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# The post-Uruguay round world trading system, industrialisation, trade and development: implications for Asia-Pacific developing countries

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17 February 1996

Online at https://mpra.ub.uni-muenchen.de/54992/
MPRA Paper No. 54992, posted 03 Apr 2014 04:29 UTC

# THE POST-URUGUAY ROUND WORLD TRADING SYSTEM, INDUSTRIALISATION, TRADE AND DEVELOPMENT: IMPLICATIONS FOR ASIA-PACIFIC DEVELOPING COUNTRIES

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First Draft
1 October 1995

Comments most welcome

THE POST-URUGUAY ROUND WORLD TRADING SYSTEM,
INDUSTRIALISATION, TRADE AND DEVELOPMENT
IN THE ASIA-PACIFIC DEVELOPING COUNTRIES

CONTENTS


I. Executive Summary

II. Introduction

III. Industrial Policy: Conceptual Issues

IV. The Uruguay Round Agreements and Industrial and Export Promotion Policies in Developing Countries

V. The Uruguay Round Agreements and Industrial and Export Promotion Policies in Japan and Korea in their High-Growth Periods

VI. Export Promotion and Industrial Policy Measures Currently Employed in Asia-Pacific Developing Countries

VII. Prospects for Industrialisation and Economic Development in the Post-Uruguay Round World Trading Order

VIII. Conclusion and Policy Implications

IX. References

X. Table 1 - Policies, measures and incentives to promote export expansion

XI. Appendix Table 2 - Export promotion laws in Korea

**The Post-Uruguay Round World Trading System,
Industrialisation, Trade and Development:
Implications for the Asia-Pacific Developing Countries**

## I. Executive Summary

The purpose of this paper is to examine the implications of the Uruguay Round Agreements for domestic economic policy in developing countries, particularly those in the Asia-Pacific region.

Apart from trade liberalization these Agreements have 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 notably by fast growing countries in the Asia-Pacific region to foster exports and to achieve rapid structural change and economic growth.

This paper has analyzed the Uruguay Round Agreements in order to answer the following three questions:

a) How will the Agreements affect the industrial and export promotion policies currently being pursued by the Asian-Pacific countries?

b) To the extent that some of these policies may need to be abandoned to comply with the Agreements, how would that affect economic development of these countries?

c) In so far as the net effects of the Agreements on the developing countries is negative, what can these countries do to eliminate, or to reduce, such unfavourable outcomes?

In examining these issues, the paper gives special attention to the cases of Japan and to those of the two first-tier NICs, Korea and Taiwan. All three countries during their periods of rapid economic growth implemented a vigorous "industrial policy" in both the broad and narrow senses of the term.

However, in the recent period, all three have been obliged to liberalise their economies. In the process they had to eschew many of the industrial and export promotion measures they successfully used in the past. The liberalisation experience of Japan, Korea and Taiwan, the paper suggests, has important lessons for the other Asian-Pacific countries confronted with the post-Uruguay Round world trading system.

The analytical part of the paper also emphasises an important conceptual point with respect to the question, what government interventions constitute an industrial policy? It is suggested here that both from the perspective of economic development and that of international competitiveness, a broader conception of industrial policy is more appropriate.

Specifically, policies employed to enhance savings and investment can have as much influence on promoting technical change, international competitiveness and industrial development as the more narrowly conceived industrial and export promotion policies. The exemplary East Asian countries used these policies to great advantage and some analysts ascribe their outstanding industrial success <u>exclusively</u> to these policies.

The examination of the Uruguay Round Agreements shows that a large number of industrial and export promotion policies currently being implemented by Asia-Pacific countries are likely to be incompatible with the Agreements. Nevertheless, the analysis of this paper suggests that there is wide enough range of permissible policies under the Agreements so as not to affect greatly the development of the relatively more advanced of these countries. This is not to deny that the abandonment of the previously permissible direct and targeted industrial and export promotion policies will have a cost. This cost has to be assessed against the greater market access available to the LDCs under the Agreements. It is suggested here that the <u>net</u> cost of the required changes in industrial policy under the Agreements are likely to be relatively small for the industrially more advanced developing countries like Malaysia, but quite large for the least developed countries like Bangladesh.

The policy recommendations of this essay are implicit in the above summary. These are explicitly set out in the last section of the paper.

## II. Introduction

The purpose of this paper is to examine the implications of the Uruguay Round Agreements for domestic economic policy in developing countries, particularly those in the Asia-Pacific region.

Apart from trade liberalization these Agreements have 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 notably by fast growing countries in the Asia-Pacific region to foster exports and to achieve rapid structural change and economic growth.

Prior to the Uruguay Round Agreements, the GATT accorded developing countries special and preferential treatment. First, it was recognized that there was a need to nurture infant industries in developing countries. Second the special difficulties that developing countries had in maintaining equilibrium in their balance of payments owing to their more fragile situation were acknowledged. Article XVIII Section B of the original GATT provided developing countries with the flexibility to impose trade measure to protect their balance of payments. Section C enabled them to take such measure for the protection of infant industry.

These provisions were not available to industrial countries. Part IV of the GATT, added in 1965, made an explicit commitment allowing developing countries preferential access to the markets of developed countries (effected through GSP schemes) and formally waived the reciprocity rule.

The Uruguay Round Agreements represent a significant set-back for developing countries in so far as they reduce their economic and trade policy options. Although the concept of special and differential treatment for poor countries is still embodied in the Uruguay Round Agreements, the provisions on subsidies, local content requirements, etc., have become much more strict, greatly circumscribing many of the industrial policy instruments traditionally used by the most successful economies of the post-Second World War period, namely countries like Korea, Japan, Taiwan Province of China.

