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INDUSTRIAL POLICY IN EAST ASIA

1950 - 1985*

Prepared by

Regional and Country Studies

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PREFACE

Within the framework of UNIDO industrial studies, the Regional and Country Studies Branch carries out policy-oriented studies, and provides national policy makers with analyses of industrial development trends and prospects.

The purpose of this report on Industrial Policy in east Asia, 1950-1985, is to attempt to provide a comparative review of past industrial policies and their effects on the actual performance of the industrial sector. This assumes particular importance in the face of prevailing uncertainty in the world economy and current re-assessments of national policies. The study was sponsored by the Section for Economic Co-operation among Developing Countries, UNIDO, and is intended to stimulate further debate and analytical work in this field.

The report draws largely on two sources. One is the deliberations and proceedings of two recent conferences at which the issues were extensively canvassed, the Fifteenth Pacific Trade and Development Conference on "Industrial Policies for Pacific Economic Growth" held in Tokyo, 26-29 August 1985, and a workshop on "Explaining the Success of Industrialization in East Asia" held at the Australian National University in Canberra, 10-12 September 1985. The individual papers presented at these conferences are listed in the references appended to this volume. The second source is the experience of UNIDO, distilled in its industrial development reviews and in various other studies and reports. Most of the statistical tables have been taken, with permission, from various conference papers. The sources given are those used by the authors of the papers whose contribution is gratefully acknowledged.

The report, after a preliminary discussion of the objectives of industrial policy, summarises the statistical evidence concerning the economic performance of the east Asian developing market economies in the past three decades. It goes on to attempt to explain their success in terms of preconditions and policies, where preconditions comprise both historical, cultural and political features of their societies and the external economic

environment, while policies include both macroeconomic policies which affect industry in general and microeconomic policies directed at particular industries, including both incentives (chiefly for export) and protection (chiefly from import competition). The report concludes with an assessment of likely future trends for the east Asian NICs and possible lessons of their experience for other developing countries and scope in this field for technical co-operation among developing countries.

The report has been prepared in collaboration with Dr. Heinz W. Arndt, Professor Emeritus at the Australian National University, Canberra, as UNIDO consultant.

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EXPLANATORY NOTES

Regional classifications, industrial classifications, trade classifications and symbols used in the statistical tables of this report, unless otherwise indicated, follow those adopted in the United Nations Statistical Yearbook.

Dates divided by a slash ('1983/84) indicate a crop year or a financial year. Dates divided by a hyphen (1983-84) indicate the full period, including the beginning and end years.

Figures may not add precisely due to rounding.

References to dollars (\$) are to United States dollars, unless otherwise stated.

In tables:

- Three dots (...) indicate that data are not available or are not separately reported;
- A dash (-) indicates that the amount is nil or negligible;
- A blank indicates that the item is not applicable;
- One dot (.) indicates that there is insufficient data from which to calculate the figure.

The following abbreviations and acronyms are used in this document:

ASEAN	Association of South-East Asian Nations
CMEA	Council for Mutual Economic Assistance
DFI	Direct Foreign Investment
EEC	European Economic Community
GDP	gross domestic product
GNP	gross national product
ISIC	International Standard Industrial Classification
MITI	Ministry for Trade and Industry (Japan)
MVA	manufacturing value added
NICs	Newly Industrialising Countries
OECD	Organization for Economic Co-operation and Development
R & D	Research and Development
SITC	Standard International Trade Classification

EXECUTIVE SUMMARY

Export-oriented Industrial Development

The distinguishing feature of the industrial development of the eight east Asian developing market economies in the past three decades is that, much like Japan in the inter-war period, they have pursued an export-oriented strategy. Hong Kong from the start, Taiwan Province of China^{1/} in the 1950s, Singapore after separation from Malaysia in the mid-1960s, the Republic of Korea in the mid-1960s, Malaysia and (in response to the increase in their oil import bill) also Thailand and the Philippines in the early 1970s, and even Indonesia (faced with the prospect of declining oil earnings) much more hesitantly in the late 1970s - all adopted a deliberate policy of encouraging and promoting manufacturing for export in line with their perceived comparative advantage. The strategy proved spectacularly successful, most clearly so in the case of the four east Asian resource-poor 'newly industrialising' countries (NICs). They not only achieved rates of economic growth matched by hardly any other developing countries, but also did relatively well in terms of income distribution and other criteria of development.

The Statistical Record

During the period 1965-1983, all eight countries did better in terms of growth of per capita income than the average of developing countries, and the four east Asian NICs achieved growth rates of per capita income almost twice the average of middle-income developing countries. More significant, during the years 1973-80, when growth in the OECD area slowed down, growth in the east Asian group of countries actually accelerated, averaging almost three times the OECD average rate. Exports of manufactures grew at very high rates in all these countries. By 1983, manufactures accounted for more than 90 per cent of the exports of the east Asian NICs and for a growing, though still much smaller, proportion in the other four ASEAN countries. Exports contributed substantially to rapid growth of manufacturing production. High rates of economic growth in these countries proved compatible with improvement

^{1/} Hereafter referred to, for short, as Taiwan Province.

in income distribution and other aspects of social development. While, in terms of income distribution alone, the record varies, with Taiwan Province and Singapore high and Malaysia and the Philippines low in ranking order, all the eight countries appear in the top half of a sample of developing countries if the criteria of growth and equity are combined.

While the fact that all these countries have enjoyed remarkably high rates of economic growth associated with export-oriented industrial development is not really in dispute, there has been much debate about the extent to which the good performance can be attributed to the policies that were adopted rather than to specially favourable preconditions, in the domestic features of their societies and the external environment.

Preconditions: Historical, Cultural, Political

At least seven features of the domestic setting of the east Asian developing market economies, the history, social structure, politics and culture of their societies, have been put forward in partial explanation of the success of their outward-looking industrial policies. They are: small size, poor natural resource endowment, external threat, predominance of growth objective, prior elimination of obstructive interests and institutions during periods of foreign rule, authoritarian political regimes and a common Confucian culture and ethic.

It can plausibly be argued that these features have contributed to success in some, if not all, of the eight east Asian countries. But there are many counter examples - countries which shared some or all of these features and did not do well and others which lacked some or all of them and performed creditably. Clearly, they are not a sufficient condition of successful industrialisation and may not even be necessary. What distinguishes them from policies is that in their very nature they are largely given, possibly slowly emulated, but not easily adopted by an effort of political will.

Preconditions: the External Environment

Since the international environment has been broadly the same for all developing countries, it cannot account for the fact that some of them have

been so much more successful than others. But it has been argued that the east Asian NICs were favoured because they embarked on export-oriented policies during a period of exceptionally rapid growth of the world economy, because for much of the period they had the field to themselves as exporters of labour-intensive manufactures and because they enjoyed exceptional external support through aid and direct foreign investment.

The main answer to the first argument is that the east Asian countries that had done so well during the period of rapid world growth of the 1950s and 1960s did even better when world growth slowed down during the 1970s. The main answer to the second point is that a considerable part of the expansion of exports of manufactures by the east Asian NICs during the 1960s and 1970s was achieved not through overall increase in demand for such products in advanced industrial countries but by their taking over markets, both in developed and other developing countries, vacated by Japan. The third argument is even less persuasive. Aid has had at best a marginal effect, except in the years of post-war recovery in Taiwan Province and the Republic of Korea, and then mainly to support very large defence spending. Direct foreign investment has been of major importance only in Singapore. In any case, it is hardly plausible to give credit to transnationals for the good performance of the east Asian NICs and blame them, as it is done so often, for poor economic performance in other developing countries.

Government Policies: the Macroeconomic Framework

If good policies are largely responsible for the successful pursuit of industrial development in the east Asian developing countries, as much of the credit is due to the generally high quality of overall economic management as to microeconomic policies directed at the manufacturing sector or particular manufacturing industries.

The most general, and in some respects most important, feature of the macroeconomic environment in all eight countries, including Indonesia after 1965, was the adoption of broadly market-oriented policies. In all of them, except Hong Kong, government played a pervasive role in the economy. But business activity was in the main left to private enterprise; the allocation of productive resources was largely left to market forces; governments

generally speaking encouraged private business to be competitive; and government policy aimed at integrating the national economy into the world market economy. Other features of economic management which contributed to success were a generally high quality of administration, by Third World standards; a strong emphasis on education; prudent macroeconomic policies which kept inflation under control and maintained realistic exchange and interest rates; and flexible response to changes in the world economy and to past mistakes.

Government Policies: from Import Substitution to Export Orientation

The most distinctive feature of specifically industrial policy in all eight countries was the deliberate adoption, in one after the other, of outward-looking industrial development. All of them began with import-substitution, in all cases (except Hong Kong) under cover of tariff protection. But all of them moved away from exclusive reliance on import substitution as its disadvantages became apparent. Given the limited size of the domestic market in small and relatively poor countries, protection of import-competing industries involved loss of allocative efficiency. Even more serious was the loss of dynamic efficiency as protected manufacturers found it easier to lobby for more protection than to improve the efficiency of their firms.

Export-orientation did not imply a move to the opposite extreme, distorting the allocation of resources in favour of exports, but rather a move to 'unshackle exports', by eliminating macroeconomic and microeconomic policies that discriminated against exports, such as overvalued currencies, tariffs and import restrictions. The advantages of export orientation were largely the converse of the disadvantages of the earlier import-substitution strategy. There were the static gains from a pattern of trade and production more in accord with each country's comparative advantage - in textiles, clothing and other labour-intensive industries which maximised their advantage of cheap labour and in the resource-rich countries also resource-based industries. In the late 1970s, as the first generation of east Asian NICs began, with rising real wages, to lose their comparative advantage in labour-intensive manufactures, they began to follow the example of Japan by shifting, with more or less deliberate government encouragement, towards

export of more skill- and technology-intensive products. Again, however, the chief benefits came from the dynamic gains from trade. Export orientation raised total factor productivity by promoting flexibility in resource deployment, the competitiveness that comes with production for contestable markets abroad, and learning of technological and managerial skills, and by fostering of good work habits and attitudes rather than 'rent-seeking' behaviour.

In none of the eight east Asian countries, any more than in Japan, did the shift to export orientation mean the end of import substitution, not even in Hong Kong and Singapore where import substitution did not enjoy tariff or other protection. In the Republic of Korea and Taiwan Province, as in Japan, protection of the domestic market through invisible barriers rather than tariffs, has continued. In all the east Asian developing market economies, moreover, the past decade has, under the impact of the energy crisis, seen moves towards a second round of import substitution, with the emphasis on capital-intensive industries. Their not altogether happy experience with these programmes has provided new object lessons in industrial policy for structural adjustment.

Government Policies: Structural Adjustment

The success with which the east Asian NICs have, in the past two decades, accomplished first the shift in industrial structure from import-substitution to export-orientation and then from labour-intensive towards increasingly skill- and technology-intensive industries has widely been attributed to the influence of the so-called 'Japan Model' - interpreted as strong government guidance of the process, through anticipation of changes in comparative advantage, picking winners and phasing out losers.

Picking winners. While there is general agreement that Japanese industrial policy rested on close co-operation between government and industry and emphasised economic growth, efficient allocation of resources and a domestically and internationally competitive economy, there are divergent views about the precise role of government, as represented chiefly by MITI (Ministry for Trade and Industry, Japan). MITI's own image of its role is of itself as the dominant partner, exercising firm guidance, picking winners and

backing selected growth industries with a comprehensive package of support, including accelerated depreciation allowances, special R & D funding, etc. Others emphasise the extent to which MITI has relied on business advice and the frequency with which, where it has taken a line of its own, it has made mistakes. MITI planning by consensus reduced the dangers of centralised investment planning. But the historical record of failures even in Japan serves as a warning against over-optimism.

Resort to government direction in industrial policy among the east Asian developing countries has varied from a heavy hand in the Republic of Korea and (rather less effectively) Indonesia, at one end of the scale, to near laissez-faire in Hong Kong, at the other. The most recent experiments in 'economic restructuring' towards heavy industry ostensibly following the Japan model in the ASEAN countries have not, so far, been an unqualified success.

Helping losers. If one side of structural adjustment is to find growth industries, whether through the market or through government attempts to pick winners, the other side is what to do with the losers, the declining industries which are losing comparative advantage. It is here, rather than at the 'sunrise' end of the spectrum, that the Japan model has so far shown itself markedly superior to general practice in other industrialised market economies. The emphasis has been on adaptation, phasing out or at least scaling down, not on protection or subsidies. The same has broadly been true in the east Asian NICs, although not many tests have yet come. The Singapore government, for instance, was quite prepared to close down the motor vehicle assembly industry when it showed no prospects of becoming internationally competitive. In Taiwan Province, the Government has at times given special assistance to companies in trouble, but the general stance of industrial policy has been to facilitate adjustment in line with market forces. The same cannot be said without considerable qualification of the other four ASEAN countries. In all four, market orientation of industrial policy has been qualified by non-economic objectives, such as regional or ethnic balance, and in varying degree hampered by entrenched protectionist sentiment and vested interests. In this respect, industrial policy in Indonesia and the Philippines still has more in common with its general tenor in most other developing countries, especially in Latin America.

The Future: Prospects and Policies

Economic growth in the developed countries seems unlikely to regain the momentum of the 1960s, and the problem this has presented to all developing countries with export-oriented industrial policies has been aggravated by protectionist measure. While the relatively open US market has been a source of strength to the east Asian NICs, their heavy dependence on that market could become a source of weakness in the next few years if the large US current account deficit requires correction. 1985 has proved a difficult year for all the east Asian countries, and there has been only half-humorous talk about 'export-led slowdown'.

But this may be taking too gloomy a view. With the exception of the Philippines and temporarily Singapore, the east Asian developing market economies are still growing faster than most others. Among other Asian countries, it is those which have in recent years adopted more outward-looking policies, such as the People's Republic of China, India and Sri Lanka, that are showing the highest rates of growth. Certainly much depends on the prospects for economic growth and a reasonably liberal trade regime in the advanced industrial countries. A special responsibility rests on Japan to open its potentially huge domestic market for the labour- and skill-intensive products which many industrialising countries can now produce increasingly competitively.

Obviously, countries which integrate their national economies into the world market economy are more exposed to buffeting by cyclical fluctuations in the developed countries and other disturbances. But the historical experience of the past thirty-five years has clearly demonstrated that there is no net gain in insulation from the world economy through inward-looking policies. On the contrary, the evidence of relative economic performance indicates strongly that the static and economic gains from international trade and factor flows on balance greatly outweigh the risks of vulnerability.

There is little ground for pessimism about the capacity of the more advanced NICs to compete in world markets. That, after all, is how Germany, France and the USA contested the field with Great Britain in the latter 19th century, and Japan and many western European countries later established a

comparative advantage in all kinds of specialised manufacture. But export markets have to be won. Hence the importance of energetic and skilful export marketing, whether through specialised trading companies or other mechanisms.

The main lessons that other developing countries can learn from the east Asian experience relate not to the amount, but to the kind, of government intervention in the economy. Much of the success of the east Asian countries has been due to good macroeconomic policies, both in the provision of education and other public goods and in prudent fiscal and monetary policies. In more specifically industrial policy, the value of the Japan Model, it would seem, lies less in the role of government in 'picking winners' - while it was easy to recognise comparative advantage in the broad range of labour-intensive industries, selecting winners among heavier industries has proved much more difficult - as in phasing out losers. Governments cannot help giving some assistance to people in declining industries. The lesson here is the desirability of helping labour and capital to move out rather than stay in such industries.

Government intervention in the east Asian countries, while often very intensive and detailed, has generally been designed to promote rather than to obstruct adjustment to market forces. To a much greater extent than in most other countries, it has followed the precept that the incentive structure of prices, in the market for goods, capital and labour, should promote adjustment and thus industrial development. 'Getting relative prices right is not the end of development. But getting prices wrong frequently is'.

Scope for Economic and Technical Co-operation among Developing Countries:

Much effort has been devoted in recent years to study and encouragement of economic and technical cooperation among developing countries. East Asian experience is of particular interest in this context because it presents two strikingly different models. The three northeast Asian NICs have pursued their export-oriented industrialisation with their eyes to the world market, exploiting their comparative advantage in labour-intensive manufactures. By contrast, the countries of southeast Asia have tried to combine

export-oriented industrial development with regional economic cooperation, within the framework of the Association of Southeast Asian Nations (ASEAN). ASEAN has been a resounding success but in cohesiveness and unity of purpose, especially towards the rest of the world, rather than in the practicalities of intra-regional economic cooperation where results so far have been meagre. Part of the difficulty has been disparity in industrial development, especially between Singapore and Indonesia. But underlying it has been the implicit perception in each country that its national economic interests were not necessarily best served by preferential treatment of the products of its ASEAN partners rather than by freedom to buy and sell in the world market.

The enormous complexity of modern industrial technology and high cost of R&D investment have caused new technical knowledge for industry (in contrast to agriculture) to be almost invariably subject to public or private property rights. Since all but the very largest countries must acquire almost all new technology from abroad, whether through licensing or direct foreign investment, the foreign exchange cost can be burdensome on developing countries. Technical cooperation among developing countries has been suggested as one way of reducing this cost. The natural monopoly of new technology held by advanced industrial countries, both market and socialist, is coming to be breached by progress of industrialising countries, not least in east Asia. Their increasing technological capability, based on a substantial stock of highly skilled manpower, enables them to play a role, still modest but growing, in transfer of technology to less advanced developing countries.

I. Introduction

Around 1970 the attention of development economists and policy-makers was drawn to the remarkable success which a number of developing market economies in east Asia appeared to have achieved with a deliberately export-oriented strategy. Hong Kong from the 1950s and Singapore, Taiwan Province of China^{1/} and the Republic of Korea from the mid-sixties had recorded very high rates of growth of GDP associated with even higher rates of growth of exports, especially of labour-intensive manufactures. The suggestion that other developing countries might benefit from adopting a similar strategy met with some scepticism based largely on the ground that such an outward-looking strategy which had been suited to the conditions of rapid growth of the world economy during the 1950s and 1960s would fail in the conditions of much slower and uneven growth of the 1970s. Yet, the east Asian so-called "newly industrialising countries" (NICs), which were now increasingly followed in their export-orientation by the other four ASEAN countries, sustained and even improved on their growth performance during the turbulent 1970s.

The early 1980s have led to some faltering in their economic performance, connected with recession in the advanced industrial countries and other factors, and again scepticism is being voiced about the advisability of an export-oriented industrialisation strategy in the years to come. It seems an opportune time to reassess the experience of the east Asian developing market economies. To do so is the purpose of this report.

The report should be seen as a contribution to continuing discussion. In the minds of many readers it will raise as many questions as it answers. Will it be possible to combine a second round of import substitution with a second round of export promotion so as to ensure the creation of a broader productive base for the industrial sectors of developing economies? Is import-dependence liable to increase significantly in the next wave of more sophisticated production for export? Will this second, higher-level of industrial transformation call for disproportionately higher endeavours in the field of technological capability and human resource development? The prospects facing industrial policy-makers during the remaining years of this century and beyond

^{1/} Hereafter referred to, for short, as Taiwan Province.

are for increasing complexity of strategy choice which will call for a flexible businesslike set of policy measures.

Further work will need to be done, by UNIDO and others, to explore these issues. In making this report available, UNIDO hopes to give a helpful stimulus to such thinking and research.

II. Policy Objectives

For the purposes of this Report, industrial policy is defined broadly as covering all government intervention concerned with manufacturing industry. As such, industrial policy is a branch of economic policy and must be conceived as serving the whole range of objectives of economic policy. In developing countries, these centre on the objective of economic development to which the promotion of economic growth is crucial but which also comprehends a variety of non-economic objectives, such as national independence, equitable distribution of the benefits of growth, as well as cultural and political values.

