Why Isn't the Whole World Experimenting with the East Asian Model to Develop?: Review of The East Asian Miracle

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Summary. — Like Narcissus, the World Bank sees its own reflection in East Asia's success. It attributes the East Asian miracle to macroeconomic basics — high saving and investment rates, expenditures on education, and exports — but in reality, these are anchored in micro-institutions that exhibit pervasive state intervention. East Asia created competitiveness by subsidizing learning, whereas Bank policy emphasizes methods that effectively curb real wages. The Report is rich in empirical data, but they do not support the Bank's dismissal of industrial policy as "ineffective," and they are presented in a way that makes it difficult for students to corroborate Bank findings. The greatest disappointment of the Report's market fundamentalism is a failure to study seriously how elements of the East Asian model can be adapted to suit conditions in other countries.

1. MARKET FUNDAMENTALISM

The World Bank's verdict on the causes of the East Asian miracle was bound to be controversial because the topic is controversial and so is the Bank. The Bank is inherently a political organization yet purports to produce objective economic analyses. Its middle management is comprised of many highly respected economists while its top management is comprised of political appointees who serve at the discretion of the industrialized countries, especially the United States.

The East Asian Miracle Report (World Bank, 1993) reflects the Bank's internal conflict. On the one hand, the Report widens the scope of the debate on the role of the state in economic development, a debate muffled by the neoliberal "Washington consensus." Most chapters indicate a thorough understanding on the part of Bank staffers of East Asian institutions and how deviations from the free market model induced development, as in the case of financial repression. The Report's analysis of policy formulation should be of interest to a wide range of developing countries. Its findings on high total factor productivity growth in the East Asian region should also stimulate further discussion. John Page, who directed the research, has done a nice job of getting his arms around a bear. On the other hand, because the Report cannot prove its own major conclusion, it is quintessentially political and ideological.

Its conclusion is that the high performing Asian economies owe much of their growth to honoring the Bank's "market-friendly approach" and "getting the basics (a twist on prices) right." The Report acknowledges that "in most of the East Asian countries, in one form or another, the government intervened systematically and through multiple channels" (p. 5). Thus, the basics cannot tell the entire story. But since they allegedly tell most of the story, and the effect of government intervention on the "supernumerary" growth rate cannot be determined (the effect might conceivably be nil or even negative), other developing countries are advised to forget intervention and focus on the fundamentals:

What caused East Asia's success? In large measure the high performing Asian economies [HPAEs] achieved high growth by getting the basics right. Private domestic investment and rapidly growing human capital, were the principal engines of growth [along with an export orientation, essential in Japan, Korea, Hong Kong, and Singapore, whose supply of natural resources, including land, was minimal]. In this sense there is little that is "miraculous" about the HPAE's superior record of growth; it is largely due to superior accumulation of physical and human capital (p. 5).

This focus on the fundamentals suggests that economic growth is a fairly straightforward process, in

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contradistinction to all the new growth models which, given imperfect information, increasing returns, multiple equilibria, path dependence, self-reinforcing mechanisms, historical lock-ins and other dynamic properties, emphasize that growth processes have "no single explanation" (Stiglitz, 1992, p. 44). The disagreement arises from the Bank's error of believing that it is possible to disentangle the "macro" basics — investment, education, exports — from their "micro" foundations, or supporting institutions. Once the two are integrated, and the macro basics are anchored in their policy formulation and implementation context, growth becomes as complex as the new formal models suggest, and the Bank's attempt to attribute most of East Asia's development to market fundamentalism becomes misleading.

For example, if East Asia has had high rates of saving and investment (most East Asian countries began the postwar period with very low rates), then these arose only in conjunction with, say, a particular structure of business enterprise and financial system (all banks in Korea and Taiwan, for instance, were publicly owned). If the high-performing East Asian countries have exported a lot and have been aided in doing so by reasonable exchange rates, then their exchange rate regimes have operated only in conjunction with extensive import substitution policies (tariffs or quotas on competing imports) and elaborate export incentive systems. Thus, one cannot separate high investment rates from financial repression, or high export growth from import substitution or deliberate export promotion.

