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THE LESSONS OF EAST ASIA

An Overview of Country Experience

Danny M. Leipziger
Vinod Thomas

A WORLD BANK PUBLICATION

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Foreword

Policymakers everywhere are searching for lessons from East Asia's enormous success in economic development. A number of recent cross-country and thematic studies have sought to identify and analyze the policies behind this success. Among them is *The East Asian Miracle*, a recent World Bank publication, which draws in part on the Lessons of East Asia project. Study teams, including in-country nationals, examined in some depth the experiences of the highly successful East Asian economies and the public policies underpinning them.

Several clear contributions emerge from this set of country studies. The research:

- Highlights considerable variation in approaches within the group of East Asian economies. For example, some economies chose a substantial degree of government intervention; others did not. The studies dispel the notion that there is a single or uniform East Asian model of success.
- Demonstrates that a core set of good economic policies—such as macroeconomic discipline, outward orientation, and human resource development—laid the foundation for East Asia's success. Pragmatic policymaking—understood as being nonideological and reversible—seems to be at the heart of these policies and merits replication.
- Dispels some of the myths about the more idiosyncratic interventions, such as "picking winners" in industry, which sometimes produced the desired result and sometimes did not. Because presence or absence of institutional features seems to have affected the outcomes of these interventions, applications to other regional contexts must be approached cautiously. A dominant finding of the studies is that serious diversions from macroeconomic equilibrium were largely avoided, even by strong interventionists. At the same time, the later generation of industrializers were more successful when they avoided these industrial policies.

A question not easily answered is why East Asian governments adopted fundamentally sound policies and were apparently able to achieve better results from their active policies and to incur lower costs from errors. In this connection, the studies touch on such dimensions

of policymaking as the role of the state, leadership, and the bureaucracy. It is one thing to describe the institutional features accompanying a successful episode, however, and quite another to know why and how those features came about. For instance, why did East Asian leaders apparently hold themselves more accountable for economic performance than has been the experience elsewhere? How did the governments manage to gain sufficient national consensus to put difficult policies into effect? These aspects of political economy cannot be ignored. Our analytic tools, however, are severely limited in penetrating these issues, in assessing their impacts, and in assigning credit to them. These country studies are only one step, although a significant one, in deepening our understanding of the experience of East Asia. It is hoped that they will prompt additional work on the institutional foundations of rapid growth.

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Vice President
East Asia and Pacific Region

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An Overview of East Asian Experience

The success of development in East Asia is legendary. No other group of developing countries has done as well in fostering growth, reducing poverty, integrating with world markets, or raising standards of living. Over the past twenty-five years, per capita incomes in the region almost quadrupled. Absolute poverty fell by about two-thirds on average, population growth rates declined rapidly, and health and education improved markedly. The first set of success stories, that of the "Asian tigers," has led to a second generation of rapidly industrializing, fast-growing economies. And now China has started a new engine of regional growth.

Although often spoken of as a single group, the East Asian economies are, in fact, remarkably diverse. The region includes some of the richest and the poorest of the world's developing countries, some of the most populous and some of the least, some with a store of natural resources and some with virtually none. Moreover, despite its steady growth, East Asia is still grappling with serious challenges, including environmental degradation, infrastructural bottlenecks, and poverty. But if there is a single firm lesson to be drawn from the region in the past few decades, it is that difficult challenges have a history of being met.

The Search for Country Lessons

Why have the different economies of East Asia been so successful? To shed light on this question, the World Bank studied several countries in the region, complementing other approaches and cross-country analyses.[1] The analyses were conducted by teams that included local experts as well as World Bank economists. The task was daunting, but it has added to knowledge and provided glimpses of why East Asia has been so successful.

The country studies show the diversity of the East Asian phenomenon, with variation among countries and over time. No one formula or standard prescription has been decisive. Several compelling factors do, however, emerge as major contributors.

It is important to note that the policy approaches adopted by East Asian economies were not uniform. Of the first generation of newly

Development Checklist

	Early NIEs				Late NIEs		
	Korea	*Taiwan, China*	*Singapore*	*Hong Kong*	*Thailand*	*Malaysia*	*Indonesia*
Initial endowments							
Natural resources	No	No	No	No	Yes	Yes	Yes
Human capital	Yes	Yes	Some	Yes	No	No	No
Foreign aid	Yes	Yes	No	No	No	No	No
Policies							
Macroeconomic stability	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Export drive	Yes	Yes	Yes	No	Some	Some	Some
Investment in human resources	Yes	Yes	Yes	Yes	Some	Yes	Some
Import openness	Some	Yes	Yes	Yes	Some	Yes	Some
Selective industrial policies	Yes	Some	Some	No	No	Some	Some
Directed credit	Yes	Some	No	No	No	Some	No
State-owned enterprises	Some	Some	Yes	No	Some	Yes	Some
Institutions							
Central economic ministry	Yes	Yes	Yes	No	Some	Some	Some
Strong bureaucracy	Yes	Yes	Yes	Yes	Yes	Some	Some
Political stability	Yes	Yes	Yes	Yes	Some	Yes	Yes
"Visionary" leadership	Yes	Yes	Yes	No	No	Yes	Some
Outcomes (compared with the rest of the developing world)							
Growth in the 1960s	High	High	High	High	Better	Average	Average
Growth in the 1970s	High	High	High	High	Better	Better	Better
Growth in the 1980s	High	High	High	High	High	High	High

industrialized economies (NIEs), the Republic of Korea, Singapore, and Taiwan, China, chose a good deal of state intervention, as did Japan earlier on. Hong Kong was an exception for the most part. Among the second generation of successful East Asian economies, Indonesia and Malaysia had little success with their early interventions, and as they became less interventionist over the past dozen years their economic performances improved markedly. Other recent NIEs, like Thailand and coastal China,[2] are avoiding interventionist industrial policies in most respects.

No one formula or standard prescription has been decisive. Several compelling factors do, however, emerge as major contributors.

These differences notwithstanding, it could not be pure coincidence that the fastest-growing economies in recent decades are concentrated in East Asia. Indeed, the country studies found that behind the substantial country variations are significant common features that policymakers elsewhere might take to heart.

A country's development prospects are influenced by three sets of factors: *endowments, policies,* and *institutions,* as set out in the Development Checklist. The checklist is illustrative and must be interpreted with caution, since the categories are at times subjective and are subject to the time period considered. Nevertheless, it is useful in drawing the patterns emerging from East Asian economies. It dispels the notion that all East Asian economies share identical features; quite to the contrary, it highlights considerable diversity. The checklist also draws a strong contrast between many characteristics common to the first-generation NIEs and those of the second.

The traditional focus of economists has been on policies, which prove to be crucial to the East Asian experience. Regional success has been analyzed by other social scientists, who have emphasized the quality of policymaking, leadership, nationhood, cohesion, and the role of the state.[3] The review of these more intangible features is motivated by the observation that similar policies undertaken elsewhere have proved less productive than in East Asia. Similarly, government interventions in many cases have not had the dire consequences that many would have predicted. Clearly one must distinguish between policy interventions and policy distortions, between distortions affecting particular markets and those affecting the economy as a whole, and between pervasive and nonpervasive distortions.

The country studies found that none of the initial four NIEs—Korea, Singapore, Hong Kong, or Taiwan, China—was generously endowed

with natural resources. (The later NIEs—Indonesia, Malaysia, and Thailand—were richer in natural endowments.) For the initial NIEs, the only resource was people, in the form of a relatively well-educated labor force. For these first-generation NIEs, economic development was a matter of survival and therefore of national urgency. They met the challenge by forcefully committing themselves to becoming exporters in global markets.