The paper is organized as follows. Section II outlines the industrial policy instruments used by Japan and Korea during their periods of high economic growth, namely 1953-1973 and 1965-1980 respectively. One objective of this discussion will be to clarify the conceptual issue of what constitutes 'industrial policy'. Section III concentrates on those parts of the Uruguay Round Agreements which have a direct bearing on trade and industrial policies of developing countries. Section IV carries out an intellectual exercise to consider the important question: which of the whole gamut of industrial, export promotion and related policies implemented by the governments of exemplary East Asian countries like Japan and Korea during their post-World War II periods of rapid industrialisation and fast economic growth, would have been permissible had the current Uruguay Round Agreements been in operation at that time. The implications of this analysis for the industrial and export promotion policies currently being followed by countries in the Asia Pacific region will be examined in the following section. Section VI analyses the salient issue of how the post Uruguay Round restrictions on domestic policy in developing countries will affect their long-term growth and development prospects. It will be argued here that these are likely to differ substantially between those of the industrializing economies which are already relatively industrially advanced and those which are just beginning to industrialize. It will also be suggested here that the experience of Japan and Korea after they liberalized their economies in 1973 and 1980 respectively has very important lessons for developing countries entering the new global liberal economic order.

Section VII concludes with an examination of the policy implications of the paper both for individual developing countries and for South-South cooperation.

## III. Industrial Policy: Conceptual Issues.

The East Asian countries have achieved a spectacular average rate of economic growth over last the last 30 to 40 years, with very substantial diversification and economic development. Korea, for example, managed to transform itself from being a largely agricultural society in 1960 to the point where it became the third country after the US and Japan to export 256K memory chips, developed by its own firms.

How does one account for this extraordinary success?

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. Until relatively recently, the Bank has argued that countries like Japan and Korea during their respective periods of high economic growth followed "market friendly" policies with relatively limited overt intervention in their economy (World Bank 1991). This position became increasingly unsustainable intellectually, since there is overwhelming evidence, generally accepted by scholars in the field, that government in Japan in the third quarter of this century did not simply pursue the "nightwatchman" role ascribed to it by the Bank but actively pursued a forceful and aggressive industrial policy (Amsden, 1989; Wade, 1990; Johnson, 1982; Singh, 1995a).

In response to such criticisms, in its latest important publication on the subject (World Bank, 1993), the Bank has conceded that there was indeed substantial intervention:

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

Despite this apparent climb down, not explicitly acknowledged, the Bank put forward a new thesis: it admitted that interventions did take place but argued that these were not as extensive as those in other developing economies. Despite being relatively limited, these worked sometimes, sometimes not.[1] More importantly, it is suggested that these countries would have achieved the same economic structure had the government not intervened. In other words, industrial policies did not have any impact on the outcomes. Thus, the World Bank (1993) on the Republic of Korea's industrial policy: "Moving away from anecdotes about individual chaebols, the quantitative importance of government intervention to alter the structure of production is not confirmed at the sectoral level (p.333)."

This industrial ineffectiveness doctrine has been severely criticized by a wide range of economists, including Amsden (1994), Kwon (1994), Lall (1994), Rodrik (1995) and Singh (1994,1995b). These writers point out that the World Bank's conclusion in based on a very narrow view of industrial policy and that it has confused instruments of industrial policy with its objectives.

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[1] World Bank (1993) concludes its analysis as follows: "What are the main factors that contributed to the HPAE's (high performing Asian economies) superior allocation of physical and human capital to high yielding investments and their ability to catch up technologically? Mainly, the answer lies in fundamentally sound, market-oriented policies. Labour markets were allowed to work. Financial markets generally had low distortions and limited subsidies compared with other developing economies. Import substitution was ... quickly accompanied by the promotions of exports. ... the result was limited differences between international relative prices and domestic relative prices in the HPAE's. Market forces and competitive pressures guided resources into activities that were consistent with comparative advantage ..." (p. 235).

Thus, the Bank's principal explanation for fast economic growth in East Asia focuses on the primacy given to market forces, prudent monetary and fiscal policies to prevent inflation and to achieve macro- economic balance, policies to get "prices right", production according to comparative advantage and openness to the international economy. In other words, the World Bank in effect reverts back to the "market friendly" approach to development.

The Bank defines industrial policy as consisting of three elements: directed credit; export promotion; and structural policy. Structural policy is regarded as the main object of the of the exercise: "We define industrial policies -- as distinct from trade policies -- as government efforts to alter industrial structure to promote productivity-based growth" (p.304)

The Bank's analysis came to the conclusion that whereas two of the elements of industrial strategy i.e. directed credit and export promotion were successful, that concerning structural policy was not. This conclusion is strange in its own terms since, if the two instruments are successful, one would expect it to contribute to the success of the objective, namely structural change.

Be that as it may, the more important point is that the Bank has ignored a wide range of measures taken by the governments in these countries to foster economic and industrial development which were part and parcel of their industrial policies. Specifically, the Bank's analysis omitted a number of policies adopted by the 'exemplary' East Asian economies of Japan and Korea, including:

a) generalized protection and not just protection for specific industries that the government wished to promote;

b) technology policies;

c) lax competition and merger policies (the Korean government, in fact, fostered large conglomerate businesses which dominate the Korean economy giving it one of the world's highest industrial concentration ratios)[2];

d) policies to promote savings and investment. These included on the investment side a range of

[2] See further Amsden and Singh (1994).

measures such as liberal corporate depreciation allowances, fiscal measures to promote corporate savings and investment; measures to promote household savings through the creation of popular postal savings institutions. The purpose of these policies was two-fold: to reduce the consumption of imported goods, on which there were, also import restrictions; to increase aggregate savings and investment in order to achieve current account balance at a high growth rate;

e) policies to restrict foreign direct investment and ownership of domestic industry. Such policies were implemented in both Korea and Japan during their high-growth periods.

The Bank's critics point out that the policies outlined above were not an ad hoc collection of aids to assist the development of industry. Rather, in each case, these were a part and parcel of a coherent, consciously framed development strategy that corresponded to the government's strategic view of the country's industrial development in relation to the world economy. This strategy was pursued in both countries in a coordinated way.

It is therefore not legitimate to judge the success of these governments' industrial policies as a whole with respect to their objective of rapid structural change and faster long term economic growth on the basis of a narrow range of policy measures and without taking into account their interactions with other instruments.

The point on savings and investment in (d) above requires special attention. It is analytically significant for the central issues to be dealt with in this paper. An outstanding fact which characterizes Korea and Japan is that, after an initial period when foreign savings were critical, their fast economic growth has been based on high rates of growth of domestic savings and investment. In an important contribution, UNCTAD economists[3] have argued that these high rates of savings and investment were

[3] See further UNCTAD (1994); Akyuz and Gore (1995).

more important in achieving technological transformation and faster growth than narrowly conceived policies to upgrade the industrial structure. They go on to suggest that, contrary to the view of the orthodox economists, government played a critical role in this process by policies which enhanced business profits and ensured that these corporate profits were invested rather than paid out as dividends.

