East Asia

Is there an East Asian model?

Helen Hughes
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Abstract

This paper argues that the rapidly growing economies of Asia represent not one but five development models. In the city states, Hong Kong and Singapore, export performance was a large component of overall growth, but in the other rapidly growing economies, although exports also played a key role, development was economy-wide.

Stable, macroeconomic policies provided the backdrop to rapid development in East Asia. By the early 1980s, the region's five countries had developed efficient financial markets. A well-structured infrastructure, both real and institutional, was another major element in rapid development.

Under the guise of dynamic comparative advantage, states of the East Asian economies also sought to pick winners and through investment in manufacturing. Direct foreign intervention did not suffer from market failures, but raised costs of

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Key to symbols used in tables

n.a. Not applicable
.. Not available
- Zero
. Insignificant
This paper argues that the rapidly growing economies of Asia represent not one but five development models. In the city states, Hong Kong and Singapore, export performance was a large component of overall growth, but in the other rapidly growing economies, although exports also played a key role, development was economy wide.

Stable macroeconomic policies were essential to growth and development in East Asia. Together with a neutral trade environment, they created a policy framework that encouraged efficient resource allocation and utilisation. Effective human resource and infrastructural development were the other main inputs into rapid development.

A so-called 'Japanese model' of direct government intervention was not conducive to rapid growth. Where governments failed to liberalise trade and finance, detailed regulation was necessary to offset the distortions created by protectionism and credit rationing. Under the guise of fostering dynamic comparative advantage, some of the East Asian economies also sought to pick winners by subsidies and through public investment in manufacturing. Direct government intervention did not offset market failures, but raised costs of production. If the larger East Asian countries had liberalised their policies more rapidly, they would have avoided such costs and could have increased living standards, particularly for lower income groups, earlier.
Is there an East Asian model?

Rapid economic growth is a post-World War II phenomenon. National income growth rates accelerated with the agricultural and industrial 'revolutions' in England in the 18th century, but average annual real national income growth rates barely reached 2 per cent (except for short periods in a very few countries, and in very special circumstances) in the 19th and first half of the 20th centuries. Most of the industrial countries put on a spurt of growth in the 1950s and 1960s with real per capita national income growing at about 4 per cent a year. The developing countries, to the astonishment of the few economists then interested in development, were not far behind. High population growth, however, made for real per capita income growth of only about 3 per cent during 1950-70 (Morawetz 1977).

Japan caught up spectacularly to advanced productivity levels with average annual per capita income growth rising from 7.3 per cent in the 1950s to 9.4 per cent in the 1960s, with double digit growth in some years (International Economic Data Bank, Australian National University). It was the first of the East Asian 'miracle' countries. The newly industrialising economies (Hong Kong, the Republic of Korea, Singapore and Taiwan) followed. Singapore and Hong Kong had per capita incomes of about US$14,000 a year in 1992, higher than Ireland or Spain. In the 1970s and 1980s it became evident that the 'nearly' newly industrialising countries (Indonesia, Malaysia and Thailand) were also growing far more rapidly than other developing economies. In the 1980s China also began its spectacular growth. In East Asia only the Philippines (while performing quite strongly by the standards of other developing economies) and Vietnam, Laos and Cambodia (the war-torn countries of former Indochina) lagged behind.

There are also a few success stories in other regions (Botswana and Malta), but the rapidly growing East Asian economies stand considerably ahead of the economic performance of most other developing economies.

I am grateful to Ruel Abello for assistance in preparing this paper and to Heinz Arndt for helpful comments.
Table 1  Economic indicators, East Asian economies, 1965-92 (per cent)

<table>
<thead>
<tr>
<th></th>
<th>Average annual real GNP growth</th>
<th>Average annual real per capita GNP growth</th>
<th>Estimated per capita GNP (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1965-91</td>
<td>1965-91</td>
<td>1965</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>8.1</td>
<td>6.1</td>
<td>3,000</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>8.9</td>
<td>7.3</td>
<td>1,200</td>
</tr>
<tr>
<td>Singapore</td>
<td>8.4</td>
<td>6.6</td>
<td>2,600</td>
</tr>
<tr>
<td>Taiwan</td>
<td>9.0</td>
<td>7.1</td>
<td>1,700</td>
</tr>
<tr>
<td>Indonesia</td>
<td>6.7</td>
<td>4.5</td>
<td>200</td>
</tr>
<tr>
<td>Malaysia</td>
<td>6.5</td>
<td>4.0</td>
<td>1,000</td>
</tr>
<tr>
<td>Thailand</td>
<td>7.0</td>
<td>4.6</td>
<td>500</td>
</tr>
<tr>
<td>China²</td>
<td>9.5</td>
<td>8.0</td>
<td>150</td>
</tr>
<tr>
<td>Philippines</td>
<td>3.8</td>
<td>1.2</td>
<td>600</td>
</tr>
</tbody>
</table>

1  In 1992 prices
2  Until the 1980s, data for China reflected political correctness rather than statistical realities. The period covered here has therefore been restricted to 1981-91 and even for these years the official data reported are probably too high.


East Asian countries have doubled their real per capita incomes every 10 years during the last 30 years. Developing economies in other regions have in general doubled their living standards only once since the 1950s. Latin American countries, which had the highest standards of living among developing economies in the 1950s, stagnated during the 1970s and 1980s. In some developing economies, notably in sub-Saharan Africa, living standards have fallen since the 1960s.