Because of East Asia's superlative output and productivity performance, it was incumbent on the Bank to go out of its way to figure out how to transfer the East Asian model (with all its internal differences) to countries that have remained underdeveloped. This cannot be done by force-feeding one East Asian model to all poor countries, as the Bank has tried to do with its "market-friendly" approach. But a step in the right direction would have been to begin to explore and analyze systematically which of East Asia's supporting institutions has served investment, education, and exports especially well with an eye toward what must be done to modify these institutions to make them work elsewhere. Instead, like Narcissus, all the Bank was capable of doing in its Report was seeing the image of its own "market-friendly" policies in East Asia's fortunes.

2. REINVENTING NASSAU SENIOR

This narcissism is inherently ideological: one cannot coherently claim that the effect of government intervention in East Asia was residual, or that East Asia really operated with "market-friendly" policies, all appearances aside. It is also doctrinaire to assert that the high performing East Asian economies could have grown as fast or even faster if their governments had intervened less or not at all.

The Report notes:

Measuring the relative impact of fundamentals and interventions on high performing Asian economies is virtually impossible. It is very difficult to establish statistical links between growth and a specific intervention, and even more difficult to establish causality. Because we cannot know what would have happened in the absence of a specific policy, it is difficult to test whether interventions increased growth rates (p. 6, emphasis added).

Quite correctly, then, the "revisionist" argument (as the Bank calls heterodoxy) — to the effect that market and state interacted impenetrably in East Asia to generate rapid industrialization — is shown to be unfalsifiable.

But speaking of the devil! If it is not possible to establish statistical links "between growth and a specific intervention," then neither is it possible to establish statistical links between growth and non-intervention. In trying to do so the Report commits the same fallacy as the unfortunate economist Nassau Senior. Confusing stocks and flows, Senior argued in the 1830s against reducing the 10-hour work day on the grounds that all profits were made in the tenth hour. In effect, the Bank also fallaciously argues that government intervention in East Asia accounted for only a small fraction of total growth and, therefore, was of minor consequence!

Equally ideological is the Report's premise that growth would have been as fast if the Bank's own "market-friendly" policies had been substituted for the actual policies which East Asia used to develop, and that other late-industrializing countries should adopt the Bank's own policies rather than East Asia's. This is an old chestnut, first heard in the form that "Japan could have grown even faster if it had followed neoclassical (or "market-friendly") policies." This type of argument is doctrinaire because neoclassical economics, while taught in academy with great vividness and conviction, is still only a theory. The policies associated with it do not automatically generate the outcomes they promise: for instance, it cannot be taken for granted that a set of "neutral," "market-conforming" investment policies will induce the "market conforming" industrial structure that neoclassical theory predicts. Between theory and practice lies a mountain of assumptions, many exogenously determined or beyond domestic policy manipulation (relating to, say, information, entrepreneurship and motivation, international price changes, and so forth). Unless enough of a model's tortuous assumptions are fulfilled, the implementation of its policy prescriptions may backfire and not generate the anticipated outcomes; or the predicted outcomes might emerge only after a lengthy and socially costly adjustment period.
Therefore, *ex ante*, the Bank’s own “market-friendly,” minimalist state policies might not have fulfilled as well as East Asian “revisionism” all the conditions necessary to achieve rapid growth of output and productivity. After all, “we cannot know what would have happened in the absence of a specific policy . . .” (p. 6).

It is a pity the *Report* did not devote more attention to Hong Kong, the supposed paragon of state minimalism, because it could have dismissed once and for all (given the Bank’s lofty authority) the delusion that Hong Kong is a replicable model (its atypical political stability and excellent geographical location have sustained its financial sector, with services now accounting for 70% of income), or even that free markets have been altogether responsible for success. Ironically, Hong Kong’s traditionally most important industry, textiles, has been strongly protected by the very type of market interference Hong Kong’s economic philosophy deplores:

Because of its comparatively longer history of development, Hong Kong possesses *larger export quotas* than Taiwan and South Korea, and especially other LDCs (Ho and Lin, 1991, p. 277, emphasis added).

These quotas have allowed Hong Kong to delay a painful process of industrial restructuring, although in anticipation of the need to create higher value added manufacturing activity, the government has, in fact, become more interventionist (Ho and Lin, 1991).

