

ASIA

Losing Traction. Asia's formula for economic success is failing. How can the tigers get back their bounce?

BY MICHAEL SCHUMAN

THE DEVELOPING WORLD HAS had no shortage of dictators who made lofty promises to uplift the poor and build powerful nations. Few ever delivered. But then there is South Korea's Park Chung Hee. A general who took control of South Korea after a coup in 1961, he ruled, often with an iron fist, for 18 years. Yet he was also deeply moved by South Korea's destitution. In the early 1960s, the country's per capita national income was just over \$100 and the economy depended on American aid. Park, a virulent nationalist, vowed to do something about this. "I had to break, once and for all, the vicious cycle of poverty and economic stagnation," he later wrote.

The solution Park divined was to hitch South Korea's future to an expanding global economy. The country took advantage of its cheap labor to manufacture necessities like shoes and clothes to sell to consumers in the developed world, particularly those in the U.S. The strategy proved to be wonderfully efficient. It drew investment capital into the country, generating factory jobs for impoverished farmers, infrastructure to supercharge commercial development, and otherwise produced wealth

South Korea could never have generated on its own. Eager to raise living standards in their own countries, Asian policymakers and businessmen to varying degrees adopted the same fast-track formula. The economies of South Korea, Taiwan, Hong Kong and Singapore did so with such success they became known as the Asian tigers. Their growth model produced miracles—and as Park said in a 1965 speech, exports were "the economic lifeline."

Today, the tigers are being tripped up by that same lifeline. As consumer and industrial demand dries up in recession-wracked Western countries, East Asia's export-led nations are proving to be extremely vulnerable to a synchronized global slowdown. Among the tigers, overseas trade is shrinking with frightening speed: Taiwan's exports in January plunged 44% from the same month a year earlier, while Singapore's fell 35% and South Korea's 33%. Overall economic growth is following suit. In the fourth quarter of 2008, Taiwan's GDP contracted 8.4% from the same period a year earlier, the worst quarter on record. South Korea's GDP shrunk 3.4% in the fourth quarter, Singapore's fell 3.7% and Hong Kong's dipped 2.5%.

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—ERIC FISHWICK, HEAD OF ECONOMIC RESEARCH AT CLSA IN HONG KONG

Illustrations for TIME by Alex Nabaum

Eric Fishwick, head of economic research at brokerage CLSA in Hong Kong, predicts these dismal numbers will persist. He sees Singapore's GDP contracting 10% this year, while South Korea's will decline 7%, Hong Kong's will slide 5% and Taiwan's will drop, stunningly, by double digits. "We've never seen an external shock in Asia like this," says Fishwick.

Too Much of a Good Thing

THE PROBLEM WITH THE TIGER ECONOMIES is that, four decades on, the spirit of Park Chung Hee is alive and well. While the mix of products may have changed from sneakers and stuffed toys to microchips and flat-panel TVs, the tigers remain heavily reliant upon exports to power growth. And like any addict, they're now experiencing the pain of rapid withdrawal as factories close and millions of workers across the region lose their jobs. Homelessness is on the rise in South Korea's capital, Seoul, where at 2 a.m. each night the city's largest train station becomes a makeshift hostel as scores of 6-ft.-long benches are taken up by dozing men and women seeking shelter from Korea's icy winter nights.

Once booming businesses are resorting to desperate discounting to try to keep customers coming. In Hong Kong, 1,000 restaurants have joined together to offer dishes such as dim sum and roast pigeon for one Hong Kong dollar (about 13¢). In Taipei, Taiwan's capital, fast-food chain KFC held a press conference last month to announce 50% discounts on every second meal ordered, only to have McDonald's employees interrupt by parading with signs promoting \$2 lunch specials.

Even at cut-rate prices, there will still be fewer chickens to fry. At the Hsinchu Science and Industrial Park, home to many of Taiwan's flagship technology companies, more than three out of four workers are currently taking unpaid leave at least one day a week. Ryan Wu, chief operating officer of job-search website 1111 Job Bank, says that conditions at Hsinchu have never been so dire in the park's 29-year history. Wu says that two years ago, the companies that job hunters most often sought out using his service were microchip makers and electronics manufacturers; last year, the most-searched-for company was convenience-store chain 7-11. "I think there's extreme panic right now," Wu says.