Rapid growth, however, is all that the East Asian economies have in common. Their 'initial conditions' and levels of development in the 1950s spanned a considerable range, their geographic and population sizes differed greatly and so did their natural resource endowments.
Table 2  Average annual rates of growth of GNP per capita, developing economies by region, 1965-91 (per cent)

<table>
<thead>
<tr>
<th>Region</th>
<th>Average annual real growth of GNP per capita per annum</th>
</tr>
</thead>
<tbody>
<tr>
<td>East Asia and the Pacific</td>
<td>5.2</td>
</tr>
<tr>
<td>South Asia</td>
<td>1.9</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>1.8</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>1.8</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>0.2</td>
</tr>
</tbody>
</table>


Table 3  Area and population of East Asian developing economies

<table>
<thead>
<tr>
<th>Geographic area (thousand square kilometres)</th>
<th>Average annual population growth 1965-91</th>
<th>Population (million) (1992)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>1</td>
<td>5.8</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>99</td>
<td>43.7</td>
</tr>
<tr>
<td>Singapore</td>
<td>1</td>
<td>2.8</td>
</tr>
<tr>
<td>Taiwan</td>
<td>36</td>
<td>20.7</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1,905</td>
<td>189.5</td>
</tr>
<tr>
<td>Malaysia</td>
<td>330</td>
<td>18.6</td>
</tr>
<tr>
<td>Thailand</td>
<td>513</td>
<td>58.4</td>
</tr>
<tr>
<td>China</td>
<td>9,561</td>
<td>1,173.0</td>
</tr>
<tr>
<td>Philippines</td>
<td>300</td>
<td>64.3</td>
</tr>
</tbody>
</table>


It is no longer disputed that the growth performance of most East Asian economies has been outstanding in social as well as economic terms in relation to other developing economies. Changes in the incidence of poverty are notoriously difficult to measure, but in the rapidly growing East Asian economies at least, it is widely postulated that rapid growth was accompanied by marked poverty alleviation (Fields 1989). Individual country estimates support this hypothesis.
Between 1962/63 and 1988 people living in poverty in Thailand fell from 57 per cent to 21 per cent of the population (26 per cent in rural and 8 per cent in urban areas) (Medhi 1992). Physical indicators of health and education also suggest a relatively equitable social performance.

<table>
<thead>
<tr>
<th>Table 4</th>
<th>Social indicators, newly industrialising East Asian economies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Life expectancy at birth</td>
<td>Population per physician</td>
</tr>
<tr>
<td></td>
<td>1990</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>78</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>71</td>
</tr>
<tr>
<td>Singapore</td>
<td>74</td>
</tr>
<tr>
<td>Taiwan</td>
<td>74</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>51</td>
</tr>
<tr>
<td>South Asia</td>
<td>58</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>61</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>68</td>
</tr>
</tbody>
</table>


Within the region economic progress is not regarded as being miraculous, but as the result of policy efforts that mobilised people and other resources to work toward rapid growth goals.

It is clear that governments played a key role in economic development in the region. But there are two interpretations of the government's role. On the one hand, it is argued that direct government interventions offset 'failures' in national and international markets and made a substantial contribution to creating dynamic comparative advantage by picking winners and encouraging them by the use of subsidies in their 'infant industry' stage. A so-called 'Japanese model' of successful intervention in the economy, particularly in industrial development, is said to be the origin of such government strategies. In this paradigm, protection, market regulation and nurturing 'infant' import-substituting and exporting industries by a barrage of incentives are seen to be the principal instruments of successful economic policy. Close cooperation, or indeed collusion, between...
government and business on the lines of a so-called 'Japan Inc' is said to be an essential component of a pro-active industrial policy and what is good for industry is presented as being good for the economy. These views persist in spite of the serious doubts that have been cast on the very existence of such a model as the source of growth in Japan (Imai 1978).

An opposing liberal interpretation ascribes economic success to the use of neutral, efficiently administered policies that gave economy-wide price signals to consumers and producers. Liberal economists argue that the soundness of underlying policies - fiscal, monetary, financial, trade, labour and infrastructure - determined the speed, sustainability and equity of growth. The East Asian experience is seen to underline that extensive regulation and picking winners, far from encouraging growth or equity, has high long-term economic costs and encourages inequitable income distribution. Government intervention can be a far more serious cause of market failure than domestic or international market imperfections.

The fruits of interventionist policies are now evident in the deep-seated problems of the Japanese economy. The Republic of Korea is unable to offset the monopolistic behaviour of the large conglomerates it created by its credit rationing policies. With the exception of Hong Kong and Singapore, and despite their rapid growth, the East Asian economies are struggling with high cost public enterprises, infant industries that will not grow up and high cost subsidies to exports. The vested interests intervention has encouraged are reluctant to give up their 'rents'. Standards of living are undermined by economic inefficiency. Excessive intervention has not only been destructive in economic terms. Political corruption and instability, disregard for social deprivation and environmental degradation are typical concomitants of interventionist policies.

The East Asian models of development

As soon as paradigms are deserted for reality it becomes evident that a 'Japanese model' of growth (whatever that may be) has not been followed in East Asian developing economies. Not one, but at least five different 'models' apply in developing East Asia.

Hong Kong and Singapore

These two city states are unique within the region, though they have similarities to other rapidly growing island economies, notably Malta. Although they were well established entrepôts by the end of the 1930s, the direction of their trade
differed. This essential difference that underlies disparities in the two economies' development is usually ignored (Young 1992). Hong Kong imported raw materials into China and exported labour-intensive manufactures from China. At the end of the 1940s many Chinese entrepreneurs fled to Hong Kong and Taiwan. Some, primarily from Shanghai, managed to take their machinery with them and some even managed to claim insurance losses on such machinery to provide themselves with working capital. They quickly developed and expanded their export business, specialising in artificial flowers, clothing, textiles, toys, sporting goods and other labour-intensive products.

The British colonial government of Hong Kong provided a neutral economic environment (Riedel 1974): macroeconomic stability achieved by low revenue import duties (2.5 per cent); low uniform company and personal income taxes (initially 12.5 per cent, rising to 17.5 per cent); and the rapid construction of social and physical infrastructure, mainly out of current revenues, for a population that grew from less than two to six million between the 1950s and the 1980s. The economy was so small and so open that instruments of monetary policy were necessarily weak. Immigration controls - labour policies - therefore became the principal instruments for influencing the level of economic activity.

Lacking an agricultural sector, Hong Kong imported food as cheaply as possible. Other low-cost consumer goods and inputs into exports followed. If ill-advised countries wanted to 'dump' goods in Hong Kong, Hong Kong consumers and producers were delighted.

