At the root of Asia's problems is a corrupt financial system in which the people have lost all confidence. By Sin-ming Shaw

Nations Crying for Leadership

INDONESIA IS A COUNTRY PARALYZED. PRESIDENT SUHARTO is now widely seen as a floundering old man unable to understand why the currency is collapsing and unwilling to let go of a nepotistic culture that, like a cancer, is pushing the country into a terminal stage. How did Indonesia come to this? Isn't it Asia's third largest country in size and population, rich in resources, boasting talented and hardworking people who have been generating impressive real growth during the better part of the past 30 years?

Last week, when the world expected Suharto to announce a belt-tightening budget in the framework set down by the IMF in exchange for help, he took the politically expedient but gutless course with a mild budget. Suharto obviously thought those who would suffer the most from an austerity program would welcome his largesse. But the people, as usual, are smarter than their leaders. The Indonesian rupiah simply collapsed after the speech, reaching a low point of 11,200 to the dollar—a drop of nearly 40 percent in less than three days. Eight months ago it was 2,400 to the dollar. The country is crying for leadership, which at this crucial moment is nonexistent.

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Unrest ahead? *Damage from 1997 anti-Chinese riots in Indonesia*

Lawrence Summers, America's deputy secretary of the Treasury, and staff from the National Security Council are now in Jakarta, pressing Indonesia to do the right things, however painful they may be either to the elite or to the people. The fact that NSC is involved confirms what many in Asia fear: an economically disintegrating Indonesia will present a security risk that could have global implications. Both Indonesia and Malaysia are Muslim countries led so far by moderate and modern leaders who have turned their backs on fundamentalist zealots. If Indonesia under Suharto collapses, who can predict what might happen to the nascent fundamentalist movements in Indonesia or Malaysia?

There are plenty of credible gripes for clever fundamentalist propagandists to exploit: the evil of Western bankers, the corruption of market economics, the total absence of spirituality in the pursuit of profit. Worse, the ultimate futility of that pursuit as evidenced by a collapsing currency and the insolvency of the entire country.

In the past the Overseas Chinese would have become the scapegoat for official policy failures. Half a million Indonesian citizens of Chinese descent were slaughtered in the 1965 racial riots caused largely by economic hardship. The Chinese were visibly better off than most locals. But this time, sitting governments cannot credibly play the ethnic card. In neither Malaysia nor Indonesia does anyone seriously believe that the Chinese are at the root of the current problems. In Malaysia everyone knows bumiputra (Malay) billionaires control all the key sectors of the economy. Similarly, in Indonesia, the whole world knows Suharto's friends and family control the pulse of the economy and benefit personally from it. His children, notably, seem unashamed about their well-publicized appetites for sweetheart deals.

Some will blame endemic mismanagement of exchange-rate policy throughout Asia—and especially in Indonesia. But this is to miss a larger point. Sound money is the most visible symbol of the integrity of the government. In every country in Asia where the currency has been in free fall—South Korea, Indonesia, Thailand, the Philippines and Malaysia—there is a mistrust of the integrity of financial institutions that intermediate between savers and borrowers. In plain language, ordinary citizens have awoken to the fact that their savings, entrusted to banks or finance companies, have been squandered.

In Korea and Japan, corruption and crony loans, though not uncommon, have been less important than other errors. Korean and Japanese companies and banks simply have no concept of earning a decent return for shareholders. Conglomerates invest money not to maximize returns but to expand market share. But when the cost of money remains higher than the returns on its investment, companies will eventually go bust—as they have started to in Korea and increasingly in Japan.

In Southeast Asia, the problem is compounded by large crony loans as well as by out-of-control credit growth. Banking liabilities in Thailand, Malaysia and Indonesia are between 130 and 160 percent of GDP. Their economies are hugely leveraged. Any wonder why citizens, individual and corporate, are selling their own currencies for the U.S. dollar?

What would restore confidence?

Some Asian governments hope for a concerted effort by the G-7 industrialized countries to intervene in the currency markets to shore up confidence. Such intervention can only be a palliative. In Thailand and Malaysia, meanwhile, leaders engage in publicity stunts, pleading for citizens to repatriate foreign assets. The only real solution is to restore confidence in the integrity and the honesty of local financial institutions. That could mean a massive firing of current managements, a closing down of bankrupt banks, a takeover of salvageable ones by solid banks, local or foreign—all to be followed by an immediate overhaul of supervisory bodies that govern these institutions.

So far the response has been at best mixed. Political leaders, except in Korea, are largely still in denial. Deep down, most Asian leaders continue to blame foreign speculators for their woes. They do not admit the problems are homegrown and have been festering for years. But if Asia's leaders do not have the courage to account for past errors and the determination to radically reform the financial system, Asia's economic crisis could yet drag the world into a major disaster.