

## **'Asian' Capitalism: Explanation of Failure as well as Success?\***

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Towards the end of the 1980's, it was fashionable to believe in the "Asian Miracle". The headlines were "Decline of America" and "Rise of Asian Capitalism". Since capitalism as such could not very well decline in one part of the world and rise in another, failure and success were conveniently associated with the adjectives "American" and "Asian" respectively. Excess liquidity in the US capital markets was led by "senior economists" with degrees in political science to pour into Asian stock markets with what was later castigated by Alan Greenspan as "irrational exuberance".

When challenged by unbelievers, the headline writers marshalled academic support from Asian experts with a culturalist bent. The "Confucian" explanation of the Asian miracle was born. If the society of a country was Confucian, so the argument turned out to be, then also the fiscal policy, the monetary policy, the industrial policy, the saving and investment balance, the shares of R&D in GNP of such a country must be somehow "Confucian". Little did it seem to matter that some of Asia's economies were located in Islamic Indonesia, Malaysia and Pakistan, in Hindu India, in Buddhist Thailand, in the Christian Philippines or in countries such as Japan and Korea where Buddhist and Christian creeds pragmatically coexist with Confucian ethics in single religious households.

One decade later, after Thailand devalued the Baht in July 1997, the opinion makers hastened to turn around by 180°. Confronted with a frenzied flight of Western capital out of Asian stocks into American bonds, perceived as the last safe haven, the talk in media town was of "Asian failure" as opposed to America's job miracle, balanced budget, high tech and "new age economics". The once vaunted "Confucian" virtues were now decried as vices, in most cases re-interpreted as patterns of corruption.

In trying to use a common standard, a *tertium comparationis*, for both Asian and Western economic performance, both failures and successes, I am sure I cannot count on many allies. In the 1980s, my husband and I explained the economic performance of Japan and some other (by no means all!) Asian countries as "More

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Western than the West".<sup>1</sup> We argued that these economies stood out in terms of a wider spectrum of economic theories competing with each other in Western dogmatic discourse than leading Western economies, and more particularly the US, Germany and France. We tried to revive interest in the subjective methodology of Schumpeterian economics whose indeterministic view of market expectations offers a healthy contrast to the static models of both monetarist and Keynesian economics. We hoped to offer a universalist critique of the prevailing culturalist view, but we had to resign ourselves in remaining a minority voice.

Today, I am prepared to voice again the minority view by submitting a universalist explanation of the "Asian Crisis". At least I do not have to turn around by 180°. I propose to use the same methodology in comparing present economic failures to past successes of some of the Asian economies involved. It is worthwhile to compare functions and dysfunctions of a country's or region's structural patterns and patterns of action in times of crisis as much as in phases of boom. More particularly, it is necessary to ask whether outstanding structures previously considered as comparative advantages of Asia, such as levels of education ("human capital"), degrees of income equality or disparity, demographic factors, resource endowment or scarcity, saving and investment propensities, are still present or have gone away, or while still present have no longer functional effects, but turned out to be a dysfunctional liability.

High levels of primary and secondary education in Japan, Korea, Taiwan and Hong Kong have been one of the most important factors of outstanding development success. They are of similar importance in mature economies going through the Kondratieff cycle towards information economies. These structural qualities of East Asian countries as compared to South Asian, African and Latin American circumstances will not go away with Asia's financial crisis: They will be an important condition of a speedy recovery from the crisis.

A very similar argument can be made on East Asia's structure of income distribution which shows much lower degrees of disparity than other regions of the world. This is particularly true of land distribution. Research by the World Bank has resulted in a remarkable covariance between long term economic growth patterns and low disparity of land distribution. This is one area in which East Asia outperforms Latin America most strikingly (table 1). This East Asian advantage may have eroded somewhat in recent boom phases, but certainly not to Latin American levels of disparity. The financial crisis may have just eliminated some of the most conspicuous cases of "new wealth", at least in terms of the book values of "bubble wealth". This structural condition appears thus excellent for recovery.