Common to East Asia's success were policies for macroeconomic stability, human resource investments, and outward orientation—quite different from what happened in most other developing regions. Because these economies to a large extent took international prices as an ultimate guide to domestic resource allocation, macroeconomic stability was seen as central to maintenance of competition. In addition, a number of regimes had a strong aversion to inflation, which strengthened the hands of technocrats. In the area of human resources, strong public policies were often augmented with high household investments in education. And in many areas, including export promotion, it was not just the design and selection of policies; it was also efficient implementation. By any standard, implementation of policies was East Asia's forte.

At the core of development success in East Asia has been pragmatic policymaking—meaning, most importantly, the relative lack of ideology and the willingness to repudiate failed policies.

At the core of development success in East Asia has been pragmatic policymaking—meaning, most importantly, the relative absence of ideology and the willingness to repudiate failed policies. Policies have been reversed swiftly if experience showed them to be ineffective. Examples include the abandonment in the early 1980s of Malaysia's experiment with selective industrial policies, Korea's curtailment of the heavy and chemical industry drive in 1979–80, and Singapore's abandonment of a high-wage policy in 1985. Indonesia's strong policy response to macroeconomic instability and Thailand's exchange rate management in the mid-1980s are other cases of timely and effective policy actions.

Bureaucracies can facilitate reform, or they can prevent it. In many successful East Asian industrializers, bureaucracies were agents of development. Put differently, East Asia's technocrats have generally been part of the political mandate for reform. In Singapore bureaucrats and party officials worked hand in glove for the national agenda. In

Indonesia and Malaysia the political leadership allowed technocrats substantial freedom to manage the economy. In Thailand the bureaucracy provided continuity when political processes faltered; and in both Korea and Taiwan, China, core economic ministries were key to government efforts to develop the economy. The means differed, but the institutions were influential in hastening economic development.

Korea, Singapore, and Taiwan, China, the fastest industrializers after World War II, are credited with "visionary" leadership and efficient bureaucracies. They also achieved national consensus on development goals and had a centralized political apparatus to implement their fairly interventionist strategies. Many observers tend to view each of these features as major, if not decisive, causes of success. Indeed, East Asia's achievements have cast a glow over the region that often transforms every initial policy and institutional condition into a positive contributor to success.

That conclusion would be too simplistic and misleading. After all, in many other countries centralized power has been accompanied by poor policies, and there are numerous examples of visionary leadership, a strong bureaucracy, and concerted government interventions being associated with poor results. Conversely, during successful episodes, some of these features were absent in other country settings. It would seem that each of these factors, taken separately, may not be necessary—and certainly not sufficient—for success, and some may have been costly even if overall success was achieved. But with hindsight, these NIEs seem to have benefited from a combination of sociopolitical features that accompanied their superior economic policies.

It should be emphasized that there were some big policy mistakes in East Asia—in industrial policy, financial policy, and the absence of sufficiently forward-looking environmental policies. As a result, the region now faces serious challenges in sustaining rapid development. Yet the questions are why did past mistakes not cause the kind of damage that is so apparent in other countries? How were these mistakes recognized and corrected? It is these issues that offer the most valuable lessons for new market entrants like Viet Nam or perennial aspirants like the Philippines. What is it about the quality of decisionmaking, and the ability to turn decisions into action, that has led to East Asia's outstanding record?

Success in the first-generation NIEs involved more intervention than in the second generation.

One strong conclusion is that macroeconomic discipline, outward orientation, and human resource investments—along with political

stability—paid off in all successful East Asian economies. Success in the first-generation NIEs, however, involved more intervention than in the second generation, an important finding in light of the greater relevance of the latter experience in the current international environment. East Asia, therefore, makes a case neither for a laissez-faire approach to economic policymaking nor for a heavy hand on the tiller. The crucial factor was the way that governments supported markets in helping to unleash entrepreneurship.

Contrary to the currently fashionable views worldwide, one of the key ingredients in East Asia's success was active government. But it was not more *government which had a positive effect—it was* better *government.*

The second strong conclusion is that, contrary to currently fashionable views, one of the key ingredients in East Asia's success was active government. But it was not *more* government that had a positive effect, it was *better* government. East Asia thus offers a contrast to widespread episodes of policy failure. Development economics lacks an adequate theory of why good government policy, combining economics, political organization, and technocratic decisionmaking, is pursued by some countries and not others.[4] Although the region offers no universal paradigm in this respect, it does provide some useful lessons in successful policymaking.

Making the Most of Initial Conditions

If asked in the early 1950s to name the success stories in the next thirty years, only a seer would have chosen Hong Kong, Korea, Singapore, or Taiwan, China. All were lacking in natural resources and all had ratios of arable land to population that were so low that meeting basic consumption needs was questionable. The two largest economies, Korea and Taiwan, China, were heavily dependent on food aid from the United States. The story of early East Asian success is much less one of favorable initial conditions than of countries turning adversity into opportunities.

Only one resource was common to all four: an adaptable and *disciplined labor force.* From around 1960, the principal distinction between these four NIEs and most low-income countries lay in human resource development. In secondary education, for example, the East Asian economies (except Indonesia and Thailand, but including the Philippines) exceeded the average of other developing countries by many multiples. They combined this high level of education with imported

technology and the return of expatriates to produce rapid productivity growth.[5] Korea, Singapore, and Taiwan, China, produced spectacular gains in tertiary education in one generation.[6]

A second initial factor was that *national vulnerability* created the necessity of economic success. Korea was a divided country competing in a cold-war environment with a more industrialized neighbor; Taiwan, China, also felt compelled to assert its economic independence; Singapore was a city-state thrust into a competitive environment and attempting to reach nationhood; and Hong Kong was a market outpost for China. This political imperative, combined with the work discipline of societies in Korea, Singapore, and Taiwan, China, seems to have turned weak initial conditions into advantages to an extent seldom seen elsewhere.

A third initial condition was the relative *equality of income* in the first-generation NIEs. This factor was more of a change brought about by policy than an inheritance. Most other low- and middle-income countries were not able to achieve similar equality of income or assets. Large land reform schemes in both Korea and Taiwan, China, did away with the landholding classes and made wage income the main source of advancement. Public housing investments in Singapore and Hong Kong were early priorities of governments bent on maintaining a national consensus on development policies.

The story of early East Asian success is much less one of favorable initial conditions than of the regions turning adversity into opportunities.

Fourth, governments embraced *export development*. This was not dictated by ideology but by realism. Small size and low incomes dictated that external markets would provide the major source of revenue for these economies. Singapore's leaders are fond of noting that their economy was too small to change international markets, so they decided to change their own economy.

Finally, export drives required *domestic entrepreneurship*. In Singapore, publicly owned corporations, behaving commercially, took the lead. In Korea the government had to foster the creation of firms, encouraging their growth and laying the foundation for the modern day *chaebol*, or conglomerate. Using the Japanese model of *zaibatsu* and the general trading company, the Korean government was able to compensate for the apparent lack of entrepreneurship. East Asian economies have done exceedingly well in monitoring each other's success and, when necessary, in borrowing one another's institutions.

External Circumstances

The original "East Asian miracle" was post–World War II Japan, which shared some similar conditions with the early NIEs, Korea and Taiwan, China. With little in the way of physical assets, all three began with the desire to accumulate capital in their first decade of development. Korea and Taiwan, China, were critically dependent on large quantities of foreign aid early on; it accounted for as much as 50 percent of fixed investment in some of the early years. For Korea over a period of three decades (1946–76), the United States alone provided more than $500 (in current U.S. dollars) per capita in economic and military assistance. For Taiwan, China, aid was $425 per capita. Once the growth engine was sparked, however, high domestic savings rates took over and maintained the process of accumulation.

Export development in the early NIEs was helped by the expanding U.S. market of the 1960s and 1970s, and the model was Japan. This was particularly true of Korea, which was most inclined to compete directly in large industries such as steel, shipbuilding, and automobiles. Taiwan, China, relied more on a range of smaller firms in most sectors,[7] while Hong Kong and Singapore were entrepôt exporters. Within two decades the "tigers" were firmly established, to the envy of other economies.

