11 laws, including those governing bankruptcy and property ownership, that were introduced by the previous government partially to conform with the IMF's loan conditions and are widely alleged to favor foreign over local investors.

So is this, as some observers have surmised, the end of an era? Was the Prime Minister's characteristically nationalistic bombast yet another indication of Thailand's growing determination to assert its full economic, as well as political, independence? Will Western policymakers and investors find their views are no longer taken into account by a government determined to pursue its own goals?

The short answer is no, not really, because Thailand took little of the IMF's advice to heart to begin with. In a 1998 letter of intent outlining the steps the government should take in the following year the IMF called on Thailand to draft plans for the full privatization of the state energy, tobacco, transport and utility monopolies, as well as the freeing up of the telecom market. Five years later, the government has taken some very tentative steps towards these goals – a stake in Thai Airways has been floated on the Stock Exchange of Thailand, and the Petroleum Authority of Thailand and Telephone Organization of Thailand are now, in name at least, private entities – but for the most part the privatization and liberalization of these crucial sectors remain as elusive as they were five years ago.

Even the changes instituted under the IMF's auspices – the tightening up of Thailand's bankruptcy legislation, for example – have hardly proven as sweeping as expected. While the new laws may have been designed to boost the rights of creditors, they seem to be less than adept at fulfilling this task in practice. Witness the ongoing saga of debt-ridden Thai Petrochemical Industry (TPI). Throughout a seemingly endless proliferation of suits and counter-suits, the Thai courts have allowed founder Prachai Leophairatana to maintain nominal control of the company despite the objections of creditors such as Bangkok Bank and Germany's KfW, who apparently have the right to appoint the administrators of an insolvent firm under Thailand's bankruptcy laws.

The reality is the economy at its strongest point since the 1997 crisis – growth surged to 6.7 percent in the first quarter of this year, and Thailand's bourse has recently ascended to its greatest heights since 1999. Any changes to Thailand's investment and ownership policies are likely to be a result of the government's perception that it is, for the first time in years, in a position of strength, as opposed to a desire to test the country's newfound "freedom" from its IMF obligations.

There is every possibility, then, that the government may indeed introduce legislative changes that appear less than friendly to foreign investors – but only to a point. IMF or no IMF, Thailand's commitments as a member of the World Trade Organization (WTO) and Association of Southeast Asian Nations (ASEAN) will keep the country squarely on the path of reform and openness – the telecom sector, for example, must be completely liberalized by 2006 if Thailand is to conform to its WTO obligations.

Healthy competition within Asia for foreign capital is also likely to prevent the Thai government from implementing any laws that would severely limit the rights of multinationals doing business there. With concerns rising about an outflow of foreign business operations to China and other countries in the region taking steps to deal with this threat – Singapore recently amended its pension system to reduce its notoriously high labor costs – Thailand will have little choice but follow suit.

Many historians argue that the country's then-rulers saved Thailand from being colonized by exhibiting a healthy amount of pragmatism. They simultaneously made necessary concessions to foreign powers while fostering a sense of unity among their own population. Despite the passing of the IMF and its increasingly nationalist rhetoric, the current government will likely do the same.

WHAT DO

Indonesia and Islamic Terrorism – More Than a Thorny Problem

By Scott B. MacDonald

In early August, the JW Marriott Hotel in Jakarta was bombed. The bomber was an Islamic radical, who drove a van into the front of the hotel, killing 12 people and wounding over a hundred others. Most of those killed or injured were Indonesian. The Marriott bombing follows the Bali bombing of October 2002, two other bombings in Jakarta (one at the parliament) and an alleged plot to kill the country's president Megawati Sukarnoputri. Although Indonesian authorities are reluctant to admit it, the rise of Islamic terrorism runs the risk of polarizing society and endangering the relatively secular nature of the government. It also casts a large shadow over the future of the country's fledgling democracy as well as the attractiveness of Indonesia as a place for foreign investment. While the Indonesian government is a considerable distance from being ousted from power, local radical Islam and its foreign links to al-Qaeda and Jemaah Islamiah (JI) represent a very challenging problem with long-term implications for Southeast Asia's largest country as well as the rest of Asia.

There are two sides of the coin in looking at Indonesia and Islamic terrorism. On one side of the coin, Indonesia has a long tradition of a tolerant form of Islam, which has functioned as a support for political stability. It has also been a pillar of Indonesian nationalism, a force that helps bind the country together. This was especially the case during the struggle for independence during the 1940s. During the Suharto years, Islam was carefully controlled and there was an emphasis placed maintaining a secular society, able to accommodate a Muslim majority, but carving out a tolerance for the Hindu, Christian and other smaller religious communities. With the end of the Suharto years and the advent of Indonesian democracy, the role of Islam in society suddenly became more central. Indeed, with the departure of East Timor, the overall numbers of Muslims as a percentage of the total population increased.