Four aspects of this general statement deserve a few words of comment because of their relevance to the issues to be discussed later in this report. They are market failure as the rationale of government economic policy; the distinction between allocative and dynamic economic efficiency as sources of economic growth; the significance of trade-offs between economic and non-economic objectives; and the role of industrialisation in development.

Governments have to act in economic matters because much of what the community wants to achieve cannot be left to market forces. There are many things that markets cannot do at all, such as the maintenance of law and order, national defence and the provision of other public goods; and there are many other things that markets do inadequately, whether because of monopolies, externalities, rigidities or failures of motivation. In this sense, the need for government action, for economic policy of any kind, can be said to arise from market failure. While there are areas of policy where the need for government action is indisputable, there are others where the relative merits of government action or inaction are debatable. They will depend on the kind and degree of market failure, on the kinds of government intervention

available and on the efficiency of government - the quality of leadership, the skills of policy-makers and the capability of administrators. In some circumstances, even where market failure is clearly in evidence, government intervention may fail to mend market failure as market forces take their course. "Government failure" may outweigh market failure.

Economic growth depends in large part on the most efficient allocation of given productive resources. This is one function that markets may perform more or less well. But economic growth depends also, and perhaps even more, on factors which go beyond the efficient allocation of given resources (in technical language, the function of markets is not merely to achieve the optimum allocation of resources on a given production possibility curve but also to shift this curve outward). These include increasing the quantity and quality of labour and capital, promoting technical progress and improving organisation to reduce transaction, information and insurance cost. They all relate to the innovative role which in market economies is the function of private entrepreneurs but which may in some circumstances be more effectively performed by government. The relative likelihood of market and government failure needs to be assessed in relation to both the "allocative" and the "creative" function of markets.

Economic growth is only one of many objectives of national policy, in developing as in more advanced countries. Some non-economic objectives, such as power and prestige, defence capability or the popularity of the regime, may be dependent on or associated with a high rate of economic growth. Other socio-economic objectives, such as an equitable distribution of income, protection of vulnerable groups, self-sufficiency, regional balance, economic stability, social security, full employment and other aspects of the quality of life, may be in harmony with economic growth or attainable at the cost of lower economic growth, depending on the particular circumstances. National policy will then aim at a mix of objectives, involving some trade-off against economic growth. An industrial policy which promises the highest rate of economic growth in the short term may therefore be rejected in favour of one designed to give greater weight to some non-economic objectives, which is not to say that it will necessarily prove the first-best, or even second-best, path to these non-economic ends. Nor can it be assumed that national policy, with its particular mix of objectives, necessarily represents a national

consensus. It may be the outcome of a power struggle, or compromises, between sections of the community with conflicting, or at least divergent, interests.

Industrialisation has been an invariable ingredient of policies for economic growth in almost all countries in modern times. There are economic and non-economic reasons for this. Among the economic ones are the fact that in modern economies, much consumer demand with rising incomes and almost all investment demand represents demand for the products of manufacturing industries and that manufacturing has seemed to offer the greatest scope for increasing productive capacity through technical progress. A wide range of historical and cross-country studies show rapid growth of manufacturing highly correlated with rapid overall growth of GDP. When developing countries embark on rapid industrialisation, technical progress enters into the productive process to increase productivity. Rising productivity in manufacturing tends to accelerate growth in other sectors. Among the non-economic reasons for high priority for industrialisation are the association of manufacturing with national security and with urban civilisation. Even in countries rich in natural resources, the contribution of manufacturing to GDP surpasses that of agriculture and other primary industries at some stage of economic development. The rate of growth and efficiency of a country's manufacturing industries is therefore crucial to the performance of its economy.

There will be frequent occasion in later chapters of this Report to refer back to these rather elementary propositions about the objectives of industrial policy.

III. Industrialisation in the East Asian Developing Market Economies: the Statistical Record

The distinguishing feature of the industrial development of the eight east Asian developing market economies is that, much like Japan in the inter-war period, they largely pursued an export-oriented strategy. Hong Kong from the start, Taiwan Province in the 1950s, Singapore after separation from Malaysia in 1965, the Republic of Korea in the mid-1960s, Malaysia and (in response to the increase in their oil import bill) also Thailand and the Philippines in the early 1970s and even Indonesia (faced with the prospect of declining oil earnings) much more hesitantly in the late 1970s - all adopted a deliberate policy of encouraging and promoting manufacturing for export in line with their perceived comparative advantage. The strategy seems to have been spectacularly successful, most clearly so in the case of the four east Asian resource-poor countries. They not only achieved rates of economic growth matched by hardly any other developing countries, but also did relatively well in terms of income distribution and other criteria of development.

Table 1 compares average rates of growth of GDP and GNP per capita of the eight east Asian developing market economies with the average for low-income, middle-income and all developing countries during the two periods 1950-65 and 1965-83. Three facts stand out. First, in all the east Asian countries, except Indonesia and Malaysia, the rate of growth of GDP was even in the earlier period above, and in the cases of Singapore and Hong Kong well above, the average of middle-income countries. Secondly, from the mid-1960s when the other four ASEAN countries also adopted increasingly export-oriented industrial policies, growth accelerated in all of them, except the Philippines. Thirdly, in the second period, in terms of growth of per capita income, all eight except the Philippines did better than the average of middle-income developing countries, and the four east Asian NICs achieved growth rates of per capita income almost twice the average of middle-income countries.

Table 1. East Asian developing market economies:
average annual GDP and GNP per capita growth, 1950-83
(percentage)

	<u>GDP Growth</u>		<u>Per capita GNP Growth</u>		<u>Per capita GNP</u>
	1950- 1965	1965- 1983	1950- 1965	1965- 1983	US \$ 1983
Singapore	5.5 ^{a/}	10.3	5.5 ^{a/}	7.4	6,620
Kong Kong	10.1	8.7	5.5	6.2	6,000
Taiwan Province	5.7 ^{b/}	8.9	4.9 ^{b/}	6.7	2,677
Korea, Rep. of	5.7	8.6	3.3	6.7	2,010
Malaysia	4.7	7.1	1.7	4.5	1,860
Thailand	6.3	7.4	3.3	4.3	820
Philippines	6.1	5.4	2.9	2.9	760
Indonesia	3.2	7.5	1.1	5.0	560
Low-income developing countries	4.0	5.3	2.0	2.7	260
Middle-income developing countries	5.0	5.8	2.4	3.4	1,310
Developed countries	4.6	3.4	3.4	2.5	11,060

Source: I.B.R.D., World Tables, 3rd Ed., 1984; I.B.R.D., World Development Report, 1985; Taiwan Statistical Data Book, 1984.

^{a/} 1960-1965.

^{b/} 1952-1965.

Table 2 puts the growth record of the east Asian group of countries in another illuminating perspective by comparing it with that of various other categories of countries during the three periods 1960-73, 1973-80 and 1981-83. The interest of this Table lies in two main facts. Growth in the east Asian group of countries accelerated after the first oil shock in 1973/74, while growth in all other categories (except India) slowed down, including and especially in the advanced industrial countries. Secondly, and partly in consequence, the average rate of growth in the east Asian countries during this latter period was almost twice that of all middle-income countries and nearly three times that of the OECD countries. Thirdly, growth in east Asian countries contracted in 1981 and especially in 1982; a revival of growth occurred in 1983 but growth was lower than in the People's Republic of China, India and in the (oil producing) middle income-countries of the Middle East and North Africa.

Table 2. Growth of GDP per capita by region, 1960-83

Country group	Population (million) 1980	GDP per capita, (US \$) 1980	Average annual real growth rate of GDP per capita (per cent)				
			1960-73	1973-80	1981	1982	1983
Low-income countries	2,098	260	3.2	3.0	2.1	2.9	5.1
Asia	1,901	260	3.6	3.4	2.6	3.4	5.9
China, People's Rep. of	980	290	6.1	4.5	1.6	5.7	7.6
India	687	240	1.3	1.8	3.6	0.4	4.1
Africa, South of Sahara	197	270	1.2	0.0	-1.5	-2.3	-2.3
Middle-income countries	1,073	1,550	3.9	2.8	-0.0	-1.0	-1.3
East Asia	322	960	4.7	5.5	4.7	1.5	3.6
Middle East & North Africa	159	1,500	4.7	1.4	-3.9	4.1	6.6
Africa, South of Sahara ^{a/}	129	960	2.9	0.8	-4.3	-5.2	-6.6
Southern Europe	91	2,340	5.0	3.1	0.5	0.7	-0.8
Latin America & Caribbean	344	2,040	3.3	2.9	-0.6	-3.2	-5.1
Middle-income oil importers	579	1,690	3.8	3.3	-0.0	-1.4	-1.5
Middle-income oil exporters	494	1,400	4.1	2.2	-0.1	-0.5	-1.1
All low- & middle-income developing countries	3,171	700	3.8	3.1	0.7	0.1	0.4
High-income oil exporters	16	14,090	6.1	2.3	-4.3	-5.9	-11.0
Industrial countries	714	10,420	3.9	2.1	0.7	-0.9	1.6

Source: World Bank, World Tables: The Third Edition (Baltimore and London: published for the World Bank by the Johns Hopkins University Press, 1983).

^{a/} Excludes South Africa, which, however, is included in sub-totals and totals. The total income of this group of countries is dominated by that of Nigeria (with about 60 per cent of the region's income).

No less striking is the contrast presented in Table 3 between the market economies of east and south Asia during the 1970s. The much more open economies of east Asia, with ratios of exports and imports to GDP of 50 per cent or more in the case of the NICs and, by the end of the decade, at least 25 per cent in the ASEAN countries, attained consistently higher growth rates than the generally more inward-looking countries of south Asia.

Table 3. Estimated rate of real economic growth of selected Asian countries, 1965-1984 (selected years)

Country	Rate of growth of real GDP (per cent)				Per Capita GNP (per cent)	
	Average Annual Growth Rate				\$	Average annual growth rate
	1970-82 (1)	1982 (2)	1983 (3)	1984 (4)			1983^{a/} (5)	1965-83 (6)
<u>NICs</u>						
Hong Kong	9.9	2.2	5.2	9.6	6,000	6.2
Korea, Rep. of	8.3	5.5	9.5	8.5	2,010	6.7
Singapore	8.5	6.3	7.9	9.1	6,620	7.8
Taiwan Province	8.8	3.4	7.3	10.6	2,670	
<u>ASEAN</u>						
Indonesia	7.7	2.2	4.2	5.0	560	5.0
Malaysia	7.7	5.6	5.8	6.9	1,870	4.5
Philippines	6.0	3.0	1.0	-3.9	760	2.9
Thailand	7.1	4.1	5.8	6.0	820	4.3
<u>South Asia</u>						
Bangladesh	4.1	0.8	3.3	3.9	130	0.5
Burma	5.0	6.0	5.5	6.3	180	2.2
India	3.6	1.8	8.0	4.5	260	1.5
Nepal	2.7	3.8	1.4	7.4	170	0.1
Pakistan	5.0	4.4	6.5	4.4	390	2.5
Sri Lanka	4.5	5.2	4.7	5.2	330	2.9
China, People's Rep. of	5.6	7.3	5.1	12.0	310	4.4
<u>World</u>						
	3.0	0.0	1.9	...	...
Industrialized	2.7	-0.1	2.4	4.4	...	
U.S.	3.1	-2.1	3.7	6.8	14,093	
Japan	4.6	3.3	3.0	5.3	9,695	
Non-oil Developing	5.1	0.6	0.7	.	...
Africa	3.7	-0.4	-0.7	...	...
Europe	5.3	2.3	2.2	...	...
Middle East	6.5	4.3	-	...	...
Western Hemisphere	5.4	-1.5	-2.1	3.4	...	

Sources: World Bank, World Development Report 1984 and 1985; Asian Development Bank, Key Indicators, Vol. 24, April 1983, 1984 and 1985; IMF, International Financial Statistics Yearbook 1984.

^{a/} World Bank Atlas Methodology, 1981-1983 base period, rounded to the nearest ten.

Tables 4, 5 and 6 highlight the very rapid rates of growth of exports of manufactures attained by all eight countries on average over the period 1960-82, but they also bring out the marked differences in stage of industrial development between the four resource-poor east Asian NICs and the resource-rich ASEAN countries. In 1960 the role of manufacturing in the economy, as indicated by its contribution to GDP, had become substantial only in Hong Kong and the Philippines which had embarked on industrialisation in the 1950s. By the end of the period, the contribution in the four east Asian countries (and the Philippines) had reached or surpassed the (by now lower) figure for the developed countries, but it was still significantly lower in the other ASEAN countries, especially Indonesia. By 1983, 90 per cent or more of the exports of the east Asian NICs consisted of manufactures (if Singapore's oil refinery products are included). Among the other four ASEAN countries, in contrast, primary commodities, though diminishing in importance, continued to predominate.

Table 4. East Asian developing market economies:
annual export volume growth rates, 1960-1982
(percentage)

	Total Exports 1960-1982	Manufactured Exports 1960-1982
Singapore	7.3	12.1
Hong Kong	9.8	11.7
Taiwan Province	17.5	24.4
Korea, Rep. of	26.4	38.3
Malaysia	4.4	11.2
Thailand	7.0	21.6
Philippines	3.9	17.1
Indonesia	8.6	28.5

Sources: I.B.R.D., World Tables, 3rd ed.; I.B.R.D., World Development Report, 1985; UNCTAD, Handbook of International Trade and Development Statistics, 1984.

Table 5. East Asian developing market economies:
the distribution of GDP and employment by sector, 1960 and 1983
(percentage)

	Share in GDP							
	Agriculture		Other Industry		Manu- facturing		Services	
	1960	1983	1960	1983	1960	1983	1960	1983
Singapore	4	1	6	13	12	24	79	62
Hong Kong	4	1	13	8	26	22	57	69
Taiwan Province	33	9	8	10	17	34	42	47
Korea, Rep. of	37	14	6	12	14	27	43	47
Malaysia	36	21	9	16	9	19	46	44
Thailand	40	23	6	8	13	19	41	50
Philippines	26	22	8	11	20	25	46	42
Indonesia	54	26	6	26	8	13	32	35
Low-income developing countries	50	37	6	20	11	14	33	29
Middle-income developing countries	22	15	9	15	22	21	21	49
Developed countries	6	3	10	11	30	24	54	62

Source: I.B.R.D., World Development Report, 1979 and 1985; Taiwan Statistical Data Book, 1984.

Table 6. East Asian developing market economies: the commodity structure of exports,
1955, 1965 and 1982
 (percentage shares)

	<u>Fuels, Minerals and Metals</u>			<u>Other Primary Commodities</u>			<u>Textiles and Clothing</u>			<u>Machinery and Transport</u>			<u>Other Manufactures</u>		
	<u>1955</u>	<u>1965</u>	<u>1982</u>	<u>1955</u>	<u>1965</u>	<u>1982</u>	<u>1955</u>	<u>1965</u>	<u>1982</u>	<u>1955</u>	<u>1965</u>	<u>1982</u>	<u>1955</u>	<u>1965</u>	<u>1982</u>
Singapore	...	21	30	...	44	13	...	6	4	...	10	26	...	18	28
Hong Kong	4	2	2	23	11	6	50	43	34	-	6	19	23	37	39
Taiwan Province	2	5	-	87	56	6	6	15	30	-	4	31	4	20	33
Korea, Rep. of	31	15	1	50	25	7	15	27	21	-	3	28	2	29	43
Malaysia	23	35	39	72	59	42	-	-	3	1	2	15	1	4	5
Thailand	15	11	7	83	84	64	-	-	10	-	-	6	1	4	13
Philippines	10	11	12	80	84	38	8	1	7	-	-	3	2	5	39
Indonesia	36	43	85	63	53	11	1	-	1	-	3	1	-	1	2
Low-income developing countries	13	11	20	70	85	80	12	16	18	-	1	5	5	7	28
Middle income developing countries	25	36	37	61	48	21	4	4	8	2	3	11	8	10	23
Developed countries	11	9	12	23	21	14	7	7	4	30	31	37	29	32	32

Sources: I.B.R.D., World Development Report, 1980 and 1985; UN, Yearbook of International Trade Statistics, 1956, 1958, 1962; Taiwan Statistical Data Book, 1984.

Purely statistical evidence of the kind presented in the preceding Tables can at best suggest, but not prove, that the high rates of growth attained by the east Asian developing market economies were the result of their export-oriented industrialisation strategies. But there are econometric studies, by G. Feder, B. Balassa and others which lend strong support to this conclusion [Balassa 1983, Krueger 1984]. Why there should be such a causal relationship is an important question to be discussed later.

Tables 7 and 8, finally, give some indication of the relative performance of the east Asian developing market economies in terms of social development, using income distribution, female life expectancy and secondary school enrolment as relevant indicators. All four east Asian NICs appear above the other four ASEAN countries in a rank order of 34 developing countries in terms of the degree of equality of income distribution, with Taiwan Province standing out in first place and Malaysia and the Philippines well down the list. But if the criterion is "growth with equity", i.e., combining the criteria of growth and distribution, all eight countries are in the top half of the sample, with the four east Asian NICs occupying the first four places. Much the same pattern emerges from the comparisons of life expectancy and school enrolment, both in terms of absolute levels and improvement, but here it is Indonesia that, despite notable improvement, still trails most behind.

Table 7. Income distribution and growth of the east Asian countries relative to a sample of 34 developing countries, 1983

	<u>Rank out of sample of 34 developing countries</u>		
	<u>Income distrib.</u>	<u>Income distrib. and GDP growth</u>	<u>Income distrib. and per capita growth</u>
Taiwan Province	1	1	1
Singapore	5	2	2
Korea, Rep. of	8	4	3
Hong Kong	11	5	4
Indonesia	15	8	8
Thailand	16	10	9
Malaysia	26	16	14
Philippines	22	17	17

Source: I.B.R.D., World Development Report, 1985. (See source for a description of the sample.)

Table 8. East Asian developing market economies: changes in longevity and secondary school enrollment, 1965, 1982 and 1983

	Female Life Expectancy (years)		Decline in Longevity Shortfall <u>a/</u> (per cent)	Secondary School Enrollment (per cent)		Decline in Enrollment Shortfall <u>b/</u> (per cent)
	1965	1983		1965	1982	
	Singapore	68	75	58.3	45	66	38.2
Hong Kong	71	78	77.8	29	67	53.5
Taiwan Province	70	75	50.0	53	98	95.7
Korea, Rep. of	58	71	59.1	35	89	83.1
Malaysia	59	69	47.6	28	49	29.2
Thailand	58	65	31.8	14	29	17.4
Philippines	58	66	36.4	41	64	39.0
Indonesia	45	55	28.6	12	33	23.9
Low-income LDCs	51	60	31.0	20	32	15.0
Middle-income LDCs	55	63	32.0	20	42	27.5
Developed Countries	74	79	83.3	71	87	55.2

Source: I.B.R.D., World Development Report, 1985.

a/ Shortfall from the maximum attainable which is assumed to be 80 years.

b/ Shortfall from 100 per cent enrollment.

