CONTRASTING NORTHEAST AND SOUTHEAST ASIAN ‘CAPITALISM’: IMPLICATIONS FOR CHINA*

Manuel F. Montes  
*East-West Center, University of Hawaii  
Keun Lee  
Seoul National University

Asia’s Economic Re-Emergence

In the last two decades of the 20th century, the countries of East and Southeast Asia re-emerged on the world economic arena and cast off their image as nations of subsistence farmers and small sweatshops. In writing about Asia, Myrdal (1968) used a contrast on the title of Adam Smith’s classic work, calling his piece “An Inquiry into the Poverty of Nations.” Asia’s long eclipse began in the 16th century, when Western countries began to overtake the nations of East and Southeast Asia. For a significant part of the region this domination involved colonization by Western nation states. While the West industrialized and expanded, state institutions in Asia rigidified, atrophied and obstructed economic transformation and effective response to the Western challenge.

Asian nations began their painful re-emergence in the second half of the 19th century with the difficult reconstitution of their state apparatuses, first in Japan and then in China. By the second half of the 20th century, other nations in the region also began to emerge from their colonial station (after a period in which Japan itself had become briefly an imperial power).

In fact in this century, it is only nations in this region which have managed to join the ranks of the industrialized West. Each of the countries that are successful have made the effort a national project, with clear state

* This paper is the synthesis of two papers, listed in the references as Montes (1993) and Lee (1993), which were presented at the International Conference on East Asian Development: Lessons on Trade Policy and Regional Development, held in Guangzhou, China, 8-11 November 1993. While the authors remain responsible for all errors in the paper, comments on previous versions from Barry Naughton, Richard Garbaccio, and editorial comments from John Thomas are gratefully acknowledged.
leadership and extensive state participation in the process. This has required a degree of coherence in state performance, which would not have been possible without the prior reconstitution of the state and during the process of growth, the management some would say suppression of domestic centrifugal forces that had made these countries vulnerable to external manipulation in previous centuries.

The second key factor in their success was the restructuring of external economic relations. In this regard, economists tend to focus on categories such as the "outward orientation" of industrial policy, which certainly played a role, as we shall discuss below. But trade orientation is only one element of the development policy and may be almost wholly conditional on other factors. What is clear is that each of the successful countries of Asia consciously set about to redefine its role in the world economy. They went from being passive markets for Western goods and colonial suppliers of raw materials to suppliers of manufactured goods to the West.

Much has been made recently of the growing "economic integration" of Asia. What is being forgotten is that, beset on relative trade shares, Asia was more economically integrated in 1938 than in 1980. Only in the 1990s did intra-Asian trade relative to trade with the rest of the world begin to match the volumes before World War II (Petri 1992). However, the trade integration of the 1930s was through colonial networks (notably Japan's). Between 1949 and 1979, China closed itself to trade with the West and the rest of Asia. During the half century between 1938 and 1988, the rest of Asia traded relatively more with the West than with each other. Asia's trade restructuring took place under the special circumstances of the 40-year Cold War, in which economic relations could be decoupled from their colonial, political prerequisites. This permitted Japan, South Korea, and Taiwan Province, and later China to export to the West, particularly into U.S. markets, while operating protectionist regimes that had been severely proscribed during the colonial era.

The process of restructuring external relations entailed enormous effort on the part of Asian economies. By applying their initial labor cost advantages and executing extensive social policies such as import

---

1 As we shall see in the case of the successful Asian countries, trade orientation was always only one element within a larger industrial policy, which eschewed placing absolute value in efficiency and freedom of commerce.

2 An opposite, and equally accurate, way to say this is that political considerations specific to the Cold War provided the basis for this relationship, i.e. the U.S. permitted Japan to export while maintaining a protectionist regime because it was a key ally. It would still be accurate to say that, in the post-World War II period, colonial-style links between economic and political relations were decoupled.
restrictions and industrial subsidies, these economies:

1. rapidly increased the proportion of domestic manufacturing output relative to that of agriculture,
2. steadily increased the domestic value-added content of exports, and
3. captured enduring international market shares in manufactured products.

Japan stumbled on and successfully implemented this approach; the other East and Southeast Asian countries are following suit albeit at different stages. With the end of the Cold War, the political bases for Asia's external economic relations are in the process of readjustment and the Asian countries will be compelled to reassess the feasibility of this strategy. Another indicator of their economic emergences that East and Southeast Asian countries are being increasingly obliged to respond to demands for more open and "fair" trading relations.

A third element in the success of the industrializing Asian countries was the cultivation of vigorous competitive pressure as the basis of their market economy. The industrializing economies are fundamentally market economies, with good circulation of commodities, flexible factor markets, and few obvious restrictions on resource mobilization. These economies were built upon long traditions of markets developed within Asia's dense populations, nurtured by rich traditions of entrepreneurship. Thus, state policy operated in a social environment that responded strongly to economic incentives.

State policy also sought to develop market "forces" in the process of development. In the most successful economies of Japan, Korea, and Taiwan, government supervision and market pressures furnished complementary "dual discipline" on private sector behavior. The Japanese government consistently strove to have at least two or three private companies in intense oligopolistic competition in developing industries. In Korea, the government drove companies in infant industries to commence export activities as soon as possible, while economic planners in Taiwan threatened to allow imports if prices of domestic substitutes moved higher than international prices. In terms of the Marxist categories of base and superstructure, the developmental state in industrializing Asian countries promoted vigorous private competitive behavior at the base, thereby stimulating productivity growth and international competitiveness, thereby securing the "development of the productive forces" of society.

Among the productive forces, labor is the most important. The industrializing Asian economies placed great emphasis on human resource development, extremely conscious of the existing gap between the
Table 1. Public Expenditure in Education as a Percentage of GNP

<table>
<thead>
<tr>
<th></th>
<th>1960</th>
<th>1989</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hong Kong</td>
<td>-</td>
<td>2.8</td>
</tr>
<tr>
<td>South Korea</td>
<td>2.0</td>
<td>3.6</td>
</tr>
<tr>
<td>Singapore</td>
<td>2.8</td>
<td>3.4</td>
</tr>
<tr>
<td>Malaysia</td>
<td>2.9</td>
<td>5.6</td>
</tr>
<tr>
<td>Thailand</td>
<td>2.3</td>
<td>3.2</td>
</tr>
<tr>
<td>Indonesia</td>
<td>2.5</td>
<td>0.9</td>
</tr>
<tr>
<td>Average (excluding Indonesia)</td>
<td>2.5</td>
<td>3.7</td>
</tr>
<tr>
<td>Brazil</td>
<td>1.9</td>
<td>3.7</td>
</tr>
<tr>
<td>Pakistan</td>
<td>1.1</td>
<td>2.6</td>
</tr>
<tr>
<td>Less developed economies</td>
<td>1.3</td>
<td>3.1</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>2.4</td>
<td>4.1</td>
</tr>
</tbody>
</table>

Note: Alternative sources of data indicate that the expenditure on public education as a percentage of GDP was 3.0 percent in Indonesia in 1989.

level of skills of their population and those of Western countries. Investment in human capital formation in these countries was assisted by rapid economic growth, declining population growth, and more equal income distribution. These combined to foster widespread household investment and lowered the costs of public investment in human capital formation (World Bank 1993: 192-196). Rapid economic growth induced higher family wage incomes, and more equal income distribution ensured that the lowest 20 percent of the population enjoyed incomes beyond subsistence, providing them with resources to invest in their children. Lower fertility rates reduced the growth rate of demand for general public educational facilities and helped to keep school enrollment rates high.