3. POINTING THE GUN INWARDS

Through various gyrations to coopt the East Asian experience, or maybe through just plain confusion, the Bank turns the “big gun” it aims against industrial policy against itself, the supposedly systematic statistical evidence it provides to debunk industrial policy’s impact on East Asia’s economics:

We find very little evidence that industrial policies have affected either the sectoral structure of industry or rates of productivity change (p. 21). . . *Industrial policies were largely ineffective* (p. 312, emphasis added).

Here’s how the *Report* arrives at this conclusion.

The Bank’s own tests of the effect of industrial policy on industrial structure (of South Korea primarily) can elicit the conclusion that industrial policy has “no effect” on sectoral configuration because:

The manufacturing sector seems to have evolved roughly in accord with neoclassical expectations; industrial growth was largely “market conforming” (p. 315).

Since industrial policy created an industrial structure that was “market conforming” (according to neoclassical definition and Bank statistical estimates), the *Report* reaches the astonishing conclusion that industrial policy was “ineffective.” Thus, the *Report* declares Korea’s industrial policy “ineffective” because it created the same market structure that neoclassical theory predicts would have evolved if South Korea had had no industrial policy at all (just a neutral neoclassical policy).

As this test result is formulated, industrial policy cannot win: if it fulfills neoclassical expectations, it is “ineffective”; if it violates them, it is inefficient! More to the point, the underlying *(and unverifiable)* presumption is that in the absence of an industrial policy, South Korea’s industrial structure would have been as “market conforming” as neoclassical theory predicts — instead of simply underdeveloped, or under the control of foreign capital, or in serious balance of payments straits, or advancing at a slower rate than it actually achieved.

Of course, it is quite possible that if the Bank had determined East Asia’s overall growth strategy, the outcome might have been a lot worse — rather than as good as or better than — what did happen. Without capital controls and other financial market “imperfections,” for instance, an undisciplined private sector might have sent its money to Switzerland, speculated more intensely in real estate, or consumed rather than invested. Without an investment policy, expenditures on primary and secondary schooling might simply have led to unemployment, and tertiary school leavers might merely have added to “brain drain.” The presumption of the Bank’s “market-friendly” approach is that investments in education obey a kind of “Say’s Law,” with the supply of educated people creating the demand necessary to employ it. Instead, investments in education may behave in accordance with Keynesian “ineffective demand.” Sub-Saharan African governments, for example, invest more than East Asian governments in education — 4.1% versus 3.7% of GDP (p. 198) — but unemployment of primary and secondary school-leavers in Africa is rampant. With respect to industrial structure, in varying degrees the high-performing East Asian economies protected their strategic industries from foreign competition and offered them tax and other financial incentives (and continue to do so). Now Bank neoliberal policy rigidly opposes any form of subsidies to industry, whether for exports or import substitutes, and enforces its will by means of the conditionality it attaches to its structural adjustment loans. Why, however, should one presume that such minimalism is superior to any of the varieties of industrial policy found in the high-performing East Asian economies?

The Bank’s second major supposed indictment against industrial policy, that targeted industries (except those in Japan) have lower productivity growth rates than some other industries, particularly textiles, is merely unconvincing. Neither the Bank’s own econometric estimates (analyzed in this issue by Jene Kwon), nor the evidence the Bank culls from
only three disparate single-country studies, normalize for inherent behavioral differences internationally in industry productivity. Yet some industries have congenitally lower productivity growth rates than others, and this may account for the Report's finding. In the study about Korea by Dollar and Sokoloff (1990), as well as in the Bank's own work, it is also unclear how targeted industries are defined. Textiles, for instance, were the most promoted industry for at least half the period Dollar and Sokoloff consider, 1963–79.

All in all, the evidence is either unbelievably weak or altogether inadmissible to support the Report's controversial conclusion that industrial policy in the world's industrial policy meccas was "largely ineffective," as most people understand that term (p. 312). Nevertheless, even if the evidence were strong and East Asia's industrial policies were "largely ineffective" in the sense of being "market conforming", then the correct, non-political policy recommendation for the Bank is crystal clear. Since East Asia has had some of the highest growth rates of output and productivity in the world, and since East Asia provides no evidence that any other set of policies is as good or better than its own set, why not advise developing countries the Bank's own "market-friendly" point of view.