The other side of the coin is that as the Islamic face of Indonesian society has become more distinct and more mainstream, the door has also opened for radicals within the same community to emerge from the shadows, developing international ties to like-minded groups and recruiting more followers. Certainly the shift to a more open political system has brought about a higher degree of uncertainty in Indonesia. Together with the round-robin of presidential leadership since 1997 and tough economic times until recently, radical Islam has become attractive as it projects a clear-cut, simple answer to complicated issues.

Another aspect of the rise of radical Islam in Indonesia is that the political class is seeking to manipulate this force. With the unpopularity of the American war against Iraq and the close U.S. alignment with Israel vis-à-vis the Palestinians, another Islamic people, radical Islamists have been quick to articulate their views and to find a sympathetic audience in the majority of Indonesians. This by no means infers that most Indonesians favor radical Islam, the creation of a theocratic state along the lines of Iran, or are inclined to attack the West and its allies. What it does mean is that radical Islam touches a sensitive spot in the country's identity – the West has long looked down on Islamic peoples. In a sense, there is a sense of grievance. After all, the Dutch long colonized Indonesia and took its natural resources. Western companies made money in the country, and Suharto was long supported by the United States. In addition, it is argued the IMF made life miserable for many Indonesians with its poorly conceived economic policies.

The danger is that elements of the political elite are still playing to radical Islamic groups, or at the very least pandering to public sentiment vis-à-vis the unfairness of an international order dominated by the United States. The comments of Vice President Hamzah Haz in calling the United States, the "king of terrorists for its war crimes in Iraq" certainly must be seen in this context. Haz was responding to international criticism that Indonesia had been lenient in sentencing Abu Bakar Bashir, the spiritual leader of JI, to only four years of jail. Haz is the leader of the conservative Islamic United Development party (PPP). He has in the past been willing to be seen courting some of the country's more radical Islamic figures.

While some groups are playing to the Islamic radicals, others remain strongly opposed or are waiting for their turn to take advantage of potential weakness in central authority. President Megawait Sukarnoputri is conducting a war against Islamic separatists in Aceh (on the northern tip of Sumatra) and is seeking to contain separatists in other regions. At the same time, presidential elections loom in early 2004. If the President slips in conducting the war, if she pushes too hard on Islamic groups in a predominantly Islamic country, or if she appears to be in the lap of the United States, her political prospects are likely to weaken. Moreover, she must tread softly with the military. Any loss of power from the civilian part of the political spectrum could be gained by the military, one of the few cohesive institutions in the country. In the past, it has also been one of the most influential. If civilian leadership is inadequate, there are leaders within the armed forces that might be tempted to step into the picture, probably in the shadows, much like Indonesian puppet plays.

What complicates matters for Indonesia is that it is not a small, insignificant country. Rather, it is a pivotal nation, located astride major lines of communication and trade between East Asia and the Middle East and Europe. It is also the world's largest Islamic nation and a major producer of oil and natural gas. For all these reasons, what happens in Indonesia matters. Consequently, the approach of the Megawati government to radical Islamic terrorism is a concern to more than just the local population. It is a point of concern to Washington, Tokyo, Beijing, Manila, Singapore and Manila. The failure to implement Financial Action Task Force (FATF) money-laundering regulations, which are aimed at hurting illegal financial activities in the country -- which could aid Islamic terrorist groups -- gives the impression that Indonesia is soft on tackling the problem.

Perceptions remain important in a globalized world – like it or not. This is important for attracting foreign investment as well as how the country interacts with the rest of the region. While the U.S. has often pushed too hard on Indonesia and certainly played to the sense of Islamic grievance, Indonesia's political elite also has to consider its responsibility to its citizens in providing sustainable economic development, a better standard of living, and clear government. Supporting men with bombs willing to kill their fellow Indonesians in grisly acts of violence is not going to build a better future for the country.

Italy in Recession

By Andrew Novo

Following the lead of the United States, the Italian economy dipped into recession in the beginning of August after posting negative growth for the second quarter of 2003. More recently, France and Germany have joined the ever-growing list of nations suffering economic contraction. In Italy, as in many other countries, the recession was an expected phenomenon based on consequences from the war in Iraq and "a poor international climate." Shrinking exports due to a strong euro and decreased tourism have not helped matters and the outlook among most economists in Italy, and throughout the world, is for little or no growth for the rest of the year. Once again, the Berlusconi government is forced to deal with an economically challenging situation at a time of increasing political volatility.

Over the past summer, Berlusconi's coalition, Casa delle Liberta, suffered a defeat in local elections in Friuli-Venezia Giulia (a region in the northeast) to the opposing left-wing L'Ulivo coalition. More significantly for Berlusconi's government, the incumbent candidate for the regional council, from the Prime Minister's own Forza Italia party, did not run. Instead, the Lega Nord, the right-wing coalition partner of Forza Italia, insisted that its own candidate, Alessandra Guerra, stand for election. Guerra was defeated. Violent recriminations within the Casa delle Liberta resulted in threats from the leader of the Lega Nord, Umberto Bossi, to pull out of the Prime Minister's coalition. At the end of August, Berlusconi and Bossi have been at odds again, this time over the issue of reforming Italy's pension system.

