WHY EAST ASIAN ECONOMIES HAVE BEEN SUCCESSFUL:

SOME LESSONS FOR OTHER DEVELOPING COUNTRIES

by

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Working Paper No. 92-2
May 1992

Abstract

By almost any standard, the countries of East Asia have outperformed other developing countries over the past three decades. While there is no "Asian Model" of development, there are some common threads that run through the development experiences of East Asian countries. These include an outward-looking strategy, intrusive but market-oriented government policies, macroeconomic policies that encourage savings and investment, and a social consensus for economic growth. The positive experience of East Asian countries has begun to influence policymakers in other developing regions.

Why East Asian Economies Have Been Successful: Some Lessons for Other Developing Countries[1]

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Introduction

The economic performance of East Asian developing economies over the past three decades has been observed with a mixture of admiration and envy by policymakers in many other developing countries. The spectacular rates of growth and the apparent (to outsiders) ease with which this growth was achieved have made the region the focus of intense study by development economists. Success has led not surprisingly to imitation: policy reforms currently underway in many developing countries are attempting to copy the policy successes of the Asian economies.

By almost any measure, the recent economic performance of East Asian economies has been astounding. Real gross domestic product in the Newly Industrializing Economies (NIEs) of Hong Kong, Korea, Singapore and Taiwan has grown between 7% and 10% per year **for thirty years.** Annual *per capita* growth has average 6.4%. In Taiwan, per capita GDP has risen ten-fold since 1960, and the NIEs as a group are quickly graduating from the ranks of developing to developed countries.[2]

The resource-rich economies of the Association of South East Asian Nations (ASEAN) have turned in lower but still robust growth records over the past several decades.[3] With the exception of the Philippines in the 1980s, ASEAN average annual per capita growth rates have been in the 3 to 4 percent range over the period; their even stronger performance in the past half-decade has made them the likely high-growth successors to the NIEs.

To the planner in Caracas or Cairo the question is whether and how the economic success of East Asia can be reproduced in other places. In particular, are their government policies that were instrumental in Asian economic success that might be usefully copied abroad. What are the lessons of East Asian success for other developing economies?

Elements of Asian Economic Growth

When we go searching for the secrets of Asian success, we should bear in mind that there is considerable diversity among the countries that make up the NIEs and ASEAN. The countries comprise a wide range of cultures, religions, ethnic groups and languages, and they started the development process from widely differing initial conditions. Among the NIEs, Hong Kong and Singapore are small city-states with no agriculture, while Taiwan and Korea are considerably larger with populations of 20 million and 42 million people respectively. Although all the NIEs are highly industrialized today, agriculture was a very important sector in Taiwan and Korea in the 1960s. Agriculture in Korea accounted for 37 percent of GDP in 1960.

The ASEAN countries are also very diverse. They range in population from less than 20 million in Malaysia to more than 50 million in the Philippines and Thailand and more than 175 million in Indonesia. Agriculture is an important, though relatively declining, sector in Indonesia and Thailand. Indonesia is a petroleum exporter and a member of OPEC. Malaysia also exports some oil.

These countries also differ politically. Some struggled for national independence: Indonesia, Korea. Some were more or less granted independence: Malaysia, the Philippines. Others were never colonized: Thailand; or never achieved full independence: Hong Kong.

Although they are widely different in some ways, the countries of East Asia share some common elements that appear to have been important in their development success. These common factors are the main focus of this paper.

Exogenous Factors (Luck)

It is tempting to think that Asia is different, that the Asian "economic miracle" is the result of a fortuitous combination of culture, proximity, and timing. The cultural argument has received considerable attention. Many people have argued that Confucianism, with its emphasis on hard work, saving, and education has been instrumental in the success of Japan and the NIEs. Certainly high savings rates have been helpful in supporting rapid domestic expansion without large external financing, and widespread education has created a large pool of literate and skilled workers in these countries. But these characteristics are not confined to countries with a Confucian tradition, nor have all countries with a Confucian tradition experienced rapid economic growth. In fact, Confucianism has been used to explain the stagnation that existed until recently in China. The recent success of ASEAN countries, which have a variety of cultural heritages, is evidence against a strict cultural theory of Asian success.