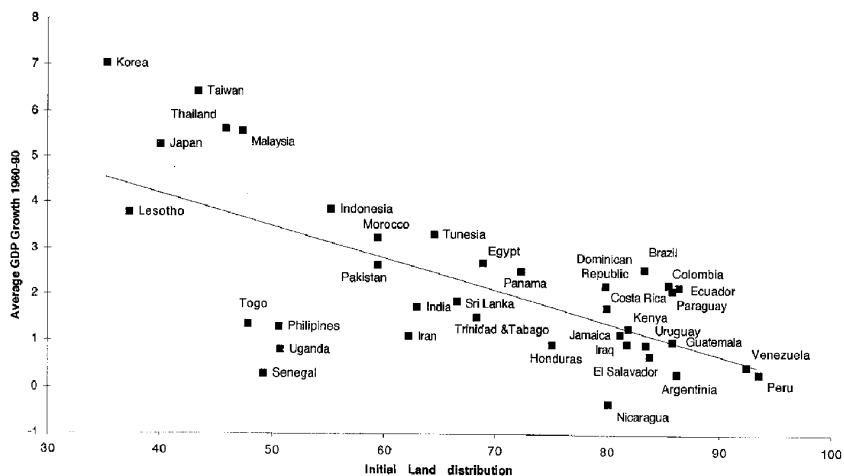
Demographic factors have played in Japan's favour up to the 1970's, but the aging of the large baby-boom generation that brought about Japan's postwar "economic miracle" and the dramatic decline of Japan's birth rate have since become a source of serious concern for economic policy makers. The biggest constraint is on fiscal

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1 Michèle Schmiegelow and Henrik Schmiegelow, *Strategic Pragmatism: Japanese Lessons in the Use of Economic Theory*, New York: Praeger, 1989; id., "Obei Ijoni Obeitekina Nihon Keizai" (More Western than the West), *Chuokoron*, 108 (January 1993) 1, pp. 72-83.

policy which in the mid 1980's began to focus on debt reduction in order to make room for future allocations for the pensions of the post-war generation. This policy shift has long stood in the way of the fiscal expansion demanded by Japan's G 7 and OECD partners as a means to get Japan out of its present deflationary spiral. But as all tools of monetary policy have been used to not avail by fall 1998 with the discount rate approaching zero, Japan may yet have to transfer the policy burden back on the fiscal shoulder again, in order to prevent the economy from sliding into a deflationary spiral.

**Table 1: Countries with more equal land distribution grow faster**



Source: World Bank, Juli/October 1996.

Whereas resource endowment is considered a comparative advantage in classical economics, resource scarcity was highlighted as a potent incentive for Japan and Korea to develop as economies creating wealth through exports of manufactured goods with high added value. But this was, of course, not an exclusively Asian pattern, since it was pioneered by Germany half a century earlier. On the other hand, the incentive remains highly topical in our era of technical innovation and transformation to the globalized information society. Here again, we find an important point of departure for East Asia's recovery from the crisis.

Asia's so-called "Confucian" saving propensities are one of the most interesting factors to look at from the threshold between past development successes and the present crisis. Throughout the 1970's and 1980's, they were rightly highlighted as one of the most important structural advantages of Japan compared to the US. Japan's household saving rates as percentages of disposable income ranged between more than 20% in the 1970's and more than 12% in the 1980's as opposed to the US range of between less than 10% or 6%. Just as a warning against falling into a culturalist trap, I have to add immediately, however, that European economies, espe-

cially Italy and France, show saving rates very similar to those of Japan and Korea. The odd man out is definitely the US.<sup>2</sup>

At any rate, for two decades, it was easy to argue that Japan's investment machine was powered by private savings, while the American saving/investment balance was unhinged by both private and public over-consumption. All this was very fine from the point of view of the theory of business cycles, as long as Japan and the US competed in an inflationary environment such as that of the 1970's and 1980's.

In the second half of the 1990's, the situation radically changed. The world economic environment shifted from inflation through disinflation to outright deflation, the latter at least in Japan. Under such circumstances, a high savings rate is a dangerous structural disadvantage rather than a comparative advantage. The reflex to save in times of adversity is precisely what the present business cycle does not need. It is macro-economic poison. This type of behaviour can turn a deflationary spiral into an outright depression. There are too many ominous reminders of the situation between 1929 to 1933 for economic policy to remain complacent.

This brings me from structural factors to factors of action. In 1989, my husband and I have proposed "strategic pragmatism"<sup>3</sup> as an explanation of outstanding patterns of action of Japanese entrepreneurs and economic policy makers.

