Catching up with the West: a perspective on Asian economic development

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I. Introduction

Following closely my remit, this paper reviews and assesses Asian economic development in the recent post-1980 period, as well as over the somewhat longer time-span since WWII. Its chief purpose is to draw analytical and policy implications from this experience. This is a challenging but pleasant task, since, conceived at least in narrow economic terms (growth of per capita incomes), the Asian story is generally speaking one of outstanding success. Indeed, it would be no exaggeration to say that post-World War II economic expansion in a number of Asian countries are the most successful examples of industrialization and fast growth over a sustained period in the entire history of mankind. Recall that Japan in 1950 produced less than 5 million tonnes of crude steel per annum and a little over 30 thousand motor vehicles of all types. The US output of steel at that time was nearly 90 million tonnes and it produced about 7 million automobiles per year. By the mid-1970s the Japanese had caught up with the US in the production of steel and replaced West Germany as the world's largest exporter of cars. By 1980 Japan overtook the US to become the largest producer of automobiles in the world.

The Japanese experience has by no means been unique. It was self-consciously emulated by countries like Korea and Taiwan, with results that are perhaps even more spectacular. In 1955, Korea was unequivocally industrially backward. Its net value of manufacturing output per head was US$8 compared with US$7 in India and US$60 in Mexico.[1] Since then, Korea has managed to transform itself from being largely an agricultural society to the point

[1] Maizels (1963), cited in Amsden and Hikino (1994).

where it is the second most important country in the world (through its firm Samsung) in electronic memory chip (DRAM) technology. By the year 2000, the country is expected to become the fourth largest car producer in the world. Nothing could be more symptomatic of the changing map of world industry when reversing historic roles, a hitherto developing country like Korea becomes a chief foreign direct investor in the heart of the industrial West, i.e. the UK.[2]

The 1980s have been rightly termed the "lost decade" for countries on the other two developing continents, i.e. Sub-Saharan Africa and Latin America. However, notwithstanding this enormous setback to development on these two continents, as well as slower economic growth in the world as a whole, the Asian industrialization and catch-up drive has continued unabated in the 1980s and into the 1990s. As we shall see below, economic expansion in Asia during this period has not just been confined to a few countries, but has been widespread. It has involved rising standards of living for billions of people, much of the human population.

Understanding and making analytical sense of this extraordinary Asian drama is indeed a heartening but rather vast task. There is also no consensus on what are the right lessons to be learnt from the East or South East Asian experience, let alone on whether or not these lessons are applicable elsewhere in the new conditions of the liberal and globalized world economy. Therefore, to keep this paper in manageable limits, its analytical part will be confined to an examination of a small number of relevant issues.

Specifically, the paper will concentrate on the extraordinarily high rates of savings and investment, particularly those of the private corporate sector, of these highly successful Asian

[2] The Korean giant LG Group recently decided to install a factory in Wales and invest US$2.6 billion. This is apparently the largest single investment in the European Union from outside the member states. (See further, The Economist, p.24, July 13, 1996.)

economies. In fact, the corporation itself and the relationship between the corporation and the government will receive special analytical attention.

These emphases on the corporation, savings and investment, it will be argued, are not only more significant for the emerging post-Uruguay Round global economic order, but they also provide the microeconomic dimension which is normally missing from the vast literature in this field. Such emphases are also more directly relevant for any lessons that might be drawn for the Latin American economies.

However, before the paper proceeds to an analysis of the above issues, the next section will set out in quantitative terms the main features of Asian economic development in a comparative international perspective. Section III will outline the more important analytical and policy questions raised by this record, of which only a small subset will be closely examined in the sections that follow.

II. Asian economic development in a comparative international context

Some important features of Asian economic development over the last three decades or so are summarised in tables 1 to 6. The following points which emerge from these tables as well from other available information (not reproduced here) deserve attention.

1. As table 1 indicates, in the last fifteen years, developing East Asia has been by far the most dynamic region of the world economy. Although the East Asian economies were growing very fast even in the previous fifteen years (1965-1980), the gap between their growth rates and those of other developing regions, such as Latin America, was relatively small (7.3% vs. 6% for Latin America). However, in the 1980s, economic growth collapsed in

Latin America (from 6% per annum to 1.6% per annum) while there was a trend increase in East Asian economic growth to 7.8% per annum.

2. Disaggregated data by sector (table 1) suggests that it was not poor agricultural but rather the abysmal industrial performance which was responsible for the collapse of economic growth in Latin America in the 1980s. Nevertheless, East Asia did record particularly strong agricultural growth during that decade.

3. In reflecting on East Asian economic expansion, the Chinese economy, because of the size of the country's population, deserves special consideration. As disaggregated data for individual countries in table 3 shows, the Chinese economy expanded at a rate of nearly 10% per annum in the 1980s, a shade below the Korean pace. In the 1990s, the Chinese growth rate has been even faster and somewhat greater than Korea's. However, the important point is that when a South Korea grows at 10% a year for fifteen years, this is an extraordinary achievement for the world to take note. However, when China with a billion people achieves a similar growth rate, this is not just extraordinary, but an epoch-making event.

4. Turning to the other main populous country, India, its performance until 1980 was relatively poor by international standards. However, since then there has been a marked improvement. During the 1980s, India was one of the few countries in the world to have achieved a significant trend increase in its growth rate. While table 3 indicates some subsequent deterioration in performance between 1990 and 1994, if the 1995 data is included - when the economy grew at 7% a year and industry for the first time achieved growth rates similar to those seen in the East Asian NICs - the overall picture for the 1990s becomes more positive.

5. Apart from the important differences in the pace of economic development of the East Asian and South Asian countries like India, it is customary and analytically useful to distinguish between two groups of countries within East Asia - specifically between North East (Japan, Korea and Taiwan[3]) and South East (Malaysia, Thailand, Indonesia[4]) Asian countries. The latter group of countries have followed rather different economic policies to those in North East Asian nations but have been just as successful during the last decade.

However, in this context UNCTAD (1996) observes that although the recent economic record of these two groups is indeed similar, taking a longer perspective reveals a significant performance gap between the groups. The exact result will depend on which periods and which countries have been considered, but the annual per capita GDP growth rates of Japan and the first-tier NICs have, on average, been roughly 2 percentage points higher than those of the second-tier NICs over the last three decades or so. The cumulative impact of this growth gap over 30 years is significant. For example, Malaysia's per capita income in 1961 was almost three times that of Korea's and almost twice that of Taiwan, (Malaysia then included Singapore, so purely "Malaysian" income would have been somewhat lower). It remained higher than the Korean per capita income until 1981, but in 1993 was less than half that of Korea, and about one-third that of Taiwan.[5]

6. The Asian countries excellent record of economic growth during the last fifteen years has certainly translated into impressive increases in the average standards of living of the population, reductions in poverty, increasing real wages and rising employment.

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[3] Korea and Taiwan are also referred to as the "first-tier" NICs

[4] These are also referred to as "second-tier" NICs

[5] See further UNCTAD (1996), page 13.

(a) Adjustment to GDP growth rate figures in table 1 for the rates of growth of population, terms of trade and net factor payments abroad, suggest that during the 1980s average per capita income in Asian countries rose by fifty percent. This compares with a decline of 15 percent in Latin America and 25 percent in Sub-Saharan Africa (UN, 1990).

(b) ILO (1995) provides evidence that in the 1980s, in the fast-growing East and South East Asian economies such as Taiwan, Korea, Singapore, and Malaysia, labour shortages emerged and there was significant immigration of labour from neighbouring low-income countries. Manufacturing employment rose at a rate of over 6 percent per annum during this decade in these dynamic economies whilst, at the same time, real earnings increased at an average rate of 5 percent per annum.

(c) With respect to poverty, available evidence for the 1980s for individual fast-growing NICs, suggests sizeable reductions in its incidence. Thus in China the incidence of absolute poverty fell from 28 percent of the population in 1980 to 10 percent in 1990; in Indonesia the corresponding reduction was from 29 to 15 percent; in the Republic of Korea from 10 to 5 percent, and in Malaysia from 9 to 2 percent.