Foreign direct investment inspired the transfer of financing and know-how in the later NIEs

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The outstanding performance of East Asia was not the result of favorable external conditions. Most other regions faced similar external conditions. But the East Asians committed themselves, almost from the outset, to become players on the global scene. With rather similar endowments, Korea and Taiwan, China, followed the Japanese lead, attempting to acquire state-of-the-art technology and inputs. Much of Korea's imitative strategy was a reaction to Japanese dominance and a desire for economic independence. Its work ethic, as seen in its 55-hour average work week, was motivated by a national drive to succeed.

The success of the second-generation NIEs in the 1980s cannot be attributed primarily to favorable external conditions, either. Indonesia, Malaysia, and Thailand were resource rich, but they did not excel until manufactured exports were developed. It is important to note that these second-generation NIEs laid the foundation for their surge with stable macroeconomic policies and political stability. These factors, plus low labor costs, appealed to foreign investors—those facing higher costs at home, such as Japan in the first instance, but later including Korea and Taiwan, China. Japanese-led foreign investment

followed American and regional Chinese capital in the southern tier, providing the transfer of technology that the first-generation NIEs struggled to acquire. This allowed the Asian "cubs" to penetrate the U.S. market, especially during the 1980s. Coupled with aggressive exchange rate policies following the Plaza Accord in 1985, they acquired a strong position as exporters. Malaysia and Thailand emerged among the fastest growing economies in the world in the second half of the 1980s.

There are exceptions to this growth. The Philippines failed to respond to the challenge, despite its rich endowment of human capital and its access to foreign aid and credit. Commentators point to the deeply rooted structure of oligopoly and the sizable inequalities in income and wealth in the Philippines as causes for the relatively poor performance. These factors, combined with a relatively weak bureaucracy, it is argued, allowed the elite to engage in rent-seeking activities at the expense of development objectives. The Philippines stands out as a country that did not achieve an export vision. Mongolia, Myanmar, Viet Nam, the Democratic People's Republic of Korea, and the Lao People's Democratic Republic for various reasons did not do well.

Elsewhere, however, there was an outbreak of "regional contagion," a factor that was undoubtedly important for the region's success. Foreign direct investment (FDI) inspired the transfer of financing and know-how in the later NIEs. In 1991 Malaysia, Thailand, Indonesia, and the Republic of Korea were the third, fifth, seventh, and eighth largest recipients respectively of FDI among developing countries, after Mexico and China. Together, they accounted for almost a quarter of total flows to developing countries; adding China raises the proportion to more than a third. In Malaysia FDI accounts for 20 percent of gross domestic investment. The figure is not much lower in the southern Chinese provinces, where the world's fastest growth is being recorded in the 1990s.

Macroeconomic Policies

Perhaps the factor most consistently present in the successful East Asian economies was a sound macroeconomic policy framework. This was characterized by fiscal discipline, adequate incentives for saving and investment, and an outward-oriented trade policy. Originally imposed by bilateral donors as a condition for continued assistance of the early NIEs, these policies were quickly internalized and became tenets of development policy.

Fiscal Discipline

One of the striking lessons from East Asia is the consistent presence of macroeconomic stability.[8] East Asia's governments exercised macro-

economic discipline, ensuring that fiscal and external deficits were generally kept in control. Prudent foreign borrowing helped East Asians avoid debt crises, which had set back progress elsewhere in the developing world in the 1980s. Macroeconomic stability gave predictable and credible signals to savers and investors about prices and returns, which in turn encouraged risk taking, investments, and growth.

The contribution of macroeconomic stability to growth came not only from low and stable deficits, but also from the composition and quality of public finances.

Over the past quarter century the fiscal deficit and the current account deficit in developing East Asia were less than half the average for other developing countries, and high-income East Asia had surpluses. Exchange rates for East Asian developing economies were seldom overvalued in contrast to the situation in other developing countries. Interest rates were generally positive in real terms, while in the rest of the developing world they tended to be negative. By and large, East Asia managed to keep inflation in single digits.

From time to time macroeconomic difficulties did occur, but they were swiftly contained to ensure that deficits never got seriously out of control. For example, Korea's inflation rate hovered around 20 percent in the late 1970s as a result of the Central Bank's financing of heavy and chemical industries and the government's purchase of foodgrains. But stability was restored as civil service salaries were contained, rice purchase prices restrained, and state spending eventually frozen (in 1983). Indonesia's public sector deficit exceeded 4 percent of gross domestic product (GDP) in 1986 as oil prices declined and terms of trade deteriorated. But the government made sharp budget cuts in 1987–88, and by 1989 the deficit was down to 1.3 percent of GDP. Malaysia's fiscal deficit approached 20 percent of GDP during 1981–82 as expenditures outstripped revenues, which were hurt by terms of trade shocks. The government quickly squeezed spending, bringing the deficit down to about 10 percent of GDP in 1984 and 5 percent in 1987, while at the same time using domestic, noninflationary sources of financing.

The contribution of macroeconomic stability to growth came not only from low and stable deficits, but also from the composition and quality of public finances. Public investment as a proportion of GDP in East Asia was similar to that in other developing countries, although it was higher in Malaysia, Singapore, and Taiwan, China. But public consumption was lower than average. The share of wages and salaries in

government expenditure has varied considerably, ranging from 15 percent in Korea over the past two decades to 30 percent in Malaysia. During periods of general restraint the East Asian economies managed to protect crucial investments, as shown, for example, by the continuous reviews of public expenditure in Indonesia and Korea.

Macroeconomic stability has been supported at times by law, which serves also to underscore the governments' commitment to providing a secure and predictable commercial environment. Indonesia and Thailand have balanced-budget laws. In Taiwan, China, before 1987, a law limited the value of outstanding government bonds to no more than 40 percent of the central government's annual budget. Stability in Indonesia has been aided by an open capital account, which, combined with the desire to avoid inflation, served as a check on monetary expansion. Finally, the personal distaste for high inflation on the part of political leaders—for example, in Korea, Malaysia, and Singapore—kept macroeconomic stability high on the policy agenda.

Underlying this macroeconomic record has been a high degree of pragmatism and flexibility, in the sense that governments had few ideological objections to needed policy corrections. Indonesia and Thailand engineered major depreciations of their exchange rates in the mid-1980s. Korea and Malaysia reversed their costly targeting of heavy industries when they proved to be a fiscal drain and threatened growth.

Investments: More and Better

Investment (as a share of GDP) in East Asia has risen sharply over the past quarter of a century, increasing from figures somewhat higher than in other developing regions to some 50 percent higher. The share of private investment in GDP rose to be two-thirds higher in the successful East Asian economy than in other developing regions. Private investment was encouraged by a generally supportive macroeconomic environment and by forward-looking public sector infrastructure investments. The lack of high tariffs on imported capital goods was also helpful in raising private investment.

Public investment shares, on average, have been similar in East Asia to those in other regions. Although cross-country comparisons may well underestimate total "public" investment in those NIEs where public or quasi-public entities played dominant roles, it is more the efficiency of public investment than its size that distinguishes its performance from that in other developing countries. East Asia's total factor productivity growth (TFPG) was three to six times (depending on the measure) greater than the developing country average. This efficiency would seem to be largely a result of the region's policy and institutional frameworks. The rate of return on World Bank projects

was higher in East Asia than elsewhere. In the period 1974–92, the average rate of return was 18 percent in East Asia, but about 16 percent in the rest of the developing world.