Italy's weakened economic position has further complicated matters between the Prime Minister and his separatist northern ally. With Italy's monetary policy governed by the European central bank, the Berlusconi government is left to make due with fiscal policy in order to bring about a return of economic growth. During his 2001 campaign, Berlusconi promised tax cuts and decreased government spending, the latter objective to be achieved primarily through a streamlining of the turgid and wasteful Italian bureaucracy. The federal tax cuts put forward in the 2003 and 2004 budgets came about through the creative bookkeeping of Finance Minister Giuliano Tremonti in the face of skepticism and concern from the European Union which is wary of Italy's burgeoning deficit. The federal tax cuts (in excess of five billion dollars) will be countered by decreased government transfers to local governments. This will result in increased local taxes. The net gain for Italian citizens will be minimal.

In keeping with his platform of reform and decreased government spending, Berlusconi has most recently set his sights on reducing the bloated Italian pension system. The Prime Minister hopes to tighten the budget by decreasing government spending in this area. However, this measure has stoked the smoldering embers of contention with the Lega Nord. Berlusconi's announcement of his desire to raise the retirement age from fifty-seven to sixty years of age by 2010 has met with staunch opposition from the Lega Nord. The Lega draws considerable support from voters who retire on pensions at fifty-seven after thirty five years of work. Eighty percent of such government pensions are received by people in the north. The issue draws important battle lines. If Berlusconi chooses to proceed with his pension plan it could well cost him the support of the Lega, which has already withdrawn from cabinet activities in the wake of the June election defeat. It should be remembered that differences over pension reform caused the withdrawal of the Lega Nord from Berlusconi's first government in 1994 resulting in its collapse. It seems that history is repeating itself – a dangerous proposition for the Berlusconi government. If the withdrawal of the Lega induces an exodus of the extreme right from the Casa delle Liberta, the Prime Minister will no longer hold a majority in the Italian parliament.

Further complicating the situation of ifs and ands is the present recovery of the American economy. Just as Italy followed America into recession, it will likely drag itself out on the coat tails of the United States. If this happens swiftly enough, the pressure to cut government spending by reforming the pension system will surely dissipate, the voices denouncing Mr. Berlusconi will soften and the Prime Minister will ride the recovery into the re-election campaign.

Israel and Globalization

By Jonathan Lemco

Israel is one of the few, if not the only, democracy in the Middle East. It also has the most dynamic economy and most vibrant entrepreneurial culture. Its economic policy-makers are proactive and its workforce is one of the most technologically innovative in the world. This is best evidenced by its success in devising new materials and techniques applicable to the defense, electronic and other industries. Not surprisingly, Israel has benefited enormously from globalized trade and investment. This is despite Israel's relatively small population base and its precarious strategic position. Of course, as the largest recipient of financial aid from the United States, Israel enjoys a particular advantage.

Since its inception in 1948, the Israeli economy has been fairly open to international markets. In the 1990s for example, the information technology and communications sector in Israel grew five-fold, reaching 14% of GDP. On the other hand, technologies are spread around the world through multinational companies, an area in which Israel is weak. The number of Israeli multinationals in the high-tech sector, as expressed in company size, is low. By definition, most Israeli high-tech companies are small firms. And they are vulnerable to a highly volatile global high technology sector.

Broad Macroeconomic Issues

To compete in a globalized world, Israeli policy-makers must seek price stability as a primary monetary policy goal, with a second goal of tempering business cycles. The main policy tool is short-term interest rates. In Israel there were two clear deviations from stable interest rate parameters; in 1998 and again in 2001. Both times, lowering the high interest rate created turmoil. Interest rate policy in a globalized world economy must be stable while adhering to medium- and long-term inflation targets.

With regard to budgetary policy, the Ministry of Finance must continue its policies of fiscal prudence. At present, Israel has a moderate external debt burden due to capable Central Bank management and strong capital inflows since the mid-1990s. Israel's ample reserves of $24 billion cover its external financing gap. Direct international investment in Israel is up in 2003 as well. But Israel does have high government deficits of 5% of GDP and public debt burdens. Unemployment is too high at

10.8% as of April 2003. Many of Israel's domestic costs are due to external shocks associated with its complex security situation. Future budgets should be rigid when it comes to government expenditures, and flexible regarding the impact on the business cycle through infrastructure investments. Otherwise, the risk of recession increases.