(d) A remarkable feature of East and South East Asian development during the relevant period has been that not only has the rate of growth been very high, but income distribution has become more rather than less equal. World Bank (1993) notes "For the eight HPAEs, rapid growth and declining inequality have been shared virtues, as comparisons over time of equality and growth using Gini coefficients illustrate".[6]

[6] It will be argued below that this conclusion of declining

The above positive East Asian record stands in striking contrast to that of Latin America and Sub-Saharan Africa in the recent period. ILO (1995) reports that in Latin America between 1980 and 1992, there was a steady fall in modern sector employment, with paid employment falling at a rate of 0.1 percent per annum during the 1980s. This reversed the trend of the previous three decades when steady economic growth had led to a significant expansion of modern-sector employment. In most Latin American countries, the average real wage fell during the 1980s, recovering in only a few countries towards the end of the decade. Minimum wage fell on average by 24 percent in real terms across the region, while average earnings in the informal sector declined by 42 percent.

III. Analytical and policy issues

The central analytical and policy question raised by East Asian economic experience is of course, what are the causes of the fast economic growth in these countries?

There is no agreement on this question. Indeed, there is a continuing controversy in which the main protagonists are the World Bank with some orthodox economists on one side and a number of academic economists, not all of whom are heterodox, on the other.[7] This debate is important for two reasons. Firstly, the World Bank professes to base its policy recommendations for countries around the globe on what it regards as the lessons to be drawn from the experience of these highly successful East Asian countries. Secondly, from an analytical point of view, the debate is clearly of central importance, precisely because of the fast growth of these economies over a sustained period. Thus, the resolution of this debate would inevitably have an important bearing on our

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inequality may require some important qualifications.

[7] See World Bank (1991, 1993); Amsden (1994a); Fishlow et al (1994); Ito and Krueger (1995); Singh (1994b, 1995a).

general ideas on growth and development.

With the publication of World Bank (1993), Singh (1994b) notes that there has been some useful narrowing of differences between the two sides, but there remains a wide gulf on a range of significant issues. These have been reviewed and commented on in Singh (1995a). The more important ones are:

(i) the question of the effectiveness of industrial policy;

(ii) the issue of "openness": how open were the East Asian economies during their periods of fast growth?

(iii) the nature of competition in domestic product and capital markets;

(iv) the role of savings and investment in East Asian economic growth;

(v) the question why the Asian countries did not have a debt crisis while the Latin Americans did;

(vi) the relationship between technology policy, industrial policy and international competitiveness;

(vii) the relationship between the "fundamentals", macroeconomic stability and industrial policy.

An analysis and resolution of these issues will determine what are the right lessons to be learned from the East Asian economic model or models. However, the economic record of these countries also raises other significant issues which are listed below.

Firstly, can the Asian experience be replicated? Apart from anything else, it is suggested that the international economic environment is totally different to-day from that in which the East Asian NICs achieved their formidable success. For example, in the post-Uruguay round emerging world trading order, many of the interventionist industrial and commercial policy instruments used by Japan, Korea and other countries will no longer be permissible.[8]

Secondly, is fast East Asian economic growth sustainable in the direct, narrow sense of the term? The subject draws its significance from the following considerations: (a) the slow-down in the Japanese economy in the 1990s which may be expected to have adverse effects on economic growth in other countries in the region; (b) secondly, the large current account deficits of the second-tier NICs and hence their vulnerability to capital outflows. It will be recalled that prior to 1980, countries like Brazil had been growing fast for a considerable period. Then suddenly Brazil, Mexico and the rest of the Latin America stumbled into a decade long crisis. In the current situation, given their present vulnerability to surges of capital flows, what is there to stop a similar fate being visited on the South East Asian NICs?

Thirdly, an alternative view to that above is that there now exists among the East and South East Asian countries a large degree of economic co-operation. This has fostered a regional dynamic which has acquired an autonomy of its own. These factors, it is suggested, would allow these countries to sustain high rates of economic growth regardless of the state of the world economy including that of Japan. Indeed, some would argue that currency appreciation and slower economic growth in Japan help developing East Asian countries positively by leading to greater Japanese FDI in these countries.[9]

Fourthly, there are special analytical issues raised by the epoch-making Chinese record. Specifically, if freely functioning internal and external markets are essential for economic growth

[8] See further Singh (1996a); ODI (1995); UNCTAD (1995); Greenaway and Milner (1995); Agosin, Tussie and Crespi (1995).

[9] See further, UNCTAD (1996).

as the Bretton Woods Institutions routinely insist, how have the Chinese been able to grow so fast with such low levels of development of capital and labour markets and highly segmented product markets? Similarly, the Chinese experience raises the important question whether privatisation of the means of production is at all necessary for adequate (from the perspective of achieving fast economic growth) development of markets to occur.[10]

These are all large questions and cannot be properly treated within the confines of this paper. The rest of the paper therefore limits itself to only one of the main themes above, namely, what are the right lessons from the Asian experience. But even within that context, the paper considers just one of the main issues, that of savings and investment. How have the East Asian economies been able to achieve such high rates of savings and investments, particularly in the private corporate sector. This involves inter alia an analysis of the relationship between the government, the corporation and the financial system in these exemplar economies.

This analysis therefore departs from the old debate about industrial policy and getting prices "right" or "wrong". It hopefully will shed some useful light on an important dynamic aspect of the East Asian experience and may also have implications for Latin American countries which are afflicted with the problem of low savings and investment rates.

IV. Savings, investment and total factor productivity growth in East Asia.

The successful East Asian countries are characterised by high rates of savings and investments. This was, however, not always the

[10] For the view of the Bretton Woods Institutions on the necessity of free and flexible markets for fostering economic growth, the classic statement is World Bank (1991). For the difficultuies that the Chinese experience over the last 15 years creates for this thesis, see Singh (1994a, 1996e).

case. For example, UNCTAD (1994) notes with respect to Japan that gross domestic fixed capital formation in that country increased from 24 percent of GNP in the early 1950s to almost 40 percent in the 1960s. The ratio of private equipment investment to GNP doubled between the early 1950s and the late 1960s, reaching 17 percent. Similarly, in Korea, gross domestic fixed investment as a proportion of GDP rose from less than 10 percent in the mid-1950s to about 25 percent in the mid-1970s , and to over 30 percent by the mid-1980s. [11] In terms of purchasing power parity Summers-Heston data, Young (1994) estimates that between 1960 and 1980, gross fixed investment to GDP ratio doubled in Taiwan, tripled in Korea and quadrupled in Singapore.

It is also to Young's (1994) credit to have established the primacy of the accumulation process in `causing' (in growth accounting terms) fast economic growth in the East Asian countries. His studies as well as those by Lau and Kim (1994) show that the record of leading East Asian countries such as South Korea and Taiwan with respect to TFP growth is far from being outstanding. Both South Korea and Taiwan achieved a lower TFP growth than Bangladesh over the period 1970-85. What this suggests is that the proximate cause of fast economic growth in the leading East Asian countries is their very fast expansion of factor inputs including physical and human capital rather than "technical progress".

How were these high rates of investment and savings achieved? There is a simple neoclassical story which ascribes East Asia's unusually high rates of savings and investment basically to sound 'fundamentals'. Specifically, it is suggested that prudent macroeconomic management, consequent low rates of inflation and low exchange rate fluctuations, coupled with good initial conditions (land reform, and hence relatively equal distribution of income and wealth, favourable human capital endowment due to universal primary education) led to fast growth of household incomes and savings. In this account, some countries were subject

[11] See Rodrik (1994a), figure 3.

initially to financial repression (eg. Korea in the mid-1960s). But once this was eliminated and real interest rates became positive, household savings rose further, as did investment.

