

Chapter 6. The East Asian Development Experience

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1. Introduction

During the second half of the 20th century East Asia has been the most dynamic part of the world economy. At the same time, their policy practices and institutions have often significantly diverged from what many people, including many East Asians themselves, regard as the 'best practice' ones found mostly in the Anglo-American economies. As a result, the East Asian economies have been at the centre of the debate in development economics since the 1960s, starting with the case of Japan, and then involving the other economies in the region.

More recently, of course, the decade-long economic stagnation in Japan and the financial crises of 1997 in countries like Korea, Indonesia, Thailand, and Malaysia, took some gloss off the region and suddenly let loose some people who claim that there never was a miracle in East Asia and that these economies were really very inefficient and corrupt economies propped up by government bail-outs. Whatever one's view on the recent events is, they should not obscure the fact that over the last few decades the region has achieved the fastest economic and social transformation in human history, which is why East Asia is such a key case in many debates in development economics.

2. The Definitional Issue

Unusually for a geography-based category, the very definition of 'East Asia' itself is a matter of controversy. The most widely-accepted definition, which is also adopted this chapter, includes in this category Japan and the so-called first-tier NICs (Newly Industrializing Countries) of South Korea (henceforth Korea), Taiwan, Hong Kong, and Singapore. The origin of this definition is rather obvious – the spectacular performance of these economies between the mid-1960s and the mid-1980s is what started the debate.

However, since the early 1990s it has become increasingly common to include the so-called second-tier NICs of Southeast Asia – such as Thailand, Malaysia, and Indonesia – in the discussion of East Asia. More recently, others have come to believe that China and Vietnam should also be included, as since the 1980s these economies moved away from Communist isolationism and have enjoyed rapid growth of the kind observed only in the above-mentioned countries.

This definitional issue is not just a pedantic one, but has an important practical implication. For, depending on one's definition of 'East Asia', the lessons that we draw from it can be quite different. For example, if we were to include only what I call the 'original five' of Japan and the first-tier NICs in this category, we are likely to conclude that active state intervention is beneficial for economic development (Hong Kong being the exception that proves the rule). On the other hand, the inclusion of the Southeast Asian second-tier NICs, which developed on the basis of much less state activism than the 'original four' (that is the 'original five' minus Hong Kong), makes it possible to argue that a high degree of state activism may not be necessary for rapid development.

In this chapter I use the term East Asia to mean the 'original five' for two reasons. First of all, it is only during the 1990s that people have started to define East Asia to include the second-tier NICs and the former Communist economies of China and Vietnam, and therefore most of the existing debates have been conducted with specific reference to the 'original five'. Introducing the new countries therefore can blur the focus of many existing debates, which some people have exploited in an attempt to discredit the 'East Asian model' as originally conceived.¹ Second, while the performances of the 'new wave' economies are very impressive, their performances are still no match to those of the 'original five'. The latter grew faster and for longer than the 'new wave' countries have, and have broken into the rank of the advanced economies, while none of the 'new wave' countries have done so (and are unlikely to do so in the near future).

3. Comparative Performance

During the second half of the 20th century, per capita incomes in the East Asian economies as we define them (the 'original five') have grown at five to six per cent per year. Given that the per capita income growth rates of the European and

the North American economies were typically not much above one per cent during the Industrial Revolution and just over three per cent even during the so-called 'Golden Age of Capitalism' (roughly 1950-75), this means that growth during this 50-year period in East Asia has been literally the fastest in human history.

What is especially notable about the growth records of the East Asian economies is that their rapid growth is an entirely postwar phenomenon. Estimates of earlier performance are not totally reliable, but the highly respected historical study of the 32 largest economies of the world by Maddison (1989) puts the yearly per capita income growth figures of Japan, Taiwan, and Korea during 1900-1950 at one per cent, 0.4 per cent, and 0.1 per cent respectively. Not only are these very low by their own postwar standards, they are also quite low by international standards of the time.

