THE PERIODICAL OBSERVER

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Unnecessary Surgery in Asia?

A Survey of Recent Articles

One after another, the economically ailing countries of Asia have gone to the International Monetary Fund (IMF), desperate for a massive infusion of money, and have reluctantly agreed to take the bitter medicine prescribed: fundamental economic reform, along Western, market-oriented lines. All but forgotten is the Asian "miracle" that had dazzled the world for a quarter-century. Now, even the foremost champion of "Asian values," Singapore's Lee Kuan Yew, is a bit on the defensive. "There are certain weaknesses in Confucianism," he admits in *Time* (Mar. 16, 1998).

But "Asian values" are no more responsible for the region's current distress than they were for its stunning success, argues Francis Fukuyama, a professor of public policy at George Mason University, writing in *Commentary* (Feb. 1998). Before, credit was given to "a combination of the work ethic, respect for community and authority, and a tradition of paternalistic government," he notes, though, in fact, Confucian values had to be combined with values imported from the West. "Economic growth was contingent on the *rejection* by Asians of important elements of their own cultural heritage, including the Mandarin disdain for commerce and physical labor." In the same way, Fukuyama says, today blame is assigned to Asian values because they supposedly "led to nepotistic credit allocation, an overly meddlesome state, and a disastrous lack of transparency in financial transactions." But in fact, he observes, "the causes of crisis vary from country to country."

The currency crisis began in May 1997 when speculators, sensing weakness in the Thai economy, began selling off the baht. They then moved on to the Indonesian rupiah, the Malaysian ringgit, the Philippine peso, and other currencies. Throughout Southeast Asia, firms that had taken out loans denominated in American dollars were suddenly unable to earn enough in local currency to pay off their debts. This threatened banking institutions, which also had borrowed billions of dollars. Thailand obtained a $17 billion bailout loan from the IMF, and Indonesia borrowed $40 billion. The crisis cost President Suharto his presidency. Meanwhile, in South Korea, business and financial institutions found themselves with short-term foreign debts, totaling some $110 billion by October—more than three times the country's foreign exchange assets. Nervous investors began selling Korean won and the IMF stepped in with a $57 billion loan, which, like the others, had major conditions attached.

This was a big mistake, contends Harvard University economist Martin Feldstein, former chairman of President Ronald Reagan's Council of Economic Advisers. The IMF, which is strongly influenced by the United States, is wrong to insist that South Korea and other Asian countries drastically overhaul their economies, he maintains in *Foreign Affairs* (Mar.-Apr. 1998). In Southeast Asia, where the currency collapses stemmed from overvalued and fixed exchange rates, the "proper remedy" would be "a variant of the traditional IMF medicine tailored specifically to each country—some combination of reduced government spending, higher taxes, and tighter credit." But instead of relying on private banks and mainly just monitoring performance, the IMF "took the lead" itself in providing credit to Thailand and Indonesia, and demanded wholesale change. In Indonesia, the fund enumerated "a long list of reforms, specifying in minute detail such things as the price of gasoline and the manner of selling plywood," and told the regime to end the country's widespread corruption and curtail the special business privileges used to enrich Suharto's family and political allies. Desirable as these reforms might be, Feldstein observes, they were not necessary to defuse the economic crisis.

The situation in South Korea, which has the 11th-largest economy in the world, is more important and different, Feldstein says. The Korean economy was performing well. Its foreign-debt problem "was clearly a case of temporary illiquidity rather than fundamental insolvency," he says. All that South Korea needed was "coordinated action by creditor banks to restructure its short-term debts, lengthening their maturity and providing additional temporary credits to help meet the interest obligations." Instead, the IMF insisted that South Korea go on a regimen of higher taxes, reduced spending, and high interest rates. Seoul was also forced to open its economy wider to foreign investors, and to make other major changes. Again, the IMF overstepped its authority, Feldstein says. Many of the reforms "would probably improve the long-term performance of the Korean economy," he concedes, but South Korea could return to the international capital markets without them. Indeed, by emphasizing the Korean economy's structural and institutional problems, he says, the IMF made the situation worse.

There is a terrible irony in forcing South Korea and other countries to open their capital markets further, writes Columbia University economist Jagdish Bhagwati in *Foreign Affairs* (May-June 1998), because "short-term, capital inflow played a principal role in their troubles in the first place." A leading free-trade advocate, he nevertheless dissents from "the mainstream view [that] a world of full capital mobility continues to be inevitable and immensely desirable." Though Wall Street naturally takes that view, free capital mobility, he maintains, is not the same as "free trade in widgets and life insurance policies," and is inherently crisis-prone. "The Asian crisis," he says, "cannot be separated from the excessive borrowings of foreign short-term capital as Asian economies loosened up their capital account controls and enabled their banks and firms to borrow abroad."

Economic thinkers from very different schools of thought have somehow managed to find in the Asian agony evidence to confirm their particular faith, economist Paul Krugman, of the Massachusetts Institute of Technology, wryly observes in the *New York Times Magazine* (May 3, 1998). He himself is one of the few economists credited—by persons other than themselves, that is—with having anticipated the Asian crisis. More than three years ago, in an article in *Foreign Affairs* (Nov.-Dec. 1994), he argued that efficiency gains, essential to long-term growth, had played only a small part in the success of the East Asian "tigers." Their spectacular growth would slow, he suggested. Still, he notes now, if he predicted anything, "it was a gradual slowdown—not the sudden catastrophe that has overtaken the region."

Even before that "catastrophe," some of the region's leaders were thinking of Westernizing their economies, maintains Sebastian Mallaby, the *Economist*'s Washington bureau chief, writing in the *National Interest* (Summer 1998). Though South Korea's economy had been "performing splendidly," at least until the market for semiconductors collapsed in 1996, most Korean economists talked even then "about the need to deregulate, to break up the conglomerates known as *chaebol*, to create a more Western style of corporate governance by fostering sophisticated banks and equity investors."

Though the IMF reforms "will not be swallowed whole" anywhere, Mallaby believes, their ultimate effect will be beneficial, making Asian economies "less state-directed, more transparent, and more open to foreigners; in short, more Western." And he marvels at the reluctance of Feldstein, Fukuyama, and other American conservatives "to celebrate the latest evidence from Asia for the superiority of their Western system."

In the long run, Fukuyama responds, most of the reforms probably are desirable. "But there is something to be said for prudence," he believes. Global competition would bring about many of the changes anyway—without stirring up nationalistic resentment. And countries must be allowed to elaborate the economic implications of democracy and markets in accordance with their own cultures. It would be very strange, he says, to conclude "that the central Western idea . . . must be equated" with whatever particular policies are in favor at the moment with the technocrats at the IMF.