

Has Asia Recovered?

It's certainly on the mend. But a brand new set of problems and a dangerous complacency pose more economic peril

By PAUL KRUGMAN

TWO YEARS AGO, A NASTY VIRUS EMERGED in Bangkok. It spread rapidly through Asia and beyond, often claiming seemingly robust economies as victims. But no new cases have been reported in the past few months, and most of the original victims seem to be past the worst. Like anyone who has been very sick and starts to feel better, they feel relieved, even euphoric.

But are we celebrating too soon? Pundits who want to sound judicious are fond of warning against generalizing. Each country is different, they say, and no one story fits all of Asia.

This is, of course, silly. All of these economies imploded within a few months of one another, and the logic of catastrophe—a combined banking and currency crisis, as panicked investors tried both to convert long-term assets into cash and to convert baht or rupiah into dollars—was pretty much the same everywhere.

Governments had no good options. If they let their currencies plunge, inflation would soar, and companies that had borrowed in dollars would go bankrupt. If they tried to support their currencies by pushing up interest rates, the same firms would go bust from the combination of debt burden and recession. In practice, countries split the difference—and still paid a heavy price.

In hindsight it is easy to find reasons why the countries deserved their punishment. Like most clichés, the catchphrase crony capitalism has prospered because it gets at something real: exces-

sively cozy relationships between government and business really did lead to a lot of bad investments.

Suppose the U.S., which is pulling in overseas money at the rate of about \$300 billion annually, were to see that inflow suddenly become a trillion-dollar outflow—which, on a relative basis, is what happened to Asia's crisis-hit countries. How solid would our financial system look?

Given that there were no good policy options, was the policy response mainly on the right track? There was frantic blame-shifting when everything in Asia seemed to be going wrong; now there is a race to claim credit when some things have started to go right.

The truth is that an observer without an ax to grind would probably conclude that none of the

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policies adopted either on or in defiance of advice given by the International Monetary Fund—which “suggested” that client countries tighten their belts and raise interest rates—made much difference either way. Whatever countries tried, just about all the capital that could

flee, did. And when there was no more money to run, the natural recuperative powers of the economies finally began to prevail. At best, the money doctors who purported to offer cures provided a helpful bedside manner; at worst, they were like medieval physicians who prescribed bleeding as a remedy for all ills.

Will the patients stage a full recovery? If by recovery you mean not just a return to growth, but a recovery that resembles what people used to regard as the Asian norm, the answer is almost surely no.

For one thing, the region's entrepreneurs are not what they used to be. By and large, Asian institutions that looked on paper like modern corporations were really overgrown family firms, whose growth depended on the personal wealth of their owners and their ability to leverage that wealth through bank loans. Well, it will be a long time before Asian banks are able or willing to provide the kind of funding they used to—and, in any case, the entrepreneurs, their fortunes slashed by the crisis, cannot provide the necessary collateral.

Even before the crisis there were indications that Asia was facing diminishing returns—that rapid growth was being sustained only by ever more massive infusions of foreign capital. Foreign investors may have stopped fleeing, but they are not going to pour in funds the way they did a few years ago.

Could the recovery be aborted, with an actual relapse? Not just yet. It would take several years of irresponsible borrowing to create the conditions for a repeat of 1997. Such things can be arranged, but the prospect does not seem imminent.

Inevitably, worries about Japan color the prospects of the whole region. And Japan was in trouble long before anyone even imagined that the words Asia and crisis could be used in the same sentence.

If developing Asia suffered from an acute, potentially lethal but short-lived fever, Japan suffers

from a slow, wasting disease, the result not of the nation's vices but of its virtues. While there are many things wrong with Japan, the immediate problem is excessive thrift: Japanese households simply save more than the country's businesses can be persuaded to invest.

Has Asia's crisis laid the foundation for sounder economic growth in the future? The answer is a definite maybe. The crisis has reinforced democratic tendencies and made it much harder for paternalistic strongmen to claim they know best. Still, it is hard to escape the feeling that a dangerous complacency is setting in. When Mexico started to recover from its 1995 "tequila" crisis, policymakers and investors alike acted as if it had been a one-time event, never to be repeated. But it turned out to be a dress rehearsal for the Asian crisis a year later. Because the world didn't end this time around, everyone is starting to believe that the situation is under control—even though proposals for international reform have been watered down to homeopathic levels. Could investors and countries really be foolish enough to make the same mistakes yet again? Of course they could. ■

Questions

1. How would you answer the question posed in the article's headline?
2. What problems may lie ahead for the economies of Asian nations?

JAPAN	SOUTH KOREA	HONG KONG	SINGAPORE	THAILAND	MALAYSIA
<p>■ GOOD NEWS: Bank reform under way; corporate mergers with foreign firms</p> <p>■ BAD NEWS: Unemployment rising; consumer spending very weak</p>	<p>■ GOOD NEWS: Proceeding on bank reform; industrial output rebounding nicely</p> <p>■ BAD NEWS: Many more debt-ridden conglomerates need to be restructured</p>	<p>■ GOOD NEWS: Property market picking up; banks beginning to lend again</p> <p>■ BAD NEWS: Currency peg to dollar means high real interest rates</p>	<p>■ GOOD NEWS: Western money is pouring in; business integrity remains high</p> <p>■ BAD NEWS: Vulnerable to economic swings of neighbors</p>	<p>■ GOOD NEWS: Bankruptcy laws passed; some balance sheets cleaned up</p> <p>■ BAD NEWS: Bad loans still on books; trade surplus shrinking</p>	<p>■ GOOD NEWS: Exports up; capital controls have contained impact of crises</p> <p>■ BAD NEWS: Foreign investors are scarce; few reforms advanced</p>
<p>Nikkei index</p>	<p>Korea composite index</p>	<p>Hang Seng index</p>	<p>Straits Times index</p>	<p>Thai Stock Exchange</p>	<p>Kuala Lumpur comp index</p>