Edward J. Lincoln *Some Missing Elements*

THE SYMPOSIUM papers and comments in this volume bring up a number of the important features of the East Asian economy. But the discussion would not be complete without consideration of a few additional points. Most of the following comments are very loosely organized around the theme of industrial policy, or government involvement in the economy.

A number of East Asian economies have been quite successful at producing high economic growth and managing industrialization. Japan has already completed this process; China and certain other countries are now experiencing it. Much of the past research and the paper by Susan Collins and Barry Bosworth have focused on seeking the sources of success. It might also be useful to view the issue from the opposite angle: how many errors can a nation make and still grow? All Asian nations, including Japan, have experienced some degree of official corruption, private collusion, artificial prices set either above or below market-clearing levels, and other distortions that ought to work against economic growth. A simple-minded focus on "getting the prices right" or creating an honest bureaucracy begs the real question of how close to these economic ideals a nation must be in order to break into high growth. For a variable such as corruption, there must be some level of rent-seeking that chokes off entrepreneurial activity. But the necessary condition for permitting rapid economic growth is clearly not zero. What surprises me about East Asia is not how many pieces of the growth puzzle these nations have got right, but how well they have done despite many obvious mistakes and distortions.

Nevertheless, one can argue that such distortions do come back to haunt nations in the long run. Problems that are papered over and mistakes that are allowed to continue uncorrected tend to fester. While they may not seriously inhibit growth for a while, they eventually exact a price. Problems of moral hazard inherent in the structure of Japanese banking, for example, as discussed in Takatoshi Ito's paper in this volume, have finally resulted in a very large bad debt problem that includes large doses of official mistakes (misjudgment at best, and outright corruption at worst). In the future, China and other Asian nations may also face mounting problems from their more serious market distortions, such as institutionalized corruption and administered prices that deviate widely from market levels.

This issue leads directly to the question of industrial policy. Recent debate about the Asian development experience has had a strong political element. In the late 1980s, Japanese government officials seconded to the World Bank became dissatisfied with the strong emphasis on deregulation, privatization, and getting prices right. Believing that their own government had enhanced domestic growth through directed credit, controlled prices, subsidies to private sector R&D consortiums, tolerance of private sector collusion, legal cartels, and heavy protectionism (on both imports and inward investment), the Japanese were eager to promote their experience as an alternative to Western neoclassical economics. They also believed that the rest of Asia was following the Japanese model and that this explained the region's rapid growth. The Japanese government funded a World Bank study of the Asian development process, resulting in the publication of *The East Asian Miracle* in 1993. But the Japanese were disappointed with the outcome of the study, which gave only very weak support to their ideas: industrial policy was identified only as a possible factor in Japanese and Korean development and as generally unimportant or undesirable elsewhere. There are legitimate theoretical and empirical issues concerning the role of industrial policy, but keep in mind that much of the debate in the past several years has primarily been a matter of politics and pride; the newly affluent Japan, now the number two funder of the World Bank, has wanted to exercise its voice and its vote to prove to the world that it is a major independent player, with its own paradigm of development to offer.

As a result of their strong desire to believe in a distinctive Japanese model of development and its replication in the rest of Asia, the Japanese have responded to the new growth accounting studies with considerable distress. Collins and Bosworth's paper in this volume lends more support to the notion that the pattern of development in Japan has been somewhat different from that in the rest of Asia. This is not welcome news to those who want to push the notion of Asian distinctiveness. According to the Japanese view, industrial policy is the crucial distinctive ingredient of Japan's high economic growth and rapid total factor productivity increases. If other East Asian countries are implementing similar industrial policies—often financed by large doses of Japanese official development assistance—why is total factor productivity not rising rapidly?

Despite the lack of statistical support for the beneficial role of industrial policy, it may be possible to find a positive impact by other means. David Weinstein suggests that Japanese industrial policy has many examples of failure to balance the successes. But this may not be the point. The existence of industrial policy may have lowered the perception of risk, thereby raising expected rates of return on investment and yielding more rapid capital accumulation. In the absence of rapid total factor productivity growth, rapid capital accumulation stands out as unusual in the recent Asian growth experience. By providing a generally favorable environment for business—with some informal or explicit advice on the allocation of investment (allowing banks and manufacturers not to worry about "overinvestment") and toleration of legalized cartel behavior (to bolster firms facing short-term financial constraints in cyclical downturns)—governments have encouraged banks to lend and firms to add capacity. Thus the macroeconomic consequences of industrial policy may be more positive than the evidence on microeconomic mistakes would suggest.

