The Asian Crisis and the Future of the International Architecture

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When the crisis first struck Asia last summer, many viewed it as a confirmation of their favorite theories. Some drew the lesson that the crisis was the inevitable result of government interference in the economy, and that by destroying once and for all the so-called "East Asian model," the crisis has proved that free market capitalism is the only viable economic system. The only way to extricate themselves from the crisis and build the foundation of strong economic growth in the future was to follow the standard approach of avoiding inflation and budget deficits while opening markets to the free movement of goods and capital.

The spreading crisis has had a much more jarring affect on our thinking. One year ago virtually no one anticipated that Indonesian GDP would contract by more than 15 percent in 1998 and that the Korean and Thai economies would contract by 5 to 10 percent. Furthermore, the crisis is now seriously threatening the future growth of Latin America, a region that followed our advice and carried out some of the most successful macroeconomic stabilization programs the world has ever seen. Finally, the problems in Russia have led some to wonder whether or not the strategy of attempting to create a market economy by focusing on privation above competition and prior to, or without, the development of the institutional infrastructure which is essential for the proper functioning of markets, was the best approach to the transition. As a result of one of the worst years in the post-World War II global economy, most observers are no longer repeating the same old mantras about the best approach to economic development, crisis prevention and crisis response.

In some areas a new consensus is beginning to form, a consensus about broader objectives as well as the use of more instruments. Financial institutions matter as much as fiscal deficits. There are widespread calls for greater inhibitions on the flow of short-term capital, and especially hot money. These emanate from people as diverse as Paul Krugman, Jeffrey Sachs, George Soros, and Paul Volcker. In other areas there are widely shared goals, like the desirability of effective international workout procedures in which the creditors share the burden, although little agreement of how to accomplish this objective, or even if it is possible.

Was East Asia to Blame?

Although most observers now see the international economic crises as a new problem requiring new solutions, some continue to castigate East Asia for what they describe as its extensive government controls, corruption, and macroeconomic mismanagement. These explanations – and their implication that the simple recipes of the 1980s are sufficient to face today's problems – is completely wrong.

First, they are inconsistent with the past success of East Asia. For the last three decades, GDP per capita has consistently grown at 5 percent or more annually in Indonesia, Korea, Malaysia, and Thailand. These gains, it is important to remember, have brought with them extended lifespans, increased educational opportunity, and a dramatic reduction in poverty. In 1995 2 out of 10 East Asians were living on less than $1 per day; in 1975 the number was 6 out of 10. Whatever else one says about so-called "crony capitalism," no one can draw a parallel between leaders like President Suharto, who oversaw a decline in the poverty rate from 64 percent in 1975 to 11 percent in 1995, and Mobutu Sese Seko, who looted Zaire, leaving its per capita income at the end of his reign at half of the level it was when he began.

Second, some of the claims about macroeconomic policy are nothing more than prejudice, the belief that "ill-mannered" poorer countries necessarily have worse policies than "well-behaved" richer ones. This view does not survive even a casual acquaintance with the data. Indonesia, Korea, Malaysia, and Thailand all save over one-third of their GDP, something from which the United States, with a national savings rate of 17 percent of GDP, could well learn. The United States is justly proud that it managed last year to bring up its (federal) fiscal surplus to roughly $60 billion, less than 1 percent of GDP. But compare that to Indonesia, Malaysia, and Thailand, which all had (general government) surpluses above 2 percent of GDP in 1995. Inflation, another warning sign that countries are trying to push beyond their capacity, was low and drifting still lower in the months before the crisis.

Third, the claims about transparency are just a form of blame shifting. We are accustomed to leaders, from Harold Wilson to Prime Minister Mahatir, blaming international speculators for all of their problems. In the last few years we have seen the emergence of a new form of blame shifting, the claim by investors that they are not to blame for making bad loans because the countries lied to them. If only they had been told the truth, they would not have gotten into the problems they did. Most of the supposed problems in East Asia, including the "lack of transparency," were not news. They were widely known prior to the crisis. Indeed, there is a serious question about whether or not all of the available information was even being used. There is no systematic evidence linking lack of transparency to economic crises. The last major banking-cum-currency crises were in Scandinavia – models of transparency. Even if there were, there is no evidence that corruption or transparency were significant problems in *all* of the East Asian countries affected by the crisis. According to a number of ratings of transparency and corruption, Indonesia was one of the worst middle-income countries. But Thailand and the Philippines were about average (and substantially above average compared to developing countries as a whole). Korea and Malaysia were consistently rated among the least corrupt and most transparent of any developing country.