With low inflation and rising per capita incomes, savings and investment were encouraged. The strongly supportive economic environment was combined with an open attitude to foreign investment. Although manufacturing for export was initially local, Hong Kong attracted foreign firms to use its workforce as a base for labour-intensive exports. This provided access to world markets and the world 'shelf' of technologies. Without protection or 'give away' incentives such as tax 'holidays' to exporters, there was no danger of foreign investors exploiting the economy.

Government regulation was largely confined to location planning to make Hong Kong's small crowded island and adjacent territories liveable. Public investment included public housing, although the flats built to replace squatters' shacks were transferred to private owners.

The influx of immigrants stimulated intense competition and flexibility. The bulk of employment, as in most developing economies, was not in factories, but economy wide in the informal sector. Subcontracting led to a high utilisation of labour by linking informal and formal employment. With rapid growth the
workforce became more skilled and wages rose steeply, at some 15 per cent a year in real terms. Rapidly growing employment also led to a rise in family incomes. The economy became diversified. In addition to the large traditional trade sector and the growing export of manufactures, tourism and financial services played an important role. Intermediation services of all types for the export of manufactured products from China expanded, particularly after 1979 when China opened its doors to world trade (Sung 1991). Within Hong Kong, manufacturing became more sophisticated.

As wages rose, Hong Kong entrepreneurs became less competitive in labour-intensive production and so began to invest abroad to expand production, taking advantage of their management and marketing experience. By the end of the 1970s they had become important investors in the export industries of many developing economies, notably in the rest of Asia, but as far afield as Mauritius and Panama (Stobaugh and Wells 1984).

With the opening up of China, a major shift of unskilled, labour-intensive operations to the mainland began. Hong Kong entrepreneurs are now estimated to employ at least four million workers in China, three million in the Pearl River delta alone, mainly in manufacturing for export. This number exceeds that of Hong Kong's entire workforce. Hong Kong, however, still exports nearly US$30 billion of manufactures compared with the US$65 billion of manufactured exports produced by China's population of more than one billion. Because its intermediation concentrates on the highly skilled end of processing, value added per dollar is higher in Hong Kong than in China.

In contrast to Hong Kong, Singapore was an inward-oriented entrepôt, importing manufactures from the rest of the world for Malaysia, Indonesia and Thailand, and sorting, packaging and processing their primary products (mainly tin, coconut oil and rubber) for export (Hughes and You 1969).

On becoming independent at the end of the 1950s, Singapore was encouraged by the World Bank and other international agencies to become an inward-oriented manufacturing centre for the Malaysian Federation. This fitted in with the ideology of Lee Kwan Yew's new socialist government. It was envisaged that Singapore would become the industrial centre of a Malaysian agricultural hinterland. Government was to play an important role in manufacturing through direct investment and picking winners for protected import substitution for the Federation market but this did not fit in with the ethnic composition of the Federation, in which Singapore tipped the balance toward a Chinese (vis-à-vis Malayan) majority. Singapore had to leave the Federation in 1965.
Singapore immediately found itself in serious difficulties. The United Kingdom planned to withdraw its armed forces which had been an important economic and employment resource for the economy. The Malaysian market was lost as the Federation became increasingly protectionist. Indonesia initiated a confrontasi policy which attempted to take away from Singapore its intermediation role in the processing of Indonesian exports.

In 1965 wages in Singapore were the highest in Asia after Japan, but unemployment was at least 13 per cent. Trade unions were Marxist led and very militant. Industrial relations were poor. The government persuaded the union movement that radical changes in attitude were necessary if the economy was to prosper, employment to grow and wages to rise. The interests of workers outside the formal, unionised sector, had to be taken into account (Goh 1977).

Singapore turned from inward to export-oriented trade policies overnight. This sudden change was only possible because it had not gone far in a protectionist direction in its two years within the Malaysian Federation. But unlike Hong Kong, Singapore did not have experience in the selling of labour-intensive manufactures abroad. Its firms knew how to import manufactures, but not how to export them. Singapore therefore invited firms from all over the world, notably from the United States, Japan and Europe, to use its labour force and infrastructure as an export base. It was successful in attracting international firms because it provided a sound social infrastructure (education and health), an internationally competitive, efficient physical infrastructure (transport and telecommunications) and an administration that had become a byword for incorruptibility. The provision of high-class housing, initially in the public sector, but later sold to private owners as in Hong Kong, made a major contribution to economic productivity and political stability (Lim 1984).

A mere three years later, in 1968, manufactured exports and the economy were booming. By the 1970s Singapore had a labour shortage, importing gastarbeiter from Malaysia, the Philippines and other neighbouring countries. Trade had expanded so that Singapore was well on the way to becoming the second largest (after New York) port in the world. Tourism flourished and financial services were developing.

As in Hong Kong, low inflation and stable exchange rates encouraged high savings and investment. A Central Provident Fund, used to stimulate private savings for housing and retirement, provided resources for public investment. The openness of the economy again limited the use of monetary instruments and the flow of gastarbeiter was used as an anticyclical measure instead (Corden 1984).
As real wages rose, manufacturing and other sectors became more sophisticated. Technology has, in less than 30 years, moved from simple assembly of electronic components to precision engineering manufacture and the production of 'robots'. A new 'triangle' policy has been put in place to employ relatively unskilled and low-wage workers in neighbouring Malaysia and Indonesia in industries which are no longer economic in Singapore. It closely parallels Hong Kong's investment in Southeast China. About half a million workers are expected to be working in spin-off industries in Indonesia alone by the end of the 1990s. More than 70 per cent of manufactured exports in Singapore are still produced by foreign firms, but, as in Hong Kong, without protection, with minimal domestic regulation and selling predominantly to world markets, foreign firms cannot earn monopolistic rents in Singapore.