During this period, the Japanese per capita income growth rate of one per cent was not only below average among the 17 major industrial countries (including the USSR) that were included in Maddison's study – Japan ranked the joint 11th (with Germany and the Netherlands) among the 17 countries – but it was also lower than those of the six largest Latin American countries covered in the study (ranging from 1.8 per cent for Brazil and Chile to 1.2 per cent for Mexico and Peru). The Taiwanese and the Korean performances were even worse. Taiwan ranked the joint 24th (with the Philippines) and Korea the joint 26th (with Thailand) among the 32 countries included in the Maddison study – the last 5 places were taken up by Indonesia, India, Pakistan, Bangladesh (all of them grew at -0.1 per cent per annum) and China (-0.3 per cent per annum). The rapid postwar growths of the East Asian economies were, therefore, completely unexpected from a historical point of view.

The postwar growths in the East Asian economies are also notable in that they have resulted in remarkable improvements in social indicators, something that not all experiences of rapid growth have led to. The records of these economies in terms of improvements in infant mortality, life expectancy, educational achievement, and other indicators of 'human development' have been very impressive. Of course, this is not to say that everything has been rosy in these countries. Political authoritarianism, human rights violation, corruption, union repression, gender discrimination, mistreatment of ethnic minorities, and so on, have all been problems in one degree or another in most of these economies. However, despite these blemishes, it would be fair to say that during the second half of the 20th century the

¹ World Bank 1993 is the supreme example of this. More on this in section 4.3 below.

citizens of the East Asian economies have experienced improvements in income and general well-being that were unparalleled in human history.

4. The Debates on East Asian Miracle

4.1. The Debate on Japan

Outside interest in East Asia obviously began with that in Japan. The initial debate on Japan was strongly influenced by the fact that, until the mid-1970s, it remained the only industrialized country of non-European extraction. Some participants in the famous debate among Marxist economic historians regarding the 'transition from feudalism to capitalism' tried to attribute this to the uniquely 'European' (that is, decentralized) nature of Japanese feudalism (Sweezy et al. 1976). In contrast, some others tried to explain this in terms of the uniquely 'collectivist' nature of the Japanese variety of Confucianism, which puts emphasis on group loyalty over personal edification that had been emphasized by the Chinese and the Korean varieties of Confucianism (Morishima 1982). The subsequent industrialization of other parts of Asia as well as the recent academic debates have revealed some problems with these early emphases on Japan's uniqueness, but the earlier debates were useful in bringing our attention to the role of social structure and moral values in economic development.

During the late 1970s and the early 1980s, Japan's spectacular industrial success and the decline of many other industrialized countries generated a heated debate, especially in the USA, on the role of Japanese-style industrial policy.² Some argued that the centralized coordination of investment and technological upgrading (but not 'planning' in the Soviet sense) helped the Japanese firms aggressively invest in 'sunrise' industries with large productivity growth potential and widespread externalities (Magaziner and Hout 1980; Johnson 1982). Others argued that the Japanese industrial policy was not very extensive and not very effective even in those few areas where it existed. They also pointed out that the success of industrial policy in Japan depended very much on the unique bureaucratic structure and the collectivist nature of the country's culture and therefore that it cannot be emulated elsewhere (Schultze 1983; Badaracco and Yoffie 1983).

Numerous studies that followed have revealed that the pro-industrial-policy authors had empirical facts on their side. Moreover, increasingly sophisticated

theoretical arguments were provided to make sense of the Japanese-style industrial policy, which could not easily be comprehended through the dominant framework of Neoclassical economics (Dosi et al. 1989; Chang 1994; Stiglitz 1996).³

4.2. The Early Debate on the East Asian NICs⁴

In contrast to the debate on Japan, in the debate on the first-tier NICs, the very existence of state intervention was a matter of controversy in the early days. Initially, many mainstream economists argued that the spectacular success of these economies owed mainly to their free-trade and free-market policies. Of course, these days, few people believe that the East Asian NICs, obviously except Hong Kong, developed on the basis of free market. However, I will start this section with the free market view, because the more recent mainstream explanations are basically attempts to save its policy conclusions, while recognizing the existence of state intervention in these countries

According to the early mainstream explanation, Taiwan and Korea initially pursued import-substitution industrialization (ISI) policy that was popular in the early postwar period. However, this quickly ran out of steam, and, unlike many other developing countries that stuck to ISI, these countries switched to free-trade, free-market policy – in the late 1950s in the case of Taiwan and the mid-1960s in the case of Korea. They introduced a unified, realistic exchange rate regime³ and liberalized trade (e.g., Ranis and Fei 1975; Balassa 1982). These policies were regarded as having radically improved the performances of their economies. First of all, it was said, realistic exchange rates allowed them to follow their comparative advantages in labour-intensive industries, and therefore to reap more gains from trade. Second, trade liberalisation improved the efficiency of the economy by exerting greater competitive pressures on domestic producers.