Generalisations based on summary statistics inevitably oversimplify the picture. There have obviously been very great differences in structure and policy between the four resource-poor east Asian NICs and the resource-rich ASEAN countries with their large agricultural sectors. Even among the former, the two city states of Hong Kong and Singapore are somewhat special cases, as traditional entrepot trading centres naturally predisposed to outward-orientation. While all eight countries can be said to be more market-oriented and open economies than most other developing countries, the role of Government in the economy in all of them except Hong Kong has been pervasive, Indonesia in particular despite moves towards deregulation remaining a highly controlled economy. Even within each group, there are considerable differences in per capita income, with Singapore and Hong Kong enjoying an average more than three times that of the Republic of Korea, and Malaysia more

than three times that of Indonesia. While Hong Kong and Singapore have throughout permitted free trade in imports as well as exports, the domestic market for many manufactures has remained effectively protected in most of the other countries. Inflation has been well contained in the two city states, Taiwan Province, Thailand and Malaysia, but there have been serious bouts of it in the Republic of Korea, Indonesia and the Philippines.

Correspondingly, although all eight now rank as middle-income countries, they have been remaining at different stages of economic development and, as has been mentioned, they embarked on export-oriented industrial development at different times. All the east Asian NICs began with the traditional products, textiles, clothing, footwear and other labour-intensive products, such as plywood, furniture and processed food, which made the most of their initially low wages. These also, together with electronics assembly, predominated among the manufactured exports of the second generation, Malaysia, Thailand and the Philippines during the 1970s. The Republic of Korea, in contrast, early emphasised heavy industries, such as shipbuilding and iron and steel, and Hong Kong, Singapore and Taiwan Province, as rising real wages made them less competitive in labour-intensive exports, have sought to move into more skill- and technology-intensive products. Meanwhile, Indonesia has tried, so far only with modest success, to gain export markets in a limited range of labour-intensive manufactures, chiefly clothing, electronics assembly and plywood.

All generalisation about these eight countries therefore require qualifications to allow for variations in their circumstances and experience. But the fact that all of them have enjoyed remarkably high rates of economic growth associated with export-oriented industrial development is not really in dispute. The debatable questions are how far their good economic performance can be attributed to the policies that were adopted rather than to special circumstances; whether the policies that were successful during the 1960s and 1970s can be expected to succeed equally well in the 1980s and 1990s; and whether the experience of the east Asian NICs is transferable to other developing countries.

The debate usually takes the form of protagonists of the export-oriented strategy claiming that the east Asian NICs did well because they adopted

appropriate policies. The critics, even when they are prepared to concede this, have tended to argue that the east Asian countries were able to adopt these policies and carry them out so successfully only because of specially favourable preconditions, both in the domestic features of their societies and the external environment, the state of the world economy. In discussing these issues in the following chapters, it will be convenient to reverse the order, beginning with the preconditions, domestic and international, and then discussing policies.

IV. Preconditions: Historical, Cultural, Political

At least seven features of the domestic setting of the east Asian developing market economies, the history, social structure, politics and culture of their societies, have been put forward in partial explanation of the success of their outward-looking industrial policies. It is readily admitted that not all these features apply to all eight countries, and that at best they apply to them in very varying degree. But it is claimed that, collectively, they have constituted a necessary, if not sufficient, condition of success.

The seven features - listed without any implication of order of importance - are small size, poor natural resource endowment, external threat, predominance of growth objective, prior elimination of obstructive interests and institutions through foreign colonial rule or military occupation, authoritarian political regimes, and, finally, a common Confucian culture and ethic.

Small size. An open economy and an export-oriented industrial policy, it is argued, are unavoidable for very small countries and easier and more advantageous for small than for large countries. A very small country is inevitably dependent on the rest of the world for most requirements beyond those of the simplest subsistence, and the small domestic market of a small country limits scope for efficient industrial production for that market based on economies of scale. At the same time, a small country is likely to find it easier than a large one to pursue an export-oriented industrial policy because its exports will generally claim a smaller share of the world market; they will therefore face a more price-elastic demand and are less likely to run into barriers or retaliation.

All these considerations are very relevant to the two city states, Hong Kong and Singapore. For neither of these was an inward-looking industrial policy aimed at the domestic market a practicable alternative (or at any rate a sensible one - there are many countries in Africa no larger than Hong Kong and Singapore which continue on this counterproductive course). They are much less relevant to the other two east Asian NICs or to the other four ASEAN countries. As Table 9 shows, three of these, the Philippines, the Republic of Korea and Thailand, are large countries, comparable in population to the United Kingdom and France, one (Indonesia) is the fifth-largest country in the world, and the remaining two (Malaysia and Taiwan Province) are commensurate with the Netherlands, Canada or Australia. Population, of course, is not the only relevant index of size. A low per capita income limits the size of the domestic market and in the early stage of export-oriented industrial development, the exports even of quite a large country are likely to constitute a very small proportion of world trade in any one product. For both these reasons, Indonesia, for example, still has the characteristics of a small country for many purposes of industrial policy. What remains true and relevant even for the larger east Asian market economies, is that the relatively small size of the domestic market offers limited opportunities for continuous pursuance of pure import-substitution; an inward-looking policy was liable to run within a decade or so into saturation or slow growth of the domestic market for even the most widely consumed manufactures.

Table 9. Population in east Asian, south Asian and selected developed countries, 1983
(in millions)

<u>East Asia</u>		<u>South Asia</u>		<u>Selected developed countries</u>	
Indonesia	156	India	733	United Kingdom	56
Philippines	52	Bangladesh	96	France	55
Thailand	49	Pakistan	90	Canada	25
Rep. of of Korea	40	Burma	36	Australia	15
Taiwan Province	19	Sri Lanka	16	Netherlands	14
Malaysia	15	Nepal	16	Sweden	8
Hong Kong	5			New Zealand	3
Singapore	3				

Source: World Bank: World Development Report, 1985.

Poor natural resource endowment. "Lucky is the country that has no mining sector and few farmers" or, in the formulation of a law attributed to the Yale economist, Gustav Ranis, "a country's development prospects are inversely proportional to its natural resource endowment". The paradox derives what plausibility it has very largely from the outstanding economic performance of the mineral-poor, land-scarce countries of east Asia, first Japan and then the four east Asian NICs.

There are both economic and broader cultural arguments for Ranis's Law. The economic argument, with specific reference to industrial development, is a long-term counterpart to the short-term "Dutch disease" problem. The latter refers to the squeeze on other traded-goods industries exerted by upward pressure on the real exchange rate due to a sudden increase in mineral (e.g. oil) export earnings. Its long-term equivalent is the effect of an ample endowment with exportable natural resources in maintaining, ceteris paribus, a relatively favourable balance of payments or high real exchange rate and thus keeping down the international competitiveness of other traded goods industries, including manufacturing, industries. It is, of course, merely another way of saying that such a country has a comparative advantage in production of primary commodities and a comparative disadvantage in manufacturing at large. This, of course, it should be stressed, does not preclude the development of a comparative advantage of specific manufacturing industries or products through technological innovation or some other source of economic efficiency.

The cultural case for Ranis's Law is simply the temptation of "lotus eating". Countries with an ample endowment of natural resources do not have to work so hard at doing well economically, or they may think so. Countries which lack natural resources must make the most of their human resources - capacity for hard work, discipline, thrift, skills, enterprise.

There is no doubt that Japan and the east Asian NICs have displayed these qualities in remarkable degree; nor have their manufacturing industries had to contend with a long-term "Dutch disease" handicap. In Indonesia, in contrast, ample oil revenues for most of the 1970s reduced both the need and the ability to develop internationally competitive manufacturing industries; and the rhetoric on the theme that "we are a rich country" frequently heard in the

Sukarno era may have contributed to an inclination to give economic problems relatively low priority. But it is difficult to see much relevance of this argument to the experience of Malaysia, Thailand or the Philippines. Ranis's Law is at best suggestive. There are many resource-poor countries that have done badly and resource-rich countries that have done well.

External threat. The perception of external danger, struggle for national power or survival, have been powerful motives for economic development. Many examples, not least Japan from the Meiji restoration onwards, spring to mind. In some countries, the national leadership has continuously and effectively used the need to strengthen the country against external threat as a means of mobilising national energy and giving rapid economic and particularly industrial development high priority among national objectives. Just as the high standing in the European growth league tables of the 1950s and 1960s of the three countries defeated in World War II, Germany, Italy and Austria, has been attributed in part to the desperateness of their economic situation at the end of the War and to the destruction of so much of their capital stock which compelled them to start again and gave them the advantage of working with best-practice equipment in many industries [United Nations 1964], so similar factors may have been at work in the Republic of Korea and Taiwan Province [T. Scitovsky 1985]. Perceived external threat, of course, also led to the allocation of much of each country's productive capacity to military expenditure, at the expense probably of private consumption and social welfare, but industrial development, especially in heavy and engineering industry, may have derived some impetus from a hidden defence agenda.

The experience of the other six east Asian developing market economies, however, demonstrates that perception of an acute external threat, while perhaps helpful, is not necessary for an effective and successful development effort. It played no part in Hong Kong where the incentive seems to have come entirely from the desire of private individuals and families to improve their material condition, nor more than quite marginally in the other countries where the national leadership found other themes on which to rest its appeal for individual and collective effort.

Predominance of growth objective. Certainly, whatever the motive or the rhetoric, the fact that rapid economic growth ranked high among national

policy objectives in all these countries was an important, even necessary, condition of success. All of them for two or three decades gave priority to economic growth over social welfare spending. If most of them devoted considerable resources to education, and largely to government-financed education, and Singapore and Hong Kong also to public housing, they did so in large part because they regarded both as growth-promoting capital formation. Protection of vulnerable or minority groups, or deliberate redistributive policies for egalitarian objectives, played a quite minor part in the mix of policy objectives in most of them, Indonesia and Malaysia with their programmes for the protection and promotion of indigenous (pribumi or bumiputra) vis-a-vis overseas Chinese business being the most important exceptions. By the late 1970s, with increasing affluence in the most advanced of the east Asian NICs, there were signs that these priorities were beginning to change. As long ago as 1972, a senior Minister in the Singapore Government said there were some intellectuals mostly, who thought that the Government's stress of national achievement was overdone [Goh 1977, p. 193]. Even in Indonesia, questioning among intellectuals of too single-minded a pursuit of economic growth led to the formulation in the Third Five-year Plan of an "eightfold path" towards greater emphasis on social justice and the quality of life [Booth-Tyabji 1979, p. 37].

Prior elimination of obstructive interests and institutions through foreign rule. The strongest case for the view that colonial rule or foreign occupation has helped lay the foundations for rapid industrial development can be made in the cases of Taiwan Province and the Republic of Korea. In Taiwan Province, during the period of Japanese colonial rule, and in both countries as well as in Japan under post-war American occupation, land reforms and the creation of rural infrastructure and institutions made an important contribution by reducing the power of a potentially conservative landlord class and providing a sound agricultural base for industrial development [Haggard 1986]. It might also be argued that Singapore and Malaysia benefited by inheriting from the colonial period an efficient government apparatus and civil service. But the legacy of colonial rule often had negative features, such as the lack of educational institutions and consequent shortage of professional and other skills and the lingering hostility to free markets in Indonesia. It will hardly do to attribute success in Taiwan Province and the Republic of Korea to the presence and in Japan and Thailand to the absence of a colonial past.

Authoritarian regimes. A much more plausible case can be made for the view that rapid economic development in the east Asian developing market economies owed much to the fact that all eight have had authoritarian political regimes of varying shades of rigour. The eight east Asian developing countries have been characterised as "insulated developmentalist states" in which "the economic policy-making progress was relatively insulated from direct political pressures" by sectional interest groups. It is worth quoting a few lines which summarize the argument: "The weakness of labour and the co-optation of the peasantry, coupled with periods of repression and economic success itself, contributed to a broader political phenomenon that differentiates the East Asian cases from other developing countries: a relative vacuum on the left. It is an important irony that economic development in East Asia has been more egalitarian than in Latin America, South Asia or Africa where leftist and populist parties and labour movements have periodically exerted strong political and ideological influence on government policy" [Haggard 1986].

It would be idle to deny that the relative weakness of rent-seeking groups [Krueger 1974] or distributional coalitions, which have so powerful an influence on economic policy in the developed market economies, has assisted the more single-minded pursuit of economic development in the east Asian countries. The lack of serious pressure of competing income claims has made it easier to pursue prudent macro-economic policies; the trade unions have contributed to creating a co-operative labour force; and even business interests have found it to their advantage to go along with government policy. But the force of this argument, too, can be overstated. Far more authoritarian regimes in the Third World have been unsuccessful than successful in their policies of economic development. In Hong Kong trade unions have been free to organize and strike but have received little support from workers [J. Riedel 1985, quoting Turner]. Singapore trade unions had few grievances while real wages were rising at 5 per cent or more a year. It could be argued that the causal relationship ran in part the other way. The political legitimacy and stability of the east Asian authoritarian Governments rested in large part on the successes of their economic policies.

Confucian culture and ethic. There is, finally, the widely entertained hypothesis that the success in economic development of the east Asian countries, including Japan, is largely to be attributed to their common Confucian culture and ethic. "What many argue distinguishes the east Asian countries, in particular the NICs, is the quality of their labour force. Diligence, loyalty, hard work and a strong appreciation of education are virtues which appear to be more abundant in east Asian NICs than elsewhere" [Riedel 1985, p.27]. Others would add respect for authority, age and officialdom, and social cohesion, subordination of individual interests to those of the family or the nation resulting, particularly in the "Japan model", in co-operative labour-management, inter-firm and government-business relations [Hirono 1986].

There can be no doubt that the qualities displayed by the people of these countries - their energy, skills, enterprise and not least their respect and demand for education - have played an important role in their exceptionally rapid economic growth. The trouble, however, with such cultural explanations of economic performance, as with the climatic theories that were once popular, is that they can explain almost anything. They have a flavour of ex post rationalisations. It is doubtful whether they are good predictors. "Why were the advantages of a Confucian heritage just discovered only in the last five or ten years?" [Riedel 1985, p. 28]. For long, western scholars attributed to Confucianism, with its low regard for money-making and technology, its conservative and hierarchical values, the decline of China. There is much evidence, from all parts of the world, that culture adapts to economic opportunity. The Javanese peasants whom the Dutch scholar, J. Boeke, thought incapable of behaving like economic men responded with alacrity when high-yielding varieties promised sure increases in yields [Garnaut-McCawley 1980]. A class of industrial entrepreneurs emerged within a few years when landowners in Taiwan Province were compensated in the land reforms of the early 1950s with shares in former Japanese manufacturing enterprises [Steinhoff 1980].

Much the same applies to all seven of the alleged domestic preconditions which have been discussed in the preceding pages. All of them have some

plausibility in relation to some, or not all, the eight east Asian developing countries. But there are too many counter examples - countries which shared some or all of these features and did not do well, others which lacked some or all and performed creditably. Clearly, such preconditions are not a sufficient condition of successful industrialization and they may not even be necessary, though all of them can be helpful. What, above all, distinguishes them from economic policies is that in their very nature they are largely given, possibly slowly emulated, but not easily adopted by an effort of political will.

V. Preconditions: the External Environment

The second set of favourable preconditions which have frequently been said to explain in large part the success of the export-oriented industrial development of the east Asian developing market economies have to do with their external environment. Of course, since the international economic environment has been broadly the same for all developing countries, it cannot as such account for the fact that some have been so much more successful than others. The very success of the NICs is, in itself, a prima facie refutation of the view that the problems of the developing countries are due to the existing international economic order. It is arguable that the international economic environment benefited the east Asian NICs in specific ways. Three arguments along these lines are worth discussing. First, the east Asian NICs had the good fortune to embark on the experiment in the two decades of exceptionally rapid growth of the world economy and international trade, the 1950s and 1960s. Secondly, as exporters of labour-intensive manufactures, they had the field to themselves for much of the period. Thirdly, they enjoyed exceptional external support through aid and direct foreign investment.

The main answer to the first point was mentioned earlier. The rate of growth of exports of manufactures and of GDP of the east Asian NICs, far from slowing down in the turbulent 1970s, actually accelerated (Table 2 above). Table 10 shows that during the decade 1970-79 total exports of the eight east Asian developing market economies grew at an annual average rate of nearly 20 per cent and exports of manufactures at well over 30 per cent, compared with

Table 10. Growth of total and manufactured exports of Asian developing countries, 1970-1984 (selected years)

Country	Annual Growth Rate (percentage)						
	Total exports					Manufactured exports ^{a/}	
	1970-79	1979-81	1982	1983	1984 ^{b/}	1970-79	1979-81
<u>NICs</u>	28.5	19.2	-1.1	8.2	20.1	29.7	19.8
Hong Kong	22.1	19.9	-3.7	4.6	29.0	22.0	19.5
Korea, Rep. of	37.9	18.9	2.6	9.1	19.6	39.2	18.6
Singapore	28.0	19.3	-0.9	5.0	10.2	33.0	20.8
Taiwan Province	30.8	18.7	-2.3	13.6	21.3	34.2	20.7
<u>ASEAN^{c/}</u>	26.2	15.0	-4.1	0.1	9.4	39.4	15.5
Indonesia	34.9	23.6	-6.2	-5.3	3.4	47.4	28.1
Malaysia	23.3	3.1	2.3	17.4	15.3	38.0	9.0
Philippines	17.6	11.5	-12.3	-1.8	9.1	33.8	17.0
Thailand	25.2	15.1	-1.2	-11.3	16.1	47.1	20.0
South Asia	15.7	7.4	1.5	8.2	...	17.2	...
Other NICs ^{d/}	20.1	13.2	-5.5	3.7	...	24.1	23.7
Other developing countries	23.7	16.0	-16.2	-13.1	...	23.5	14.8
World	20.6	10.0	-7.2	-2.4	...	19.7	17.4

Sources: Asian Development Bank, Key Indicators of Developing Member Countries of ADB, Manila, April 1985; UN Commodity Trade Statistics 1970, Statistical Papers Series D, Vol. 20 (Nos. 1-3, 1-10, 1-36, 1-46, 1-49, 1-50), United Nations, New York; UN Commodity Trade Statistics 1981, Statistical Papers Series D, Vol. 31 (Nos. 1-4, 1-10, 1-11, 1-15, 1-18, 1-19, 1-21, 1-22); Series D, Vol. 28 (Nos. 1-25); United Nations, New York, May 1982; UN 1981 Yearbook of International Trade Statistics, New York, 1981; The Trade of China (Taiwan District) 1981, Statistical Department, Inspectorate General of Customers, Taipei, Republic of China, May 1982; Direction of Trade Statistics Yearbook 1984, International Monetary Fund, Washington, D.C., USA.

a/ SITC 5+6-67-68+7+8.

b/ Preliminary figures.

c/ Excluding Singapore.

d/ Defined as in OECD (1979): Argentina, Brazil, Greece, India, Israel, Portugal, Spain, Yugoslavia.

rates of around 15 per cent for south Asia and around 20 per cent for world as a whole. Nor did protectionist pressures, which undoubtedly intensified as unemployment rose in the advanced industrial countries during the 1970s, seriously impede the growth of exports of manufactures by the east Asian developing countries, chiefly because the US market remained relatively open [Hughes and Krueger, 1984]. Clearly, earlier fears that the countries whose export-oriented industrialization strategy had proved so successful during the period of relatively smooth and rapid growth of the world economy before 1970 would prove vulnerable during the disturbed decade of oil shocks and slowdown of growth in the OECD countries proved groundless.