Those microeconomic mistakes are real, as Weinstein points out. Japan has probably allocated excessive resources to favored industries—including steel, shipbuilding, and semiconductors—not to mention pursuing foolish agricultural policies that have resulted in a wildly inefficient sector. However, although such efforts at directed credit, price-fixing, and trade protection may not have been good for the long-term efficiency of the economy, they have had an international impact. Perhaps the best way to think of this is as the international transmission of domestic distortions. The Japanese steel, shipbuilding, and semiconductor industries stand out as tremendous successes in international trade. Even today, Japan produces around 45 percent of global shipping tonnage and roughly 40 percent of global semiconductor output. If Japan produces too much in these industries, therefore, other nations produce too little. This has been the essence of many U.S. complaints about Japanese trade and industrial policies, since American firms often lose out when Japanese industrial policy is active. Concern over the desire of other Asian nations to emulate these aspects of Japanese industrial policy is a major reason why the U.S. government has pushed so hard to have China conform to World Trade Organization rules before it receives membership and has promoted the Asia Pacific Economic Cooperation as a vehicle to speed East Asian nations toward more open trade policies.

In general, there is more to be said about trade and investment policies. This is one dimension on which Asian experience varies widely—most countries have been protectionist, but Hong Kong has not. Japan placed very stiff constraints on inward foreign direct investment, but other countries have actively encouraged investment. Were Asian nations really to adopt the ''Japanese model'' of development and impose severe conditions on Japanese and other foreign firms that try to invest in their economies, the Japanese would probably be less enthusiastic about selling their own experience as a model. The data that Barry Naughton presents in this volume on the high share of Chinese exports produced by foreign-invested firms (to the detriment of purely domestic establishments) draw a stark contrast between Chinese behavior and past Japanese behavior. And since the methods used to produce indexes of ''openness'' seem very flawed, I am not sure that exercises to measure the impact of trade and investment policies on growth, such as Collins and Bosworth present in this volume, are very fruitful. The debate over desirable trade and investment policies for developing nations is likely to continue.

All of the above comments concern the role of government, but there is an even more general point to be made. One of the distinctive features of the rapidly growing Asian nations in the past several decades has been their basic political stability. By contrast, much of Africa has been torn apart by violent transfers of power, colored by radical ideologies and tribal animosities; Latin America has also experienced struggles over socialist and communist ideology; and the Middle East remains embroiled in bloody conflicts over Israel and Islamic fundamentalism. During the postwar period, much of Asia has emerged from a century of internal and external conflict into relative political stability: Japan in 1945, China after the final paroxysms of the Cultural Revolution in the 1970s, Indonesia once Suharto took control in 1966, Malaysia and Singapore after winning independence in the 1960s, Taiwan after the Kuomintang brutally established its control in the early 1950s, South Korea after the end of the Korean War, and Thailand also at the end of World War II. Most of these countries are not democracies, although South Korea and Taiwan have made very substantial strides in this direction in the past decade. Peace and stability obviously have a favorable impact on perceptions of risk and expected returns from investments in the private sector, and must be elements in the Asian success. Indeed, those parts of the region that have most recently suffered from war or violent repression—including Vietnam, Cambodia, Burma, and the Philippines—have the weakest economic records.

Many of the uncertainties in Asia's economic future lie precisely in this realm of political stability. Hong Kong reverts to Chinese ownership in 1997, and the consequences for investor confidence cannot be known. Taiwan faces similar uncertainity for as long as it continues in the strange limbo of a successful economy that is not officially recognized as a nation by much of the world. Suharto has led Indonesia for thirty years, but is now aging in a country without a clear succession process. And no one can predict the political future of post-Deng China. One would like to believe that the existing record of growth and development has been sustained long enough that new political leaders will perceive greater gain in upholding current political and economic regimes than in imposing radical change, but there is no guarantee of such a benign future.