² For reviews of this debate, see Thompson 1989; Chang 1994 ch. 3.

³ In the 1980s, growing attention was also being paid to the secrets of Japanese corporate success. Many argued that the structures of corporate governance, financing, and production organization that characterize the Japanese firms provide them with distinctive advantages over the 'Western' (or rather Anglo-American) firms, as they encouraged long-term commitment and productive investment (see Dore, 1987; Best, 1990; Aoki & Dore (eds.), 1994). While no other country could and did import the Japanese institutions of corporate governance and production organization wholesale, the Japanese corporate success has led to a widespread emulation of certain aspects of Japanese production techniques and management skills since the 1980s all over the world.

⁴ In this section, like most of the literature, I will focus on Taiwan and Korea, given the exceptional nature of Hong Kong and Singapore as city-states.

However, a number of researches published in the early- to mid-1980s revealed that this was a fundamentally misleading picture (Jones and Sakong 1980; Amsden 1985; Luedde-Neurath 1986). They showed that the extent of trade liberalisation was rather limited, while foreign exchange rationing continued, especially in Korea which had a persistent balance of payments problem. They also documented the extensive array of trade and industrial policy measures deployed by these governments with a view to upgrading their industries. Also, as Chang (1993) later pointed out, the early Neoclassical explanation was not convincing even in its own theoretical terms. First of all, a more liberalized economy is not necessarily more efficient, even in purely Neoclassical terms – the Second Best Theorem of Lipsey and Lancaster states that the removal of market distortions in some but not all markets does not guarantee that the economy achieves higher allocative efficiency. More importantly, even as one of the leading Neoclassical trade economists, Anne Krueger admits (Krueger 1980), there is nothing in Neoclassical theory that tells us that an allocatively more efficient economy will grow faster. Indeed, from a Schumpeterian point of view, where ‘monopoly rent’ (or ‘entrepreneurial profit’ as Schumpeter calls it), is necessary for people to invest in innovation, allocative *inefficiency* is an inevitable feature of a dynamic economy (of course, the reverse is not true).

4.3. The More Recent Debates on East Asian Miracle

In response to the above-mentioned criticisms, some mainstream economists argued that the widespread import protection in the East Asian countries did not have ill effects, because their governments countered them with export subsidies, thus maintaining a ‘virtual free trade’ regime where there existed incentive neutrality between exports and production for the domestic market (Little 1982; World Bank 1987). Others, however, have shown that there was nothing ‘neutral’ about trade regimes in these countries. They argued that the trade regimes prevailed in these countries was a deliberate mixture of infant industry protection, relatively free trade in inputs (especially inputs for exports), and export subsidies, rather than a simulation of free trade as the theory of virtual free trade would have us believe (Wade 1990; Chang 1993).

In the late 1980s, there was a full frontal attack by a group of heterodox economists and other social scientists on the then orthodoxy of ‘free market, free trade East Asia’ (Amsden 1985, 1989; Wade 1990; Chang 1993). They emphasized

that all the first-tier NICs except Hong Kong practiced Japanese-style strategic industrial policy. They argued that these countries promoted industries with high growth potential and widespread externalities through an array of means, which included: infant industry protection; export subsidies, including tariff rebates on imported inputs used for exports; coordination of complementary investments; regulation of firm entry, exit, investments, and pricing intended to 'manage competition'; subsidies and restriction of competition intended to help technology upgrading. They also argued that these countries could successfully import and assimilate foreign technologies because they could: skillfully integrate their education and training policies with industrial policy; effectively initiate and subsidize private-sector R&D while also providing public-sector R&D in key areas; and deliberately regulate technology licensing and foreign direct investments in a way that maximizes technology spill-over.

