



ASIA WILL BE THE OIL CRISIS WINNER

As oil prices rise in the wake of Iraq's invasion, people are once again assuming that Asian oil importers will be hurt the most. After all, Japan, South Korea, Taiwan, Hong Kong, and Singapore have virtually no domestic fuel supplies.

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The same assumption prevailed after the oil crises of 1973 and 1978. South Korea, we were told by virtually every analyst, was on its way to bankruptcy by the mid-1970s. The other NICs should expect the same fate, and Japan's years of rapid growth should be over.

Just the opposite happened. By 1976, South Korea had a trade surplus with the Middle East. All of the NICs and Japan continued to enjoy rapid growth. The economies of the smaller Asian countries grew so rapidly during the terrible 1970s that, by 1980, their aggregate trade was larger than Japan's. Meanwhile the West sank into stagflation. In proportionate degrees, this pattern will repeat itself in the 1990s.

***Oil prices pass
through***

How can this happen? First, Pacific Asian countries pass much of the increased oil price right through. They pay the higher price when they import the oil, but they get much of it back when the export plastics and a host of industrial products with high energy or petrochemical content.

***Japan & NICs adjust
faster***

Second, these countries adjust faster and thereby gain a long-term competitive advantage. Since they have more competitive markets, and sometimes government assistance with adjustments, they are quicker to grab new opportunities. Thus, South Korea in 1974-'76 became overnight one of the world's international construction giants, beating out Western firms to build roads, ports, dams, and other large projects all over the Middle East.

Although their governments often facilitate the adjustment, the most important thing Pacific Asian governments do is to allow the market adjustment to occur. In the fast-growing Pacific Asian countries, fuel prices rose rapidly and conservation began immediately. But the U.S. government kept price controls on key fuels until 1980. Not only did American conservation lag, but American auto buyers did not face the full consequences of higher oil prices until seven years after the initial increases. Thus Detroit had no incentive to move quickly toward smaller cars and more efficient engines.

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In this and many other markets, Asian producers got the better part of a decade of technological innovation because their governments accepted the necessity of adjustment while Washington pandered to voters' desire to be insulated from economic reality.

In the 1990s, Pacific Asian countries will continue to pass much of the oil price increases through to ultimate consumers. And they will continue to adjust more decisively than competitors.

***Competitors will be
badly hurt***

Large, sustained oil price increases will make the tragedy of Africa even worse, with the notable exceptions of those countries, like Nigeria, which export oil. The price rises will slow the growth of Western Europe, except Britain and Norway, and will add greatly to the economic mess of Eastern Europe and the cumulating costs of that mess for Western Europe. They will exacerbate the U.S. choice between recession and inflation. They will worsen the debt problems of Brazil and many other Latin American countries, but hasten the improvement of Mexico, which now has both oil money and adjustment. They will slow the U.S.S.R.'s economic collapse and accelerate China's return to growth.

***Asia will slow, but
bounce back***

Pacific Asia will not completely escape suffering. It will experience higher inflation, and growth will slow somewhat because its customers in America and Europe will buy less. The economic consequences of the oil price rise will be greater than in the 1970s, because domestic consumption has risen quickly and because democratization in Taiwan and South Korea (and modestly greater populism in Japan) may mean somewhat slower adjustment. But in the 1990s their economies, with far less debt and far more diversity, can more easily absorb a shock. They will still pass through most of the rise in costs, and they will still adjust far faster than competitors.

***Winners: Indonesia,
Malaysia, Japan, NICs***

Within Asia, Indonesia will be the biggest winner. It has learned the art of rapid adjustment and its imminent takeoff has been slowed only by its huge foreign debt. The decline of Indonesia's debt service ratio was already rapid; now it should be spectacular.

Malaysia, an oil exporter, will be a more modest winner.

Japan, Taiwan, South Korea, and Hong Kong will experience short term adjustment problems but will make gains in world market share. Hong Kong will benefit both from rapid adjustment and from relaxation of China's financial squeeze.

The Philippines will be Asia's big loser. A Latin American country in all but location, the Philippines will pay higher oil prices but will not reexport those prices with its sugar, coconuts, and copper. Its worst problem, the overhang of debt that has already been worsened by exploding trade imbalances, will worsen decisively. And domestic politics always has priority over economic adjustment measures in Manila, so domestic oil price subsidies will undoubtedly rise.

Most Asian markets will decline from the shock of Middle East news. The declines will go far beyond anything justified by the slowdown in Western markets. In fact, the declines will reflect wildly exaggerated images of the effects of the oil price increases on the great oil importers of Pacific Asia. The investor who remembers the history of the 1970s can profit greatly by recalling the lessons of that history: the excess declines will reverse, and over the longer term Asia's share of world trade will rise.

Loser: Philippines

***Markets will overreact,
then rebound***

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