Beyond these supporting influences, the state played an active role in human capital formation. As a percentage of GNP, the industrializing Asian countries invested a larger proportion of their GNP, early on in their growth process, even when they were relatively and absolutely poorer. Table 1 shows that, even in the 1960s, public expenditure on education in these Asian countries exceeded those of less developed countries.

Investment in education will be a key issue for China. Using data from Northeast China (which is more advanced than the rest of the country), Lee (1993) compares China's share in governmental expenditure to those of Taiwan and Japan at comparable levels of development and finds that expenditures in that region are lower than that of Taiwan and only half that of Japan. In terms of the school enrollment ratio, the Northeast China
average of 0.664 is well below the level (about 0.75) achieved by Taiwan, Korea, and Japan (0.93) in 1965.

In this survey of development strategies of East and Southeast Asia, we shall focus on key elements that have particular pertinence to development issues in China. In the next section, we shall begin by reviewing the basic patterns of Asian development. In Section 3, we shall discuss the role of the state and development policy. In Section 4, we shall discuss development issues in China with references to the experiences of East and Southeast Asia.

**Patterns in Asian Economic Development**

At the present time, the economies of Asia present a vast range of size and levels of development (Table 2). Singapore’s per capita income of $14,487 is 60 times that of Lao PDR at $243. The dispersion in economic situation offers the basis for the economies in the region to draw on each others’ comparative advantages to advance their own economic development.

In the 30-year period 1960-91, the newly industrializing economies (NIEs) of Hong Kong, South Korea, Singapore and Taiwan each grew at over 8 percent per year (Table 3). Thailand and Malaysia grew at least 7 percent per year in the same period and Indonesia at almost 6 percent. Japan attained an average rate of growth of 6.6 over the same 30-year period, tapering off in the 1970s from rates that exceeded 10 percent in the 1960s. In the 1980s, the growth rates of the Asian NIEs have also begun to taper off, while that of the dynamic ASEAN nations (Indonesia, Malaysia, and Thailand) are increasing slightly. Charts 1 and 2 dramatize the rapid rates of growth in the 1970s for the Asian NIEs and the ASEAN countries and, by construction, over-emphasize the tapering off of growth in the 1990s for the NIEs.

**Development Policy and the Role of the State**

For economists, discussions about development strategy invariably begin with a consideration of the state’s role in the economy, often presented as a “choice” between bureaucracy and the market. This piece will be no exception.

The experience of the East Asian capitalist economies of Japan, Taiwan,
<table>
<thead>
<tr>
<th>Group/countries</th>
<th>Population (millions)</th>
<th>Area (1,000km²)</th>
<th>GDPa (US$m)</th>
<th>Per capita (US$)</th>
<th>Merchandise exports (US$m)b</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Developing countries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>NIEs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>5.8</td>
<td>1</td>
<td>82,837</td>
<td>14,394</td>
<td>98,557</td>
</tr>
<tr>
<td>Korea</td>
<td>43.3</td>
<td>99</td>
<td>282,971</td>
<td>6,540</td>
<td>69,522</td>
</tr>
<tr>
<td>Singapore</td>
<td>2.8</td>
<td>1</td>
<td>39,984</td>
<td>14,487</td>
<td>56,819</td>
</tr>
<tr>
<td>Taiwan</td>
<td>20.4</td>
<td>36</td>
<td>175,428</td>
<td>8,599</td>
<td>75,535</td>
</tr>
<tr>
<td><strong>ASEAN-4</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>187.8</td>
<td>1,905</td>
<td>116,476</td>
<td>620</td>
<td>29,430</td>
</tr>
<tr>
<td>Malaysia</td>
<td>18.2</td>
<td>330</td>
<td>46,672</td>
<td>2,569</td>
<td>33,714</td>
</tr>
<tr>
<td>Philippines</td>
<td>62.9</td>
<td>300</td>
<td>45,038</td>
<td>716</td>
<td>8,840</td>
</tr>
<tr>
<td>Thailand</td>
<td>56.9</td>
<td>513</td>
<td>80,172</td>
<td>1,430</td>
<td>28,245</td>
</tr>
<tr>
<td><strong>South Asia</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>115.6</td>
<td>144</td>
<td>22,761</td>
<td>197</td>
<td>1,667</td>
</tr>
<tr>
<td>Burma</td>
<td>41.7</td>
<td>677</td>
<td>23,753</td>
<td>572</td>
<td>215</td>
</tr>
<tr>
<td>India</td>
<td>848.6</td>
<td>3,228</td>
<td>268,006</td>
<td>315</td>
<td>16,144</td>
</tr>
<tr>
<td>Nepal</td>
<td>18.5</td>
<td>141</td>
<td>2,517</td>
<td>136</td>
<td>275</td>
</tr>
<tr>
<td>Pakistan</td>
<td>115.5</td>
<td>796</td>
<td>42,952</td>
<td>372</td>
<td>6,352</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>17.2</td>
<td>66</td>
<td>10,231</td>
<td>593</td>
<td>2,009</td>
</tr>
<tr>
<td><strong>Other Asia</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chinac</td>
<td>1,150.8</td>
<td>9,561</td>
<td>371,173</td>
<td>323</td>
<td>58,919</td>
</tr>
<tr>
<td>Lao PDR</td>
<td>4.3</td>
<td>237</td>
<td>1,033</td>
<td>243</td>
<td>78</td>
</tr>
<tr>
<td><strong>Pacific islands</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fiji</td>
<td>0.7</td>
<td>18</td>
<td>1,337</td>
<td>1,802</td>
<td>426</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>3.7</td>
<td>463</td>
<td>3,627</td>
<td>980</td>
<td>1,317</td>
</tr>
<tr>
<td>Vanuatu</td>
<td>0.2</td>
<td>12</td>
<td>154</td>
<td>1,024</td>
<td>15</td>
</tr>
<tr>
<td>Western Samoa</td>
<td>0.2</td>
<td>3</td>
<td>109</td>
<td>676</td>
<td>8</td>
</tr>
<tr>
<td><strong>Developed countries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>17.3</td>
<td>7,687</td>
<td>293,183</td>
<td>16,947</td>
<td>41,930</td>
</tr>
<tr>
<td>Canada</td>
<td>27.0</td>
<td>9,976</td>
<td>592,825</td>
<td>21,956</td>
<td>127,459</td>
</tr>
<tr>
<td>Japanc</td>
<td>123.9</td>
<td>378</td>
<td>3,362,601</td>
<td>27,135</td>
<td>306,580</td>
</tr>
<tr>
<td>New Zealand</td>
<td>3.4</td>
<td>269</td>
<td>42,405</td>
<td>12,546</td>
<td>9,545</td>
</tr>
<tr>
<td>United States</td>
<td>252.7</td>
<td>9,373</td>
<td>5,672,600</td>
<td>22,449</td>
<td>416,510</td>
</tr>
</tbody>
</table>