The Singapore government, in contrast to Hong Kong's colonial administration, had a strongly interventionist outlook as it moved towards independence in 1959. Public investment in production carried over from socialist ideology. The Singapore Economic Development Board was established to administer a regulatory environment. It was to be a model 'one stop shop' facilitating rapid entry, particularly for the foreign investors that were seen as essential to the economy. Tax holidays were retained from the Malaysian Federation regulatory, protectionist environment and credit and land subsidies were made available to incoming firms. For the Economic Development Board bureaucrats, these became important 'talking points' in negotiations with foreign investors. But interviews with investors suggest that such incentives did not affect investment decisions, confirming the experience of other countries in this regard (Hughes and You 1969).

Singapore's attempts to pick winners were so counter-productive that they were soon abandoned. The first export industries picked by the bureaucrats - clothing and textiles - proved to be unsuccessful. Clothing exports did not 'take off'. A heavily subsidised 'Singapore silk' venture went so poorly that it had to be dropped. Electronic assembly flourished instead. Picking winners became highly suspect after a reputable German camera enterprise, having been granted a monopoly in Singapore, failed, depriving Singapore of developments in lens technology. The debate has continued in Singapore for bureaucrats have a strong interest in maintaining regulatory environments. But the Singapore government gave up picking winners in favour of supporting market trends, notably, as wages and skills rose, in taking up opportunities to move up the skill and technology ladder.

After 25 years of very successful development, the government now realises that much of its direct intervention has been redundant, if not counter-productive.
It is withdrawing from participation in commercial production and considering further privatisation even in 'public goods' fields. Income taxes are relatively high (almost 50 per cent for corporations and, together with Central Provident Fund contributions, even higher for individuals). The elimination of tax incentives in favour of low corporation taxes is being planned to increase efficiency. Credit subsidies were largely phased out in the 1970s. It is argued that reduced public intervention will release many able public officials into the private sector where they are expected to be more productive than they are in their present positions.

The Singapore government, even more than Hong Kong, has made an important contribution to development and the quality of life through spatial planning. Singapore is a garden city, emphasising environmental and aesthetic concerns. In urban transport policy it is a world leader - mass public transport is excellent and, despite a high level of motor car ownership, there is almost no traffic congestion. Prices are used in combination with low levels of regulation to achieve socially desirable outcomes. Singapore's social orientation probably accounts for its apparently low growth in total factor productivity (Young 1992).

Taiwan and the Republic of Korea
These two economies had quite different 'initial conditions'. Taiwan was a fairly well developed agricultural economy in the 1930s, with strong transport and infrastructural services. It was not greatly affected by World War II and it received a major injection of skilled and entrepreneurial immigrants from China in the late 1940s. As in Hong Kong, many immigrants brought capital, machinery and world market knowledge. The Republic of Korea, in contrast, was completely ravaged by war. In the early 1950s it was a very poor country. Its per capita income was lower than that of the Philippines. In the winters thousands of people died of hunger and cold.

Both economies had land reforms related to the expropriation of colonial landlords and their feudal collaborators, but agriculture stagnated in the 1950s because of inward-oriented protectionist policies. Fiscal problems followed from protection. Both economies sought refuge in severe financial repression (McKinnon 1973). Interest rates were kept down and credit was rationed to large firms by the government. The very large aid inflows of the 1950s were dissipated in corruption, remitted abroad or wasted. Inflation was high and the exchange rate was overvalued. Stagnation followed. It is a myth that education expenditures and protection for infant industries in this period laid the foundation of subsequent industrial exports. In both countries exporters had to
struggle against policy-created biases (Li and Yeh 1967; Li 1976; Mason et al. 1980; Kuo, Ranis and Fei 1981; Kuo 1983).

Development only came with changes in economic policy at the end of the 1950s in Taiwan and in the early 1960s in Korea. The catalyst was the threat, and then the reality, of the United States reducing and eliminating the substantial volumes of non-military aid it was providing to these economies. Both countries reformed their fiscal policies and henceforth have worked mainly with balanced budgets. Infrastructural development first began in this framework. Monetary policies could then be tightened without crippling the economies, inflation was brought under control and exchange rates were depreciated to balance of payments equilibrium levels and remained stable.

Reformers were not politically strong enough in either Taiwan or the Republic of Korea to abolish protection or to introduce competitive financial systems. Both countries therefore attempted to reach 'neutral' policies by offsets to protection in agriculture and for exports and by credit rationing.

Of the measures taken to counter protection, the most important, and the only ones that did not have harmful side effects, made it possible for exporters to import inputs at world prices, by exemption from import restrictions and import duties. Other incentives, including subsidies for agricultural inputs, privileged access to the domestic market (via monopolies and limitations on entry), 'wastage allowances', subsidised credit and tax 'holidays' were of doubtful value in stimulating output and exports (Herderschee 1990), distorted the economy and required armies of administrators whose judgements were arbitrary and often counter-productive.

Overcoming the distortions created by protection and counter-intervention was very costly. Financial 'repression' distorted investment among, and within, sectors. Elaborate rural poverty alleviation programs were introduced to offset the effect of biases against agriculture. Somewhat paradoxically, by the 1980s these had become agricultural protection policies (following European, Japanese and US practices). They damaged the Korean (Anderson and Hayami 1986) and Taiwan economies. Much direct intervention in manufacturing and service industries was necessary to offset the effects of 'tailor-made' tariffs. Such intervention benefited large corporations and their workers but was a major cost for the low income earners, who made up the majority of the workforce.

Those in the informal workforce not only had to absorb both the costs of protectionist policies, but also those of the interventions and subsidies used to counter them. The fiscal and macroeconomic costs created by distorting policies reduced the availability of funds for social and environmental concerns. Both
countries lagged behind Hong Kong and Singapore in housing and other social amenities. As per capita incomes rose in Taiwan and the Republic of Korea, protectionist cum subsidy policies were also seen as running counter to GATT rules. Trade retaliation problems arose.

In the late 1960s, and again in the late 1970s, the Republic of Korea returned to large scale public investment and subsidised private investment in 'basic' industries. Residual industrial protectionist ideologies were part of the motivation, but strategic considerations also played a role. The attempts to create metal processing, heavy engineering and chemical industries were costly and created fiscal problems and inflation. Only in iron and steel did the initial high subsidies lead to international competitiveness.