One does not have to accept the UNCTAD thesis entirely or exclusively to appreciate the point that industrial policy in the narrower sense and the broader policy concerning savings and investment are both important. In this context, Johnson et al (1989) were indeed right to refer to Japan's "developmental policy" rather than "industrial policy": "The purpose of the policy was domestic development and it grew out of the conviction that comparative advantage can be created by intentional government policy".

The aim of this conceptual discussion has been to emphasize the point that, even though the post-Uruguay trading regime may restrict the use of a number of instruments of industrial policy narrowly conceived, it does not prevent resort to policies regarding domestic savings and investment. These, as explained above, are just as critical to industrial success as traditional industrial policy.

In this connection, it is useful to reflect on the fact that, in the talks between the United States and Japan on strategic trade impediments , the purpose of which was to achieve level playing fields for the two countries, more than one hundred such impediments were identified. Interestingly, the latter included Japan's very high savings rate compared with that of the US. This was thought to give Japan an "unfair" competitive advantage and therefore the US wanted Japan to reduce its savings rate in order to have level playing fields. Naturally, the Japanese response was that the same effect could be achieved by the US increasing its own savings rate. Fortunately, for all its disadvantages for developing countries, the new WTO regime does not concern itself with the question of the level of savings compatible with level playing fields in current and prospective members of WTO.

In the next section we will outline the main provisions of the Uruguay Round Agreements that relate to industrial policy in order to ascertain which of the kinds of instruments used in Korea and Japan during their high growth phase will still be permissible and those which are now prohibited.

## IV. The Uruguay Round Agreements and Industrial and Export Promotion Policies in Developing Countries[4]

The Uruguay Round Agreements contain some advantages but many disadvantages for developing countries. Distinguished Third World commentators [see for example, Agosin et al.(1995), UNCTAD (1995)] regard the net balance to be negative. On the specific issue of restrictions on industrial and export policies, the following Agreements are relevant[5]:

Agreement on Subsidies and Countervailing Measures

Agreement on Trade-Related Investment Measures (TRIMs);

[4]The information contained in this section is based on Agosin et al. (1995), Amsden (1995), GATT (1995), GATT (1993), UNCTAD (1995 and 1995a), Weston (1995), Greenaway and Milner (1995), IMF (1995), ODI (1995), WTO (1995).

[5] The citations from the Uruguay Round Final Act for these Agreements or Decisions are as follows. Agreement on Subsidies and Countervailing Measures (Annex 1A); Agreement on Trade-related Investment Measures (TRIMS) (Annex 1A); Understanding on Balance-of-Payment Provisions of the General Agreement on Tariffs and Trade 1994 (Annex 1A); Agreements on Trade-related Aspects of Intellectual Property Rights (TRIPS) (Annex 1C); General Agreement on Trade in Services (GATS) (Annex 1B); The Decision on Measures in Favour of Least Developed Countries is one of the Ministerial Decisions and Declarations.

Understanding on Balance of Payments;

Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs);

General Agreement on Trade in Services (GATS);

Decisions on Measures in Favour of Least Developed Countries

Subsidies and Countervailing Measures: The Agreement on subsidies includes several new elements compared to the GATT and Tokyo Round, which could circumscribe developing country policy options. Specific and general subsidies are defined, with only specific subsidies being subject to discipline. (for the purposes of the Agreement, a subsidy is defined as involving a financial contribution by a government or public body, or income or price support). Specific subsidies are classified as prohibited, actionable and non-actionable. Prohibited subsidies are those granted contingent upon export performance, or upon the use of domestic over imported products. Non-actionable subsidies include: a) subsidies which are not specific; and b) among specific subsidies those granted for basic and applied industrial research, those granted to disadvantaged regions (subject to certain specification), as well as those relating to new environmental laws. All other subsidies are actionable, that is, action can be taken against them if they cause adverse trade effects in other members.

The Agreement on subsidies does recognize that these may play an important role in the development programmes of some countries and allows for certain concessions under special and differential treatment for these countries. For, example, least developed countries are given an 8 year transition period to phase out export subsidies.

The TRIMs Agreement likewise prohibits five types of TRIMs. These mainly involve measures which require particular levels of purchase or use of products of domestic origin (namely local content requirements), or which restrict imports to an amount related to the volume of exports. Again the TRIMs Agreement recognizes the special needs of developing countries and permits them to apply temporarily prohibited TRIMs for the protection of infant industries or to protect their balance of payments.

The 1979 Declaration on Trade Measures Taken for Balance of Payments Purposes, which many developing countries used has been made more stringent than before. It stipulates that countries imposing restrictions for balance of payments purposes should do so in the least trade-disruptive way and should favour price-based measures (for example import surcharges and deposits which are transparent), rather than quantitative restrictions.

The TRIPs Agreement creates difficulties for developing countries with respect to their policies on technology transfer and the development of their indigenous capacity in a number of areas. The agreement has three main features:

a) the establishment of minimum standards of protection for each main category of intellectual property rights;

b) the procedure and modalities to be incorporated in national legislation so that IPRs can be effectively enforced; and

c) applying the general disputes settlement mechanism of the Uruguay Round

The Agreement also specifies the application of national treatment and most-favoured-nation treatment, in other words foreign rights owners must be given no less favourable treatment than nationals and the principle of most-favoured-nation treatment must also apply, thus preventing discrimination. The obligation to provide national treatment and most-favoured-nation treatment applies twelve months as from the date of entry into force of the Agreement.

Until now, countries could exclude certain areas of inventions from patent protection, define the duration of the terms of a patent, as well as the set of exclusive rights conferred on a patent holder. Thus developing countries could to a certain degree frame their patent laws in accordance with their development objectives. The TRIPs Agreement removes most of these freedoms and reduces the scope for national decisions in most areas of intellectual property rights.

The IPRs legislation provides owners of intellectual property access to international trade sanctions to gain the enforcement of these new standards. However, least developed countries are given up to 11 years, while other developing countries have five years to comply with the international standards[6].

