

The Economy in Perspective

Rebooting Asia ... History repeats itself in the Far East, having repeated itself not long ago in Latin America. Nations that seemed on a straight path of economic development have suddenly veered off, hurting their trading partners and inflicting tragedy on their citizens. What causes these calamities, and why do they seem to arise so suddenly? What can be done to cure or, better yet, prevent them? A general theory would be presumptuous, since each historical episode has its own context and nuances, but we can extract some common elements and lessons.

Economists have long attributed economic progress to capital accumulation and education. Standard growth theory says that a nation can accelerate its pace by augmenting its capital stock and attaining a more educated labor force. While it seems plausible (even likely) that worker education and capital differentials help explain inequalities of wealth among nations, economists have yet to fashion a theory in which these two factors alone can explain all observed disparities.

More recently, development economists have begun to appreciate that economies vary importantly in their openness to innovation. Educated labor and ample capital help up to a point, but the key is a nation's ability to deploy these resources to maximum advantage. Nearly 150 years ago, Ralph Waldo Emerson wrote that the wisdom of nations was shown in what they did with their surplus capital. The ones that grow rapidly for long periods may well be those that not only save and educate, but also excel at adopting new technologies and business practices.

How can nations create these conditions? With the crumbling of the Berlin Wall, history returned a verdict against totalitarian regimes whose comprehensive national planning systems effectively ration consumption and control investment. There was another model, based on a partnership between the state and concentrated industrial conglomerates, that seemed capable of producing significant gains in southeast Asia's living standards. In fact, some countries in the region made such dramatic wealth gains that their economic philosophies won American converts who saw in them a superior framework for broad-based competition.

Nothing succeeds like success, and there is no disputing what many rapidly industrializing na-

tions have achieved since the 1960s. According to one study, between 1960 and 1985, several southeast Asian countries roughly doubled their wealth position relative to the United States. These economies generated large increases in their capital stocks with high domestic saving rates and devoted sizable resources to education and training; small wonder that foreign capital followed. But hindsight reveals that the economic development models espoused by many of these countries contained a fatal flaw.

Their governments retained a considerable role in directing resource allocation through trade policies, tax and subsidy codes, and public expenditures. In particular, government practices favored a business structure featuring groups of interlocking firms that spanned many industries. Because these groups usually included banks, credit was often available on loose terms. Careless financing mattered little in the initial phase of economic development, because there were so many promising investment projects to fund. Later on, however, when world competition intensified and investment projects required closer scrutiny, inability or unwillingness to be more disciplined exacted a heavy toll.

As the afflicted nations scramble to restructure their economies and restart their growth processes, they will be tempted to assert that they need only resolve the bad debts and bankruptcies, and then life can resume. This is unlikely to be. As a Dickens character once remarked, "Change begets change. Nothing propagates as fast. ... The mine which Time has slowly dug beneath familiar objects is sprung in an instant; and what was rock before, becomes but sand and dust."

Daunting as the task of reanimating Asian economies may be, it does not begin quite from scratch. Their market orientation still exists, and their competitive instincts remain intact. Just consider how far these nations have come in the span of a single generation. While we cannot deny the difficulties lying ahead, at least there is a solid foundation to build on. The significance of the Asian crisis must not be ignored or downplayed. But in the decade-long units we should use to judge economic development, these nations have ample time to correct their problems and even to prosper.