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Path-Dependent Reforms of the East Asian Development Model

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Professor Park and associates' chapter shows that the recent Asian crisis has led to profound rethinking about the merits and demerits of the so-called East Asian development paradigm. The authors delineate three differing perspectives. The first claims that the American model of capitalism has proven superior to the Japanese one, so that (implicitly) the sooner the East Asians Americanise (more fully liberalise) their economies the better. On the contrary, the second view argues that the rapid rebound of the East Asian economies in the aftermath of the Asian crisis suggests that the model that served East Asia so well for 30 years is fundamentally solid, and that at most minor reforms are required for the coming future. The third position, that is espoused rather convincingly by Professor Park and his associates, is that the pre-crisis model must evolve significantly, not because it was unsuitable in the past but because it could become outdated in the future, given the many changes taking place both domestically (the democratisation of their societies) and internationally (globalisation).

Since Professor Park presented this chapter in Latin America, I would like to complement what to me seems a persuasive presentation with what, from a Latin American perspective, seems to be the sources of East Asia's past success and what weaknesses or reforms it might seem in need of for the future.

To begin with, though there are many features in common, there are also important differences between many of the countries, especially as we shift the focus from Japan, to China or to the Tigers. Moreover,

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there are also important differences within the "Tigers". Just to cite a few:

- Korea, as Japan, has grown largely on the basis of domestic firms and entrepreneurs financed locally, as compared to Malaysia and Singapore whose development has relied heavily on direct foreign investment by transnational corporations.
- Conglomerates and large firms have dominated in Korea, whereas small and medium-sized firms have been the rule in Taiwan.
- Hong Kong has the most open and least interventionist economy, not of Asia, but of the world; this contrasts with the protection afforded most sectors elsewhere in the region.
- Unlike the United States, but more like Japan, there are very close, long-term relations between firms and banks in much of East Asia, especially in Korea.

The implication for me is that the diversity of these experiences suggests that none of the above features were essential to their success.

Viewed from Latin America, what indeed seems central in explaining East Asia's success from 1955-1997 and beyond are the following five features:

Undoubtedly, the first feature which stands out is their *ultra* export promotion bias (vs. import substitution alone and no more, as in Latin America until the 1980s) thus forcing their firms to learn to either compete with the world's most efficient firms in third markets or, eventually, go under. And since these economies are, for the most part, scarce in natural resources, if they were to promote exports these would necessarily have had to focus on manufactures. Their instruments of choice for export promotion were for the most part different forms of export subsidies. Since export subsidies are no longer feasible, given the WTO rules, I would like to know what other export-promotion policies, if any, were used – or was it principally export subsidies? If so, Latin America and East Asia in the future would have to consider WTO-compatible export-promotion policies, such as credits to exporters of non-traditional exports at international interest rates – given the normally much higher domestic interest rates, this is a tacit credit subsidy, but is WTO friendly.

Moreover, while East Asian countries are heavily export-oriented, many of these countries still maintain important restrictions on imports. Might import liberalisations and FTAs not be one of the liberalisations needed in the future or are these countries to continue to shelter domestic agriculture and import competing manufactures? These are reforms that Professor Park and his colleagues do not emphasise but which, from my perspective, would be important within the spirit of a strong export orientation.

The second feature which stands out is East Asia's high savings and investment ratios. In part these are the result of investment opportunities; in part, it seems, these are also due to an active policy of savings promotion (for example, Singapore's social security surpluses). I would certainly like to know (and so would the rest of the world) what the secret was. For savings rates of near 30 percent (not to mention close to 40 percent in China) are the order there (vs. 22 percent in Latin America).

Third, I was under the understanding that insofar as labour markets were concerned there was far more flexibility in East Asia than met the eye. In effect, Japan certainly and Korea also, pay participatory wages (that is, where an important component of income is made up of a wage which varies with the firm's output, sales, profits, etc.) – thereby enabling firms to lower wages and thus prices in the face of economic downturns to maintain sales (output and employment) rather than having to lay-off as in the US and Latin America. This provides important labour market flexibility, though it is not of the type typically argued for in this region (to wit, lower minimum wages, lower severance pay, lower indirect taxes on wages). If my impression is correct, this feature of East Asian labour markets warrants greater emphasis.

Fourth, we must not forget that all of these East Asian countries were late starters. The ultimate basis of their spectacular performance would seem to derive from the fact that they actively sought out to identify and incorporate best practices and modern technology. Some did so attracting transnational corporations with modern technology and market access (Malaysia and Singapore); others – Japan and Korea – pursued an active policy of intelligent imitation, be it "learning by visiting", "learning by photographing", learning by taking things apart or reverse engineering and "learning by paying for it" (licensing).

Incidentally, while Korea's strong investment in R&D is much heralded (today close to 3 percent of GNP), in fact, in the hey day of its growth in 1955-1980, this percentage was less than 1, just as in Latin America today, while its strong purchases of licenses – something it long did and still does – tends to be overlooked. For as late as the mid-1980s Korea paid 0,5 percent of GNP in royalties for licenses, five times what Latin America currently spends. Moreover, as was pointed out in a seminar on technology policy in CEPAL several years back, Korean firms came to Canada – knowing what technology they wanted and what other technologies were available in their stead in the rest of the world. Hence, they bargained from a show of strength or knowledge. Latin American firms, by contrast, were passive and laid back and often were sold licenses by Canadian firms without knowing clearly what the alternatives were.

I would like to have more details on all of these forms of "catch up". For East Asia, as Latin America, has only half caught up, so it still has a long way to go before it will have used up this source of growth.

Last, but not least, though the East Asian economies are all market economies, it is noteworthy that, except for Hong Kong, few are in the forefront of economic liberalisations. A ranking by the Fraser Institute by the degree of economic liberalisation shows that while Singapore is even more liberal than the US, the same is not true of Korea and Taiwan (who have the same amount as Sweden – *not* the hallmark of free markets). And what are we to say of continental China – the fastest growing economy of the last 20 years? Even Argentina and Brazil are well ahead of China in terms of economic liberalisation. Yet their growth rates are but a fraction of China's rates. Hence, it would seem that while a fair amount of economic liberalisation is necessary to have good growth, beyond a certain threshold, economic growth and degree of economic liberalisation are not closely related. Which is not to say that it might well be that in coming years greater liberalisation will be needed.

Which brings me back to Professor Park and associates' conclusion. While East Asia was in the catch-up phase, and so long as it continue to be so, it is quite understandable that active and interventionist policies have been successful, for the trajectory of the economy was reasonably predictable. Yet as East Asia approaches the technological frontier and international best practices, it will no doubt have to adapt its model to acquire an institutional frame more suited to such a condition. As the authors so correctly emphasise, these adaptations need to be consistent with East Asia's past model. In this sense, they must necessarily be path-dependent and should not be imposed or imported from outside. Given the forces of democratisation, political and economic governance will no longer be able to be handled by a limited technocratic elite, no matter how professionally competent. Similarly, while globalisation and freer financial markets are part of the present not to mention the future, the international financial architecture is not yet in place that can spare developing countries from severely disruptive speculative attacks. And until such an architecture is found and established it would be folly for East Asia to liberalise financially without limit or restraint.

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