The close proximity of the high growth countries in Asia and the sequential manner in which they developed has been an important factor supporting their growth. The NIEs and later the ASEAN countries benefitted from the demonstration effect of Japanese post-war success and from access to expanding markets in their rapidly-growing neighbors. We discuss this so-called "flying geese" pattern of development further below.

Although such factors may have played a role in Asian development, much of Asian development success appears to flow from less exotic sources, especially from enlightened government economic policies. Governments of East Asian economies have adopted domestic policies that promote efficient use of resources and that encourage private-sector initiative. These policies include sound macroeconomic policies to stimulate savings and maintain price stability and market-oriented industrial policies that encourage competition and efficiency.

Domestic Resource Mobilization

An important factor behind rapid growth in East Asian has been the region's high rates of domestic savings that have fueled high rates of investment. Like Japan, the NIEs and ASEAN countries (with the exception of the Philippines) have either dramatically increased or maintained high levels of savings over the past three decades.[4] Korea increased its savings rate from only 1% in 1960 to 35% today; Singapore dissaved in 1960, but today saves more than 40% of GNP.[5] These high rates of savings are due in part to government policies that encourage savings, including measures to maintain positive real interest rates. This extensive redirection of income from expenditure to savings created a large pool of funds for domestic investment in infrastructure, productive capacity and education.

Savings and capital formation have been encouraged by the maintenance of government fiscal and monetary policies conducive to steady, non-inflationary growth. East Asian governments have placed a premium on fiscal responsibility and low inflation, and they have been willing to suffer short-term economic pain to support these goals. For example, Korea used a self-imposed austerity program in the 1980s to keep servicing requirements on its large foreign debt from overwhelming its current account. Their ability to succeed in this clearly depends on a fairly high degree of social stability and public acceptance of these measures, an issue to which we return below.

Outward-Looking Policies

One of the most visible features of developing East Asian economies has been the importance of export growth in their development. Trade has truly been an engine of growth in the region. During the 1970s, exports grew by 27% in Korea and by more than 10 percent in the Philippines, Singapore, and Thailand. In the 1980s, when world trade grew at about 2 percent per year, the NIEs, Malaysia and Thailand saw exports grow by more than 10 percent per year, and in Indonesian and the Philippines exports grew at rates exceeding 6 percent. As a result, the NIEs' share of world exports rose from less than 2 percent in 1960 to more than 8 percent by 1988.

The key to the export success of Asian developing economies is their early rejection of import substitution policies in favor of outward-looking policies. Import substitution policies were favored by many developing countries in the early post-war period. Such policies have an obvious political appeal, both for nationalistic reasons and because they provide a quick initial spurt of economic growth as domestic demand rises to replace imports. The welfare costs of import-substitution are well known. High trade barriers protect inefficient domestic industries from foreign competition and prevent specialization to take advantage of international gains from trade. Dependence on domestic markets alone may lead to inefficiently small scale of plants and inferior technology. The import-substituting country will likely get little help from exports, since restrictive import policies appreciate the real exchange rate and raise domestic production costs through high prices of imported inputs.

The export-oriented strategy of East Asian developing economies allowed them to exploit their comparative advantage—the production of labor-intensive export goods. Specialization in such goods also meant that labor would share in the proceeds of rapid growth, as wages rose with the increasing marginal product of labor. Outward orientation exposed Asian firms to the "discipline of the market," forcing them to become efficient in order to compete internationally, and ensuring that they would evolve along with changing world demand patterns.