Israel is a trading nation, and this has contributed to lower prices and a higher standard of living. As a small nation, pursuing international trade agreements are the only way it can ensure its relatively high levels of prosperity can be sustained. Indeed, Israel's export oriented economy has generated per capital income that is similar to some EU countries. It is a virtual par with Spain and higher than Greece and Portugal. The Israeli per capita income is much higher than the 10 countries that will join the EU in 2004. However, most of these countries are growing economically while Israel is in the third year of a recession.

That said, if there is progress attained by the internationally sponsored 'Road Map" aimed at resolving the Israeli-Palestinian conflict, coupled with a global economic recovery, then the Israeli economy should emerge from recession in 2003. At 0.5% in real terms this year however, growth remains below potential.

Globalization's Reach into Israel

As of August 2003, 2.2 million Israelis (32.8% of the total population), use the Internet. This is one of the most wired nations in the Middle East. Further, the telecommunications market in Israel is growing rapidly. Data communications is the growth engine, and the forecast for Israeli data communications growth is 31.2% through 2007. Wireless data communications revenue accounts for half of the data communications total and should expand by an average of 43% per year until 2007, according to the Israel High-Tech and Investment Report.

Also, according to the Israel High-Tech and Investment Report, the Israeli telecommunications market revenue amounted to $3.78 billion in 2002, of which $2.6 billion came from cellular communications and $1.17 billion from fixed line communications. Clearly, this is a burgeoning industry poised to benefit from greater international ties.

Israel's biotech sector is also a growing force to be reckoned with. BioTechnology General, InterPharm Laboratories, and especially Teva Pharmaceuticals are the largest of the approximately 140 firms developing world class pharmaceutical and other products and technologies. The biotech industry in Israel employs about 40,00 people and its output, as of June 2003, was in excess of $800 million per year. Teva Pharmaceuticals alone was responsible in 2002 for more than $550 million in exports of its Multiple Sclerosis Copaxone drug.

The number of biotech startups is high and equals the number of companies in such countries as Switzerland, Sweden and France. Furthermore, Israel's medical device industry, numbering more than 400 companies, is growing as well and is a world leader in the production of cardiac stents.

Finally, Israeli defense exports hit an all-time record in 2002. Signed contracts for defense industry deals with foreign armies reached $4.18 billion, a nearly 70 percent rise compared to 2001. The main customers for Israeli weapons systems are the U.S., followed by India and various Southeast Asian countries. Not surprisingly, the identity of many of the countries acquiring weapons systems are not revealed. As of July 2003, Israel is fifth as a military exporter behind the U.S., EU, Russia and Japan. But it is also among the leaders in exporting electronic equipment and high-tech military equipment.

Conclusion

Israel is a small country faced with a challenging strategic environment. But its population is educated and its industries have produced goods and services that are in demand worldwide. The Israeli economy has demonstrated an ability to compete with much larger competitors. In short, globalization has offered opportunities to Israel that have allowed it to transcend its small size and realize a standard of living for its citizens that are among the highest in the middle east.

BUSINESS

Russian Tycoons Face the Heat

By Sergei Blagov

MOSCOW - The ongoing controversy around Russia's top oil company, Yukos, has prompted fears that the Kremlin might review the privatizations of the 1990s. Meanwhile, Russian official statements remain somewhat ambiguous. Notably, President Vladimir Putin has called for a crackdown on economic crimes but said individual rights should be respected, carefully avoiding taking sides in a dispute around Yukos. Putin's previous comments were marked by his characteristic ambiguity and avoided any direct reference to Yukos. However, Putin spoke out against the use of detention for suspects accused of economic crimes.

The probe into Yukos began with the arrest in July of Platon Lebedev, a right-hand man of Russia's richest man, Yukos chief executive Mikhail Khodorkovsky. Lebedev is the billionaire chairman of the board of Group Menatep, the holding company that owns 61 percent of Yukos.

Prosecutors have charged Lebedev with defrauding the state of $283 million in the 1994 privatization of the Apatit fertilizer company. His arrest was followed by criminal investigations into its alleged tax evasion and role in several murders of officials and businessmen.

Khodorkovsky, who has backed some political parties that compete with the main pro-Kremlin party in December's parliamentary elections, has dismissed the accusations against his company and blamed a power struggle within President Putin's administration.

In 1995, Khodorkovsky bought Yukos, the second biggest oil company in Russia, and the fourth largest in the world, thus becoming a billionaire almost overnight. In oil reserves (11.4 billion barrels) Yukos is close to British Petroleum (about 12 billion barrels), which is worth some $180 billion. Khodorkovsky bought 78 percent of Yukos shares for $170 million and even this money was believed to be budget funds operated by Menatep Bank. Menatep Bank, which belonged to Khodorkovsky, had been entrusted with holding the auction to sell Yukos. There is therefore no big suprise that Khodorkovsky proved to be the winner.

