IS ALL WELL IN EAST ASIA?

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Abstract

This paper argues that serious signs of economic weakness, which could lead to social and political disintegration, are emerging in some of East Asia’s leading economies. The first section discusses the economic policy distortions that weaken East Asian countries’ participation in the global economy. A slowing down of growth rates may be expected as the more advanced of the East Asian economies catch up with the more mature industrial countries, but if present policy distortions are not contained and reversed, a substantial fall in growth rates and worsening income distribution will lead to economic stagnation and widespread social and political unrest before high incomes are reached. The second part of the paper turns to underlying political economy issues that have to be resolved if growth with equity and environmental sustainability, and hence social well being and economic and political development, are to continue.

1. Policies that undermine participation in the global economy

The emergence of East Asian countries as leaders of world development in the second half of the twentieth century has not been ‘a miracle’, but followed tough economic and social policies that most other developing countries were not willing to adopt. Accumulating evidence suggests, however, that in several of the East Asian countries policies are now being seriously compromised, so that the pace and quality of development are becoming questionable. There is still considerable potential for growth, but there are also extremely worrying signs of possible economic, and hence social and political breakdown.

During 1996, when the world economy and world trade were growing strongly, exports declined in all East Asian countries, indicating a sharp decline in international competitiveness. Other worrying economic indicators include rising current account deficits in several countries, falling net current account surplus with the rest of the world for the East Asia region as a whole and fiscal difficulties with consequent budget deficits in several countries (Asia Pacific Economic Group 1997).
Table 1 East Asian exports, 1992-1996 (percent annual change)

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Source: Asia Pacific Economics Group (1997), *Asia Pacific Profiles 1997*, The Australian National University, Canberra

1.1. Protectionism and industrial regulation

It is widely accepted that protectionist policies, and the regulatory controls that have to accompany them to make protection work, are the very antithesis to participating in global trade in goods and services and of maximising the benefit of international flows of capital and labour. Existing and potential producers, however, have a very strong vested interest in maintaining and increasing protection, even if it is at the cost of the development of the economy as a whole. On the other hand, producers and consumers who would gain from greater competitiveness are not aware of the benefits they could gain, and are not organised. Many public servants earn high rents, including the exercise of power as well as pecuniary benefits, from the regulations required by protectionist policies. Every shabby argument that has been used for years to prevent integration into the world economy is hence resurfacing in East Asia.

The rest of the world is alleged not to ‘play by the rules’, but to engage in protectionist practices. ‘Dynamic comparative advantage’ is said to need ‘infant industry’ nurturing by the picking of ‘winners’ which have to be granted high tariffs and subsidies. Protected domestic markets are said to be needed by exporters, presumably to ‘dump’ products in export markets. Yet it is well known that industries protected from international competition are likely to exploit domestic consumers, particularly in small markets, bringing excuses for regulating entry into production, for controlling prices, for giving subsidies for research and development and for the training of workers. Overall such cushioning of inefficient producers is known as ‘industrial policy’. A very considerable body of empirical research has refuted the claims made for the benefits of ‘industrial policy’ during the last 30 years. The proponents of protectionist policies who claim to have found a link between statist and dirigiste policies
and growth (Amsden 1979 & 1989, Wade 1990, Aoki et al. 1997) have been shown to be ignorant of the basic facts of development in East Asia (Hughes 1995), but vested interest groups continue to use their arguments. Evidence is ignored for the sake of sectional gains. The slowing down of trade liberalisation in several East Asian countries indicates the resurgence of protectionism in countries that have greatly benefited from participation in global trade in the past. Plans for the establishment of highly protected automobile industries, particularly where they are allied with personal privileges, are reminiscent of Latin American economic management. They will almost certainly lead to similarly disastrous results. In Latin America years of slow growth, grinding poverty and political unrest have led to unprecedented levels of crime, so that even the rich are now at daily risk of their lives. The transitional economies do not appear to have grasped the essence of the 'non-zero-sum' benefits of trade. Although China’s economic growth since its ‘opening of doors’ has been based on access to world markets for labour intensive goods, its policies remain highly protectionist and monopolistic, closely allied to capital inflow controls. For example, a ‘deal’ has been made with a British firm to establish one protected monopoly enterprise, with central and provincial government participation, to produce motor vehicles spare parts in each province, thus almost certainly guaranteeing poor quality, high prices and an inability to export. Yet motor vehicle spare parts are an industry in which local entrepreneurs have been able to start up in developing countries. Competition can flourish because economies of scale are relatively limited. There are hundreds of examples of protection for foreign investment-cum public sector joint ventures in Vietnam and thousands in China that will lead to monopolistic profits at the cost of consumers and further investment. It is no wonder that foreign firms are fighting each other to gain such privileged entry into Chinese and Vietnamese markets!