Analysis of national rates of return on investment does show that those who have industrialized rapidly are more efficient users of capital.[9] The question is whether this is the result of better project selection, swifter implementation, or better capture of externalities. Evidence tends to indicate that all three factors were at work. NIEs are, of course, often caught in a virtuous cycle with respect to project selection, particularly as far as scale is concerned. Rapid growth tends to validate after the fact somewhat risky initial investments. Cases in point are the Seoul-Pusan highway in Korea and the scale of production of China Steel in Taiwan, China. Implementation records can be inferred from the experience of World Bank projects: East Asia's success in implementation has been superior. Most interesting is the conclusion that the use of five-year plans and of coordination mechanisms to convey information between the government and the private sector has enhanced the level and quality of private investments, particularly in the early NIEs.[10]

Educational investments thereafter were also higher, leading to universal primary education and widely available secondary education.

Much of the gain associated with capital accumulation depends on the productivity of labor. To begin with, the educational status of the population was, in general, higher in East Asia in the 1960s than in other developing regions. Educational investments thereafter were also higher, leading to universal primary education and widely available secondary education. As fertility rates fell in the 1970s, education expenditures per child increased. Various indicators suggest that the quality of education is also high in the region compared with elsewhere. An indication of the desire to increase human capital is the high proportion of investments in education made by private households; in Korea an equal share of GDP was spent by the private and public sectors. High-quality labor, as seen in Korea and Singapore for example, has aided industrial flexibility, increased economic efficiency, and produced greater equity.

East Asia's investment performance has been aided by rapidly increasing savings (as a share of GDP) as well as by external capital flows. Domestic resource mobilization is a regional strength, fostered by high private savings, as well as fiscal prudence that generated increasing public savings. Savings shares are now more than 50 per-

cent higher on average than in other developing countries. Although savings propensities may be dominated by income gains, demographics, and the like, East Asian experience points to low inflation and generally higher real interest rates than elsewhere. This alone does not explain the region's prodigious savings, however. There seems to be a natural drive to save, as seen in curb-market savings and cooperative savings clubs, which were prominent in the first-generation NIEs. Governments helped transform these informal savings into formal savings by fostering savings institutions such as postal savings accounts and generally excluding savings from taxation. Mandatory savings schemes were also favored by some. Given the high rates of return on invested capital, encouraging savings in East Asia has not been a problem and has led to a virtuous savings-income cycle.

Outward Orientation and an Export Push

East Asia's success in international trade and investment is well documented.[11] The region's developing economies expanded their exports more than twice as fast as the average for other developing countries, tripling the share of exports in GDP over the past quarter of a century. Their share of foreign direct investment in developing countries rose from about 16 percent in 1970 to more than 33 percent in 1990. The flow of trade and investments was crucial to the transfer of technology and the gains in efficiency and productivity. Thus, exports fueled growth to an extraordinary degree.[12]

That much may be beyond dispute; the nature of the underlying policies is not. The question remains, how much free trade and how much intervention took place in East Asia? This raises the important distinction between free trade and neutrality of incentives. Depending on its nature, an intervention can have different effects on incentives; sometimes it is market distorting, sometimes not.

Recent evidence on the relative prices for exports, imports, and domestic goods suggest a remarkable degree of neutrality in East Asia. In other words, local prices of traded goods, on average, departed much less from world prices than in other developing regions, even though there were substantial variations for some individual items and for some countries in East Asia. Prices of traded goods for the East Asian economies were generally closer to world prices than elsewhere.[13]

Nevertheless outward orientation should not be equated with import openness. Especially in the 1960s and 1970s, several economies exhibited moderate import protection. While such protection in East Asia was usually offset by export incentives, as late as the mid-1980s the effective protection rate for manufacturing was nearly 30 percent in Korea, 50 percent in Thailand, and 70 percent in Indonesia. By the end

of the decade, however, these rates had declined substantially, to the benefit of exports and the economy.

In East Asia economic policies ensured that import protection did not produce the anti-export bias that it did elsewhere.

One key difference in the earlier (1960–80) period was that in East Asia economic policies ensured that import protection did not produce the anti-export bias that it did elsewhere. This distinction can be traced to the region's general unwillingness to allow the exchange rate to become overvalued and to the fact that exporters were given access to offsetting incentives (for instance, duty exemption, free access to foreign exchange, and free trade zones) which favored exports. There was also effective institutional support for exports (especially in Korea, Singapore, and Taiwan, China) as well as considerable labor market flexibility. The effects of successful government support are typified by the assistance that led Malaysia to start growing palm oil—it became the world's largest producer, with half the acreage under public control—and the Pohang Steel Complex in Korea, which became a global leader, again in public hands.

A favorable domestic climate for FDI was another key difference. Foreign capital was welcomed, whether in the form of wholly owned subsidiaries of multinationals, joint ventures, or licensers. Malaysia and Thailand achieved dramatic shifts in favor of FDI in the 1980s; today China is doing the same, with similarly impressive results. Malaysia again illustrates the point about government support: many multinationals in electronics invested in the country in response to active government encouragement. Today Malaysia is the developing world's largest exporter of semiconductors, and the third-largest producer after Japan and the United States.

Selective Industrial Policy

The term industrial policy has many meanings. In the East Asian context, it has been used synonymously with deliberate attempts to change a country's industrial structure, usually to encourage the growth of capital-intensive industries. The debate about industrial policy is rich. Initially neoclassical economists were pitted against a small group of interventionists. With the success of East Asian economies, however, industrial policy is no longer a dirty phrase to most economists. Indeed, numerous elegant reasons have been advanced in support of market intervention, ranging from classic externalities to information gaps[14] and strategic trade advantages.[15] The debate has turned to the role of government in guiding markets[16] or deliberately

underpricing capital to achieve rapid industrialization.[17] These discussions cannot be divorced from the more general role of government in coordinating investment decisions and supporting infant industries with the ultimate aim of penetrating world markets. The most forceful examples of selective industrial policy are Japan and Korea. These examples are very important, but they tell only a partial story of East Asia's success. A great deal more can be learned from individual country assessments.[18]

The Korea Story

Korea pursued an industrial policy—that is, the comprehensive use of public instruments to industrialize—at least from the start of the Third Republic under President Park Chung Hee. However, during the 1961–71 period this policy was sectorally neutral. Manufactured exports were promoted through a familiar range of policies, but the government was satisfied to capitalize on Korea's comparative advantage in labor-intensive manufactures. Beginning in 1971, however, the government began a coordinated campaign, known as the Heavy and Chemical Industry (HCI) drive, to build up six designated industries. It increased protection and provided many incentives to certain firms whose actions were carefully controlled.[19]

Korean intervention differed from the policy pronouncements in Brazil or India and many other import-substituting countries. Success was measured by export performance, and eventually all subsidies were expected to be withdrawn.

The most important measure was heavily subsidized credit. What distinguished this industrial intervention was not only its thoroughness but also its premise that firms in steel, shipbuilding, machinery, electronics, petrochemicals, and metals would achieve internationally competitive levels within a decade. In this respect, Korean intervention differed from the policy pronouncements in Brazil or India and many other import-substituting countries. Success was measured by export performance, and eventually all subsidies were expected to be withdrawn. The nature of the policy is clear, although it has at various times been judged both a failure and a success. For our purposes, it is enough to say that Korea did alter its industrial structure dramatically, and in most of the targeted industries it succeeded in penetrating international markets. The issue, however, is not whether technical efficiency was achieved, but whether it was achieved profitably. The country study concludes that the policy was, on balance, successful but that its long-term costs are usually understated. Specifically, the social-

ized nature of risk bearing and the tight controls on the financial system in Korea led to many publicly managed bailouts of industry. Today the financial sector is still not free of the shackles of directed credits or their costs, as borne by commercial banks, government banks, and the central bank itself.[20]