Because the privatization laws that were in place in the 1990s left much to be desired, companies that were won in rigged auctions, like Yukos, are now open to attack. Recent public opinion polls, conducted in the wake of the first moves against Yukos, show that the vast majority of Russians are still bitter about that. One poll found that 77 percent think that privatization should be reviewed. Arguably, there are people in the Kremlin who agree.

Meanwhile, Russian Prime Minister Mikhail Kasyanov has publicly spoken out against jailing those found guilty of economic crimes. Kasyanov's open siding with Yukos is a sign that the struggle between Yukos and the prosecutors is only part of a bigger battle for economic leverage and power between the old elite that obtained power and vast wealth under President Boris Yeltsin and the former KGB colleagues of President Putin. Kasyanov, who has been a key government player since the early 1990s, is seen as a member of the old Yeltsin elite, also known as the Family.

The dispute around Yukos has been seen as an assault on Khodorkovsky for supporting opponents of Putin's allies in this December's parliamentary elections.

Even Guennady Zyuganov, leader of the Russian Communist Party, has described the assault on Yukos as an action in "barbarous forms." "As soon as Yukos leadership indicated their political ambition, a strike ensued," he told the journalists in Moscow earlier this month.

Until recently, Zyuganov has repeatedly denounced the 1990s privatizations as a sham. Yet earlier this year media reports have suggested that Khodorkovsky provided financial backing for Zyuganov's Communists, but he has denied this.

There should be no surprise that there have been warnings against reshaping corporate ownership rights in Russia. Undoing privatizations of the 1990s would be "suicidal" for Russia, Economic Development and Trade Minister German Gref has stated.

Moreover, yet another Russian oligarch, Vladimir Gusinsky, 51, was detained in August at the Athens International Airport on his arrival from Tel Aviv, where he has been living in self-imposed exile since fleeing Russia in 2000.

Russia's Prosecutor General's Office has reportedly filed a request to extradite Gusinsky from Greece. The charges are linked to the alleged embezzlement of a $250 million loan extended by state-controlled Gazprom to Gusinsky's former Media-MOST empire in the 1990s. The team investigating Gusinsky is headed by Salavat Karimov -- the same person who is investigating Yukos on suspicion of stealing state property.

In April 2001, Spain turned down a request from Russia to extradite Gusinsky, who holds Russian and Israeli passports and was living there after fleeing Moscow to escape what he called politically motivated prosecution over his media's critical reports of the Kremlin. Authorities denied they were muzzling independent media, saying they instead were investigating financial wrongdoings at Media-MOST.

The Kremlin crackdown on one of the country's business moguls is not just another twist in the ongoing political struggle -- it says a lot about the very nature of the political system, argues Lilia Shevtsova, a senior associate of the Carnegie Endowment for International Peace. Putin nor his praetorians had any intention of starting nationalization -- the president's hungry wolves were just hoping for a slice of the pie, she said.

It has been understood that by launching criminal probes President Vladimir Putin's administration wants to remind the tycoons that the should stick to business and stay out of politics.

"Should the state decide to launch a second bolshevik revolution, the consequences would be severe, yet that does not mean that nothing can be done to redress the abuses associated with privatization," said Marshall Goldman, associate director of the Davis Center for Russian and Eurasian Studies, Harvard University. "The state could raise, and make a strenuous effort to collect, taxes on both production and exports, but such measures would probably not be enough to satisfy public anger and resentment," Goldman said.

The odds then are that there will always be the threat that not only Putin, but future Russian leaders will also periodically feel tempted or pressured to harass other oligarchs, he said.

KWR Viewpoints

Creating Value Key to Korea's Long-Term Success

By Keith W. Rabin

This article was originally published in the Korea Times on August 31, 2003

Despite its underlying attractiveness and reasonably strong macroeconomic fundamentals, international investors remain cautious about South Korea.

While the SK Global situation is largely resolved, and growth prospects and fiscal flexibility are high by regional standards, too many uncertainties prevail.

This is true both on the peninsula and in global markets as a whole.

South Korea suffers from a greater threat from the North, the effect of a strengthening China, a still weak Japan and an unclear economic outlook in the United States and Europe.

This is compounded by concerns over consumer debt, labor tensions, and worries over the sustainability of reform and the ability of the new government to operate in an effective manner.

Recent announcements that South Korea has entered a recession for the fourth time in history and that its fiscal surplus has dramatically declined only leads to further concern.

To reassure investors, many stress South Korea's ability to restore growth and momentum as a recovery takes shape in the U.S. While possible, this is dangerous as it presupposes there will be a U.S. recovery and creates a scenario where Seoul's success is dependent upon events beyond its control.

It also contributes to a perception of South Korea as a high beta economy, that is more a leveraged play on growth in the U.S. rather than a promising story in and of itself.

Therefore, in the present environment, where investors seek to lower their risk exposure, South Korea suffers in comparison with other investment destinations, including China, Japan, and even India, Russia and Thailand, which many believe offer better value as well as a lower dependence on U.S. markets.

