

BUSINESS DAY



Back to school: Asia values education so administrations invest heavily in social infrastructure to maximise long-term economic potential

Why we must learn those winning ways

TO UNDERSTAND why Britain is experiencing a period of prolonged low inflation, and why governments can and should play an important role in a country's economic success, look at south-east Asia. I have just returned from a 10-day business trip to five countries in the region. Like my other frequent visits, there was much to see and learn. Not only is it already an important area of the world economy, its significance is set to grow as more countries try to repeat Japan's post-war economic success.

In recent months there have been two

different debates about the relevance of Asia — one among academic economists, the other among British politicians. Both are important.

Some US academics argue that the economic success can be ignored as it is just due to Asia's low starting point. Their argument is that the economies are simply employing people who used not to work and are giving them more machines to work with. Although output is rising, this process cannot continue for ever.

Analogies are also drawn with Russia in the early Sixties. Then the West, particularly America at the time of the space race, feared Russia and the Soviet bloc were going to become the dominant economic power. Of course, they did not.

But there is a big difference between Russia then and Asia now. For a start, rather than bureaucrats deciding prices in Russia, the market decides prices in Asia, allowing an efficient allocation of resources. Asia is open to the world economy in a way Russia never was, benefiting from imports and capital inflows. For instance, emerging market equity funds rose from \$12.3 billion (£8 billion) in 1990 to a phenomenal \$123.8 billion by 1994, and of this 58% was directed from the West.

There are, of course, many countries in Asia. They do not all possess the same characteristics and some are indeed in a catch-up phase, China among them. But some countries look like they could soon leave us behind and it is from these high performing Asian economies that we have much to learn.

The World Bank classified these as Japan, the four "tigers" of Hong Kong, Korea, Singapore and Taiwan, and the three "nearly industrialised" economies of Indonesia, Malaysia and Thailand. Their combined share of world exports has con-

ECONOMIC VIEWPOINT



South-east Asia is showing the road ahead and exporting low inflation, says Dr Gerard Lyons

tinued to grow, from 7.9% in 1965 to 18.2% in 1990.

As these countries have become more important, global competitive pressures have intensified. The result has been a very different cyclical recovery for Britain and other industrialised economies.

The low-inflation international environment is explained mainly by the consequences of developments in south-east Asia. Costs there have been low but 10 or 20 years ago goods from places such as Hong Kong were usually also low quality. Not now. South-east Asia is now producing low cost, high quality goods. This has triggered intense global competition.

The clearest evidence of this is the extent to which labour costs have been held down in Britain and America. The result has been low inflation at the expense of sluggish wage growth and greater job insecurity. Thus consumers, who in the late Eighties were prepared to pay higher prices because their wages and house prices were rising, are now expecting value for money.

Retailers are forced to keep prices down to maintain market share. Producers are forced to keep prices down to stay in

business. The result is a self-feeding cycle of low inflation that is set to continue as competitive pressure from south-east Asia intensifies. Essentially the region is exporting low inflation.

The other debate about Asia has focused on the role of government. Some British politicians, including Hong Kong Governor Chris Patten, argue that the message is that low public spending is a prerequisite for economic success. This is wrong.

In the successful Asian economies the government has played an effective and crucial role by ensuring that labour markets remain flexible and by encouraging investment in education, infrastructure and industry.

‘Private sector savings must be encouraged to create a pool for investment’

Governments in south-east Asia may not spend much but their long-term thinking and planning is very effective.

The lesson for Britain is not that government spending should be reduced, it is that the government can play a useful role in key areas of the economy.

Our labour market must remain flexible to compete and attract inward investment. Yet this is only half the story. Just as Asia's quality of production has increased, so too must



Patten: missing the point

ours. There clearly has been some improvement among British companies but more needs to be done.

Compared with Asian economies, the UK does not save and invest enough. The most effective solution is for government to encourage private sector savings in order to create a pool of money for investment and to reduce the high welfare burden of public spending.

One way, common in Asia, is to shift to a partially funded social security system where people are forced to save out of their income.

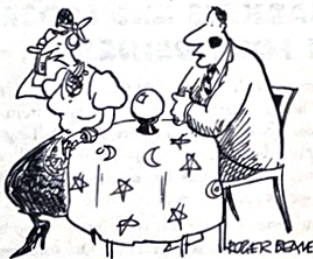
We also need heavy investment in social infrastructure, which will raise long-term economic potential.

Across Asia people value education highly and governments there have responded by investing heavily in primary and secondary education.

When the private sector is worried about demand and short-term problems, and does not want to invest, the government steps in to give them incentives to do so.

In Britain, policy should be aimed at encouraging investment in value-added areas, whether it be in finance, services or industry. The size of Britain's public sector may have to fall but in a world of volatile capital flows, the message from Asia is there is an even greater need for effective policy.

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