Many of those who emphasize the importance of industrial policy in the first-tier NICs draw our attention on the existence of what Chalmers Johnson (1982) calls the 'developmental state' in these economies.⁵ The proponents of the developmental state thesis argue that what distinguishes the East Asian states from other states most clearly is not the policy tools that they used but their greater degree of autonomy from interest groups that enabled them to discipline the recipients of their supports when performance lagged. Evans (1995) advanced this argument further and developed the notion of 'embedded autonomy'. He argued that the state autonomy possessed by the East Asian states was particularly beneficial because it was embedded in a dense policy network that linked them with the private sector, which provided a vital channel for information collection and interactive learning in the policy process.

The 'heterodox' attack since the late 1980s prompted the World Bank, as the leading proponent of the orthodox interpretation of the East Asian experience emphasizing the role of market forces, to respond with the famous *East Asian Miracle* Report (henceforth EAM) in the early 1990s (World Bank, 1993). The EAM acknowledged that there had been extensive state interventions in the East Asian economies and that some of these have been beneficial. However, it argued that industrial policy in these economies had been largely unsuccessful, with the partial exception of Japan. It also put great emphasis on the fact that the second-tier NICs of Southeast Asia grew rapidly without such policy, thus suggesting that East Asian-

style industrial policy is not necessary for successful economic development. It then questioned whether the East Asian-style industrial policy could be practiced in other developing countries with under-developed bureaucracies and operating in an international environment much less tolerant of interventionist industrial and trade policies than it was in the 1960s or the 1970s.

The EAM has been subject to a wide range of criticisms.⁶ Many people found misleading its 'dilution' tactic of including the Southeast Asian economies as an integral part of East Asia. The critics argued that this deliberately blurred the focus of the earlier debate that the EAM was supposed to be a part of, which after all was about the 'original five' or even the 'big three' (Japan, Korea, and Taiwan). A number of commentators have also questioned the theoretical framework and the empirical methods underlying the study, especially those concerning the assessment of industrial policy (Lall 1994; Rodrik 1994; Chang 1995).

One positive contribution of the EAM was to emphasize the issue of policy implementation. It especially drew our attention to the role of high-quality bureaucracies and institutions that link the government and the private sector (e.g., Japan's deliberation council). However, the EAM took this one step too far and argued that therefore other developing countries that do not have such institutions should not attempt East-Asian-style industrial policy. In its view, the 'good' institutions of East Asia cannot be emulated elsewhere because they are largely products of idiosyncratic historical factors (e.g., Confucian bureaucratic tradition, ethnic homogeneity). However, this argument ignores that many of the allegedly idiosyncratic institutions in the East Asian countries were in fact recent constructs, which were created 'along the way' rather than before they embarked on industrial policy experiments (Johnson 1982; more on this later).

Shortly following the debate surrounding the EAM, there was a brief period when the so-called 'productivity debate' was in the limelight. This debate was prompted by the celebrated article by the American economist Krugman (1994). Krugman cited a number of growth-accounting studies allegedly showing that the East Asian economies, once again with the exception of Japan, have grown almost exclusively on the basis of factor accumulation (greater investment and larger labour

⁵ Further works in the tradition are compiled in Woo-Cumings eds., 1999.

⁶ See Chang 1995, appendix; Fishlow et al. 1994; the special symposium in the April 1994 issue of *World Development*.

inputs) rather than of productivity growth. He then argued that, as they will soon exhaust the possibility of accumulation-based growth, these economies will grind to a halt in the near future – in a manner similar to what happened to the Eastern European economies, another set of accumulation-led economies, since the 1970s. He asserted that this apparent parallel between the two groups of ‘Eastern’ economies shows the limitations of ‘collectivist’ economic systems and the superiority of individualistic ‘Western’ economies.

Against Krugman, we should first of all point out that there are many growth accounting studies, for what they are worth, that contradict the studies that Krugman uses. I say ‘for what they are worth’, because growth accounting exercises are riddled with serious theoretical and statistical problems (Abramovitz 1989, ch. 1). But more importantly, economic history shows that economies at the earlier stages of development are bound to rely more on factor accumulation than innovation and productivity growth but that they are able to make a transition to a productivity-driven growth regime - indeed, estimates show that in Japan, Korea and Singapore, productivity growth accelerated over time. Even more important is the fact that it is precisely with the help of the organizational and institutional capabilities that had been accumulated in the earlier stage of development that economies are later able (or not) to make a transition to a productivity-driven growth regime. It is exactly because Krugman fails to understand the role of organizational and institutional factors in the process of economic development that he could lump the East Asian economies together with the Eastern European socialist economies.