To minimize this reliance on U.S. economic performance, Seoul needs both to focus on the development of value-oriented strategies and to explain these developments in an effective manner.

Business theory holds a competitive advantage is defined through lower cost or greater value, preferably both. Companies such as Samsung and LG Electronics and Hyundai Motor are learning this lesson.

They are building market share - irrespective of the underlying contraction and deflationary pricing trends troubling the global electronics, technology, auto and other industries.

For example, market research firm Display Research noted Samsung Electronics took a 30.2 percent market share in North America's LCD TV market and 34.3 percent of Europe's during the second quarter. It surpassed Japan's Sharp, estimated to have held 25.9 percent of the U.S. market and 17.5 percent of Europe's.

Samsung officials also express confidence the firm will soon beat Sharp in the Japanese LCD TV market.

Similarly, Hyundai Motor is also achieving success, recently announcing that rising exports had countered an 11 percent contraction in domestic sales, and its first-half net profit jumped

10.6 percent year-on-year to an all-time high of 988.5 billion won.

Korean firms are also gaining market share in cellular handsets at the expense of Nokia, Motorola and other long-established competitors.

In addition to a keen commitment to product development, it is no coincidence these firms are also among South Korea's savviest marketers. They devote large amounts of funding to building an extremely important intangible - brand image.

Their success is reflected in Interbrand and BusinessWeek magazinesrecent designation that Samsung Electronics possesses the fastest growing brand value in the world - rising about 30 percent over each of the past two years.

The long-term success of Korean firms will largely be determined by their ability to move beyond the tendency to base their competitiveness almost exclusively on cost-efficiency.

Enhanced brand value not only increases demand and economies of scale, but also leads to higher margins and profitability. Combined with additional attention to financial communications, investors are also more content to maintain a long-term commitment.

Once again, one can observe this phenomenon in the performance of Samsung Electronics. It reported a 41 percent decline in its second quarter earnings, yet continues to trade at an all-time high.

South Korea as a whole must also incorporate these lessons if it is to successfully reposition itself as the "Dynamic Hub of Asia" and to realize the vision of becoming an international service and logistics center.

The nation must do a much better job of defining and telling the "Korea Story" and the capabilities of individual firms and its population. This requires ongoing planning and outreach.

It will not be achieved by the occasional ad hoc announcement, advertisement, road show or short-term domestically-focused efforts that have been organized in the past when some emerging problem or issue was deemed worthy of an immediate response.

While many of these efforts have been well organized and well received by participants, they do little to create sustainable value.

Rather insufficient follow-up and thought has been allocated to the ongoing communications and interaction that is part of every successful public and investor relations initiative.

The fact is while the nation possesses a wealth of characteristics that makes it, and its individual firms, an attractive investment story, U.S. investors and opinion leaders - beyond the small, dedicated group of Korea watchers and members of the Korean-American community -remain largely unaware of its potential.

Therefore, while South Korea has done far more than most other Asian nations in implementing reforms and the measures to promote a more dynamic and competitive business environment, U.S. investors and businesses continue to view it as a difficult and unapproachable market that is extremely dependent on growth in the U.S.

Similarly, Korean firms possess real technological and other advantages in many industries, yet with few exceptions these achievements go unrecognized and the firms do not benefit from the additional market share, pricing power and valuation premium that should result.

Brand value and investment sentiment are not made, nor are major transactions contemplated, simply on the basis of one-day conferences or seminars. They require ongoing communications and interaction.

Just as a U.S. company would be unlikely to achieve success in South Korea through occasional visits to Seoul, it is not possible to communicate complex messages and to manage relationships in the U.S. simply on the basis of random, disconnected activities.

In spite of its underlying attractiveness, it is by no means clear why foreign investors, businesses and consumers should buy into the Korea story as a whole or, with a few notable exceptions, as individual firms.

It is therefore the challenge of every Korean company and government organization to invest in the activities needed to overcome this important obstacle.

Otherwise, while there will inevitably be cyclical upturns, South Korea's economic competitiveness will be eroded over the long-term in favor of lower-cost and more value-oriented competitors.

Emerging Market Briefs

By Scott B. MacDonald

Chile – Unemployment Falls: The Chilean economy has made a substantial recovery in 2003, though high unemployment has remained a lagging point of concern. It now appears that the employment picture is beginning to brighten. The government announced in late August that the jobless rate fell to 9.1% in the three months to July, from 9.4% at the end of the similar period in 2002. Pushed along by additions in manufacturing, building and retailing, employment grew by 3.3.%. Real GDP in 2002 was 2.1%, reflecting tough global markets for most goods exported by Chile. For 2003, real GDP is expected to be 3.5%, well ahead of most of Latin America.