Agricultural Progress

Although we tend to associate Asian economic success with manufacturing prowess, agricultural growth has played an important role in East Asian development success. Agricultural production in the NIEs and ASEAN countries increased substantially in the 1970s and 1980s with the introduction of "green revolution" technology and development of markets and infrastructure in these countries. In addition to improving nutritional standards, growth in agriculture aided the growth in non-farm sectors of the economies. Agricultural processing sectors benefitted directly. As farm incomes rose, peasant farmers increased demand for the consumer products of the emerging manufacturing goods industries. Foreign exchange earnings from surging agricultural exports assisted the import of capital goods needed by expanding industry.[6]

Investments in Human Resources

The rapid industrialization that has occurred in Japan, the NIEs and the ASEAN countries would not have been possible without substantial growth in the skills, knowledge, and ability of domestic labor forces. The countries share a common commitment to education, introducing universal primary education, and later secondary, teachers' colleges, and advanced universities. They have also made substantial investments in other programs that enhance human resources, including health care and family planning. In Taiwan, a clinic with family planning, immunizations and basic health care services was within walking distance of every village by 1960. Government policies to improve nutrition and control population growth have been important in improving the quality of life and of human capital in these countries.

Successful Implementation of Growth Policies

We might agree that the policies just described are conducive to economic growth, and yet wonder at the apparent ease with which they were implemented and sustained eliminating many of the policies that discriminated against exports, such as import quotas and licensing requirements, and they began providing incentives for industries with export potential. Several countries devalued their previously-overvalued currencies. The shift toward manufactured exports has been dramatic. Indonesia has seen manufactured exports rise from 7 percent of total exports in 1984 to 25 percent in 1989.[7] Even in the Philippines, where reforms have been slower to work, manufactured goods export earnings rose from 16 percent of total exports to 66 percent between 1975 and 1988.[8]

Although Japanese growth was admired by these countries, it was the success of Korea and Taiwan that was most influential in changing the policy orientation of ASEAN governments. Korea and Taiwan had begun their development surge from not much higher than the typical ASEAN country, so their success demonstrated that rapid growth was not an unreachable goal.

The staggered transition of East Asian economies to export-oriented development policies was beneficial in several ways. The example of successful Asian neighbors was clearly influential in changing government thinking about development policy. The rapid growth of Japan in early years provided a booming market for the primary product exports of the other countries. As Japan and then the NIEs moved up the industrial ladder to more capital- and technology-intensive products, the ASEAN countries were able to take their place as producers of textiles, clothing, light manufactures, and recently high tech "commodities" like computer components. Japan provided a ready supply of capital and technological know-how to support industrialization in other countries in the region, a role that the NIEs are now beginning to play within ASEAN. This distinctive pattern of development, with Japan pulling along the NIEs, who pull along the ASEAN countries, has been called the "flying geese pattern" of development.

The United States has also contributed to growth in East Asia, most importantly by providing a large and relatively open market for exports. The countries of this region (including Japan) are production, not consumption, centers; domestic markets in the region alone would not have been able to sustain such rapid export-led growth. Early on, the U.S. also provided much of the foreign direct investment in the region, although Japan, and increasingly the NIEs, have replaced the U.S. as a primary source of foreign capital. Finally, the "security umbrella" of U.S. military presense in the region permitted East Asian countries to minimize military expense and created a stable environment able to attract long term capital investment.

Pro-Market Government Intervention

The hand of government is very visible in the workings of East Asian economies, but its behavior is quite different than in many other developing countries. Rather than operating numerous government enterprises and tightly controlling the allocation of factors of production, East Asian governments have generally emphasized market- and private sector-oriented policies. This feature has become even stronger in recent years as the NIEs and increasingly the ASEAN countries as well have moved further to implement policies that increase efficiency, including deregulation, enterprise reform, and privatization.