Faced with considerable macroeconomic difficulty in the period 1979–80, largely as a result of the second oil shock, Korea abandoned the HCI drive. Over the next decade the government stopped trying to pick winners; it liberalized trade; and it loosened its grip on the financial sector. Some Korean economists argue that Taiwan, China, outperformed Korea without undertaking the costly HCI drive.[21] Others say that the interventions were largely successful in accelerating the process of dynamic comparative advantage and that were it not for the oil shock, the period would have been an unqualified success. This evidence is reviewed in the Korean case study. No other rapid industrializer intervened quite so heavily, although the new literature on Taiwan, China, shows an effort to direct the industrial efforts of entrepreneurs.[22]

The Singapore Story

The government of Singapore had few qualms about intervening to supplement market forces and bring about desired industrial change. Clearly the size and malleability of the economy made control easier, but Singapore also developed institutions that made it possible. Singapore has been aptly described as a corporate state because the distinction between government and business—indeed between the

Without capital, technology, or entrepreneurship, Singapore put its industrialization squarely on the shoulders of multinational corporations and foreign direct investment.

political leadership and the bureaucracy—is murky. The first key to Singapore's industrial strategy was an accurate assessment of the country's national resources, followed by clear industrial goals and an understanding of the relationships and ingredients needed to achieve them. Without capital, technology or entrepreneurs, Singapore put its industrialization squarely on the shoulders of multinational corporations (MNCs) and foreign direct investment. To attract FDI, it invested heavily in education and technical skills and in the infrastructure that MNCs value. Where necessary, it used government-linked companies (GLCs) to push its development agenda, although these GLCs were run on a commercial basis.

Recognizing that their city-state, with its limited physical resources, would have to depend on re-exports, Singapore's first generation of leaders built their industrial strategy around labor policy. Singapore's First Five Year Plan stressed technical education, school building, and family planning. The political agenda included the 1967 Employment Act, which established national employment regulations and clearly delineated worker benefits to attract foreign investors, and the 1968 Industrial Relations Act, which pioneered three-year collective bargaining agreements. The National Wage Council was a tripartite forum (business-government-labor) established in 1972 to make wage recommendations on the basis of productivity gains and the cost of living. As in Korea, wages were a policy tool used to ensure competitiveness. Balancing these labor market interventions were social policies (such as housing) to improve living standards and a major public role in education and training.

In addition to encouraging foreign investors, the government decided in the late 1970s to promote higher technology and higher-value-added industries. It instituted a high-wage policy in an attempt to move quickly out of traditional labor-intensive manufactures. Although this policy did stimulate investment in electronics, machinery, pharmaceuticals, and precision products, by 1985 Singapore experienced its first severe recession. Rather than nominally devalue the currency, the government opted to decrease labor costs through a large reduction in employer contributions to the Central Provident Fund. The implicit 12 percent wage cut was possible because the union movement was allied with the government and the political leadership. In effect, the government tried to position its labor force to be attractive to multinationals, adjusting its price, augmenting its skills, and tinkering with financial incentives to change its trade pattern and stay ahead of its competitors in East Asia.

The Indonesia Story

In much the same way that Korea pursued its capital-intensive HCI drive in the 1970s, Indonesia tried to create its own dynamic comparative advantage in the early 1980s. Under a blueprint known as the Investment Policy List, industrial entry was directly controlled, capacity limits were set, local content requirements were enforced, and foreign investment was discouraged. Behind high trade barriers, local industry, mostly in the form of state-owned companies, attempted to move into "upstream activities," to produce more "value added," and to protect itself against the terms of trade losses it suffered in the post-oil-boom years. This foray into steel, plastics, and petrochemicals, helped by subsidized credits and trade protection, was a failure.

Indonesia impoverished in the 1960s, an oil economy in the 1970s, and an inefficient spender in the early 1980s, has now become another East Asian dynamo. It has done so through traditional outward-oriented policies and an abandonment of selective industrial policies.

The Indonesian experience suggests that capital-intensive industrial transformation cannot easily be imposed. Indeed, it is not even necessary for late industrializers. Between 1985 and 1988 the government changed course. It reduced its share in the industrial sector from 43 to 23 percent (1989). Industrial concentration (measured as the share of output from the four largest producers) fell from 54 percent, on average, to 32 percent. Trade was dramatically liberalized and foreign investment actively encouraged. The results were remarkable: despite a cumulative terms of trade drop of more than 40 percent between 1986 and 1988, the productivity of land, labor, and capital grew strongly in 1988–91, GDP grew at an average 7.1 a year, and non-oil exports boomed. Indonesia, impoverished in the 1960s, an oil economy in the 1970s, and an inefficient spender in the early 1980s, has now become another East Asian dynamo. It has done so through traditional outward-oriented policies and an abandonment of selective industrial policies.

The Malaysia Story

Over the term of its Fourth Five Year Plan (1981–85), Malaysia pursued import substitution with renewed vigor. Its models were Japan and Korea (hence the "Look East Policy," a term coined in 1981) and the decision to bring in Korean advisors to help pick and produce industrial winners. The government created a holding company, the Heavy Industries Corporation of Malaysia (HICOM), which was charged with creating a nucleus of critical industries, including basic metals, machinery and equipment, automobiles, building materials, pulp and paper, and petrochemicals. The public sector's investment in HICOM from 1981 to 1986 was intended to reach 6 billion to 8 billion ringgits, equal to the national development budget.

Faced with mounting deficits, the government changed policy and began a major program of privatization.

The symbol of this selective industrial policy was the Proton Saga, a car whose production was heavily subsidized by both the Malaysian

government and its Japanese partner, Mitsubishi. Unlike Korea's HCI push, which was aimed at achieving international competitiveness, HICOM industries, although monitored by the government, were under no such compulsion. They lost money, suffered from poor management and excess capacity, and required government bailouts. Between 1981 and 1985 the number of nonfinancial public enterprises rose from 498 to 702, while the percentage that was profitable fell from 62 to 55 percent. Faced with mounting deficits, the government changed policy and began a major program of privatization.

The lessons can be summarized as follows. First, industrial policy was aimed at internal industrial objectives, such as changes in ownership and employment patterns, rather than at the achievement of international levels of efficiency or export targets. For this reason, in part, the system of rewards and penalties could not be ruthlessly applied. Second, clear overall goals were not established whereby infant industries would be judged. Third, insufficient domestic competition was fostered to create incentives to perform, and systems for monitoring state-owned enterprises were inadequate. Fourth, the selection of industries was based too heavily on traditional import-substitution criteria and insufficiently on global marketing concerns.

The Taiwan, China, Story

A glance at the history of Taiwan, China, could suggest that the country's initial conditions—the economic infrastructure from Japanese colonialism, entrepreneurial talent from mainland China, and U.S. aid—were unique. But its rapid industrialization owed much more to domestic policies.[23] In addition to the early success of land reform in bringing about remarkable equity of income and wealth, policies for macroeconomic stability, domestic investments, and industrial development were highly effective.

In the 1980s, the policy switched to place a greater emphasis on liberalization and export development. The results were striking.

After the import substitution phase of 1953–57, the government promoted exports during the period 1958–72. It gradually reduced import protection and offset anti-export bias by providing free trade status and other incentives for exporters. It also set export targets and supported the development of labor-intensive industries. Economic growth between 1963 and 1972 averaged nearly 12 percent a year.

For various economic and political reasons, the 1970s saw the emergence of a more self-reliant strategy with large investments in infra-

structure, industrial upgrading, and further import substitution. Public enterprises were used as a means of industrial policy, especially for a big push in heavy and chemical industries. Some of these state enterprises—for example, China Steel Corporation—performed remarkably well by any standard, but many were outright failures. Economic performance, although robust overall, revealed strains, especially in competitiveness. In the 1980s, the policy switched to place a greater emphasis on liberalization and export development. The results were striking. The economy generated massive payment surpluses and the means to invest elsewhere in the region on a scale rivaling that of Japan.