India Infoline

India – S&P Upgrades the Outlook on Banks: Like many developing countries, India's track record in banking has not been stellar. The practice of stuffing state-owned banks with bad loans to money-losing state-owned companies was well rooted in the system. In addition, competition was long kept under control. Although there are still issues of inefficiency, bad loans and the need to upgrade technology in many banks, there have been positive changes in recent years. Standard & Poor's in early September 2003 changed the outlook of the banking system from negative to stable. In doing so, the rating agency commented: "Key watershed structural reforms in India so far have improved the health of the banking sector's asset quality, profitability, and capital adequacy."

Malaysia – Growth on the Upside: Malaysia's real GDP for Q2 2003 expanded at a faster rate than expected, hitting stride at 4.4%. The median forecast by economists had expected 3.9%. Economic growth was fuelled by rising demand for commodities and higher prices, which boosted exports. This more than compensated for a decline in electronics exports and the impact of SARS. A government stimulus package, launched in May, also helped stimulate growth.

AsiaLinks

Pakistan – Earning Praise: The management of the Pakistani economy has never been easy. Beyond facing ongoing problems that almost always threaten political stability, the economy has struggled to find a competitive nitch in the global economy and attract foreign investment. Consequently, when there is good news it should be acknowledged. In late August, the Asian Development Bank (ADB) commended Pakistan for its economic recovery. The ADB's annual economic update for the South Asian country forecast economic growth in the year to next June (Pakistan's fiscal year) would rise to 5.3%. In the fiscal year that just ended in June (2002-2003), real GDP was a robust 5.1%, up from a more modest 3.1% in 2001-2002. Helping stimulate economic expansion over the last few months has been the early monsoon rains, which significantly ended a brutal three-year drought. The expectation is that with a more regular pattern of weather, the agricultural sector will have a much stronger performance. This is important as agriculture accounts for a quarter of GDP and more than two-thirds of the nation's 145 million people rely directly or indirectly on farm incomes.

The ADB also noted that a sharp fall in interest rates has reduced borrowing costs for the corporate sector and the better business environment has helped fuel a recovery in the Karachi Stock Exchange, up more than 60% in 2003. Remittances from overseas Pakistanis, worth around $4 billion last year, are helping to fuel growth. Although Pakistan faces tough political issues, there has been a greater degree political stability under the current Musharraf government over the last couple of years. This does not ignore the challenges of radical Islamic groups that have conducted their own war against the West in a series of bombings. However, the political issue is a point of concern to the ADB going forward. The ADB warned that if relations between the government and opposition remain tense over the position of General Pervez Musharraf, the country's leader, some of the economic gains could be jeopardized.

Pakistan remains one of the more geo-politically significant countries in Eurasia, with its borders touching Afghanistan, Iran and India and being close to the Persian Gulf. Progressive economic development is critical if this pivotal state is to remain anchored as an ally of the West. Clearly grinding poverty and inequality are the breeding conditions for radicalism, be it Islamic or another ideological passion. Pakistan has made economic gains over the last couple of years. It is important for that process to continue. If not, the door to more political instability opens, something that would not be benefit the majority of the Pakistani people or the neighborhood.

Romania – IMF Targets at Hand: It has been a long haul for the Romanian economy since the fall of its communist dictator Nicholae Ceausescu in 1989. After a number of false starts, the Balkan country now appears set to successfully complete its two-year $413 million IMF program. Romania has done much to meet IMF targets for reform of public sector finances and restructuring publicly-owned companies. The government plans to end the IMF program in September and to start a new one, though its need for IMF financing has declined..

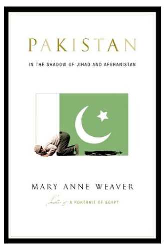
Taiwan – Q2 Real GDP Disappoints, but...: As the number for the second quarter of 2003's real GDP was announced, there was a sense of disappointment in trading rooms in Taipei. Real GDP contracted by 0.1% year-on-year, largely due to the negative impact of SARS. This was evident in the pronounced downturn in domestic demand (-2.6%) and fixed asset investment (-10.2% year-on-year). Simply stated, SARS drove consumers out of the stores and helped add to the uncertainty facing many companies, forcing them to curtail business travel and postpone corporate investment. Despite the disappointing second quarter results, it is likely that the Taiwanese economy has hit the bottom of the cycle. Prospects for the second half of 2003 look better due to pent-up consumer demand and corporate investment. Reflecting this, the Taiwanese government raised its 2003 forecast for real GDP from 2.9% to 3.1%, while 2004 growth is expected to accelerate to 3.8%.

Thailand – Slower Industrial Production...: After several months of very robust industrial production, the pace slowed down in July. Usually slowing industrial production would be a sign of something to worry about. In the case of Thailand it is probably a good thing – industrial production in July was 10.3%, down from a blistering 11.2% in June. This was the tenth straight month of industrial production in excess of 10% in 2003, reflecting the fast pace of growth in Thailand. Slowing down and taking stock is perhaps not a bad thing.