While broadly valid, this answer is in need of some qualifications. First, the high rates of growth of total exports of some of the south-east Asian countries, especially Indonesia and Malaysia, largely reflected booming earnings from oil and some other primary commodities. Secondly, the high rates of growth of exports of manufactures, again especially in the case of Indonesia, were from a very small base. Thirdly, growth of GDP and exports in all these countries did slow down in the early 1980s, in response to the second oil shock and the prolonged international recession, most of them (except the Republic of Korea and Malaysia) actually experiencing a decline in export earnings in 1982. As the US economy recovered strongly in 1984, exports and growth in the east Asian NICs and in Malaysia and Thailand also bounced back, but remained subdued in Indonesia, largely because of sagging oil prices, and depressed in the Philippines because of mounting economic and political trouble [UNIDO Industrial Development Reviews, 1985]. In 1985, all the east Asian NICs and especially Singapore ran into serious economic difficulties which clouded the prospects for the rest of the 1980s. These most recent developments and their implications will be examined further in the last chapter. Meanwhile, however, it must be granted that, despite the good record of the 1970s, no final verdict can as yet be rendered on the degree of vulnerability of export-oriented developing countries to disturbance in the world economy.

The argument that the east Asian NICs did so well with export-oriented industrialization because they had the field to themselves is also at best a half-truth. The east Asian NICs were clearly not the first Asian countries to industrialize. Not only Japan but also India began to industrialize in the

1860s. During the second half of the 19th century India's industrial growth had averaged 10 per cent a year and in the last three decades before 1914 exceeded that of Germany. In conditions of relatively free trade, India had developed the world's fourth largest cotton textile industry and second largest jute manufacturing industry by 1914 when modern manufactures accounted for 20 per cent of Indian exports. Indian industrial growth slowed down in the inter-war years under the impact of protectionist policies at home and abroad, and even more with the industrial policies adopted after independence [Lal, 1985]. In 1950 the east Asian countries were industrially well behind India. What advantage the Republic of Korea and Taiwan Province had gained in industrial development during the Japanese colonial period was largely destroyed by war [Riedel 1985, p.30].

A major reason for the success of the four east Asian NICs in expanding their exports of textiles and other labour-intensive manufactures during the 1960s and early 1970s was structural adjustment in Japan. During the inter-war period, Japan with her low unit labour costs had become the largest exporter of such products and she regained this position during the 1950s. But as real wages rose rapidly, she increasingly lost this source of comparative advantage. She responded in part by relocating labour-intensive industries to the Republic of Korea, Taiwan Province, and other developing countries and partly by moving out of labour into capital- and technology-intensive industries. A considerable part of the expansion of exports of manufactures by the east Asian NICs during the 1960s and 1970s was achieved not through overall increase in demand for such products in the advanced industrial countries but by their taking over markets, both in the advanced industrial countries and in other developing countries, vacated by Japan [Table 11].

By 1980 there was evidence that the second generation of east Asian NICs, the ASEAN countries, were beginning to benefit in a similar way at the expense of the first generation. As rising real wages in Taiwan Province, the Republic of Korea, Hong Kong and Singapore were eroding their comparative advantage in labour-intensive products, they in turn found it necessary to move into more capital- and skill-intensive manufacturing or service industries, to the benefit of other newly industrializing countries, including those of ASEAN, or by in turn relocating some of their labour-intensive industries in these

Table 11. East Asia's share of world exports of labour-intensive manufactures, 1962-1981
(percentage)

	1962-68	1969-71	1972-76	1977-81
Japan ^{a/}	13.17	12.95	9.64	5.93
Hong Kong, Taiwan Province, Korea, Rep. of	4.23	7.20	10.26	14.11
ASEAN ^{b/}	.66	.59	1.19	2.30
People's Republic of China	1.92	1.70	1.83	2.73

Source: United Nations, International Trade Data Tapes.

a/ Net of imports.

b/ Including Singapore.

countries [Hughes-Parry 1985]. Table 12 shows that, as the share of labour-intensive manufactures in the exports of the east Asian NICs declined between 1970 and 1981, it rose in the exports of the ASEAN countries. (The extent of the shift is partly masked by the ambiguity of the category "electrical machinery" which in the ASEAN countries, represented almost wholly electronics assembly while in the NICs it consisted increasingly of more sophisticated products.)

Table 12. East Asian developing market economies: exports by principal commodity groups, 1970 and 1981
(Per cent of total exports)

	NICs		ASEAN	
	1970	1981	1970	1981
Textiles	9.6	8.1	0.5	1.3
Clothing	18.3	14.6	0.1	2.0
Electrical machinery	8.1	14.0	0.1	3.8
Miscellaneous	14.5	9.5	0.3	0.8
Other	18.9	29.6	3.9	4.9
Total manufactures	69.4	75.8	4.9	12.8

Source: United Nations, Commodity Trade Statistics, various issues.

How far this process, and its benefits, will extend into the 1980s is another question. As more and more developing countries, including the People's Republic of China as well as most of those of south Asia, let alone NICs in other continents, turn away from import-substitution towards more export-oriented industrial policies, the field will become more crowded. This, too, is a question that will need to be taken up again in a subsequent chapter.

There are few developing countries to whose good economic performance external support, whether through aid, direct private investment or credit, made a decisive contribution. Most aid has political or humanitarian motives and tends to go to countries which, for one reason or another are least successful economically. Similarly, private capital flow tends to be attracted by good economic performance, prospective profitability in the case of direct foreign investment and creditworthiness in the case of loan capital. Good or bad economic performance by developing countries depends primarily on national policy.

The rapid post-war recovery of the Republic of Korea and Taiwan Province, during the 1950s and accelerating growth during the early 1960s has sometimes been attributed to the large volume of US aid they received in the early post-war years. It is true that in the early 1950s US aid financed up to 40 per cent of imports of goods and services of the Taiwan Province and that aid to the Republic of Korea before, during and after the Korean War was very large, peaking at about \$250 million in 1963. Thailand and the Philippines benefited from spillover of US expenditures during the Vietnamese war, Hong Kong and Singapore were subsidized in the early years by the United Kingdom, and Indonesia received aid both before and after the change of regime in 1965/66. But most of the massive aid received by the Republic of Korea and Taiwan Province was designed and used to support very heavy defence expenditure, and in the case of all the other countries aid, even when it was effectively used, was marginal. This is not to say that it was unimportant. In some countries in some years it valuably contributed to political stability, balance of payments and budget support, physical infrastructure and economic policy advice. But many other developing countries have received as much or more aid, both capital and advice, without being able to make good use of it.

The only one of the eight east Asian developing countries that has relied heavily on direct foreign investment (DFI) has been Singapore (Hughes-Parry 1986). Substantial flows of DFI have in some years gone to Malaysia, Thailand

and Indonesia. But in the Republic of Korea, Taiwan Province, and the Philippines, the contribution of DFI to the finance of domestic investment has been small. The Republic of Korea by a deliberate policy, and the Philippines increasingly to relieve economic difficulties, have relied on foreign loans; Hong Kong and Taiwan Province, from 1960 onwards kept total capital inflow to a minimum and in recent years have become substantial capital exporters. Malaysia has generally been a net capital exporter. As Table 13 shows, in only three of the eight countries, Singapore, the Republic of Korea and Indonesia, did total capital inflow contribute more than one-quarter to the finance of domestic investment.

Direct foreign investment - predominantly US in Hong Kong, Singapore and the Philippines, predominantly Japanese in the Republic of Korea, Thailand and Indonesia - undoubtedly made an important contribution to the development of export-oriented manufacturing industries, chiefly through the supply of technical, management and access to markets. Through subsidiaries or joint ventures, multinational corporations are estimated to have been directly responsible in the mid-1970s, for between 10 and 20 per cent of the exports of manufactures of Hong Kong, Taiwan Province and the Republic of Korea, and for as much as 70 per cent in the case of Singapore [Hughes-Parry 1986, citing Nayyar, p.16]. But these countries received as much direct foreign investment - and particularly in the case of the Republic of Korea technology transfer through licensing agreements - as they were able to attract. In this sense, DFI was a policy, rather than an exogenous, variable in their industrial development.

This last point suggests a further comment under the general heading of the external environment. It has been fashionable in recent years to blame the ills of developing countries on the machinations of multinational corporations, declining terms of trade, the debt crisis and other features of the existing international economic order. Whatever the pros and cons of direct foreign investment, it is not plausible to give credit to multinationals for the good economic performance of the east Asian NICs and blame them for poor economic performance in the rest of the third world. More specifically, the self-interested involvement of multinationals in exports of manufactures, most directly through sourcing of components, has helped the east Asian NICs not only by providing market links but also in countering protectionist pressures in the OECD countries - they have provided countervailing power [Hughes-Parry 1985].

Table 13. East Asian developing market economies: rates of domestic and foreign savings, 1950-1984
(percentages)

	Gross National Savings Rate						Rate of Net Foreign Savings Inflow					
	1950- 1960	1960- 1970	1970- 1981	1982	1983	1984	1950- 1960	1960- 1970	1970- 1981	1982	1983	1984
Singapore	...	14.9	29.1	40.0	41.9	...	12.2	8.4	11.6	5.1	3.2	...
Hong Kong	9.2	20.6	28.33	28.2	25.1	29.0	-0.1	0.0	-1.6	3.5	1.9	-4.7
Taiwan Province	9.8 _{a/}	19.8	32.3	30.4	31.6	33.8	6.5 _{b/}	2.1	-1.7	-5.8	-8.8	-12.5
Korea	3.3	13.7	22.6	24.1	26.4	...	8.2	9.5	6.8	2.3	0.8	...
Malaysia	23.2	20.6	25.6	27.0	29.2	30.9	-11.0	-2.4	0.5	8.3	4.8	0.2
Thailand	15.3	19.9	20.6	20.9	17.9	20.9	0.2	2.6	5.5	0.1	5.1	2.2
Philippines	14.3	18.2	23.8	21.6	20.6	17.4	1.0	1.9	4.9	6.8	6.6	0.5
Indonesia	...	4.9	20.1	18.7	19.9	...	...	6.2	0.1	3.9	4.2	...
Low-income developing countries	...	13.9	14.9	...	...	...	...	2.3	3.7	...	...	...
Mid-income developing countries	...	17.3	20.1	...	21.0	...	...	0.9	2.0	...	1.0	...
Developed Countries	20.9	21.6	22.2	...	20.0	...	-0.5	-0.5	-0.4	...	0.0	...

Sources: I.B.R.D., World Tables, 3rd ed.; ADB, Key Economic Indicators, May 1985; Taiwan Statistical Data Book, 1984.

a/ 1955-1960.

b/ 1952-1960.

Note: A negative sign indicates a net outflow of domestic savings.

As for the terms of trade, the oil-importing countries among the east Asian NICs undoubtedly suffered a severe loss of real income when oil prices quadrupled and doubled again, but the shock led them to redouble their efforts to expand exports of manufactures; conversely, Indonesia as an oil exporter, though benefiting from a huge improvement in her terms of trade, was thereby, as was pointed out above, on balance held back in her industrial development. Most of the eight east Asian developing countries managed to avoid a large foreign debt. Of the two with high debt/GDP ratios, the Republic of Korea has not been seriously troubled because of her good export performance, while the Philippines has been in serious difficulties because of domestically generated problems. Taking it by and large, the east Asian developing market economies found the international economic order of the 1960s and 1970s a favourable environment for rapid economic growth and they made the most of it.

VI. Government Policies: the Macroeconomic Framework

It has been necessary to devote the preceding two chapters to the preconditions of successful industrialization in the east Asian developing market economies in order to deal with the argument that it was these unusual preconditions that made possible the adoption of good policies, in other words that these countries managed "good policies only because, as some one has put it, they have the kind of people they have" and because they were lucky in their timing. It is, of course, an argument that can never be finally resolved. In many countries of the Third World, the adoption of such market-oriented, outward-looking policies would have been more difficult because of historically conditioned political obstacles; and cultural factors - attitudes, institutions, patterns of behaviour - would have rendered such policies less effective, as indeed proved to be the case in varying degree in the resource-rich ASEAN countries. But favourable conditions and good policies interact. Attitudes and patterns of behaviour respond to economic opportunities. Political obstacles which seem irremovable in conditions of economic stagnation may dissolve in conditions of rapid economic growth. Vested interests which obstruct the adoption of good policies are themselves often created by bad ones. The high level of education, the relative competence and integrity of the bureaucracy, the widespread consensus on priority for economic growth and the role in the economy accorded to private enterprises in the eight east Asian countries - all these were as much the results as preconditions of government policies.

Moreover, to underline an important point made earlier, whatever the relative weight attached to preconditions and policies in the success achieved, there is one very practical reason for focusing primarily on the policies that were adopted: it is the policies that may have lessons for other developing countries. Preconditions are given, policies are at least in principle open to choice. Even if the preconditions are unfavourable, it is useful to know which are the better and which the worse policies, which the more and which the less likely to achieve the desired objectives.

The policies which attract most attention in explaining success or failure in industrial development are naturally those designed to assist or promote manufacturing industry in general or in particular. But it has often been pointed out that successful industrial development depends hardly less on the macroeconomic framework set by the broader range of government policies and that it is to the generally high quality of overall economic management in the east Asian NICs and, at least in some respects also in the other four ASEAN countries, that their good industrial development performance must in part be attributed. These macroeconomic policies - defined as policies which do not discriminate between sectors, industries or firms - will therefore be examined first.

The most general, and in some respects most important, feature of the macroeconomic environment for industrial development in the eight market-oriented developing countries of east Asia is also one of the most difficult to define precisely. It relates to the term "market-oriented". Government policy in all these countries, including Indonesia after 1965, explicitly rejected public ownership of the means of production and centralized planning and control of the economy. But none of them, with the exception of Hong Kong, adopted a policy of laissez faire. In all the others, Governments played a pervasive role in the economy. In several of them, especially Indonesia, a considerable part of the modern sector, not least in manufacturing, consisted of public enterprises, and the private sector was subject to extensive government regulation. Nonetheless, all of them could be said to be market-oriented in that business activity was in the main left to private enterprise, that the allocation of productive resources was largely left to market forces, that governments generally speaking encouraged private business to be competitive and that, to a greater degree than in most

developing countries, government policy aimed at integrating the national economy into the world market economy. In the "index of price distortions" through government intervention of one kind or another compiled by the World Bank in 1983, all five of the eight countries for which data were available, even Indonesia, were found to be less distorted than the average of the sample of developing countries (and the same would have applied a fortiori to the other three, Hong Kong, Singapore and Taiwan Province) [World Development Report 1983, p. 60].

Even Hong Kong's laissez-faire policy accorded Government an important role with respect to what Adam Smith called the three "duties of the sovereign" - defence, law and order, and public goods. The Hong Kong Government once explained that, in its view, "the Government's principal role is to ensure the provision of an adequate infrastructure to enable industry to function efficiently and profitably with minimum interference" [Riedel 1985, p.31]. High, or at least adequate minimum, quality of performance of the duties of the sovereign has certainly been an important contribution of policy to industrial development in all eight countries. Law and order have been well maintained in the east Asian NICs, as has, generally speaking, been efficient and honest administration. In the other four ASEAN countries, the standard of the former has been high except earlier in Indonesia and latterly in the Philippines. If the same cannot be said without reservations about the latter, at least two of them, Malaysia and Thailand have been well above Third World average also in this respect. In none of the eight - and this can be said even of Indonesia since the early 1970s - have transport, utilities and communications been the bottlenecks they have been in India, for example, or in many African countries.

Reference has already been made to the outstanding contribution to industrial development, certainly in the east Asian NICs, as earlier in Japan, by the provision and encouragement of education. An important part, it has been suggested, of the reason why by 1983 Japan had achieved 12 times the per capita income of Thailand although both countries embarked on modernisation in the same year, 1868, was that in that year already three-fifths of Japanese had a good primary education while the people of Thailand were still largely illiterate [Hirono 1986]. As was shown above (Table 8), all four east Asian NICs have achieved secondary school enrolment ratios comparable to those of developed countries and even the Philippines and Malaysia are in this respect

above the average of middle-income developing countries. "Abundant high-quality manpower with basic academic training in science and technology," it has been said, "is Taiwan Province's most important resource" [Liang 1985, p.25]. The Republic of Korea has made up for a lower rate of public expenditure on education by such high priority for children's education in the private consumption expenditure of their parents that total expenditure on education has been running at the extraordinarily high figure of 9 per cent of GNP [T. Scitovsky, 1985, p.219]. The Republic of Korea, also, has been ahead of most developing countries, including the other east Asian NICs, in government R&D expenditure by private industry and encouragement of technological innovation [UNIDO Indonesian Industry Sector Study 1984a, Vol. III, part 3; Koepstorff 1985].

Another important feature which has distinguished general economic policy in these eight countries from many other developing countries is generally prudent macroeconomic management. As Table 14 shows, five of the eight countries have a remarkable record of keeping inflation under control, better than that of the advanced industrial countries. Even the three countries which suffered serious bouts of inflation, the Republic of Korea, Indonesia and the Philippines, countered them sufficiently to keep their average inflation rate well below that of middle-income developing countries. It seems likely that domestic financial stability and export orientation were causally interrelated. Openness of the economy required cautious domestic financial management since changes in the nominal exchange rate could not significantly influence the real exchange rate, and a low inflation rate in turn helped maintain international competitiveness.

Prudent demand management has, generally, gone hand in hand with promotion of financial development. Taiwan Province, as early as the 1950s pioneered the policy of deregulating interest rates to encourage saving and efficient allocation of capital. The Republic of Korea followed suit in the mid-1960s. The other six have all subsequently opted for financial liberalisation, including in the early 1980s even Indonesia, and the Republic of Korea for the second time. All succeeded sooner or later in ridding themselves of overvalued currencies. Hong Kong and Singapore have built up major international financial centres, and Malaysia and Taiwan Province, have become net capital exporters. Some of them, especially the Republic of Korea and until recently

Table 14. East Asian developing market economies:
inflation rates, 1965-83
(Per cent, annual average)

	1965-73	1973-83
Hong Kong	6.4	9.9
Korea, Rep. of	15.5	19.0
Singapore	3.1	4.5
Taiwan Province	4.3	7.9
Indonesia	63.0	18.0
Malaysia	1.2	6.5
Philippines	8.8	11.7
Thailand	2.5	8.7
Japan	6.3	7.7
USA	4.7	7.5
Middle-income developing countries	5.2	29.3
Developed market economies	5.2	8.0

Source: World Bank, World Development Report,
various issues.

Indonesia, have relied heavily on bank lending as an instrument of government control, or at least guidance, of investment [cf. Scitovsky 1985; Wade 1985]; and there is as yet little development of an active securities market in any of them. But low inflation, financial development and rapid growth have combined to yield remarkably highest rates of domestic resource mobilisation and investment in all of them (Table 13 above).

High rates of growth, not least of manufacturing production, in the east Asian NICs during the 1960s quickly absorbed open unemployment and, in the Republic of Korea and Taiwan Province, labour released by agriculture. With full employment and rapid growth in labour productivity came a sustained rise in real wages which helped maintain a flexible labour market and industrial peace. In the other four ASEAN countries, labour market experience remained more mixed. As Table 15 shows, real wages rose rapidly also in Malaysia and recovered in Indonesia during the 1970s but probably fell in the Philippines and rose little in Thailand which still had large reserves of rural labour. Manufacturing employment rose substantially in Thailand and Malaysia but, with increasing emphasis on capital-intensive industry, only sluggishly in the other two countries.