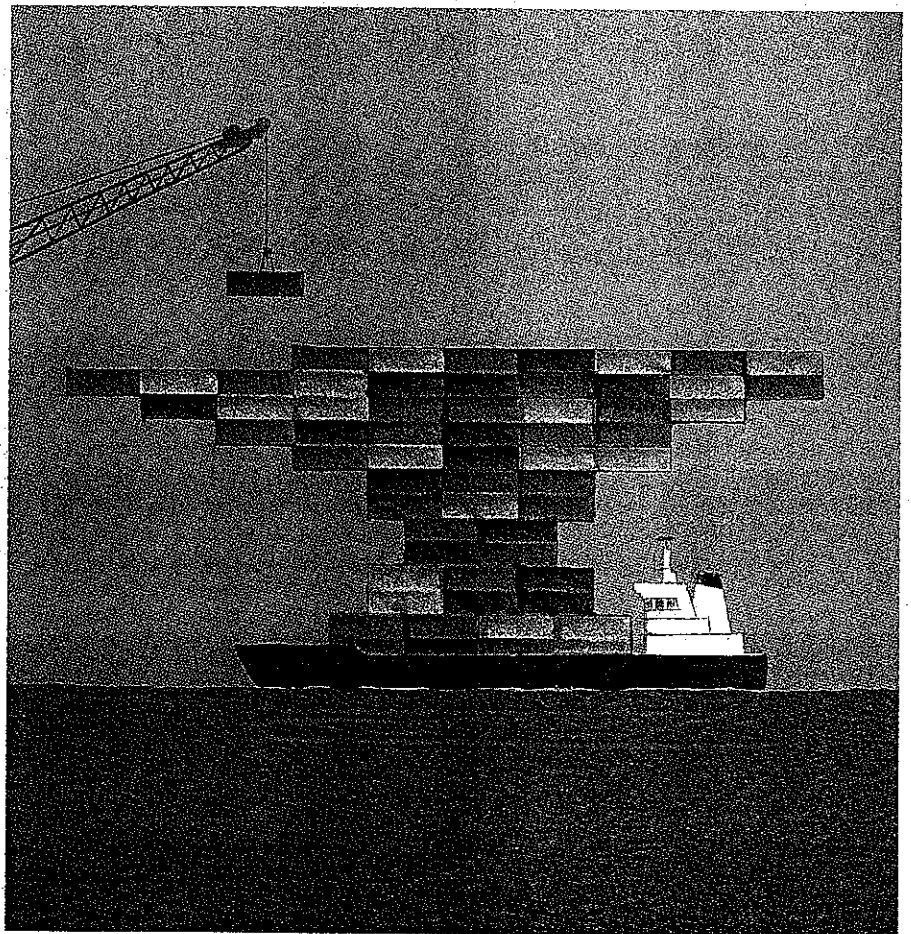
That panic is felt by politicians and policymakers, who have slashed interest rates and hiked fiscal spending in an attempt to stimulate growth. In January, Taiwan's government doled out \$2.6 billion in spending vouchers—or about \$100 a person—to encourage consumers

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to splash out. The administration of President Ma Ying-jeou is also pushing a \$14.7 billion program of infrastructure projects through the legislature, which includes funding for construction of better bridges and more subways. Singapore in January announced a \$13.4 billion "Resilience Package" that will increase the country's budget deficit to a record level. Yet there is a limit to what governments can do. Exports are simply too important to the tiger economies to be easily replaced. They represented 74% of Taiwan's GDP and 46% of South Korea's in 2007. "You can't change the [export] model," laments Song Seng Wun, an economist at CIMB-GK Research in Singapore. "You just have to make sure everyone can take the downturn."

This Time It's Different

ASIA HAS SUFFERED RECESSIONS BEFORE, of course, and bounced back strongly. But this downturn is different. Unlike during recessions in 1997-98 and 2001-02, Asia's favorite customer—the American consumer—appears to be making profound changes in his purchasing habits. In the long run, this may be a good thing. Roughly 25% of Asia's final exports end up in the U.S., and economists have been warning



for years that America's penchant for borrowing and spending, coupled with Asia's pattern of saving and selling, created massive trade imbalances that would ultimately prove to be economically destabilizing.

But in the short run, Asia is finding itself powerless to adjust quickly to the swift, steep decline in trade, which is not limited to U.S. exports. Trade among Asian countries is also plummeting, because much of this intraregional commerce is indirectly dependent upon Western consumption. A high proportion of Taiwan's trade with China, for example, has been made up of electronic components shipped to Chinese factories for assembly into finished products—which eventually wound up on the shelves of stores in the U.S. As a result, Taiwan's China trade is contracting twice as fast as the island's U.S. exports.

In short, Asia's growth model resembles a vast Ponzi scheme, one that is precariously perched on the expectation that Americans will continue buying more and bigger TVs, computers and cars forever—which in turn allows Asia to forever goose its growth by adding industrial capacity to feed the West.