Book Reviews

Mary Anne Weaver, Pakistan – In the Shadow of Jihad and Afghanistan (New York: Farrar, Straus and Giroux, 2002). 284 pages. $24.

Reviewed by Scott B. MacDonald



Click here to purchase "Pakistan - In the Shadow of Jihad and Afghanistan" directly from Amazon.com

Without any doubt, Pakistan, sitting in strategically located South Asia, has become a pivotal nation. What happens in Pakistan will have an impact on India, Afghanistan and the Middle East. The ripples will extend outward into Europe and, of course, into Washington, D.C. Yet, Pakistan is a relatively poor nation, divided by ethnic, regional and religious differences, and has a long history of political upheaval. What elevates the South Asian country is its location next to Afghanistan, a former base to al-Qaeda and India, its long-term rival. Add in the importance of location is the fact that Pakistan is the only Muslim country to be a declared nuclear power. Consequently, there are pressing reasons to have a better understanding of this country. Mary Anne Weaver, a foreign correspondent for The New Yorker, provides an excellent tour de force in her Pakistan – In the Shadow of Jihad and Afghanistan.

Weaver's book is well worth reading. The style is easy, though at times, meandering, as one door after another is opened to the reader through various interviews with Pakistanis of all levels – from prime ministers and generals to mullahs and workers. Weaver has a strong love for her subject matter. One ultimately walks away from Pakistan with an understanding of how this country was transformed by the decade-long war fought against the Soviet Union in Afghanistan. In particular, the creation of militant Islamic groups fighting a jihad against the godless Soviet invaders had a massive impact on radicalizing Islam in Pakistan.

As Islamic groups became involved in Afghanistan, Pakistan was the ideal base – predominantly Muslim, extensive and porous borders, and a culture supportive of weapons. Indeed, Pakistan became an attractive recruiting area for radical Islam. Poverty is widespread, central authority is often weak or inept, and corruption is widespread. While Weaver is critical of the Pakistanis for allowing this situation to evolve, she is equally critical of the United States, with its poorly thought-out policies in Afghanistan and Pakistan. Weaver has done an admirable job in presenting Pakistan, a country that sports nuclear weapons and at the same time runs the risk of becoming a failed state. Although hopeful about the future, she is savvy enough to understand that Pakistan’s challenges remain substantial.

Recent Media Highlights

- KWR International to Support CSFB DNA’s New Sovereign Data+ Information Service
- Asia Society Presents Investing In China's Financial Markets II: New Players in a Changing Investment Climate on Sept 22, 2003
- AICC to Host Breakfast Meeting with Indonesian President Megawati in NYC on September 23, 2003
- JETRO: Can Japan Maintain its Movement Toward an Economic Recovery?
- Special Report: Japan – The Political Game Becomes More Complicated
- Asia Times - Japan: The light at the end of the tunnel?
- JETRO: Businesses & Investors Perceive a Change in Japan's Economic Prospects
- Koizumi’s Art of War – Elections in November
- JETRO: Can Japan Maintain its Movement Toward an Economic Recovery?

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KWR International, Inc. (KWR) is a consulting firm specializing in the delivery of research, communications and advisory services with a particular emphasis on public/investor relations, business and technology development, public affairs, cross border transactions and market entry programs. This includes engagements for a wide range of national and local government agencies, trade and industry associations, startups, venture/technology-oriented companies and multinational corporations; as well as financial institutions, investment managers, financial intermediaries and legal, accounting and other professional service firms.

KWR maintains a flexible structure utilizing core staff and a wide network of consultants to design and implement integrated solutions that deliver real and sustainable value throughout all stages of a program/project cycle. We draw upon analytical skills and established professional relationships to manage and evaluate programs all over the world. These range from small, targeted projects within a single geographical area to large, long-term initiatives that require ongoing global support.

In addition to serving as a primary manager, KWR also provides specialized support to principal clients and professional service firms who can benefit from our strategic insight and expertise on a flexible basis.

Drawing upon decades of experience, we offer our clients capabilities in areas including:

Research

- Perception Monitoring and Analysis
- Economic, Financial and Political Analysis
- Marketing and Industry Analysis
- Media Monitoring and Analysis

Communications

- Media and Public Relations
- Investment and Trade Promotion
- Investor Relations and Advisory Services
- Corporate and Marketing Communications
- Road Shows and Special Events
- Materials Development and Dissemination
- Public Affairs/Trade and Regulatory Issues

Consulting

- Program Design and Development
- Project Management and Implementation
- Program Evaluation
- Training and Technical Assistance
- Sovereign and Corporate Ratings Service

Business Development

- Business Planning, Development and Support
- Market Entry, Planning and Support
- Licensing and Alliance Development
- Investor Identification and Transactional Support
- Internet, Technology and New Media

For further information or inquiries contact KWR International, Inc.

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