5. Explaining the East Asian Development Experience

Before moving on to the debate on the recent Asian crisis, let me synthesize the debates up to now and summarize what I regard as the essence of the ‘traditional’ East Asian model.⁷ Three major policy areas - that is, macroeconomic, external, and industrial – are discussed.

5.1. Macroeconomic Management

⁷ I say ‘traditional’ as this model has gone through quite a lot of changes since the late 1980s or the early 1990s.

Mainstream accounts of the East Asian miracle (e.g., EAM) puts great emphasis on the prudent macroeconomic management of the East Asian countries. It is argued that their policy-makers put emphasis on attaining macroeconomic stability (defined as low inflation), which provided the basis for high investment that drove their economies.

This is a very misleading interpretation of East Asian macroeconomic policy. In East Asia, industrial upgrading, and not macroeconomic stability (still less low inflation), was the overarching aim of economic policy.⁸ Especially until the 1970s the East Asian, especially the Japanese and the Korean, governments pursued what Chang (1993) calls 'pro-investment macroeconomic policy', which resulted in considerable inflation. For example, average rates of inflation (measured by the average annual growth of consumer price index) in Korea was 17.4% in the 1960s and 19.8% in the 1970s, which were higher, or not much lower, than those found in many Latin American countries during the same periods. In the 1960s, the Korean inflation rate was higher than those of Venezuela (1.3%), Bolivia (3.5%), Mexico (3.6%), Peru (10.4%), and Colombia (11.9%), and was not much lower than that of Argentina (21.7%). In the 1970s, it was higher than those found in Venezuela (12.1%), Ecuador (14.4%), and Mexico (19.3%), and was not much lower than those found in Colombia (22.0%) or Bolivia (22.3%) (Singh 1995, table 5).

At the same time, until they became quite rich, serious policy attempts were also made to repress consumption demand so that more resources can be released for investments.⁹ The banks, which have been owned and/or controlled by the state, were instructed not to make consumer loans, and heavy taxes were imposed on luxury consumption goods. The control was even stricter when it came to consumptions which involved foreign exchange expenditure. In the earlier stages of development, "luxury" goods imports were either banned or subject to high tariffs and inland taxes. In the Korean case, foreign holidays were banned until the late 1980s.

5.2. External Policy (or the Question of "Openness")

⁸ Taiwan was a partial exception. The Kuomintang government that has ruled Taiwan since 1949 has had a political aversion to inflation for historical reasons, as it regarded its failure to control inflation in the as one of the main reasons why it lost the mainland China to the Communists.

⁹ See Chang 1993 and 1997 for further details.

Given their export successes, it is often uncritically assumed that the East Asian economies were wide open to the outside world on every front, but their openness has been highly selective. They were more open in areas like trade, technology, and debt, but less open for foreign direct investment, and almost completely closed in relation to the capital market. Even within the relatively open areas like trade and technology, the degree of openness differed across the sectors, and changed according to the changes in industrial policy.

There were various restrictions on the areas in which FDI was allowed, and even when foreign direct investment was allowed, foreign majority ownership was practically banned outside the Free Trade Zones (FTZs). As of mid-1980s, for example, only 6% of multinationals in Korea (including the ones in the FTZs) were wholly-owned subsidiaries, compared to 50% in Mexico and 60% in Brazil (Evans 1987, p. 208). In the Taiwanese case, where the absence of large private sector firms resulted in the relative lack of credible joint-venture partners with TNCS, at around 30%, the ratio was considerably higher than that in Korea, but still much lower than in Mexico or Brazil. Even technological licensing, which was preferred to foreign direct investment, was put under heavy restrictions.

This is not to say that the East Asian policy-makers were against importing foreign technology. On the contrary, they have always been keen to acquire the latest foreign technology. However, restrictions on technology imports were imposed because the East Asian policy-makers have regarded the accumulation of technological capabilities by domestic firms as a vital condition for effective industrial upgrading.