From the point of view of developing countries, the TRIPs Agreement has serious limitations with the respect to the transfer of technology, in that:

(a) reverse engineering (a method of evaluation of a product in order to understand its functional aspects and underlying ideas) and other traditional methods of imitative innovation are now restricted.

(b) patentability is now extended to almost all fields of technology; and

(c) the burden of proof has been reversed so that the onus in now on the accused patent infringer to prove non-infringement.

[6] In the case of the latter group of developing countries, an additional five years is allowed with respect to pharmaceuticals and agricultural chemicals, where these have not already been accorded patent protection, which is the case in many developing countries.

Patent holders can no longer be obliged to operate a patent locally in countries where they are registered, but the Agreement gives them exclusive rights of importation. One effect of the TRIPs Agreement in a globalized economy, with low tariff barriers for manufactured products, may therefore be to encourage greater flows of trade rather than the diffusion of technology to developing countries.

The General Agreement on Trade in Services (GATS) provides for the first time a set of multilateral rules for the conduct of trade in services, and also creates a framework for continuing liberalization. The basic principles underlying GATS are a complete coverage of all service sectors, an obligation to provide national treatment to service providers of other nations as well as most-favoured-nation obligations so as not to discriminate between service suppliers, and increasing participation in world trade in services on the part of developing countries. It is provided that these principles be applied with considerable flexibility and countries are free to decide which services will be subject to market access commitments in their national schedules, which are annexed to the Agreement and are an integral part of the Agreement.

The GATS Agreement does not contain a separate chapter on special and preferential treatment of developing countries comparable with Part IV of the GATT. This is because it is contended that development considerations permeate the whole Agreement. However, once a country makes a commitment under Article XVI to market access with respect to particular sectors, then it is obligated not to maintain or adopt:

(a) limitations on the number of service suppliers;

(b) limitations on the total value of service transactions or assets with respect to specific service providers;

(c) limitations on the number of natural persons that may be employed in a particular service sector or that a service supplier may employ;

(d) restrictions or requirements of specific types of legal entity or joint venture through which a service supplier may supply a service;

(e) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment.

A footnote to Article XVI.1 on market access states that, if a member undertakes a market access commitment under this section, it is obliged to permit cross-border movement of capital if that is an essential part of the service itself.

For developing countries, these are extensive commitments which can adversely affect the development of the domestically owned service sector[7]. There is, of course, an important qualification to Article XVI covered by the phrase "unless otherwise specified in its schedule". So, in principle, a developing country could put limitations on its liberalization commitments regarding the sectors listed on its schedule. The significant question is, therefore, how much bargaining power an individual developing country has to enter such restrictions with respect to the items on its schedule.

These limitations on the ability of developing countries to promote the development of their domestic service industries against international competition are in practice likely to prove no less onerous than those with respect to manufactures. This is because a typical developing country is likely to give in under the dual pressure from the advanced countries to "be serious" in its negotiations and from the Bretton Woods institutions to liberalize its services in any case.

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[7] In addition, Article XI provides that , except on balance of payments grounds, a member shall not restrict international transfers and payments relating to specific commitments.

The Decision on Measures in Favour of Least Developed Countries recognises the special status of LLDCs (Least Developed Countries). The preamble of the Decision notes that "their participation in the multilateral trading system should be seen in the light of their special development and trade needs as recognised in a number of GATT decisions related to special and differential treatment". Consequently, these countries, have been subjected to fewer obligations than LDCs or developed countries, granted longer implementation periods and importantly given "increased technical assistance in developing, strengthening and diversifying their production and export bases, including those of services, as well as their trade promotion". The definition of LLDC under the WTO is the same as in GATT, that is, countries "designated as such by the United Nations". This group currently comprises about 48 countries.

## V. The Uruguay Round Agreements and Industrial and Export Promotion Policies in Japan and Korea in their High-Growth Periods

In the light of the above discussion of the Uruguay Round Agreements, this section carries out the intellectual exercise mentioned in the Introduction. It asks the question which of the industrial and export promotion policies undertaken by Japan and Korea during their industrialization drive would have been impermissible had the Uruguay Round Agreements been in force then. An interesting related issue is: even if some policies had been disallowed, how would it have affected economic development in these countries? Would an East Asian miracle still have been possible?

In considering these questions it is important to enter a caveat. To some degree what precisely is and is not permissible under the new regime is a speculative question. All we have at the moment are the Agreements, but no case law based on them. Until the Agreements are implemented, and the world finds out whether the new Disputes Settlement Mechanism indeed has real bite, the exact status of the

Agreements entered will not be clear. It is for example quite possible that the new adjudicating machinery under the Agreements may not operate as envisaged. Under pressure from powerful industrial countries, the Dispute Settlement Mechanism could dissolve into a negotiating body like the old GATT, with all its implications for the credibility of WTO judgements. Nevertheless, the Agreements, as the discussion of the previous section showed, have prima facie seriously limited economic policy options open to developing countries.

To make the discussion more specific, the instruments of industrial and export promotion policies either by Japan or by the republic of Korea during their periods of rapid economic growth -- Japan between 1950 and 1973 and Korea during the 1960s and the 1970s -- are summarized below[8].

1. import restrictions, both general and specific

2. favouring particularly sectors for export promotion and in some cases particular firms for that purpose

3. seeking compliance for subsidies given to exporters by means of export targets for specific firms (the Korean case)

4. interest rate subsidies and the availability of credit and foreign exchange to favoured firms that met export targets;

5. general export promotion, in Japan through JETRO (Japanese external trade organization) and

[8] For information on Japan, see among others Johnson (1982), Okimoto (1989), Tsuru (1993), Caves & Uekusa (1976). For Korea see Amsden (1989), Chang (1994). The export promotion laws of Korea are summarised in Table 2 in the Appendix.

in Korea via KWOTRO;

6 provision of infrastructure including human capital;

7. taxation relief on imported inputs and on R&D expenditures

8. allowing favoured conglomerates to import capital goods and foreign technology and to raise cheaper finance on international markets

II. Industrial policy measures

a) lax enforcement of competition policy, including the extensive use of cartels.[9]

b) government creation and promotion of conglomerates in Korea;[10]

c) tax concessions to corporations to increase investment;

d) promotion of a close,longterm relationship between finance and industry which was critical to the implementation of the industrial policy[11];

e) labour repression to ensure labour peace in a period of gigantic structural change (this applies to Korea rather than to Japan)[12];

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[9] See further Amsden & Singh 1994.