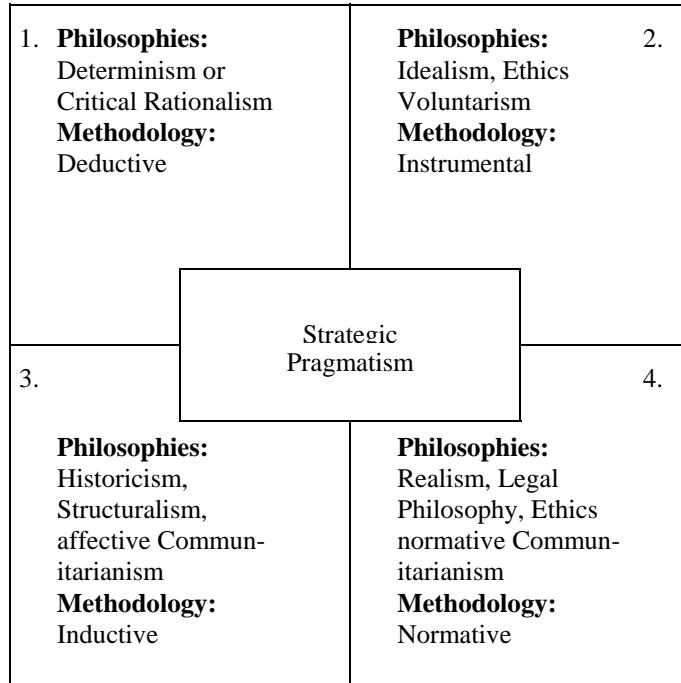
I propose to compare patterns of action just as structures in phases of boom and phases of bust. For me, the decisive question is to which degree strategic pragmatism has been present in times of success and absent in times of failure. Among the important components of such strategic pragmatism are Schumpeterian entrepreneurship, the entire spectrum of Tinbergen's economic policy mix, the reliability of contracts and regulations as emphasized by Coase's and North's institutional economics and, finally, indeed, as one part of a differentiated spectrum of factors, the presence of patterns of motivation of action identified by Max Weber's sociology of religion as "typically capitalist". I maintain that 'Asian' savings behaviour and work ethics can be at least as outstanding as Weber's protestant models.

Strategic pragmatism requires the realization that all knowledge is temporary, that action may be required even under conditions of uncertainty and across the cleavages of dogmatic contention, and, above all, that adjustment and correction is imperative as soon as failure is recognized. Philosophically speaking, pragmatism means to eschew dogmatism. Rather than aligning practice with theories adhered-to for their own sake, pragmatism puts theories in the service of practice as problem solving devices following the method of trial and error. Pragmatism of this kind is more than "muddling through". It is the translation of the scientific standard of critical rationalism into economic policy, technology policy, ecological policy and business strategies. The philosophies and methodologies functionally combined in strategic pragmatism are presented in table 2.

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2 *OECD Economic Outlook*, (June 1998) 63.

3 Schmiegelow and Schmiegelow 1989.

**Table 2: Philosophies and methodologies combined in Strategic Pragmatism**

Japan's economic development over three decades was easy too explain in terms of a particularly outstanding correspondence with four economic theories that in the West are pitted against each other in entrenched dogmatic dissension. The Japanese cut across contending economic doctrines offered an ideal-typical case of philosophical pragmatism.

1. The often mythologized dynamism of Japanese entrepreneurship was perfectly explainable in terms of Schumpeterian economics.<sup>4</sup>

Schumpeter's "Austrian" economics focuses on the dynamic and innovative qualities of the entrepreneur and takes the global rather than the national economy as a framework. The Schumpeterian entrepreneur thrives on free trade, is the prime source of technological innovation and may reap his biggest profits by a supply push "educating" consumer demand. Schumpeterian economics is far more advanced than neo-classical theory by treating the market not as a deterministic model in equilibrium, but as a place governed by uncertainty in which subjective expectations of sellers and buyers meet in indeterministic fashion.

4 For a comparative analysis of Schumpeter's significance in economic thought, see Schmiegelow and Schmiegelow 1989, Chapter 2.

Schumpeter's theory is the only economic theory which followed the Heisenbergian shift to indeterminacy immediately as it occurred in natural sciences.

2. The Japanese combination of Keynesian demand management, moderately monetarist monetary policy, Colbertist industrial policy and courageously interventionist ecological policy represented a uniquely complete application of the full range of Tinbergen's theory of economic policy.

Tinbergen's<sup>5</sup> theory of economic policy is an inversion of the logic of neo-classical economics. While neo-classical analysis hopes, for example, to find out which level of inflation will result from a given discount rate, the theory of given, while instrument values (such as the discount rate) are treated as unknown and are therefore the subject of investigation and advice to policy-makers.

In his work on qualitative structural policies and fundamental reforms, Tinbergen took a pragmatic trial-and-error approach recognizing the scientific uncertainty of economic and ecological development. In many ways the Tinbergian economic policy-maker is a perfect methodological public sector equivalent of the Schumpeterian entrepreneur.