Besides "administrative guidance" (to which the Report devotes a total of three paragraphs), here's what some of those so-called market-friendly East Asian policies included:

Policy interventions took many forms — targeted and subsidized credit to selected industries, low deposit rates and ceilings on borrowing rates to increase profits and retained earnings, protection of domestic import substitutes, subsidies to declining industries, the establishment and financial support of government banks, public investments in applied research, firm- and industry-specific export targets, development of export marketing institutions, and wide sharing of information between public and private sectors. Some industries were promoted while others were not (pp. 5–6).

4. CITING ORIGINAL SOURCES, OR "GETTING THE COPYRIGHT"

Since it is impossible to verify formally either the orthodox or revisionist arguments about the role of government in East Asian growth, we must be content, as the Report notes, with what Keynes calls essays in persuasion. Which side, then, is more persuasive in the Report?

The answer lies in the active role in the Report played by the Bank's top management. The genesis of the East Asian Miracle study started with the Japan Delegation's frustration with what it saw as the Bank's obsessive emphasis on free market policies despite contrary East Asian evidence (Lall, in this issue, covers the background). Eventually, the Bank agreed to undertake an in-depth analysis of growth in East Asia, financed by Japan. It insisted, however, on top management control over the final product. What is the probable cost to the reader of this control?

One cost is that the revisionist view has not been allowed to do its own persuading. It is synthesized by the Bank, if presented at all. It is rehashed rather than reported first-hand, and consequently, most contentious issues are not seriously debated. Simply the Bank marshals as much evidence as possible for its own "market-friendly" point of view.

A "veil of money" separates the reader from East Asian development in the form of expensive "background papers" by consultants, hand-picked and hired by the Bank, who collaborate with Bank insiders and personally interpret what they believe happened in East Asia, based, in some cases, on extensive bibliographical references mainly to their own work. Most experts outside immediate Bank circles, who have studied East Asia for years, are rarely cited, if at all. How can one conduct a serious analysis of East Asian development without at least referring to the major works of such scholars as Ronald Dore in the field of labor organization; Yung Chul Park or Hugh Patrick in the field of finance; Miyohei Shinohara or Kim Kwang-Suk in the field of trade, and Takafusa Nakamura, Ryoshin Minami, Kazushi Ohkawa, Samuel Ho, etc., for a general overview of the development process?

The failure to recognize classic works in the debate and to cite the original source — "to get the copyright" — means that all information to the reader is filtered. Much of the statistical data are not fully identified. Would financial repression, for example, appear so "moderate" if Table 5.5, with simply an "International Monetary Fund" unpublished source, had presented not just data on deposit rates but also on lending rates, including effective real interest rates on foreign loans (which were mostly negative)? Would repression have appeared moderate if the table had shown the (huge) gap between freely determined interest rates in dollar markets and administered rates in commercial banks (presumably the source of the table's deposits), or had disaggregated real domestic interest rates for the 1980s, when they were high, from real interest rates for earlier years (although the table does contain standard deviations)? Data tend to be presented in such a way that curious students cannot easily return
to original sources to check out the debate on East Asia for themselves.

The inclusion or exclusion of information, of course, is also under Bank control. The Report cites three studies (p. 206) that purport to show a positive association between real interest rates and saving, but fails to mention the strong cross-country evidence (Giovannini, 1985; Khatkhate, 1988), or any country-specific findings (say, Yu, 1988, for Korea) that indicate no relationship between these two variables. This is in spite of the Bank's insistence on "getting interest rates right" and East Asian governments' maneuvers to keep them low, in order to stimulate investment (the Report also omits any mention of the fact noted earlier that Korea's and Taiwan's banking systems were until very recently entirely in public hands).