The World Bank (1993) represents a considerable advance on this orthodox story. In response to the criticisms of the neoclassical analysis, it accepts that fast growing East Asian countries did not eliminate financial repression. It also acknowledges that governments in these countries adopted a host of measures to raise both the levels of savings and investment, as well as to influence the allocation of investments. It is, however, argued that the financial repression practised in these countries was relatively mild and that this did not adversely affect savings.

Following Akyuz and Gore (1996) and Singh (1996b) the analysis below presents a more complex view of the accumulation process in East Asia. This view stresses the central role of profits in providing both the inducement to invest and the means to pay for investment. Profits are also of course a consequence of investment. This investment-profitability nexus was not, however, a spontaneous outcome of the invisible hand of the market but rather, the government policy measures and the government-business interactions were central to generating and sustaining it. At the aggregate level the net result was greatly increased propensities to save and invest and the ex-ante equality of savings and investment at high rates of economic growth.

This conceptualisation of the East Asian experience is in the classical tradition and also suggests that high rates of investment lead to faster technical progress, greater learning by doing, and through cumulative causation, to a virtuous circle of greater competitiveness and faster economic growth.[12] So in this analysis the emphasis is on the dynamics of the accumulation process (mediated through high profits) the associated technical change and the growth of productivity rather than on static resource

[12] Kaldor (1965, 1967).

allocation and getting prices right or wrong. The argument is illustrated below by considering the case of Japan and South Korea.

V. Investment, profits and savings in Japan in the high growth period (1950-1973)[13]

As seen before, in the early 1950s, the Japanese level of industrialisation was not all that different from that of today's semi-industrial countries. Indeed in 1952 the value of Japanese exports was lower than that of India's (Krueger, 1995). However, as a consequence of the extraordinary economic growth in the 1950s and 1960s - when Japanese industrial production expanded at the phenomenal rate of about 13 percent per annum, GDP at 10 percent per annum and its share in world exports of manufacture rose by a huge 10 percentage points - by the early 1970s, Japan had graduated to the status of an OECD country. The Japanese experience since 1973, although it still has implications for developing countries, is not as directly significant as the earlier period.

Table 7 and 8 provide comparative information on investment rates, savings rates and profits for Japan and other industrial countries.[14] Table 7 shows that even excluding residential construction, Japan was investing more than a quarter of its GDP on average in the two decades 1953-72. Table 8 indicates that the average savings propensities of household, business as well as government sectors in Japan were higher by a considerable margin than those in other countries.

Table 9 suggests that at the macroeconomic level Japan had a much higher share of profits in national income as well as considerably

[13] The analysis of this and the following section is based on Singh (1996b).

[14] Comparable data is more easily available for other industrial than for developing countries.

higher profit rates than other industrial countries in the period under consideration. In 1970, gross profits constituted more than half of gross value added in Japan compared with less than a quarter in the UK and USA and about a third in countries like Germany and Italy.

These high Japanese profit rates arose in important part from heavy state intervention which guided the Japanese economy during this period. The government had two main proximate objectives: to attain a current account equilibrium at as high a growth rate as possible; to increase the private sector's propensities to invest and save so as to substantially raise the long term growth rate of the economy. The Japanese government sought to achieve the above objectives by building up the strength and capabilities of its corporations so that these could compete with their counterparts from advanced countries in the international market place. For this purpose a number of measures were taken which directly helped increase the resources available for corporate investment. These were coupled with a range of indirect policies which affected positively the external environment of the corporate sector and thereby also helped raise profits. Some of these measures are briefly outlined below.

V.1 Direct policy instruments

These comprised, among other things, a wide variety of fiscal incentives to promote corporate growth. Initially, in the early 1950s, the fiscal incentives included accelerated depreciation for important industrial equipment, a special deduction for export earnings, a tax free reserve for losses from export transactions, and reduced tax rates on interest and dividends. Over the next two decades, an extraordinary range of other tax concessions were added to this list. To illustrate, there were more than twenty five tax free reserves which were available to corporations by 1975 including: reserves for bad debt, reserves for loss on returned goods unsold, bonus reserve, reserve for retirement allowances, reserve for special repairs, etc.[15]

V.2. Indirect policy instruments

V.2.a. Domestic competition[16]

Corporate profits were also enhanced by restrictions on domestic competition which prevailed in the Japanese product markets. To promote investment and technical change, instead of permitting unfettered competition, the Japanese government controlled and guided domestic competition in the relevant period in a purposeful manner. Competition in Japan has both been encouraged, but notably also restricted in a number of ways. This has been particularly true during the years of rapid growth, 1950 - 1973. The agency primarily responsible for the antitrust enforcement in Japan is the Fair Trade Commission. However, in the Japanese scheme of government it has much less power compared with MITI which is responsible for the country's industrial policy. Although the FTC has never been entirely toothless and antitrust-enforcement in Japan is not a totally meaningless charade, most scholars agree that in any conflict between the two agencies' objectives (e.g. over the promotion of large scale firms or price fixing arrangements during a business cycle downturn), it is MITI and its industrial policy which by and large have prevailed over the FTC and the competition policy.

To illustrate, it is useful to reflect on some of the blatant restrictions which were imposed by the Japanese Government in the 1950s and 1960s on domestic product market competition. To meet its myriad goals which continually changed in the light of economic circumstances facing the country, MITI encouraged a variety of

[15] See Tsuru (1993). For studies of the effects of these fiscal measures see Ackley and Ishi (1976); Pechman and Kaizuka (1976).

[16] The following analysis is based on Amsden and Singh (1994) to which the reader is referred for a fuller discussion.

cartel arrangements in a wide range of industries — export and import cartels, cartels to combat depression or excessive competition, rationalization cartels, etc. According to Caves and Uekusa (1976), in the 1960s, cartels accounted for 78.1 percent of the value of shipments in textiles; 64.8 percent in clothing; 50.0 percent in non-ferrous metals; 47 percent in printing and publishing; 41.2 percent in stone, clay and glass; 34.5 percent in steel products, and 37.2 percent in food products. Although these cartels functioned for only limited periods of time and there was wide variation in their effectiveness, Caves and Uekusa observed that "their mere presence in such broad stretches of the manufacturing sector attests to their importance." (page 147).

Similarly, believing that large scale enterprises were required for promotion of technical change and for Japanese firms to compete effectively with their western counterparts, MITI encouraged mergers between leading firms in key industries. The fact that the agency did not always succeed in its efforts (notably in the car and machine tool industries) does not detract from the anti-competitive bias of many of MITI's policies and actions. The anti-competitive actions were often re-enforced through MITI's use of "administrative guidance" to firms and its discreet directions to industry associations with whom it invariably had close links.

However, these restraints on competition are only a part of the story. An equally significant part of is MITI's strong encouragement of vigorous domestic oligopolistic rivalry and international competitiveness. In general, whether competition was promoted or restricted depended on the industry and its life-cycle: in young industries, during the developmental phase, the government discouraged competition; when these industries became technologically mature, competition was allowed to flourish. Later, when industries are in competitive decline, the government again discourages competition and attempts to bring about an orderly rationalization of the industry (Okimoto, 1989).

V.2.b. External competition

Protection was of central importance in Japanese industrial development during the miracle years. The trade policy had to be complementary to competition policy for otherwise a recession cartel, for example, could have been easily overwhelmed by foreign imports. Similarly, import restrictions could have overwhelmed competition altogether were it not for the performance standards that industries receiving protection were forced to meet by the government (through, for instance, MITI's control over foreign exchange, etc.).[17] During the 1950s and 1960s, the Japanese economy operated under a regime of draconian import controls, whether practised formally or informally. As late as 1978, manufactured imports constituted only 2.4% of the Japanese GDP; the corresponding proportion in Britain and other countries of the EEC was five to six times larger. Even in the US which traditionally, because of its continental size, has a relatively closed economy, the volume of imported manufactured goods in the late 1970s was proportionally almost twice as large as in Japan (Singh, 1995a).

