MISUNDERSTANDING THE EAST ASIAN CRISIS

By Mahbub ul Haq

East Asian industrializing tigers were like well-built, reliable, speedy cars. They have hit a bump in the road and developed a flat tire. Instead of fixing the flat tire, the international financial institutions are trying to reinvent the car. That is a mistake.

There is nothing wrong today about the economic fundamentals in East Asia. The human capital is educated, well-trained and technologically skilled. The rate of domestic saving normally exceeds one third of national incomes—still about the highest in the world. Budget deficits are generally below 2% of GNP—among the lowest in the world. Economies are open, tariffs are low, economic institutions fairly well-established, and export competitiveness respected in global markets. Most developing countries will take decades to reach where East Asia is already positioned in the world economy.

The current crisis is a short-term liquidity crisis, not a long-term development crisis. East Asian banks made some bad loans—not unusual in a period of an exciting pace of fast growth. Short-term debts, particularly the inflow of hot money, was not carefully monitored. The U.S. and Japanese economies have suffered worst financial troubles in the past than East Asia (lest we forget the Saving and Load Associations fiasco in the United States and the stock exchange bubble in Japan). These financial problems were fixed overtime. There was no need to reinvent the car. It was enough to repair the flat tire.

That is why the current analysis of the East Asian crisis is so baffling. To begin with, it is the height of intellectual dishonesty to call an experience "The East Asia Miracle" for list two decades and then to turn an intellectual somersault within a year and to start labelling it as "Crony Capitalism". Nothing much has changed in East Asian economic fundamentals. A few air pockets cannot call into question the sturdiness of the airplane.

What is also amazing is that the IMF is dealing with East Asia with the same standard Cookie-cutter approach that it applies to all its clients in the developing world. For instance:

reduce budget deficits, but one may ask why when they are already so low and when there is a need to grow these economies, not to ~~deplete~~ deflate them? Also, financial irresponsibility has arisen not on the part of profligate governments, but by private financial markets. Why rush in with the same standard recipe of cutting down government spending, downsizing public institutions, sacrificing social safety nets, and often slashing education and health budgets—thereby unbalancing human lives while over-balancing financial budgets?

Let us also face another bitter truth. The East Asian crisis says even more about the ? importance of global economic governance than about the inefficiency of national actions. The world simply does not have a credible lender of last resort which can b~~o~~ail out countries from short-term liquidity squeezes so that they do not inflict long-term economic damage. Central banks perform this role at the national level. But we have no World Central Bank. The IMF by now is a pale shadow of what it was supposed to be. At its creation, Lord Keynes wanted IMF to have resources equal to 50% of world imports while the powerful U.S. delegate, Harry White, held out for a more conservative target of 15%. In actual fact, IMF's resources now equal around 1% of world's imports. Private speculators can normally mobilize over ten times as many financial flows in a day as the IMF totally commands. It is a fair question, therefore, whether the world monetary policy is run by the IMF or by private speculators.

What is more, financial hurricanes now speed across borders at the rate of over $1,200 billion every 24 hours at the touch of computer keys. Their speed is breathtaking, their direction unpredictable, and their impact ~~can~~ sometimes ~~be~~ very destabilizing. These financial flows are inspired both by rational expectations and by irrational panic. That is why James Tobin, Nobel Laureate in Economics, suggested about two decades ago that a small tax be imposed ("Tobin Tax)" to throw some sand in the wheels of these panicky financial flows, to make the cost of short-term currency movements quite high without affecting long-term investments, to ensure a greater national control over global currency movements. In the aftermath of the East-Asian crisis, the proposal merits ~~a~~ even more serious consideration. The worst of the financial crisis ~~world~~ would have been avoided had Tobin tax existed.

There are at least three lessons we must reaffirm from the recent East Asian experience. Globalization should still be treated as an opportunity, not a threat, though it needs to be skillfully managed. I was simply amazed that some South Asian policy makers (particularly in India and Pakistan) started congratulating themselves that they had not adopted the economic liberalization policies of East Asia and hence escaped recent financial turbulence. This is such a mistaken view. East Asia started behind South Asia in 1960 but is now 27 times ahead in its average per capita income. South Asia is a bicycle economy (compared to the car economy of East Asia) and the absence of a puncture should be no cause for celebration. The challenge is to graduate from a bicycle to a car economy, which cannot be done without universal education, rising investment and fast economic liberalization - the path that East Asia has already covered.

Second, whatever adjustment measures are taken must protect human development levels and social safety nets. World Bank's own studies demonstrate that as much as 80% of East Asia's real economic wealth consists of human and social capital. If that is impaired in the process of clea~~r~~ning up the financial system, the real costs will be permanent and wholly unnecessary.

Third, East Asia does ~~not~~ need to make a more structural change. China has emerged by now as the low-cost supplie~~s~~r of low and medium tech consumer goods to the growing middle class of the world. East Asia must reposition itself to higher technologies, better skills and more complex manufacturing processes - much as Japan was obliged to do by the emergence of East Asian industrializing tigers three decades ago.

It is time, therefore, for a calm analysis of what really went wrong in East Asia. And where exactly did we go wrong in our own understanding and analysis. Some intellectual humility will help.

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May 14, 1998

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