The Asian countries are far from *laissez-faire* economies. Governments in these countries went well beyond the traditional neoclassical role of providing public goods such as infrastructure, justice, defence, and education. They also set industrial objectives and steered investment activities through a wide range of incentives. This is especially true in Korea, where the government still maintains a significant amount of control. But the thrust of such activities was generally to facilitate private sector activities by maintaining a relatively open economic environment and "getting prices right," so that home industries would be competitive on world markets. When industries were protected during their gestation period, it was made clear that the protection was to be temporary, and that the industry would have to become competitive relatively quickly. Direct participation in the form of government enterprise was relatively uncommon. This strategy of strong government policy in conjunction with a private sector-oriented approach has been called "neoclassical intervention."

The strong pro-market government intervention practiced by East Asian developing economies is not without its problems. The strategy of "picking winners" is fraught with danger. It may be fairly easy in the early stages of development to pick the winners—textiles, garments and other light manufactures are natural choices. but this gets more difficult when the sectors involved are heavy- and high-technology industries. It is not easy to anticipate changes in comparative advantage in later stages of more capital-and-skill-intensive production, and mistakes can be costly. Both Korea and Singapore made major mistakes in the early 1980s and had to make substantial revisions in their development plans.

Another important feature of government policy in Asian developing countries has been the consistency with which its basic thrust has been maintained over years and decades, and the adaptability leaders have shown in adjusting the details as changing circumstances required. We have noted above that governments in these countries have been very successful in maintaining macroeconomic policies that are conducive to capital formation and non-inflationary growth. Political stability in many of these countries has made this an easier task than in some other developing regions. But even countries that have experienced changes in governments—Thailand had several coups during the 1970s and another last year—have managed to keep their basic macro and industrial policies intact. This has created a stable, predictable economic environment within which business can operate effectively. But governments have also been flexible when that was necessary. Countries were willing, for example, to discard policies that targeted high-tech development when these plans turned out to have been ill-advised.

A Social Consensus for Development

Developing countries in East Asia have experienced relatively little of the social conflict that has marred development efforts in some other regions. The manner in which development strategies were designed and the way that growth proceeded helped to create a consensus among government, business, intellectuals and the populace in favor of development reforms. This consensus made possible a more rapid implementation of development policies than would otherwise have been possible.

In some respects, the limited social conflict over development resulted from a happy historical accident that there was no strong existing ideological opposition to capitalism or western-type industrialization. Intellectuals and politicians were less concerned with North-South relations and more concerned with real economic results. Economic growth was essentially a national policy, and the Asian governments used economic growth to legitimize their regimes.

Business commitment to development policy was guaranteed by the close cooperation between business and government in establishing economic policy. In the Asian form of capitalism, the government and business consult closely with one another. This is in marked contrast to the adversarial relationship between government and business in the West. This close cooperation not only helps to ensure that economically-sound policies are adopted, but also that a constituency exists that supports (indeed has a vested interest in) these policies. Japan is well known for its close working relationship between government and business but this kind of capitalism is not limited to Japan. In Korea, considerable efforts have been made to engage the industrialists, bankers, and government officials in deliberations concerning the selection of appropriate investment projects. In Thailand, the Joint Public and Private Sector Committee, which is chaired by the Prime Minister, brings together government officials and businessmen in an ongoing policy dialogue.

This cozy relationship between business and government can have drawbacks, of course. There becomes a fine line between cooperation and corruption, and irregularities such as the Recruit scandal and the recent Japanese banking scandal are likely to arise from time to time. To avoid such problems, it is important to create as transparent relationships as possible and to maintain accountability through bureaucratic or elective means.

Perhaps most important in forging a social consensus in Asian developing countries has been the commitment of the general population to development policies. Here, the absence of strong labor unions in most Asian countries made this easier to achieve. But the manner in which development progressed was equally important. early success of labor-intensive light manufacturing industries meant that labor shared considerably in the economic gains from the early stages of industrialization. At the same time that average incomes rose in these countries, income distributions also became more equitable. The policy planks that stressed education and health care also directly benefitted the masses.