Financial rationing in the Republic of Korea, led to the strengthening of a dozen large conglomerates (chaebol) at the cost of small and medium-sized firms. By the 1980s it had become clear that the absence of small and medium-sized firms was hindering the export and overall growth effort, but it has thus far proved impossible to reduce the economic and political power of the chaebol. The failure to develop an efficient and competitive financial system also led Korean firms to use imported rather than domestically produced machinery (because foreign loans were readily available), discouraging the development of the capital-goods industry despite government investment intended to foster it.

Taiwan's financial policy was less repressive. A secondary, informal, market was allowed to cater for small and medium-sized firms, and a much more diversified development of firms than in the Republic of Korea ensued. Taiwan's policies were also more open to foreign investment. The Republic of Korea's chaebol successfully prevented competition from foreign investors, at the cost of relatively weak technological development in some sectors of the economy.

The Republic of Korea and Taiwan pioneered export processing zones, mainly to provide foreign firms with the equivalent of a free trade base where imported inputs could be obtained at international prices. In both economies these zones also overcame language difficulties, the political problems Japanese investors faced in their former colonies, and corruption. Masan and Kaohsiung, the pioneering East Asian export processing zones, became successful, exceptionally so among some 700 export processing zones founded in developing economies worldwide since the mid-1960s (Warr 1990). The stability of the economic environment in which they operated was also a key factor in their success.

Much of the interventionist effort was, in any case, for show. Seoul had a 'war room'. Its walls were covered by charts of individual firms' export trends. Direct telephone lines linked the Minister for Trade to the firms' chief executives. If the
charts showed insufficient growth in exports, the Minister could harangue the executives. But output and export growth are closely related to the stability of macroeconomic policy and the absence of adventures in picking winners rather than to Ministerial telephone calls (Balassa 1971, Lim 1981, Koo 1984).

Amsden (1979 and 1989) and Wade (1990) have argued that it was public intervention in Taiwan and the Republic of Korea that was responsible for economic success. They ignore the distortions created by the unreformed components of policy and the extent to which interventions were necessary to offset these distortions. Amsden and Wade also ignore the costs imposed by rent seeking by corporations and public officials. The buildup of such vested interests in protection and regulation during the 1960s and 1970s made it very difficult to reform these economies by reducing protection and opening up the financial sectors. Taiwan has been much more successful in moving toward neutral price signals than the Republic of Korea, which remains heavily interventionist. The relative fragility of the Korean economy and its political instability attest to the high costs of intervention.

Indonesia, Malaysia and Thailand

Malaysia had a strong primary product exporting economy but Indonesia and Thailand were among the poorest countries in the world in the 1950s, despite relatively rich agricultural and, in Indonesia's case, mineral resources. Each of these countries adopted conservative macroeconomic policies (Indonesia after 1965) with balanced budgets and rigorous monetary stances. Thailand and Malaysia, like Singapore, controlled inflation remarkably successfully. All three countries saw reasonable macroeconomic stability in the 1970s despite petroleum booms in Indonesia and Malaysia (Lim 1973; Booth and McCawley 1981; Hill 1989; Warr forthcoming).

Indonesia, Malaysia and Thailand were all conventionally import-substitution oriented, but protection for import-substituting manufacturing was lower than it had been in the Republic of Korea and Taiwan in the 1950s and in most other developing economies until the 1980s. In Indonesia and Thailand smuggling kept the economies more open than tariff rates indicate. The combination of macroeconomic prudence and relative trade neutrality enabled all three countries to take advantage of the new technologies so that agricultural performance was very strong. Malaysia and Thailand diversified agricultural exports in the 1960s and moved into manufacturing for export in the 1970s, with local and foreign investment (including flows from Hong Kong and Taiwan). In the long upswing of the 1980s, as petroleum prices fell, Indonesia joined Thailand and Malaysia in
exporting labour-intensive manufactures. Relatively small local producers took
the lead (Suphachalasai 1989, Saad 1993).

Protectionist interests sought to increase protection and other forms of
subsidies to industry in all three countries in the 1970s so that offsets to protection
(lifting quantitative import restrictions on inputs and tariff exemptions) had to be
introduced. Credit subsidies and tax holidays were also used, but had little
positive effect (Suphachalasai 1989, Herderschee 1990, Saad 1993). Rent seeking
was thus encouraged, but trade policy reforms were successfully begun in all
three countries during the 1980s.

Growing informal sector opportunities economy wide meant major inroads
were made into unemployment and underemployment even in so large a country
as Indonesia (the third largest developing country in the world) as well as in
Thailand and Malaysia. All three countries still had some way to go to achieve
reasonable living standards for their people, but in comparison with the
Philippines within the region, and with most other developing economies outside
the region, their progress was remarkable.

China
China is the only centrally planned, or formerly centrally planned, economy to
achieve rapid growth during the 1980s. Two sectors were responsible for its
dramatic emergence from economic stagnation.

The return of agricultural production from collective to individual farming
initiated the transformation of the economy. When it became evident that food
shortages were imminent at the end of the 1970s, the government not only turned
to small-scale, individual farming, but took steps to reduce the bias against
agriculture inherent in artificially low agricultural prices that were intended,
together with high protection, to stimulate industrialisation. Agricultural
production and rural incomes rose rapidly, although the multiplier effects on the
economy were muted by the inefficiency of the state sector in manufacturing and
services and the repression of service industries.