Table 15. East Asian developing market economies:
indicators of labour market conditions, 1955-1983 (selected years)
(percentages)

	Growth of Real Wage		Open Unemployment		Growth of Manufacturing Employment	
	Period	Rate	Period	Rate	Period	Rate
Singapore	1965-73	0.6	1967-73	6.0	...	
	1973-83	5.4	1973-83	3.7	1973-83	5.5
Hong Kong	1960-70	4.7	1960-70	4.2	1961-71	4.7
	1970-80	4.2	1970-80	4.5	1971-84	4.3
Taiwan Province	1960-73	7.7	1960-73	1.6	1960-73	8.1
	1973-83	6.5	1973-83	1.0	1973-83	4.8
Korea, Rep. of	1963-73	5.4	1965-73	5.3	1963-73	11.2
	1973-83	9.5	1973-83	4.2	1973-83	6.3
Malaysia	1962-73	0.0	1967-72	7.2	...	
	1973-81	5.0	1973-83	5.7	1973-83	8.1
Thailand	1961-73	0.0	...		...
	1975-79	2.0	1973-82	0.8	1973-83	10.0
Philippines	1965-73	-1.6	1960-73	6.5	1960-73	2.6
	1973-81	0.0	1973-83	4.4	1973-83	4.0
Indonesia ^{a/}	1955-67	-3.4	1961-71	5.5	1961-71	3.3
	1971-80	5.1	1976-82	2.5	1976-82	1.2

Sources: Hill and Ariff (1985); Pitt (1981); Hong (1981); Akrasanee (1981); Lal (1983); Kirkpatrick (1985); Sung (1984); Riedel (1974); Taiwan Statistical Data Book, 1984; Major Statistics of the Korean Economy, 1985; ADB, Key Economic Indicators, 1977 and 1985.

^{a/} The Indonesian data are particularly suspect due to changes in definition of organized manufacturing sector over time and other anomalies.

A feature of overall economic policy in all these countries, more elusive but probably very important to their success, has been flexibility. This has partly been implicit in their market orientation but has also been conspicuous where Government has been entirely in control. Some of these countries have drawn up 4 or 5 year development plans but, like Japan, they have not allowed the pattern and rate of economic growth to be constrained by them. Government policy-makers have generally been willing to learn from past mistakes and to

reverse course. In some cases the response was quick, as in the shift from import substitution to export-oriented industrial policy in Taiwan Province, the Republic of Korea and Singapore in the 1960s, Singapore's decision to scrap the motor vehicle assembly industry in 1980, or the abolition of exchange control by Indonesia in 1970 and by Singapore in 1978. In other cases, it came more slowly, as in the corresponding move into manufacturing for export in the other four ASEAN countries in the 1970s or financial liberalization in Indonesia and the Republic of Korea in the early 1980s. Another example, of special importance to industrial development, has been the early adoption of structural adjustment policies with the decline in comparative advantage in labour-intensive manufactures. But this belongs less to macroeconomic than to specifically industrial policy which is the subject of the following chapters.

VII. Government Policies: from Import Substitution to Export Orientation

Countries embarking on industrialisation normally begin by producing at home manufactures hitherto imported. In most cases, domestic manufacturers are initially granted tariff or other protection from imports. Import substitution has the advantage that a ready-made market exists, and it is relatively easy to protect infant industries. In the early post-war years and during the 1950s, import substitution received further strong impetus, beyond that resulting from wartime interruption of trade, from import restrictions imposed in many developing countries for balance-of-payments reasons, from pessimism about their world markets for primary products and their capacity to compete with advanced industrial countries in exports of manufactures, and in some countries from a belief that the central planning model had demonstrated the merits of autarkic industrial development [Arndt 1981; Little 1982].

Import substitution under cover of protection has also characterised the first phase of industrial development throughout Asia, except in Japan where the "unequal treaties" initially imposed free trade although Japanese industrial development has nonetheless for a century been largely directed towards the home market, and in Hong Kong which, with its entrepot past and aided by post-war influx of Shanghai industrialists, was able from the 1950s to stand on its own feet in domestic and export markets.

In the other seven of the east Asian developing countries, protection through tariffs and quantitative import and exchange controls was given to domestic manufacturing industries for varying periods, in the Republic of Korea, Taiwan Province and the Philippines from the early 1950s, in the case of the latter as part of a deliberate import-substitution strategy. Singapore imposed tariffs and quotas after independence in 1959, largely with an eye to the market of a Malayan federation of which it was then a member, as did Malaysia and Thailand when they embarked on industrialisation in the early 1960s. Indonesia's industrial development, limited and precarious until the mid-1960s, has until recently been almost wholly for the domestic market and heavily protected.

Taiwan Province and Singapore were the first to move away from sole reliance on import substitution. In Singapore's case, the rationale for import substitution disappeared with the breakdown of federation with Malaysia in 1965. Its policy-makers promptly drew the consequence by reverting to free trade and encouraging manufacturing for export through tax concessions to exporters and foreign investors. In Taiwan Province the shift towards a more outward-oriented strategy came even earlier, in the late 1950s, when the exchange rate was unified, the currency devalued and incentives to exports introduced or strengthened. This was followed from the mid-1960s by substantial import liberalisation, with abolition of quantitative restrictions and reduction of tariffs to low levels for most imports.

The Republic of Korea also engaged in deliberate promotion of exports from the early 1960s. Both in the Republic of Korea and Taiwan Province, export promotion consisted chiefly in dismantling or offsetting previously instituted macroeconomic policies that discriminated against exports and partly in measures actively discriminating in favour of exports. The ending of multiple exchange rates and overvaluation of the currency were the most important among the former set of measures, but they also included export-processing zones and bonded factories which helped exporters chiefly by eliminating red-tape in securing remission of such duties. Active discrimination in favour of exports mainly took the form of cheap bank loans and of tax concessions, such as exemption from indirect taxes for exports and inputs into exports and of part of export earnings from income tax. In the Republic of Korea, export production was also aided by export insurance and discounts on railway

freights and electricity rates [Scitovsky 1985, pp.234f.]. The value to exporters of these concessions is estimated to have been around 10 per cent of gross export receipts in both countries in the late 1960s [Balassa cited in Scitovsky 1985, p. 235]. The results achieved by these policies in both countries were spectacular. Over the period 1965-81, exports of the Republic of Korea (in US dollars) rose at an average annual rate of 35 per cent, of the Taiwan Province at 27 per cent. The high rate of growth propelled by exports also caused imports to rise (by 27 per cent annually in the Republic of Korea and 26 per cent in Taiwan Province) but less rapidly than exports, so that the balance of payments improved [Scitovsky 1985, p. 235].

Malaysia and Thailand, encountering the limits to import substitution in a small domestic market and encouraged by the success of the east Asian NICs, began in the early 1970s to follow their example by encouragement of labour-intensive export industries - chiefly textiles, clothing and electronics assembly, but also timber and rubber processing and, in the case of Thailand, precious stones and jewelry. By 1982, textiles, clothing and electronics assembly were estimated to generate two-thirds of Malaysian exports of manufactures and two-fifths of full-time employment in Malaysian manufacturing industries. Both countries, however, were somewhat unfortunate in the timing of export-orientation, benefiting disproportionately from boom conditions in their OECD markets in the early years and running into recession at the end of the decade. This, and the discovery of substantial resources of oil (Malaysia) and natural gas (Thailand), induced both countries to shift the emphasis of industrial policy in the early 1980s towards heavy industry.

In the Philippines and Indonesia the desirability of more export-oriented industrial development came to be recognised somewhat later, underlined in the case of the former by a rising oil import bill in the early and late 1970s, and in the latter by declining oil prices in the mid-1970s and early 1980s. There was some liberalisation of tariffs, and in both countries exports of a limited range of labour-intensive manufactures (chiefly electronics assembly in the Philippines and garments and plywood in Indonesia) expanded rapidly from a small base. But in both countries, inefficiencies and vested interests fostered by a long period of protected import-substitution limited the scope of export-oriented manufacturing as well as its impact on the domestic economy [cf. UNIDO Industrial Development Reviews 1984 and 1985; also Ariff and Hill 1986].

The reasons for the progressive shift from import substitution to export orientation in the east Asian developing market economies during the 1960s and 1970s are not hard to find. They were basically increasing concrete evidence of the disadvantages of the former and the success of the latter strategy of industrial development.

The most obvious limitations of an import-substitution strategy are those imposed by the size of the domestic market which depends not only on the size of the country's population but also, as large countries have sometimes been reluctant to recognise, on average per capita income. In all but very small or poor countries there is always some scope for import substitution but even in large countries it is, in its nature, limited. The first phase of import substitution ends when imports of the standard manufactured consumer goods, such as textiles, clothing, footwear and simple household goods, have been largely replaced and further expansion depends on growth of domestic demand alone. If, as is almost invariably the case, domestic manufacturers require tariff or other protection from import competition, there is a loss of allocative efficiency reflected in a loss of real income inflicted on domestic consumers in the form of higher prices or lower quality of home-produced goods. The loss of allocative efficiency arises from the allocation of resources to manufacturing industries in which, at least initially, the country has a comparative disadvantage. The protection afforded to these industries can be shown to discriminate against actual or potential export industries in which the country has a comparative advantage, partly by raising the cost to these export industries of local factors of production and of imported inputs and partly by reducing imports and thus, through the effect on the exchange rate, the prices exporters obtain (in home currency) for their products [Corden 1980, p. 67].

Protection for import-competing domestic manufacturing industries is usually justified by the "infant industry" argument - that the protected industries will gradually, through "learning by doing" and increasing attainment of economies of scale, become internationally competitive. The trouble is that, in almost universal experience, the protected infants fail to grow up. (It is moot point whether the infants grew up so well in Japan because they were, or were not, protected.) The inefficiencies created by protection against imports are liable to become cumulative. If tariffs give

insufficiently secure protection, often because they are eroded by smuggling, they are commonly reinforced by import licensing of ever-increasing product coverage and ever finer selectivity. If, as is often the case, import substitution is at first embarked upon to relieve balance-of-payments difficulties, the consequences of overvaluation of the currency in the form of a proliferating network of exchange controls add to the stifling effects of bureaucratic regulation, which in turn generates black markets requiring more controls. If industries producing consumer goods are also assisted by low or zero duties on imported capital equipment, in a "cascading" tariff structure, there is a bias in favour of capital-intensive methods of production which is reinforced if industries are also helped by cheap credit or other investment subsidies.

Most important of all, there is the working of the political market of "rent-seeking" vested interests. Protected manufacturers find it easier to lobby for more protection than to improve the efficiency of their firms. Non-protected and disadvantaged industries complain about unfair treatment and demand compensatory assistance. Labour in protected industries shares in the rents through higher wages, at the expense of employment opportunities for other sections of the work force. Price distortions maintained by the regulatory framework reduce flexibility, the capacity of the economy to adjust. In sum total, the adverse effects of the dynamic losses imposed by an import-substitution regime on the efficiency of the whole economy may greatly exceed those due to the more obvious loss of static allocative efficiency.

These problems of the import-substitution approach to industrial development first became apparent in Latin America, India and the Philippines. From the late 1960s they became the subject of a large literature [Little-Scitowsky-Scott 1970; Asian Development Bank 1971; Balassa & Associates 1971; Krueger 1978, 1983] which undoubtedly contributed to the change in the climate of opinion in favour of a more export-oriented strategy. It is important to understand that this strategy did not imply a move to the opposite extreme, distorting the allocation of resources in favour of exports, though this has happened in some degree in some cases. The primary objective was to "unshackle exports" [Riedel 1985, p.35], to eliminate, or at least reduce, the discrimination against exports introduced by import-substitution policies, in other words to move towards a more neutral

policy stance, not markedly biased in favour of either import substitution or export promotion. In this sense, it was a more market-oriented policy, though in most of the east Asian countries government policy remained strongly interventionist.

The advantages of export orientation in this sense were found to be very largely the converse of the disadvantages of import substitution that had come to be experienced. There was, first and most obvious, the improvement in resource allocation implicit in a pattern of trade and structure of production more in accord with comparative advantage. All the east Asian countries had initially an abundance of relatively unskilled labour. Export orientation enabled them to follow the course pioneered by Japan in the inter-war years - to maximise the advantage of this cheap labour by competing in overseas markets for labour-intensive products, chiefly the traditional triad of textiles, clothing and footwear, but also miscellaneous manufactures from Hong Kong's dolls and wigs and Taiwan Province's tinned mushrooms, to Thai jewelry, Philippine furniture, and later electronics assembly and components, the latter largely through offshore sourcing by US and relocation by Japanese companies. Low labour costs gave these industries a competitive advantage in overseas markets and their labour intensity reinforced the beneficial effects of their rapid growth on employment.

While the resource-poor east Asian NICs had to rely almost wholly on their comparative advantage in cheap unskilled and later increasingly in skilled labour, export-oriented industrial development in the resource-rich other four ASEAN countries could also draw on comparative advantage in resource-based manufacturing industries, such as mineral or cash crop or timber processing industries - "export substitution" in Hla Myint's phrase [quoted ADB 1971].

In the oil and metals sectors, such processing industries tended to be very capital-intensive. They, therefore, contributed relatively little to employment. But provided they had a genuine comparative advantage (at international prices), their development represented a more efficient use of resources for growth, even in purely static terms, than highly protected production for the home market.

Again, however, the most important advantages of export orientation were almost certainly the dynamic gains from trade. These gains, it is important

to note, were not confined to the direct contribution made to GDP growth by rapidly growing export industries; they extended throughout the non-export sectors. Export orientation, as Balassa has put it, raised "total factor productivity through its favorable effects on the efficiency of resource allocation, capacity utilization, economies of scale, and technological change" [Balassa 1983, p.1], to which one might add the broader effects on the competitiveness and flexibility of the economy, as well as on income distribution. None of these effects is easy to demonstrate conclusively, let alone quantify [Balassa 1983, ICORs Krueger 1983, p.147]. But there is a wide consensus in the literature that they largely account for the outstanding development performance of the east Asian countries which was documented in chapter III.

Export orientation can reap economies of scale not available in production for a small domestic market. How important this is depends on the technical conditions of production and market structure in different industries, as well as on the size (and per capita income) of the country. For processes and activities which are highly divisible and have constant returns to scale, the size of production run does not matter [Krueger 1983, p.145], which partly explains why in Taiwan Province and Hong Kong, in particular, manufacturing industries consisting of hundreds of very small firms were able to do so well. Even in these industries, however, there may have been industry-wide pecuniary economies of scale, related to infrastructure, marketing, etc., which would not have been obtainable without the addition of exports to sales in the home market. Industries with processes for which there is a minimum efficient size of plant or production run, such as motor vehicles, tyres, metal smelting and fabrication, shipbuilding and many others, cannot operate efficiently in a small economy without export markets, and for many such modern industries the home market even of very large but poor developing countries, such as India or Indonesia, is too small.

Economies of scale may or may not be significant but there is little doubt about the powerful stimulus to efficiency and growth which export orientation gives by freeing business enterprise from some of the shackles of bureaucratic regulation and by exposing the domestic economy to international competitiveness. Naya has well summarized these benefits: "Flexibility in resource deployment; competitive abilities that arise from production for

contestable markets abroad; learning of technological and managerial skills; fostering of good work habits and attitudes rather than 'rent-seeking' behaviour; all tend to be more associated with export-oriented, outward-looking development strategies. In turn, these dynamic gains are reinforced by domestic economic policies that allow both market forces to work and improve the infrastructural and institutional framework of the economy" [Naya 1985, p.28; cf. also Donges 1985; Krueger 1983].

Not all these benefits will accrue inevitably and in all circumstances. Feeble domestic manufacturers may be put out of business rather than stimulated by international competition. Markets may work imperfectly. Regulation may be needed for non-economic objectives. But the evidence is overwhelming that in the east Asian countries the shift from import substitution to export orientation released energies which translated into astonishingly rapid and dynamic growth. Merely to be relieved of the incubus of overvalued currencies, of restrictions on imports of necessary materials and equipment, and of the need for innumerable official signatures for almost every business transaction, gave a lift to anyone with a spark of enterprise. Lobbying for government protection or subsidies did not wholly disappear but it ceased to be the easiest road to profitability or survival. Risk-takers now had the advantage over those preferring the monopoly rents of the quiet life. Exporting reduced information costs by establishing contact with foreign suppliers and buyers, business trends and practices, new ideas and technologies. Price signals in the market provided a feedback, facilitating the correction of mistakes and adjustment to changing market conditions. Market orientation in trade policy was in most countries accompanied by liberalization of financial and foreign exchange markets. More realistic interest rates encouraged higher rates and more efficient use of domestic saving [Scitovsky 1985; Riedel 1985; Hughes 1985]; more realistic exchange rates helped release investment and growth from chronic balance-of-payments constraints.

Export-oriented industrial development, finally, is widely believed to have been an important contributory factor in the combination of high rates of growth with relatively low and diminishing income inequality in the East Asian NICs [Riedel 1985, p.21; Naya 1985, p.18; and references]. Sustained high demand for labour consequent upon rapid growth of labour-intensive industries

proved an effective - perhaps the most effective - way of alleviating poverty. Real wages rose extremely rapidly in all four countries, and in some - certainly in Taiwan Province and during the 1960s in the Republic of Korea, and probably also in Singapore and Hong Kong although no reliable data for the two city states are available - the share of labour in national income increased [Scitovsky 1985, p.241]. Export-oriented industrial development does not guarantee overall improvement in a country's income distribution. This depends on many other factors which have probably been favourable in the east Asian NICs but much less so in the other four ASEAN countries or in Latin American NICs, such as Brazil or Mexico. But there can be little doubt that it is, in itself, a potent favourable factor.

In none of the eight east Asian countries any more than in Japan, did the shift to export orientation mean the end of import substitution, not even in Hong Kong or Singapore where import substitution did not enjoy tariff or other protection. In most of them, manufacturers producing for the domestic market particularly in intermediate and engineering goods industries, continued to enjoy some degree of tariff protection, though generally at much reduced effective rates, exporters being compensated more or less fully for the higher costs by tax and other concessions. In addition, invisible barriers of one kind or the other limited access to their domestic markets for imports of manufactures from other countries.

Table 16 shows that, except in Singapore (and a fortiori Hong Kong for which such data are not available), effective rates of protection remained quite high even after liberalization reforms, at least in sensitive categories, such as transport equipment and consumer durables. The most widely discussed case of a huge potential market largely closed to foreign manufacturers despite low formal trade barriers is, of course, Japan. Explanations of the puzzle range from the high quality of Japanese products, at least in Japanese eyes, to business practices and marketing arrangements which severely handicap, if not altogether exclude, foreign suppliers [Saxenhouse 1985, Kraus-Luetkenhorst 1984]. Much the same is said to apply, if not quite in the same degree, to the Republic of Korea. Even of Taiwan Province it is said that formal liberalisation has been qualified by "the reluctance of the lower ranks of the bureaucracy to give up their restrictive powers" [Liang 1985, p.20]. These failures to liberalise imports more

effectively have been, and remain, of concern to foreign Governments and exporters seeking access to these markets, but since export industries have been generally exempted or compensated they do not detract from the export orientation that has characterised the trade regime of these countries. This regime has not been one of free trade but of "free trade for exporters".

Table 16. Rates of nominal (N) and effective (E) protection, 1965-1980 (selected years)
(percentage)

	<u>All Manufactures</u>		<u>Consumer Durables</u>		<u>Machinery</u>		<u>Transport Equipment</u>	
	N	E	N	E	N	E	N	E
Singapore (1967)	3	6	7	10	5	6	1	-1
Taiwan Province (1969)	12	15	14	29	9	1	27	55
Korea, Rep. of (1968)	11	1	31	51	28	43	54	164
Korea, Rep. of (1978)	18	31	40	131	18	47	31	135
Malaysia (1978)	22	39	55	173	22	39	0	-5
Thailand (1978)	27	70	57	496	21	58	80	417
Philippines (1965)	51	51	70	86	16	34	...	75
Philippines (1980)	...	70	...	115	...	24	...	...
Indonesia (1975)	20	30	...	224	...	15	...	715

Sources: Tan and Hock (1982); Lee and Liang (1982); Westphal and Kim (1982); Luetkenhorst (1984); Ariff and Hill (1985); Power and Sicat (1971); respectively. Quoted in Riedl (1986).