**Notes:**
- c. GNP.

**Source:**
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>NIEs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>5.6</td>
<td>9.4</td>
<td>8.4</td>
<td>8.5</td>
<td>-0.1</td>
<td>11.9</td>
<td>9.2</td>
<td>10.3</td>
<td>13.0</td>
<td>10.1</td>
<td>na</td>
</tr>
<tr>
<td>Korea</td>
<td>8.8</td>
<td>9.4</td>
<td>8.2</td>
<td>8.8</td>
<td>6.9</td>
<td>12.4</td>
<td>12.0</td>
<td>11.5</td>
<td>6.2</td>
<td>9.2</td>
<td>8.4</td>
</tr>
<tr>
<td>Singapore</td>
<td>8.9</td>
<td>9.5</td>
<td>7.3</td>
<td>8.5</td>
<td>-1.7</td>
<td>2.0</td>
<td>9.5</td>
<td>11.1</td>
<td>9.4</td>
<td>8.2</td>
<td>6.7</td>
</tr>
<tr>
<td>Taiwan</td>
<td>9.2</td>
<td>10.2</td>
<td>8.0</td>
<td>8.9</td>
<td>5.0</td>
<td>11.6</td>
<td>12.3</td>
<td>7.3</td>
<td>7.4</td>
<td>3.9</td>
<td>7.3</td>
</tr>
<tr>
<td>ASEAN-4</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>3.6</td>
<td>7.8</td>
<td>5.8</td>
<td>5.9</td>
<td>2.5</td>
<td>5.9</td>
<td>10.5</td>
<td>0.5</td>
<td>7.5</td>
<td>7.4</td>
<td>na</td>
</tr>
<tr>
<td>Malaysia</td>
<td>na</td>
<td>8.1</td>
<td>5.7</td>
<td>7.0</td>
<td>-1.0</td>
<td>1.1</td>
<td>5.4</td>
<td>8.9</td>
<td>8.7</td>
<td>9.8</td>
<td>na</td>
</tr>
<tr>
<td>Philippines&lt;</td>
<td>5.2</td>
<td>6.3</td>
<td>2.0</td>
<td>4.5</td>
<td>-4.5</td>
<td>1.9</td>
<td>5.8</td>
<td>6.8</td>
<td>5.6</td>
<td>3.7</td>
<td>na</td>
</tr>
<tr>
<td>Thailand</td>
<td>8.0</td>
<td>7.4</td>
<td>7.3</td>
<td>7.6</td>
<td>3.5</td>
<td>4.9</td>
<td>9.5</td>
<td>13.2</td>
<td>12.1</td>
<td>10.0</td>
<td>na</td>
</tr>
<tr>
<td>South Asia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>na</td>
<td>6.7</td>
<td>3.5</td>
<td>4.7</td>
<td>3.7</td>
<td>4.7</td>
<td>4.0</td>
<td>2.9</td>
<td>2.5</td>
<td>6.6</td>
<td>3.3</td>
</tr>
<tr>
<td>Burma</td>
<td>3.5</td>
<td>3.6</td>
<td>2.4</td>
<td>3.2</td>
<td>3.2</td>
<td>-1.1</td>
<td>-4.0</td>
<td>-11.4</td>
<td>7.4</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>India</td>
<td>3.9</td>
<td>3.2</td>
<td>5.9</td>
<td>4.4</td>
<td>5.5</td>
<td>4.5</td>
<td>4.9</td>
<td>9.7</td>
<td>6.2</td>
<td>5.5</td>
<td>na</td>
</tr>
<tr>
<td>Nepal</td>
<td>1.5</td>
<td>2.6</td>
<td>4.2</td>
<td>2.8</td>
<td>6.1</td>
<td>4.3</td>
<td>3.9</td>
<td>7.3</td>
<td>3.9</td>
<td>3.6</td>
<td>na</td>
</tr>
<tr>
<td>Pakistan</td>
<td>4.9</td>
<td>3.7</td>
<td>6.6</td>
<td>5.1</td>
<td>7.6</td>
<td>5.5</td>
<td>6.5</td>
<td>7.6</td>
<td>5.0</td>
<td>5.3</td>
<td>6.5</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>5.3</td>
<td>5.3</td>
<td>2.1</td>
<td>4.3</td>
<td>5.0</td>
<td>4.3</td>
<td>1.5</td>
<td>2.7</td>
<td>2.3</td>
<td>6.2</td>
<td>4.8</td>
</tr>
<tr>
<td>Other Asia</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>China&lt;</td>
<td>2.9</td>
<td>7.5</td>
<td>8.9</td>
<td>6.4</td>
<td>13.5</td>
<td>7.7</td>
<td>10.2</td>
<td>11.3</td>
<td>3.7</td>
<td>4.8</td>
<td>na</td>
</tr>
<tr>
<td>Pacific Islands</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fiji</td>
<td>5.7</td>
<td>5.3</td>
<td>1.7</td>
<td>3.9</td>
<td>-5.1</td>
<td>8.1</td>
<td>-6.6</td>
<td>0.8</td>
<td>11.7</td>
<td>5.4</td>
<td>na</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>4.5</td>
<td>5.6</td>
<td>1.6</td>
<td>3.4</td>
<td>3.6</td>
<td>5.6</td>
<td>2.8</td>
<td>2.9</td>
<td>-1.4</td>
<td>-3.7</td>
<td>na</td>
</tr>
<tr>
<td>Solomon Islands</td>
<td>na</td>
<td>na</td>
<td>1.9</td>
<td>1.9</td>
<td>2.6</td>
<td>-2.2</td>
<td>-5.1</td>
<td>na</td>
<td>na</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>OECD</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>5.2</td>
<td>3.6</td>
<td>3.3</td>
<td>3.7</td>
<td>4.7</td>
<td>1.9</td>
<td>4.5</td>
<td>3.9</td>
<td>4.1</td>
<td>1.2</td>
<td>-2.2</td>
</tr>
<tr>
<td>Canada</td>
<td>5.8</td>
<td>4.7</td>
<td>3.1</td>
<td>4.1</td>
<td>4.8</td>
<td>3.3</td>
<td>4.3</td>
<td>4.6</td>
<td>2.5</td>
<td>0.5</td>
<td>-1.5</td>
</tr>
<tr>
<td>Japan&lt;</td>
<td>12.0</td>
<td>5.2</td>
<td>4.1</td>
<td>7.0</td>
<td>5.1</td>
<td>2.7</td>
<td>4.4</td>
<td>6.2</td>
<td>4.8</td>
<td>5.2</td>
<td>4.5</td>
</tr>
<tr>
<td>New Zealand</td>
<td>4.2</td>
<td>2.3</td>
<td>2.0</td>
<td>2.7</td>
<td>-1.0</td>
<td>3.1</td>
<td>-1.1</td>
<td>1.1</td>
<td>0.7</td>
<td>0.2</td>
<td>na</td>
</tr>
<tr>
<td>United States&lt;</td>
<td>4.5</td>
<td>2.8</td>
<td>2.6</td>
<td>3.2</td>
<td>3.5</td>
<td>2.9</td>
<td>3.4</td>
<td>4.4</td>
<td>2.5</td>
<td>1.0</td>
<td>na</td>
</tr>
</tbody>
</table>

Notes: na=Not available.

c. 1981-87 for Solomon Islands.
e. Real gross national product (RGNP).
f. Real national income (RNI).

Source: Hong Kong, Census and Statistics Department (CSD), Monthly Digest of Statistics, various issues.
and South Korea has led to a recognition—even by institutions that had originally been unsympathetic to the idea (World Bank 1993)—of the potential of non-market institutions to overcome the limitations of market signals as guides to attaining national objectives. These successes also stand in sharp contrast to the Southeast Asian experience, in which industrialization proceeded at a slightly slower rate but where government disregarded market signals less extensively. On the basis of the above countries alone, it appears that decreased reliance on market signals procures more rapid development. We contend that the experience of this sample of countries indicates that predicting the probability of development on the market-versus-government “choice” is misplaced and that, instead, the character of state intervention is more important.

