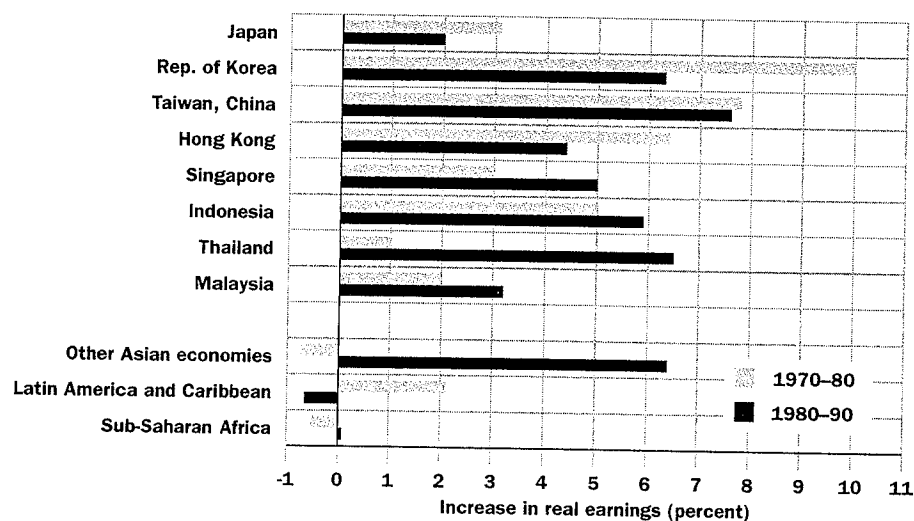


HPAE governments have generally been less vulnerable than other developing-economy governments to organized labor's demands to legislate a minimum wage. Rather, they have focused their efforts on job generation, effectively boosting the demand for workers. As a result, employment levels have risen first, followed by market- and productivity-driven increases in wage levels. Because wages or at least wage rate increases have been downwardly flexible in response to changes in the demand for labor, adjustment to macroeconomic shocks has generally been quicker and less painful in East Asia than in other developing regions. More rapid adjustments contributed to the HPAEs' sustained economic growth, which in turn made possible much more rapid wage growth than in other regions (see figure 10).

High productivity and income growth in agriculture contributed to labor market flexibility by helping to keep East Asian urban wages close to the supply price of labor. In contrast to many other developing economies, where the gap between urban and rural incomes has been large and growing, in the HPAEs the incomes of urban and rural workers with similar skill levels have risen at roughly the same pace; moreover, the overall gap between urban and rural incomes is smaller in the HPAEs than in other developing economies. In Sub-Saharan Africa, Latin America, and South Asia, where wages in the urban formal sector are often pushed up by legislated minimum wages and other nonmarket forces, urban wage earners often have incomes twice their counterparts' in informal sectors.

**Figure 10 Increase in Real Earnings**



*Note:* Index for Taiwan, China: 1979 = 100. Other Asian economies are Bangladesh, India, Pakistan, and the Philippines.

In contrast, the gap between the formal and informal sectors in East Asia is only about 20 percent.

East Asia's more rapid wage increases are also partly the result of a slower growth of supply and more rapid growth of demand for labor. Slower growth in supply has been largely a function of declining fertility rates. When the currently high-income economies were industrializing during the nineteenth century, their populations grew at an average annual rate of only 0.8 percent. Today, Sub-Saharan Africa's population is growing at roughly four times that rate; the populations of Latin America and South Asia are growing at roughly three times that rate. Only in East Asia have population growth rates declined to levels approaching those which prevailed in the high-income economies.

We have already seen how early demographic transitions markedly reduced the rate of growth of the school-age population, thereby easing the financial burden of maintaining education enrollment rates. Similarly, early demographic transitions also reduced, with a lag, the rate of growth of new entrants into the East Asian labor force. The annual rate of labor force growth during the 1980s was 2.6 percent in Sub-Saharan Africa and Latin America and 2.2 percent in South Asia. In East Asia, despite increases in the participation rates of women, the rate was 1.8 percent (see table 6).

At the same time, labor demand has been growing faster among the HPAEs than in other regions. For the period 1960–90, the rates of growth of wage employment in manufacturing, construction, and services have tended to be substantially higher in East Asia than in Sub-Saharan Africa, Latin America, or South Asia. Moreover, as labor demand grew, it also became more and more skill-intensive. Because educated workers were readily available, East Asian exporters have been able to shift to production of tech-

**Table 6 Labor Force Growth Rates**

<i>Economy/region</i>	<i>1980–85</i>	<i>1985–2000</i>
<i>HPAEs</i>	2.5	1.8
Indonesia	2.4	2.2
Korea, Rep. of	2.7	1.9
Malaysia	2.9	2.6
Singapore	1.9	0.8
Thailand	2.5	1.7
<i>South Asia</i>	2.2	2.2
<i>Latin America and Caribbean</i>	2.8	2.6
<i>Sub-Saharan Africa</i>	2.3	2.6

nologically sophisticated goods when rising wages eroded international competitiveness in labor-intensive manufactured goods.