5.3. Industrial Policy

The basic idea behind the East Asian industrial policy is that, in a world where technologies are not blueprints (and therefore learning is important), it makes sense for the state to create temporary protective barriers to give the firms the incentives to start new industries and the resource to invest in learning-related activities (e.g., training, R&D).

Typically, the East Asian states have chosen several industries at a time as 'priority sectors' and provided supports designed according to the particular needs of these sectors. These sectors had priority in acquiring rationed (and often subsidised) credits and foreign exchange, state investment funds, preferential tax treatments (e.g., tax holidays, accelerated depreciation allowances), and other supportive

measures. In return for these supports, they became subject to state controls on technology (e.g., production methods, product variety), entry, capacity expansion and reduction, and pricing.

Given that the industrial policy measures used in the East Asian countries were actually quite similar to the ones used in other developing countries, where such policies were less successful, many people have asked why the East Asian countries were particularly successful in using these measures.

The first reason is policy realism. Although the final goals were often ambitious, the choice of priority sectors were made only after careful considerations had been given to things like world market conditions and the state of local technological capabilities.

The second is policy flexibility. Like any other businessman trying to move into new sectors, East Asian policy makers often made mistakes. However, they were quite willing to acknowledge mistakes and re-direct their policies if they did not work.

Last but not least, their states had more 'autonomy'. The key to the success of industrial policy is that state support for an industry should be withdrawn when necessary (e.g., when the performance is lagging or when the industry has outgrown its need for protection). Otherwise, the support becomes permanent featherbedding that produces no improvement in productivity. What differentiates East Asia from other countries is that the East Asian states have been willing and able to withdraw such support whenever necessary, because they were highly autonomous states. The point is that, as the state-created incentives dampen the disciplinary forces of the market, the success of an industrialisation strategy based on such incentives critically depends on the willingness and the ability of the state to discipline the recipients of such supports. And in this conjunction, we should also note the role that emphasis on exports played, as it provided the state with relatively 'objective' criteria that it could use in disciplining the recipients of its supports. Another important point to note in relation to the issue of state autonomy in East Asia was that this autonomy was deeply embedded in a dense network of institutions that enabled productive public-private sector interactions (deliberation councils, policy study groups, etc.) (Evans, 1995). In this way, the state could exercise its autonomy in a way that is attentive to private sector interests but not swayed by it.

6. Japanese Stagnation and the Asian Financial Crisis

With the bursting of the asset bubble in the early 1990s, the Japanese economy entered a period of prolonged recession – in fact, the longest in its modern history. In the meantime, some East and Southeast Asian economies (Thailand, Malaysia, Indonesia, Korea, and Hong Kong) have experienced major financial crises in 1997.

These two events together, especially when set against the strong performance of the US economy during the last half of the 1990s, have prompted many people to argue that 'Asian capitalism' in the end was a house of cards. By the late 1990s, it was widely argued that the East Asian economies were in trouble because of the structural inefficiencies. These inefficiencies are said to be due to factors such as excessive state intervention, market-defying private-sector institutions (such as lifetime employment and pathological corporate governance institutions), corruption, and the lack of transparency in the management of government and corporations.¹⁰

In addressing this view, it should first all be emphasized that there never existed such thing as 'Asian capitalism'. We can certainly talk about the 'East Asian model', practiced by the 'big three', and to a lesser extent by Singapore, but this model did not extent either to Hong Kong or the Southeast Asian economies. It is interesting, then, to note that it is mostly the more market-oriented economies of Hong Kong and Southeast Asia that are in crisis, rather than the countries that have practiced the 'East Asian model'. The economies of Taiwan and Singapore were somewhat affected by the crises in the region but survived them more or less unscathed. Japan may have had a prolonged recession during most of the 1990s, but this by no means is a crisis situation, except perhaps in terms of the wounded national pride and the spreading sense of uncertainty about the future in the country. The obvious exception in this regard is Korea. However, given that the country had moved to a much more market-oriented model since the early 1990s, it is probably more accurate to attribute its crisis to the demise of 'East Asian model' in the country rather than to its perpetuation (Chang 1998).