Export orientation is not without its costs. Apart from general opposition to a market economy (which is not prominent in the east Asian market economies, except to some extent in Indonesia), three main objections are commonly advanced. One is that, by integrating national economies into the world market economy, it renders them more vulnerable to external fluctuations and shocks. The second is that, once substantial import-substitution industries have been built up under cover of protection, removal - especially sudden removal - of this protection inflicts undue hardships on some sections of the community. The third is that, at best,

export orientation is feasible only at a fairly advanced stage of economic development, after an initial industrial infancy phase, to be reckoned in decades, of import substitution. The first two of these objectives will be considered in some detail in the next two chapters. But a word should be added about the third.

In principle it should be no more difficult to "learn by doing" in an export industry than in an import-competing one. In practice, however, it is much easier for Governments to protect infants in the home market than to subsidise their exports (if only because export subsidies are more liable to provoke retaliation). Almost anything can be sold in a fully protected home market. No manufactures can be sold abroad without skilful marketing which requires knowledge and experience not generally at the disposal of manufacturers in developing countries. In the east Asian countries, this marketing function has been performed partly by buyers from the developed importing countries (or transnationals in the case of offshore sourcing) or, most vigorously and successfully in the Republic of Korea, by specialised trading companies, modelled on the Japanese sogo shoshas [Scitovsky 1985, p.237].

Towards the end of the 1970s there was a shift in industrial policy in all the east Asian developing market economies from labour-intensive towards more capital and skill intensive industries and in some of them, in consequence towards a "second round of import substitution". Scitovsky has summarised the considerations behind this shift in the case of the Republic of Korea: "The desire to exploit the comparative advantage of the Republic of Korea in skilled labor, to defeat United States import restrictions by increasing the domestic value-added content in textile exports, to diversify exports, partly by stepping into the void created by Japan's diminishing competitiveness in some sectors and by the advanced countries' own reduced output of certain products for fear of industrial pollution, and to cater to the Republic of Korea's own increased domestic demand, including the demand of its export increased domestic demand industries for intermediate goods. Finally, defense considerations, prompted by the threatened withdrawal of American forces from the Republic of Korea, also played a part" [Scitovsky 1985, p. 258]. In the case of the Republic of Korea, the shift was from light industries, such as food-processing, textiles, clothing and plywood, to steel, chemicals,

shipbuilding, construction, motor vehicles and, within textiles, to sports clothing and other speciality and high quality items. The gradual and quite successful shift during the early 1970s was suddenly drastically speeded up when 80 per cent of Fourth Five-Year Plan investment was crowded into three years (1977-1979), just as the world economy was moving into a severe and prolonged recession, with very adverse effects on domestic inflation, capacity utilisation and the competitiveness of exports of the Republic of Korea [ibid.].

In Hong Kong and Taiwan Province the change resulted mainly from business reactions to loss of competitiveness in labour-intensive industries with rising real wages, although in Taiwan Province there was also considerable investment in state-owned steel, shipbuilding and petrochemical industries. In Singapore, Government direction was largely responsible for the decision to develop one of the world's largest oil refining centres and petrochemical industry and also played an important part in encouraging private investment in such service industries as tourism (hotels) and finance (the Asian dollar market). Just as Singapore sought to take advantage of its key location in Asian oil trade, so the other ASEAN countries were all tempted into heavy industry programmes by their endowment with natural resources, oil, natural gas and minerals. The not altogether happy experience of all four with these programmes presents illuminating case studies in problems of structural adjustment which are the subject of the following chapter.

VIII. Government Policies: Structural Adjustment

The previous chapter has traced the shift from an import-substitution strategy of industrial development to an export-oriented one based chiefly on labour-intensive manufactures - in the East Asian NICs during the 1960s and in the other four ASEAN countries during the 1970s - and the moves towards more capital- and skill-intensive industries in the late 1970s as rising wage costs at home and narrowing market prospects overseas seemed to turn comparative advantage away from labour-intensive industries.

What role did government industrial policies play in this process of structural adjustment? Is it true, as is widely believed, not least in some of

the ASEAN countries, that success was largely due to the influence of the "Japan Model" - strong government guidance of the process, through anticipation of changes in comparative advantage, picking winners and phasing out losers? To examine this question is the purpose of this chapter.

It is not a question that permits a straightforward answer, if only because, despite extensive discussion, the working of industrial policy in Japan is not yet well understood and because the role of Governments differed considerably among the east Asian NICs themselves.

Picking winners. Patrick has pointed out that there are two schools of thought about Japanese industrial policy. "One school sees Japan as embodying a state-guided capitalist developmental system in which MITI [Ministry for Trade and Industry] and industrial policy have played a central role. In this view, government leadership has been the key to Japan's economic success, with business a willing follower. An extreme version of this approach is encapsulated in the phrase Japan, Inc.... The other school sees the basic source of Japan's economic growth in a vigorous private sector which energetically, imaginatively and diligently engaged in business, productive investment and in commercially oriented research and development and in the saving to finance those activities. Business entrepreneurs were the engine of growth" [Patrick 1983, pp. 15f.].

MITI itself has leant towards the first school. MITI liked to think that it could better anticipate the long-run strategic needs of the economy than could the market-place. It saw its task as accelerating the transfer of resources to the major industries of the future while smoothing the process of decline of uncompetitive industries. The industries of the future would be industries of significant size in which Japan would have a future comparative advantage as relative supplies and costs of factors of production changed with domestic growth and evolving international economic conditions, industries for which domestic and world demand could be expected to be highly income-elastic and in which Japan would become internationally price-competitive [ibid. p.6].

It was a market-oriented policy which emphasized economic growth, efficient allocation of resources and a domestically and internationally competitive economy. It rested on close co-operation between Government and

business, but Government - represented primarily by MITI - was in the driving seat. MITI picked the winners, and once it had selected a winner, it backed it with a comprehensive package of support: accelerated depreciation allowances, special R&D funding or tax benefits and loans through the Japan Development Bank or other financial institutions. MITI's objective was to use "market incentives to encourage business behaviour in desired directions" - desired by MITI [ibid. p.9].

As far as outsiders can judge, this MITI image of its own role was an important part, but not the whole, of the truth. It probably requires qualification in at least three respects. First, it does not seem to have been simply MITI officials who picked the winners. There was continuous close consultation, and interchange of information, between MITI and business, at least big business, and the selection, it appears, was frequently based on business advice. Secondly, MITI's encouragement of competition was not unqualified. Certainly it aimed at making Japanese industry internationally competitive. It also promoted competition among Japanese firms, for example by encouraging the co-existence of several firms in each growth industry. But it also regarded it as one of its tasks to avoid "excessive competition" [Uekusa-Ide 1986], a task which must have muted competitive pressure on individual firms, and, as was noted earlier, domestic Japanese industry was not generally exposed to foreign competition until it was well able to hold its own.

Thirdly, MITI has a by no means unblemished record in "picking winners". It had some notable successes but also a good many important failures. Many of Japan's most successful industries of the 1960s - consumer electronics, motor cars, indeed virtually all consumer goods - succeeded on their own without special government support. MITI initially opposed the establishment of the steel industry (and, it is said, of Sony). It sought unsuccessfully to prevent the emergence of new motor car manufacturers and only thus failed to kill at birth one of Japan's success stories, Honda. In promoting dubiously competitive petroleum and energy-intensive industries, such as aluminium, in the 1960s, MITI, like others, failed to foresee the rise in energy prices which rendered these industries even less competitive. MITI encouraged a huge expansion of shipbuilding which was widely, and as it turned out correctly, expected to run into worldwide excess capacity. Among industries which MITI at

various times saw as potential winners but had to abandon in the face of foreign competition were the production of construction equipment, chain saws, marine engines and plate heat exchanges. The chemical industry which MITI pushed vigorously has remained fragmented and plagued by high costs [Kasper 1985; Patrick 1983; also S. Brittan 1984].

The success of Japan's industrial policy during the past quarter century is indisputable, and it would be unreasonable to deny MITI share in the credit. MITI's role in gathering and facilitating exchange of information about market and technology trends and in steering industrial policy through a consensus established by and with industry participants - "industry planning from the bottom up", as it has been called [Kasper 1985, p. 4] - must have helped by reducing risk and information costs. More generally, industrial development unquestionably benefited from Japan's tradition of co-operative and mutually-beneficial government-business relations - Patrick contrasts it with "America's adversarial, suspicious, more individualistic society and its institutions" [Patrick 1983, p.11]. But whether MITI's record demonstrates the value of the "Japan Model" in the sense of strong government guidance of the process of structural adjustment and particularly of a government role in picking winners, is an open question. "Investment decisions must be based on predictions of future needs and availabilities; and politicians and civil servants need be no worse than businessmen at weighing all the information available for making the best predictions. People in government, however, are seldom affected quite so personally and profoundly by the outcome of their investment decisions as are businessmen... Moreover, central planners can too easily overrule businessmen's dissent, which puts official investment plans in danger of being too monolithic, too narrowly and confidently focussed on what seemed best in the planners' judgment." [Scitovsky 1985, pp. 256f.]. MITI planning by consensus must have reduced this danger, and there is no doubt of the high average level of professional quality of MITI staff. But the historical record of failures even in Japan serves as a warning against over-optimism.

The east Asian NICs followed the Japan model in varying degree, and here, too, the record of Governments in picking winners is mixed. The Hong Kong Government adopted a policy of what its Chief Secretary once called "positive

non-interventionism": "When faced with an interventionist proposal, the Hong Kong Government does not simply respond that such a proposal must, by definition, be incorrect. It is true that, more often than not, we come to the conclusion that the balance of advantage lies in not intervening. Yet, in all cases, decisions are made positively, and not by default, and only after the immediate benefits and costs, to the extent that they can be confidently predicted, are weighed against the medium- and longer-term implications of the interventionist acts proposed (including the inevitable difficulties of unwinding them)" [Quoted, Riedel 1986].

The industrial policy of the Taiwan Province has been only marginally more interventionist than Hong Kong's. During the 1960s the Government certainly did all it could to encourage investment in export-oriented labour-intensive manufacturing industries by the various macroeconomic policy measures that were described earlier (above, Chapter VII) but it left investment decisions by and large to business. Its objective was to create "an essentially free-trade, free-market regime for exports and export production" [Scitovsky 1985, p. 223]. In the face of the problems presented to sustained expansion of labour-intensive manufactures by rising labour costs at home and slower growth and protectionism abroad, the Government has responded by promoting a shift from unskilled-labour and capital- and energy-intensive industries to skill and high technology areas. It provided incentives in the form of cheap credit and tax holidays and took a major initiative in the form of a science-based park or industrial estate to encourage new "strategic" industries, especially machinery-manufacturing and information and electronics industry. A program of technical co-operation projects was designed to attract overseas technology, and if the first major investments attracted were in McDonald's hamburgers, Kentucky Fried Chicken and Procter and Gamble's toothpaste, this was at any rate evidence of its willingness to let business seek out opportunities; with increased emphasis on government and private R&D spending, the emphasis, it was hoped, would shift towards high-tech before long (Liang 1985, pp. 14f.).

In the Republic of Korea, government influence over economic affairs was very much greater and more detailed. "The machinery of economic planning was larger, more elaborate, more centrally and prominently placed in the Republic of Korea Government's administrative hierarchy" and the planners made

extensive and forceful use of a wide range of incentives, and of the dependence of business on bank lending, "to assure private industry's close compliance with their plans" [Scitovsky 1985, p. 229]. Business was far more concentrated in large conglomerates than in Taiwan Province, and Government continually pushed investment and growth well above the rate that could be financed from domestic saving, at the price of almost chronic inflation and increasing foreign debt. But, as in Taiwan Province, for at least a decade from the mid-1960s, the thrust of industrial policy was to take full advantage of the Republic of Korea's relatively low labour costs in world markets for labour-intensive manufactures, with outstanding success. In the 1970s, as already pointed out (ibid. p. 44), the emphasis for various reasons shifted towards more capital- and skill-intensive development, initially quite successfully. But in 1977, in the last years of the Park regime, this shift was suddenly greatly accelerated and many costly mistakes were made. The petrochemical industry was given heavy protection from imports, at the cost of higher prices to users, including exporters, reduction in the size of the domestic market and underutilization of capacity. More than \$3 billion was invested in expansion of the merchant marine, with subsequent losses and bankruptcies. Overseas construction, especially in the Middle East, was encouraged to expand with rising oil prices, only to be in trouble when oil prices fell. "Picking winners" had not been difficult when low wage costs made labour-intensive industries an obvious target. It was another matter when it came to choosing among hundreds of heavier and technologically more sophisticated industries, each requiring the investment of very large amounts of capital.

Singapore industrial policy stood somewhere between that of Hong Kong and the Republic of Korea. Like Hong Kong, Singapore maintained free trade, encouraged a highly competitive domestic economy and followed a course of prudent demand management, keeping inflation well under control and avoiding foreign debt. But much more like the Republic of Korea, the Government in Singapore kept business on a tight rein. A variety of incentives, as well as monitoring and regulatory devices, were used to steer investment in what government policy-makers thought appropriate directions. As in the Republic of Korea, this worked well while comparative advantage lay obviously with labour-intensive export industries. It became more difficult when, in the late 1970s, Singapore's comparative advantage seemed to be shifting towards skill- and technology-intensive industries. Already in the early 1970s advantage had

been taken of the oil boom to promote the creation of very large oil refining capacity, and of Singapore's presumed comparative advantage in service industries to promote tourism and international finance. In 1979, as part of a new strategy of "economic restructuring", the National Wages Council deliberately began to raise wage levels to discourage low-skill, labour-intensive activities. By 1985, oil refining and the hotel industry were in deep trouble and, with rising domestic costs and sluggish world demand, economic growth came, at least temporarily, to a halt [Kirkpatrick 1985].

In the other four ASEAN countries where the move towards export-oriented manufacturing at various times during the 1970s had been carried out in the main by measures of trade liberalization and export incentives which involved no major direct government control of investment, the "Japan model" became a prominent theme in government thinking and public discussion about economic policy around 1980. In Malaysia in particular, "Look East" became a much-heard slogan. One suspects that to many in the political leadership the appeal lay in the image of the Japanese as diligent patriots ready to subordinate personal interests to the common good. But the notion that Japan's economic success had been due to strong government guidance of the economy, as contrasted with western "laissez faire liberalism", also fell on receptive ears. It served to justify a shift towards more interventionist industrial policies.

In all four countries: Governments, enticed by oil, gas and mineral resources, anxious to reduce dependence on a few labour-intensive export industries and impressed by the new priority accorded in the east Asian NICs to skill intensity and high-tech, adopted ambitious plans for heavy industry development. Malaysia's Fourth Plan of 1981 contained a heavy industry program, including large automobile, cement, sponge iron, methanol, paper, engineering and petrochemical plants [UNIDO Industrial Development Review 1985, p.4]. In the Philippines, the Government in 1980 embarked on a program of eight "major industrial projects" based on exploitation of the country's natural resources with massive injections of foreign capital and technology [UNIDO Industrial Development Review 1985, p. 6]. Thailand's Fifth Plan, adopted in 1982, contained a far-reaching Eastern Seaboard Development program, including a large petrochemical complex [UNIDO Industrial Development Review 1985]. In Indonesia where, with the financial resources and apparent

opportunities created by the oil boom, industrial development had during the 1970s become increasingly capital intensive, the lure of high-tech found expression in the Nurtanyo project for the production of modern aircraft and other advanced equipment [Ariff-Hill 1985; Roepstorff 1985].

In Malaysia and Thailand, severe budget and balance-of-payments constraints in the less favourable conditions of the prolonged international recession compelled drastic cutbacks of these programs in mid-term plan reviews [UNIDO Industrial Development Reviews 1985]. In the Philippines, the "major industrial projects" had to be virtually abandoned as political and economic problems mounted. In Indonesia, too, the financial repercussions of declining oil prices required severe pruning of some of the more ambitious oil sector and other public investment plans, although the Nurtanyo project appears to continue to enjoy high priority in the allocation of resources.

It is too early to judge how these programs will fare through the 1980s. The evidence so far does not suggest that "economic restructuring" ostensibly guided by the Japan model has been an unqualified success.

Helping losers. If one side of structural adjustment is to find the growth industries, whether through the market or through government attempts to pick winners, the other side is what to do with the losers, the declining industries which are losing comparative advantage. It is here, rather than at the "sunrise" end of the spectrum, that the Japan model has so far shown itself markedly superior to general western practice. There has, in Japan and the east Asian NICs, been a greater willingness to phase out, rather than protect and attempt to resuscitate, "sunset" industries.

In the 1960s, as Japan was losing her comparative advantage in labour-intensive industries, business responded to market signals without major government initiatives in restructuring, except for some MITI help in coal mining, cotton textiles and wood industries [UNIDO 1983]. As Table 17 shows, the relative importance of textiles in Japanese manufacturing declined steeply, and there were smaller falls in food processing and, in the 1970s, in the clothing, footwear and furniture industries (and changes within these and other industries which such aggregated figures do not reveal). Adaptation to changing comparative advantage proved relatively easy in a period of very

rapid overall economic growth and was further facilitated by the flexibility and mobility of that part of the Japanese work force not anchored in the core of life-long employment. Outside Japanese agriculture, there was little organized political pressure for protection.

Table 17. Labour-intensive manufacturing industry, Japan, 1963, 1978 and 1981

(Per cent of total manufacturing)

	<u>Value of Gross Output</u>			<u>Number of Employees</u>		
	1963	1978	1981	1963	1978	1981
Food processing	10.1	9.7	8.9	9.6	9.5	9.5
Textiles	10.5	4.8	3.9	14.2	8.6	7.0
Clothing	1.3	1.3	1.1	2.8	4.3	4.2
Footwear	0.2	0.2	0.4	0.3	0.3	0.3
Furniture	0.8	1.0	0.9	1.6	1.7	1.1

Source: United Nations, Yearbook of Industrial Statistics, various issues.

The industries which got into difficulties in the late 1970s presented much more difficult problems of adjustment and redeployment of resources. The Depressed Industry Law of 1978 designated fourteen industries as "structurally depressed", including aluminium refining and synthetic fibres hurt by high energy costs, shipbuilding by low world demand, electric furnace steelmaking, ferrosilicon and linerboard by low domestic demand, and spinning and chemical fertilizers hit by increased competition from newly industrializing countries [Uekusa & Ide 1985, p.17]. The law called for a number of measures to assist structural adjustment in these industries, including collective capacity reduction (which was exempted from anti-monopoly legislation), a joint credit fund for the purchase of scrapped facilities and various measures to help displaced workers and depressed communities (ibid.). But the emphasis was on adaptation, phasing out or at least scaling down, not on protection or subsidies.

The same has broadly been true in the east Asian NICs, although not many tests have as yet come. In the Republic of Korea, employment in the food processing, textiles, footwear and furniture industries declined relatively between 1970 and 1978 and even absolutely in the next four years, but government industrial policy focused on the expanding capital-intensive industries and did nothing to halt the decline. The Singapore Government, as was mentioned before, was quite prepared to close down the motor car industry when it showed no prospect of becoming internationally competitive and has been content to use macroeconomic measures, stepping up public works and reducing intake of foreign workers, to cushion the economy in the recent recession, rather than intervening in particular industries. In Taiwan Province, the Government has at times given special assistance to companies in trouble [Liang 1986] but the general stance of industrial policy has been to facilitate adjustment in line with market forces.