### **Capital Markets and Allocation**

The HPAEs influenced credit allocation in three ways: enforcing regulations to improve private banks' project selection; creating financial institutions, especially long-term credit (development) banks; and directing credit to specific sectors and firms through public and private banks. All three approaches can be justified in theory and each has worked in some HPAEs, yet each involves progressively more government intervention in credit markets and so carries a higher risk.

Government relationships with banks in the HPAEs have varied widely. In Hong Kong banks are private and regulated primarily to ensure their solvency. In Indonesia, Malaysia, Singapore, and Thailand, banks are privately owned and exercise independent authority over lending. While governments have broadly guided credit allocations through regulations and moral suasion, project selection is generally left to bankers. In other HPAEs, banks have been subject to direct state control or stringent credit allocation guidelines. For example, Indonesia, Korea, and Taiwan, China, tightly controlled the allocation of credit by public commercial banks.

Each of the HPAEs made some attempts to direct credit to priority activities. All East Asian economies except Hong Kong give automatic access to credit for exporters. Housing was a priority in Hong Kong and Singapore, while agriculture and small and medium-size enterprises were targeted sectors in Indonesia, Malaysia, and Thailand. Taiwan, China, has recently targeted technological development. Japan and Korea have used credit as a tool of industrial policy, organizing contests through deliberative councils to promote at various times the shipbuilding, chemical, and automobile industries.

The implicit subsidy of directed-credit programs in the HPAEs was generally small, especially in comparison with other developing economies (see table 7), but access to credit and the signal of government support to favored sectors or enterprises were important. In Korea, the subsidy from preferential credit was large during the 1970s, resulting in a big gap between bank and curb market interest rates. This gap has declined sharply in recent years, as Korea has shifted away from heavy credit subsidies to selected sectors. In Japan, implicit subsidies were small and the direction of credit may have been more important as a signaling and insurance mechanism than as an incentive.

Although East Asia's directed-credit programs were designed to achieve policy objectives, they nevertheless included strict performance criteria. In



## Trade Policies and Patterns of Protection

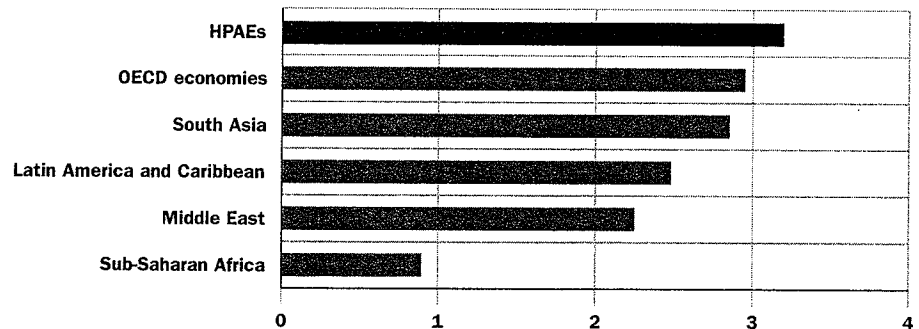
Most HPAEs began industrialization with a protectionist orientation and gradually moved toward increasingly free trade. Along the way they often tapped some of the efficiency-generating benefits of international competition through mixed trade regimes: they granted exporters duty-free imports of capital and intermediate goods while continuing to protect consumer goods. Export prices were set in the international market and were often substantially less than current marginal or average cost. Profits in protected domestic markets offset export losses, while competition in the international market pushed firms to maximize efficiency.

Despite the protection of domestic manufacturers evident in all the HPAEs except Hong Kong and Singapore, domestic prices in these economies are more closely aligned to international prices than in other developing regions. Two bodies of evidence support this conclusion. First, nominal tariff rates adjusted for nontariff barriers are lower in the HPAEs than in most other developing economies. Second, comparisons of real GNP across economies indicate that domestic relative prices for tradable goods in the HPAEs are more closely aligned to international prices than in other regions.

One of the few systematic attempts to compare nominal tariff rates across a broad range of developing economies concludes that they were lower in the HPAEs than in any other group of developing economies except the island economies of the Caribbean and the oil states of West Asia. The difference between Latin America (albeit before its recent trade liberalizations) and the HPAEs is striking. Thus while the HPAEs favored import substitutes, they did so less than most other developing economies.