The taxonomy first suggested by Myrdal (1968) between “hard” and “soft” states serves as a useful starting point. Hard states are conceptualized as those which are autonomous from the partisan interests of social groups and foreign interests, while soft states are not. If autonomy from partisan interest is a definition of the hard state in its passive meaning, the hard state in its active sense can be defined as one that is capable of imposing an obligation on people in all social strata, and of executing the performance of the obligation with rewards and penalties. In soft states (which Myrdal (1968: 277) associated with the low level of social discipline in South Asian societies) there is an unwillingness and an inability on the part of the leadership to impose such obligations on the society.

Capacity: State versus Society

In the case of the East Asian states, Lee and Lee (1992) suggest that the hard state emerges from the tradition of Confucian Chinese culture and inherent nationalism. This makes it possible for the citizens of China, Japan, Korea, and Taiwan to view the state as a mobilizer for some common goal, such as economic development. Although explicit coercion

---

3 It is difficult to provide a clear index of extensiveness of government intervention, because it is possible that by statute all countries intervened in the same number of commodities (as would be measured by, say, the proportion of tariff lines subject to import restrictions). What we mean by “extensiveness” here is that bureaucratic control and the resources under government control (to bias economic outcomes) appear to be greater in East Asia than in Southeast Asia.

4 Recognition of the possibility that the state is partially endogenous to the vested interests of the society is the difference between neoclassical political economy and traditional neoclassical welfare economics (Colander 1984, Srinivasan 1985).
was, in reality, frequently employed, the Confucian tradition helped to justify political authority by stressing the collective interest and the ruler’s responsibility to secure the needs of the ruled.

The Confucian tradition designated the hard, nationalistic state as the mobilizer for social purposes. In the Northern Three economies, the political leadership proposed (1) that economic development was a national imperative and (2) that a strong, modern economy was a public good that would benefit every member of society (although in reality the sacrifice of the many created disproportionate opportunities for the few). Such a consensus on basic goals—regardless of whether it was created in a deceptive manner through false persuasion, through coercion, or genuinely based on shared beliefs—is one of the most important requirements for the capacity of the state to intervene deeply (Eads and Yamamura 1987).

Among the nations in Southeast Asia, Singapore while steadfastly proclaiming its multi-ethnic basis, shares many of the features of the Confucian state. The other Southeast Asian states (Indonesia, Malaysia, the Philippines, and Thailand) did not embark upon the development process with the same cultural endowment. A meritocratic government bureaucracy is an explicit manifestation of the Confucian hierarchical model, and on this basis alone state interventionist capacity was more limited among these countries.

Specific conditions provided relatively greater state “hardness” on the part of Indonesia, Malaysia, and Thailand (the “Southern Three”) than the Philippines. In these three countries, the military and its role in addressing real and perceived ethnic, religious, and external threats to national integrity, the persisting dominance of specific parties or political factions, and the rise to prominence of a small “technocratic” corps provided some autonomy for the state from conflicting particularistic interests. This autonomy, combined with nationalism derived from anti-colonial struggles (including Thailand’s), provided the basis for state leadership in the development process. While this degree of autonomy married with technocratic prowess will not resolve conflicts of distribution of gains and losses, it provides some basis for state leadership based on the interest of the whole nation, instead of the interest of the currently ruling faction.

The Philippine experience, which wanted for the special factors of the

---

5 The so-called growth ideology that was supported by the political stability of harsh or soft authoritarianism contributed to lengthening time horizons and made manufacturing a much more feasible alternative to commerce as a field of entrepreneurial activities (Johnson 1987).
Southern Three and perhaps labored under deeper structural weaknesses,\textsuperscript{6} provides a mirror on the issue of capacity. Philippine development plans and policies have tended to consist of the commingled conflict\textsuperscript{7} interests key economic and political factions. The Philippine development plans have tended to be extremely flexible. Instead of expressing a vector of priorities, these have provided sufficient leeway for well-connected businessmen to propose protection or subsidies for their projects. The martial law years (1972-1986) provided some autonomy, but maintenance of martial law required the creation of an alternative business elite, in face of the sullen acquiescence if not steadfast resistance from pre-existing elite groups (Montes 1989). The process of creating an alternative and private business class ultimately proved costly in terms of a foreign debt overhang, so that in the end it appears as if the spate of temporary autonomy had not actually been applied toward the project of national development.

\textit{Division of Responsibility: State versus Private Business}

State intervention in the Northern Three has often been described by the term industrial policy (\textit{sangyo seisaku} in Japanese; \textit{chanye zhengce} in Chinese), which targeted the development of specific sectors. Industrial policy included direct government intrusions into the debailed operation of individual enterprises with measures intended to improve their

\textsuperscript{6} The Philippines shares with many Latin American countries a highly concentrated land ownership of a small group of families that provides an independent economic basis, especially with regard to the state. Thus, at another, perhaps deeper level, the special circumstances of the other Southeast Asian countries might have been sustainable only to the extent that this special type of wealth concentration did not exist. In the case of South Korea, growth has engendered the recent emergence of a small group of families that enjoys some autonomy from the state. Moreover, factors absent in the other Southeast Asian countries but present in the Philippine case might have been important in terms of sustaining the Latin features of the Philippine political economy. An example would be the interaction between the fiercely competitive political elite and the U.S. interest to mediate these conflicts, maintain a minimum of elite solidarity, and suppress social challenges in order to secure its military facilities through much of the post-World War II period.

\textsuperscript{7} The issue is not that other interventionist governments do not have conflicting economic interventions in practice, but that even statements of economic purpose can be interpreted in effectively opposite ways. Corazon Aquino's 1987-1992 development program proclaimed land reform to be the "centerpiece" of her strategy. While groups outside the government and external donors interpreted it differently, actual government practice did not accord land reform the attention, sequence, and budget priority implied. In practice it meant that land reform could be associated with and conditional upon all other government interventions, from poverty alleviation, to boosting agricultural productivity, to carrying out trade reform.
operations (Johnson 1982).

Industrial policy aimed to direct business activities toward serving public goals. Implicit in this approach is a rejection of Adam Smith’s hypothesis that public purposes are best served by allowing private agents maximum leeway to pursue their own self-interests. Instead, profit-based signals, used in private business decision-making, were seen not to be necessarily supportive of national economic interests. This position justified administrative regulations and price distortions, which restricted private decisions over consumption and savings, work and leisure, and the sectoral distribution of investment funds.

Socially, the Asian antipathy to the Smithian position defined a role for the state in the development process that went beyond the control of business monopolies and provided a tenable demarcation between public and private roles, even when intimate operational “coordination” occurred between the two. The contrary Western view is encapsulated in the formulation “What is good for General Electric is good for the country.” Such arguments are decisive in the Philippines, which has a strong American tradition. In the Asian view, however, the private sector serves the social interest, represented by the state policy.

The Asian conception justified direct state intervention into big private business in Japan and Korea, and the erection of a large public sector consisting of numerous state enterprises in Taiwan. In the latter case, the state was able to directly control production activities and the investment patterns. In the former cases, the operational boundary between the private and the public sector was not as sharp as it is in Western capitalism. The state and private businesses maintained a close, long-term cooperative relationship and the state participated in enterprise decisions akin to that of a business partner.