The Thailand Story

Thailand has had fairly consistent and rapid growth since 1955. It has emphasized private sector development, outward orientation, and macroeconomic stability. In the 1960s and the 1970s the government made various efforts to protect and promote domestic industry, but compared with the efforts of Korea or Taiwan, China, they were not highly coordinated. The general thrust of policy since then has been to allow free markets rather than to intervene in them. A half-hearted attempt at capital-intensive industrial promotion was pursued in the Eastern Seaboard project, but, in the end its more costly and inefficient elements were abandoned.

As a result, Thailand avoided costly industrial adventures, while maintaining basic macroeconomic stability.

Within this overall picture, import-substitution policies in the 1970s favored capital-intensive industries. Industry's share of GDP rose substantially in the 1970s, while its share of the labor force showed little increase. Balance of payments problems and concern with the pattern of industrialization prompted a shift in the early 1980s to export development and import liberalization. Effective protection for manufacturing was reduced by the mid-1980s, although it was much higher than in Korea and Malaysia. Any anti-export bias, however, was vigorously offset by exchange rate policy, export incentives, and the promotion of FDI by the Board of Investments.

On balance, sectoral interventions had only mild effects on overall performance. The government's interventions were poorly coordinated, the private sector was robust, and Japanese investment was heavy. As a result, Thailand avoided costly industrial adventures, while maintaining basic macroeconomic stability. It could of course be argued that more-effective intervention could have raised growth rates further, but that presumes a state apparatus which Thailand did not possess.

The Hong Kong Story

Hong Kong embarked on its export drive in the early 1950s, a decade before the other early NIEs. It has always been different from the other three, particularly in the small and noninterventionist role of its government. For most of the past forty years, Hong Kong's economic growth and productivity growth were the highest in the region. Industrialization was initiated by migrant industrialists, largely from Shanghai, but was fostered by local merchant entrepreneurs. Small enterprises flourished, supported by a government dedicated to stability and "positive nonintervention."

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Hong Kong's continued prosperity in the past dozen years has been built on the links with southern mainland China—and vice versa. During this period China doubled its average income faster than any other country on record. The growth of Guangdong province, which is adjacent to Hong Kong and where millions of migrant workers from other provinces come to work, has been phenomenal. Today the province aspires to be the fifth "tiger," and it has achieved this through free market policies rather than state intervention.

The Diversity in Industrial Policy

East Asia's industrial policies showed great diversity. Not all governments intervened heavily, and not all interventions were successful. In the first-generation NIEs, the record points to the potential rewards of socializing risk under an industrial policy. But the risks of such an approach are equally important, as illustrated by the failures of such a policy approach in Malaysia and Indonesia. The success of Thailand, Hong Kong, and recently the coastal provinces of China show the merits of avoiding unbridled industrial activism. Countries entertaining an activist industrial policy need to weigh both the risks and the potential gains of this gamble.

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Where there were successes, they were based on export development. Governments did not merely provide protection for a local

industry (as was the case in many countries outside the region), but provided support of many kinds to help industry achieve export competitiveness. Crucial elements were that (a) government guided, but did not override the decisions of firms; (b) international price signals were used to gauge efficiency and success; and (c) firms were offered support in exchange for specific performance requirements.

More generally, the conditions needed for selective industrial policy to work are not usually present. In addition to the capacity to select potential winners linked to exports, a successful policy depends, first, on the ability of society to place efficiency and public interest above rent seeking and, second, on pragmatic and flexible policymaking, including the ability to reverse failed policies.

If these preconditions can be found, it can be argued that they offer the potential for effective government action short of concerted industrial intervention. Some of the earlier intervention policies are in any event probably not replicable today, given a less receptive trading environment for export subsidies, more open capital markets, and freer labor markets. Instead, the augmented view of public policy that we advocate emphasizes government's role in supporting investments, particularly in infrastructure and labor skills, international marketing, and technology acquisition. What has separated successful industrializers from unsuccessful ones has been whether or not international efficiency was achieved. This yardstick can be either imposed by government as a quid pro quo for time-bound public support or implicitly supplied by foreign investors. Evidence of the 1980s from China, Indonesia, Malaysia, and Thailand tends to show that the second-generation NIEs have relied on foreign investment to provide this discipline.

Policymaking

Common to successful government interventions was the pragmatism and flexibility to change course as needed. What characteristic of policymaking can be associated with such a pattern? In East Asia it seems that governments are repeatedly able to distance themselves from past policies that have failed or are no longer useful. This flexibility should not be mistaken for good luck. More often it was associated with problems or crises that led to change, as indicated by the following examples.

In Korea the end of the heavy-handed HCI interventions, under which the bulk of industrial credit was absorbed by large capital-intensive industries, was prompted by the second oil shock.[24] When, in 1980, the economy went into recession, the government opted for macroeconomic stabilization, and the fiscal drain of HCI was no longer affordable. Trade liberalization was begun in earnest. Credit allocation

once more favored exporters, commercial banks were privatized, and troubled HCI industries were put under new management. In the following years, incentives to encourage R&D and technological upgrading were put in place, and interventions concentrated on strategic bailouts rather than on picking winners.[25]

In East Asia it seems that governments are repeatedly able to distance themselves from past policies that have failed or are no longer useful.

In 1967 Indonesia was not only poor (with a per capita income of $50 and with 60 percent of its population living in absolute poverty), it was also indistinguishable from many other inward-oriented developing countries that were awash with licensing restrictions and protection. Hyperinflation produced the 1967 Balanced Budget Amendment and a new dedication to controlling inflation. But despite significant macroeconomic reforms during the 1967–73 period, after the first oil boom the country's inward orientation was encouraged by heavy-handed selective intervention. By 1985 about 28 percent of import categories required licenses, there was a large current account deficit, and the debt service ratio was 40 percent. Faced with a deteriorating macroeconomic situation, the government changed course, with a major devaluation and sharp macroeconomic adjustments. It gradually liberalized trade so that the effective rate of protection on capital goods industries fell by 50 percent between 1987 and 1990.

Countries with oil resources, such as Indonesia and Malaysia, at first reacted to their surpluses predictably, by spending more. However, within five years of the second oil shock both had cut their fiscal deficits and adjusted their exchange rates in order to compete in the region's increasingly tough manufacturing arena. Macroeconomic policies, far from flawless, were subject to scrutiny and revision. And industrial policies, if they conflicted with prudent macroeconomic policy, were also adjusted or abandoned.

A striking example of policy change is the increasing role of market economics in the southern provinces of China. These "experiments" have been largely successful—in fact, the volume of trade between Guangdong and Hong Kong is now almost the size of the Hong Kong's GDP. The success of China's Special Economic Zones (SEZs) in Guangdong and Fujian is attributable to the ease with which capital and technology are admitted, the flexibility of wages, the freedom to import materials and remit foreign exchange, and the shift in the state's role toward emphasis on the provision of infrastructure in the SEZs to attract foreign investment.[26]

Bureaucracy

In most East Asian countries, selection for the bureaucracy is an honor, and government has been able to pick its officials from prestigious universities. In Korea graduates of Seoul National University fed the bureaucracy, with the best of them going to the core economic ministries. A Confucian level of status ordinarily reserved for scholars also placed bureaucrats in a preferred position.[27] Overseas training often furthered the career prospects of government officials, and ministers frequently vied for the best-trained technocrats. Central banks also managed to attract highly skilled staff as did research institutes, which (particularly in Korea) were strongly affiliated with government. Fellows of the prestigious Korea Development Institute were more highly paid than ministers, and generous financial incentives were offered to returning foreign-trained experts by the research arm of the Ministry of Science and Technology. Indeed the "reverse brain-drain" was a major factor in upgrading the skills of the Korean bureaucracy.

