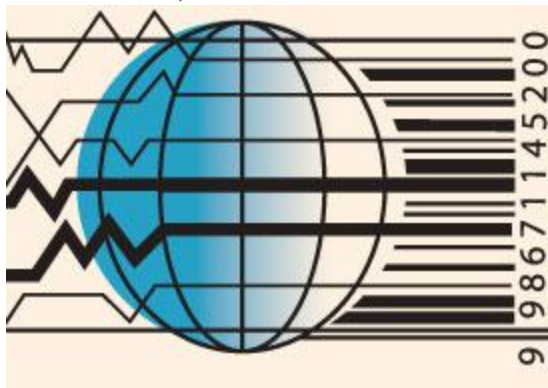


# Capitalism in crisis: Perilous path to prosperity

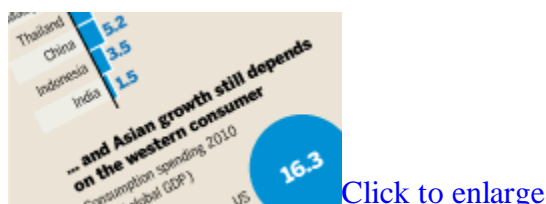
By David Pilling

As west sinks, eastern economies soar



A few years ago, it would have been difficult, if not impossible, to imagine European leaders, begging bowl in hand, turning to [China for a financial bail-out](#). Equally, few would have predicted that Chinese leaders visiting Washington would publicly berate US policymakers about their mismanagement of the world's biggest economy. But the world has changed. The implosion in 2008 of the financial system in the US and Europe and last year's [European sovereign debt crisis](#) have accelerated the shift of economic momentum to Asia.

In 2012, the US and Europe are likely to be flirting with recession for much of the time. Barring a hard landing in China, [Asia-ex Japan should continue to clip along nicely](#) at around 7 per cent, according to most economists.



The dramatic change in fortunes has spawned a degree of triumphalism among some Asians. “There’s no crisis of capitalism,” says Meghnad Desai, emeritus professor at the London School of Economics. “There’s a crisis of western capitalism, which has gone geriatric. The dynamic capitalism, with its energy, innovation and sheer greed for growth has moved east.”

Lord Desai is not alone in sensing some sort of moral comeuppance. Asian countries have been “stamped upon” by the west for centuries, he says, and until relatively recently berated as “basket cases” unable to feed themselves. Now, he says, it is the people of the south in general and Asia in particular who are managing the wealth-generating forces of capitalism better.

But that sense of triumph only goes so deep. For at least three interconnected reasons, the crisis of capitalism in the west is deeply unsettling for the east as well. First, apart from Japan, South Korea and a few other small states, such as Singapore, Asian countries are still mostly poor or middle income at best. Many had plotted a path towards future prosperity via the adoption of progressively more “capitalistic” policies – opening their economies to market forces by loosening the state’s hold over banks, interest rates and currency movements. But that path to prosperity now looks more perilous than before, prey to boom and bust and to financial catastrophe.

The Asian technocrats who had put their faith in a gradual shift to free-market capitalism, often in opposition to more interventionist or nationalist voices at home, are confused or disillusioned. Changyong Rhee, chief economist at the Asian Development Bank, feels the sense of intellectual disarray. Much of the confusion, he says, stems from the fact that western governments have changed their tune so radically since Asia’s own financial crisis in 1997.

Then, the International Monetary Fund – stepmother of the *laissez faire* Washington Consensus – prescribed drastic medicine for economies such as Thailand, Indonesia and South Korea. They were told to cut government spending, even in the teeth of recession, and to raise interest rates, to sever links between banks and the state and to deregulate. Now western economies are prescribing almost the opposite medicine for themselves. They are cranking up fiscal and monetary policy, lowering interest rates and using state money to bail out banks.