Lee (1992) conceptualizes the close relations between the government and large firms in Korea as a “quasi-internal organization” along the lines of Williamson’s (1975) transaction cost economics. Similar networks between the state and big firms existed in Japan. The so-called administrative guidance (oyosei shido), meaning non-legally binding guidance issued by ministries mostly in written form but on occasion orally, was based on a long-term, multifaceted, and intense relationship (Eads and Yamamura 1987).

---

8 Attributed to Charles Smith, president of General Electric, while serving on the U.S. War Planning Board during War II.
9 In the case of Taiwan, the Kuomintang government’s effort to build the state sector partly originates from political reasons (see Haggard (1990) and Ho (1978)).
Direct state intervention in the Northern Three into business was effective in changing the rate of investment in certain economically strategic industries and led private businesses to do something other than what they would otherwise have done without the intervention (Amsden (1989), Wade (1990), Johnson (1982)). State activism spilled over into creating new organizations to undertake needed initiatives. Based on transaction cost economics, Lee (1992) argues that internal implementation by a quasi-internal organization can be more effective than "market implementation" in achieving identified developmental goals.

In the Southeast Asian countries, the state participated extensively through the establishment of state enterprises. These efforts were motivated by two, often reinforcing motivations: (1) the need to nationalize colonial enterprises (not applicable to Thailand since it had not been colonized) and (2) the need to establish ventures considered critical for industrial development independent of existing business groups. In Malaysia, the extensive state enterprise sector was also intended to help redistribute economic access and power to indigenous Malays under the New Economic Policy (NEP).

Singapore operates a wide ranging set of what Singaporeans call "government-linked corporations" (GLCs), which are controlled, if not fully owned, by the government or government investment funds and have acquired a reputation for not only professional operation but also profitability. Government participation in Indonesia is prominent in oil and natural gas, utilities, steel, aluminum, fertilizer, cement, sugar refining, transportation and communications. Based only on the centrally-owned enterprises, total sales of the 214 officially acknowledged state enterprises amounted to two-thirds of Indonesia's GDP in 1986-87.

---

10 The Philippine experience is not strictly comparable since the private sector has always dominated the public sector, which had been confined to utilities during the colonial period. Independence from the U.S. evinced not the nationalization of foreign enterprises, but instead their Filipinization, with the purchase of control by private Philippine interests, after local groups had accumulated sufficient resources. The extensive state sector which emerged in the early 1980s, was principally the result of the government being compelled to take equity positions in private firms that had failed to service government-guaranteed external debt. The eventual failure of firms with external debt in the 1980s and the action by the government bowing to pressure from foreign creditors to accept the losses amounts to the nationalization or the socialization of private losses.

11 The figure is from Naya and James (1989: 46) and the ratio is between a gross value concept to the value-added concept of GDP. The ratio is still a good indicator of the size of the public sector, and reflects the fact that state enterprises are also found extensively, not only in the petroleum sector, but also in plantation agriculture, such as the state monopoly in clove production.
In Malaysia, under the NEP, the government began to own and operate banks, hotels, agricultural milling companies, office blocks, factories, and plantations. This is in addition to public control in areas considered critical to industrialization: chemicals, automobiles, foundries, iron, and steel. The economic participation of public enterprises in Thailand is not as extensive as in Indonesia or Malaysia. Nevertheless, these enterprises are important in the economy and are found in a wide array of enterprises, including some consumer products. In 1986, the deficits of state-owned enterprises represented $1.7 billion, or about 3.5 percent of GDP. More than two-thirds of Thai external public debt arose from public enterprise borrowing (Naya and James 1989: 21).

The state-private demarcation of roles of Indonesia, Malaysia, and Thailand could not rely on Confucian principles as in the Northern Three; it instead operated within a persisting business-government tension, mostly based on ethnic divisions. The overseas Chinese have traditionally dominated the business sector in the region, but they have had to act within a precarious social acceptance in which the government represents the national interest and has sufficient power to restrain ethnic-based complaints against the business sector. Historically, the overseas Chinese had been imported by colonial powers to assist, under a short leash, in trading activities.

Public superiority over the private sector—often labelled "coordination"—in the Northern Three is replaced by reciprocity and counteraction in the Southern Three. Reciprocity consists of business cooperation with the state's development programs, in exchange for legal and cultural protection and latitude to operate. Overly intrusive state interference provokes obstruction by the private sector and counteraction to undermine state objectives. Thailand's ability to implement extensive exchange restrictions has always been circumscribed by the ability of the trading class to smuggle goods in and out of the country. Indonesia's early and out-of-phase liberalization of capital accounts can be interpreted not only as a policy "choice" but also as a recognition of the limits of controlling capital flows to and from Singapore.

Performance: Market Limits to Internal Implementation

Non-market hierarchical allocation helps to resolve the problems of imperfect markets and policy implementation because such a network structure allows for the specialization of decision making, economizes on communication costs, and reduces uncertainty by coordinating the
decisions of interdependent units in adapting to unforeseen contingencies.

A comparison of the Taiwanese and Korean experiences in import substitution of heavy and technology-intensive industries in the 1970s illustrates the difference between market and internal implementations. In Taiwan, private entrepreneurs were unable and unwilling to make large capital investments with long gestation periods (Park 1990). As a result, the government had to rely on state-owned enterprises to undertake the investment and the outcome was not uniformly successful. In contrast, South Korean chaebols (big conglomerates), supported by ambitious government schemes, jumped in without caution, resulting in excessive and duplicative investment.

Indonesia provides another example of the limits of state intervention. A sharp rise in the number of public enterprises in Indonesia occurred in the 1970s and early 1980s, financed through expanding oil revenues. By the mid-1980s, there was a complex system of control that accompanied their proliferation, with supervision spread over 14 ministries. There were uncounted provincial and local public enterprises and 214 centrally-owned companies (Bhattacharya and Pangestu 1992: 36). During the balance of payments crisis in this period, the burden from the weaknesses of public enterprises threatened continued growth. Since many of these enterprises were oriented toward the domestic economy and were import dependent, they sustained large losses when the currency was devalued. These companies had long enjoyed protected domestic prices and were particularly vulnerable when import restrictions were liberalized.

Internal implementation can be quick in achieving tangible, but not necessarily economically efficient outcomes. Eads and Yamamura (1987: 447-448) identified the limits of industrial policy's advertised prowess in creating competitive advantage, by illustrating several cases of failure despite MITI's aggressive guidance and assistance.

As a device to guide economic decisions, industrial policy cannot totally substitute for underlying cost conditions. Bureaucratic implementation cannot monitor, take account of, and much less regulate all price and cost vectors that attend economic operations-information that is naturally generated in voluntary, private markets.

Lee and Lee (1992) propose that in the Northern Three private enterprises were under the "dual discipline" of markets and networks. The state enlisted the assistance of markets for constraining private sector behavior and visibly sought to increase competitive behavior by consistently attempting to have at least two or three private companies participating. This is opposed to "market-suppressing" intervention,
which engenders increasing market fragmentation or the proliferation of rent-seeking opportunities (Lim 1981: 4-8).

In Japan, although domestic producers were immune to competition from imported goods and were less dependent on the world market than were Korean and Taiwanese producers, they expanded through severe discipline in a partly government-created oligopolistic competition and in a relatively large domestic market (Hadley 1970). Korea and Taiwan, with their smaller domestic markets, allowed more monopolistic production in some industries. Nevertheless, the Korean government strongly encouraged the infants of these industries to begin exporting very soon (Westphal 1982) and thereby exposing them directly to international competition. Taiwan relied more on the threat of allowing imports in if the prices of domestic substitutes moved much higher than the international prices (Wade 1988).