The fundamental problem with the arguments that try to explain the Asian crisis in terms of institutional deficiencies is that they never clearly specify these

¹⁰ Krugman 1998 was arguably the most influential article along this line, despite never having been properly published. For criticisms of this argument, see Singh 1999 and Chang 2000.

deficiencies except in the broad and vague terms, often summarized in the catch-all term of 'moral hazard' (Chang 2000). Moreover, these arguments are not very well supported by facts (Radelet and Sachs 1998; Chang 2000). First of all, if one cared to look, all the necessary information to predict trouble in these countries was available at least for a couple of years before the crisis (e.g., the BIS reports in the years leading to the crisis), so the 'lack of transparency' argument is suspect. Second, there is no evidence for the existence of extensive government guarantee. There were bail-outs, but they were, especially in Korea, often accompanied by punishments of the responsible managers. Even in cases like Indonesia, where state discipline was weak, it does not make sense to argue that 'cronyism' was the main cause of the crisis. Given that cronyism by definition works only if it is confined to a small group, it is not plausible to argue that the 3,000-plus Indonesian manufacturing firms that borrowed from abroad all had cronyistic connection. As for corruption, it was there in abundant quantities in all the countries concerned all the time, and was diminishing, if anything, in the run-up to the crisis.

Although no one would deny certain economic and institutional weaknesses of the crisis economies of Asia, an increasing number of people, across the ideological spectrum, see the origins of the crisis elsewhere (Furman and Stiglitz 1998; Radelet and Sachs 1998; Singh 1999; Chang 2000). Many now believe that the main causes of the Asian crisis lie in factors such as: the deficiencies in the international financial architecture (e.g., unstable exchange rates, the absence of lenders of last resort); instability in the international capital markets due to increasing financial deregulation and globalization; the premature capital market liberalization and opening in the absence of proper supervisory mechanism in the crisis countries. They argue that the crisis occurred because the above-mentioned factors have magnified the famous Kindlebergerian cycle of financial 'manias, panics, and crashes' that have been present in virtually all financial crises since the 17th century (Kindleberger 1986).

Finally, whatever one's view on the Asian crisis is, the Japanese case needs to be discussed separately. Above all, it should be noted that, while poor by its own historical standards (Japan's per capita income grew at over 6% between the 1950s and the 1970s and at around 3.5% even during the 1980s), the Japanese economic performance during the 1990s is by no means a disaster by international standards. For example, during the 1990s, a number of advanced economies have grown more slowly than Japan in per capita terms (Canada, Switzerland, Italy, and Sweden). Once again in per capita terms, its performance during the 1990s was not much

behind that of the US, which is supposed to have entered a new 'golden age' (however, note that, contrary to the popular myth, the US growth rate over the last decade is actually below its historical average). According to the World Bank data, between 1990 and 1999, the US grew at 2.4% and Japan at 1.5% in per capita terms – hardly an earth-shattering difference. And at least since the spring of 2001, with the bursting of the internet bubble and the revelation of major corporate corruption scandals, the US economy has been experiencing a continued trouble, with no immediate end to it in sight.

7. The Question of Replicability

The question of replicability has been a persistent theme in the debate on East Asia. In the early days of the debate, when the mainstream economists recommended the supposedly 'free market-free trade' model of East Asia to other developing countries, many Dependency theorists pointed out that there were too many historical, geopolitical, and perhaps cultural idiosyncrasies that made the model generally inapplicable, although they did not question the mainstream characterisation of the model itself.¹¹ Later, when it became clear that the East Asian countries did not succeed on the basis of 'free market-free trade' policy, the mainstream economists adopted the Dependency style argument, which they had disparaged so much earlier, and argued that the model cannot be replicated, because its success was based on certain unique conditions which other countries do not possess.¹² How plausible is this argument?¹³

It has often been argued that Confucian culture that has dominated East Asia generated hard work, high savings propensity, zeal for education, and acceptance of authoritarian measures, thus making economic development easier. It is also pointed out that, largely because of Confucian tradition, the East Asian countries were

¹¹ On the curious similarities between the early mainstream and the Dependency interpretations of the East Asian experience, see Chang 1990. For criticisms of the 'idiosyncrasy' arguments, see Chang 1995.

¹² World Bank 1993 is the best example.

¹³ There is another type of 'non-replicability' argument, which emphasizes the difficulty of using the East Asian style 'non-market-conforming' trade and industrial policy instruments in the new international trading regime under the WTO. This argument is examined in chapter 13, section 5 of this volume.

uniquely endowed with high-quality bureaucracy from early days of their economic development.