This is borne out by comparisons of international and domestic prices. Figure 11 shows an index of outward orientation based on international comparisons of price levels and price variability for the HPAEs compared with other regional groupings. The HPAEs as a group are more outward oriented than other regions; their relative prices are closer to and more consistently related to international prices. While any large, multi-economy effort at real price comparisons is subject to methodological and empirical criticism, the results are broadly indicative and consistent with other evidence: East Asia's relative prices of traded goods were closer on average to international prices than those of other developing areas.

The HPAEs have maximized the benefits of an outward orientation by actively seeking foreign technology through a variety of mechanisms. All welcomed technology transfers in the form of licenses, capital goods imports, and foreign training. Openness to foreign direct investment has speeded technology acquisition in Hong Kong, Malaysia, Singapore, and, more recently, Indonesia and Thailand. Japan, Korea, and, to a lesser ex-

**Figure 11 Index of Outward Orientation**

tent, Taiwan, China, restricted foreign direct investment but offset this disadvantage by aggressively acquiring foreign knowledge through licenses and other means.

In contrast, other low- and middle-income economies such as Argentina and India, besides being less outwardly oriented than the HPAEs, have adopted policies that actively hindered the acquisition of foreign knowledge. Often they have been preoccupied with supposedly excessive prices for licenses; they have refused to provide foreign exchange for trips to acquire knowledge, been restrictive of foreign direct investment, and have attempted prematurely to build up their machine-producing sectors, thus forgoing the knowledge embodied in imported equipment.

### Promoting Specific Industries

Most East Asian governments have attempted to promote specific industries or industrial sectors to some degree. The best-known instances are Japan's heavy industry promotion policies of the 1950s and the subsequent imitation of these policies in Korea. These policies included import protection as well as subsidies for capital and other imported inputs. Malaysia, Singapore, Taiwan, China—and even Hong Kong—have also established programs, typically with more moderate incentives, to accelerate development of advanced industries. We find very little evidence that industrial policies have affected either the sectoral structure of industry or rates of productivity change. Indeed industrial structures in Japan, Korea, and Taiwan, China, have evolved during the past thirty years as we would expect on the basis of factor-based comparative advantage and changing factor endowments.

It is not altogether surprising that industrial policy in Japan, Korea, and Taiwan, China, produced mainly market conforming results. While selectively promoting capital- and knowledge-intensive industries, these governments also took steps to ensure that they were fostering profitable, internationally competitive firms. Moreover, the way in which they formu-

lated industrial policies introduced a large amount of market information, and used performance, usually export performance, as a yardstick. In other HPAEs, such international market links were not used and industrial policies were unsuccessful, as in the cases of the heavy industry push in Malaysia and the state-supported effort to build an aerospace industry in Indonesia.

### **Achieving Productivity Growth through an Export Push**

One combination of fundamental and interventionist policies practiced in the HPAEs has been a significant source of rapid productivity change: their promotion of manufactured exports. Although all HPAEs except for Hong Kong passed through an import-substitution phase, these ended earlier than in other economies, typically because of a pressing need for foreign exchange. In contrast to many other economies, which tried to preserve foreign exchange by tightening import controls, the HPAEs set out to earn additional foreign exchange by increasing exports. Malaysia and Singapore adopted trade regimes that were close to free trade; Japan, Korea, and Taiwan, China, adopted mixed regimes that were largely free for export industries. Indonesia and Thailand, beginning later, adopted export incentives and moved gradually to reduce domestic protection. In each of the HPAEs, exchange rate policies were liberalized and, often, currencies were devalued. Overall, these policies exposed much of the industrial sector to international competition which increased productivity growth.

The northern-tier economies—Japan, Korea, and Taiwan, China—stalled the process of import liberalization, often for extended periods, and heavily promoted exports. Thus while incentives were largely equal, they were the result of countervailing subsidies rather than trade neutrality; promotion of exports coexisted together with protection of the domestic market. In the Southeast Asian HPAEs, conversely, governments created an export push through a gradual but continuous liberalization of the trade regime, supplemented by institutional support for exporters. In both cases, governments were credibly committed to the export-push strategy, and producers, even those in the protected domestic market, knew that sooner or later their time to export would come. These experiences suggest that economies making the transition from import substitution regimes to more balanced incentives would benefit from actively promoting exports, especially in cases where import liberalization is moving slowly.

Manufactured export growth provided a powerful mechanism for technological upgrading. Because firms which export have greater access to best-practice technology, there are both benefits to the enterprise and spillovers to the rest of the economy which are not reflected in market transactions. These information related externalities are an important source of rapid

productivity growth. Both cross-economy evidence and more detailed studies of the industrial productivity performance of Japan, Korea, and Taiwan, China, confirm the significance of exports to rapid productivity growth.