From the Asian perspective that makes the west seem hypocritical at best. At worst, it looks as though the cherished assumptions about how best to run an economy are hokum. “We feel bitter,” says Mr Rhee. “We wanted to do these interventionist policies, but we were prohibited. So what model should we follow now?” China, he says, had been committed to gradual market reform. “The question was: what was the right speed? Now they are asking whether the destination is right or not.”

Richard Koo, chief economist at the Nomura Research Institute, looks at the crisis from the perspective of Japan. Tokyo, he says, was berated for years by western policymakers for not writing off its problem loans more quickly and for not taking more drastic monetary policy measures to reflate the economy. What they did not understand was that in a post-crash “balance sheet recession”, where the private sector is so indebted it no longer wants to borrow, normal economic solutions no longer work, he says. Economic textbooks contain no answers to capitalism’s current woes.

“What we went through in last 20 years in Japan and what the US and the [UK are now going through](#) is that, even with zero interest rates, people don’t want to borrow,” he says. “They just pay down debt.” If he is right, then western economies are now likely to go through a prolonged period of Japanese-style slow growth. It may not be much consolation, but Japan at least will be able to say: “We told you so.”

**Growth that looks meaningless unless it improves lives**

As Asian economies close the gap on western living standards, an awkward question lurks beneath their seemingly spectacular progress. Can Asians enjoy western standards of living without destroying the planet?

Chandran Nair, author of *Consumptionomics*, a book that questions the sustainability of the imported western growth model, argues that they cannot. His views are controversial. To suggest that Asians must refrain from a western lifestyle would be regarded by many as an affront to perfectly legitimate and long-delayed aspirations.

But Mr Nair, a Malaysian, says this is denial. How can everyone in China or India eat sushi like the Japanese or drive cars like Americans, he asks, without draining the seas of fish and the deserts of oil? Western capitalism, he says, built its high living standards on abundant resources, partly supplied by colonialism. The US had few people and seemingly limitless resources, the opposite of what is now true in Asia.

The answer, Mr Nair argues, is to price resources properly. You can own a car, but only if you pay for the roads you drive on and the (unsubsidised) petrol you use. That is a stark message both for westerners and increasingly for Asians, many of whom are coming to see a western lifestyle as a birthright.

Amartya Sen, the Nobel Prize-winning economist, argues from a different perspective that Asians need to redefine what kind of growth they want. In an essay in Outlook magazine with Jean Drèze, a development economist, he writes that “economic growth is not constitutively the same thing as development”. India has grown strongly for 20 years but “the progress of living standards for common people, as opposed to a favoured minority, has been dreadfully slow”. Growth can be useful. But without public policies to ensure that the fruits of that growth go to improving health, nutrition and education, it has little meaning, he says.

The recognition that 20 years of growth has had minimal impact on the lives of 800m Indians lies behind [Sonia Gandhi's championing of a food security bill](#), which aims to subsidise food for nearly two-thirds of the population. Whether this initiative by the leader of the ruling Congress party is a vital step towards more equitable development or a socialist fantasy that will wreck government finances is a matter of heated debate.

These arguments dovetail with Mr Nair's concerns that the majority of Asians are instead being sold a capitalist fantasy. “They've gone to the west and bought the idea that wealth trickles down,” he says. “But the gravy's too thick and there's not enough to go around.”

Second, for all the once-fashionable talk of Asian values, no Asian economy has come up with a coherent alternative to capitalism. Certainly, there have been variations on the capitalistic theme, including a more interventionist state. But the radical anti-capitalist experiments, chief among them Chinese-style communism and India's Nehruvian “socialism”, have been abject failures.

China abandoned Communism in the late-1970s when Deng Xiaoping opened up the economy to market forces. India too in 1991 ditched its own brand of socialism, which had condemned it to the plodding “Hindu rate” of growth. Other countries, such as Vietnam, have followed suit by

opening up their economies, unleashing fast growth of their own. Conversely, those countries that have stuck doggedly to non-market systems – such as North Korea, Myanmar and Laos – have continued to wallow in poverty.