This cannot be said without considerable qualification of the other four ASEAN countries. True enough, all four in varying degree opted for export-oriented industrial development in the 1970s, and the problem of phasing out modern industries has not yet presented itself in any of them. But in all four, market orientation of industrial policy has been qualified by non-economic objectives, least so in Thailand though even here regional balance and help to small-scale industry have been important considerations, much more so in Malaysia and Indonesia for the protection and promotion of indigenous (bumiputra/pribumi) vis-à-vis overseas-Chinese enterprise, and both in Indonesia and the Philippines where moves towards a more outward-looking and market-oriented industrial policy have had to contend with deeply entrenched protectionist sentiment and vested interests. In this respect, industrial policy in Indonesia and the Philippines still has more in common with its general tenor in most other developing countries (especially in Latin America) and indeed increasingly in recent years many of the OECD countries, than with that of Japan and the east Asian NICs.

The contrast hinges, in essence, on the extent to which declining industries and other vulnerable groups are best served by an industrial and general economic policy which aims at rapid economic growth and flexibility or whether special protective measures are needed. In the advanced industrial countries protectionism is motivated primarily by a desire to maintain

employment and alleviate social problems in industries adversely affected by technological change or for other reasons no longer able to compete internationally. While this sentiment is buttressed by powerful political pressures exerted by organized interest groups of capital and labour, it derives support from wide sections of public opinion; as Caves has said, the average citizen's objective function in most western countries must be interpreted as including a term for "the utility gained from the knowledge that fellow citizens have been treated fairly" [Caves 1986].

Even in Japan and the Republic of Korea, this combination of public sympathy and the working of the political market - reinforced in this case by defence arguments for self-sufficiency in food - has sustained protectionist policies for agriculture which cannot be justified on economic grounds. In Indonesia and Malaysia, protection and promotion of indigenous business have been the single most powerful motive for interventionist and regulatory industrial policies, although a good many other non-economic objectives - considerations of equity in the context of regional industrial development and fostering of small-scale industry, considerations of national autonomy in the control of foreign investment and of self-reliance in support of neo-mercantilist commercial policy - have also played a part in both these countries, as in the Philippines [Ariff-Hill 1986].

Economic analysis cannot refute the case for non-economic objectives of national policy. What the economist can do is to put up warning signals about the extent to which sentiment disguises rent-seeking by sectional interests and about the frequency with which well-intentioned industrial policies for non-economic objectives prove counterproductive. For one thing, policy cannot protect everybody; protecting some must hurt others. Unlike economic growth, protection is in practice almost always a zero-sum game. Sometimes it is possible to soften the shock and spread the costs of adjustment, through open or hidden subsidies paid for by taxpayers or consumers at large. But policies to protect property rights in particular jobs or sunk capital inevitably fail and merely add to the costs of adjustment deferred if the problems of an industry are not reversible.

Protecting jobs in an uncompetitive textile industry by protectionist barriers to imports may destroy more job opportunities in export and other

industries [Lloyd 1986], and if the "vulnerable group" happens to be highly paid automobile workers equity is not obviously served by subsidies to the automobile industry (White 1986). In the long run, the most insidiously counterproductive effect of protection is that it deprives the intended beneficiaries of the incentive to help themselves; it encourages them to lobby for more protection rather than seek out market opportunities, and this applies as much to pribumi in Indonesia as to capital and labour in high-cost industries in advanced industrial countries.

In Japan and the east Asian NICs, industrial policy during the past quarter century has been relatively free of such avowedly protectionist measures (although, as was pointed out earlier, domestic industry has in practice enjoyed a good deal of de facto insulation from import competition, at least in Japan and the Republic of Korea). High priority accorded to economic growth and to efficiency over social objectives has been one factor in this; the relative weakness of organized pressure groups a second; the actual achievement of rapid economic growth, by facilitating continuous adjustment, a third. None of these three factors may be as effective in the future as in the past. With increasing affluence the weight in the mix of national objectives has already begun to shift from economic growth to various aspects of the quality of life; government dominance over organized pressure groups has probably weakened; and growth itself has slowed down. It may become more difficult to maintain the policies for industrial development which have been so conspicuously successful.

To consider future trends and policies from this point of view is the purpose of the final chapter.

IX. The Future: Prospects and Policies

The preceding chapters have discussed the success of export-oriented industrial development in the east Asian developing market economies. An attempt has been made to assess how much of this success must be attributed to unusually favourable conditions, domestically and externally, and how much to good policies. There remains the task in this chapter to consider what lessons, if any, the east Asian experience has for other developing countries. What are the prospects for export-oriented industrial development

for the 1980s and beyond, in east Asia and elsewhere? How far is the success with which the strategy met in east Asia replicable elsewhere? What specific policies are most promising?

Prospects. Little need be added to what was said before about favourable domestic preconditions. Not that they were unimportant, in Japan and the east Asian NICs in particular. Unquestionably, one reason why the people of these countries did so well was because of the sort of people they were - hard-working, thrifty, enterprising, relatively well educated, individually competitive yet as communities socially cohesive. But, to repeat a point made before, such explanations in terms of historical and cultural factors, even where they are more than ex post rationalisations, carry no lessons for others because a country's history and culture cannot be imitated. Education may change people's behaviour and attitudes in ways more conducive to rapid industrial development, increasing affluence in ways less conducive, but such changes occur slowly and cannot easily be accelerated or retarded by Governments. For this reason, the more success can be traced to deliberate policy reforms which could be adopted elsewhere, rather than to immutable preconditions in history and culture, the better. Who, a decade ago, would have been bold enough to predict the outward-looking economic policies that have, in this decade, been adopted in the People's Republic of China?

The external preconditions, the international economic environment, which the east Asian NICs enjoyed, raises much more pointed questions. Economic growth in the developed countries has slowed down considerably as compared with the high tide of the 1950s and 1960s and seems unlikely to regain such momentum soon, if ever. The problems this has presented to all developing countries with export-oriented industrial policies have been aggravated by resort to protectionist measures by Governments of the developed countries under pressure, in conditions of high unemployment, to help their own high-cost industries. Higher tariffs, import restrictions, voluntary export restraint agreements and various kinds of invisible barriers adopted in almost all the developed market economies have particularly hit developing country exports of labour-intensive manufactures, such as textiles, clothing and footwear, but have also extended to more capital- and skill-intensive industries in which the advanced NICs have become competitive, such as electronic and engineering products.

Reference has been made in earlier chapters to the economic difficulties which all the east Asian developing market economies have encountered in recent years. The prolonged international recession slowed down their export growth, particularly to the EEC, partly because their currencies - tied to the strong US dollar - made their exports less competitive, and to the Middle East with the slump in oil prices and earnings. Although exports to the USA fluctuated with cyclical conditions in the US economy, falling in 1982, bouncing back strongly in 1983 and 1984, but weakening again in 1985, the relatively open US market has been the main source of continuing strength of world demand for east Asian manufactures (Fig. I). It accounted in 1984 for 35 per cent of Japanese exports, 50 per cent of Taiwan Province's, 45 per cent of Hong Kong's, 35 per cent of the Republic of Korea's and 20 per cent of Singapore's. But this dependence on the US market may prove a source of weakness in the next few years. For strong US import demand has depended on continuous growth in the US current account deficit, financed by capital inflow which, attracted by high US interest rates, has kept up the value of the US dollar. When this situation ended in early 1986, the east Asian export-oriented economies will bear the brunt [cf. Mohs 1985, Wade 1985, Streeten 1982]. As Table 18 and Fig. I show, 1985 has been a bad year for all the east Asian developing market economies and 1986 is not, at the time of writing, expected to be much better. No wonder, there has been only-half-humorous talk about "export-led slowdown". [Far Eastern Economic Review 26/9/85].

But all this may be taking too myopic and gloomy a view. Similarly pessimistic prognoses were made for the export-oriented developing countries when the secular-boom decades of the 1950s and 1960s gave way to the turbulent decade of the 1970s, yet that decade, as shown earlier, brought even faster growth of both exports and GDP in these countries. Export pessimism is a common failing because in a world market economy it is always easier to identify the obstacles than the opportunities, and it is a failing to which those are most prone who in any case distrust market forces and prefer inward-looking policies.

A substantial part of the slow-down in economic growth in 1985 in Thailand, Indonesia, the Philippines and Malaysia was due to a virtual across-the board decline in commodity prices - coffee, rubber, tin, palm oil,

timber, sugar and rice. Commodity prices are generally expected to remain sluggish in 1986 and this will constrain the ability of east Asian developing countries to improve their economic performance. The rapid fall in oil prices in early 1986 will cause considerable problems for Indonesia and to lesser extent Malaysia. In Indonesia this may to some extent be offset by an increase in output of oil and other commodities such as tin.

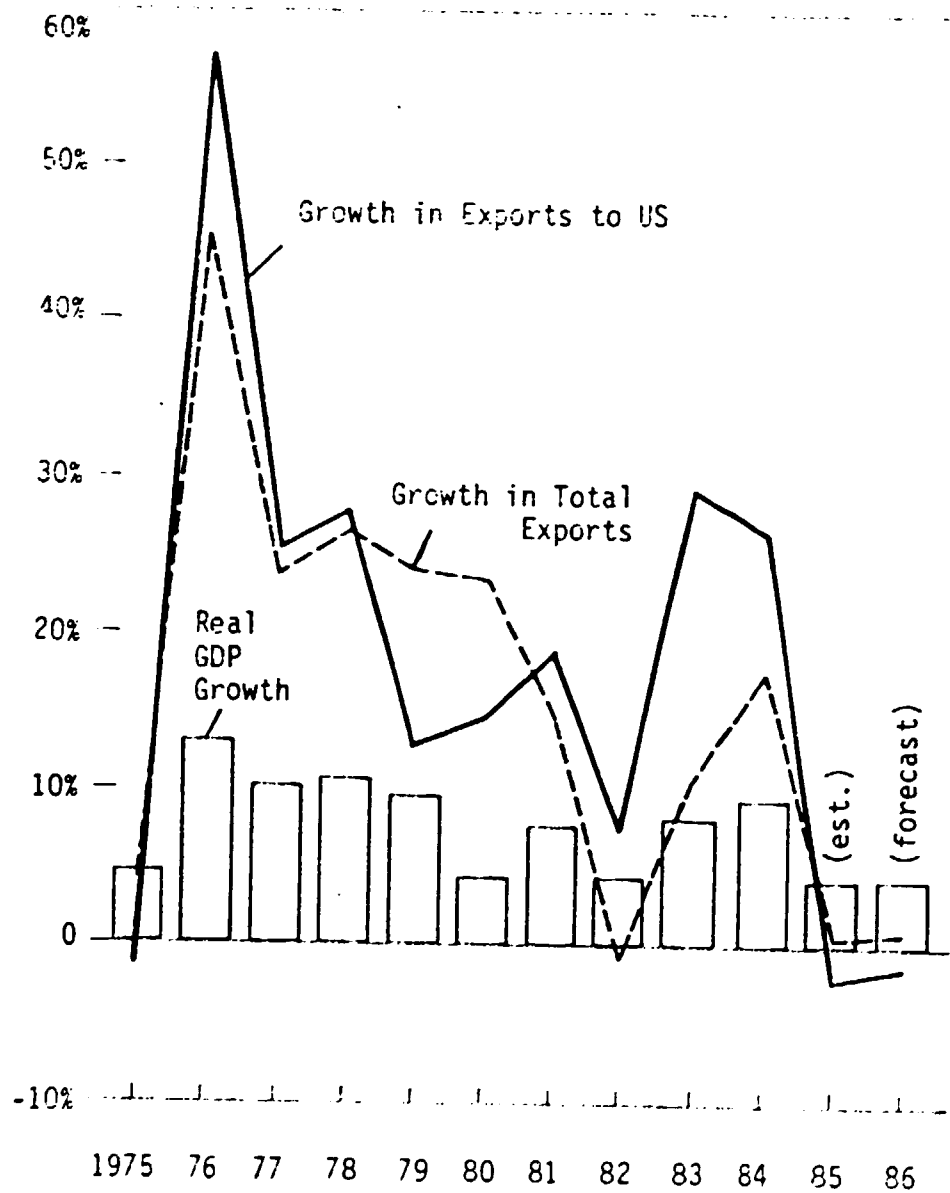
The oil import dependent east Asian developing countries with high external debt ratios will benefit most from the fall in oil prices, interest rates and the increased tempo of economic growth in the developed countries. With oil prices at \$15 a barrel (as compared with previous price at \$27 a barrel) it is estimated that the Philippines will gain over \$1 billion in their current accounts (15-20 per cent of imports), Taiwan Province \$2 billion (10 per cent of imports) and the Republic of Korea over \$3 billion (10-15 per cent of imports), assuming unchanged intensity of oil use.^{1/}

Debt servicing however will remain a problem, particularly in Indonesia, Thailand and the Philippines where the debt service ratio is over 25 per cent, and to some extent the Republic of Korea. The new Government in the Philippines is endeavouring to attract more direct foreign investment in an effort to reduce its dependence on borrowing. Although the Republic of Korea continues to attract substantial Euro-market funds and will benefit from falling oil prices, concern has been expressed over the magnitude of the current level of debt. The other NICs have all built up relatively sound international liquidity positions which should, in the case of Hong Kong and the Taiwan Province, facilitate efforts to maintain high economic growth rates. However Singapore, whose economic problems have been compounded by difficulties in the financial sector, may need to reconsider its high wage and exchange rate policies.

With the exception of the Philippines and momentarily Singapore, the east Asian developing market economies are still growing faster than most other market economies, developed or developing; and among other Asian developing countries, it is those which have in recent years adopted more outward-looking policies, such as the People's Republic of China, India and Sri Lanka that are showing the highest rates of growth (see Tables 2 and 3 above).

^{1/} ESCAP, Bangkok World LINK meeting (8-12 September 1986), Pre-session Documentation, April 1986.

Figure I. Asian NICs^{a/}: Real GDP and Export Growth, 1975-1986



Source: ESCAP, Bangkok World LINK meeting (8-12 September 1986), Pre-session Documentation, April 1986.

^{a/} Hong Kong, Singapore, Republic of Korea and the Taiwan Province.

Table 18. Projections of Asian economic growth, 1984-1987

	GDP		Real GDP Growth Rates			
	(in billion US\$ at 1975 prices)		(per cent)			
	1984	Source	1984	1985	1986	1987
				(Estimate)		(Forecast)
Indonesia	54.2	a/ UNIDO	4.3	3.0	2.0	2.4
		b/ LINK	5.0	2.8	3.4	4.2
		c/ FEER	...	0-1.8	0-1	...
		d/ The Economist	5.8	2.9	0.5	...
Korea, Rep. of	40.0	a/	8.4	5.2	7.3	6.6
		b/	7.9	5.0	6.5	6.8
		c/	...	5.0	7.5-8	...
		d/	8.4	5.1	6.6	...
Taiwan Province	32.6	a/	10.5	4.8	6.7	5.8
		b/	11.0	5.0	5.8	6.9
		c/	...	4.7	6-8.5	...
		d/	10.5	4.7	6.0	...
Thailand	27.6	a/	6.0	4.0	4.2	3.8
		b/	6.0	4.0	3.9	4.4
		c/	...	4.1	4-4.5	...
		d/	6.0	4.1	3.7	...
Malaysia	17.7	a/	7.6	2.8	2.8	3.6
		b/	7.6 ^{e/}	4.2	4.8	5.0
		c/	...	2.8	0-3	...
		d/	7.6	2.8	2.1	...
Philippines	22.6	a/	-4.6	-4.3	-1.2	0.6
		b/	-5.5	-3.6	-3.0	2.5
		c/	...	-3.95	-2-0	...
		d/	-5.3	-4.0	0.8	...
Hong Kong	19.7	a/	9.4	1.0	3.9	5.1
		b/	9.4	5.3	5.9	6.8
		c/	...	0.8	4-5	...
		d/	9.3	0.8	5.1	...
Singapore	12.4	a/	8.6	-1.8	0.9	2.6
		b/	8.2	-1.6 ^{e/}	0.8 ^{e/}	3.4 ^{e/}
		c/	...	-1.7	-2-0	...
		d/	8.2	-1.8	-1.5	...

a/ UNIDO forecast (May 1986).

b/ ESCAP, Bangkok World LINK Meeting (8-12 September 1986). Pre-session Documentation, April 1986.

c/ Far Eastern Economic Review, 8 May, 1986, p. 144.

d/ The Economist, 3 May 1986, p. 115.

e/ GNP.

Certainly, much depends on the prospects for economic growth and a reasonably liberal trade regime in the advanced industrial countries, especially the United States and western Europe. While protectionist policies did not hold back east Asian exports of manufactures in the 1970s as much as had widely been feared [Hughes-Krueger 1984], such policies can still do much damage, both to export-oriented developing countries, and to economic efficiency and living standards of the advanced countries themselves.

A special responsibility rests on Japan to open up its domestic market to exports of manufactures more effectively than hitherto. Japan's is potentially a huge market for precisely the labour-intensive and simpler capital- and skill-intensive manufactures which many developing countries, not only in east Asia but also in south Asia and Latin America, can now produce increasingly competitively. Given Japan's large balance-of-payments surplus, it is difficult to believe that aggressive import liberalisation, including action to prize open the domestic marketing structure by such measures as tax incentives to sell imported goods, coupled with moderately expansionary domestic monetary-fiscal policy, which would be helpful to the rest of the world, would pose any threats to Japan's domestic economic stability. One might add in parenthesis that a similarly valuable contribution to the industrial development of developing countries could be made by the CMEA countries whose domestic markets remain relatively closed to manufactures from the developing market economies.

Taiwan Province and Hong Kong, in particular, have demonstrated that there is also increasing scope for South-South trade. Table 19 shows that developing country markets by 1983 accounted for almost 40 per cent of the exports of the east Asian NICs and for 33 per cent of those of the ASEAN countries. Exports of traditional products, such as textiles and clothing, from the NICs to other developing countries declined in the 1970s as the latter developed their own capacity, but exports of electrical machinery, resource-based and miscellaneous manufactures increased.