Not one shred of opposing evidence is presented in one of those sermonizing Bank "empty economic boxes" (Clapham, 1922) that dwells on the allegedly high financial costs of Korea's heavy industry drive in the late 1970s (Box 6.3). Simply we are told there and elsewhere that "excessive" targeting brought Korea to the brink of disaster. We are not told, for instance, that the most highly targeted heavy industries, chemicals and machinery, accounted for a much lower share of outstanding nonperforming loans than outstanding total loans, or that 60% of all nonperforming loans were accounted for by one industry, construction, whose private firms, on their own volition, overinvested in the Middle East (Amsden and Euh, 1990, Table 11). Nor are we told that heavy industry succeeded in becoming Korea's leading export sector by the early 1980s, very shortly after being targeted, thereby rescuing the economy from one of its deepest recessions; or that a Korean chaebol's automobile exports, emblematic of heavy industry, were the hottest selling economy car in the United States for two consecutive years; or that Korea's state-owned integrated iron and steel company became one of the most efficient and profitable in the world; or that before neoliberalism became the rage in Washington, the Bank itself supported Korea's heavy industrialization drive (Kim, 1992). So how do all of these omissions square up with the Report's homily that only the most mild, "moderate" targeting possibly worked in East Asia, and probably could not work at all elsewhere?

Findings for East Asia that over turn theoretical sacred cows of the Bank are not flagged as such. (Note, for example the discussion in support of "crowding-in," with no reference to the debate started by Lance Taylor's work (1988)). There is no discussion whatsoever of the relationship between industrialization and East Asia's investments in university training, which were critical to build a competent civil service, because official Bank policy considers tertiary education a strictly private affair.

If on some key issues single Bank studies are offered as the only empirical evidence, then on other key issues no empirical evidence is provided at all, to wit:

Industrial policy advocates believe that the short run allocative costs of establishing internationally uncompetitive industries will be outweighed by the longer run benefits of rapid productivity change in the promoted and linked sectors. But as the many infant industries that have never grown up amply demonstrate, protection does not ensure that the promised learning and economies of scale actually materialize (p. 294–295, emphasis added).

Which infant industries failed to grow up in East Asia's case? If there were any, what were the reasons for their failure and how can those failures be avoided? Since the Bank has the resources, why not actually test, or provide some industry case studies, to show how the "short-run allocative costs" compare with the "long-run productivity [and employment and balance of payments] benefits," and if the comparison is unfavorable to intervention, why not learn what went wrong with the aim of improving intervention in the future?

In short, the Report does not live up to expectations of providing a judicious and detached appraisal of disagreements about East Asia's miracle. In my opinion, the revisionist view, if there is a single one, is not given a fair shake, especially because the Report does not seriously examine the possibility, or explore how to overcome the problems, of implementing a customized East Asian model in other late-industrializing countries. The Report's conclusions were foregone.

5. A "THIRD WAY"?

Why did East Asian governments intervene so much in the first place? The Report provides a few theoretical speculations (p. 293) suggesting that it was niceties such as "pecuniary external economies" that drove conservative East Asian governments to manage the entire industrial transformation of their economies. The Bank misses the urgent need for governments to intervene in the accumulation process in countries, such as those of East Asia, that have had to industrialize "late," without the competitive advantage in the marketplace of new, innovative products and processes. (As Johnson, 1982, noted about Japan: "Economic crisis gave birth to industrial policy," p. 114.) It was technological innovations and other competitive assets, of course, that made it easier for Britain and the United States (the Bank's paragons) to industrialize using less government support of business than late-industrializing countries have found unavoidable in order to grow (see Hikino and Amsden, 1994).

The East Asian lesson that might profitably be told to today's least developed countries and to some of the late industrializers trying to get back on track, is that in
The Bank also distances itself from revisionism and low-productivity countries aiming to industrialize with a "third way." Nevertheless, those who see the East Asian story as one of the application of pure laissez-faire and the more recent revisionist view that it all resulted from the activity of a highly intrusive government" (Ranis, 1989, p. 1443). Japan had higher wages but proportionately higher productivity (and quality) than either Korea or Taiwan. Therefore, Korea and Taiwan faced an immediate choice, as depicted in Figure 1. They could either cut real wages further to become internationally competitive (a movement from $B$ to $C$), or they could subsidize business, in this case the textile industry, offering it preferential credit and protecting it from Japanese exporters and Japanese foreign investors, until it learned enough to raise productivity (and quality) to reach Japan's level (at $A$) of unit labor costs (a movement from $B$ to $D$, with subsidies financed either through foreign borrowing or taxation).