These facts alert us to other roles outward orientation has played in Asian development strategies. We recognize that, at least for the Northern Three, the need to obtain essential inputs, technologies, capital, and markets to achieve economies of scale weighed heavily in adopting outward orientation. Participation in the world market subjects the economy to external conditions and restricts the scope for intervention of the national government. However, these constraints have not proved too costly relative to their benefits. Export orientation imposed "market" discipline, which the domestic market is not able to offer to protected producers, and thereby posed a set of constraints on domestic economic policies that prevented the adoption of measures that may have been severely antithetical to growth (Lee 1992). Externally determined world market prices force export-oriented firms and the political leadership to be economically and politically efficient.

In other words, the insufficiency of both economic and political competition within a nation is complementary to competition in world markets. It is for this reason that the Korean chaebols and Taiwanese state-owned enterprises were able to maintain efficiency and competitiveness despite domestic protection. In contrast, an inward-oriented economy that is without this discipline is more prone to waste resources and rent-seeking activities (Srinivasan 1985).12

In addition to domestic or world market discipline, administrative interference supplemented the market in the Northern Three in terms of

---

12 China's restriction of international trade, particularly after the Sino-Soviet dispute, was one reason for a slowdown in productivity growth.
more immediate and everyday discipline. The routine disciplinary function of the government operated through an intimate network among state agencies and big firms. In the Northern Three, the government as a supplier of credit had a strong incentive to become well-informed about the conditions of the firms. Firms that did not show satisfactory performance or that borrowed without due commercial caution could not normally expect the continuation of loans. The combination of the goal-committed government and the unique government-business relationship made it possible for even protected producers to be under strong pressure to become more efficient in the future (Lee 1992; Jones and Sakong 1980).

For public enterprises, budget allocation represented the principal disciplining function, and this was not applied continuously as long as debt could be accumulated. The export performance and the narrower amplitude of macroeconomic crises in the Northern and Southern Three and Singapore provided more resources for both waste and orderly retreat. Indonesia, Malaysia, and Korea lived more precariously in macroeconomic terms but have managed orderly adjustments from crisis situations.

The liberalization of Indonesia's capital account in the early 1970s is a key example of market realities providing a ceiling to the level of public intervention. Under this institutional setting, indications that costs of public expenditures are not financiable, generate pressures on the exchange rate. On the other hand, Taiwan, Japan, and Thailand earned reputations for conservative macroeconomic management by imposing an overall ceiling on losses generated by the government enterprise sector.

**Instruments of Intervention**

Asian governments intervened to promote specific industrial sectors. We gather into one group exchange controls, cascading tariffs, tax incentives, and subsidies, and into a second group more discretionary selective credit allocation and administrative supervision. In the 1980s, the Northern Three softened their interventions in both groups, which indicates the deep and extensive nature of these reform programs. Indonesia, Malaysia, the Philippines, and Thailand have announced strong commitments to diminish industrial targeting policies but have some distance to go.

In the early 1980s, for example, the Indonesian government sought to increase the local content of different assembly activities. The interventions initially covered motor vehicles, tractors, diesel engines, and
Table 4. Indonesia: Effective Rates of Protection in Manufacturing

<table>
<thead>
<tr>
<th></th>
<th>1975</th>
<th>1987</th>
<th>1990</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Industries</td>
<td>38.7</td>
<td>8.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Non-oil</td>
<td>–</td>
<td>–1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Oil refining</td>
<td>–</td>
<td>–1.0</td>
<td>–1.0</td>
</tr>
<tr>
<td>Iron and steel</td>
<td>18.2</td>
<td>13.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Chemicals</td>
<td>28.4</td>
<td>14.0</td>
<td>13.0</td>
</tr>
<tr>
<td>Cement</td>
<td>63.6</td>
<td>60.2</td>
<td>53.6</td>
</tr>
<tr>
<td>Capital Goods Industries</td>
<td>15.3</td>
<td>150.0</td>
<td>97.0</td>
</tr>
<tr>
<td>Engineering goods</td>
<td>–</td>
<td>152.0</td>
<td>139.0</td>
</tr>
<tr>
<td>Intermediate Goods Industries</td>
<td>49.0</td>
<td>42.0</td>
<td>40.0</td>
</tr>
<tr>
<td>Wood and cork products</td>
<td>–1.2</td>
<td>25.0</td>
<td>33.0</td>
</tr>
<tr>
<td>Rubber and plastic products</td>
<td>426.0</td>
<td>87.0</td>
<td>64.6</td>
</tr>
<tr>
<td>Consumer Goods Industries</td>
<td>116.2</td>
<td>87.0</td>
<td>64.6</td>
</tr>
<tr>
<td>Food, beverages and tobacco</td>
<td>336.2</td>
<td>122.0</td>
<td>124.0</td>
</tr>
<tr>
<td>Paper and paper products</td>
<td>87.3</td>
<td>31.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Textiles, cloth and footwear</td>
<td>231.8</td>
<td>102.0</td>
<td>35.0</td>
</tr>
<tr>
<td>All Manufacturing</td>
<td>74.1</td>
<td>68.0</td>
<td>59.0</td>
</tr>
<tr>
<td>(excluding oil refining)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All Tradeables (excluding oil products)</td>
<td>29.7</td>
<td>26.0</td>
<td>24.0</td>
</tr>
<tr>
<td>IMPORT-COMPETING PRODUCTS</td>
<td>61.0</td>
<td>39.0</td>
<td>35.0</td>
</tr>
<tr>
<td>EXPORT-COMPETING PRODUCTS</td>
<td>–6.0</td>
<td>–2.0</td>
<td>–1.0</td>
</tr>
</tbody>
</table>

Source: Bhattacharya and Mari Pangestu (1992), Table 12, p.43.

motorcycles and were later enlarged to include construction equipment, diesel engines, homes appliances, and electronic goods (Bhattacharya and Pangestu 1992: 34). Table 4 provides evidence that, as late as 1990, protection heavily favored basic and capital goods industries, and import-competing industries. Indonesia’s sectoral intervention found its greatest expression in the system of annual credit ceilings for different types of projects. Indonesia’s trade reforms are in the process of design and internal negotiation, and the importance of direct credit allocation has dwindled with the financial liberalization of the mid-1980s.

Financial and administrative supervision represented the strongest tools of industrial promotion in the Northern Three. The scarcity of capital forced firms to depend heavily on credit for raising finance beyond retained earnings. In the absence of effective capital markets, the state
used its control over the banking system to channel domestic and foreign savings to selected industries or firms. Virtually all banks are owned by the government in Taiwan, which was also true in Korea until the late 1980s. Although many banks have been privatized, the Korean government still remains the biggest shareholder and maintains effective control over banking institutions through the acceptance by private partners of the government's power of appointment of key management positions to safeguard access to central bank credit, a power called "moral suasion" in Western economies.

In Japan, the banks are largely privately owned, but they depend upon the central bank for access to supplementary deposits on which to expand their lending (Johnson 1982; Wade 1988). Their enormous levels of borrowing from the central bank are permitted so long as they respect the central bank's conditions for the allocation of lending.