This expectation has now been dashed, and the scheme is unraveling. Debt-ridden, house-poor and increasingly unemployed, U.S. shoppers are cutting back. Consumer spending in the U.S. dropped at an annual rate of more than 3% in both the third and fourth quarters of 2008—the steepest consecutive quarterly declines on record. As incomes shrink and America adopts a more frugal mind-set, some economists do not expect shoppers to return to free-spending ways for years—or perhaps generations. Economist Stephen Roach, chairman of Morgan Stanley Asia, says that “there is good reason to believe the capitulation of the American consumer has only just begun.” U.S. consumer spending as a percentage of GDP reached 72% in 2007, well above the pre-bubble norm of 67%. Using that as a gauge, Roach says that only 20% of the potential retrenchment of spending has taken place, even after the dramatic decline at the end of 2008. “The imbalance that contributed to the crisis—overconsumption and excessive savings—cannot continue,” says Ajay Chhibber, director of the Asia bureau at the United Nations Development Program in New York City. “The model where you stimulate and [then] go back to the old days is gone.”

Building a Better Tiger

ASIAN LEADERS FOR YEARS HAVE RECOGNIZED the need to reduce dependence upon exports to the developed world. But as long as the engine wasn't broke, they weren't

inclined to make extraordinary efforts to fix it. Now, it appears Asia's primary growth driver is, at the very least, badly bent. Meaningful reforms that diversify the sources of economic growth may be needed if the region is to avert a prolonged period of moribund economic activity.

The first layer of diversification must come in the makeup of the tigers' export markets by strengthening and extending trade links beyond the U.S. and Europe. Policymakers in Taiwan aim to do this by stimulating trade with other emerging

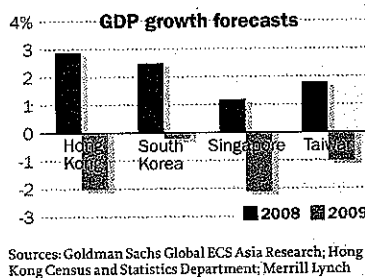
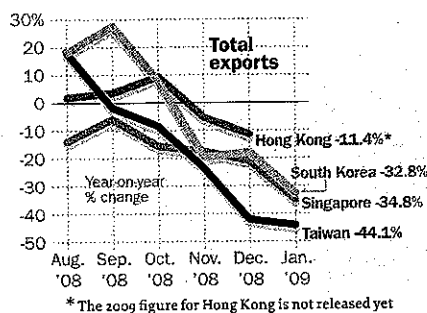
homes for the elderly, that would relieve some of the financial burdens on working-class families and encourage them to spend rather than save. “What tended to be taken care of in the household could become more marketized,” says Lim Won Hyuk, an economist at the Korea Development Institute in Seoul. “There is a lot of room for job creation.”

South Korea's service sector in general is still fettered by regulation that stifles its development as a source of growth and employment. A December report by the Organization for Economic Cooperation and Development found that service companies are burdened by higher taxes and energy costs than manufacturers, while excessive regulation creates barriers for start-ups. Hwang Doo Jin, an architect who operates his own small firm in Seoul, complains of endless, stressful hours untangling the confusing rules that govern his business. “It is easier to produce a masterpiece than run a viable business over time,” Hwang says.

The tigers are already heading in the right direction. Shortly after South Korean President Lee Myung Bak took office last year, he launched a program to improve the services sector by increasing financial assistance to targeted businesses and by reducing red tape. Taiwan President Ma Ying-jeou is undertaking his own deregulation program, with a special focus on Taiwan's biggest trading partner, China. Ma believes that sectors of Taiwan's economy, such as tourism and finance, have been stunted by the island's political standoff with Beijing. (China considers Taiwan a renegade province.) Ma is pushing for an agreement with China that would allow for free flows of capital and services across the Taiwan Strait for the first time. He has already opened the island to mainland tourists and eased restrictions on Taiwan investment in China.

Yet if the tigers really want to thrive in the future, the answer might lie in rejecting another legacy of Park Chung Hee: the idea that governments alone can successfully engineer high economic performance. Jim Walker, an economist at independent research firm Asianomics in Hong Kong, argues that politicians still intervene too much in their economies instead of allowing market forces to work. “What governments need to do is start trusting their own people rather than hoping the West is going to get it right all of the time,” Walker says. For the tigers to keep roaring, they may need to find their future, for the first time, at home. —WITH REPORTING BY NEEL CHOWDHURY/SINGAPORE, NATALIE TSO/TAIPEI AND JENNIFER VEALE/SEOUL ■

Tumbling Trade. Plunging exports are killing growth rates



markets, such as Russia, Brazil, India and the Middle East. Commerce within the region also needs a boost. The tigers need to “open up trade among the markets here, and to develop local goods that are attractive to local markets,” says Joe Zveglic, assistant chief economist at the Asian Development Bank in Manila.

The second layer of diversification requires reducing overall dependence on trade by promoting domestic consumption and expanding service sectors. Park Chung Hee's growth model discouraged investment in domestically focused sectors and consumer spending—both of which could provide a cushion to Asian economies in global downturns. Vestiges of his biases remain, to the detriment of the South Korean economy. For example, South Korea hasn't developed the kind of social services, such as day-care centers for the children of working parents and