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Third, Asians are in no position to rejoice at a crisis of capitalism in the west since their economies, in the words of Donald Tsang, chief executive of Hong Kong, are all in the same global boat. “If part of the boat has a hole in it, you cannot stay afloat,” he says. In India, there are deep worries that the country’s own growth story, driven by capitalist family businesses and western finance, may be fading. Even [China is slowing down](#), with a minority of economists predicting a hard landing.

Few in Asia would yet claim they can do without solid demand from the US and Europe. [Zhu Min](#), the Chinese economist who is deputy managing director at the IMF, said recently that Chinese consumers account for just \$2tn of demand compared with US consumers who, even in their current straitened circumstances, spend around \$10tn a year. If western capitalism is ablaze, the flames will sooner or later lick at Asia’s door.

The crisis of capitalism in the west poses many questions for the proper stewardship of Asian economies. The unifying theme is: how active a role should the state play? Asian economies have been criticised by western experts for being too interventionist. Until recently, the plan for most had been to gradually remove the guiding hand of the state. But the failure of rational market theory in the west and the obvious pitfalls of light-touch regulation, have made some Asian policymakers more wary of rushing towards liberalisation.

The question of how the state should act covers almost everything from financial supervision to industrial policy. One of the most crucial issues is the role of banks. In Asia, banks have tended to have a narrower function than in the west. Their role has been to funnel money to the “real” economy, principally the manufacturing sector.

Given the mess in which western banks have landed their economies, Asians might be tempted to stick to their narrow model. Not only are such banks less likely to land the economy in trouble, but they are easier to corral in times of stress. Since 2008, Beijing has found it useful to have tame banks through which it can direct credit to the real economy at fixed interest rates. Now they have seen the dangers of letting banks loose, why on earth would Asian governments move towards a more “sophisticated” western banking model?

Yao Yang, deputy dean of China’s National School of Development at Peking University, argues that this would be entirely the wrong lesson. “There are people in China, both in the government and in the intelligentsia, who believe that China should go back to its old government-centred model,” he says. “However, most people still believe that China should continue on its road to a more open economy.”

Others point out that [state-led banks](#) can – and do – get into trouble by allocating capital, not according to risk and reward but government diktat. Mr Rhee of the ADB argues that Asian

economies would be ill-advised to abandon their development of deeper capital markets. “If you don’t fly there is no accident,” he says of recent western catastrophes. “The west has lots of aeroplanes, so they crash. Should we have no aeroplanes?”

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One further question left hanging from capitalism’s crisis is how unequal Asian societies should be. Many Asian countries, China and India chief among them, have predicated their [growth strategies on a trickle-down theory](#). By allowing the emergence of a super-wealthy class, the idea is that everyone will benefit. But as in the west, Asians too are questioning this *laissez faire* approach.

“The advantage of the Anglo-Saxon model is clear. It encourages innovation, it is versatile, and it promotes individual freedom,” says Mr Yao. “But its disadvantages are equally clear. It is very fluid, it is cruel to employees, and it brings large destructive forces when economic downturns come.” He favours a Nordic system of high taxes, relative equality and less boom and bust. But in Asia, only Japan and South Korea come anywhere close to that model.

After so much lecturing from the west, Asians may take some pleasure in American and European discomfort. But the truth is that no Asian country has come up with a better model. The only large Asian economy to get within a hair’s breadth of American living standards is Japan. But its [economy stalled](#) as it entered the home straight. China has built a machine to produce fast growth in a poor country. But there is no guarantee its system will be able to match western living standards without a radical overhaul.

In the absence of anything better, Asian governments that want to raise their people’s income will have to fall back on some flavour of capitalism. “If you look at China, this really shows the power of capitalism, the power of market mechanisms and incentives,” says Mr Rhee. “Some elements of capitalism are clearly necessary.”

Certainly, within the broad definition of capitalism, the state can be bigger or smaller, it can intervene more or plan less. These policy alternatives are up for discussion in many Asian countries. But when push comes to shove, most are convinced by capitalism. For them it remains the worst possible economic system – except for all the others.

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