The Limits to East Asian Growth

Although economic growth in East Asia has been impressive, it has not come without problems. The past few years have shown that there is such a thing as too much (or at least too fast) economic growth. Rapid expansion has begun to test the limits of existing resources—of skilled labor, infrastructure, and the environment. Real wages have risen rapidly, undercutting competitive advantage in labor-intensive manufactures. demands for faster wage growth has become more vocal; Korea has experienced labor agitation over the wage issue in recent years. The NIEs especially are being squeezed from above and below, being forced to provide more income for their citizens while facing increasingly competitive products from China and Southeast Asia. In many countries roads and utilities are overloaded by the demands of new factories and their workers. Deforestation and declining air and water quality are environemental costs. In coming years, East Asian governments face the prospect of sharply higher spending on infrastucture and training, and a reorientation of capital investment toward technically-sophisticated products, if they are to continue the steady improvement in living standards that they have seen in the past three decades.[9]

The East Asian economies are also facing a less hosptiable external environment for their products. Trade friction between the U.S. and Japan spills over to U.S. trade relations with other Asian countries, threatening more restrictive U.S. import markets in the future. Because the U.S. is by far the dominant market for many Asian exporters, there is a serious need to prevent further trade deterioration and to seek out new markets in Europe and Asia.[10] New discriminatory trade blocks also threaten to divert trade away from Asian countries. Countries in the region are particularly concerned about the possible inclusion of Mexico into the North American Free Trade Area, fearing that products produced with inexpensive Mexican labor will have a competitive edge in the U.S

Developing-Country Responses to East Asian Success

The impressive development record of East Asian countries has not been lost on the rest of the developing world. As countries have begun to adjust to the reality of terms of trade deterioration and have attempted to escape from under the weight of the debt crisis, many have adopted economic restructuring programs that incorporate some of the elements of East Asian experience.

These efforts have already begun to bear fruit. Nowhere have signs of an economic turnaround been more evident than in Latin America. The backdrop for Latin American reform was fairly grim. After substantial rates of growth in the 1960s, growth in Latin America slowed in the 1970s and fell even further in the 1980s. For some countries (Uruguay, Argentina and Bolivia), per capita GDP is now at or near the level it was in 1960. Only Columbia, Mexico, and Brazil have seen average per capita GDP growth above 2% over the last three decades. (Brazil experienced 4% average per capita growth.) As a result, levels of per capita income for Latin American countries have fallen relative to those in East Asia. Most Latin American countries still have per capita incomes greater than East Asian countries (except for Hong Kong and Singapore), but that gap has narrowed considerably.

In the past several years, economic reform programs in Latin America, especially in Mexico, Chile, Columbia and Venezuela have begun to turn the tide. Mexico has returned to growth in the 4-5 percent range, with investment growing in the 8-10 percent range. Venezuela and Chile have enjoyed similar or higher growth rates in the past two years. Columbia, still struggling with domestic terrorism, has maintained growth in the 3 to 4 percent range recently.

A primary element of Latin American reforms has been a renewed emphasis on market mechanisms. Mexico, for example, has completed a comprehensive program of trade liberalization, financial deregulation and privatization. Other countries have followed suit, reducing tariff walls, renegotiating with developed country banks and the IMF to reduce still heavy debt burdens, and reducing budget deficits to get their fiscal houses in order. Inflation rates are at manageable levels of 20-30 percent in Mexico, Chile, Columbia and Venezuela, although they are still in the hundreds of percent in Brazil, Argentina, Peru and Uruguay. A consensus for reform seems to have emerged in Latin America. An *Economist* magazine article summarizes the mood:

> "Avoid fiscal deficits and restrain monetary growth. Keep the exchange rate realistic and liberalize currency controls. Cut import tariffs to 20% or less, to keep local producers competitive and push them to seek markets abroad. Abolish those easy-to-collect taxes on exports. Keep real interest rates positive. And privatize. The buzzwords are sustained, non-inflationary, export-led growth."[11]

The financial markets have responded favorably to these reforms. Latin American stock markets are booming, fueled in part by a return of domestic capital that had fled abroad. The privatized Mexican telephone company is one of the most actively-traded stocks on the New York stock exchange. The value of Latin American debt in secondary markets, which had traded at steep discounts less than two years ago, has risen by about 20-30% of face value since then.