Exports also played a key role. From 1948 to 1978 exports were low, at 1 or 2
per cent of GDP. Mineral products in short supply in China had to be exported.
The value added (at international prices) component of manufactured exports was
low. That is, the domestic cost of producing many manufactured exports was
higher than the prices obtained for the products abroad. The quality of exports
and marketing was poor. Most goods had to go through Hong Kong to be sold at
all.
When economic stagnation forced China to open its doors in 1979, five special economic zones were established, with very considerable government investment, to become 'windows on the world'. They were to import high technology from abroad, to experiment with foreign investment and to export goods from China. Fourteen coastal cities with varying degrees of central investment funding and independence were added to these zones in the 1980s and more special zones (including Hainan island and the Pudan area of Shanghai) have been added since. The special economic zones have now been in existence for some 10 years. They have absorbed so much public investment that for political reasons it is essential that they should be seen as success stories. The special economic zones have led to large population inflows to the designated areas despite the prohibitions on labour mobility in China, and on wealth creation for local enterprises and for the cadres running them. However, cost-benefit analysis suggests an egregious waste of public funds, a choice of capital-intensive technologies that is quite inappropriate to local conditions because of high capital subsidies and for the most part, a leakage of foreign exchange abroad rather than foreign exchange earning (Wall 1990; Lin 1991).

State trading corporations have been given somewhat greater freedom in their export dealings since 1979. But they essentially still sell products from state enterprises and their subcontractors, the latter often being more efficient than the parent enterprise. The design and quality capacity in this sector is nevertheless poor and productivity is low. In many enterprises, after rising somewhat in the early 1980s, productivity has again fallen. The value added (at international prices) in exports from these enterprises is often negative.

Foreign investors are permitted to engage in joint ventures with local enterprises, to remit profits earned in exporting and to some extent to use export earnings to remit profits earned in producing for the domestic market, but this situation is also uncertain and fluid. Decisions are only made after long delays, often arbitrarily. Official rulings remain unpredictable. Real labour costs are not as low as they appear at first sight. Special economic zones impose many surcharges on labour (and other factors of production) and labour practices lead to low productivity and hence high labour costs. The formal foreign investment response to manufacturing for export was accordingly low in the 1980s (Yang Gang 1993). Most foreign investment has been in tourism but returns on such investment to China and the investors has also been, at least initially, low (Tisdell and Wen 1990).

As already noted, China began to open up to the international economy at a time when rising wage levels in Hong Kong (and Macau) and Taiwan began to price these economies out of world markets for labour-intensive products.
Although formal investment in China, particularly in special economic zones and in other 'designated' areas, was too cumbersome for large and successful firms from Hong Kong and Taiwan, small entrepreneurs from these countries were willing to become involved in production in China in an informal way, usually negotiating directly with village and township enterprises and even with (national and provincial) state enterprises. This enabled them to come into production much more quickly than formal processes would allow.

Inputs were imported into China and finished products were shipped abroad at prices which enabled the investor to take out a profit. Competition among investors meant that excessive profits through other than arms' length pricing of inputs and outputs were limited.

The investors supplied some equipment. The emphasis was on labour-intensive production to take advantage of low real-labour costs negotiated by these firms by introducing piece work and shift work. The machines imported were usually second-hand. These investors also contributed management, design, inspection and marketing. The local enterprise contributed the premises and workforce, more or less on market terms. Wages were initially low, reflecting the low marginal productivity of labour, but have risen as skills and the volume of production has grown. Workers benefited, as did the cadres negotiating the deals and the communities which housed the enterprises. The Pearl River delta is now a booming area and so are several other regions of Southeast China. Some local entrepreneurs, including private individuals, so-called 'cooperative' enterprises, township and village enterprises and some state enterprises have followed these initiatives without overseas Chinese partners to produce for domestic and, to a lesser extent, export markets.

China has become a dual economy in a new sense in a mere 10 years. The pace of central government reform remains slow. Public ownership is still a tenet of Communist Party faith. A dual price system is a constant invitation to corruption. Fiscal and financial systems are in disarray with resulting inflationary pressures. 'Overheating' has to be followed by severe monetary constraints to bring the economy back to a more even keel. More profits are to be made from gambling on foreign exchange and other price changes than from production. A legal framework and institutional development are lacking. Equity is the main victim of such growth, but the economy is operating because market signals are working in agriculture and in exports, where private ownership has become tacitly accepted. Whether the growth of the new private sectors will rapidly lead to a breakdown of the state economy, or whether a dual economy will persist at the cost of economic development and particularly of equity, is still an open question.
Philippines

The Philippines correspond to a Latin American rather than an East Asian model. In the 1950s the Philippines was the most advanced country in East Asia, but by the 1960s it began to lag behind other East Asian countries. Agricultural stagnation has been an endemic problem, in contrast to the rest of the region.

High protection from the 1950s led to fiscal problems. This was compounded by failure to tax personal incomes other than those of public servants and workers in large corporations. Corporation taxes were similarly limited, public expenditures were wasteful and a highly profitable repressed financial system flourished. Macroeconomic policies failed to stabilise the economy, leading instead to high inflation, balance of payments crises, exchange overvaluation and depreciation. Protection offsets and incentives to exports, including export processing zones, failed to work. 'Stop-go' policies, unsuccessful reform attempts, heavily subsidised public and private borrowing abroad leading to high debt and corruption characterise the economy. Real wages in the Philippines have stagnated for 20 years. Temporary and permanent emigration has proved to be the only relief for unemployment and underemployment (Baldwin 1975; Bautista 1989).

The role of government

Discussion of the role of the government in East Asian development has been distorted by the attempts to apply a 'Japanese model' with the focus of attention on the growth of manufacturing and exports of manufactures (Amsden 1989, Wade 1990). A more realistic account shows the balanced growth of primary (particularly agricultural), secondary and tertiary industries, and the important role of economy-wide policies that made overall growth with equity possible.