Protection, together with restrictions on domestic competition, provided the Japanese companies with a captive home market leading to high profits which enabled them to undertake high rates of investment, to improve the quality of their products, and also to capture markets abroad. The latter was of particular importance to Japanese firms, since in return for protection, MITI often imposed on them export and world market share performance targets. Companies recognized that to move forward, to have access to foreign technology, licenses etc., they had to export.

[17] To illustrate, Japan's machine tool industry was given selective tariff protection specifically for those machine tools with potentially high income elasticities of demand and high productivity growth rates. But machine tool builders benefiting from protection were required to produce at least 50% of their output in the form of computer numerically controlled machine tools by a certain date (Amsden and Hikino,1994).

The emphasis on exports and on maintaining oligopolistic rivalry - instead of concentrating resources and subsidies on a single "national champion", which many governments in their industrial policies are prone to do - are the key factors which distinguish Japanese policies from those of other dirigiste countries.

V.2.c. Low interest rate policy

Another important feature of the external environment faced by Japanese firms during this period was the government's low interest rate policy. This policy helped both to increase the resources available to firms for investment as well as to enhance their willingness to invest. The government practised "financial repression" ie. it kept the interest rate structure more or less stable at relatively low levels. In effect, this amounted to credit rationing at the discretion of the Bank of Japan and other banks under the so called "window guidance" of the Bank of Japan. Credit rationing and low interest rates were also used to subsidise specific industries favoured by the government. Leaving aside the problem of credit rationing and interest subsidies, the importance of the government's low interest policy for highly-geared Japanese corporations cannot be exaggerated. However, in macroeconomic terms such a policy can only be sustained if there is an adequate supply of savings, an issue taken up below.

V.2.d. Administrative guidance and coordination of corporate investments

In addition to the policies outlined above which directly or indirectly assisted the corporate sector by either increasing corporate profits, or by enhancing the internal resources available to corporations for investment, the government also used other important instruments and policies to guide and help the corporate sector. The most significant of these was "administrative guidance".

This was particularly important during the high growth period as what in effect MITI did in that period was to orchestrate investment and technology races among oligopolistic firms in favoured industries. Such races needed to be carefully controlled as otherwise excess capacity may be created which will adversely effect the future corporate inducement to invest. Scott (1991) outlines MITI's characteristic method in relation to the expansion of the steel industry in the 1950's: "Japanese firms were required to wait their turn to build a new plant while a competitor built new capacity and achieved high volumes. Next time the roles will be reversed. This kind of coordination was carried out under the aegis of the government by MITI. Later the system required the scrapping of old capacity as a condition for permission to build new. As a result Japan with a smaller home market than the US built 10 plants larger than any in the US (p.54)."[18]

In terms of economic theory, in the context of the real world of incomplete markets and ubiquitous potentialities of coordination failures, MITI's actions in this sphere amounted to being the ringmaster and the referee to ensure coordination of corporate investment decisions.

V.2.e. Profits and savings

It was seen earlier that not only Japanese aggregate savings ratios were high by international standards, each sector of the Japanese economy - households, corporations as well as the government - saved considerably more than its counterparts in other countries. The high saving propensity of the Japanese corporate sector can be attributed to high profits and high inducement to invest. It was also in part due to the particular feature of the Japanese financial system which permitted companies to follow a policy of low dividend payouts. (See further below)

[18] Quoted in Singh (1995d), p.25.

However, Akyuz and Gore (1996) point out that the high savings propensity of the Japanese household sector can also be attributed in part to high levels of profits in the Japanese economy. This is for two reasons. First, the household sector includes unincorporated enterprises whose savings propensities tend to be high and whose incomes depend on profits. Secondly, bonus payments to workers which constituted almost a quarter of their annual incomes were also basically a function of profits. Again, the propensity to save out of these bonus payments - which many workers particularly during this period regarded as windfall payments - is estimated to have been quite high.

There are of course a whole host of other explanations for the high savings propensities of the Japanese household sector. These include the fast rate of growth of household incomes, the age and employment structures of the population, the lack of publicly provided social security.[19] Low income elasticity of demand for foreign goods, the low level of development of financing and credit facilities for consumers, formal and informal controls on imports of consumer durables can also be expected to have helped played a significant part in keeping household consumption low.[20]

V.2.f. Corporate rates of return and corporate objectives in Japan

It would appear from the discussion so far that during Japan's high growth period, government policies played a key role in raising aggregate profits in the economy and in enhancing the resources available to corporations for investment. These high profits together with other government policies are seen to have contributed significantly to the high savings and investment rates

[19] There is a large literature on the subject of why Japanese savings have been so high. For a recent review see IMF (1995). See also Maddison (1992); Kojima (1995).

[20] See Felix (1994).

in the Japanese economy.

This analysis is however, incomplete since the discussion of profits in the previous sections has been conducted at a macroeconomic level. A fuller investigation of the subject must also consider the magnitude and significance of the corporate profit rates at the microeconomic level. Table 10 presents information on corporate profitability and profit margins in Japan, U.S. and Germany. The data indicate that contrary to the findings of the national accounts statistics on the aggregate share of profits in GDP as well as profit rates on aggregate capital stock, both the rates of return and the profit margins of Japanese firms have been lower than those of U.S firms. The observed differences in the corporate rates of return in the two countries can in principle arise from differences in accounting conventions, taxes etc. However, detailed analysis shows that even allowing for these factors, Japanese firms in most industries have lower operating margins and returns on assets than the corresponding US firms.[21]

That the Japanese rates of return are lower than those of the US at the microeconomic level is not necessarily inconsistent with the much higher Japanese share of profit in the national income relative to the US. Indeed many economists regard it as a virtue of the Japanese financial system which allows Japanese firms to continue to survive and to invest even when their rates of return are very low. A lower threshold rate of return allows Japanese managers to undertake investments that US firms find unacceptable. To the extent that a higher rate of investment allows faster turnover of capital equipment and hence greater technical progress and new product development, this give the Japanese firms a competitive edge over the American corporations.

[21] See further Blaine (1993). Blaine has carried out a comprehensive examination of the financial statement ratios of large firms in 13 major industries in the U.S. and Japan over the period 1985-89.

The MIT Commission on Industrial Productivity (1989) regarded this factor as a major reason why U.S. firms lost out to the Japanese corporations in the U.S. home market in a wide range of electronic products. The Commission investigations showed that when a Japanese firm entered one of these markets, there was a fall in the rate of return of the existing U.S. firms in the industry due to greater competition. This often resulted in the U.S. firms leaving that industry fairly quickly and diversifying and investing their resources elsewhere since they could not accept such low returns. Japanese companies were however able to sustain these low rates of return for long periods.

Survey data on the objectives of Japanese corporate managers repeatedly show them to be much more interested in pursuing market share than earning a high rate of return on assets or increasing the wealth of the shareholders. Thus for instance, Doyukai's (1988) study of Japanese, European and U.S. firms, showed the three most important goals for the managers in Japan were improving firm's ratios of new products and businesses, followed by gaining market share and improving return on investment. Capital gains for shareholders ranked at the bottom of the list and was cited by almost none of the sample managers in Japan as an important goal for their companies. In the United States in contrast, by far the most important goal was improving return on investment, followed by capital gains for shareholders; gaining market share was the least significant objective. European managers showed improving return on investment, gaining market share, and reformulation of international strategies as three important goals. Capital gains for shareholders was placed last on their list.[22] The important question raised by such studies is why are Japanese firms able to pay so little attention to share prices and rate of return on assets. To answer this question, it is necessary to look at the relationship between the Japanese corporation and the financial system.

[22] Doyukai's study which is in Japanese is quoted in Kojima (1995). See also Abegglen and Stalk (1985).

V.2.g. The Corporation and the financial system in Japan

There are two main reasons why the Japanese companies are able to pursue goals such as market share and product improvement and be much less concerned with share prices and rates of return on capital, particularly in the short term. The first is that the Japanese corporations are not subject to the ever present takeover threat of the kind which the firms in the U.S. and U.K. have to endure. Secondly they have long-term and close relationships (as opposed to arms-length dealing) with their "parent" banks.