These reforms have not come painlessly, of course. The sharp cuts in government spending have reduced expenditure on basic services like water, sewers, schools and hospitals. Unemployment has grown in most countries, and the number of people below the poverty line has increased. So far, however, no political firestorm has developed. Presidents in Mexico and Argentina were reelected in spite of economic hardships. Nevertheless, the governments in Latin America face a serious tradeoff between the pace of reform and social unrest.

Lessons for Egypt (an Outsider's View)

In many ways, to the outsider Egypt looks like the archetypal developing country of the 1990s. It has lived through a period of reliance on import-substituting development policies, and now maintains a large government sector, centrally-controlled production and allocation, and an export sector dependent on oil and the Suez canal. The burden of high levels of government spending has led Egypt to accumulate a heavy load of international debt, and to resort in part to seigniorage with its associated inflation. Like other developing countries, it is trying to implement market-based reforms, but progress is impeded by entrenched bureaucracy and fear of social unrest. A brief look at the Egyptian situation suggests the benefits from pushing forward with such reforms, as well as the difficulty in doing so.

The legacy of import-substitution in Egypt is certainly familiar to many of this audience. Development in Egypt has traditionally been heavily managed from the center to promote import-substituting production. As a result the country has a massive public sector. In recent years, government expenditures have constituted nearly half of GDP. Many non-government industries are heavily subsidized either through direct subsidies, or, more importantly, through implicit subsidies from price controls. The most important of these are regulated energy and food prices. These subsidies and the large government payroll have necessitated heavy foreign borrowing (when that was available) and more recently increased printing of money. Inflation, meager net savings, and heavy resource transfers abroad have been the result. The extensive system of implicit and explicit subsidies contributes to microeconomic price distortions that are "internationally notorious."[12] The resulting pattern of financial rates of return has almost no relationship to estimates of the true economic rates of return.[13]

In the past several years, the government of Egypt has made efforts to reduce the macro and micro distortions created by large and intrusive government. Real interest rates, which had been negative, have been made more realistic, reducing the disincentives to save. The government hopes to stabilize its budget deficit at a "manageable" 10% of GDP through a new sales tax and paring down of direct subsidies and reduction of public sector real wages. Much of the remaining government deficit is now financed by debt rather than bank loans, reducing inflationary pressure.[14] Price increases for fuel, electricity and communications have been pushed through. By being on the "right side" in the Gulf War, Egypt has received forgiveness or favorable rescheduling on $25 billion in foreign debt. The government may be on the way to establishing a more stable macroeconomic environment, and one conducive to capital formation.

The heavy control of industry prices remains a severe obstacle to a more efficient economy. A successful shift to export-led growth would require elimination of price controls that discriminate against goods for which Egypt potentially has a comparative advantage in favor of others for which it clearly does not. The current system has reduced cotton exports to a small fraction of their 1970s levels and has increased Egypt's dependence on expensive imported food. Meanwhile production of capital-intensive goods, such as aluminum, has expanded. This costly scheme not only fails to create competitive goods for the world market, but increases unemployment by displacing workers from labor-intensive sectors.[15] Prices of inputs—energy, agricultural products, capital—must be restored to market levels before incentives for efficient production will exist.

The overwhelming size of the public sector in Egypt will make the transition to market-oriented industry more difficult. An increased role for the private sector will require substantial dislocation of public-sector employees. For this reason, the government appears to be moving conservative toward more decentralization of decision making within the public sector rather than extensive outright privatization.[16] It seems doubtful that this will radically improve the efficiency of state enterprises. Bureaucratic rigidity and infighting also make wholesale change more difficult to implement.