1.2. ‘Leap frogging’ into high technology

The seamless transfer of technology from more to less economically advanced countries has been one of the principal contributions to economic development made by global flows of trade, capital and labour. The transmission mechanisms are various. Direct foreign investment is one, but it is only a very small component of the international transfer of technology. Access to patents, admittedly at a market determined cost, is a very large source of technology transfer. An even greater ‘shelf’ of technology is in the public domain, open to adaptation and as a basis for further innovation, for countries that find access to it through education at home and abroad. Technologically advanced production in Hong Kong, Singapore, Taiwan and the Republic of Korea has often been developed by those who have graduated from universities in more economically advanced countries.

Empirical experience and research suggest that efficiency gains from the introduction of advanced technology are maximised when new techniques are introduced as part of an upward overall movement in skill that follows from the appropriate utilisation of human resources and capital. Some technological ‘leap frogging’ may take place when innovations are appropriate to skill and capital levels. Fixed wireless telephony to replace fixed telephone lines is an example. But ignoring skill and capital levels to introduce technologically ad-
vanced industries, such as jet aeroplane construction, before the economy is ready for them is so costly that it is counterproductive.

1.3. Lagging infrastructure

It is well established that it is both extremely costly and impractical to invest in infrastructure ahead of developmental needs. In the early stages of development, infrastructural strains can be overcome by industrial estates, export processing zones, specialised education and training and limited port and transport construction. But at the stage of development now reached in most East Asian countries, infrastructural development has to be economy wide if power, transport, telecommunication, educational and other bottlenecks are not to put a brake on development. A poor spatial distribution of urban areas, and the lack of infrastructure within towns and cities, is visibly creating high infrastructural costs for production.

The task in advanced East Asian countries is not only to catch up with high income countries in terms of per capita income, but also in terms of assets. The latter, including social as well as physical infrastructure, is a much more formidable challenge than the mere growth of income and yet incomes can not grow unless infrastructural bottlenecks are overcome.

The statist ideological influences on development, with inefficient public ownership of infrastructure, have exacerbated the inherent difficulties of mobilising investment in large scale infrastructural projects. Privatisation and private direct foreign investment can undoubtedly contribute toward infrastructural development, but many current initiatives are likely to result in a new wave of debt ‘crises’ because appropriate regulatory regimes that would enable competitive conditions to be established and enforced are lacking. Most infrastructural sectors are ‘natural’ monopolies or oligopolies. They have to be regulated if corporatisation, privatisation and domestic as well as foreign investment is to lead to efficient and equitable outcomes. Proceedings without appropriate rules will lead to very great difficulties for investors and aid donors.

1.4. Equity issues

Equity - between town and country, among various ethnic groups, in terms of asset and income distribution, and particularly in terms of access to services such as health, education, the law, pure water, air and recreation - clearly grow in importance as countries become more developed. In the first stage of export led development, supported by stable macroeconomic policies, East Asian countries performed well in equity terms. Agriculture was not neglected and productive employment grew rapidly in other sectors. Macroeconomic policies that kept a cap on inflation avoided the Latin American erosion of low incomes. Poverty declined rapidly. But economic and social policy distortions are now halting the reduction of poverty. The transitional economies, in particular, by following development patterns more akin to those of Latin America than those of the East Asian leaders, are worsening income distribution. The social effects of these trends are already evident in riots and other social protests, albeit, as yet, on a small scale. If these trends are not contained, they could destabilise countries, so that the underlying essential condition of East Asian development, that is, social
stability and political security, will be eroded.

2. Worrying political economy trends

In Myrdal’s *Asian Drama* (1963) several East Asian developing countries were regarded as ‘basket’ cases, so prone to corruption that they were never likely to grow and develop. Taiwan was one of these. More acute analysts, however, had a much more positive, and as it turned out realistic, view of East Asian development potential. They correctly saw corruption as arising from distorted policies and direct government intervention in the economy. They argued that if countries such as Taiwan reformed their economic regimes, they would grow rapidly (Asian Development Bank 1971, Little, Scitovsky and Scott 1970). They linked East Asia’s potential to the opening up of world trade through multilateral GATT trade negotiations and growing world capital and labour flows. The benefits of what has come to be known as ‘globalisation’ were clearly set out.

The exploitation of comparative advantage to increase economies of scale and specialisation, it was argued, would lead to favourable resource allocation and high resource utilisation, notably of labour. The utilisation of ample resources (labour) rather than scarce resources (capital), and also of natural resources such as land and minerals where these were available, would follow.