Obviously, countries which integrate their national economies into the world market economy are more exposed to buffeting by cyclical fluctuations in economic activity in the advanced industrial countries and other disturbances. But the historical experience of the past forty years has

clearly demonstrated that there is no net gain in insulation from the world economy through inward-looking policies. On the contrary, the evidence of relative economic performance of inward- and outward-oriented economies indicates strongly that the static and dynamic gains from international trade and factor flows on balance greatly outweigh the risks of vulnerability. The trend towards more outward-looking policies, even in Asian countries which had for long been wedded to inward-looking trade regimes, such as the People's

Table 19. Direction of exports of Asian NICs and ASEAN countries, 1970, 1979, 1981 and 1983

Destination	Origin ^{a/}	Asian NICs				ASEAN Countries ^{b/}			
		1970	1979	1981	1983	1970	1979	1981	1983
NICs		7.8	8.7	9.9	7.9	18.9	17.8	17.8	21.0
ASEAN ^{b/}		10.2	9.4	10.3	12.2	5.2	3.1	3.6	3.9
South Asia		0.8	2.5 ^{c/}	3.0 ^{c/}	3.1 ^{c/}	0.6	1.3	1.6	1.7
Middle East		1.5	5.7	5.9	6.2	1.2	1.6	2.3	2.0
Other developing countries		10.0	7.6	9.8	9.6	1.8	3.3	5.9	4.8
Japan		11.7	13.1	10.4	9.1	28.4	33.1	32.7	30.3
US		31.8	26.5	25.9	31.5	19.6	19.3	17.7	18.7
Australia		2.3	2.5	2.7	2.2	1.8	1.4	1.8	1.2
EEC ^{d/e/}		15.0	16.2	13.1	10.9	15.4	14.5	11.3	11.0
Other developed countries ^{f/}		<u>7.0</u>	<u>6.0</u>	<u>4.9</u>	<u>4.7</u>	<u>3.1</u>	<u>2.3</u>	<u>2.2</u>	<u>2.4</u>
Total Pacific ^{g/}		63.8	62.7	59.2	62.9	73.9	76.0	73.7	75.1
Total developing countries		30.3	33.9	38.9	39.0	27.7	27.1	31.2	33.4
Total developed countries		67.8	64.3	57.0	58.4	68.4	70.6	65.7	63.7

Source: UN, Commodity Trade Statistics, various issues.

a/ Definition of country groups as in UN Commodity Trade Statistics.

b/ Excluding Singapore.

c/ Excludes exports from Taiwan Province.

d/ Including United Kingdom.

e/ Including Greece starting in 1981.

f/ Excluding Centrally Planned Economies.

g/ Pacific trade includes trade with NICs, ASEAN, Japan, U.S., and Australia.

Republic of China, Pakistan and Sri Lanka and even Burma, suggests that, at least in Asia, this evidence has come to be accepted as convincing.

Policies. What policies - industrial policies in the widest sense - are most likely to minimise the risks and maximise the benefits of an export-oriented industrial policy?

The first point to stress is that export orientation and import substitution are not mutually exclusive. Import substitution goes on all the time in the course of economic development, as domestic capacity to produce goods and services efficiently improves. In countries at a very early stage of industrial development, such import substitution may need some infant industry protection. There may also be a case for a "second round" of import substitution in more advanced industrialising countries as and when they begin to lose their comparative advantage in labour-intensive industries. Such second-round import substitution may take the form of domestic production of capital equipment hitherto imported or of further processing of primary products for the home market or for export ("export substitution"), and it may justify some initial government encouragement and assistance. But it should not be the excuse for a return to inward-looking, protectionist policies. Assistance should take the form of incentives and subsidies rather than barriers to imports (and if the latter are needed at all, in the form of tariffs rather than import licensing), so that the new industries are from the beginning exposed to international competition. For the same reason, and to take all possible advantage of economies of scale, the new industries should be encouraged from the outset to seek export markets; subsidies should therefore, in part and preferably, consist of export incentives of various kinds. Where the new industries produce capital equipment, it is particularly important that they do not damage domestic user industries through high-cost or low-quality output [UNIDO Indonesian Industry Sector Study 1984a].

Similar considerations apply to structural adjustment from labour-intensive to more capital-, skill- or technology-intensive export industries, if and when the need for such adjustment arises. A good deal of pessimism has been expressed in various quarters in recent years about the market prospects for further expansion of exports of labour-intensive manufactures and about the capacity of any developing countries to compete

with the advanced industrial countries in export markets for capital and technology intensive manufactures. Developed countries protectionism, as was emphasised above, is undoubtedly a matter of the most serious concern to countries which still depend mainly on comparative advantage based on low wage costs, and the market for such products may become even more competitive as a third and fourth generation of NICs - including not only the People's Republic of China and the countries of south Asia, but also developing countries in Africa, Latin America and the Middle East - seek to enter this market through the 1980s and 1990s. Not all will be successful. But judging by the experience of the east Asian NICs during the past two decades, success in this field may well do more for industrial and general economic development of many developing countries than any alternative strategy.

Pessimism about the capacity of the more advanced NICs to compete in world markets for more and more sophisticated manufactures is even less justified. That, after all, is how Germany, France and the USA contested the field with Great Britain in the latter 19th century, and Japan and many of the western European countries, from Italy, Sweden and Switzerland, to the Netherlands, Denmark, Belgium and Austria, and more recently also Spain, Yugoslavia and others, established a comparative advantage in all kinds of specialised manufacture. The Republic of Korea in steel, shipbuilding, construction and transport equipment, Taiwan Province in electronics and electrical machinery, India in spinning and weaving equipment, Brazil in motor cars and military hardware - these are only the most conspicuous examples of a new generation of mature industrial countries emerging from among the newly industrialising countries of the 1960s and 1970s.

Export markets do not fall like manna from heaven; nor can they be created by government intervention. Governments can help by providing incentives, to use the accepted euphemism for export subsidies, so long as they do not become too blatant and provoke retaliation. Particularly useful forms of indirect subsidy may be export credit, export insurance, and the provision of information and contacts through trade commission and similar services. But the task of marketing exports, which is much more demanding for manufactures than for primary commodities, and for more differentiated capital- and technology-intensive than for the more standard labour-intensive ones, requires entrepreneurial initiative much more likely to be found in the

private sector. While the large transnational corporations have the capacity to do their own marketing, smaller manufacturers in developing countries can be greatly assisted by specialised trading companies, such as have played so important a part in modern Japan and have operated effectively in the Republic of Korea. Other industrialising countries may find this a useful example to follow.

What lessons does the experience of the east Asian developing market economies have with respect to specific policies? The analysis of this experience in the preceding chapters has suggested a number of such lessons which may be summarised under three headings: the provision of public goods, macroeconomic policy, and industrial policy (in the narrower sense of policy directed at the structure of manufacturing industry).

The east Asian NICs owe much of their success to the fact that they have generally enjoyed efficient Governments. Their Governments have been able to provide efficient administration and good infrastructure and have given high priority to education; and in varying degree the same can be said - at least relative to average developing country standards - of the other four ASEAN countries. Joan Robinson, noted socialist economist, inferred in one of her last publications from a comparative study of southeast Asian countries that "the degree of government action to be taken in an economy should be considered in the light of the efficiency and honesty of a Government; if a Government is not efficient and honest enough, it is far better to let markets express themselves, otherwise control will lead to more control, corruption, abuses and inefficiency" [Joan Robinson 1982]. Even economists of a more market-oriented persuasion have conceded that interventionist policies may work if Government is in able hands. "In the Republic of Korea's practice ... potential dangers inherent in too much control over investment were avoided most of the time, thanks to exceptionally able and intelligent planning" [Scitovsky 1985, p. 258]. Unfortunately, the availability of exceptionally intelligent planners cannot be taken for granted. Even in the Republic of Korea, Government at the end of 1970s made "serious mistakes which would probably have been avoided under less tight governmental controls" [Ibid.].

The presumption that education is good for industrial development may be largely an act of faith. A respect for education may be part of a generally

achievement-oriented social ethos, so that its specific contribution to success in industrial development cannot be easily identified. Much depends on the kind of education. Comprehensive primary education not matched by further opportunities at secondary and tertiary level may lead to frustration and restlessness; generous provision of tertiary education may turn out unemployable graduates if demand and supply are ill-fitting. But all the east Asian countries - Japan, the Republic of Korea, Taiwan Province and Singapore, in particular - seem to have benefited greatly from an ample supply of manpower with a basic scientific and technological training.

Rather different issues arise in connection with the much discussed question of the role of Government in the acquisition of technological knowhow. Government expenditure on R&D has been relatively low in Japan and the east Asian NICs where this has been left largely to private firms. It was Japanese private business that, from the Meiji period onwards, took the initiative in the acquisition of overseas technology, and this has broadly remained the case in Japan. Government-funded R&D expenditure reached 30 per cent of total R&D outlays in the 1970s and its share has been declining since, while competition for the development of high technology has raised R&D expenditure in the private sector [Uekasa 1986, p. 21].

Taiwan Province has in the past relied largely on import of foreign technology through continuous inflow of imported capital goods, although there have been suggestions that with the move towards high-tech, Government will need to assume a portion of the risk by providing some R&D funds and encouraging collaboration between business and research centres [Liang pp. 16f.]. In the Republic of Korea, the Government, to facilitate the development of industrial technology for capital goods production, in 1979 designated certain capital goods as "newly developed innovative machines" and offered special incentives for their production and purchase. The scheme attracted mostly small- and medium-sized companies which developed many innovations in response to market needs, quality being controlled by an independent quality inspection laboratory [UNIDO 1984, I (33)]. Singapore, more than the other east Asian NICs, has relied on foreign direct investment as the main channel for the acquisition of industrial technology. More recently, reverse DFI has become an interesting alternative device, exemplified by the establishment by the Republic of Korea and Singapore

electronics companies of subsidiaries in Silicon Valley, California, to learn more about the business [The Economist 28/4/84]. DFI and licensing arrangements have also become means whereby technical and management knowhow spreads from the industrially more advanced east Asian NICs, especially Hong Kong and Taiwan Province, to the less advanced other four ASEAN countries, especially Malaysia and Indonesia [Hughes-Parry 26f.]. In these and other industrially less developed countries, the most important task for Governments is to encourage the development of a basic engineering infrastructure, training facilities and efficient workshops, so as to upgrade local capacity to absorb, apply and adapt new technology [UNIDO Indonesian Industry Sector Study 1984a, Vol. I, p. 61].

The chief prerequisites for industrial development in macroeconomic policy are undoubtedly prudent domestic demand management and policies to ensure freedom from balance-of-payments constraint. The Republic of Korea and Indonesia did well despite severe bouts of inflation, but it is difficult to believe that they would not have done still better had they managed to keep the domestic economy on a more even keel. Severe balance-of-payments constraint, with its vicious circle of overvalued currencies, trade and exchange controls and still larger deficits, has been the bane of economic and industrial development in many Third World countries. In the east Asian countries, freedom from such constraints for most of the time has been both cause and result of export-oriented policies. The early establishment of a uniform exchange rate and abolition of quantitative import restrictions and exchange controls, usually accompanied by liberalisation of financial markets, have been major factors in freeing exports and thus stimulating industrial development, while rapid growth of exports has in turn helped maintain a healthy balance of payments situation.

The unfortunate experience of several Latin American countries, especially Chile, following sudden liberalisation of foreign trade and payments in the mid-1970s has led to some rethinking of appropriate policy packages. Questions have been raised, in particular, about the relative merits of sudden liberalisation (which minimises the opportunities for the formation of hostile coalitions) and gradual liberalisation (which softens the shocks and hardships of adjustment); about the desirability of using the exchange rate for domestic price stability (e.g. pegging the currency to a strengthening US dollar) at

the cost of eroding the competitiveness of traded goods industries; and about the danger of destabilising capital flows following abolition of exchange controls [Donges 1985, pp. 23, 36]. The experience of Chile where a sharply appreciating exchange rate, reinforced by rapidly rising real wages (fueled by indexation to higher past inflation rates) and high interest rates, led to a disastrous outflow of capital, has suggested to some that restrictions on capital flows should be lifted only after trade has been liberalised [ibid.]. Similarly, the Republic of Korea is said to have succeeded in retaining the benefits of low interest rates without risk of capital outflow only by maintaining exchange control [Scitovsky 1985, p. 236]. Experience of many other developing countries, however, suggests that exchange control, ostensibly designed to control capital flows but extending inexorably to current account transactions, may be very damaging to trade. Indonesia, has managed to avoid seriously destabilising capital flows without having to reimpose exchange control.

There is, finally, the policy area of structural adjustment. This was fairly thoroughly discussed earlier and requires here only a brief summary of the two main conclusions. The first is that Governments are generally not very good at picking winners. The Governments of Japan and the east Asian developing market economies had little difficulty in deciding that low wage costs conferred a comparative advantage on labour-intensive export industries and then providing appropriate export incentives. But when it came to selecting potential winners among heavier industries, many mistakes were made. In the developed market economies of the OECD area Governments have largely given up trying to find the future growth industries or products, a task they leave to large and small companies and these companies' research, development and marketing departments. It seems likely that the current vogue in southeast Asia for the "Japan Model" will gradually give way to similar self-restraint. This of course does not mean that Government has no role to play at the "sunrise" end of the spectrum of structural adjustment. Government inevitably impinges at so many points on decision-making in the manufacturing sector - through its role in macroeconomic policy, in banking and the capital market, in R&D and monitoring of foreign investment and licensing, in commercial policy and industrial relations - that Government and business depend on one another for information; and in practice non-economic

aspects of national policy such as defence, and the political process, will almost always involve some degree of control by Government over business.

The second main conclusion is that Governments cannot help giving some assistance to losers. This is not because of any general presumption that redistributive or other social welfare policies are the best way of reducing poverty or inequality. The evidence of the east Asian countries rather goes the other way: it was rapid export-oriented industrial growth which, by raising real wages, did most, certainly in Taiwan Province and probably also in the other three east Asian NICs, to raise living standards and achieve a relatively even income distribution. But public sentiment and political pressures make it difficult for Governments to avoid giving some help to declining or depressed industries. The important lesson here is the desirability of helping labour and capital to move out rather than stay in such industries; to adjust rather than to dig in. If protection has to be given, it should be "credibly temporary" protection, preferably at rates "pre-set to decline" [Lawrence 1986].

It is in relation to this aspect that government industrial policy in the east Asian countries has been mostly clearly superior to its counterpart in most other market economies, developed or developing. Government intervention, while often very intensive and detailed, has generally been designed to promote rather than to obstruct adjustment to market forces. It has, in that sense, to use the OECD phrase, consisted of "positive adjustment policies". To a much greater extent than in most other countries, it has followed the precept that the incentive structure of prices, in the markets for goods, capital and labour, should promote adjustment and thus industrial development. To quote a well-known saying by Peter Timmer: "Getting relative prices right is not the end of development. But getting prices wrong frequently is" [quoted Riedel 1985, p. 43].

X. Scope for Economic and Technical Co-operation among Developing Countries

UNIDO has devoted much effort in recent years to study and encouragement of economic and technical co-operation for industrial development among developing countries (UNIDO 1984b, 1984c, 1984d). The rationale for this approach, apart from the universal support that "co-operation" commands in

almost all human endeavour, is a desire to reduce dependence of the South on the North, especially because of what is seen as the reduced value of the North as an "engine of growth" for the South in the circumstances of slower world economic growth during the past decade (UNIDO 1984b, p. 103). It may therefore be desirable to add to the preceding chapters on industrial policy in the east Asian developing countries a brief note on the light that east Asian experience throws on scope for such co-operation.

Economic co-operation. East Asian experience is of particular interest in this context because it presents two strikingly different models. The three northeast Asian NICs, the Republic of Korea, Taiwan Province and Hong Kong, have pursued their export-oriented industrialisation with their eyes on the world market, exploiting their comparative advantage in labour-intensive manufactures. Their main markets, and their main sources of technology and capital, have been in the industrial countries of the North. Economic co-operation with one another, or with other developing countries, has played virtually no part in their industrial strategies and policies.

By contrast, the countries of southeast Asia - including Singapore which resembles the northeast Asian NICs in other respects - have tried to combine increasingly export-oriented industrial development with regional economic co-operation. The Association of Southeast Asian Nations (ASEAN) was, in its original economic design, based on the case for regional integration that had been developed in Europe and Latin America in the 1950s (United Nations 1974). Its central thesis was that industrial development for an integrated region could overcome some of the limitations of small domestic markets. Regional integration was to be achieved mainly in three ways: intra-regional trade liberalisation; allocation among member countries of large industrial projects with preferential access to member countries' markets; and private sector co-operation in so-called "complementation" schemes in which each country would produce different components of a motor car or other complex product (Arndt & Garnaut 1979; Suhartono 1986).

ASEAN has been a resounding success, perhaps more so than any other regional grouping among developing countries. But its success has been in the degree of cohesiveness, of belonging together and unity of purpose, which it has engendered, especially in relations with the rest of the world, rather

than in the practicalities of economic co-operation. Here results have so far been meagre. There has been progress in intra-regional trade liberalisation measured by the large number of items on which tariffs have been reduced or eliminated, but the items have been almost entirely of no or minimal importance in mutual trade; the process of tariff liberalisation has not yet touched major sensitive items, nor has it extended to non-tariff barriers. Of the five major public-sector industrial projects initially envisaged, only one, the Indonesian urea plant (which had already been planned as a national project), has been completed, and this is now in difficulties. Nor have any of the private sector "complementation" schemes as yet overcome the obstacles to agreement as to which country should produce which component (Wawn 1982; Narongchai 1984; Rieger 1985; Wong 1985).

Part of the difficulty of attaining more substantial results has been the disparity in industrial development and international competitiveness among the five original member countries, especially between Singapore and Indonesia. But underlying it has been the implicit perception in each country that its national economic interests were not necessarily best served by preferential treatment of the products of its ASEAN partners rather than by freedom to buy and sell in the world market. The likely costs of trade diversion have tended to outweigh the potential benefits of trade creation (Ariff & Hill 1985). ASEAN efforts to expand trade with other developing countries have frequently encountered trade barriers more intractable than those imposed by developed countries (Wadhva & Asher 1985).

This is not to decry the value of economic co-operation among developing countries, both neighbours and others further afield. Anything that removes bureaucratic and other obstacles to mutual trade in goods and services and jointly builds institutions which, by reducing information and transaction costs, improve the working of markets almost certainly benefits all concerned. But the ASEAN experience cautions against expecting a decisive contribution to industrial development from this approach.

Technical co-operation. While much new technology for agriculture has been developed by public or foundations-endowed research institutions which have made this knowledge freely available as a public good, the enormous complexity of modern industrial technology and high cost of R & D investment

have caused new technical knowledge for industry to be almost invariably and universally subject to property rights, held by governments or by private corporations. Since all but the very largest countries must acquire almost all new technology from abroad, the acquisition of new industrial technology involves a cost in foreign exchange, whether as licensing fees or as part of a direct foreign investment package, which can be burdensome on developing countries. Technical co-operation among developing countries has been suggested as one way of reducing their dependence on the advanced industrial countries as the source of new technology and the cost to them of acquiring such technology (UNIDO 1984b, UN-ESCAP 1983; Lall 1984).

The most obvious limit to what can be achieved in this way is the near-monopoly of new industrial technology held by advanced industrial countries, both developed market economies and centrally planned economies. But this monopoly is increasingly being breached with the progress of industrialising countries in the Third World. Direct foreign investment by multinationals from the newly industrialising countries, not least in other developing countries, has been an important new feature of the world economy in the past decade (Wells 1983; Lall 1983; Dahlman 1984). Much of this investment has come from the east Asian NICs.

In the past two decades, all four of them have developed substantial stocks of technically and scientifically skilled manpower which, while not yet capable of contributing major innovations in industrial technology, can apply and adapt new technology and establish a comparative advantage in skill- and technology-intensive industries - the Republic of Korea in steel and shipbuilding, Taiwan Province and Hong Kong in electronics and textiles, Singapore in ship and oilrig repair and petrochemicals - at least vis-a-vis industrially less developed countries of the Third World. This technological capability also enables them to play a role, still modest but growing, in transfer of technology to other developing countries, including the other four ASEAN countries, through direct foreign investment (UN-ESCAP/UNCTC 1984; Thee 1984). The fact that their own factor endowment is still closer to that of the industrially less advanced countries means that their technology may often be more appropriate than the very highly capital intensive and sophisticated technology obtainable from the United States and other developed countries (Kojima 1977), although they lack the advantage of developed countries

multinationals in giving access to large developed countries home markets. In the wider sphere of managerial know-how, and the essential business infrastructure of accounting, financial, trading and marketing skills, a good deal of interchange already goes on, in the form of inter-governmental technical assistance and services provided commercially, and is being promoted within ASEAN by various co-operative schemes (Akrasanee 1984).

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