Macroeconomic stability

Macroeconomic stability is the economic cornerstone on which East Asia's export success has been built. Hong Kong, Malaysia, Singapore and Thailand from the early 1950s, Taiwan and the Republic of Korea from the time they adopted growth policies in the late 1950s and early 1960s respectively, and Indonesia from 1965, relied on taxes rather than on borrowing or printing money to finance recurrent and development expenditures. Public expenditures were largely kept within the bounds of revenues and when budget deficits threatened to balloon out, they were cut back sharply. In the Philippines such prudence was disregarded. Inflation is the principal single indicator of macroeconomic effectiveness.
The efficiency of tax collection and public expenditures varied considerably from Singapore and Hong Kong at one end of the spectrum to the other countries in the region. Indonesia and Malaysia were fortunate in having high petroleum revenues. But with the exception of the Philippines, public finance standards were either high at the beginning of the rapid growth period or were improved markedly as countries developed. Some gains were even made in petroleum-rich Indonesia. Fiscal effectiveness made it possible for monetary policies to concentrate on price stability, that is, on keeping inflation rates low and exchange rates in equilibrium. Rapid growth encouraged private savings and enabled public savings to be invested in infrastructural developments, reducing overall costs of production. Relatively high domestic savings and investment indicate the effect of successful macroeconomic policies on growth.

<table>
<thead>
<tr>
<th>Table 5</th>
<th>Average annual rate of inflation, East Asia and other developing economies, 1965-90 (per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1965-80</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>8.1</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>18.4</td>
</tr>
<tr>
<td>Singapore</td>
<td>5.1</td>
</tr>
<tr>
<td>Taiwan</td>
<td>6.0</td>
</tr>
<tr>
<td>Indonesia</td>
<td>35.5</td>
</tr>
<tr>
<td>Malaysia</td>
<td>4.9</td>
</tr>
<tr>
<td>Thailand</td>
<td>6.2</td>
</tr>
<tr>
<td>China</td>
<td>-0.3</td>
</tr>
<tr>
<td>Philippines</td>
<td>11.4</td>
</tr>
<tr>
<td>Low and middle-income developing countries</td>
<td></td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>11.4</td>
</tr>
<tr>
<td>South Asia</td>
<td>8.3</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>13.6</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>31.4</td>
</tr>
</tbody>
</table>


In financial policies there was again a spectrum from the internationally competitive financial markets of Hong Kong, Malaysia and Singapore to the highly repressed financial system of the Republic of Korea. In Korea, government
rationing of credit to private enterprises required detailed bureaucratic intervention resulting in considerable inefficiency throughout the economy. In the Philippines, financial repression distorted the structure of production and led to inefficiency and to high borrowing abroad for unproductive purposes. Private and public borrowing thus gave rise to Latin American levels of debt.

Table 6  Gross domestic savings and investment, 1965, 1975 and 1990 as a share of GDP (per cent)

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>29</td>
<td>25</td>
<td>34</td>
<td>36</td>
<td>24</td>
<td>29</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>8</td>
<td>19</td>
<td>36</td>
<td>15</td>
<td>27</td>
<td>37</td>
</tr>
<tr>
<td>Singapore</td>
<td>10</td>
<td>29</td>
<td>45</td>
<td>22</td>
<td>40</td>
<td>39</td>
</tr>
<tr>
<td>Taiwan</td>
<td>16</td>
<td>23</td>
<td>37</td>
<td>23</td>
<td>31</td>
<td>23</td>
</tr>
<tr>
<td>Indonesia</td>
<td>8</td>
<td>26</td>
<td>37</td>
<td>8</td>
<td>..</td>
<td>37</td>
</tr>
<tr>
<td>Malaysia</td>
<td>24</td>
<td>26</td>
<td>32</td>
<td>20</td>
<td>25</td>
<td>32</td>
</tr>
<tr>
<td>Thailand</td>
<td>19</td>
<td>22</td>
<td>30</td>
<td>20</td>
<td>27</td>
<td>38</td>
</tr>
<tr>
<td>China</td>
<td>25</td>
<td>31</td>
<td>40</td>
<td>24</td>
<td>..</td>
<td>37</td>
</tr>
<tr>
<td>Philippines</td>
<td>21</td>
<td>25</td>
<td>17</td>
<td>21</td>
<td>31</td>
<td>23</td>
</tr>
</tbody>
</table>


Neutral trade policies

The five East Asian models show five different approaches to trade policy. The openness of Hong Kong's and Singapore's economies complemented prudent macroeconomic policies so that export and overall growth was stimulated.

High export growth facilitated management of the balance of payments and macroeconomic stability in the rapidly growing countries throughout the region. Inflows of foreign investment (except in the Republic of Korea) supported growing efficiency in production by accessing new technologies from the rest of the world as skills developed and real wages rose.

Macroeconomic stability and neutral trade policies encouraged efficient resource allocation among sectors (with a consequent growth of tourism, financial services and other service sectors) and led to investment abroad as wages rose rapidly, that is, particularly in Hong Kong, Singapore, Taiwan and the Republic of Korea. Rapid export growth and a high export to GDP ratio (given each country's size) were leading factors, though not the sole sources of growth.
Table 7  Average annual real growth of merchandise exports, 1965-90 (per cent)

<table>
<thead>
<tr>
<th></th>
<th>1965-80</th>
<th>1980-90</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>9.1</td>
<td>6.2</td>
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<td>Korea, Republic of</td>
<td>27.2</td>
<td>12.8</td>
</tr>
<tr>
<td>Singapore</td>
<td>4.7</td>
<td>8.6</td>
</tr>
<tr>
<td>Taiwan</td>
<td>18.9</td>
<td>12.1</td>
</tr>
<tr>
<td>Indonesia</td>
<td>9.6</td>
<td>2.8</td>
</tr>
<tr>
<td>Malaysia</td>
<td>4.6</td>
<td>10.3</td>
</tr>
<tr>
<td>Thailand</td>
<td>8.6</td>
<td>13.2</td>
</tr>
<tr>
<td>China</td>
<td>4.8</td>
<td>11.0</td>
</tr>
<tr>
<td>Philippines</td>
<td>4.6</td>
<td>2.5</td>
</tr>
<tr>
<td>Low and middle-income developing countries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>6.1</td>
<td>0.2</td>
</tr>
<tr>
<td>South Asia</td>
<td>1.8</td>
<td>6.8</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>5.7</td>
<td>-1.1</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>-1.0</td>
<td>3.0</td>
</tr>
</tbody>
</table>