[10] See Chang (1994).

[11] Johnson et al 1989.

[12] See further You and Chang (1992).

f) establishment of state industries to enhance industrial development (this again applies to Korea rather than to Japan);

g) administrative guidance used extensively both in Japan and Korea.

Which of these policies would have fallen foul of the Uruguay Round Agreements had these been in operation at the time? Clearly, many of these would appear prima facie to be in violation of the new Agreements, particularly in the areas of TRIMs, subsidies, and technology policy (TRIPs). The short answer is that had Japan and Korea implemented these policies in the post-Uruguay Round period a good number of those in section I - though not all - would not have been permitted. Most of those in section II would have been allowed, provided they had been skilfully operated. The two countries would have had to tailor their interventions to be compatible with the new trading rules. Specifically, as noted in section III, these rules allow subsidies for technological development, as long as they are non-specific. Other subsidies would have needed to have been given in the form of regional aid; or to small and medium enterprises. However, Japan and Korea would not have been able to provide generalized protection of the kind they implemented as a background to the other more targeted policies.

It is ironic that the World Bank (1993) singles out the export promotion policies followed by Japan, Korea and other successful East Asian NICs during their high-growth periods as having been particularly useful in contibuting to their overall economic success. Yet many of these policies are in clear violation of the Uruguay Round Agreements. It should be remembered that these policies included export targeting, namely, subsidies based on achievement of export performance standards. For the Bank, meeting export performance standards provides an objective international market test for competitiveness and efficiency, and therefore the best indirect test of the usefulness of subsidies and or other forms of infant industry protection. To that extent the latter policies gain the Bank's endorsement and the institution recommends them to other developing countries.

A similar point is made with even more force by Alice Amsden, who in most matters is at the opposite end of the policy debate. She argues that the most important reason why industrial policies were successful in countries like Japan and Korea and unsuccessful in Latin America was that the former countries imposed performance standards, particularly in terms of export performance. In Latin America, on the other hand, subsidies were given in a blanket fashion without the government requiring anything in return.

Under the Uruguay Round Agreements, most aspects of the export promotion policies followed in Japan and Korea would have had to be abandoned. The two main permissible policy instruments would have been: (a) government provision of information to exporters and (b) changes in the exchange rate. The latter is, of course, not an easy instrument to use because of its pervasive impact on the whole economy through its effects on distribution of income, and hence on inflation.

However, the establishment and operation of JETRO in Japan and KWATRO in Korea would still have been compatible with the new multilateral trade regime, since all that these agencies did was to provide information on export opportunities. But in so far as these or other agencies provide a free insurance element for exports or export guarantees these would have been in violation.

Infant industry protection is permitted under the Uruguay Round Agreements, but for a limited period, having to be phased out within a period of ten years for the least developed and five years for other developing countries. Given the handicaps that a developing country has at the start and the time it takes to acquire the capabilities to compete with advanced country corporations, the necessary period for infant industry protection is likely to be much longer than is allowed for in these Agreements. Korea, it should be borne in mind, provided protection for its car industry for 30 years before its cars could compete with US car output[13]. Korea is tod a significant exporter of cars to the US and other advanced countries and it is estimated that by the year 2000, Korea will have the world's fourth biggest car industry. Yet as late as last year, a paltry 4,000 foreign cars were sold in South Korea. Clearly car imports are still being restricted in that country through formal or informal means.[14]

Another major instrument used by Korea to steer firms towards its industrial development goals was to heavily subsidize interest rates and preferential credit allocation to particular firms. These again will be ruled out by the new trading arrangements unless it was part of a programme of infant industry protection. Similarly discrimination against foreign investment and its prohibition in many cases would fall foul of the new regulations.

On the other hand, the following measures which are not part of a narrow industrial policy but which were nevertheless crucial to Korea's industrial drive would still be permissible. These include general fiscal concessions to corporations, the provision of subsidized R&D up to a certain level, measures to promote corporate investment and discourage the payment of dividends.

In the next section we shall consider the current situation of Asian-Pacific developing countries with respect to export promotion and industrial policy measures which are being used in these countries. The implications of the Uruguay Round Agreements, discussed in this section with respect to the counter-factual thought experiment concerning the Japanese and Korean policy programs, are directly relevant to the question as to which of the Asia-Pacific countries' policies would no longer be permissable and which ones could still be used subject to modifications.

[13] See further Amsden and Singh (1994) and Amsden (1989).

[14] The Economist, September 30th - October 6th, page 18 and 19.

## VI. Export Promotion and Industrial Policy Measures Currently Employed in Asia-Pacific Developing Countries

Information provided by the governments of Asian-Pacific developing countries to UNCTAD and to GATT reveals that these countries presently use a wide range of policies to promote exports and industrial development. To illustrate, we examine in some detail below the case of Malaysia, a leading second-tier NIC. Similar information for a number of other Asia-Pacific countries is summarised in Table 1.

### Malaysia

1. Export subsidies

Malaysia provides different levels of indirect subsidies to its exporters without maintaining direct export subsidies.

2. Duty and tax concessions

a) To encourage exports to non-traditional markets, a double-taxation deduction is allowed on premium payments to export credit insurance taken for such markets with a company approved by the Ministry of Finance. Certain expenses incurred by resident companies for the purpose of seeking opportunities to export overseas are also eligible for double deductions.

b) An Abatement Incentive of Exports of 25 per cent of the ratio of export sales to total sales was granted to resident companies exporting products manufactured in Malaysia, and an Export Allowance of three per cent of f.o.b. export value was granted to trading companies that exported products manufactured in Malaysia and for exports of agricultural products approved by MITI, but these were abolished in respect of exports made on or after 1994.

c) An Industrial Building Allowance consisting of an initial allowance of 10 per cent, and an annual allowance of two per cent, is granted to companies in respect of buildings used as warehouses and bulk storage installations for storing goods for export. A draw-back of excise duty in respect of parts, ingredients or packaging material may be claimed if they are used in the manufacture of exported goods. Manufactures are eligible for full drawback on all taxes paid on materials for manufacture of goods that are subsequently exported. Delivery of goods to a Free Zone is regarded as exportation.

