What Asia CAN TEACH The Indebted West

BY KISHORE MAHBUBANI

A surprisingly little-known feature of Asia's economic miracle is how much it has relied upon Western wisdom. Asian societies are flourishing today because they have finally absorbed and implemented traditional Western strengths such as political pragmatism and sound economic policies. But paradoxically, just as Asia has embraced these pillars of Western wisdom, America and Europe are abandoning them in favor of

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NEW CONSUMERS
CHINA'S MIDDLE CLASS IS EXPANDING.

increasingly polarized politics and reckless magical thinking about their financial soundness and future resources. For most of the 20th century, Asia asked itself what it could learn from the modern, innovating West. Now the question must be reversed: what can the West's overly indebted nations learn from a flourishing Asia?

First and foremost, the West should relearn the virtue of pragmatism. A few decades ago, Asia's two giants were stagnating under faulty politico-economic ideologies: strict Marxism in China, Nehruvian socialism in India. In both states, dogmatic theory trumped economic practicality, which left their societies weak and uncompetitive. However, once China began embracing free-market reforms in the 1980s, followed by India in the 1990s, both nations achieved rapid growth. Crucially, as they opened up their markets, neither country threw the proverbial baby out with the bath water—instead, they balanced capitalism with judicious government direction. As Indian economist Amartya Sen has wisely said, "The invisible hand of the market has often relied heavily on the visible hand of government."

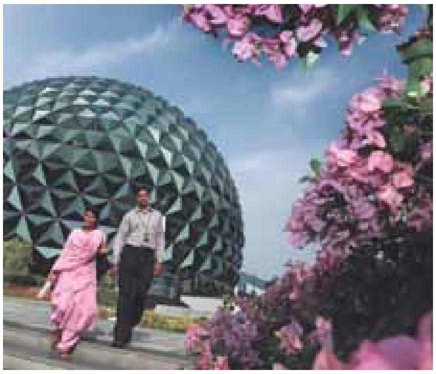
Contrast this middle path with the U.S. and Europe, which have each gone ideologically overboard in their own ways—and whose utter lack of pragmatism helped precipitate the global financial crisis. For its part, since the 1980s, America has been increasingly infatuated with the ideology of unfettered free markets and increasingly dismissive of the role of government, following Ronald Reagan's dictum that "government is not the solution; government is the problem." Former U.S. Federal Reserve chief Alan Greenspan took this ideology to the extreme by refusing to regulate the large new market in derivatives that emerged under his watch and that quadrupled between 2002 and 2008 to 12 times the size of the total world economy. Of course, when the markets crashed in 2007, it was decisive government intervention that saved the day. Despite this, many Americans still espouse an ideological opposition to "big government," as evidenced by the current wave of antitax Republicans and Tea Party candidates who swept the country's midterm elections.

If Americans could free themselves from their antigovernment straitjackets, they would begin to see that the U.S.'s problems are not insoluble. A few sensible federal measures could put the country back on the right path. A simple consumption tax of, say, 5 percent would make a significant dent in the huge government deficit without damaging productivity. A small gasoline tax would help wean America from its dependence on oil imports and create incentives for green energy development. In the same way, a significant reduction of wasteful agricultural subsidies and other earmarks could also lower the deficit. But in order to capitalize on these commonsense solutions, Americans will have to put aside their own attachment to the rhetoric of smaller government and less regulation. U.S. politicians will have to courageously follow what is taught in all public-policy schools in the U.S.: that there are good taxes and bad taxes. Some work. Some don't. Asian countries have embraced this wisdom, and have built sound long-term fiscal policies as a result. America should take note.

Meanwhile, Europe has fallen prey to a different ideological trap: the belief that its governments would always have infinite resources, and could continue borrowing as if there were no tomorrow. Unlike the Americans, who felt the markets knew best, the Europeans failed to anticipate how the markets would react to their incessant borrowing. The IMF has warned that sovereign debt in the advanced G20 countries is set to reach or exceed 100 percent of their GDP in the next few years. In Greece, the public debt has reached almost 140 percent of GDP, and the markets have demonstrated how they will react. It's not surprising that America's crisis was precipitated by a firm (Lehman Brothers), while Europe's was precipitated by a government (Athens). Now Europe is "paying the price for the fact that we lived above our means with amazing profligacy, and failed to reduce the role of the state," says former Greek finance minister Yannos Papantoniou.

