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I.M.F. Turns on the Charm in Asia

By ALAN WHEATLEY

BEIJING — That warm glow and soft purring emanating from South Korea was the International Monetary Fund trying, yet again, to put the Asian financial crisis behind it.

The I.M.F. needs Asia on its side. As the fastest-growing part of the world economy, the region will wield increasing clout at global institutions like the I.M.F. and provide more of their financing.

The problem, to put it bluntly, is that Asia does not need the I.M.F. — or even like the I.M.F., whose invasive policy prescriptions are blamed in the region for having exacerbated the 1997-1998 meltdown.

Hence the charm offensive by the fund's managing director, Dominique Strauss-Kahn, at a big conference in the central South Korean city of Daejeon last week.

"Let me be candid," he said. "We have made some mistakes. We have learned the importance of focusing on essential policies, and of protecting the most vulnerable, when tackling a crisis."

Declaring that he wanted Asian countries to see the I.M.F. as a second home, Mr. Strauss-Kahn added: "Asia's time has come in the global economy, and so it must be at the I.M.F."

But there was an implicit quid pro quo. In return for a bigger role, Asia had to take more responsibility for reducing global imbalances. Governments had to nurture a "second engine of growth" — domestic demand — instead of relying so much on exports, now that Europe and America face years of belt-tightening.

In a nutshell, Mr. Strauss-Kahn seemed to be saying: The I.M.F. is ready to change. Is Asia?

"The decisions made now will impact Asia's performance for decades to come," he said.

Against that background, it is reasonable to ask whether Asia will be able to rise to his challenge.

Shares in Indonesia are near record high levels, reflecting confidence in economic changes. India and Malaysia have both cut domestic fuel price subsidies to reduce their budget deficits.

Yet some contributors to a recent publication on the policy site VoxEU.org, titled "Rebalancing the Global Economy: A Primer for Policymaking," wonder whether Asia really can change its spots.

The most striking imbalance in Asia is that it saves too much, and a major reason for that thriftiness is beyond the control of governments: The bulk of Asians are in their prime working years, when people salt away money for their old age.

But policy makers could do much more to promote more balanced growth. For example, they could build social safety nets to reduce the need to save and allow currency appreciation.

Jong-Wha Lee, chief economist at the Asian Development Bank, said governments should give priority to enhancing the investment climate; Asia's current account surpluses reflect in part a paucity of domestic investment, especially in long-term infrastructure, he argued.

"The business environment across the region lags behind the world's competitive economies because of serious shortcomings in regional institutions and skill shortages. Remedying these weaknesses will help translate domestic savings effectively into domestic investment," Mr. Lee wrote.

His case is buttressed by a new World Bank report, "Investing Across Borders, 2010," which examines the openness of 87 economies to foreign direct investment. East Asia and the Pacific score poorly, with more curbs than any other region in the world on foreign-equity ownership, starting local businesses and gaining access to industrial land.

Underdeveloped financial sectors are also holding up Asia's economic transformation. The old model of a bank-dominated financial system that paid depositors a pittance and funneled cheap loans to exporters and manufacturers is past its sell-by date.

"The process of creating diverse financial institutions has happened too slowly, relative to the needs of the rising middle class and aging demographics," Andrew Sheng, an adjunct professor at the University of Malaya and Tsinghua University in Beijing, wrote in the latest East Asian Bureau of Economic Research newsletter.

Deeper foreign exchange and capital markets would also help countries absorb capital inflows instead of imposing administrative controls on them, as Indonesia and South Korea have done.

Linda Lim, a professor of business strategy at the University of Michigan, said financial liberalization had helped Asian rebalancing but was incomplete because of nationalist objections and resistance to increased competition.

One example was the continued dominance of state-owned banks in China, Mr. Lim wrote in the VoxEU.org e-book.

"But it is the corporate restructuring necessary to reduce high corporate savings rates that is likely to prove most politically intractable, requiring authoritarian and semi-authoritarian governments to relinquish state control of economic resources and activity on which their political power is partly based," Ms. Lim added.

Ms. Lim singled out Singapore, Malaysia and China as countries where there was little political pressure on state-owned and government-linked firms to distribute their income to increase domestic consumption.

Yung Chul Park, a professor at Seoul National University, also put economic rebalancing in a political context.

Despite vanishing overseas markets, policy makers would be wary unless they were sure that domestic demand would be as powerful as exports in driving growth. Also, rebalancing entails removing taxes and other incentives that favor exporters, while pursuing deregulation and steps to improve inferior productivity in nonexport sectors.

"East Asia may have difficulties in finding such measures," the professor concluded drily.

Mr. Strauss-Kahn knows all this, of course. But the Daejeon meeting was an opportunity to accentuate the positive and not to dwell — too much at least — on the past.

“Rapid growth has turned the region into a global economic powerhouse, and Asia’s economic weight in the world is on track to grow even larger,” he said.

Alan Wheatley is a Reuters correspondent.