3) Export finance

The Export Credit Refinancing Scheme (ECR) of the Bank Negara has the following features:

a) To be eligible, goods should at least fulfil a minimum of local content requirement of 30 per cent of raw materials used, and have a minimum value added of 20 per cent (companies whose products do not fulfil this may apply for special consideration).

b) The interest rate charged since October 1991 is 7 per cent, compared to a banker's rate of about 7.5 per cent.

c) The maximum refinancing period is four months for the preshipment facility and 6 months for the post-shipment facility.

d) For the pre-shipment facility, the refinancing is 80 per cent of the contract value of eligible amount as specified in the Certificate of Performance. For the post-shipment facility, refinancing can be 100 per cent of the export value. The minimum value is RM 10,000 for both facilities, while the maximum limit is RM 50 million.

4. Export insurance and guarantees

The Export Credit Insurance and Guarantee Scheme (ECIG) provides insurance coverage of up to 85 per cent of export value against the non-payment of foreign buyers. The Scheme is funded by the Malaysia Export Credit Insurance Berhad (MECIB), which also provides protection for bond indemnity, buyer credit guarantee, bankers' export finance and confirmation of letters of credit by banks. In the Sixth Malaysia Plan (1991-95), the level of insurance coverage, which was less than one per cent of total exports, was expected to double.

5. Export promotion and marketing assistance

a) The government launched the Malaysia External Trade Development Organisation (MATRADE) in June 1993. Its main responsibilities are to assist in maintaining the competitiveness of Malaysian value-added products and services in the global market place. MATRADE is an information and advisory service for the government and the private sector, and also assists Malaysian exporters to participate in trade missions and international trade fairs.

b) The establishment of a Malaysian Trade Centre in Rotterdam will provide companies with the necessary facilities for the promotion and marketing of their products.

c) Government expenditure for export promotion has increased from RM 10.2 million in the Fifth Malaysia Plan to RM 136.7 million in the Sixth Malaysian Plan.

6.Measures affecting production and trade

i) Registration licensing: All companies (domestic or foreign-owned) with shareholders' funds of RM2.5 million, or 75 or more full-time employees, engaging in any manufacturing activity, must obtain a licence from the Licensing Officer. As a rule, expansion of production capacity is also subject to licensing, but an existing licensed export-oriented company can undertake expansion of production capacity without a further licence.

ii) Competition policy: There are no competition or anti-trust laws.

iii) Adjustment assistance:

a) The wood-based, textile, machinery and engineering sectors have been identified for industrial adjustment. Companies undertaking approved industrial adjustment programmes are eligible for Industrial Adjustment Allowances (IAA); the amount of the IAA may reach 100 per cent of capital expenditure incurred by a manufacturing company.

b) In February 1991 an Industrial Adjustment Fund (IAF) was launched. RM 500 million was allocated for the scheme, to be managed and disbursed by Bank Negara to three participating development financial institutions. By the end of 1992, nine applications were approved, involving RM 29 million.

iv) Incentives for investment

a) The investment climate was liberalized with the passage of the Promotion of Investments Act, 1986. The government now pursues a liberal policy on foreign direct investment, summarized as follows:

i) no equity condition is imposed on manufacturing projects involving the export of 80 per cent of more of output;

ii) a foreign investor can have 100 per cent equity ownership for a project of at least $M 50 million or 50 per cent value-added, if the products do not compete with local manufactures;

iii) majority equity ownership for high-technology projects or for priority projects;

iv) up to 30 per cent foreign equity for projects involving the export of less than 20 per cent of output;

b) Incentives for the manufacturing sector:

Schemes include Pioneer Status (whereby companies selected pay tax on 30% of their statutory income for 5 years from a production date determined by MITI; more favourable tax relief of up to a 100% exemption may be given in certain cases); Investment Tax Allowance (selected companies will be granted an allowance of 60% in respect of qualifying capital expenditure incurred within 5 years from the date of approval of the project) and Reinvestment Allowance (an allowance against tax of 40% of capital expenditure incurred by the companies concerned).

c) Incentives for small and medium-scale industries: These include Pioneer Status, Investment Tax Allowance, double deduction for the promotion of exports, a reinvestment allowance of 50% on qualifying capital expenditure, and various loans and grants (the government channels special low interest funds and guaranteed soft loans to specialized development finance institutions, who then lend to business enterprises).

d) Provision of industrial infrastructure: Foreign investors can locate their plants in industrial estates, free zones and licensed manufacturing warehouses, and have access to modern facilities. The government has allocated 30% of total development expenditure in the Sixth Malaysia Plan 1991-95 for infrastructure upgrading and expansion of these areas.

**v) Assistance for R&D:** The key areas designated for industrial technology development are automated manufacturing technology, advanced materials technology, biotechnology, electronics and information technology. Incentives include various tax relief and allowances ranging from 2%-10% on capital expenditure and industrial building allowances. There is in particular a 5 year tax exemption for approved research companies and new technology based firms.

**vii) Production subsidies:**

Industry: there are no subsidies for industrial production per se.

**viii) Regional assistance:** Federal government transfers for development purposes to states amounted to RM 11.8 billion in 1993. In the states of Sabah and Sarawak, the government has introduced the following specific measures: manufacturers who export rattan and most wood products are eligible for double tax deduction on transportation costs; and a 100% Industrial Adjustment Allowance is granted to companies to encourage wood-based projects to relocate or expand into Sabah and Sarawak.

Table 1 sets out Malaysia'a industrial and export promotion policies in a comparative international perspective. The table provides summary information on the policies being operated in these spheres for a number of Asian-Pacific countries. It is clear from the table that the Malaysian situation is in no way unique. Most other governments in the region are also similarly interventionist and operate a wide range of industrial and export promotion measures. Even a country like Thailand, which has a reputation for being relatively less interventionist implements the whole gammut of such policies, including export performance requirements. In fact the two countries with the least interventions in table 1 would appear to be Korea and Japan, whose cases we shall consider in some detail in the next section.