The steady upgrading of labour skills and technology and increasing capital availability per worker, including a growing capacity for technological adaptation and innovation, were also seen as important because they would lead to rapid economic growth with improving equity, largely related to rising employment in high productivity economic activities throughout the economy.

Taking advantage of the global expansion of trade, capital and labour movements, required domestic policy frameworks that created stability, that is, low inflation, high rates of savings and investment, and the development of an appropriate social (schools and health) and physical (transport, communications, urban development) infrastructure. Participating in globalisation also meant abandoning the negative, regulatory, ‘picking winners’ policies that led, at best, to the waste of resources and at worst to egregious economic and political corruption.

The experience of the past 30 years has demonstrated the strength of the linkages between domestic policies, global trade, capital and labour flows and growth. The East Asian countries, starting with Japan, that have taken advantage of globalisation by adopting reasonably favourable domestic policies, have achieved the principal objectives of development in raising the standards of living for the majority of the population.

Many of the East Asian countries that have been successful could have grown even more rapidly, achieved greater equity and taken greater care of the environment, if their policies had not had to bend to the vested interests established during pre-outward oriented, protectionist periods. Remnants of protection for domestic industries (agriculture, manufacturing and services) inevitably led to corruption, as did ‘repressed’ financial systems, inadequate and inequitable taxation regimes, distorted infrastructural expenditures and public ownership. The vested interests of regulation oriented public servants and politicians with utopian technological ambitions delayed progress and distorted resource allocation and utilisation. The fanfare
with which the World Bank's *East Asian Miracle* was promoted for a time lent support to at least partial dirigisme. But as this study came to be analysed, it became clear that this attempt at an argument against economic liberalism severely distorted the experience of development in the leading East Asian economies (Ranis 1995). Hong Kong has been an open, market oriented economy since World War II. In Singapore market signals dominated after separation from Malaysia in 1965. Departures from market imperatives were found to be costly and soon abandoned. The main government inputs were into infrastructure and even there privatisation is now seen as being efficient and equitable. Taiwan and the Republic of Korea, however, did not have the political strength to reform their trade and financial policies when they began to reform in the late 1950s and 1960s. They had to shore up their distorted economies with regulations although these regulations led to further distortions and social costs. Taiwan only liberalised its policies in the 1980s (Hughes 1995). Serious policy distortions are still evident in the Republic of Korea and in Indonesia, Malaysia and Taiwan which followed the general Taiwan-Korea development pattern.

The association of inappropriate economic policies with slow growth, persistent poverty and encouragement to corruption was demonstrated in the Marcos years in the Philippines. The entrepreneurship of individuals, repressed at home, has been able to rescue the Philippine balance of payments through permanent and temporary emigration, but production remains inefficient and standards of living have stood still for more than 30 years. Children are still going hungry because policies that would have enabled the Philippines to take part in world trade and capital markets have not been adopted.

International economic flows have become increasingly complex since the 1950s, when the case for taking advantage of international trade and investment was first put against the protectionist and statist views that prevailed in South Asia, Latin America and the Middle East. The utter failure of central planning has contributed further empirical evidence to the strength of the liberal case for markets. Economic liberalisation has become even more important in the 1990s than it was in the early years of East Asian development. Continuing adjustment to changing technology and trade makes reforms essential and urgent.

2.1. Fortress regionalism

Protectionist regionalism among developing countries was strongly fostered by various UN organisations from the 1950s, leading to severe economic difficulties for the participants. All the inward-oriented regional organisations failed. ASEAN was an exception because it rejected economic regional integration to become, instead, an extremely successful political ‘club’. The evolution of the EC-EU, followed by NAFTA, put a serious strain on the multilateral system, endangering the Uruguay Round of negotiations by the protectionist stances of agricultural and other interests. The Uruguay Round finally succeeded in spite of the lack of support of major industrial vested interests. Continuing negotiations demonstrate the strength of the multilateral system.

The East Asian countries, by supporting ‘open regionalism’ have provided a healthy balance for the ‘fortress regionalism’ emanating from Europe and North America. The formation of ASEM to complement APEC is an important step in this direction. The East Asian coun-
tries understand the benefits of talks among neighbours compared to the high costs of trade diversion in inward oriented regional trade arrangements. The battle against destructive regionalism, is, however, far from over. Protectionist forces within East Asia, within APEC and within ASEM, will no doubt continue to try to subvert ‘open regionalism’ as they did prior to the Bogor APEC meeting (APEC Eminent Persons’ Group 1993). AFTA could become destructive if it were to turn inward instead of opening up its market on an MFN basis.