In the case of the East Asian countries, supporting the development efforts was a consensus on the part of government, business, intellectuals and the citizenry that the development program was desirable. It may be difficult to forge such a consensus in Egypt. The anti-imperialist and socialist traditions in Egypt shape thinking in government: "There is so little agreement within Egypt on the appropriate economic and social path the country should be following—whether socialist, capitalist, or Islamic—that various voices within individual ministries compete for President Mubarak's attention."[17] There are also a large number of businesses with vested interests in the status quo.

Getting the populous on board will also be difficult. The social cost of reform is potentially very great. Reduction of food subsidies or basic social services from a growing, impoverished population will be painful. The government remembers well the 1977 bread riots in which 100 people died, and is wary of opportunism by Islamic fundamentalists. The government of Egypt needs to facilitate quick and visible relocations of workers to the new growth industries, whatever they may be, in order to demonstrate the gains to the general public from market-based reforms.

Conclusions

By any reasonable standard, the NIEs have outperformed all other developing countries in the past three decades. The ASEAN countries have also been relatively successful. While exogenous factors such as initial conditions, location, and culture may have played a part in this success, they were not of primary importance. The common element in each of these success stories appears to be consistently-applied, sound economic policies. Asian developing countries have embraced outward-looking development strategies that promote industrial competitiveness within a conservative, non-inflationary macroeconomic environment conducive to savings and investment. These countries have emphasized social programs—education, training, health care—that raise the quality of human resources and that help generate a social consensus for economic growth.

The experience of these countries suggests some general principles that may guide policy design. Government policies can be implemented more effectively and with less distorting effects by using indirect controls that work through the price mechanism rather than direct controls. Fiscal and monetary restraint that encourages stable prices and exchange rates is important for maintaining a healthy environment for saving and investment and for protecting price competitiveness of the country's goods. Trade, financial, industrial and labor policies all contribute to these goals.

Unfortunately, neither economic theory or the East Asian experience gives us a clear road map to follow in achieving these goals. Lowering tariff barriers, depreciating the exchange rate, removing exchange controls, and reducing the role of public enterprises may all be beneficial in creating the appropriate development environment, but there is little in the Asian experience to tell us what is the best sequencing, timing or speed of the various reforms. In the Asian experience, many alternative approaches have been used. Taiwan, for example, emphasized competition within the domestic economy, and its economy has many small firms and no extremely large ones. Korea, however, based its development on a few large conglomerates. Both Taiwan and Korea have kept tight control over capital flows, while the ASEAN countries generally have had more liberal financial policies. Indonesia, for example, liberalized capital flows at a much earlier date than trade flows. These different experiences suggest the need for a flexible approach that seeks out what works best in any specific country.

Aside from uncertainties about the timetable and sequencing of reforms, there are roadblocks along the way to outward-looking, market-oriented reform. First, a reduction of import protection and removal of subsidies to public enterprises will lead to bankruptcies, and unemployment will rise in some sectors. This can generate intense political opposition to liberalization and privatization. The reform package must include policies to speed the reallocation of resources toward export sectors.

Second, a depreciation of the exchange rate and trade liberalization may lead to balance of payments problems. Because of likely short-run J-curve effects, imports may increase faster than exports initially, and programs to accelerate export response would be helpful. Cheap export financing in the short run may allow a faster export response.

Third, inflation may tend to rise under devaluation, reducing the favorable effects on competitiveness. The uncertainty associated with inflation will also reduce the incentives for savings and investment. Maintaining reforms at all becomes difficult if inflation gets out of hand. Therefore, anti-inflationary stabilization policies must be adopted in conjunction with the liberalizations.