It is evident from the analysis of sections III and IV that a number of policies in table 1 being implemented by the Asian-Pacific countries would fall foul of the Uruguay Round Agreements. The discussion in section IV of the compatibility with the Agreements of the industrial and export promotion programs followed by Korea and Japan in the past during their respective high-growth periods, is applicable mutatis mutandis to the current policies of Malaysia and other Asian-Pacific countries. Thus, non of the export promotion measures employed by the Malaysian government listed above under i to v above (export promotion and import restriction) will be permissible under the new trading regime to the extent that they involve an element of subsidy. Neither will, under TRIMs, the export performance requirements implemented by countries like India and Thailand. However, as noted in the earlier discussion, a number of general industrial policy measures being used by the Asian-Pacific countries will still be acceptable, as well as programs to assist regions, new technological developments, and small and medium size enterprises.

## VII. Prospects for Industrialisation and Economic Development in the Post-Uruguay Round World Trading Order

An essential question for the Asia-Pacific countries is how would the limitations on domestic policy options imposed by the Uruguay Round Agreements affect their future development. In this connection the post-liberalization experiences of Japan, Korea and Taiwan are highly relevant.

Japan began to liberalize its economy after 1973 under external pressure, particularly from the US. As is in part evident from table 1, Japan today uses few of the industrial and export promotion policy instruments which it so successfully employed during its high-growth period (1950-1973). Similarly, its tariffs on manufactured imports have long been comparable to those of other industrial countries, if not lower. Does that mean that the Japanese government no longer has an industrial policy?

Not so, according to many students of the Japanese economy. As Johnson et al (1989) point out, the country's traditional developmental policy - based on protection of the home market and promotion of domestic industries through a variety of measures-continues. To achieve its aims, MITI has to use more indirect instruments as well as moral persuasion to a far larger degree than it did before. "Administrative guidance", MITI's close links with industry and trade associations and, importantly, "business practice" are the essential policy tools in the new context. The industrial policy focus would now appear to be on the so-called sunrise industries (i.e. industries of the future such as biotechnology, new materials, etc.) and sunset industries (i.e. declining industries, such as textile, steel and shipbuilding where Japan has lost its competitiveness). Johnson, Tyson and Zysman suggest that in response to the liberalization pressures of the post-1973 period, the government has implemented a "moving band of openness" in which "restrictions on the ability of foreign firms to develop a permanent presence in the Japanese market have been removed only where Japanese firms have already achieved a dominant position at home and a strong often dominant position abroad. In other words, restrictions have been removed when they don't matter anymore" (pp. 111). This may be an extreme position, but its basic truth is corroborated by other writers on Japanese industrial policy (see further Okimoto, 1989, and Dore, 1986).

What the Japanese example shows is that a country is able to pursue an effective policy even in a liberalized world economy if it has the right kind of non-governmental institutions. In Japan, the role of "business practice" seems to be important in restricting imports. Thus in the recent dispute between the United States and Japan concerning auto parts and auto imports, it was difficult for the United States to claim that the Japanese government was flouting the WTO rules. As the Japanese government rightly pointed out, if the Japanese companies do not find it profitable to display US products in their showrooms it would be wrong for the government to force them to do so. The latter course would certainly be against the letter and spirit of a liberal world economic order. Similarly, through trade associations, MITI and other government agencies continue to have a close relationship with Japanese business and still offer "administrative guidance". The firms are under no obligation to accept this guidance, but they usually do so.

Korea has been attempting to liberalize its economy since 1980, again under external pressure, and again particularly from the United States. However, as Amsden (1995) points out, a considerable part of this liberalization was required in any case by the stage of development the country had already reached. As a late industrializer, having graduated from the low-tech labour intensive textile sector, Korean had to diversify into mid-technology market niches. However, it was finding it much more difficult to buy such foreign technology or to copy it than in the earlier stages of its industrialisation. Similarly Amsden notes that in the case of Taiwan, its machine tool industry is now being forced to acquire technology by taking over small American machine tool firms with financial difficulties.

Therefore, both in Korea and Taiwan, the emphasis in the recent period has been on government subsidization of R&D and other measures to help technological upgrading. Taiwan's Industrial Upgrading Statute provides preferential tax and credit for R&D, subject to the firms investing a specified percentage of their sales in R&D (exact percentage is a function of firm size), establishing personnel training, creating international marketing networks, and complying with environmental standards. If a firm's ratio of R&D expenditure to annual total sales is lower than the prescribed standard, then it is obliged to contribute the difference to a government-controlled R&D fund for financing collective R&D projects.

Similarly, the Korean government has provided incentives for the establishment of central R&D laboratories to each of the big business groups. Amsden points out that another linchpin of Korea's R&D system is over a hundred national R&D projects that are a joint effort between the government and the private sector. The net results of these measures is that Korea has, in relative terms, by far the largest expenditure on R&D among developing countries: 1.9 percent of GNP in 1988, compared with 1.2 percent for Taiwan Province of China (1988), 0.9 percent for India (1986) and Singapore (1987), 0.5 percent for Argentina (1988), 0.6 percent for Mexico (1984) and 0.4 percent for Brazil (1985). The country's performance in this area outstrips that of many developed countries - for example Belgium (1.7 percent in 1987), Denmark (1.5 percent in 1987) and Italy (1.2 percent in 1987). It is, of course, still below that of industrial superpowers, Japan (2.8 percent in 1987) and Germany (also 2.8 percent in 1987). [UN, 1993; Singh, 1995b]

Moreover, Hou & Gee (1993) and Amsden (1995) suggest that the governments in both Korea and in Taiwan are using "regional policies" to support technological development and the diversification of industrial structure. Both governments have created science parks and special industrial estates for technology-intensive firms. Amsden observes:

East Asian economies have liberalised, yes, always with a big "but".... Korea abolished export subsides in 1983, for instance, but privileged exporters are still subsidised by investment at credits below-interest market rates, low cost land sites, aid to R&D, and inexpensive technology from government procurement projects"[15].

The following main points emerge from this survey of post liberalisation industrial policies in Japan, South Korea and Taiwan. Firstly and importantly, the governments in these countries have continued to be actively engaged in industrial policy even though they do not have available to them the same kinds of coercive and targeted policy instruments as they were able to employ in the pre-liberalisation period . What these countries have done is to change the direction and focus of their industrial policies towards technological development and industrial deepening and diversification. Much of this change in focus had in any case become necessary because of endogenous reasons.