The reasons behind these reasons lie in the organisation of the Japanese corporation and the nature of the financial system. In sharp contrast to the situation in the U.S. and the U.K., there are hardly any hostile takeovers. The main reason for this phenomenon is the nature of the share ownership in the typical large Japanese corporate group. Generally speaking, three quarters of the shares in such a corporation are likely to be held by suppliers, customers and the lead bank. In other words, there is a concentration of share ownership in a relatively small number of "safe" hands. Only a quarter of the outstanding shares are traded on the market which makes it almost impossible to mount a successful hostile takeover. The independent shareholders are obliged to defer to the far larger holdings of the corporation's stakeholders.[23]

There is evidence that the Japanese government, after the second world war, deliberately instituted a bank-based rather than a stock market based system. Thus for example as Somel (1992) notes, the Japanese government prevented the securities market from growing by making securities unattractive for ordinary savers, restricted residents' and non-residents' access to Japanese securities markets and Japanese access to foreign securities markets, and provided the finance and funds required by the deficit corporate sector through the banking system. From a sociological

[23] See further Abegglen and Stalk (1985); Odagiri (1994).

perspective, Dore (1985) suggests that in Japan, not only is the stock market viewed with suspicion by the general public, it also has rather inferior social status. It is the real wealth creating corporate sector or the government which attracts the best talent rather than the stock market.

Thus a typical large Japanese corporation is much less subject to the "short-termism" which is inherent in the Anglo-Saxon stock market economies.[24] The Japanese firm is regulated by internal group mechanisms, where the group bank plays a critical role. There are sound analytical reasons, as well as empirical evidence for the view that this kind of bank-based regulation is more conducive to long-term investment not only in plant and equipment, but more importantly in training and in firm-specific, often intangible, human capital.[25]

To sum up, the low observed corporate rates of return in Japan do no contradict the concept of the investment-profits- savings nexus. The nature of the Japanese corporation, the characteristic features of the country's financial system and the relationship between the two help provide a more complete analysis of how the nexus operated in Japanese economic development during that country's high growth period.

VI. The government and the corporation in Korea

The Korean story of successful industrialisation in the last three decades is intimately linked with the development and the success of the giant Korean corporations, the Chaebols. These are the large highly diversified, indeed, "idiosyncratic" conglomerates

[24] There is a large literature on the stock market and the short termism that it typically engenders. For a recent review, see Singh (1995c). See also Stein (1988, 1989); Cosh, Hughes and Singh (1990); Porter (1992); Kojima (1995); Froot, Perold and Stein (1992). For an opposite point of view on the subject see Marsh (1990).

[25] See further Frank and Mayer (1990); Jacobson and Aaker (1993); Stiglitz (1993) and Allen and Gale (1995).

which have dominated the Korean economy during this period of extraordinarily fast economic growth. The Koreans have also followed a vigorous Japanese-type industrial policy - if anything, the policy has been even more interventionist than in Japan. It has also been marked by a close relationship between the government and business. However, the nature of this relationship in Korea has been somewhat different than that in Japan. Likewise, although there are broad similarities, there are also important differences between Japan and Korea with respect to (a) the organisation, ownership patterns and governance of the conglomerates in the two countries; (b) the respective financial systems; and (c) the industrial strategies. The discussion below will attempt to highlight the differences.

VI.1 Conglomerate organisation and the financial system in Korea

The Korean industrialisation and catching up with advanced countries started in earnest in the early 1960s with the military coup by General Park Chung-Hee (later the President). Park made economic development the top priority of his regime. After an initial period of tension between the government and business, Park came to the view that the large private conglomerate businesses were to be the main vehicles for Korea's catch up (Amsden, 1994b).

The government of Korea in its support of private business went one step further than the Japanese. It actively helped create large conglomerates, promoting mergers and directing entry and exit of firms, according to the requirements of technological-scale economies and world-demand conditions. The result is that the manufacturing industry of the country displays one of the highest levels of market concentration anywhere - whether among the developing or the developed economies. The top 50 chaebols accounted for 15 percent of GDP in 1990. Among the largest 500 industrial companies in the world in 1990, there were 11 firms from the Republic of Korea - the same number as from

Switzerland. UN (1993) observes in relation to the industrial structure of the Republic of Korea:

> Such a structure is the deliberate creation of the government, which utilised a highly interventionist strategy to push industry into larger-scale, complex technologically demanding activities while simultaneously restricting FDI inflows tightly to promote national ownership. It was deemed necessary to create enterprises of large size and diversity, to undertake the risk inherent in launching high-technology, high-skill activities that would remain competitive in world markets. The chaebols acted as the representative and spearheads of the government strategy: they were supported by protection against imports and TNC entry, subsidised credit, procurement preference and massive investments in education, infrastructure and science-technology network.

There are some important differences between the Korean chaebol and the Japanese kieretsu. In the Japanese kieretsu, there is a sharp divorce of ownership from control. Although as noted in Section V, nearly three quarters of the shares in a kieretsu member firm may be held in "patient" hands of other stakeholders, there is, nevertheless, very little family share ownership and control. In contrast, the Korean chaebol are to a considerable extent family owned and controlled. The absence of family ownership means that the Japanese corporations are effectively run by professional managers. The chaebol however, are run by the founding families who take the top management positions rather than professional managers.[26]

The second crucial organizational difference between the chaebol and the kieretsu derives from the important differences in the

[26] Professionalisation of management is however gradually taking place in many chaebol. See further Amsden (1989).

financial systems of the two countries. The Korean financial system during the high growth period (1960-1980) was effectively under state control so that the relationship between the main bank and the "group" firms in Korea has been rather different from that in Japan. In Japan, the group's main bank may be subject to government persuasion through "window guidance" etc. by the Bank of Japan, but it is nevertheless a private entity. When the main bank is directly state owned and controlled as in Korea for much of the period, the relationship between the bank and the firms in the group becomes rather different. The state-owned bank provides the government with an additional layer of control as well as information about the group's activities. Lee (1992) has argued in defence of this kind of relationship between the financial system and the corporate organization, that the government and large private organizations together can be regarded as forming an internal capital market. Following Williamson (1975), Lee suggests that such an internal system is not necessarily inefficient and can in fact be more effective than a free market financial system which suffers from various market imperfections.

VI.2. Industrial strategy

After a period of import substitution industrialisation in the 1950s and 1960s, the Korean government embarked in the mid-1960s on a purposive strategy of promoting exports, whilst maintaining protection of its own market. An essential purpose of this policy was to attain a current account equilibrium at as high a long-term growth rate of the economy as possible. This task was more difficult for Korea than for Japan for two reasons. First, Japan was relatively more developed than Korea. Secondly, Japan had a much larger internal market. It is arguable whether or not Japanese economic growth during the high growth period was export-led (Tsuru, 1993). The share of exports in GDP increased only to a small degree in the two decades 1953 to 1973, from 6.5 percent in 1953 to 8.9 percent in 1973. Korean industrialisation on the other hand was definitely export-led. In the comparable period of high growth in Korea, its exports increased from 4.8 percent of GDP in 1963 to 34.0 percent in 1980 (Krueger, 1995).

To achieve such export-led growth required stronger government involvement in building up the capabilities of private corporations to compete in the international market. The government did this by a wide range of measures which helped the corporate sector to invest and to improve its technological development, as well as have the resources to finance these investment projects. Some of the policies adopted by the government for these purposes are elaborated below.

VI.3. Domestic and external competition[27]

Contrary to a priori expectations as well as the experience of Japan during its high growth period, economic growth in Korea was not accompanied by declining concentration at either the industry or aggregate levels. This was due to the pattern of industrial expansion: "Korea's growth in value added is due first to expansion of existing firms, second to entry of offspring firms, and only to a minor extent to net entrance of new entrepreneurs" (Jones and Sakong, 1980, p.176).