Gradual trade liberalization was a particularly important qualitative policy of both Japan and Korea, since their future as export nations and members of the OECD depended on such integration in the world trade system. Today, a reform of the banking supervision regimes is of similar importance. Kim Dae Jung's Korea seems to show above-average determination to go ahead in this area. Malaysia and Indonesia still have a long way to go in this direction.

3. Japan's success in integration of economic policy and corporate strategies through non-coercive administrative guidance in economic policy and the information-sharing networks of the *keiretsu* in business strategies could be analysed as a superb case of reducing transaction costs through implicit contracts<sup>6</sup> such as those that have since been analyzed by the 1992 and 1993 Nobel price winners Ronald Coase<sup>7</sup> and Douglass North<sup>8</sup> in their institutional economics, more particularly non-coercive administrative guidance.

Like Schumpeter and Tinbergen, Coase and North recognize uncertainty and imperfect knowledge in real-world free markets. This is the very starting point of institutional economics. Institutions such as laws, statutes, ethical codes, explicit or implicit contracts reduce the uncertainty under which market participants need to make their rational choice. Institutional economics must thus be seen in a complementary relation to neo-classical rational choice theory. Institutions reduce transaction costs by solving the "prisoner's dilemma" of game theory through providing the same amount of information to both players. This explains

5 Jan Tinbergen, *Economic Policy: Principles and Design*, Amsterdam: North Holland, 1956. For an analysis of the methodological contribution of Tinbergen's theory of economic policy, see Schmiegelow and Schmiegelow 1989, Chapter 3.

6 Schmiegelow and Schmiegelow 1989, Chapter 5.

7 Ronald Coase, "The Nature of the Firm", *Economica*, 4 (1937), pp. 386-405, and id., "The Problem of Social Cost", *Journal of Law and Economics*, 3 (1960), pp. 1-44.

8 Douglass North, *Institutions, Institutional Change and Economic Performance*, Cambridge: Cambridge University Press, 1990, p. 5.

why advanced economies with highly developed institutions such as the US, Western Europe and Japan have performed better economically than countries with low levels of institutional development and high levels of non-punishable corruption, for that matter.

Of course, corruption is a serious problem legally, ethically and, indeed, as a structurally entrenched pattern, politically. From the point of view of institutional economics, an entrenched pattern of corruption can also constitute a decisive impediment to economic development (Douglass North). But, of course, there are cases of corruption in highly developed countries as well, in North America and Western Europe just as in Japan. A recent index of "Transparency International", a non-governmental organization based in Berlin, offers a list of 85 ranks, with Denmark as the least corrupt country, holding rank 1 and Kamerun rank 85. Remarkably, "Confucian" Singapore and Hong Kong hold ranks 7 and 16 respectively, outperforming the US with rank 17. Indonesia finds itself on a dismal rank 80.<sup>9</sup> The important distinction is that economically and politically stable countries have legal systems that make corruption a punishable offence. My definition of "Asian" capitalism thus includes such a legal system.

Indonesia's "crony capitalism", which is rightly castigated by both the IMF and Megawati Sukarnoputri, is not an example of sustainable capitalist success. In capitalism, there are cycles of boom and cycles of recession. In countries strangled by corruption there are no such cycles, because there is no economic development. If such a country unexpectedly experiences a sequence of boom and bust in terms of capital inflows and capital flight, the explanation is not corruption, but lack of risk analysis of foreign investors.

North recognizes that there are institutions that increase rather than reduce transaction costs. Bureaucratic over-regulation is a case in point. But on balance, a country with a highly developed and adaptable mix of institutions, is better off than one without any institutions.

The discussion on "deregulation" in the US, Europe and Japan would thus be well advised not to be happy with getting rid of as many institutions as possible, but to carefully differentiate between transaction cost reducing and transaction cost increasing institutions. Both the Tinbergian policy-maker in the public sector and the Schumpeterian entrepreneur in the private sector have a crucial interest in creating, rather than dismantling institutions that contribute to the dynamism of the economy by reducing transaction costs.

Whether Malaysia is well advised to abolish the freedom of capital flows is highly doubtful. Korea's strategy looks much more promising. There continues to be cooperation between government and the private sector in Korea, but it is more transparent than before and does not involve the closing of borders in the financial sector.