One of the roles of research institutes has been to digest experience from foreign sources. Copying the successful actions of others is considered part of prudent policy. This search for policy lessons and advice extends to international organizations, such as the World Bank, whose advice is sought, if not always followed. Although both the Bank and Korean authorities enjoy noting that the Bank opposed expansion of the automobile industry in the mid-1970s, it is more telling that the Bank's work on trade liberalization and energy pricing actively supported government reforms.

East Asia's bureaucracies emphasized managerial organization and functional responsibilities. Governments centered their efforts on core economic ministries, which formulated and coordinated economic policy. A pioneer was Korea's Economic Planning Board, but similar core ministries exist throughout Asia. How did these technocrats in East Asia succeed where other well-trained bureaucrats failed? Country experiences provide some important clues.

Organizationally, economic teams in Indonesia and Korea were coordinated and led by a single, clearly identified "economic czar"— a coordinating minister for economic, industrial, and financial affairs in Indonesia, and the deputy prime minister and minister of the Economic Planning Board (EPB) in Korea. In Korea the EPB has traditionally contained both the planning apparatus responsible for successive five-year plans and the budget function that finances those plans. Coordination of economic policy was equally strong, if not quite so ministerially prominent, in Malaysia. There the Economic Planning Unit (EPU) reports directly to the prime minister, which is also the case with Singapore's Economic Development Board (EDB). Thailand's National Economic and Social Development Board (NESDB)

performed a similar coordinating task in forging a consensus on development goals.

Nevertheless, there is variation in the roles of economic ministries. Malaysia's EPU is unusual for both its small size and its clear mandate to serve the prime minister, and Thailand's NESDB is distinguished by the unique way it achieves consensus. In both countries one may argue that the central bank's role was critical, and that the strong voice of finance ministries on macroeconomic management usually dominated economic policymaking. In Thailand the action of the technocrats in devaluing the baht in 1984 is seen by many as the critical action that restored the credibility of macroeconomic management and laid the basis for Thailand's financial and industrial surge later in the decade. In Malaysia the voices of prudence in the Ministry of Finance and Bank Negara kept inflation low for decades, despite variation in industrial policies.

Among planning ministries, those in Korea and Singapore stand out, in part for their ability to implement decisions. The quality of implementation depends on a clear identification by government officials with the goals being pursued. In Korea monitoring of key economic variables (notably exports) was an obsession, and it permeated the bureaucracy. The extra export effort of the "final 100 days" of each year was legendary. Plan targets, although in some sense indicative in market economies, were usually exceeded, and public officials were held accountable for their achievement. Performance evaluation and monitoring systems have become models for the management of public enterprises as well.[28]

Singapore's economic policy apparatus has been different but no less effective. The Economic Development Board, established in 1961, was able to coordinate policy, offer incentives to foreign investors, acquire land, create industrial estates to attract multinational corporations, and take equity stakes in corporations. Beginning with the First Five Year Plan, the EDB was charged with ending bottlenecks, creating new programs, and spearheading Singapore's development drive. In the process, it created the Jurong industrial estate, began a joint-venture shipyard project with Japan, offered incentives to investors under the 1961 Pioneer Industries Ordinance (which deferred 90 percent of the corporate profits tax for a period of fifteen years for export industries), and promoted exports via the Economic Incentives Bill of 1967. As its economic objectives matured, Singapore played a prominent role in establishing a Joint Industry Training Scheme with the participation of foreign companies and in attracting foreign investors to Singapore.

The role of technocrats in Indonesia is not dissimilar to that in Korea and Singapore. Indonesia's leadership delegated economic policy to a group of senior officials. This alliance has served both parties well, as it combined pragmatic leadership with capable implementation. In Korea President Park quickly formed an alliance with the technocrats

he needed to implement his vision of Korean development, relying on engineers to design his industrialization strategy and on economists to secure financing. In Singapore the distinction between political affiliation and technocratic position has often been blurred; the goals of the People's Action Party and the national economic goals were the same.

Leadership

The East Asian state has a record of maintaining political and economic stability and of pursuing long-term development goals. The first-generation NIEs quickly developed enough consensus on development goals and a sufficiently broad distribution of benefits to push the economic agenda forward. How was this accomplished? While we do not have the analytic tools to answer this question definitively, country experiences provide useful insights.

In Korea and Taiwan, China, land was a scarce asset, and both regimes were prescient in redistributing land to small farmers. These rural constituencies are still conservative and progovernment today. By contrast, land reform has eluded countries such as the Philippines, and the uneven distribution of income has perpetuated poverty and alienation. Korea managed, over the 1965–85 period, to maintain reasonable equality between urban and rural incomes. Special rural development programs (such as the *Saemaul* movement), agricultural price supports, and a relatively large rural investment program were prominent features of Korean development. In Singapore early support and trust were built on the housing policies led by the Housing and Development Board. Through its efforts begun during the First Five Year Plan, public housing construction was one of the plan's top priorities. As a result, owner-occupied housing rose from less than 10 percent of the population in 1970 to 80 percent in 1980.

In these first-generation NIEs, the notion of shared sacrifice can be seen in anticonsumption campaigns, long hours for workers and managers, and the virtual absence of capital flight. The corollary of shared return is also seen in the dramatic increases in wages and in the unprecedented gains in social indicators, to the point where absolute poverty has been virtually eliminated.

The role of the state in the second-generation NIEs—Indonesia, Malaysia, and Thailand—is far less uniform. The clarity of equity objectives was perhaps most visible in Malaysia's New Economic Policy, a two-decade plan (1970–90) to reorder the distribution of income and wealth in favor of the Bumiptera (Malay) majority. This goal of raising the incomes of the Malay majority served to unite the Muslim population and may have been responsible for keeping interracial peace. The government's other emphasis, on education and agricul-

tural advance, did yield high returns and can be credited with bringing the percentage of people in absolute poverty down to single digits.

In Thailand there was initially no strong equitable-growth strategy in place. Indeed, there was no consensus for any particular set of development objectives. The country's success came later, largely as a result of prudent macroeconomic policies, the beneficent role of foreign investment, and the contagion factor. Observers credit the relatively conservative bureaucracy with steering a steady course amid political vacillation and upheavals and the monarchy with keeping social stability and a sense of nationhood.[29]

Observers have also attributed some of East Asia's economic success to the concentration of political power in many of the countries in question. In Indonesia, Korea, Singapore, and Taiwan, China, to varying degrees, the state held enormous power, dissent was largely absent, and bureaucrats had a relatively free hand in pursuing reforms. The greater equality of income in these economies may also have aided reforms by limiting the differences among winners and losers, but the absence of outright opposition to policies decided at the top is said to have expedited economic reforms. In fact, Singapore's former President Lee Kwan Yew has questioned the compatibility of purely democratic models with rapid development.[30]

None of the East Asian economies succeeded unless it had three attributes: outward orientation, macroeconomic stability, and investment in people. These economies were not always blessed with this triad. They developed institutions and policies that delivered it.

Clearly, however, the equating of political control and economic success is far too simplistic and misleading. Authoritarianism has not been in short supply in the developing world; yet in most authoritarian regimes economic policies have been poor and results disastrous. The East Asian experience shows superior performance under a variety of different political situations. Both authoritarian and participatory institutional mechanisms in East Asia managed to achieve features favorable to rapid growth–reducing uncertainty, improving economic incentives, limiting economic controls, providing adequate support services, and, often, providing a strategic vision. All this shows the merit not of political control but, rather, of the ability to use political and institutional features to achieve development objectives. The pragmatism of government meant—with the benefit of hindsight—that when it intervened to speed development, the probability of failure was much lower than elsewhere.

Conclusions

The evidence from East Asia contradicts forcefully the notion of any single, decisive cause of economic success. Instead, it points to a combination of tangible factors consistently associated with progress. None of the East Asian economies succeeded unless it had three attributes: outward orientation, macroeconomic stability, and investment in people. These economies were not always blessed with this triad. They developed institutions and policies that delivered it.