The basic problem with this argument is that Confucian culture has been there for centuries but did not lead to development earlier. Indeed, until the 1950s, many people blamed Confucianism for holding East Asia back. Confucianism, like all other cultures, contains many elements that are harmful for growth – for example, it has a deep-seated contempt for commercial and industrial activities, while its emphasis on hierarchy is seen as impeding creativity.¹⁴ The point is that Confucian culture *became* supportive of economic development, not by nature but because it had been deliberately re-fashioned to promote economic development.

In response to the argument emphasizing the role of historically-endowed high-quality bureaucracy in East Asia, it should be pointed out that such bureaucracy was a recent creation. The East Asian countries, especially Korea and Taiwan, had to spend a lot of time and energy in reforming their bureaucracies and training their bureaucrats before they could establish the kind of bureaucracies that they have now (Cheng et al., 1998). It is instructive to note in this context that Korea was sending its bureaucrats for training to the Philippines and Pakistan until the late 1960s.

In this context, it is interesting to note that many people who express scepticism about the transferability of the East Asian model are quite cavalier when it comes to the transferability of the ‘market-dominated models’ of the Anglo-American economies. There may be an element of Anglo-centrism here, but the more important problem is the implicit assumption behind this argument that markets are easy to create and therefore can be transplanted anywhere, while other institutions are not so.

However, markets are *not* natural phenomena that develop spontaneously, and like other institutions, have to be deliberately constructed.¹⁵ Thus seen, it is not that replicating the East Asian model requires institution building (and therefore is next to impossible) while replicating the Anglo-American model does not require it (and therefore is easy). They just require building different sets of institutions. Indeed, if the free market system is so ‘natural’ and easy to replicate, the former socialist countries should not have had so much trouble establishing the market economy during the 1990s.

¹⁴ Krugman 1994 is alluding to this aspect of Confucian culture, when he characterizes the East Asian economic system as ‘collectivist’. See section 4.3 above.

¹⁵ Polanyi 1957 is a classic argument along this line. Also see Chang 2002.

In other words, the argument that the East Asian model cannot be replicated elsewhere because of its unique institutions sees institutions as something fixed and under-estimates the possibility of institutional transfer, adaptation, and innovation. In fact, if there is one lesson from the East Asian economies that is transferable everywhere, it is that the development of a late-developing country depends critically on how successfully it can engage in the importation, adaptation, assimilation, and innovation of institutions, and not just of technologies.

The early Japanese experience is particularly instructive here. When the Japanese first embarked on the industrialisation process, they had to import a lot of foreign institutions, picking what they thought were the most suitable among the 'best practice' ones. So if we look at the early Meiji period, we find an institutional patch-work. The commercial law system was from France, their criminal law from Germany, the Central Bank from Belgium, the Navy from Britain, the Army from Germany, the education system first from America but later from Germany, and so on (Westney, 1987). These imported institutions were adapted to the local conditions, while new institutions (e.g., lifetime employment, just-in-time production system) were subsequently invented. If the Japanese gave up on institutional learning on the ground that their historical and cultural backgrounds are too different from the 'Western' ones, we would not have had the East Asian miracle in the first place.

I would agree with those who express scepticism about the replicability of the East Asian model, if all they mean is that countries with different conditions may have to find different solutions to similar problems. However, they often have a very exaggerated view about the superiority of the 'initial conditions' of the East Asian countries, and have an unduly pessimistic view about other countries changing their conditions. So they believe that initial institutional (and cultural) conditions are almost perfectly binding and therefore countries which do not start with the East Asian sort of initial conditions cannot emulate them. One curious thing here is that most of these people do not seem to believe that the 'initial conditions' may be equally binding when countries aim to imitate the Anglo-Saxon model that they typically recommend.

8. Concluding Remarks

During the last few decades of the 20th century, the East Asian economies have gone through the fastest economic and social transformation in human history. Their successes and failures have generated many heated debates that have significantly affected the way in which we understand some key issues in development economics. While these economies have moved away from their traditional models to one degree or another (most dramatically in the Korean case), their importance in the world economy can only increase in the conceivable future. Therefore, a correct understanding of their past experience and current situation remains crucial in development economics.

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