Sensible, reasonable people have counseled moderation, rejecting extremism and "both the claims of those who see the East Asian story as one of the application of pure laissez-faire and the more recent revisionist view that it all resulted from the activity of a highly intrusive government" (Ranis, 1989, p. 1443). The Bank also distances itself from revisionism and neoclassical orthodoxy alike, offering its "market-friendly approach" as a "third way." Nevertheless, low-productivity countries aiming to industrialize without the equivalent of Hong Kong's competitive assets and with higher unit labor costs than foreign competitors in industries they should otherwise be expected to compete in, face only two immediate, realistic alternatives to becoming internationally competitive, as suggested in Figure 1: they can cut real wages or they can raise productivity (and if one option is superior to the other, there is no reason to combine both). The experience of Korea and Taiwan, and earlier Japan, and now most other high-performing Asian economies, suggests that the latter option is more growth-enhancing but too time-consuming for most private firms to undertake without government support, the amount and duration of support depending on the industry.

Given this choice, the Bank's "market-friendly approach," like neoclassical orthodoxy, boils down to the "not-so-friendly-to-labor" approach of cutting real wages. Almost all East Asian countries introduced policies to restrain real wages, repressing organized labor in the name of fighting communism. But their growth strategies and policy interventions were "revisionist" in the sense of using hothouse measures to raise productivity and thereby cut unit labor costs. In the most fundamental sense, therefore, the Bank cannot claim the East Asians as adherents of its "market-friendly" model. Nor can it claim to have provided proof, analytical or empirical, of a "third way" to rapid economic transformation.

6. CAN THE BANK BE REFORMED?

One comes away from the East Asian Miracle Report with a sense of just how powerful the World Bank is. The contest between the revisionists and the orthodox is like a small firm confronting a multinational enterprise, or a guerilla army engaging a nuclear power. The Japan Delegation has done a good service in trying to get the Bank to recognize the reality of a successful development model that "got the basics" at variance with Bank policy. The "wrong" prices versus the "right" prices is a valid distinction, what with East Asia's subsidized domestic investment credits and negative real interest rates on foreign loans for the critical development decades, continued preferential credit, research and development (R&D) support, and trade protection for struggling mid-tech and now high-tech sectors, pervasive state administrative guidance and entrepreneurship, and an overarching "reciprocal principle" of never giving anything away to business for free without stipulating a monitorable performance standard in exchange (Amsden, 1989) — what the Report calls "competitive contests." But whether top management will open the Bank's windows to empirically grounded ideas and try to make the East Asian model work elsewhere is another issue, and one which raises the question of whether it is possible to
reform the Bank from within, as the Japan Delegation is trying to do.

What makes the Bank so powerful is that it has no real rival. The Bank has become a virtual monopoly, if not in its lending operations then in its research work. Regional banks, such as the Inter-American Development Bank and the new European Bank for Reconstruction and Development, fall over themselves to cooperate, rather than compete with "big brother." The Asian Development Bank is heavily influenced by Japan, invests mostly in infrastructure, and conducts little research of its own. Most United Nations organizations have been stripped of their economic functions. In Eastern Europe, the Bank's only possible competitor is Sachs Associates!

There is also very little reason to expect the Bank to reform from within. There are high costs for the Japan Delegation, in terms of ruffling U.S. feathers, to take on the Bank over development issues. Ironically, the Report should also please the Japanese government (and its academic advocates as well) which, given international criticism of government interventionist policies, has been officially disclaiming any role for itself in the workings of the Japanese economy (the same disclaimers are heard from the governments of Korea and Taiwan). As for the United States, a change of political regime in Washington, from Republican to Democrat, may have some effect on Bank policy, but past Bank policy has strongly supported U.S. bipartisan interests, so the motive for reform is weak.

Still, there are examples in history of guerilla armies winning, and small firms trouncing large ones, depending on the quality of the product. Time will tell about the power of the "market-friendly" versus the East Asian approach.

REFERENCES