In Japan and Korea, government exercised almost direct control over private sectors through their control of credits. In contrast, the Taiwanese government did not exercise such direct control over small business-oriented private businesses through bank credits, relying instead on the regulation of imports and foreign exchange.\(^{14}\) However, small private firms were heavily dependent on production linkages with the dominant large-scale firms (Wade 1990: 249): the Taiwanese government controlled the state-owned, large enterprises, which had a more significant impact on the economy in the 1950s and 1960s than the numerous small and medium-sized private enterprises.\(^{15}\) Thus, to the extent that government intervention was effective toward the large-scale sector, the government was able to influence the investment decisions of the private sector. Although Taiwan's industrial policies have not been as aggressive as those in Korea and Japan, the argument that Taiwan is a good example of a free-market economy is misleading.\(^{16}\)

As exercised in the Northern Three, financial control dominated tariffs, import quotas, tax incentives, and entry or trade licenses in terms of

\(^{13}\) According to Zysman's (1983) definition, the Northern Three had credit-based financial systems, as opposed to the capital market-based financial systems that prevailed in the United States and England. Firms in Taiwan and Korea depended more on bank credits than did most other developing countries (Wade 1988: 132).

\(^{14}\) Given the relatively high rate of private savings, Taiwan's private sectors were less dependent upon state-owned banks for credit. Also, for political reasons, indigenous Taiwanese businessmen wanted to be less dependent on a government with mainland origins (Ho 1978; Ii 1990).

\(^{15}\) In the 1950s, state-owned enterprises accounted for an average of 50 percent of manufacturing value-added in Taiwan (Park 1990).

\(^{16}\) For an explanation of the differences, see Wade (1988) and Park (1990).
effectiveness. First of all, financial control involves discretionary control. With credit allocation, the state not only can control the financial ability of firms, but also can demand the firm's compliance in other matters. A second qualitative difference is that the state's financial control is not predicated on its political authority, which is the case for other instruments based on legislation and/or administrative regulation. Rather, the state's financial control is based on the state's economic power, which in turn derives from its ownership of either banks (in Korea and Taiwan) or funds themselves (in Japan, city banks owe money to the central bank). Third, whereas most other controls except licensing are aimed at specific industries or sectors, and thus affect firms only indirectly, financial control can be directly aimed at individual firms.

Financial control in the Northern Three shares many of the features of the control mechanism in socialist economies, which utilized only a modicum of macroeconomic management but relied heavily on microeconomic, discretionary, ownership-based, and direct firm-level control. Control of this type depends on the excellence of planning, monitoring and supervision and informal influences such as personal contacts, networking, and agility in managing central supervision on the part of the firm. Over the long term, the failure of socialist-type control, relative to that in the Northern Three, can be attributed to failures in planning, monitoring, and supervision. The intense attention paid to market-generated information in conducting these activities in the Northern Three is a marked contrast to the approach in the command economies.

Such discretionary, ownership-based, industrial policy through financial allocation has also brought about widespread losses and banking crises in Indonesia, Malaysia, and the Philippines. In these countries, macroeconomic management was weaker (against which Thailand's management stands as exceptionally robust) and the state-private sector relationship was actuated not for control purposes but for accommodation and reciprocity.

**Issues of Development Strategy for China**

The state played a central but constraining, role in Northern and Southeast Asian approaches to development. In East Asia, the state dominated the process, but has now begun to lose its dominant position with the growth of industrial enterprises. In Southeast Asia, the state
played a counterposing role, attempting to direct the private sector toward national goals while resisting private pressures to lose its own bearings.

It is probably safe to say at this point that the Northern Three and Singapore have secured for themselves a place at the table of industrialized countries. These countries have begun to wrestle with issues of technological competition with the industrial economies. The Southern Three of Indonesia, Malaysia, and Thailand have much more ground to cover, but they have the advantage of a more independent private sector than the Northern Three at a similar stage of development. They will have to continue to work with problems of development finance, human resource development, and export penetration.

China shares many of the advantages of the Northern Three, especially regarding the traditional position of the state in society. In terms of economic development, however, its per capita income is behind that of the Southeast Asian countries. To some extent, the kind of national consensus on basic goals and the role of state activism to attain these goals, as in the Northern Three, existed in China since 1949, even though these have been subject to evolution. China’s development path originally focused on redistributive goals, which probably became compulsory in the project to reunify and reconstruct society. For the future, it can draw "lessons" from the experience of both types of Asian development paths.

Three key elements constituted the developmental regime among the East Asian capitalist economies. First, state activism in the Northern Three was based not only on the political authority of the state, but more importantly on actual economic power derived from the state ownership of banks or loanable funds. The state’s financial control over big business worked as a highly discretionary tool, qualitatively different from that in minimalist states. Second, private businesses in the Northern Three were subjected to a double disciplines namely, market discipline especially from exogenous world markets in the cases of the more outward-oriented Taiwan and Korea and market conforming network discipline based on the intimate long-term relationship between the well-informed state agencies and businesses. Third, state activism targeted strategic sectors and big businesses where the private-public boundary was ambiguous or did not exist (as in the case of Taiwanese state-owned businesses) and only indirectly tried to influence the small- and medium-scale private sector.

At this point, the question is whether China has the capacity to use all three elements to its advantage. The Northern Three model can be characterized as late capitalistic nation building, exploiting the traditions of Confucianism and nationalism, led by an independent bureaucracy
executing a well-informed industrial policy of selective protection and outward orientation. Based on the experiences of China itself and the Northern Three and the problems that have been encountered among the Southeast Asian countries, this development approach depends on a "hard" state that is resistant to partisan pressures from social forces. Only by securing its independence from partisan interests can an active state harness private initiative for social purposes. Political stability is also important since it lengthens the time horizons of private entrepreneurs.

If we think of the degree of state activism as ranging from a minimal state on the right to a maximal state on the left, China is trying to find the optimum degree of state activism in designing her own developmental regime. The history of the Japanese state indicates how difficult it is to find the optimal degree of state activism. Modern Japan, between 1868 and the early 1880s, went too far to the left with direct state operation of economic enterprises (Johnson 1982). Meiji Japan began to shift toward the right to correct the earlier failure. However, even during Showa Japan, with the establishment of MITI in 1925, the history of the degree of state involvement is checkered.

It should also be pointed out that the success of discretionary financial control in the Northern Three depended on: (1) a strong, cost-conscious bureaucracy overseeing the financing of state companies and (2) a strong economic drive and a corresponding need for credit on the part of private companies. The scope for control (which was smaller because of the sizes of the economies), united leadership from the top, and the degree of government mobilization provided Korea and Taiwan with advantages in financial monitoring and allocation in the state enterprise sector. The increasing complexity of their economies and the loosening of political control has intensified pressures for more rapid privatization of the state sector.

In the case of lending to the private sector, the incentive to use resources non-wastefully\textsuperscript{17} depends very much on private ownership and the expectation that the borrower would be the beneficiary of her own good performance. Even if big business firms in the capitalist Northern Three

\textsuperscript{17} Non-wasteful is not the same as the absence of credit diversion. For our purposes, it means that credit is applied to domestic capital accumulation instead of consumption or capital flight. Regarding the uses of credit by Korean chaebols, the recent effort to prohibit the use of fictitious names in making banking deposits indicates to many Koreans that credit diversion was substantial and the chaebols earned substantial amounts of money as a result. Thus, rather than trying to say that the diversion was small, we can say that it contributed to the chaebols' capital accumulation and hence enabled them to invest in new and risky lines of business. For the contrary case of the Philippines, see Montes and Ravalo (1992).
were, to a certain extent, under the so-called soft budget constraint due to their extraordinary connections with state agencies, it did not necessarily lead to weak motivational efficiency as it does in socialist firms, which was true in China. In fact, it led to exactly the opposite behavior, excessive risk taking.\(^\text{18}\) The difference in behavior can be traced to nothing other than the difference in ownership.