It is our view that any country which achieves successful performance in these policy inputs will be amply rewarded in income gains. But would that be enough to reproduce the remarkable growth of East Asia? The notion persists that similar actions on these three fronts will not produce similarly large payoffs in other country circumstances.

Getting Higher Payoffs

First, there is something to be learned from East Asia's style of policymaking that translates policies on paper into practice. Many of the features associated with such effectiveness—consensus building, policy flexibility, and pragmatism—are replicable. Most clearly, countries need to develop a mandate for development and also to continually reassess their strategies. Mechanisms of formulating development plans in East Asia served to inform and coordinate the activities of economic agents; annual management plans served to monitor performance of the public and private sectors and to signal the need for policy revisions. East Asia managed to develop business-government relations that allowed such revisions to take place in a mutually beneficial manner.

Picking winners leads to high rewards in a small percentage of cases where the experiment is successful and to disastrous results in a large percentage of failures.

Second, East Asia is getting a greater payoff for its actions because of regional contagion. The proximity to other successful countries provides a special advantage. In particular, Japan has played a strong leadership role in transferring technology and ideas around the region. At first glance, this advantage may not seem replicable, but that conclusion may well be wrong. With the revolution in communications, geographic proximity is less relevant, and other growth centers are likely to emerge. Increasingly, outward orientation and sound domes-

tic policies enable a country to share technologies and ideas from around the world. Another advantage of regional contagion is that there are proximate comparators for economic performance, which is useful if public policies are openly scrutinized.

Third, does a state need to go further than adopting the fundamentals of strong economic management? The country studies leave no doubt that government intervention in picking winners was prominent in some East Asian countries. The evidence also suggests that some others in the region did equally well without government direction, or because such directions failed and were abandoned. In other regions where governments have tried to pick winners, the failure rate has been even higher.[31] In the worldwide context, the issue boils down to probabilities: picking winners leads to high rewards in a small percentage of cases where the experiment is successful and to disastrous results in a large percentage of failures.

Early versus Later NIES

As seen in the Development Checklist, political stability, efficient bureaucracies, macroeconomic stability, export drive, and investment in human resources were common features across most successful East Asian economies. But with the exception of Hong Kong, the first-generation NIEs had some systematic differences from the second-generation NIEs.

In the first-generation NIEs the state generally had a more forceful role in industrialization. Starting with visionary leadership and supported by strong economic ministries, governments "went for broke," acquired technology feverishly and invested heavily in upgrading labor skills. A few used directed credit as part of their strategy, relying on state enterprises when private firms were lacking. What lowered the risks of these policies was strong macroeconomic discipline and the use of international price signals as a guide to performance. Macroeconomic discipline meant that countries abandoned imprudent policies when stability was at risk. The use of international prices helped them to measure the performance of infant industries.

The second-generation NIEs differed considerably from the first in terms of initial conditions and, to some extent, political institutions. The availability of resources in Indonesia, Malaysia, and Thailand allowed a more relaxed pace of development. More reliant on foreign investment than on aid, the second-generation NIEs did not have to follow such an aggressive policy of acquiring technology. Where selective industrial policies were attempted, these policies largely failed. Yet regional contagion, low wages, and strong fundamentals fostered export industries. Liberalization and reforms removed the public sec-

tor from inefficient activities in Malaysia and Indonesia, and even in Thailand state enterprise reform is now a priority. Open capital accounts contrasted with the financial controls used in Japan and Korea in earlier decades.

The Question of Replicability

Much intellectual energy has been devoted to deciding the right degree of government involvement in industrial policy. This may not be the central question, however. What is clear from the combined experience of East Asia over the past three decades is that certain common features dominate, and that they involve some fundamental public policies. Countries may choose "supplemental policies" in an effort to achieve a "growth overdrive,"[32] but these idiosyncratic policies are difficult (if not impossible) to replicate.

More importantly, there are few cases, if any, where countries that pursued the "core policies" have not succeeded. Put differently, governments that have adopted the essential policies—stable economic management, investment in human capital, and export drive—have been able to entertain the option of a larger role for government in industrialization policy. Whether such interventions would succeed has depended primarily on the policy objective itself and, secondarily, on the institutional capacity to execute it. Unless these policies are continuously reassessed (and, if necessary, reversed), they stand little chance of success. Moreover, as the evidence of the second-generation NIEs demonstrates, they are neither essential to, nor sufficient for, rapid growth.

The big question for policymakers is why such diversity of experience in East Asia has produced uniformly good results. The first answer is that success has not been universal. The Philippines, for example, was not able to combine enough positive factors from among macroeconomic stability, strong technocratic bureaucracy, export competitiveness, political stability, and policy consistency. Equally puzzling is why other countries, such as India, even during periods featuring macroeconomic and political stability and perhaps a talented bureaucracy, have not done equally well. In some, bureaucracies were impediments to private entrepreneurship rather than instruments of change. In others, policy was ideologically determined and was not critically reassessed for its effectiveness. And in yet others, no social consensus existed under which a national development strategy could be forged and implemented.

The diversity of experience within East Asia suggests that universal and sweeping prescriptions are not possible and that country-specific circumstances will dominate. Yet the body of East Asian evidence

points to the dominant contribution of stable and competitive economic policies to the unleashing of private entrepreneurship. More often than not, the key to the policymaking process was the positive role of government in charting a development course, creating a longer-term vision shared among key participants, and fashioning an institutional framework for nonideological and effective policy implementation.

Notes

1. The Country Lessons project includes case studies of Hong Kong, Indonesia, Korea, Malaysia, Singapore, and Thailand, as well as two cross-country papers. Individual studies have been disseminated by the World Bank in the Lessons of East Asia series. See also World Bank 1993, *The East Asian Miracle,* the major institutional product on this subject, and *World Development Report 1991.*

2. China clearly pursued very interventionist policies until the late 1970s. Since then the country has been adopting market reforms gradually with spectacular results. In view of its special circumstances, China is not a central part of this discussion.

3. See for example Haggard 1990; Johnson 1987; Vogel 1991.

4. See Fishlow 1991.

5. See Bhattacharya and Page 1992.

6. See Birdsall and Sabot 1993; Barro and Lee 1993.

7. See Dahlman and Sananikone 1993.

8. See Corden 1993.

9. See World Bank 1993, *The East Asian Miracle.*

10. See Campos 1993.

11. See Krueger 1985; Westphal 1990.

12. See Balassa 1988; Pack and Page 1993.

13. See Thomas and Wang 1990; Bhalla 1993; Dollar 1992.

14. See Stiglitz 1989.

15. See Krugman 1990.

16. See Wade 1990.

17. See Amsden 1989.

18. See individual country studies in the Lessons of East Asia series. Hong Kong: Chau 1993. Indonesia: Bhattacharya and Pangestu 1993. Korea: Kim and Leipziger 1993. Malaysia: Meyanathan and Salleh 1993. Singapore: Soon and Tan 1993. Thailand: Christensen and others 1993.

19. See World Bank 1987.

20. See Leipziger and Petri 1993; J. H. Kim 1990; and Nam 1990, 1991.

21. See Yoo 1990.

22. See Wade 1990.

23. See Dahlman and Sananikone 1993.

24. See World Bank 1987; Sakong 1993.

25. See Leipziger 1988.
26. See Brown 1993.
27. See Song 1990.
28. See Shirley and Nellis 1991.
29. See Christensen, Dollar, Siamwalla, and Vichyanond 1993.
30. Point made by the Hon. Lee Kwan Yew in "The Proven Path to Economic Growth," a speech in Manila, November 19, 1992.
31 See World Bank, *World Development Report 1991.*
32. See Petri 1993.

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