The output of the top 5 and 10 business groups grew much faster than GNP, so that aggregate economic concentration rose spectacularly (Kim, 1987). Korea's all-industry average 3-firm concentration ratio remained higher than Japan's --- 62% compared with 56.3% respectively (in the early 1980s) (Lee and Lee, 1990). Between 1970 and 1982 the share of total manufacturing shipments produced under a competitive market structure decreased from roughly 40% to 30%, while the share produced by oligopolies increased from 35% to 50% (Lee and Lee, 1990).[28]

[27] This section is based on Amsden and Singh (1994).

[28] By 1987, however, the share of shipments in Korea produced under competitive market conditions did, in fact, rise, to 43%, while the share

Nevertheless, there is ample evidence that the big business groups still exhibited highly rivalrous behaviour (Kim, 1992). This was because under rapid growth conditions, as well as the rules of the game which the state had established, there was neither the incentive nor the ability for big business to collude. The Korean government went out of its way to ensure that big business did not collude, by allocating subsidies only in exchange for strict performance standards (Amsden, 1989). After 1975, inter-group competition in Korea heated-up as each chaebol tried to qualify for generous subsidies to establish a general trading company by meeting government performance standards regarding minimum export volume and number of export products (Cho, 1987).

Although the Korean government disciplined subsidy recipients, it also supported them for lengthy periods until they ultimately became internationally competitive. This enabled firms to have long time horizons for their investment plans. For example, in the Korean automobile industry, for 30 years no foreign cars were to be seen on Korean roads and no Korean cars were to be seen on foreign roads. In the event, the industry's leader, the 90% locally-owned Hyundai Motor Company, became the first late-industrialising automobile maker to export to Europe and the United States (Amsden, 1989).

VI.4. Inducement to invest and the socialisation of risk

As in Japan, the government in Korea played a critical role in enhancing and maintaining at a high level the corporate inducement to invest. However, the state in Korea was not just a referee or a ringmaster in orchestrating investment races, it was also a nursemaid and a fairy godmother to the chaebol. During the 1970s

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accounted for by oligopolies fell, to 40% (Lee and Lee, 1990). This rise of competition cannot be attributed to anti-monopoly legislation, which was introduced in the 1980s but which was implemented only weakly and sporadically. Thus, as in Japan, rapid growth in Korea was accompanied ultimately by declining industry concentration.

when the government implemented its extremely ambitious "heavy and chemical industry" (HCI) program, it virtually became a co-partner with the leading chaebol and "socialised" the risks involved.

These risks - both technological and market - in the production and sale of sophisticated new products were indeed formidable for the Korean private corporations. Left to themselves, the private sector may not have undertaken these risky investments at all. However, goaded by the government, provided with finance at subsidised rates through the nationalised banking system, the fiercely competitive top chaebol were more than willing to fully participate in these new ventures. To illustrate, here is the story of the production of microwave ovens by the Korean company Samsung Industries, as told by an institution, the World Bank, not particularly known for its support of the state nurse-maiding of industrial production.

> The government's Economic Development Board was a key player in Samsung's success. Government officials were keenly aware that the Republic of Korea could not rely forever on low wage manufacturing. Just as the United States had lost countless textile industry jobs to Korea, they reasoned, so Korea would one day find it could no longer compete for labour-intensive manufacturing jobs with low-wage neighbours such as China and Indonesia. To prepare for that day, government officials, working in consultation with the private sector, developed incentives for new knowledge- and capital-intensive industries. Incentives varied widely and included the government's building industrial parks, subsidising utilities, giving tax rebates for exports, and making cheap loans for investment in new products. By 1980, urged forward by subsidies and incentives, Korean industry had moved into steel, ships, and even cars and was about to leap into world class electronics.

Samsung made good use of these measures; company managers met frequently with government officials to trade ideas and projects. Even so, penetrating the world microwave market dominated by Japan was no easy task. By the late 1970s, when global production hit 5 million per year, Samsung had made a total of only 1,460 microwave ovens. The company's first break came in 1980, when a US department store, looking for cheaper substitutes, ordered several thousand ovens. Soon production had risen to 100,000. When General Electric, unable to keep pace with the Japanese competition, decided to stop manufacturing microwaves itself and import the ovens under its own label instead, Samsung was a logical choice. The company has never looked back, and it now exports the ovens under its own name as well as buyers' labels. (World Bank, 1993, pp. 130)

Another important example of heavy state intervention in support of industry is provided by the recession of the early 1970s. In view of the high leverage of Korean chaebol, the recession, coupled with devaluation and a rise in interest rates, threatened the financial viability of many strategic corporations engaged in HCI. The government responded forcefully with the Presidential Emergency Decree of August 1972, which declared a moratorium on corporate debt to curb market lenders. Kim, Shim and Kim (1995) note that all corporate loans from the curb market were converted into long-term loans to be paid on an instalment basis over a five year period with a grace period of three years. A maximum interest rate of 16.2 percent was fixed on these loans while the prevailing curb market rate was over 40 percent per annum.

Korea's HCI drive is often criticized by orthodox economists (see World Bank, 1993; Krueger, 1995) as an example of inefficiency and waste and general government failure. However, this assessment is disputed by many economists who point out that there were inevitable teething troubles with a highly ambitious program of this kind designed to fundamentally transform the structure of the Korean economy. On a long-term view, HCI can be regarded as being exceptionally valuable as since the mid-1980s it has been the main source of Korea's outstanding export success in the world markets (Amsden, 1989; Kim, Shim and Kim, 1995). Moreover, the latter three authors also suggest that HCI expanded the spectrum of the product mix in the economy and provided domestic producers enormous scope for learning by doing. They believe that the Korean experience confirms the Lucas (1993) hypothesis that the quicker the introduction of new products, the quicker the process of learning by doing and the faster the overall expansion of the economy. Kim, Shim and Kim conclude that the government's active risk sharing with private firms made an important contribution to the successful implementation of the HCI program.

VI.5. The financing of corporate growth in Korea

Table 11 provides comparative information on the financing of corporate growth for four industrial countries - the U.S., the U.K., Germany and Japan - and for Korea. The table is based on aggregate flow of funds accounts and refers to the non-financial corporate sector as a whole. The figures for the industrial countries refers to the period 1970 to 1989 and for Korea for the years 1975 to 1990. There are serious deficiencies of data in making such international comparisons, but as far as possible a broadly similar methodology has been used for the decomposition of the sources of finance for all five countries in table 11. It would have perhaps been more useful to compare the Korean pattern of financing corporate growth with that of other semi-industrial countries, but unfortunately the lack of comparable flow of funds data prevents such an exercise.

Table 11 shows that the Korean pattern of financing of corporate growth is much more similar to that of Japan than that of the other three industrial countries. The Korean corporations finance an even smaller proportion of their growth from retained earnings than the Japanese companies. The Korean companies also rely to a greater extent on new equity finance than companies in the U.K. or the U.S. where one might have thought a priori that stock market financing would be more important. The results of table 11 conform to the conclusions reached by Singh and Hamid (1992) and Singh (1995b) that large developing country corporations rely to a greater extent on a) external finance, and b) on equity finance than advanced country corporations.

The greater reliance on external finance by developing countries is not difficult to explain: given their much faster growth rates, the developing country corporations need both more internal and external funds to finance their growth. Indeed, Cho (1995) reports for Korea a consistent negative relationship between internal finance and loan finance, suggesting that the lower the level of internal finance, the greater the "need" for companies to finance its investment program from outside sources. The greater reliance on equity financing of the Korean than of the advanced country corporations is a more complex subject which is not directly relevant to the purpose of the present paper. This issue is, however, fully examined in Singh (1995b).

VI.6. Profits, savings and investment at the macroeconomic level

We have seen above that the Korean corporate sector relied heavily on external sources (mainly banks) to finance its growth. It is also clear from the previous discussion that at the microeconomic level, the Korean chaebol were not motivated by short term profitability but rather by their desire to maintain and improve the market share. It will be recalled from Section V that the Japanese firms behaved in a similar way, but the factors which were responsible for inducing such firm motivation were somewhat different in the Japanese case as compared with that of Korean firms. In Korea, the state played a much more overt and visible role in influencing firm motivation and behaviour.