If there were any doubts in the past as to whether administrative guidance was a pattern of action as thinkable in the West as in Japan, they could be put to rest

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9 Transparency International (TI), *1998 Corruption Perceptions Index. Index Data*.  
<http://www.gwdg.de/~uwww/CPI1998.html>

since the rescue of New York's biggest hedge fund, Long Term Capital Management (LTCM), by an international group of clients and non-client banks and brokerage firms under the guidance of the Federal Reserve. Of course, the stakes were enormous. Alan Greenspan was clearly concerned about the impact of a failure of a fund with uncovered positions exceeding 100 bn US\$, if not much more. And, of course, the Federal Reserve did not bail out LTCM itself, but merely used its moral suasion to convince banks and brokerage firms to come to the rescue. But, then, such moral suasion is precisely what is called administrative guidance in Japan.

4. Many of Japan's allegedly unique societal, national or corporate structures could also be perfectly analyzed in terms of Weberian sociology, and more particularly the Japanese savings patterns, work ethics and capitalist empire building. They could be characterized with similar ease as "Protestant", "Confucian" or "Buddhist".<sup>10</sup>

On the basis of his study of 19th century Germany, Weber believed that Protestantism was the true source of capitalism. Unaware of the religious and ethical roots of the rise of the merchant class in Tokugawa Japan, he did not recognize that Buddhism and Confucianism could similarly contribute to the rise of capitalism in Osaka as in Hamburg. That does not invalidate his discovery that there are important cultural conditions for capitalist performance in free markets. What it invalidates is his assumption that Protestantism is the unique such condition.

In fact, the more evident scientific uncertainty in free markets, the greater perhaps the impact of an ethical orientation of entrepreneurial behaviour and economic policy. This is especially true for the orientation of technological innovation and environmental protection.<sup>11</sup> But it may even help in persuading a bank such as Deutsche Bank to help rescuing LTCM in which it had no stake whatsoever, but whose collapse might rock the boat of the entire banking industry along with the world economy.

So far, I have discussed domestic structures and pattern of action in Asia. But the analysis of Asia's past successes and present problems would be incomplete without considering how far factors external to Asia have contributed to Asia's present crisis. One question is whether the 'boom' phase of the last Kondratieff cycle of technical innovation in the area of microelectronics has come to an end in Asia earlier than in the US, just as it has begun earlier in the Japan of the mid 1970's. Another is whether there is a paradigm change in global economic thought from expectations of an endless "bull-market" in a technology-driven "new age economics" to the spreading anticipation of an impending global deflation. This paradigm change might have affected Japan earlier than Western Europe and the US. Inversely, it came too late, at least in Alan Greenspan's view, to Wall Street, whose "irrational exuberance" flooded Asia's emerging markets with capital inflows

10 Schmiegelow and Schmiegelow 1989, Chapters 4 and 6.

11 See on this subject, Henrik Schmiegelow, "Community, Society and Ethics in Democracy", in Michèle Schmiegelow (ed.), *Democracy in Asia*, Frankfurt: Campus & New York: St. Martin's Press, 1997, Chapter 2.

considered as reckless in hindsight. In that perspective, Asia's current crisis may appear as the irrational depression typical of "the morning after".

As far as Japan's bubble of the late 1980's and its bursting in the early 1990's are concerned, both can be explained as failure of strategic pragmatism combined with external factors. Indeed, the bubble would not have occurred without the relentless US pressure on Japan to expand domestic demand in the second half of the 1980's. This pressure was motivated by US trade policy but officially rationalized in terms of a rather crude Keynesianism. The bubble burst when the then Governor of the Bank of Japan, Mieno, brutally raised interest rates in the early 1990's. Again, US advice was prominent in this case, this time not from the Keynesian, but from the monetarist side of the dogmatic battle of "Western" economics.

Finally, a note of caution. I do not propose to explain the current Asian crisis by political variables. From the explanations I have offered in this paper, it should be obvious that I am not among those who explain past economic success in Asia to authoritarian patterns and, hence, the present crisis as a consequence of the spread of democracy in Asia over the past decade. I do believe that there can be links between economic and political developments. But as I have explained in detail elsewhere<sup>12</sup> their relation is an inversion of the authoritarian explanation of economic success. I have argued that there is no cultural barrier to democracy in Asia and that rapid economic development in Asia has supported democratization. Today's challenge for leadership, both Asian and Western, is thus to steer the world economy out of its present downward spiral in order to avoid a repetition of the cycle from deflation to depression to failure of democracy which occurred 70 years ago.

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12 Schmiegelow, Democracy in Asia, 1997.