

BY ROBERT J. BARRO

A 'YANKEE IMPERIALIST' OFFERS ASIA A ROAD MAP



REVIVAL: Countries hard-hit by crisis could strengthen their banks by allowing foreign ownership. South Korea should consider dollarization

Before the 1997 financial crisis, the fast-growing economies of East Asia were favorites of economists and international investors. Then Indonesia, Malaysia, South Korea, and Thailand were hit hard with currency devaluations and high interest rates. A 40-year period of sustained rapid growth was replaced in 1998 by sharp economic contractions in these countries, ranging from 7% in South Korea to 15% in Indonesia. What has happened since? Are the subsequent reforms and economic recoveries strong enough that investors should rush back into these four crisis countries?

In terms of economic growth, the recovery has been impressive in South Korea, with growth averaging 9% a year for 1999-2000. The rate has slipped recently. Reasonable recoveries occurred in Malaysia and Thailand. Indonesia has yet to grow much at all.

Other signs are much less favorable. In the past, the four crisis countries had been known for high rates of saving and investment. In 1997, ratios of investment to gross domestic product ranged from 30% to over 40%. These values collapsed by 10 to 15 percentage points during the financial crisis and have yet to rebound much. Although the earlier levels of investment were excessive, the failure of investment to recover suggests that businesses do not anticipate returns to the sustained high growth of the past.

This impression is reinforced by stock-market prices, which have yet to gain their 1996 levels in U.S. dollar values. Thus, the stock markets also point toward lower growth. The obvious comparison is with Japan at the end of the 1980s, where the collapse in stock prices accurately signaled more than a decade of subsequent growth at anemic levels.

At a recent conference I attended in South Korea, economists from the International Monetary Fund and elsewhere discussed possible policy changes that might improve the economic outlook. My suggestions led some participants to label me a "Yankee imperialist," although I naturally regarded this characterization as unfair.

My first ideas were about the banking sector. Although economically important, this sector has been a recurring source of problems for many middle-income countries. In South Korea, the banks are predominantly government-owned and -run, a situation that does not look promising for the efficient allocation of credit and the promotion of growth. The government has been dragging its heels on privatizing the banks, especially with regard to sales to foreigners. This

policy is a mistake, because foreign ownership of banks offers a number of advantages to a middle-income country.

First, a foreign company with strong capitalization could withstand the disturbances that in the past have led to bank failures. Second, the government would have limited ability to pressure a foreign-owned bank to lend money to favored sectors, such as the large business groups (*chaebol*) in South Korea. This immunity to pressure is favorable for the economy but may explain the reluctance of many governments to encourage foreign ownership. Finally, the government would not be inclined to bail out a foreign-owned institution; knowing this, the institution would have to be prudent in its lending practices.

In such matters, Asian countries could learn from Mexico. With Citibank's purchase of Banamex and the buyout of two other institutions by Spanish companies, the three largest Mexican banks will now be run by strong foreign institutions. Because of these changes, Mexico's banking sector finally looks promising.

CLOSE TIES. Another issue in South Korea is the too-big-to-fail doctrine, which had been applied in the past to the *chaebol*. More recently, the government has been willing to allow the market to decide which businesses will survive, as was clear with the failure of Daewoo. However, this policy will soon be tested again, as the government seems tempted to intervene with troubled parts of Hyundai.

Finally, I suggested that South Korea consider relinquishing its own currency and adopting the U.S. dollar. Dollarization would avoid the kind of currency crisis that occurred in 1997-1998. Although South Korea would have to abandon an independent monetary policy, such independence has always been a mixed blessing. Moreover, unlike Argentina, which has recently had problems with its currency board because of the strong U.S. dollar, South Korea is linked fairly closely to the U.S. in trade and other dimensions. Another favorable element is that dollarization could be combined with negotiations on freer trade with the U.S.

My proposal for dollarization, combined with my endorsement of foreign buyouts of banks, led to the Yankee-imperialism charge. However, the more serious issue is whether I am correct that these policy changes would improve the economic outlook and encourage the return of investor enthusiasm. My fallback position is that Yankee imperialism is the best type of imperialism.

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