In the case of lending to private firms (or semi-private firms that were originally founded by collectives), motivational efficiency requires a sharper definition of the nature of private ownership in China. With respect to state enterprises, the limits of and stresses from bureaucratic supervision have similarly created pressures toward more widespread privatization.

In late 1992, the phrase “socialist market economy” replaced the formulation “commodity economy with plan” to describe China’s social system.\(^\text{19}\) This idea was to combine plans and markets: state enterprises were supposed to be under plans while non-state enterprises were under markets, thereby treating these enterprises differently. The phrase “socialist market economy” denotes equal treatment for all kinds of enterprises, regardless of ownership. Both state and non-state enterprises are now supposed to compete on an equal basis in markets. Under this view, “socialism” is confined to a concept of the continuing dominance of large and medium-sized state enterprises in important sectors of the economy. Questions can be raised about the long-term sustainability of this narrow definition.

In 15 years of reform, Chinese authorities exerted great effort to revitalize medium and large-scale state enterprises, which continue to claim significant subsidies from the public budget. The excessive and unprofitable fixed investments that characterize these enterprises help to explain the relative stagnation of heavy industry compared with the non-state-enterprise-dominated light industry. The two-tier price system (which compels large- and medium-scale enterprises to sell most of their output at price-controlled levels) has discriminated against heavy industry, such as in coal, oil and power generation. In economic terms, the explosive growth of light manufacturing has been subsidized through losses by heavy industry. Nevertheless, there is a need to overcome the

\(^{18}\) Park (1990) discusses risk taking in the form of excessive and duplicative investments in the heavy industry drive in Korea in the late 1970s. See Kornai (1986) for the term, “soft budget constraint.”

\(^{19}\) The term “commodity economy” was used instead of “market economy” for ideological reasons since, at that time, the Chinese leadership still did not like the term “market.”
losses in this sector, else they will prove a significant bottleneck for the continued growth of the Chinese economy.

Most state agencies that supervise state firms in China report to provincial industrial ministries or local supervisory agencies. These provincial agencies had complete control over every aspect of firm management in the pre-reform period. The introduction of market "forces" has threatened the authority and control of these state agencies, and thereby their defined interests. Some of these state agencies are less interested in overall economic rationality than in local or personal concerns. If the agencies seek to maintain their control over firms for the sake of control, their actions tend to be "market-defying" in nature. China's previous proficiency in decentralization is now proving to be problematic in managing the state enterprise sector.

In contrast, the state agencies in the Northern Three that applied the state's financial leverage over firms were from ministries in the central government. Their control tended to be "market-conforming," in that their objective was to foster competitiveness of specific sectors or firms, which would have otherwise been difficult to attain by market forces alone within a short period of time (Eads and Yamamura 1987: 435). In the centralized credit bureaucracies in the Northern Three, the motivation was to buffer against market swings and to anticipate market developments, not to go against market determined costs.

Market pressures, as long as they spring from a broad economic base, correlate responsible economic behavior with a matching level of payoffs of rewards and penalties. Socialist central planning in China cut the link between performance and payoff, in order to widen the base on which economic outcomes would be derived; however, this decoupling depressed incentives. In the capitalist Northern Three, state intervention did not suspend this most important function of the market, the disciplining of producers against the wasteful use of resources. This is the reason direct state intrusion into business activities (especially state-owned enterprises in Taiwan) was generally effective and did not result in bureaucratic rigidity and inefficiency as in socialist planned economies, including China.

Market verification played a key role in the efficacy of the network organization in the Northern Three and helped to repress inefficient behavior from bureaucrat-business collusion and from prolonged industrial protection. Because protectionist trade regimes suspend market verification, the state in the Southeast Asian countries must continually resist these pressures and manage a retreat from periodic macroeconomic
crises. In China, the network-like connection has spawned instances of collusion between local state authorities and enterprises and in the expropriation of state assets for irregular private gains (Lee 1991). The trend toward privatization of economic activities will not be smooth, but it is irreversible in China\(^{20}\) as a consequence of the need for the state to solve its financing deficits.

If China were to pursue the Northern Three development approach, the state would have to find the means to strengthen financial control over the economy while privatizing most economic activities, except for strategic sectors.\(^{21}\) In this approach, the state retains not only political and regulatory control but actual and discretionary economic power. An efficient financial and government bureaucracy at the national level has to be established and the progressive opening of goods markets and privatization of enterprises undertaken, in order to lighten the burden on such a bureaucracy.

**Conclusion**

It is likely that China’s economic emergence will continue to represent the leading edge of Asia’s economic re-emergence. As we have pointed out in the introduction, it is likely that the follower countries will face a structure of external economic relations different from that which the East and Southeast Asian countries faced when they began their development process in the 1950s and 1960s.

Using the East and Southeast Asian experience as a mirror, we have illustrated the daunting internal requirements for China’s development. Moreover, China’s development drive will have to prosper within the possibilities of the given external conditions. China is finding it in its interest to accede to the General Agreement on Tariffs and Trade (GATT), which entails reduction in its scope for industrial policy. The state in China has limited control over its financial system as indicated by the importance retained earnings have played in fixed investment\(^{22}\) in the 1980s, and will find itself constrained by external pressures to liberalize its

\(^{20}\) See McMillan and Naughton (1992) about the irreversible trend toward a market economy in spite of a lack of a grand plan for China’s economic reform.

\(^{21}\) Lee (1993) makes this suggestion as the most promising path for China’s economic reforms.

Chen, Jefferson, and Singh (1992, p.217) explain how the central bank lacks both independence from state authorities and power over local investment activities.

\(^{22}\) Garbaccio (1994).
capital markets even further.

Horizontal trading and financial relations in the region are evolving quite rapidly and reducing the importance of the old vertical relations. While this is a welcome advance from reliance on trade with the former colonizing countries, it creates pressures for speedier liberalization of external economic relations. These stresses have increased as the leading Asian countries of Japan, Korea, and Taiwan are coming under increasing pressure (from the West and from their own development requirements) to soften their aggressive trade regimes if they want to retain access to developed country markets and foreign technology. For the follower countries, these changes create new challenges for more rapid upgrading of state capacity and the capacities of indigenous private actors. In the case of China, pressures to liberalize have already become significant. This process will make for interesting times for China.

References


the NICs. Ithaca: Cornell University Press.


Chart 1

GDP Per Capita
(U.S. dollars)

Hong Kong, Census & Statistics Department, Hong Kong Monthly Digest of Statistics, various issues.
Chart 2
GDP Per Capita
(U.S. dollars)

Source: International Monetary Fund, International Financial Statistics, various issues
Chart 3
Agriculture and Manufacturing Ratios
(percentage of GDP at current prices)

Source: World Bank, World Tables, various years.
Chart 4
Agriculture and Manufacturing Ratios
(permission of GDP at current prices)

Source: World Bank, World Tables, various years
Chart 5
Labor Force Structure and Manufacturing Output
1960-1990 (in percentages)
Chart 6
Savings and GDP Per Capita Ratios
(percentage of GDP at current prices)

Hong Kong, Census & Statistics Department, Hong Kong Monthly Digest of Statistics, various issues.
Chart 7
Savings and GDP Per Capita Ratios
(percentage of GDP at current prices)

Source: International Monetary Fund, International Financial Statistics, various issues