We shall now examine the role of profits in the Korean economy at the macroeconomic level and consider how these might have contributed towards meeting the macroeconomic constraint of the equality of ex ante savings and investments at high growth rates. Table 12 provides information on the gross share of profits in gross production as well as aggregate profit rates for the Korean manufacturing industry over the last three decades. Unfortunately similar data is not available for other semi-industrial countries to permit a comparative exercise.

Two important points emerge from table 12. First, the Korean profit share in the 1960s and the 1970s was very high - averaging well over 40 percent in both decades. These figures for both profit share and profit rates for two decades are similar to those of Japan during that country's high growth period. Secondly, we note a trend decline in both profit rates and profit shares in Korea after 1978. Between 1977 and 1987, average profit share declined by at least 5 percentage points. There appears to have been a further sharper decline since 1987.

Table 13 provides information on sectoral savings and investment ratios for Korea and a small group of other countries in Asia and Latin America for which flow of funds accounts are available. In considering this data, it must be born in mind that they are subject to serious statistical deficiencies. Moreover the data does not pertain to exactly the same period for each country. For example the Indian figures are averaged over the period 1970-1982, the Chinese cover the years 1982 - 1986, Thailand 1981 - 1983, and Columbia 1970 - 1986. Nevertheless, these are the best comparable data on sectoral savings and investment behaviour available for LDCs and they do provide some useful insights.

The table reveals the following main points. First business investment as a proportion of GNP was greater in Korea than in any other country except China. In general, Malaysia and Thailand also recorded greater business investment ratios than the two Latin American countries in the sample - Colombia and Ecuador. Second, if we turn to savings, we again find that business savings in China, Korea, Thailand and Malaysia were considerably greater in proportionate terms than those in Colombia and Ecuador. Thirdly, the data show that in terms of household savings, the Korean record was no better than that of India and the Philippines and not at all that different from Colombia and Ecuador. So unlike the case of Japan, which it will be recalled from Section V had greater sectoral savings ratios for each of the three sectors relative to other industrial countries, the Korean superiority in relation to other developing countries is marked only with respect to business investment and business savings. It is also noticeable that although business savings in Korea are high in comparative international terms, these can finance only 40% of business investment; the rest of the finance has to be mobilised from the other sectors.

VII. Summing Up

The last two sections have examined in some detail the accumulation process in the two exemplary East Asian economies both at the micro and macro-economic levels. Particular attention has been paid here to (a) the role of the government and government-business interactions; and (b) the relationship between the financial system and the corporation. These relationships have been crucial for raising and maintaining at a high level the corporate propensity to invest in East Asian countries during their high growth phases.[29] Our analysis has also emphasised the role of the government in ensuring high corporate and overall profits in order to satisfy inter alia the macroeconomic constraint on savings and investment. As Akyuz and Gore (1996) note: "...in this way, East Asian NIEs have been able to avoid the kind of problems associated with Soviet-type investments not based on profits, as well as the Latin American phenomenon of profits without investment".

[29] For an analysis of government-business interactions in Taiwan and for their role in raising the corporate propensity to invest, see Rodrik (1995).

VIII. Implications for Development Thinking

We now bring together the threads of the previous discussion in order to examine its implications for development thinking and practice. The next section will consider what useful policy lessons, if any, can be drawn from this analysis for the Latin American countries in the context of the new global economic order.

With regard to development thinking, the first point which emerges from this paper concerns the role of large domestically owned third world firms in economic development. This subject has received very little attention in the literature. The literature emphasises capital accumulation but studies it by and large at a macroeconomic level. The question of investment allocation is indeed examined at a microeconomic level, but it is done within the context of cost-benefit analysis of investment projects. However, economists have been slow to recognise the fact that industrialisation and development are actually carried out by firms, organisations and managements. We have not so far begun to develop an analytical perspective on the nature and role of these entities in carrying out industrial development. There is no theory of the third world firm. Is a large third world firm much like a large firm in the advanced countries or are there important differences between the two?

To illustrate the significance of this point it is useful to draw attention to Aoki's (1990) work on the differences between Japanese and Anglo-Saxon firms. Aoki has emphasised the differences between the two groups of firms with respect to (a) their relationship with their workers; (b) their respective managerial cultures; (c) relationships with the providers of finance; (d) relationships with their suppliers and sub-contractors; (e) their respective ownership patterns. He has formalised these differences into a distinct theory of the Japanese firm.

There are indeed very important differences between large third-world firms and those in the US and Western Europe both today and in the past when these countries themselves were industrialising. It is a remarkable fact that the large private sector third-world firms tend to be highly diversified industrial groups operating in a number of unrelated fields, i.e. they are what might be called "irrational" conglomerates. This kind of 'group' business organisation seems to have arisen in countries with diverse cultures, institutions and historical development. Such widely diversified groups comprise the leading firms in India, Korea, Mexico, Brazil, Argentina and many other countries. Of the 31 largest private industrial enterprises in the semi-industrial countries in 1987, 27 were diversified groups which were mostly family controlled (Amsden and Hikino, 1994).

The large third world firms have been increasing their share of world output. In 1962 there were only four third world firms - two from South Africa, one from India and one from Turkey among the five hundred largest industrial enterprises in the world. By 1992 this number had risen to thirty three. It included twelve Korean companies whereas in 1962 there was not a single company from that country among the top five hundred.[30]

The special characteristics of contemporary giant third-world firms need systematic investigation. How for example, do large Latin American "groups" differ from Asian "groups". Is it true that, as some students suggest, in the typical Latin American "group", corporations control the group bank, while it is the other way round in East Asia?

Secondly, the main part of the paper has provided an analysis of the high corporate rates of savings and investment in East Asian economic development. Apart from its own interest, this emphasis is also significant for another important analytical and policy reason. It will be recalled that the recently concluded Uruguay

[30] The source of these data is Amsden and Hikino (1994).

Round Agreements have, in addition to trade liberalization, also extended multilateral rules and disciplines to a number of policy areas affecting industrial development and competitiveness with regard to both goods and services. Such policies -- generally defined as industrial policies -- have been extensively used in the past, notably by fast growing East Asian countries, to foster exports and to achieve rapid structural change and economic growth.

However, a number of these policies will fall foul of the Agreements, particularly in respect to provisions on trade related investment measures (TRIMS) (See further Singh, 1996). This could seriously handicap developing countries who wish to emulate the example of the successful East Asian economies.

There is however a way out of this predicament. This is because even though the post-Uruguay Round trading regime may restrict the use of a number of instruments of industrial policy with respect to the promotion of exports and the control of imports, it does not regulate government policies towards domestic savings and investments. In analytical terms, the focus on raising the propensities to save and invest can be regarded as an alternative way of enhancing a country's long term international competitiveness.

Historically, the East Asian governments have promoted international competitiveness by following both sets of policies simultaneously - i.e. the normal industrial and commercial policies with respect to exports and imports as well as policies which enhance savings and investments. Pursuing complementary means to attain the same ends would appear to be the optimal policy stance for even if one set of measures do not fully succeed, the others may work better and help reach the target. However, if the WTO regime effectively rules out over time traditional industrial policy, the other policy measures acting on the propensities to save and invest, can by themselves, still promote technical change and international competitiveness. This will particularly be so for the more developed of the industrialising countries, for example, Malaysia, Korea, or Thailand.