Table 8  Export of goods and services to GDP ratio, 1965 and 1990 (per cent)

<table>
<thead>
<tr>
<th></th>
<th>1965</th>
<th>1990</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>71</td>
<td>135</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>9</td>
<td>31</td>
</tr>
<tr>
<td>Singapore</td>
<td>124</td>
<td>189</td>
</tr>
<tr>
<td>Taiwan</td>
<td>19</td>
<td>48</td>
</tr>
<tr>
<td>Indonesia</td>
<td>5</td>
<td>26</td>
</tr>
<tr>
<td>Malaysia</td>
<td>43</td>
<td>78</td>
</tr>
<tr>
<td>Thailand</td>
<td>17</td>
<td>36</td>
</tr>
<tr>
<td>China</td>
<td>4</td>
<td>18</td>
</tr>
<tr>
<td>Philippines</td>
<td>17</td>
<td>28</td>
</tr>
</tbody>
</table>


The combination of stable macroeconomic and neutral trade policies enabled growth to be balanced within and among sectors. Although production shifted
toward manufacturing and services, agricultural productivity continued to grow (except in Singapore and Hong Kong, of course). Too much must not be read into sectoral production shares in the nine economies, but the shares are indicative of the role of principal trends. The importance of services - formal and informal - in output and employment (and in Singapore and Hong Kong even in exports).

### Table 9 Sectoral distribution of GDP, 1990 (per cent)

<table>
<thead>
<tr>
<th>Agriculture</th>
<th>Manufacturing</th>
<th>Public utilities</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>- 18</td>
<td>8</td>
<td>73</td>
</tr>
<tr>
<td>Korea, Republic of</td>
<td>9 31</td>
<td>14</td>
<td>46</td>
</tr>
<tr>
<td>Singapore</td>
<td>- 29</td>
<td>8</td>
<td>63</td>
</tr>
<tr>
<td>Taiwan</td>
<td>4 38</td>
<td>3</td>
<td>55</td>
</tr>
<tr>
<td>Indonesia</td>
<td>22 20</td>
<td>20</td>
<td>38</td>
</tr>
<tr>
<td>Malaysia</td>
<td>16 27</td>
<td>14</td>
<td>43</td>
</tr>
<tr>
<td>Thailand</td>
<td>12 26</td>
<td>13</td>
<td>48</td>
</tr>
<tr>
<td>China</td>
<td>27 38</td>
<td>4</td>
<td>31</td>
</tr>
<tr>
<td>Philippines</td>
<td>22 25</td>
<td>10</td>
<td>43</td>
</tr>
</tbody>
</table>


Government intervention in Hong Kong and even in Singapore was largely confined to infrastructural development. Although Singapore's socialist production ideology was quickly abandoned in favour of economic liberalism, remnants were sustained by the vested interest of public servants in their positions in mixed (public and private investment) enterprises. This delayed fiscal reforms (lower corporate taxes but no tax 'holidays' and privatisation) but did not disrupt the economy because public intervention was only permitted where it followed market trends. The waste engendered was accordingly limited. In broad terms and in most respects Singapore grew as fast as Hong Kong. The main cost of the largely redundant public activities was to retain able Singaporeans in the public service and thus delay the evolution of indigenous enterprise.

Because Taiwan and the Republic of Korea did not move to trade neutrality at the time of macroeconomic reform, they had to counter the high costs of protection for manufacturing in attempting to establish neutrality by regulation. In both countries protection was implemented through quantitative import restrictions (including import licences), escalating and highly variable tariffs, controls over entry into production, production quotas, licensing and price
controls. Policy distortions meant that resource allocation was distorted. Governments sometimes attempted to offset distortions by credit and other subsidies. Foreign investment had to be regulated to avoid the exploitation of domestic markets by foreign companies.

Regulations to offset the cost of distortions introduced by inappropriate policies led to many additional intra and inter-sectoral distortions, rent seeking and corruption. The administrative system required to implement regulations, instead of reducing 'market failure', made it pervasive. Ultimately, intensive public intervention was needed to make the economy work at all. Stable macroeconomic policies and counters to inappropriate policies made progress possible. Export growth brought competitiveness and a growing recognition that trade and financial policy reforms could replace the costly administrative environment.

Indonesia, Malaysia and Thailand followed the same broad path as Taiwan and the Republic of Korea, but their endowment of natural resources was richer and they had (with smuggling), lower levels of protection. Agricultural growth was less impeded. The petroleum boom gave Indonesia and Malaysia considerable resources for public investment in the social and physical infrastructure. Some petroleum rents were wasted in both Indonesia and Malaysia on unsustainable state enterprise investments and protectionist measures, but the fall in petroleum prices in the early 1980s brought sharp pressures for economic reform to maintain economic growth.

China is in a time warp. It has put a high priority on macroeconomic stability, but it is still a highly controlled economy. Macroeconomic instruments, notably efficient and equitable taxation, are yet to be established. Monetary and financial policies lack an institutional base. Protection is still largely quantitative. Government intervention is all-pervasive and its costs are extremely high. The low shares of services and public utilities in the economy reflect both China’s low level of development and the Marxist belief that services are not productive. Hopefully economic development in agriculture and the export sector is now so deeply entrenched that the reform process will continue.

In some senses it seems that the successful East Asian models are not too different from that in the Philippines. Countermeasures attempted to offset protectionist and repressed financial policies, but they were unsuccessful, as they were in most developing economies following this pattern of development in the absence of prudent macroeconomic policies.
Postscript

The debate about government intervention is not merely of academic relevance. Of some 150 developing economies only a handful, including the ones discussed in this paper, have shown rapid, equitable and sustained growth. It matters to most developing economies that are yet to achieve such progress, and to reforming centrally planned economies, which paradigm worked in East Asia. Was detailed government intervention on the lines of a 'Japanese model' the instrument of success? Or was success achieved by liberal policies leading to economy-wide macroeconomic stability and international trade neutrality that enabled direct government intervention to be substantially reduced and phased out?
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