Fourth, favorable external conditions are important for a successful shift to outward-looking growth policies. There has recently been some concern that the world trade environment is not big enough to accommodate the increasing number of developing countries that are turning to outward-looking policies. This "new export pessimism" is based on concerns that developed country markets could become flooded with goods from developing country exporters. But the world export market is not fixed. Increased trade liberalization should create new opportunities for gains from trade for all countries. And from the standpoint of an individual country, it is always possible to take over the market share of other countries by becoming more competitive. Finally, comparative advantage is a dynamic process. As Japan developed, rising wages in Japan meant its advantage in labor-intensive manufactures was lost to the NIEs. Japan moved on to technology-intensive goods. Similarly, the NIEs are now seeing their comparative advantage in labor-intensive goods eroded by competition from ASEAN countries.

This discussion, however, does point out the strong interest that developing countries have in maintaining an open world trade environment. Developing countries may stand to lose the most if the world trading system deteriorates into a set of "Fortress

Europes" and "Fortress North Americas." Developing countries should be strong advocates for multilateral free trade, and they should be willing to demonstrate their commitment by making concessions of their own at the bargaining table.

1. Presented at the conference, "The New Development Economics in Global Context," at the American University in Cairo, May 28, 1992. Thanks to Bill Fox for helpful comments.

2. Seiji Naya and Pearl Imada, "Development Strategies and Economic Performance of the Dynamic Asian Economies: Some Comparisons with Latin America," *The Pacific Review* 3, 4, 1990. Development statistics in the following pages are also taken from this source unless otherwise noted.

3. ASEAN was formed by Indonesia, Malaysia, the Philippines, Singapore and Thailand in 1967 (Brunei became a sixth member in 1984) for reasons that were more political and diplomatic than economic. But reflecting changed politics and economic conditons in the region, the countries have recently begun to cooperate more extensively on economic issues. The ASEAN countries agreed in January of this year to form a free trade area over the next 15 years.

4. The Philippines has traditionally had savings rates below those of other ASEAN countries, and Philippine savings rates further declined during the 1980s, probably largely a result of sluggish growth and economic uncerstainty associated with political instability.

5. The dramatically high rate for Singapore is partly the result of a system of forced savings into a mandatory retirment plan, the "Providence Fund." Whether forced or not, these funds represnt a large pool of resources available for financing investment.

6. See William E. James, Seiji Naya, and Gerald Meier, *Asian Development: Economic Success and Policy Lessons*, University of Wisconsin Press, 1989, Chapter 5.

7. Asian Development Bank, *Asian Development Outlook 1991*, p. 89.

8. Icay, Maria Cecilia, "Manufactured Exports: Its Role in Philippine Development," U. Hawaii mimeo, 1992.

9. Seiji Naya, "Asian NIEs and the New Latin America: Growth Imperatives for Korea (an Outsider View)," presented at the International Trade and Business Institute, Seoul, Korea, February 18, 1992.

10. See Byron Gangnes, "Can ASEAN Countries Survive a Hostile Trade Environment? Evidence from Linked Econometric Models," presented at the conference, "Exports, Foreign Investment, and Growth in East and Southeast Asia: A Model Simulation Workshop," the International Centre for the Study of East Asian Development (ICSEAD), Kitakyushu, Japan, 1-2 August, 1991.

11. The *Economist*, October 19, 1991. pp. 22-24.

12. Alan Richards, "The Political Economy of Dilatory Reform: Egypt in the 1990s," *World Development* 19, 12, 1991, p. 1724.

13. World Bank, "Arab Republic of Egypt: A Study on Poverty and the Distribution of Income," draft report, Jan. 5, 1989, p. 22, as cited in Richards (1991).

14. The *Economist*, Jan 18, 1992, p. 43 and Richards, 1991.

15. It also likely increases the budget deficit. If government enterprises were allowed to earn a market ratre of return, net government revenues would increase. One study estimates that raising rates of return to 10% (still below the market rate) would improve the Egyptian budget deficit by about LE 1200 million. See William F. Fox, "The Effects of Public Sector Price Increases on the Egyptian Government Budget," University of Tennessee, mimeo,

16. Richards, 1991, p. 1728.

17. Denis J. Sullivan, "The Political Economy of Reform in Egypt," *International Journal of Middle East Studies* 22, 1990, p. 319.