Secondly, it is important to observe that the current industrial policies being followed in these countries by and large conform to the requirements of the Uruguay Round Agreements. The latter , it will be recalled, permit various kinds of general subsidies, aid for technological development and regional development. Moreover, business practice, trade associations and traditionally close business-government relationships which are not covered by the new Agreements have also become important instruments of industrial policy in some of these countries.

An important implication of the above analysis for the developing Asia- Pacific countries is that the impact of Uruguay Round Agreements is likely to depend to a significant degree on the level of development of the country. Economies like Malaysia which are technically and industrially more advanced will be able to follow the example of Japan, South Korea and Taiwan and thereby escape most

15 See Amsden (1995), p.2.

of the adverse effects of the limitations on domestic policy imposed by the Agreements. Such countries have endogenous reasons for changing the focus of their industrial policies; they also possess the institutional capabilities for doing so.

On the other hand, for the least developed countries, these policy limitations would be much more onerous, notwithstanding the special concessions made to them. However the operative word here is "onerous". Industrial policy will not be impossible for these countries in the new world trading order, although they would be better off if they were able to employ the wider range of the traditional industrial and export promotion policy instruments. The very backwardness of these countries and their greater distance from the international technological frontier requires more forceful and targeted efforts by the government to overcome these handicaps in the way suggested by the economic historian Alexander Gerschenkron (1966) in his analysis of economic backwardness among European countries in the 19th and early 20th century. Unfortunately, these are just the kind of policy measures being ruled out by the post-Uruguay Round trading regime, albeit with a time lag.

## VIII. CONCLUSION AND POLICY IMPLICATIONS

This paper has analyzed the Uruguay Round Agreements in order to answer the following three questions:

a) How will the Agreements affect the industrial and export promotion policies currently being pursued by the Asian-Pacific countries?

b) To the extent that some of these policies may need to be abandoned to comply with the Agreements, how would that affect economic development of these countries?

c) In so far as the net effects of the Agreements on the developing countries is negative, what can these countries do to eliminate, or to reduce, such unfavourable outcomes?

In examining these issues, we have given special attention to the cases of Japan and to those of the two first-tier NICs, Korea and Taiwan. All three countries during their periods of rapid economic growth implemented a vigorous "industrial policy" in both the broad and narrow senses of the term. However, in the recent period, all three have been obliged to liberalise their economies. In the process they had to eschew many of the industrial and export promotion measures they successfully used in the past. The liberalisation experience of Japan, Korea and Taiwan has important lessons for the other Asian-Pacific countries confronted with the post-Uruguay Round world trading system.

The analytical part of the paper has also emphasised an important conceptual point with respect to the question, what government interventions constitute an industrial policy? It is suggested here that both from the perspective of economic development and that of international competitiveness, a broader conception of industrial policy is more appropriate.

Specifically, policies employed to enhance savings and investment can have as much influence on promoting technical change, international competitiveness and industrial development as the more narrowly conceived industrial and export promotion policies. The exemplary East Asian countries used the former policies to great advantage and some analysts ascribe their outstanding industrial success exclusively to these policies.

The examination of the Uruguay Round Agreements shows that a large number of industrial and export promotion policies currently being implemented by Asia-Pacific countries are likely to be incompatible with the Agreements. Nevertheless, the analysis of this paper suggests that there is wide enough range of permissible policies under the Agreements so as not to affect greatly the development of the relatively more advanced of these countries. This is not to deny that the abandonment of the previously permissible direct and targeted industrial and export promotion policies will have a cost. This cost has to be assessed against the greater market access available to the LDCs under the Agreements. It is suggested here that the net cost of the required changes in industrial policy under the Agreements are likely to be relatively small for the industrially more advanced developing countries like Malaysia, but quite large for the least developed countries like Bangladesh.

The policy conclusions of the paper are implicit in the above summary. These may be explicitly and succinctly stated as follows:

1. The first important point is that despite the restrictions imposed by the Uruguay Round Agreements, it is still possible for countries to pursue an effective industrial policy as the examples of South Korea, Taiwan and Japan demonstrate. In fact, these restrictions make an industrial policy all the more necessary. This is because the time period available to the countries to enhance the capabilities of their corporations to international competitive standards has been greatly shortened by the Agreements. It therefore necessitates much more purposive and focused government interventions in the period allowed.

2. Secondly, in view of the limitations imposed on the traditional instruments of industrial policy, developing countries need to have a wider conception of "industrial policy" and the measures which constitute such a policy. As mentioned above, countries should pay special attention to policy measures to increase domestic savings and corporate investment. In the case of semi-industrial countries,in particular, such policies which are not covered by the Agreements, can be greatly beneficial to promoting technical change and international competitiveness.

3. Thirdly, developing country governments can also assist their industrialisation drives and the international competitiveness of their producers by concentrating greater effort than before in providing to the producers as cheaply as possible, if not freely, a wide range of infrastructural facilities. These

facilities include for example training for the labour force, services of scientific research laboratories, science and industrial parks, or providing cheap land or commercial buildings. These could, in principle, also include cheap housing for the workers (as in Hong Kong which reduces the pay bill of the employers), health services, etc. The only limitation on these measures is that they have to be provided on a general basis rather than being restricted to specific exporting firms.

4. Fourthly, the developing countries should learn from the experience of Japan in establishing non-government institutions or modes of "business practice" which can effectively protect domestic industry. As noted in Section VI, the Agreements apply much more to government interventions rather than to measures taken by trade associations or by private organisations.

5. Lastly and importantly, the new world trading order requires even more than before South-South cooperation. As many Third World analysts rightly suggest, developing countries were most likely much better off under the old GATT than under the Uruguay Round Agreements. However, it will be appreciated that the latter are here to stay. Developing countries should therefore take full part in the workings of these Agreements, particularly, in the Dispute Settlement Mechanism and in the development of the case law, so as to obtain maximum space for their economic development. In view of the disproportionate weight and power of the rich countries in the world trading system, the only way developing countries can create such space, and more importantly, not to let it be further encroached ( for example though the establishment of onerous environmental and labour standards) is through cooperation and collective action. International agencies like UNCTAD have a responsibility to assist poor countries in this essential task.

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