## Lessons for Other Developing Economies

**W**HAT LESSONS CAN OTHER DEVELOPING ECONOMIES learn from East Asia's experience? First, getting the fundamentals right was essential. Without high levels of domestic saving, broadly based human capital, good macroeconomic management, and limited price distortions, there would have been no basis for growth and no means by which the gains of rapid productivity change could be realized. Policies to assist the financial sector's capture of nonfinancial savings and to increase household and corporate savings were central. Acquisition of technology through openness to direct foreign investment and licensing were crucial to rapid productivity growth. Public investment complemented private investment and increased its orientation to exports. Education policies stressed universal primary education and improvements in educational quality at primary and secondary levels.

Second, very rapid growth of the type experienced by Japan, the Four Tigers, and more recently the East Asian NIEs has also benefited from careful policy interventions to accelerate growth. All interventions carry with them costs, either in the form of direct fiscal costs of subsidies or foregone revenues, or in the form of implicit taxation of households and firms, for example, through the structure of protection or interest rate controls. One of the defining characteristics of interventions in the HPAEs is that in general they have been carried out within well defined bounds limiting the implicit or explicit costs. Thus, price distortions were present but not excessive; interest rate controls generally had as benchmarks international interest rates; and explicit subsidies were kept within bounds. Given the overriding importance that each of the HPAEs ascribed to macroeconomic stability, interventions which threatened to undermine that policy fundamental were modified or abandoned—for example, the heavy and chemical industries drive in Korea or the heavy industry push in Malaysia. These limits to intervention stand in sharp contrast to many other developing economies where interventions have not been consistent with macroeconomic discipline.

Whether these interventions built on the rapid growth made possible by good fundamentals or detracted from it is the most difficult question



we have tried to answer. It is much easier to show that the HPAEs limited the costs and duration of inappropriately chosen interventions—itsself an impressive achievement—than to demonstrate conclusively that those interventions that were maintained over a long period accelerated growth. Our assessment is that promotion of specific industries generally did not work and therefore holds little promise for other developing economies. Directed credit has worked in certain situations but carries high risk. The export-push strategy has been by far the most successful set of policy intervention and holds the most promise for other developing economies. But the efficacy of institutionally demanding strategies—including some of the more narrowly targeted aspects of the export-push strategy—is uncertain in other settings, and they are clearly difficult to imitate when strong institutions are not securely in place. Moreover, many HPAE interventions carry high risks that probably make them unsuitable for adaptation in parts of Sub-Saharan Africa and Latin America, and elsewhere in Asia, where activist government involvement in the economy has often gone awry. Promoting specific industries or attempting to leap stages of technological development has often been a costly failure; strongly negative real interest rates and large subsidies to borrowers debilitate the financial system; and directing credit without adequate monitoring and selection of borrowers distorts allocation. Thus, the fact that interventions were an element of some East Asia economic success stories should not become a reason to resist needed market-oriented reform.

Even so, an export-push strategy appears to hold great promise for other developing economies. Exports are a powerful mechanism to acquire and master foreign technology. Moreover, the most important export promotion measures remain viable in today's global economy, despite increasing pressure on developing economies to refrain from interventions that violate international trading rules such as the General Agreement on Tariffs and Trade. Key pro-export policies, such as creating a free trade environment for exporters, providing support services for small and medium-size exporters, improving business-government communications, and easing the decline of uncompetitive industries are unlikely to provoke opposition from trading partners. However, more highly targeted interventionist measures, such as export subsidies and directed credits linked to exports—precisely those that are difficult for many developing economies to manage—are incompatible with a changing world trading environment.

East Asia's own responses to changing domestic and international circumstances put these lessons in perspective. The HPAEs are themselves involved in a continuing process of reform, adapting policy instruments and institutions to achieve the objectives of continued growth with equity. In

many cases these reforms involve reducing, modifying, or abandoning policy instruments which were judged to have succeeded in the past. Korea's financial sector reform, Indonesia's trade reforms, Thailand's promotion of foreign investment, and Malaysia's privatization programs are cases in point. The outcome of these initiatives will provide further valuable lessons on how successful policy instruments shift over time, as the relative roles of markets, the public administration, and the private sector change in response to economic and social development.

The experience of the HPAEs broadens our understanding of the range of policies that contribute to rapid growth. It also teaches us that willingness to experiment and to adapt policies to changing circumstances is a key element in economic success. What we have not discovered fully is why the governments in these economies have been more willing and better able than others to experiment and adapt; answers go beyond economics to include the study of institutions, and the related issues of politics, history and culture. Taking such questions into account complicates rather than simplifies the task of development. In every economy, however, governments face a two-pronged task: they must select and adapt policies, both fundamentals and interventions, according to their institutional circumstances, and at the same time strive to upgrade institutional capability to make policy implementation more effective and to increase the number of available policy options.