2.2. Strategic trade theories

During the 1980s, when the traditional attacks on trade, capital and labour flows came to be seen as counterproductive to development, ‘strategic’ trade theories renewed, in an apparently sophisticated format, the case for protectionism. It was argued that intra-industry trade, mainly among highly industrialised countries, was based on economies of scale and on product differentiation. To benefit from these, countries had to protect their producers in domestic markets to provide a base for exports (Helpman and Krugman 1986, 1989, 1988). It was soon seen that these theories were the same old wolf in the same old sheep’s clothing. The benefits and costs of exploiting domestic monopoly power through trade by ‘optimum tariffs’ had been long identified and seen to be impracticable in the vast majority of cases in the real world. The benefits of domestic monopolies are usually greatly exceeded by the costs. Many more exports have been based on the economies of scale reaped in international trade than in domestic markets. Most monopoly industries are poor exporters. Strategic trade theory is, nevertheless still being widely used to support latter-day protectionism.

2.3. ‘New’ growth theory

It is not unusual for the supporters of illiberal economic views to wrap themselves in highly sophisticated econometric methodologies. ‘New’ growth theorists have claimed that total factor productivity has stagnated or even been falling in East Asian countries, so that their growth has merely resulted from the primitive accumulation of capital and labour. In Singapore, in particular, total factor productivity is alleged to have declined during the past 30 years. Singapore’s economic performance was hence ludicrously compared to that of the Soviet Union (Krugman 1995). Re-working the data, Rao (1996) showed that total factor productivity has not declined, but has grown quite considerably in Singapore. The ‘new’ growth theory’s conclusion that growth is a matter of chance and even ‘luck’ (Easterly 1996) can not be taken seriously. It suggests that the East Asian countries’ efforts to reform their policy frameworks have been of no account.

The ‘new’ growth theorists have been able to deflect development theory into unproductive by-ways because East Asian social scientists have played a very small role to-date in such debates. East Asian countries devote considerable resources to natural sciences, but they neglect the social sciences despite the importance of theory and research in development. They can no longer, however, expect the United States and European countries to undertake the bulk of research in this area. They need to be building the institutions that can undertake research and contribute to policy formulation to ensure healthy development in the region.
2.4. Asian values and the Asian road to development

It is natural that countries and regions take pride in their achievements. It is also natural that they take pride in their cultures and how these relate to economic, social and political achievements. The world is all the richer for such contributions to the vast global heritage. But the world has also seen that taken too far, national pride can be disastrously misused.

East Asia’s leadership of the developing countries’ economic growth and development is, not surprisingly, giving rise to expressions of considerable satisfaction, if not hubris. But at the margin the ‘Asian ethic’ is being used, as the ‘Protestant ethic’ was once used in Europe (Weber 1904), to justify irrational explanations of growth that could lead East Asian countries into economic difficulties.

East Asian countries are not the only rapidly growing developing countries. Botswana and Mauritius have performed extremely well. So has Chile since it adopted liberal economic policies in the early 1980s. ‘Asian values’ - the qualities of hard work, family cohesion and respect, appreciation of learning and business talents, combined with honesty and modesty - are present in all cultures, as are negative qualities. National policies determine whether, and to what extent, the positive or negative cultural aspects develop.

Not all Asian, or even East Asian, countries are performing well despite their common heritage. Although China has been posting rapid growth rates, it has been clear for some time that reality does not match the data. China has undoubtedly shown a tremendous explosion of entrepreneurial and management talent, notably in the countryside, but the success of its industrial and service sectors is less clear. China’s export performance, which has underwritten China’s growth, was highly dependent on Hong Kong and Taiwan investment (Yung-wing Sung 1991). Most state enterprises are still extremely inefficient, and if they export, they do so at a loss. Industries such as steel, other metal products and chemicals have very high costs.. Services, including transport and communications, are not developing strongly. Their lagging performance is impeding the spread of efficient production and the rise of living standards. Income distribution, by geographic areas and even within the rapidly growing coastal areas, is widening. In Vietnam the situation is even worse. If this is, indeed, ‘the Asian approach’ to transition from centrally planned to market economics as the Asian Development Bank has argued (1996), the outlook for the East Asian transitional economies is extremely poor.

3. Conclusions

The successful performance of the leading East Asian countries in taking advantage of global trade, capital and labour flows, is undisputed. So is the potential for East Asia’s further growth. It would be foolish, however, to ignore current economic indicators. Continuing initiatives that further distort economic policies, the slow pace of economic reform and the failure to build analytical perceptions within the region are weakening the East Asian development effort. The social and political implications of poor and worsening income distribution are too well known to require elaboration.

It is time for realistic approaches to future development.
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