Thirdly, another implication of the analysis of savings, investment and profits in this paper for development thinking concerns income and wealth distribution. As noted earlier a striking aspect of the success of the exemplar East Asian countries is that they have been able to achieve fast economic growth while maintaining a relatively equal distribution of income. However, an important question is what has happened to wealth distribution? It is well known that in Japan and Korea, the land reform under US auspices led to a relatively equal initial distribution of income and wealth. However, in the subsequent industrialisation of these countries, corporate profits, savings and investment increased enormously. Industrial concentration may not have increased but it has remained high (Amsden and Singh, 1994). One would expect in these circumstances that, other things being equal, the wealth distribution in the urban economy will become more unequal. UNCTAD (1994) suggests that there is indirect evidence that this is what has actually happened. If so, this may require revision of political economy interpretations which are extant and which assume that neither income nor wealth distribution has worsened in East Asian economies.[31]

The question of wealth distribution in these countries therefore requires systematic research. If the wealth distribution, despite high corporate profits, savings and investments, did not become more unequal over time, what market or non-market mechanisms prevented that? If it did become more unequal, what are its implications for the political economy of these countries? In principle it is quite possible that even if there is no trade-off between growth and income inequality there may well be one between growth and wealth inequality.

[31] See for example Alesina and Perotti (1996); Alesina and Rodrik (1994a).

IX. Lessons for Latin America?

I turn now to the more difficult question: what are the lessons of the East Asian story for Latin American countries? Can the Latin Americans learn anything from the East Asians on, for example, how to improve their corporate savings and investment record? This is a complex issue because although the lessons of the East Asian experience are clear enough, there does not appear to be the appropriate political conjuncture for Latin Americans to be willing either to heed such advice or to learn from that experience.

This Latin American political conjuncture, whereby most governments in the region are in one form or another following the Washington Consensus and abandoning long-held dirigiste policies, coincides with a broader movement in the world economy towards liberalisation and globalisation. In this overall context, the following points in relation to the relevance of the East Asian experience for Latin America seem to me to be significant.

First, it is clear that the successful East Asian countries have not followed the "market friendly" approach as enunciated in its classic form in World Bank (1991). In order to prevent the concept from being a mere tautology, the Report, to its credit, defined market friendly fairly precisely: a) intervene reluctantly, b) apply checks and balances, and c) intervene openly. As is evident from the discussion in this paper as well as from much scholarship in this area[32], the East Asian governments did not intervene reluctantly: rather, they pursued vigorous and purposeful industrial policies.[33] Nor did they intervene openly or transparently as evidenced by the widespread use of administrative guidance. They did, however, apply checks and balances in the form

[32] See Amsden (1989); Wade (1990); Singh (1995a, 1995b).

[33] There is a dispute about the effectiveness of industrial policy, but most economists accept (including World Bank (1993)) that such dirigiste policies were actually implemented by the successful East Asian states.

of performance standards (notably with respect to exports) in return for subsidies and other government concessions. In relation to corporate investment and savings, the government again, as seen in previous sections, had a major role in raising and maintaining at a high level the corporate propensity to invest. It used, inter alia, trade, financial and competition policies to create "rents" which boosted corporate profits, but it also took steps to ensure that these rents were not consumed but were translated into investment. With the blessings of the government, if not its outright control, the financial system worked in such a way that the managers were able to pursue long-term investment strategies rather than being constrained by short-term goals of profitability and earnings per share. Thus, these prolonged high corporate investment rates which have been critical to East Asian growth were not simply the result of getting the macroeconomic fundamentals right and in achieving low and stable inflation but rather the outcome of a visible process of government intervention.

Secondly, in the current context of liberalisation and globalisation, the East Asians have been reluctant liberalizers. Contrary to the Bretton Woods Institutions, the East Asian countries during the last three decades have not sought close integration with the world economy but rather what I have called elsewhere a "strategic integration" - i.e. they have integrated up to the point and in the spheres where it was in their interest to do so. Thus, they have traditionally been open with respect to exports but not so open with respect to imports. It was noted in the introduction to this essay that by the year 2000 South Korea is expected to become the fourth largest car producer in the world. Even now it has sizeable exports to the United States and Western Europe and yet in 1995 the country imported only 4,000 cars. Although somewhat self-serving, many students of the Japanese economy would endorse the following recent complaint[34] from the Federation of Swedish

[34] See, for example, Johnson, Tyson and Zysman (1989).

Industries concerning the "Asian way" of doing business:

> ...it is necessary to face the new challenges presented to the present international trading system by "the Asian way" of regulation and of business. So far this challenge has been encountered mainly in relation to Japan, which has adhered to (almost) every letter in the GATT agreement, and at the same time managed to circumvent the spirit of the agreement by maintaining various formal and informal non-tariff barriers to imports, which have resulted in continued large surpluses. Only recently have these barriers begun to be dismantled, but the surplus is still large. These barriers combined with structural surpluses have shaken the confidence of the general public and of many economic operators in the fairness of the system, and contributed to continuous and rising pressures for increased protection in Europe and in North America from sectors which feel hurt by such policies. We also see the Koreans and the Chinese emulating important parts of the Japanese practices, while the records of South East Asian nations are more mixed.[35]

The East Asians have similarly been less than forthcoming in implementing financial liberalisation.

Thirdly, both in relation to trade and financial liberalisation, the contrast between the East Asian and the Latin American countries could not be more striking. The Latin Americans have enthusiastically reduced tariffs and trade barriers as well as capital controls.[36] The central issue is: will the liberalisation experiment succeed in terms of evoking an adequate supply response?

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[35] See Hagdahl and Ekdadl (1996), p11.

[36] For an interesting analysis of the reasons for the Latin American enthusiasm for liberalisation, see Rodrik(1994b) and Krugman (1995).

Although the jury is still out, so far the evidence is not very favourable to the Washington Consensus. Despite the huge capital inflows in the 1990s, the Latin American growth rate in the first half of the decade has only been about 3 percent per annum. This is roughly half the long term rate (6% p.a. between 1965 and 1980, see Table 1) achieved in the bad old days of dirigiste policies.

More importantly it is also coincidentally less than half the rate required, on past statistical relationships, to provide remunerative employment for just the new entrants to the fast growing Latin American labour forces.[37] Similarly, in relation to corporate profits and investment, Palma (1996) reports for a sample of six Latin American countries for which he had comparable data that the share of profits in GNP in these economies increased by ten percentage points (from 50 to 60 percent) with the recovery that started in 1987. However, corporate savings and investment hardly increased at all. There is also evidence that the commodity composition of Latin American exports is moving in the adverse direction, i.e. towards those products where world demand is expected to grow slowly.[38]

It would appear to an observer of Asian economic development that the precipitate and uncontrolled trade liberalisation which occurred in Latin America in the 1980s was probably not well-timed. It took place when Latin American industry was competitively weak because of the low levels of investment during the course of the debt crisis. However, the situation seems to have been made doubly difficult for the real economy in many countries by the financial liberalisation which has been implemented towards the end of the last decade. In the wake of the financial crisis which overwhelmed Mexico in December 1994, Latin American economies have already paid a heavy price for this liberalisation in terms of loss of output. Further, stock markets have played a key role in the internal and

[37] See further Singh and Zammit (1994).

[38] UNCTAD (forthcoming).

external financial liberalisation process which has taken place.

Apart from the macroeconomic effects of financial liberalisation, it is arguable that the consequent growing hegemony of the stock market in these economies may at the microeconomic level hinder rather than help industrialisation and economic growth. Long ago Keynes observed (Keynes, 1936, p. 139) that " when the capital development of a country becomes the by-product of the activities of a casino, the job is likely to be ill-done." The enormous fluctuations on the Latin American stock markets in the recent period unrelated to any fundamentals,[39] would appear to confirm Keynes' characterisation of such markets as casinos. Even if the Latin American industry can bear the burden of trade liberalisation, the cross of financial liberalisation may be crippling.[40]

However, as noted earlier, the jury on the supply response and the real economy is still out. If adequate supply response continues to be elusive, at what point will the architects of the Washington consensus be willing to admit that the experiment has failed?

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[39] El-Erian and Kumar (1995) report that between 1983 and 1993 stock market volatility in Mexico was nearly fifteen times as large as that in the US or Japan. See further Smith and Walter (1996) and Calvo et al. (1996).

[40] For a fuller discussion of the issues raised in this paragraph see, Singh (1996c, 1996d).