Today, the EU is in firefighting mode to stave off sovereign collapse. In concert with the IMF, it has created a €440 billion fund to bail out Europe's troubled economies. This will buy the EU time. But it will not solve the bloc's larger problem—namely its unsustainable belief that national governments will always have enough revenue to pay for everything. They won't. Just as America needs to learn how to intelligently raise taxes, the Europeans need to learn how to intelligently cut expenditures—a challenge that Asian economies were taught by their own past crises to surmount. Fortunately, there's a lot of fat in European budgets that can be trimmed. Farm subsidies can be slashed, and Europe's problem of mounting pension debt can be solved by gradually raising retirement ages and trimming benefits. Courageous leaders such as France's Nicolas Sarkozy and Greece's George Papandreou have already led the way on these reforms. In Britain, Prime Minister David Cameron has forced his nation to undergo strict budget cuts. When more European leaders demonstrate similar mettle by attacking wasteful government expenditures, the markets will take note and ease the pressure on the euro.

Another timely lesson that the West can relearn from Asia is on the benefits of free trade. Both European and American populations are now frightened of free trade, seeing it as a synonym for jobs migrating overseas. As a result, the U.S. Congress has been unable to pass the free-trade agreements (FTAs) that America signed with Colombia, Panama, and South Korea. By contrast, the world's largest FTAs came into force in 2010 in Asia: between China and the 10 nations of ASEAN (involving 1.9 billion people), and India and ASEAN (1.7 billion people), as well as agreements between ASEAN and South Korea, Australia, and New Zealand. These pacts are not perfect. But by opening markets, Asia has paved the way for a better allocation of scarce resources, higher productivity, and improved well-being. The recent FTA between the EU and South Korea gives hope that Europe and America may once again embrace trade liberalization, as Asia is doing.



LOOK TO THE EAST INDIA HAS ADOPTED FREE-MARKET PRAGMATISM.

For most of the 20th century, **Asia** asked itself what it could learn from the modern, innovating West. Now the **question** must be **reversed.**

Right now, Asia could also teach the West a thing or two about the importance of continued investment in science and technology. In 2008, for the first time, East Asian companies and governments invested more in research and development than North America or Europe: $387 billion compared with $384 billion and $280 billion, respectively. Hence, while Asia invests in cutting-edge technology to train a huge new generation of scientists and engineers, schools in the West struggle to keep up student numbers in unpopular math and science classes. Then there's the matter of Asia's expanding middle class, the ultimate measure of a society's long-term health. Thanks to Asia's large investments in education and its rapid economic growth, it will contribute most of the new entrants to the burgeoning global middle class that's set to explode from about 1 billion strong this year to 3 billion in 2030. Many of these newly flush consumers will want to buy Western luxury products and spend tourist dollars in Europe and the U.S. Western multinational corporations have understood the importance of these new consumers, and are targeting them accordingly. But Western public opinion and government policy are lagging. During the U.S. midterm elections, the airwaves were filled with anti-China scare ads. This is not the smartest way to treat your future customers.

Going forward, the big question that America and Europe will need to ponder is why Asia will continue to grow despite the economic travails of the rest of the world. Some of it has to do with a natural rebalancing of history: from A.D. 1 to 1820, China and India were the world's largest economies. In the 21st century, they are once again returning to their natural perches. As they do, the West will have to give up its ideological predisposition to lecture others and instead develop an ability to learn from Asia. Paradoxically, these lessons are the very ones that the West used to offer the world: political and economic pragmatism, free trade, enthusiasm for science and technology, and investment in the middle class. Of course, this won't be the first time the West has needed to relearn its own wisdom from the East. Once upon a time, the great European Renaissance was facilitated by the preservation of Greek and Roman wisdom—lost to Europe during the Dark Ages—in the universities and libraries of the Arab world. Let's hope the current financial Dark Ages for the West last a much shorter time.

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